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Supreme Court Overturns Long-Standing *Per Se* Rule Against Vertical Minimum Price-Fixing

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This morning, the Supreme Court overturned its long-standing *per se* rule against vertical minimum price-fixing and held that such agreements shall be evaluated under the more flexible "rule of reason." *See Leegin Creative Leather Products v. PSKS, Inc.*, Case No. 06-480. The Court's 5-4 decision, authored by Justice Kennedy, overturns the *per se* rule against vertical minimum price-fixing first announced by *Dr. Miles Medical Co. v. John D. Park & Sons Co.* in 1911.

In overturning *Dr. Miles*, the Court concluded that application of the *per se* rule to vertical agreements on price is inconsistent with modern antitrust and economic analysis. Under the new rule announced by the Court, vertical minimum price-fixing agreements will be evaluated under the 'rule of reason,' which takes into account market dynamics and weighs the anticompetitive effects of a practice against its procompetitive benefits.

In many respects, today's *Leegin* decision will provide businesses with greater freedom and flexibility to develop efficient sales, distribution, and licensing arrangements that support their strategic objectives and enhance their competitiveness. In particular:

- Manufacturers and licensors of intellectual property will have greater flexibility to enter into express minimum resale price maintenance ('RPM') agreements in their product distribution and licensing arrangements;
- Manufacturers will no longer be required by federal antitrust law to resort to less efficient alternative arrangements to control distribution of their products, including Colgate policies, minimum advertised price agreements, and exclusive distribution territories.

On the other hand, the expanded flexibility that *Leegin*'s rule of reason standard offers businesses is likely, at least in the short term, to be clouded by legal uncertainty. In particular:

- Parties contemplating entering into minimum RPM agreements must continue to evaluate the risks arising under state antitrust laws and the competition laws of foreign jurisdictions.
- In addition, since federal courts applying the rule of reason may still prohibit anticompetitive uses of these arrangements, there is likely to be a period of legal turbulence and uncertainty as lower courts seek to develop standards and workable principles to distinguish between procompetitive and anticompetitive minimum RPM agreements.

Background

PSKS, a retailer of "Brighton" brand products manufactured by Leegin, brought an action against Leegin, claiming that Leegin violated Section 1 of the Sherman Act by entering into illegal agreements with retailers to fix the retail sales price of "Brighton" products. A jury found for PSKS, and the Fifth Circuit upheld the jury's verdict based on the long-standing *per se* rule against vertical minimum price-fixing.

Discussion & Analysis

The Supreme Court's decision to overturn the *per se* rule of *Dr. Miles* reflects modern antitrust analysis and economic learning, and brings the treatment of minimum RPM agreements into the 21st century and in line with the Court's other recent antitrust jurisprudence relating to vertical restraints of trade. In overturning *Dr. Miles*, the Court recognized that minimum RPM often may benefit consumers, and that manufacturers and retailers may have a number of procompetitive purposes for entering into minimum RPM agreements:

- Minimum RPM agreements may stimulate competition among different brands of the same type of product by reducing the incentives for intrabrand competition among retailers selling the same brand;

- Minimum RPM agreements may increase the availability of choices for consumers, making it easier for consumers to select among low-price, low-service brands, high-price, high-service brands, and brands that fall in between or include different combinations of price point and service.

- Minimum RPM agreements may facilitate greater availability of retailer service by reducing the incentives for free riding and providing sufficient margin for retailers to develop the optimum mix of service and selection.

- Minimum RPM agreements can increase interbrand competition by helping to induce new retailers to make the necessary investment in capital and labor.

Notwithstanding these potential competitive benefits of minimum RPM agreements and the Court's conclusion that such agreements should be evaluated under the rule of reason, the Court recognized that minimum RPM agreements can be anticompetitive in some circumstances. While a rule of reason analysis would require a full evaluation of the market circumstances before finding an agreement to be unlawful, the Court suggested that minimum RPM agreements nonetheless may present antitrust risk under the following types of circumstances:

- Minimum RPM agreements can be used to facilitate collusive behavior among either competing retailers or competing manufacturers. In such a case, the minimum RPM agreement may be unlawful under the rule of reason because competitors used the agreement to facilitate a *per se* unlawful horizontal cartel.

- Dominant retailers may insist on minimum RPM agreements to forestall or protect against competition from new, lower-cost distribution channels. Such an arrangement may be unlawful under the rule of reason if the dominant retailer has a sufficient share in the market that the minimum RPM agreement actually has the effect of increasing costs or reducing output.

- Dominant manufacturers may insist on minimum RPM agreements in an attempt to give retailers an incentive not to sell the products of rival manufacturers. Depending on the market conditions, it is possible – though somewhat implausible – that such an agreement might have the effect of reducing overall competition in the marketplace.

As described above, the Court balanced these competing considerations and concluded that the *per se* rule is inappropriate for minimum RPM agreements, and the rule of reason shall apply going forward. This decision will harmonize the Court's treatment of minimum RPM agreements with the treatment of various other types of arrangements used by manufacturers to control product distribution, including: (a) customer and territorial distribution allocations; (b) exclusive distribution arrangements; and (c) maximum RPM agreements.

It is important to note that the Court's *Leegin* decision represents only a first step – albeit a very important one – in fully rationalizing the law in this area. The Court today recognized that lower federal courts will, over time, develop a "litigation structure" with presumptions, standards of proof, and guidelines to create clearer boundaries for the application of the rule of reason to minimum RPM agreements. Similarly, the law in two other areas remains uncertain, at best:

- **State Law**: In addition to federal antitrust law, each state has its own set of antitrust laws and judicial precedent. Most state courts defer to the federal courts in interpreting state antitrust law, but the degree of deference varies considerably by state. In light of the Court's decision in *Leegin*, many states will certainly conclude that minimum RPM agreements are not *per se* unlawful under state antitrust law, but it will take some time before the issue can work its way through the state courts.

- **Competition Law Outside the U.S.**: Minimum RPM agreements raise different, and often serious, issues under the competition laws of other national jurisdictions. It is far too early to predict whether the Court's decision today will have any long-term effect on the law in those jurisdictions. Accordingly, a multinational manufacturer or licensor of intellectual property must carefully consider the applicable law in each jurisdiction affected by a potential minimum RPM agreement.