Antitrust Alert

Everything Must End Eventually: The Fifth Circuit Buries *Leegin* Epic Vertical Price Fixing Case is Over

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In its second encounter with *PSKS, Inc. v. Leegin Creative Leather Products, Inc.*, the U.S. Court of Appeals for the Fifth Circuit on August 17, 2010 affirmed the dismissal on the pleadings of the plaintiff's antitrust claims for vertical minimum price fixing (aka resale price maintenance). This was a huge swing. In the first encounter in 2006, the Court had summarily affirmed a large jury verdict in favor of PSKS based on the same claims. However, in the interim the United States Supreme Court granted *certiorari* and shook the antitrust world by overturning one of its oldest antitrust decisions, *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 31 S. Ct. 376 (1911), which had established a *per se* rule of illegality for vertical minimum price fixing agreements between a manufacturer and its distributors. What had been a winner under the old law was a loser under the new law.

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 policy requiring Brighton retailers to follow suggested resale prices. 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 Supreme 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 of approximately $1.2 million.

After the Fifth Circuit affirmed in a short not-for-publication opinion based on *Dr. Miles*, Leegin asked the Supreme Court to review the *per se* rule 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 anticompetive, 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 established in *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977). The Supreme Court remanded the case to the Fifth Circuit for further proceedings consistent with its opinion. The Fifth Circuit 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. The Fifth Circuit affirmed Judge Ward on each point.

In light of the intervening 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.

The Fifth Circuit noted that the Supreme Court's decision in *Leegin* had torn "down the artificial doctrinal wall between vertical price and non-price restraints" with the result that it could draw on the substantial body of precedent involving vertical non-price restraints that had developed after the *GTE Sylvania* decision. The Court agreed with Judge Ward that in order to prevail on its vertical minimum price fixing claim PSKS was required to plead and prove a relevant geographic market. It also agreed with Judge Ward that the two markets alleged by PSKS failed as a matter of law.

The first alleged market was the "retail market for Brighton's women's accessories." The Fifth Circuit agreed with Judge Ward that PSKS could not limit the market to the single Brighton brand. Judge Ward had 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 Fifth Circuit arguably went farther, holding that a single brand could constitute a relevant market only where "consumers are 'locked in' to a specific brand by the nature of the product." PSKS had not alleged any such structural barriers to competing products.

The second alleged market was the "wholesale sale of brand-name women's accessories to independent retailers." Judge Ward had found this market definition to be gerrymandered in every element, and the Fifth Circuit agreed. The attempted focus on "wholesale" sales was inappropriate because "the relevant market definition must focus on the product rather than the distribution level." The attempted focus on "brand name" accessories failed because PSKS failed sufficiently to allege "why Brighton goods are not interchangeable with non-brand products." The attempted focus on "women's accessories" was "too broad and vague a definition to constitute a market." It grouped products as dissimilar as shoes and picture frames despite the fact that they are obviously not substitutes for one another. Finally, the attempted focus on "independent retailers" failed because "PSKS has not alleged facts that could establish why independent retailers do not compete with larger chain stores in the distribution of Brighton products."

Using the economic logic of the Supreme Court's decision in *Leegin*, the Fifth Circuit also rejected the competitive harms alleged by PSKS. The notion that Leegin's pricing policy forced consumers to pay "artificially high prices" for Brighton products "defies the basic laws of economics." "Absent market power, an artificial price hike by Leegin would merely cause it to lose sales to its competitors." The Court noted that "robust competition can exist even in the absence of price competition" if some competitors choose to stress non-price factors such as service and attractive shopping environments. Thus, the termination of PSKS was not harm to competition, because the antitrust laws protect competition, not competitors. Finally, the Court noted that PSKS had not alleged that the source of the Leegin pricing policy was either a cartel or retailers or a dominant retailer, fact patterns that the Supreme Court had identified as possible indicators of competitive problems.

The Fifth Circuit agreed with Judge Ward that PSKS's attempt to introduce new "horizontal" *per se* theories failed as a matter of law for both procedural and substantive reasons. PSKS had chosen to go to trial only on the old *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. Although not strictly necessary to its decision, the Fifth Circuit agreed with Judge Ward that the new claims failed on the merits 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. Agreeing with Judge Ward and eight other circuits, the Fifth Circuit flatly rejected this "dual distribution" argument. In terms of its economic incentives, the Court held that "Leegin is thus no different from a manufacturer that does not have retail stores…."

The other horizontal theory was a "hub and spoke" theory in which Leegin allegedly was the hub and its retailers were the spokes. However, since PSKS had not alleged that the retailers had agreed on prices among themselves, "there is no wheel and therefore no hub-and-spoke conspiracy…."

PSKS tried to bolster its horizontal conspiracy 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. The

Fifth Circuit arguably went farther. In language that is certain to be quoted in the future, the Court held that "[a] manufacturer's discussion of pricing policy with retailers and its subsequent decision to adjust pricing to enhance its competitive position do not create an antitrust violation or give rise to an antitrust claim."

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 or addressed on appeal.

Even after this latest decision motions for rehearing or rehearing *en banc* or a petition for *certiorari* are still possible, but those are rarely granted. Thus, *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 to fight the case through the entire federal court system not just once, but 1 and 2/3's times.

As the Fifth Circuit's decision confirms, 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. Juries like bargains and do not easily understand the economic arguments on which *Leegin* is based. Rule of reason cases can be lost. 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 strong supporters of the old federal *per se* rule. Also, legislation has been introduced in Congress that would overrule *Leegin* if enacted. As a result, it is important to get legal advice before making changes, and it may be wise to continue to rely primarily on pricing policies rather than agreements. However, at least for now, in federal court and in the state courts that follow federal precedent, if an agreement is found, companies will have the opportunity to show that their practices do not, in fact, harm competition.

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