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Supreme Court Overturns Century Old Rule that Vertical Price Restraints are *Per Se* Illegal

The U.S. Supreme Court has ruled that vertical minimum price restraints (sometimes referred to as resale price maintenance or "RPM" agreements) are not *per se* illegal, but rather are subject to review under the rule of reason.[1] In reaching this result in a 5-4 decision, the Court, in an opinion by Justice Kennedy, explicitly overruled its contrary 1911 decision in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*[2]

The decision may have immediate practical significance in opening the door to consideration by manufacturers of agreements with retailers that would preclude discounting from manufacturers' suggested prices for their products. As both the majority and the dissenting opinions recognized, there will be at least a period of uncertainty as businesses and the courts sort out what factors might render particular RPM arrangements violative of the rule of reason, notwithstanding the removal of the risk of *per se* illegality.

The *Leegin* decision was the fourth major antitrust decision of the 2006 term. All four decisions resulted in victories for the antitrust defendants. Although one of the earlier decisions, *Twombly v. Bell Atlantic*, suggested that specific language in an earlier precedent dealing with pleading standards had "earned its retirement,"[3] *Leegin* represents the first explicit overruling of prior antitrust precedent in these four cases.

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1 *Leegin Creative Leather Prod., Inc. v. PSKS, Inc.*, No. 06-480, 2007 WL 1835892 (U.S. June 28, 2007).

2 220 U.S. 373 (1911).

3 *Bell Atlantic Corp. v. Twombly*, 127 S. Ct 1955, 1969 (May 21, 2007)

The case arose when a retailer that had been selling leather goods manufactured by Leegin at discounts of 20% was cut off for violating an agreement with Leegin that set minimum resale prices. The retailer sued, alleging that Leegin had imposed an illegal vertical price agreement on it. The district court refused to allow Leegin to present expert evidence as to the pro-competitive benefits that its pricing policy provided, holding that such evidence was irrelevant since an agreement of the sort the retailer claimed it had been required to enter was *per se* illegal. A jury returned a verdict for plaintiff that, after trebling, led to a judgment for the retailer of $3,975,000. The Fifth Circuit, citing *Dr. Miles*, affirmed.

In reversing, the Supreme Court majority opinion noted that the *Dr. Miles* decision had been premised in large part on the common law rule against restraints on alienation (a concept rooted in real property concerns) rather than on concerns related to business practices. It noted that the decision also equated horizontal and vertical restraints, an equation the Supreme Court had abandoned decades ago. It concluded that the reasoning in *Dr. Miles* did not itself support *per se* treatment and that the Court was therefore required to consider now the competitive effects of vertical price restraints to determine if the *per se* treatment was nevertheless appropriate, i.e., if it could be said that the effect of such restraints was always or almost always anti-competitive such that case by case testing under the rule of reason was unnecessary.

Both the majority (Chief Justice Roberts and Justices Scalia, Thomas and Alito joined Justice Kennedy's opinion for the Court) and dissent (written by Justice Breyer, joined by Justices Stevens, Souter and Ginsburg) recognized that in certain circumstances vertical price restraints could be anti-competitive. Such arrangements can serve to facilitate cartel behavior by making it easier for manufacturer members of the cartel to monitor prices and identify any price-cutting in violation of the illegal cartel agreement. RPM arrangements also can facilitate collusion among retailers themselves.

But the Supreme Court majority and the dissent also recognized that significant arguments could be mustered for the pro-competitive impact of RPM arrangements. Specifically, the majority noted, such agreements can encourage interbrand competition, a significant factor because "the primary purpose of the antitrust laws is to protect [this type of] competition."[4] Vertical price restraints can also serve to promote the provision of various services by retailers who can do so undeterred by the fear of "free riding."[5]

The principal point of disagreement between majority and dissent had little to do with the fact that vertical price restraints could have both pro- and anti-competitive impact. Rather the question was the significance to be accorded the rule of *stare decisis* given the nearly century old holding in *Dr. Miles*. The majority found *stare decisis* not to bar abandonment of the *per se* rule. It stated that respected authorities in the economic community concluded that, given

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4 *Leegin*, 2007 WL 1835892, at *9.

5 Discounters can benefit from or "free ride" on costly display and demonstration services provided by full price merchants when potential customers learn about the products elsewhere but buy the product at the low-priced discounter.

the pro-competitive benefits of vertical price restraints in various situations, an across the board *per se* condemnation was inappropriate. This was reinforced in the majority's view by the fact that both the Department of Justice and the Federal Trade Commission, the antitrust enforcement agencies with "the ability to assess the long-term impacts of resale price maintenance" recommended abandonment of the *per se* rule.[6] The majority opinion noted that past efforts to circumvent *Dr. Miles* through unilateral refusals to deal based on resale price led to economic inefficiencies and inconsistencies that themselves supported abandonment of the *per se* rule in this context.

The dissent noted that while there was no doubt that the free-riding phenomenon existed, there was no real information on the frequency with which this, in fact, occurred. It noted that little had changed in the last few decades during which *Dr. Miles* had been repeatedly relied upon by the courts and business. Justice Breyer suggested that, in the absence of some clear change in circumstances over the last several decades, interests rooted in reliance on established precedent and the simplicity of administering the established *per se* rule supported continued adherence to the holding of *Dr. Miles*. He noted that factory discount stores and malls dependent on large discount stores for support had relied on the existing law. He concluded that the change would lead to higher consumer prices and "considerable legal turbulence as lower courts seek to develop workable principles," and that the majority had failed to demonstrate new or changed conditions that warranted abandonment of the established rule.[7]

The majority emphasized that it was not adopting a rule of *per se legality* for vertical price restraints, but only abandoning the rule of *per se illegality*.[8] It directed that in applying the rule of reason to such restraints in the future, the courts should look to a number of factors in assessing legality, among them: the number of manufacturers making use of such restraints in a given market and the presence or absence of market power on the part of those making use of such restraints; and whether the restraint originated with the retailer or the manufacturers, with greater concern existing where such restraint were retailer-initiated. It expressed the hope that over time courts would devise rules of analysis, perhaps even "presumptions" that would provide more guidance to business and streamline the complicated process of rule of reason litigation.[9] The majority made clear that notwithstanding its rejection of *Dr. Miles' per se* ban on vertical price restraints, horizontal cartels among retailers or manufacturers remain unlawful *per se* and a vertical price agreement that facilitates such horizontal agreement would also be illegal under the rule of reason (and itself could be some evidence of the existence of a horizontal cartel).

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6 *Leegin*, 2007 WL 1835892, at *15.

7 *Id.* at *33.

8 *Id*. at *18.

9 *Id*. at *14.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or e-mail Dean Ringel at (212) 701-3521 or dringel@cahill.com; or Patricia Farren at (212) 701-3257 or pfarren@cahill.com; or Elai Katz at (212) 701-3039 or ekatz@cahill.com.