SUPREME COURT APPLIES “RULE-OF-REASON” STANDARD TO RESALE PRICE MAINTENANCE AGREEMENTS

In one of the most significant antitrust decisions in decades, the Supreme Court today overturned the 96-year-old rule that resale price maintenance arrangements—agreements between suppliers and their distributors or retailers fixing a minimum resale price—are illegal per se. Under today’s decision in *Leegin v. Creative Leather Products, Inc.*, No. 06-480 (U.S. June 28, 2007), all such agreements are now subject to the “rule of reason,” a method of analysis under which the claimant must prove that the arrangement harms competition substantially in the market as a whole. Under the now-abandoned per se rule, such anticompetitive effects had been presumed conclusively. The decision in *Leegin* overrules a long line of Supreme Court precedents dating back to the decision in *Dr. Miles Medical Co. v. John D. Park & Sons*, 220 U.S. 373 (1911).

Under *Leegin*, it is now no longer necessary for manufacturers merely to “suggest” a resale price. Manufacturers now can direct the specific price to be charged. The only constraint, under the rule of reason, is that the arrangement cannot be one that causes prices to increase, or quantity, quality, or consumer choice to decrease, in the market as a whole—a market that includes all brands, not just the manufacturer’s brand. Devices that firms have employed for years to avoid application of the per se rule of *Dr. Miles* are no longer required. Companies now can direct specific resale prices to be charged, need not utilize agency or consignment arrangements in order to direct prices, need not adopt cumbersome “minimum advertised price programs,” and no longer need exercise extreme caution to avoid “agreements” with dealers or retailers (as opposed to unilateral actions) on the prices to be charged.

Today’s decision came in a 5-to-4 opinion, with Justice Anthony Kennedy writing for the majority and Justice Stephen Breyer writing for the dissenters. But the decision may not be the last word. Most states have their own antitrust laws, and many of them may choose not to follow the Supreme Court’s decision. And there will undoubtedly be some efforts in the Congress, which had never expressed dissatisfaction with *Dr. Miles*, to overrule *Leegin* and reestablish the per se rule. The story undoubtedly will continue to unfold over the next several years or longer.

The Court’s opinion did not explain precisely how rule-of-reason analysis would be applied in resale price maintenance cases, but the Court did indicate circumstances in which anticompetitive effects might be present and, presumably, would be sufficient evidence of illegality in the absence of countervailing procompetitive effects. Specifically, the Court said:

To the extent a vertical agreement setting minimum resale prices is entered upon to facilitate either type of cartel [among competing dealers], it . . . would need to be held unlawful under the rule of reason. . . . Resale price maintenance, furthermore, can be abused by a powerful manufacturer or retailer. A dominant retailer, for example, might request resale price maintenance to forestall innovation in distribution that decreases costs. A manufacturer might consider it has little choice but to accommodate the retailer’s demands for vertical price restraints if the manufacturer believes it needs access to the retailer’s distribution network. A manufacturer with market power, by comparison, might use resale price maintenance to give retailers an incentive not to sell the products of smaller rivals or new entrants. As should be evident, the potential anticompetitive consequences of vertical price restraints must not be ignored or underestimated. Resale price maintenance should be subject to more careful scrutiny . . . if many competing manufacturers adopt the practice. . . . The source of the restraint may also be an important consideration. If there is evidence retailers were the impetus for a vertical price restraint, there is a greater likelihood that the restraint facilitates a retailer cartel or supports a dominant, inefficient retailer.

The Court added, however:

[That a dominant manufacturer or retailer can abuse resale price maintenance for anticompetitive purposes may not be a serious concern unless the relevant entity has market power. If a retailer lacks market power, manufacturers likely can sell their goods through rival retailers. . . . And if a manufacturer lacks market power, there is less likelihood it can use the practice to keep competitors away from distribution outlets.

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Today’s decision gives firms a good deal more freedom in structuring their distribution systems, but they will need to exercise some caution going forward to avoid litigation—especially if a firm has a substantial market share.

Note that the Dr. Miles per se rule applied only to agreements fixing minimum prices. Agreements fixing maximum resale prices, and agreements that do not fix particular resale prices or price levels have, under recent decisions, been analyzed under the rule of reason. See State Oil Co. v. Khan, 522 U.S. 3 (1997) (maximum prices); Business Electronics Corp. v. Sharp Electronics, 485 U.S. 717 (1988) (agreements not fixing particular prices or price levels). Nothing in today’s opinion changes those legal rules. Neither does anything in today’s decision change the rule that agreements fixing prices among competing dealers or retailers—horizontal agreements—remain illegal per se. See United States v. General Motors Corp., 384 U.S. 127 (1966).

The decision in Leegin no doubt will affect businesses across many sectors, and provides an opportunity to reexamine distribution practices in light of this substantial change in the law. Please contact Jonathan Jacobson, Susan Creighton, Scott Sher, Chris Compton, or another member of Wilson Sonsini Goodrich & Rosati’s antitrust practice to discuss any questions that you have regarding the decision’s impact on your sales and marketing strategies.