

Berkeley Center for Law, Business and the Economy
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Resale Price Maintenance Comes Out of the Kloset

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On Thursday, the United States Supreme Court released a major antitrust decision revisiting the practice of “retail price maintenance” (RPM) and a precedent that has stood for nearly a century. In *Leegin Creative Leather Products, Inc. v. PSKS, Inc. (d.b.a. Kay’s Kloset)*, --- S.Ct. ----, 2007 WL 1835892, the Court held that contrary to its prior precedents, price maintenance should be judged uniformly under a rule of reason analysis.

Leegin came to the Supreme Court on an appeal from the 5th Circuit, where a unanimous 3-judge panel had upheld a lower court’s judgment for a retailer who had challenged a manufacturer’s pricing policy. The manufacturer in question, Leegin, produced women’s fashion accessories under the name of “Brighton,” and maintained a policy of doing business only with retailers who charged the suggested retail prices, implying a refusal to sell to discounters. Pursuant to this policy, Leegin suspended all sales to PSKS in late 2002 when it discovered that PSKS’s retail store (Kay’s Kloset) had been placing the entire Brighton line on sale below the prescribed prices. PSKS responded by suing under the Sherman Act, contending that Leegin had entered into illegal agreements with retailers in restraint of trade, and seeking lost profits. A jury found for PSKS, awarding it \$1.2 million, which was subsequently trebled under statute and then augmented further by an award of PSKS’s attorneys fees.

When it affirmed the retailer’s victory last spring, the Court of Appeals leaned heavily on the nearly century old precedent from *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911). In *Dr. Miles*, the Supreme Court first established a rule stating that resale price maintenance agreements are a *per se* violation of the Sherman Act. Although continuing to be good law, the punch of *Dr. Miles* had softened over the years, with subsequent cases narrowing its scope and context to the judicial assessment of vertical price fixing between manufacturers and retailers. But because this case presented just such a situation, the panel found that the *per se* rule applied, so it was unnecessary to make numerous factual inquiries that the rule of reason would otherwise require (such as the competitive harm to the women’s apparel market caused by Leegin’s RPM policy).

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On Thursday the Supreme Court reversed. Writing for the 5-4 majority, Justice Kennedy maintained that a *per se* prohibition is appropriate “only if courts can predict with confidence that it would be invalidated in all or almost all instances under the rule of reason.” The *Dr. Miles* doctrine, he wrote, no longer deserved such confident support, and was justified more by “‘formalistic’ legal doctrine rather than demonstrable economic effect.” Justice Kennedy then proceeded to review at some length the economic literature on the desirability of price restraints, noting that it was decidedly mixed, and concluding that continuing with the *per se* rule “would proscribe a significant amount of pro-competitive conduct,” rendering such restraints inappropriate for categorical condemnation. The opinion then went on to articulate a number of factors that would be relevant in prospective rule-of-reason analysis, including the number of manufacturers adopting such practices, their market power, and the source of the restraint.

Justice Breyer, writing for the dissent, also reviewed the mixed academic literature on price maintenance, but maintained that a *per se* rule might still be appropriate if (1) as an empirical matter, the anti-competitive uses of RPM are more likely or plausible than competitive uses; or (2) courts would have a difficult time differentiating laudable from undesirable applications of the practice. He also took issue with the majority’s willingness to overturn *Dr. Miles* after a century of reliance by consumers, retailers and manufacturers.

From a doctrinal standpoint, the Court’s *Leegin* decision completes a 30-year trajectory of narrowing the *per se* rule. In 1977, the Court’s decision in *Continental T.V. v. GTE Sylvania* (433 U.S. 36) eliminated *per se* illegality in favor of rule-of-reason treatment for all vertical restraints not explicitly involving price, and in 2006, in *Illinois Tool Works Inc. v. Independent Ink, Inc.* (547 U.S. 28), extended this approach to tie-in arrangements involving patent-protected tying products. The Court has also made it increasingly difficult for plaintiffs to challenge even price restraints on a *per se* basis, first raising the threshold for showing the requisite agreement in *Monsanto v. Spray-Rite* (465 U.S. 752 (1984)), then raising the degree to which such agreements must focus specifically on price in *Business Electronics v. Sharp* (485 U.S. 717 (1988)). With *Leegin*, the Court has closed the loop, indicating that henceforth all vertical price restraints will be judged under the rule of reason.

After chipping away for over three decades at categorical, *per se* rules applied to vertical restraints, this decision finally fells the tree, a move long advocated by the (so-called) “Chicago School” of antitrust. But it also in many ways reflects the ambivalence that most economists have about RPM in general. Viewed skeptically, price maintenance

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policies can inefficiently facilitate the enforcement of horizontal cartels, or discourage entry by small competitive entrants that might offer low-price, low-service alternatives. Viewed more optimistically, however, RPM helps support efficient allocations of market risk between manufacturers and retailers, and may keep retailers from wastefully cannibalizing one another's entrepreneurial efforts (where consumers window shop at high-service retailers and then purchase from discounters). A fundamental paradox at the core of RPM explains the ambivalence of economists: RPM can increase quality competition in a manufacturer's brand by eliminating price competition. Consequently, economists who have analyzed RPM largely concur that its ultimate defensibility turns principally on the factual context in which it is employed, a perspective that is consistent with a rule of reason approach.

Even though the economic policy consequences of RPM seem most consistent with a rule of reason approach *in theory*, it is worth noting that the rule of reason is frequently an imposing, complicated and expensive obstacle for plaintiffs *in practice*. Although the majority opinion appears somewhat sensitive to this reality, it would not be surprising if at least some deserving future plaintiffs chose not to challenge suspect RPM arrangements, avoiding the costs, risks, and evidentiary obstacles that the rule of reason introduces. The possible underdeterrence of RPM arrangements, harmful in specific market contexts, would then be a matter of some concern to both federal and state antitrust enforcement authorities and at the least might require the allocation of enforcement resources to a field that has not recently been at the forefront of either the DoJ's or the FTC's priorities.

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