SUPREME COURT OVERTURNS LONGSTANDING PRECEDENT AND RULES THAT MINIMUM RESALE PRICE RESTRAINTS ARE SUBJECT TO THE RULE OF REASON

In a June 28, 2007 opinion, the Supreme Court overruled a 96-year-old prohibition on vertical minimum price restraints that was established by the Court shortly after the passage of the Sherman Act in *Dr. Miles v. John D. Park and Sons Co.* and held for the first time that minimum resale price restraints are not per se illegal. The Court's 5-4 decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc. dba Kay's Kloset*, No. 06-480, __ S. Ct. __, 2007 WL 1835892, held that, because vertical minimum price restraints could not always (or almost always) be presumed to be anticompetitive, they should not be treated as per se unlawful but instead should be evaluated under the rule of reason approach used in most antitrust cases.

Under the rule of reason approach, the anticompetitive and procompetitive effects of a given practice are evaluated on a case-by-case basis. It is important to emphasize that, under the rule of reason, a given vertical minimum price restraint may still be found unlawful where it can be demonstrated that its effects are more likely anticompetitive than procompetitive. More stringent state antitrust law requirements may also continue to apply to vertical minimum price restraints.

Background

Leegin arose from a dispute between Creative Leather Products, Inc. ("Leegin"), a manufacturer of high-end leather goods, and Kay's Kloset ("Kay's"), a retail store that had sold Leegin products but which Leegin subsequently terminated. In 1997, Leegin adopted a policy of generally refusing (with limited exceptions) to sell to retailers that discounted Leegin's goods below Leegin's suggested prices. In 2002, Leegin discovered that Kay's had been marking down Leegin's entire line by 20 percent. Leegin requested that Kay's cease such discounting. Kay's responded that it had discounted Leegin's products to compete with nearby retailers who were similarly undercutting Leegin's suggested prices.

After Leegin stopped selling to Kay's, Kay's sued Leegin, alleging, among other things, that Leegin had violated antitrust laws by entering into agreements with retailers to charge only those prices fixed by Leegin. A jury found in favor of Kay's and awarded $1.2 million in damages (before trebling).

Decision

The Supreme Court agreed with Leegin and several amici, including the Department of Justice and the Federal Trade Commission, which argued that the possible procompetitive justifications for a manufacturer's use of minimum resale price maintenance compel abandonment of the per se rule against such vertical restraints. The outcome of *Leegin* is consistent with the trend in the antitrust treatment of vertical restraints generally, reflected in the Court's decisions in *Continental TV v. GTE Sylvania* (1977), ruling that vertical **non-price**

restraints should be analyzed under the rule of reason, and *State Oil v. Khan* (1997), ruling that vertical **maximum** price agreements should be analyzed under the rule of reason.

The majority opinion identified and discussed several potentially procompetitive results of minimum vertical price restraints that had long been discussed in economic literature, including primarily the possibility that such restraints on **intra**-brand competition might promote more effective **inter-**brand competition. The Court stated that "the promotion of inter-brand competition is important because 'the primary purpose of antitrust laws is to protect [this type of] competition'." *Leegin*, WL 1835892 at *7 (citing *State Oil v. Khan*, 522 U.S. at 15).

The Court observed that economists and others have frequently argued that minimum vertical price restraints might enable manufacturers to curtail undesirable "free-riding" by discounters on the promotional and service efforts of "full-service" retailers. The Court also observed that minimum resale price maintenance might increase inter-brand competition by facilitating market entry for new manufacturers and brands: By assuring retailers that later intra-brand price competition will not occur, minimum resale price maintenance might prompt manufacturers and retailers to make investments in new products or services that might otherwise not be made, and might allow a manufacturer to increase its market share by inducing its retailers to perform based upon a guaranteed margin.

The Supreme Court majority acknowledged at length the potential anticompetitive consequences of minimum resale price maintenance, particularly the potential for such restraints to facilitate unlawful horizontal cartel activity at both the manufacturer and retailer levels. Accordingly, the Court instructed lower courts to employ the rule of reason diligently in each case. The Court provided some guidance to the lower federal courts by identifying certain factors such courts should consider in their analysis. First, the number of manufacturers making use of minimum resale price requirements in a given industry should be scrutinized in an effort to detect whether they were the product or symptom of an unlawful horizontal agreement. Second, the source of the restraint must be examined, because evidence that retailers were the impetus for the restraint could suggest that the restraints were instituted to facilitate a retailer cartel or to support a dominant but inefficient retailer. Third, the market power of the respective parties at both levels of distribution should be examined, because manufacturers or retailers lacking market power are less likely to use minimum resale price restraints anticompetitively.

Dissent

The dissent focused primarily on the judicial doctrine of *stare decisis*, which generally disfavors abandonment of established judicial precedent. Noting that the per se rule against vertical minimum price restraints had long been embedded in antitrust law, the dissent contended that "[i]t reflects a basic antitrust assumption (that consumers often prefer lower prices to more service). It embodies a basic antitrust objective (providing consumers with free choice about such matters). And it creates an easily administered and enforceable bright line." *Leegin*, WL 1835892 at *23.

Implications

The rule of reason, not a per se rule of unlawfulness, is now the standard by which minimum vertical price restraints will be assessed under federal antitrust law. Because the rule of reason approach is a case-by-case, balancing approach, companies will need to pay careful attention to how the case law regarding minimum resale price restrictions develops in federal and state courts.

The degree of uncertainty about the potential effects of *Leegin* may be most acute under state "baby Sherman Acts" and "baby FTC Acts." It is unclear whether individual state courts that do not automatically follow federal precedent will adopt the rule of reason approach to analyze minimum resale price restraints, or will continue to adhere to the per se rule of unlawfulness. This uncertainty may be heightened by the close vote in *Leegin*.

Thus, it will be important for parties contemplating vertical agreements on minimum resale prices to evaluate the potential competitive effects of such practices in the particular circumstances involved in order to assess the probability of a successful legal challenge to those practices.

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