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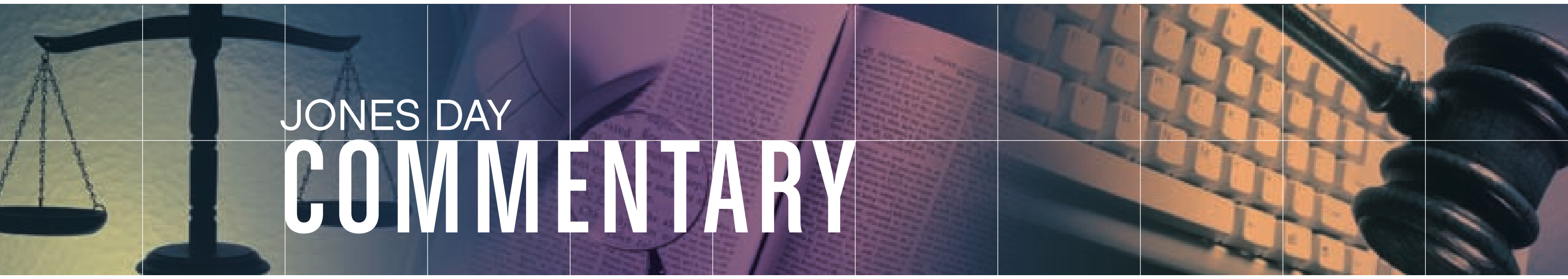


ANTITRUST

# *DR. MILES* RECEIVES ITS COUP DE GRACE

Finally! *Dr. Miles* is dead! Perhaps not quite as important as the demise of the Wicked Witch of the West in *The Wizard of Oz*, but still a pretty significant fatality in the antitrust world.

The symbolism alone is important. *Dr. Miles* had become antitrust's appendix—a vestigial reminder of antitrust the way it used to be. The last three decades have seen a steady march of economic realism into antitrust law, a process that has gained momentum over the last decade. Just the last two years have brought a flurry of Supreme Court decisions that collectively have reshaped the antitrust landscape. Last week's *Leegin* decision is a fitting exclamation point at the end of what amounts to a very strong declarative statement from the Supreme Court about how American antitrust law now works, 117 years after its creation. But this decision may turn out to have considerable practical significance as well, for it gives manufacturers a whole new set of tools to use marketing their goods.

For non-antitrust lawyer readers, *Dr. Miles* is the 1911 Supreme Court decision that held that agreements between a manufacturer and a distributor setting the minimum price at which the distributor will sell the manufacturer's goods—so-called resale price maintenance, or RPM, agreements—were *per se* illegal, meaning they were illegal even if there was no showing of anticompetitive effect. Reflecting the legal formalism that reigned at the time, the Court did not base its rule on an analysis of the economic impact of such agreements, but rather on an analogy to the common-law rule forbidding restraints on alienation. *Dr. Miles* probably made little sense when decided, but it had long ago become, to borrow a phrase from Justice Douglas, an "artifact in the stream of the law."

Antitrust law today, and increasingly for the last 30 years or so, is driven by economic analysis and a focus on consumer welfare, factors that were simply not on the radar screen in 1911. During these last three decades, antitrust jurisprudence has seen a steady march away from analysis by anecdote and slogans to more detailed fact-based efforts to discern the actual effects of a challenged practice, often through sophisticated economic analysis. In 1977, this developing approach produced the Supreme Court's *Sylvania* decision, eliminating the *per se* rule against nonprice vertical restraints, and holding that such agreements should be tested by the standard antitrust "rule of reason," which balances anticompetitive effects and procompetitive benefits to determine the net impact on competition. The Court has now completed the circle, coming to the same conclusion about vertical restraints involving agreements setting minimum prices (it abolished the *per se* rule against maximum price agreements in the *Kahn* decision in 1997). A visitor from another planet might well ask why it took so long to get to what seems such a sensible result. It's a good question.

Given the merits of the arguments against *per se* treatment of RPM, it is hard to avoid the conclusion that one reason, perhaps the principal reason, why this artifact finally was pushed out of the shipping channel is the changed composition of the Supreme Court. Over the last two terms, the Supreme Court has issued seven antitrust decisions. By comparison, in most of the Court's last 20 or so terms, having even one antitrust decision was news, and having no decisions was not uncommon. Clearly, Chief Justice Roberts is interested in business cases, and in antitrust cases in particular, and the addition of Justice Alito has probably increased the Court's willingness to take more definitive positions in the business cases it has accepted for review. Since support for *per se* treatment of RPM has long been more political than substantive, the replacement of O'Connor (known more for seeking middle grounds, which in antitrust resulted in such decisions as *Jefferson Parish* in 1984, preserving the *per se* label for tying analysis but imposing an analysis that was essentially rule of reason) with Alito, and Rehnquist (who had little interest in antitrust) with Roberts (very interested in antitrust) has had an enormous impact. In any event, whatever the reason, *Dr. Miles* is now officially dead, and that is a good thing.

*Leegin* involved pretty simple facts. The plaintiff was PSKS, a women's clothing and accessories retailer. Leegin manufactured Brighton women's accessories. By 1999, Brighton was PSKS's best-selling and most profitable line. During that period, Leegin had created a marketing incentive program that required participants to agree to follow the "Brighton Suggested Pricing Policy." In 2002, Leegin discovered that PSKS was discounting Brighton goods in violation of Leegin's pricing policy. Leegin suspended all shipments of Brighton goods to PSKS, resulting in a substantial decline in PSKS's sales and profits. PSKS responded with a lawsuit claiming that its pledge constituted an illegal RPM agreement with Leegin, and PSKS won a jury verdict of $1.2 million in compensatory damages, which the trial court trebled. The Fifth Circuit affirmed, saying that it was bound by *Dr. Miles.*

The Supreme Court reversed, abolishing the absolute prohibition that *Dr. Miles* had imposed on any manufacturer's agreement with retailers that set minimum prices for sale of the manufacturer's products (the same sort of prohibition that had applied to maximum resale price agreements until *Kahn* in 1997). Even under *Dr. Miles*, of course, there had always been ways that manufacturers could control (or at least influence) retail prices, but they were either costly or complicated, and frequently both. The most conceptually simple way was to vertically integrate, for the manufacturer to also sell directly at retail. But vertical integration is not a desirable strategy for many producers and is, in any event, a strategy that requires considerable investment, one which not all producers have the ability to make. And then there were the various work-arounds, which highlighted the tension between *Dr. Miles* and the economics of real life, involving the use of targeted marketing and promotion expenditures that had the practical effect of establishing resale prices. Alternatively, manufacturers relied on *Colgate*, a case decided just eight years after *Dr. Miles,* in which the Court held that while *agreements* regarding minimum pricing violated antitrust law, manufacturers were free to take *unilateral action* terminating distributors who failed to sell at the manufacturer's specified prices. The variety of work-arounds was limited only by human ingenuity, which is to say that there was an almost infinite number of different efforts by manufacturers to accomplish indirectly what *Dr. Miles* said they could not do directly.

*Leegin* has now revoked the *per se* rule against RPM, meaning that those manufacturers who see commercial advantage in doing so may be more direct in their arrangements with retailers. But despite the wails of some commentators, *Leegin* should not lead to broad price increases at retail stores. First of all, in competitive markets, most manufacturers cannot afford to raise prices. No manufacturer will even attempt to impose minimum-price agreements unless it believes that RPM will lead to greater profitability. If a manufacturer's products face easily available substitutes or alternatives that customers can choose if the manufacturer's products become too expensive, the manufacturer will use an RPM agreement to raise prices at its own peril. To be sure, such agreements could allow manufacturers to increase the level of service that retailers provide in connection with the sale of the manufacturer's goods by allowing the manufacturer to ensure that the retailer will not be undercut on price by a lower-service retailer. But if the manufacturer misjudges the price/service bundle that is most attractive to consumers, fewer of them will buy its products, and the manufacturer will be forced to change its approach, ultimately leading the manufacturer to provide the price/service bundle that consumers value most highly. And in a competitive market, some manufacturers will pursue the low-price strategy.

If, by contrast, the manufacturer faces few real substitutes, then its use of RPM could, at least theoretically, raise antitrust concerns, even under the rule of reason. *Leegin*, after all, does not establish a rule of *per se* legality. It merely says that when an RPM agreement is challenged, it should be tested under the normal antitrust standard, the rule of reason. A manufacturer's adopting an RPM program, and enforcing it through the termination of retailers who do not comply, almost certainly will produce litigation, and in that litigation the plaintiffs now will have the obligation to show why the conduct attacked is anticompetitive—again, just as is the case in most other areas of antitrust law. If a manufacturer with market power were attempting to use such agreements to stymie innovation in distribution that decreases costs or to create barriers to entry for smaller manufacturers or new entrants to the market, such uses would be subject to attack under the rule of reason. Similarly, use of such agreements to facilitate horizontal price fixing, among either manufacturers or retailers, could be challenged under the rule of reason approach. All the Court said in *Leegin* was that there was no point in throwing out the baby with the bathwater.

In addition, the fact that mass retailers (the Wal-Marts and Targets of the world) are very attractive customers to many manufacturers, because of the volumes they are able to move, will itself constrain the widespread adoption of RPM programs. To adopt an RPM program that forecloses those retailers (or, with some products, reduces or eliminates online discounters) will be something that is done only after very careful thought, and it will simply not be appealing for many manufacturers. In short, today's decision may lead to a greater use of RPM agreements, and those agreements may pose some problems for retailers whose business model is to compete solely on price, but there is no reason to conclude that RPM will become the standard operating procedure for manufacturers across the board or that it will have widespread price effects.

In addition to announcing the end of the *per se* ban on RPM, *Leegin* also made three other important contributions to the development of antitrust law:

First, the Court strongly reiterated the principle that *per se* rules are the exception, and not the rule, in antitrust law. *Per se* treatment is strictly confined to those restraints that would always or almost always tend to restrict competition and decrease output. The rule of reason, with its case-by-case analysis, is the default, and "only if courts can predict with confidence" that a particular practice would have an anticompetitive effect in all or almost all instances, is resort to a *per se* rule appropriate. Such language may encourage defendants to mount challenges to the few remaining *per se* categories populating the antitrust landscape—tying cases are the obvious possibility.

Second, the Court reaffirmed the notion that the key inquiry in modern antitrust enforcement is the impact of a challenged restraint on *interbrand* competition, which the Court characterized as the principal focus of the antitrust laws. In other words, it is competition among manufacturers promoting differing brands that the antitrust laws seek to foster, not necessarily competition among different retailers selling the same brand. This continues the focus on interbrand competition that has been present at least since *Sylvania,* and it will further complicate efforts to attack vertical agreements. This may have some real impact in intellectual property licensing cases, where vertical analysis is common.

Third, in overruling *Dr. Miles*, the Court held that *stare decisis* is not as "significant" in Sherman Act cases as it is in other areas of law. Invoking the notion that the Sherman Act is a "common-law statute," the Court recognized more explicitly than in the past that constant change to conform to changing economic circumstances and knowledge should be the norm for antitrust, and thus a principle of broad application like *stare decisis* has less significance in antitrust. This point, rather than the merits, was the main focus of Justice Breyer's dissent. Justice Breyer is very knowledgeable about antitrust, having served at one point in his career as the Chief Counsel for the Senate Judiciary Committee's Antitrust Subcommittee, and he was the author of some important and influential antitrust decisions in his tenure on the First Circuit prior to being elevated to the Supreme Court. But his dissent leaves one with the impression that it was just going through the motions on the merits issues and was aimed more at what the majority decision could mean for the potential disregard of *stare decisis* principles in other areas of law.

The full impact of *Leegin* will take some time to see. In the short run, there will likely be some manufacturers who have used broad-based distribution that may now decide to concentrate their distribution among a smaller group of retailers who would agree to invest in greater marketing and customer service efforts for the manufacturers' products in exchange for a guarantee that they will not be undersold by other retailers. Luxury-good manufacturers in particular may seek to maintain greater control over their pricing in order to better promote their overall brand. But some of the retailers who feel RPM's squeeze will sue, and that will produce decisions, ultimately by the courts of appeals. Only then will we see clearly how the rule of reason will be applied in RPM cases. In addition, given the lack of consensus on the Court, it is likely that there will be efforts in at least some states to maintain the old approach under state antitrust law, so we may see the kind of divergence between state and federal law that we have seen with respect to the passing-on issue in damage calculations after *Illinois Brick*.

One thing that is clear now is that *Leegin* is a fitting end to what can only be described as a second straight blockbuster Supreme Court Term for antitrust defendants. The net effect of the Court's antitrust decisions this year and last strongly favors business, a result that has accelerated the trend of the last couple of decades (with only occasional blips). In the aggregate, these decisions have made antitrust more rational, more predictable, and more focused than before on overall consumer welfare, rather than individual plaintiffs. But there is still work for the Court to do in this area. The Court has not decided a substantive merger case in more than 30 years; merger analysis would benefit enormously from Supreme Court attention. A tying case reaching the Court would give it the opportunity to make clear that it is the rule of reason that applies to those claims as well. And bundling/leveraging issues, like those in the Third Circuit's *LePages* decision that the Court declined to hear several years ago, will no doubt get to the Court soon. Given this Court's affinity for antitrust, additional important decisions may be just around the corner.

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