Implications of the Supreme Court Decision Overturning the Ban on Resale Price Maintenance Agreements

On June 28, 2007, the U.S. Supreme Court issued its opinion in Leegin Creative Leather Products v. PSKS, Inc., a 5–4 decision overturning the almost century-old rule announced in Dr. Miles Medical Co. v. John D. Park & Sons (1911). Dr. Miles had held that minimum resale price agreements were illegal per se. This bulletin briefly discusses the facts of Leegin; the new legal standard for judging retail price maintenance agreements; the reasoning applied by both the majority and the dissent; and the implications of the decision for clients.

**Facts:** Leegin makes the popular brand of Brighton leather products, which it sells only to specialty stores that emphasize customer service. Leegin adopted a policy requiring its retailers to agree that they would not sell Brighton goods at less than Leegin’s suggested retail prices. In announcing the policy, Leegin explained that it was motivated both by brand-protection concerns and by its desire to encourage its dealers to provide top-quality service. Leegin stopped selling to a particular store, Kay’s Kloset, after it discovered that the store had been marking down the whole Brighton line in violation of Leegin’s price maintenance requirement; Kay’s Kloset filed suit. The lower courts refused to permit Leegin to introduce evidence of the procompetitive aspects of its price maintenance policy, instead applying the Dr. Miles per se rule against resale price maintenance agreements in upholding a jury verdict against Leegin. The Supreme Court reversed, concluding that a per se ban on these types of vertical restraints was inappropriate because of the significant number of potentially procompetitive justifications for a manufacturer’s use of minimum resale prices.

**The New Rule:** The Court’s decision in Leegin does not mean that the imposition of minimum resale prices is always legal. Instead, courts will now consider resale price maintenance cases using the “rule of reason.” The rule of reason allows restraints that, on balance, benefit competition and consumers, while forbidding anticompetitive restraints. In order to decide whether a restraint stimulates competition or not, rule of reason analysis takes into account such factors as “specific information about the relevant business,” “the restraint’s history, nature, and effect,” and any identifiable competitive benefits that might result from retail price maintenance. This analysis often requires expert economic testimony. Even after Leegin, a decision to impose minimum resale prices may still result in antitrust liability if the court finds that the agreement lacks procompetitive benefits and instead raises prices or restricts output.

**Legal Reasoning:** The Court, in an opinion authored by Justice Kennedy, pointed out a number of procompetitive justifications that can result from vertical price maintenance agreements. These can include the stimulation of interbrand competition, the reduction of free riding on service provided by competitors, and the facilitation of new entry. Resale price maintenance agreements are, in particular situations, the least costly ways to capture these...
benefits. While the Court acknowledged potential harms that might result from resale price maintenance agreements, it concluded that a per se rule against them was inefficient. Foreclosing any potential benefits in order to prevent potential harms increases the cost of antitrust enforcement because it forces manufacturers and retailers to use more costly methods to capture the benefits that can result from resale price maintenance. The Court concluded that the doctrine of stare decisis did not require adherence to the “flawed antitrust doctrine” announced in Dr. Miles.

In a vigorous dissent, Justice Breyer challenged the Court’s decision to overturn the per se rule against vertical price maintenance agreements. Justice Breyer first took issue with the Court’s willingness to abandon the Dr. Miles rule in contravention of “ordinary considerations of stare decisis,” particularly without evidence of more clear and immediate benefits. Justice Breyer acknowledged that there were some potential procompetitive benefits, but was hesitant to overturn the per se approach because of uncertainty about how often potential benefits actually outweigh potential harms. He noted some of the same possible harms pointed out by the majority, including facilitation of manufacturer or retailer cartels, and abuse of market power by dominant manufacturers or retailers. Justice Breyer pointed out that applying the rule of reason in vertical resale price maintenance cases will be challenging, involving difficult questions of fact and law, as well as large costs on both parties relating to retention of experts and discovery.

**Implications:** As noted before, application of the rule of reason to retail price maintenance agreements means that while some such agreements may now pass muster under the antitrust laws, others may still be found illegal. In light of this potential uncertainty, caution remains necessary for any company seeking to constrain resale prices charged for its products. In particular:

- Leegin deals only with vertical restraints, meaning restraints imposed by entities at different levels of the distribution chain. Price agreements among horizontal competitors (whether retailer-to-retailer or manufacturer-to-manufacturer) will still be treated as per se illegal and may even be a criminal offense. This will be a particularly sensitive issue for manufacturers with “dual distribution” models, meaning that they sell both to dealers and direct to consumers. More generally, there remains a risk that any agreement with both vertical and horizontal elements will be viewed as horizontal.

- Manufacturers that have or arguably have market power will need to be very cautious before attempting to restrain pricing practices by their retailers. Leegin’s majority and dissent both expressly noted that a resale price maintenance agreement can be “abused by a powerful manufacturer or retailer.”

- Manufacturers considering imposing restrictive pricing policies should be thoughtful in articulating the procompetitive and proconsumer aspects of their pricing policies (e.g., enhanced service, brand protection), both in internal documents and in materials transmitted to retailers. Manufacturers also should consider following Leegin’s lead in allowing retailers to offer discounts on products that are not selling well.

- Timing issues may turn out to be very important in making vertical/horizontal and unilateral/multi-lateral distinctions. For example:
  - A manufacturer that imposes a minimum resale price “on its own,” prior to receiving input from retailers, may be relatively safe under Leegin; but if the same manufacturer imposes the same restraint after receiving complaints from multiple dealers about “price-cutters,” it risks becoming entangled in accusations that it has facilitated a horizontal price-fixing conspiracy among the dealers. This is an area in which conflicting or ambiguous documents could potentially create issues that would make summary judgment more difficult.
  - Both the majority and dissent in Leegin express concern about markets where resale price maintenance agreements are common. Accordingly, a manufacturer that is the first in its market to impose a minimum resale price may be safer under Leegin than a manufacturer who imposes the same restraint only after observing other competitors adopt minimum prices. However, Leegin is
not clear as to whether the first mover(s) will also be at risk of liability if other manufacturers later adopt the same practices.

- Manufacturers doing business in Europe should be aware that Leegin is not consistent with European Union law, which generally forbids resale price maintenance agreements (with exceptions including pharmaceuticals, books, and newspapers).

We also see the following additional implications for manufacturers resulting from the Leegin decision:

- Plaintiffs may now be more reluctant to challenge vertical pricing agreements that have colorable procompetitive justifications because defendants are now clearly permitted to argue to the jury about those justifications.

- Manufacturers that do not compete solely on price may be able to offer retailers and consumers more options with respect to intangibles such as location, service, and convenience for consumers, without concern over discounts causing brand dilution. For example, a manufacturer of a luxury brand might be comfortable authorizing additional retail vendors of its products.

- Resale price maintenance requirements are most likely to proliferate in markets where service is or could be a significant value added for the consumer, or where consumers are brand-sensitive, or both. Note that the service rationale offered in Leegin was relatively weak; manufacturers in other industries likely can articulate stronger explanations for why higher retail prices support consumer-friendly services.

- Some manufacturers may see Leegin as enhancing their ability to create a “level playing field” between their bricks-and-mortar retailers and their Internet retailers, particularly discount Internet retailers. Future litigation in this area is likely.

- Application of Leegin is likely to be particularly challenging for high-technology, high-service markets such as pharmaceuticals and medical devices. In those markets, manufacturers may have legitimate patient-safety and brand-protection justifications for insisting on minimum prices. But markets such as those also tend to be more concentrated, and plaintiffs may argue that minimum price agreements will facilitate cartels or allow dominant firms to abuse their power.

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