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ANTITRUST ALERT

SUPREME COURT OVERRULES *DR. MILES*: VERTICAL AGREEMENTS SETTING MINIMUM RESALE PRICES ARE TO BE JUDGED BY THE RULE OF REASON

On June 28, 2007, the U.S. Supreme Court issued one of its most noteworthy antitrust decisions in decades in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.* The decision overrules the ninety-five-year-old *per se* rule set forth in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), that it is illegal under § 1 of the Sherman Act, 15 U.S.C. § 1, for a manufacturer to agree with its distributor to set the minimum price the distributor can charge for the manufacturer's goods. The Court now holds that all vertical price restraints are to be judged by the rule of reason, the usual standard applied to determine if there is a violation of § 1 of the Sherman Act.

This decision will likely have a significant effect on how manufactures, distributors, and retailers deal with one another as businesses reconsider and adjust their marketing strategies in light of the greater flexibility afforded them. For example, manufacturers and retailers in any traditional distribution chain now have greater flexibility to coordinate how they position products in the market. The *Leegin* decision gives them leeway to negotiate a price floor that would protect a retailer's margins against competition from discounting retailers as a means of fostering greater promotion and service. The decision should apply to traditional distribution relationships for consumer products as well as to industrial supply chains and, potentially, circumstances involved in the licensing of intellectual property. A patent holder and its licensee now may want to consider the price terms that the licensee might charge for the patented product.

In evaluating the effect of *Leegin*, however, a note of caution is warranted. The *Leegin* Court did *not* hold that resale price maintenance is *per* se *legal*. Rather, the Court made clear that the antitrust laws will continue to apply under the rule of reason, and the Court highlighted some of the circumstances that might warrant greater antitrust scrutiny. Moreover, while the *Leegin* decision substantially changes the federal antitrust rules, some state laws still pose significant impediments to implementation of new distribution practices, as will the antitrust laws of some foreign nations for businesses with international operations. In short, while *Leegin* releases somewhat the brake that the federal antitrust laws placed on resale price maintenance, there are still substantial curves in the road for distribution of goods and services and careful legal guidance in this area is needed. The Supreme Court in fact stated its expectation that the *Leegin* decision will lead to further litigation before the rules of the road are clear.

BACKGROUND

The *Leegin* case arose from a dispute between Leegin Creative Leather Products, Inc. (Leegin), a designer and manufacturer of fine leather goods, and PSKS, Inc. (PSKS), the owner and operator of a women's apparel store. PSKS purchased from Leegin "Brighton" fine leather goods. The Brighton goods became PSKS's most important brand and at times accounted for nearly 50 percent of its profits.

Leegin adopted a retail pricing and promotion policy, under which Leegin would refuse to sell Brighton goods to retailers who discounted those goods below the suggested retail prices. Leegin's reason for adopting the policy included providing the specialty retail stores a sufficient profit margin to provide the customer with excellent service and to protect the brand's image and reputation. Leegin later discovered PSKS had been marking down Brighton goods by 20 percent. PSKS refused to cease discounting, contending that nearby retailers were also undercutting Leegin's suggested retail prices. Leegin stopped selling Brighton goods to PSKS. PSKS then sued Leegin alleging violations of the antitrust laws by entering into agreements with retailers to charge only those prices fixed by Leegin.

At trial, Leegin planned to introduce expert testimony describing the pro-competitive effects of its pricing policy. The trial court, however, excluded the testimony, relying on the *per se* rule. The appellate court affirmed a jury award in favor of PSKS. The U.S. Supreme Court then granted certiorari to determine whether vertical minimum resale price maintenance agreements should continue to be treated as *per se* illegal.

OVERVIEW

Section 1 of Sherman Act prohibits agreements that impose an unreasonable restraint on trade. Generally, the rule of reason is the accepted standard for testing whether a practice is a restraint of trade. The rule of reason requires the factfinder to weigh all the circumstances surrounding a given practice in deciding whether the practice should be prohibited. The rule distinguishes between restraints with anticompetitive effect and restraints stimulating competition.

There are some restraints, however, that are deemed unlawful *per se*. The *per se* rule eliminates the need to study the reasonableness of an individual restraint. The *per se* rule applies to restraints that the courts can predict with confidence would be invalidated in all or almost all instances under the rule of reason.

Dr. Miles established a *per se* rule against a vertical agreement between a manufacturer and its distributor to set minimum resale prices. That opinion, decided shortly after the enactment of the Sherman Act, reasoned that vertical price fixing benefited competing distributors not manufacturers, and should therefore be treated as equivalent to a horizontal price fixing agreement among distributors. In *Leegin*, the Supreme Court rejected this rationale for *per se* treatment. Instead, re-examining the underlying economic basis for resale price fixing, the Court said that while some such agreements may have anticompetitive effects, others would not, reflecting what the Court found were legitimate justifications for a manufacturer to use resale price maintenance. The Court thus overruled *Dr. Miles,* holding resale price maintenance agreements subject to the rule of reason, and inviting the lower courts to sort out the lawful from the unlawful in what could prove to be a torrent of new antitrust litigation.

IMPLICATIONS

Leegin has a direct impact on manufacturers, distributors, and retailers of goods. These parties may now consider resale price maintenance agreements in an effort to improve competitiveness and increase sales. Nevertheless, any type of agreement would be subject to the rule of reason and could be found to be an unreasonable restraint on trade.

The Court has provided some guidance as to when such agreements would be unreasonable restraints under the rule of reason. If imposed by a single manufacturer in a competitive market, the Court suggested that resale price maintenance would not be an unreasonable restraint on trade. On the other hand, the Court indicated that resale price maintenance should be subject to more careful scrutiny under the following circumstances, among others:

- many competing manufacturers adopt the practice
- the manufacturer or retailer engaged in the practice has market power
- retailers were the impetus for a vertical price restraint.

Despite this guidance, the Court recognized that because *Dr. Miles* outlawed resale price fixing for almost 100 years the lower courts lack experience in applying the rule of reason to such agreements. The Court said it anticipated that with more experience, over time the lower courts would become efficient, perhaps through the use of presumptions, in eliminating anticompetitive restraints from the market, while providing effective guidance to businesses. In the meantime, businesses that implement resale price maintenance should ensure their practices are clearly pro-competitive under the newly established rule of reason. Moreover, because it is uncertain at this point the extent to which state law antitrust courts will follow *Leegin*, businesses also need to consider the impact of state antitrust law before deciding whether, and in what geographic areas, to change their existing vertical pricing policies.

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