KIRKLAND & ELLIS LLP

ALERT

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Supreme Court Strikes Down *Per Se* Treatment of Resale Price Maintenance

Since 1911, it has been *per se* illegal for a manufacturer and its distributors to agree on a minimum resale price. This practice, known as resale price maintenance or "RPM," was condemned by the Supreme Court in one of the earliest high-court Sherman Act cases, *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), and has been reaffirmed throughout the years. *See, e.g., Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 720 (1988). That is, until now. On June 28, the Supreme Court expressly overruled *Dr. Miles* in the much-anticipated *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, — S. Ct. —, 2007 WL 1835892 (June 28, 2007).

In *Leegin*, Leegin (a clothing manufacturer) terminated PSKS (a clothing retailer) for selling Leegin's products at prices lower than the sales prices Leegin had requested. PSKS then brought suit against Leegin, alleging that Leegin violated the Sherman Act by obtaining agreements from other clothing retailers on minimum retail prices for Leegin's products. At trial, Leegin defended its conduct by arguing it did not have agreements with retailers, but that — consistent with the *Colgate* doctrine, which theoretically provided safety from *Dr. Miles* — what it was really doing was unilaterally announcing a minimum price and terminating those dealers who sold under that price. *See United States v. Colgate & Co.*, 250 U.S. 300 (1919) (upholding the "right of a trader or manufacturer engaged in an entirely private business ... freely to exercise his own independent discretion ... and ... [to] announce in advance the circumstances under which he will refuse to sell"). The jury disagreed with Leegin and returned a verdict for PSKS.

On appeal, Leegin argued for reversal on the basis that a *per se* rule of illegality for minimum retail price fixing is inconsistent with modern antitrust jurisprudence, citing the Court's decisions in *Khan v. State Oil Co.*, 522 U.S. 3 (1997) (declaring vertical maximum price fixing subject to the rule of reason) and *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977) (holding that a restriction on the locations from which the retailers resold the merchandise was subject to the rule of reason). The Supreme Court agreed.

> Justice Kennedy (writing for a 5-4 majority) succinctly explained that:
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> The court has abandoned the rule of *per se* illegality for other vertical restraints a manufacturer imposes on its distributors. Respected economic analysts, furthermore, conclude that vertical price restraints can have procompetitive effects. We now hold that *Dr. Miles* should be overruled and that vertical price restraints are to be judged by the rule of reason.

The Court did, however, voice its lingering concerns about dominant firms using RPM to harm competition (by preventing discounting), as well as retailers and manufacturers using RPM to

organize and police cartels. But in the end, the Court was persuaded that minimum resale price restraints are not *per se* harmful to competition because of the potential procompetitive effects on interbrand competition. The Court said preserving interbrand competition is the "primary purpose of the antitrust laws."

The question now becomes what will courts look for in deciding whether RPM programs are lawful or illegal under the rule of reason. Fortunately, the Court provided some guidance. RPM should be subject to increased scrutiny:

- where many competing manufacturers adopt the practice (covering a large part of the industry's output);
- if there is evidence that retailers were the impetus for the RPM;
- if a dominant manufacturer (i.e., one with market power) adopts RPM to gain monopoly profits as opposed to inducing retailers to provide services, or adopts it to thwart entry by smaller firms; and
- if a dominant retailer insists the manufacturers adopt a RPM practice to hinder innovation in distribution.

Going forward, if you decide that an RPM strategy is in your — independent, of course — economic best interest and will help you compete in the marketplace, there are some precautions that you should consider taking in light of the Court's decision. For example,

- Adopt it soon before there is any push by retailers to encourage you to adopt one.
- Make sure that you document the procompetitive benefits of (and business rationale for) adopting a RPM strategy; for example, to make sure the retailer has sufficient margins to keep your products on the shelf, advertise and promote your products, has trained salespeople, etc. Having a procompetitive reason will also help deflect an inference of conspiracy if all of your competitors adopt RPM.
- If you arguably have market power in the sale of a product, you will need to take extra precautions in both executing the RPM strategy and drafting the documents about it.
- Make sure your employees are prepared with the right response, if a retailer requests you to engage in RPM.
- Do not ignore state antitrust laws. Although it is likely just a matter of time before state courts follow *Leegin* in applying their own state laws, that obviously has not occurred yet.

We of course stand by ready to assist you in light of this change in the law and the other recent pro-business Supreme Court rulings. We can help you better articulate your procompetitive rationales, manage the documentation and implementation of a RPM policy, and navigate any potential state-law pitfalls.

Should you have any questions about the matters addressed in this Alert, please contact the following Kirkland & Ellis authors or the Kirkland & Ellis attorney you normally contact:

Christopher T. Casamassima
Kirkland & Ellis LLP
777 S. Figueroa Street
Los Angeles, CA 90017
ccasamassima@kirkland.com
+1 (213) 680-8353

Colin R. Kass
Kirkland & Ellis LLP
655 Fifteenth Street, N.W.
Washington, D.C. 20005
ckass@kirkland.com
+1 (202) 879-5172

Marimichael O. Skubel
Kirkland & Ellis LLP
655 Fifteenth Street, N.W.
Washington, D.C. 20005
mskubel@kirkland.com
+1 (202) 879-5034

Tefft W. Smith
Kirkland & Ellis LLP
655 Fifteenth Street, N.W.
Washington, D.C. 20005
tsmith@kirkland.com
+1 (202) 879-5212