Leegin Returns to East Texas to Die: Epic Vertical Price Fixing Case Goes Full Circle

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Earlier this month, the Eastern District of Texas dismissed all claims in an antitrust case that has made history. In 2007, the United States Supreme Court shook the antitrust world with its decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 127 S.Ct. 2705 (2007). The Court overturned one of its oldest antitrust decisions, *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 31 S. Ct. 376 (1911),, which had held that agreements between a manufacturer and its retailers on the minimum price to be charged by the retailers were *per se* illegal under the federal antitrust laws. The Supreme Court decision generated widespread attention, so our description of it will be brief.

The case arose when Leegin, a maker of high end women's purses and other accessories sold under the Brighton trademark, terminated PSKS as a retailer because of clear and intentional violations of its resale pricing policy. At trial in Judge Ward's court in Marshall, Texas, the jury found that Leegin had gone beyond merely stating and enforcing a *policy* (which standing alone is legal under the Court's decision in *United States v. Colgate & Co.*, 39 S. Ct. 465 (1919)) and had entered into *agreements* setting the minimum prices at which retailers could sell its products. Under the longstanding *per se* rule against such agreements, Leegin was denied the opportunity to show that its actions were either competitively benign or even pro-competitive. Not surprisingly, the jury found liability, and the court trebled the damages award.

After the Fifth Circuit affirmed based on *Dr. Miles*, Leegin asked the Supreme Court to review that precedent in light of more recent Supreme Court cases and an extensive body of more recent economic analysis showing that vertical price fixing agreements are not always or nearly always anticompetitive, as required for *per se* treatment. The Court granted *certiorari* and reversed, holding that such agreements should be judged under the rule of reason, which balances actual competitive harm against procompetitive benefits. In doing so, the Court brought the law governing vertical price agreements into conformity with the law on vertical non-price agreements. The Supreme Court remanded the case to the Fifth Circuit which then remanded to the District Court where it sat for almost a year before PSKS began to prosecute it again.

PSKS eventually filed an amended complaint which attempted to assert a rule of reason case under the new rule established by the Supreme Court. In addition, however, PSKS attempted to assert new *per se* claims based on the allegation that Leegin's agreements were horizontal. After briefing and argument, Judge Ward held that the claims were defective as a matter of law and dismissed the case.

In light of the change in legal standards, PSKS was entitled to try to assert claims under the rule of reason. However, since the original case was premised on the *per se* rule, the facts did not fit easily in a rule of reason framework. PSKS alleged two economic markets in which to evaluate the competitive effect, but Judge Ward had little difficulty finding these markets to be deficient.

The first alleged market was the "retail market for Brighton's women's accessories." Judge Ward noted that numerous cases have rejected the effort to define single brand markets. While Brighton purses are obviously differentiated to some degree, there was no basis to conclude that they do not compete with other high quality purses.

The second alleged market was the "wholesale sale of brand-name women's accessories to independent retailers." Judge Ward found this market definition to be gerrymandered in every element. The attempted focus on "wholesale" sales was inappropriate because it did not focus on how the agreements impact consumers. The attempted focus on "brand name" accessories was conclusory, and the pleading failed to allege facts to show that consumers would only turn to brand name products as substitutes for the Brighton products. The attempted focus on "women's accessories" grouped products as dissimilar as shoes and picture frames despite the fact that they are obviously not substitutes for one another. Finally, in addition to being vague, the attempted focus on "independent retailers" failed because there was no reason to think that consumers would not purchase from other types of retailers if they sold the same products.

In the absence of adequately defined relevant markets, the rule of reason case failed as a matter of law because there was no market context in which to assess any competitive effects. The attempt to introduce new "horizontal" *per se* theories also failed as a matter of law for both procedural and substantive reasons.

PSKS had chosen to go to trial on only the *per se* rule against vertical minimum price fixing. Under the so-called mandate rule, the case on remand was limited to the vertical price fixing theory that was tried and appealed. In addition, however, Judge Ward held that the new claims failed anyway.

One horizontal theory was premised on the fact that Leegin operated a small number of its own retail outlets. PSKS argued that since Leegin operated at the retail level, the agreements that it made with its many retailers should be treated as horizontal agreements. Many cases have rejected this "dual distribution" theory, and Judge Ward did too.

The other horizontal theory was a "hub and spoke" theory in which Leegin was the hub and its retailers were the spokes. PSKS tried to bolster this theory with evidence of a sales meeting at which Leegin had asked the opinion of some of its retailers on a minor application of the pricing policy and later announced its decision to the same effect. Judge Ward found the allegations to be insufficient to establish this conspiracy. There was no allegation that the retailers had agreed among themselves or that Leegin's own interests were not the driving force in the announced decision. As a result, the allegations did not go beyond a vertical agreement because "PSKS is missing the requisite wheel in the classic hub and spoke arrangement."

At the first trial, Leegin was prepared to prove that it had important and legitimate business justifications for its pricing policy and also to introduce economic evidence that its actions did not and could not harm competition in the highly competitive market in which it and many other, often larger and more powerful firms operated. Those arguments tend to raise fact questions that may be hard to resolve on summary judgment. Because PSKS did not get past the important market definition / market power screen, however, those issues were not litigated on remand.

Barring yet another appeal, for which there seems to very little basis, *Leegin* appears to be over at last. An important antitrust principle was established because Leegin's owner, Jerry Kohl, was willing to spend the time and money necessary. As the ruling on remand shows, the Supreme Court's decision in *Leegin* will profoundly impact litigation in this area. However, companies should not assume that there is now a rule of *per se* legality. Companies with arguable market power are at some risk, and should implement their distribution policies with care. Although *Leegin* has changed the federal antitrust rules, many states have their own antitrust laws, some of which contain independent *per se* rules, and many state enforcers were big supporters of the old federal *per se* rule. As a result, it may be wise to continue to rely primarily on pricing policies rather than agreements. At least now, if an agreement is found, companies will have the opportunity to show that their practices do not, in fact, harm competition.

Tyler Baker is the head of the Antitrust Litigation group at Fenwick & West LLP. He represented Leegin in all phases of this litigation. Earlier in his career, he was the law clerk for Justice Lewis F. Powell, Jr. in Continental T.V., Inc. v. GTE Sylvania, Inc., 97 S. Ct. 2549 (1977), in which the Supreme Court held in an opinion by Justice Powell that the rule of reason applies to vertical non-price agreements. He is not entirely neutral on these issues.

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