No. 06-480

IN THE

Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,

Petitioner,

v.

PSKS, INC., doing business as Kay's Kloset . . . Kay's Shoes,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

BRIEF FOR PETITIONER

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QUESTION PRESENTED

This Court has held that antitrust "*per se* rules are appropriate only for conduct that . . . would always or almost always tend to restrict competition." *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 723 (1988). Modern economic analysis establishes that vertical minimum resale price maintenance does not meet this condition because the practice often has substantial competition-enhancing effects. The question presented is whether vertical minimum resale price maintenance agreements should be deemed *per se* illegal under Section 1 of the Sherman Act, or whether they should instead be evaluated under the rule of reason.

PARTIES TO THE PROCEEDING AND RULE 29.6 STATEMENT

In addition to the parties named in the caption, Toni Cochran L.L.C., doing business as Toni's, was a plaintiff below. Its claims were dismissed by the district court before the case was submitted to the jury.

The corporate disclosure statement included in the petition for a writ of certiorari remains accurate.

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The court of appeals' opinion is unpublished but electronically reported at 2006 WL 690946. Pet. App. 1a. The order denying the petitions for rehearing and for rehearing en banc is unreported. *Id.* at 16a. The opinion of the United States District Court for the Eastern District of Texas is unreported. *Id.* at 12a.

JURISDICTION

The district court had jurisdiction over respondent's claims pursuant to 28 U.S.C. § 1331. The court of appeals had jurisdiction to review the district court's final judgment pursuant to 28 U.S.C. § 1291. The court of appeals filed its opinion on March 20, 2006. It denied the timely petitions for rehearing and for rehearing en banc on July 19, 2006. The petition for a writ of certiorari was filed on October 4, 2006, and granted on December 7, 2006. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

Section 1 of the Sherman Act (15 U.S.C. § 1) provides, in pertinent part:

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce . . . is hereby declared to be illegal.

STATEMENT

Petitioner Leegin Creative Leather Products, Inc. ("Leegin") respectfully requests that the Court overturn the *per se* rule of *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), and reverse the decision below, which rests upon that legally and economically insupportable rule. Under the rule of *Dr. Miles*, agreements between a manufacturer and its retailers establishing minimum resale prices for the manufacturer's goods are *per se* unlawful. This *per se* rule is premised upon the antiquated common-law rule against "restraints on alienation," and it squarely conflicts with the modern economic understanding that resale price maintenance agreements can have significant *procompetitive* effects. This economic understanding has been embraced by this Court in a series of decisions over the last thirty years, in which the Court has overturned analogous *per se* rules against other vertical agreements that have similar competitive effects. *See State Oil Co. v. Khan*, 522 U.S. 3 (1997); *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977). As in *Khan* and *Sylvania*, the *per se* rule at issue here has been subject to overwhelming criticism and lacks support under the economic approach that this Court's recent antitrust jurisprudence has applied. By applying the rule of reason to resale price maintenance agreements, the Court can make the antitrust analysis of all vertical agreements consistent, economically rational, and proconsumer.

1. Leegin has built a successful family business in the crowded and intensely competitive marketplace for women's fashion accessories. In 1990, Leegin introduced the "Brighton" brand with a line of women's belts, and it later added other types of accessories to the Brighton line. Leegin has differentiated its products from the myriad other brands of leather goods and accessories available in department stores and mass merchandisers by focusing primarily on independently owned boutique stores offering a level of service and

personal attention that consumers frequently cannot find elsewhere. 6.R.5-11.[1]

Leegin's strategy has succeeded. Brighton has become a brand equated with quality, value, and customer service. Brighton products did not even exist until 1990, yet ten years later, despite competition from hundreds of other brands of women's accessories, Brighton products were sold in more than 5,000 specialty stores nationwide. 5.R.125-26; 6.R.17-20; 7.R.15. While Leegin has achieved impressive success from its humble beginnings, it is still a small company when compared to the much larger manufacturers and retailers with which it and its retailers compete. 3.R.813-20.

2. In 1997, as part of its overall strategy, Leegin instituted the "Brighton Retail Pricing and Promotion Policy," pursuant to which Leegin announced that it would do business exclusively with retailers who follow its suggested retail prices for Brighton products. 6.R.10.[2] There were two principal reasons for Leegin's adoption of the pricing policy. First, it was Leegin's view that the typical retail strategy of putting products on and off "sale" degrades a manufacturer's brand by causing customers to feel cheated when they buy at the wrong moment. 5.R.106-24. Leegin's policy instead furthered an "everyday fair price" approach. *Id.* Second, the pricing policy was designed to develop the Brighton brand by giving retailers incentives to provide special attention and service to prospective Brighton customers. 5.R.115-27. In small specialty stores, attractive presentation and customer service are central to the shopping experience, but providing those services is not costless to retailers. *Id*. Through its pricing policy, Leegin ensured a sufficient margin to retailers

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1 "R" refers to the record on appeal. Citations to the record are to the volume of the record, followed by the page number in that volume.

2 Leegin's pricing policy permitted retailers to discount Brighton products that they did not wish to re-order from Leegin.

to give them the incentive to focus on Brighton products and to provide high-quality service. *Id.*

Leegin's pricing policy was successful, and sales of Brighton products grew considerably after its inception. For example, sales of Brighton handbags increased from 125,609 units in 1996, to 375,480 units in 2003. *See* Expert Report of Kenneth G. Elzinga ("Elzinga Report") at 20 n.26 (Pet. App. 37a).

3. Plaintiff PSKS, which operated a retail store known as "Kay's Kloset" in Lewisville, Texas, was one of the stores to which Leegin sold Brighton products. In December 2002, Leegin learned that PSKS was selling all Brighton products below the suggested prices, in violation of Leegin's pricing policy. 6.R.112-13. In response, Leegin suspended all shipments of Brighton products to PSKS. 6.R.118-19; 7.R.102-09. PSKS then filed this suit, alleging that Leegin's pricing policy constituted an unlawful agreement in restraint of trade under Section 1 of the Sherman Act.

At trial, the district court, applying the *per se* rule of *Dr. Miles*, refused to allow Leegin to introduce evidence that its pricing policy promoted interbrand competition. In particular, the court excluded the testimony of Leegin's economic expert, Professor Kenneth G. Elzinga. 1.R.325-33. Professor Elzinga would have testified, *inter alia*, that Leegin lacks market power and that its pricing practices were procompetitive because they fostered interbrand competition. Elzinga Report at 5-20 (Pet. App. 22a-37a). The district court also denied Leegin's request for an instruction that would have allowed the jury to apply the rule of reason (1.R.190-92), which requires an antitrust plaintiff to demonstrate that the defendant's conduct unreasonably restrains competition in a relevant market before it will be found unlawful (*see Texaco Inc. v. Dagher*, 126 S. Ct. 1276, 1279 (2006)), and instead instructed the jury that the alleged resale price maintenance agreement between Leegin and its retailers was *per se* unlawful (11.R.42).

PSKS argued at trial that, because Leegin had referred to its pricing policy in written agreements with certain retailers, its otherwise lawful *policy* had been converted into an illegal *agreement*. The jury found that Leegin had agreed with its retailers to establish minimum resale prices, and therefore returned a verdict in favor of PSKS. Based on the verdict, the court awarded PSKS $3.6 million in trebled damages and $375,000 in attorneys' fees. Pet. App. 3a. Leegin renewed its motion for judgment as a matter of law and moved in the alternative for a new trial. The court denied Leegin's motions, stating that "[w]hether the per se classification of such agreements is wise is not for this court to decide." *Id.* at 12a.

The Fifth Circuit affirmed the district court's decision, rejecting Leegin's request for rule-of-reason treatment because lower courts "remain bound by [the Supreme Court's] holding in *Dr. Miles*." Pet. App. 4a.

After the Fifth Circuit refused to stay its mandate, Leegin applied to Justice Scalia for a stay pending the filing and disposition of a petition for a writ of certiorari. No. 06A179. Justice Scalia granted a temporary stay pending a response from PSKS. After a response was received, Justice Scalia referred the application to the Court, which granted the stay pending the filing and disposition of Leegin's petition.

This Court subsequently granted certiorari.

SUMMARY OF ARGUMENT

The *per se* rule against resale price maintenance established in *Dr. Miles* squarely conflicts with this Court's modern antitrust jurisprudence, which limits the use of *per se* rules to practices that "always or almost always tend to restrict competition and decrease output." *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 723 (1988) (internal quotation marks omitted). Like all other vertical agreements, the validity of resale price maintenance agreements should be determined on a case-by-case basis under the rule of reason—rather than under a rigid *per se* rule—because economic analysis demonstrates that such agreements often have substantial *procompetitive* effects.

1. This Court has rejected *per se* treatment of vertical agreements that do not invariably have anticompetitive effects. *See State Oil Co. v. Khan*, 522 U.S. 3, 18 (1997) (unanimously overturning the *per se* rule against vertical maximum price-fixing because there was "insufficient economic justification" for the rule); *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 47-48 (1977) (rejecting the *per se* rule against vertical nonprice restraints). In so doing, the Court has emphasized that a "departure from the rule-of-reason standard must be based upon demonstrable economic effect," *Sylvania*, 433 U.S. at 58-59, and it has required "experience with a particular kind of restraint [that] enables the Court to predict with confidence that the rule of reason will condemn it," *Khan*, 522 U.S. at 10 (internal quotation marks omitted). Neither of these prerequisites to *per se* treatment is met here.

The decision in *Dr. Miles* rests upon the outdated common-law prohibition upon "restraints on alienation"—a concept that the Court rejected in *Sylvania* and *Khan* as a basis for a *per se* rule—rather than upon economic analysis of resale price maintenance or judicial experience applying the rule of reason to such agreements. When modern economic analysis is brought to bear on resale price maintenance, it becomes clear that *per se* treatment is inappropriate because such agreements have a number of procompetitive uses that can enhance consumer welfare. *See, e.g.*, Thomas R. Overstreet, Jr., Bureau of Econ., Fed. Trade Comm'n, *Resale Price Maintenance: Economic Theories and Empirical Evidence* 164 (1983) ("the economic theories and the available empirical evidence rather clearly suggest that the *rigid* application of a strict standard of per se illegality for RPM [resale price maintenance] is inappropriate" (emphasis in original)). For example, a manufacturer could use resale price maintenance to provide incentives for retailers to engage in promotional activities that are necessary to the efficient marketing of its products, or a new entrant could use resale price maintenance to induce competent and aggressive retailers to carry its product and invest in demand-creating services. The provision of these sought-after services enhances interbrand competition and benefits consumers.

Although resale price maintenance may not *always* be used for such procompetitive purposes, there is no basis to conclude that the effects of resale price maintenance are so invariably harmful to competition as to justify *per se* treatment. In situations where the practice does have a substantial adverse effect on competition in a relevant market, rule-of-reason analysis is sufficient to proscribe its use.

2. Moreover, retaining the overbroad *per se* rule of *Dr. Miles* actually would reduce competition because the rule unnecessarily limits the options available for manufacturers to promote their products, reducing the variety of promotional strategies in the marketplace and forcing inefficient choices on manufacturers who would otherwise use resale price maintenance as a promotional tool. In this case, for example, Leegin used resale price maintenance to provide incentives for retailers to market its products effectively against its larger rivals, and the strategy allowed a small manufacturer to distinguish itself from its larger competitors and expand its marketplace presence. The antitrust laws should promote such efforts, not condemn them.

3. The reasons advanced by PSKS for retaining the rule of *Dr. Miles* do not justify its continued existence. For example, *stare decisis* is not a basis for retaining the rule of *Dr. Miles*. *Stare decisis* has diminished force in the antitrust context because the Sherman Act is a dynamic statute that Congress intended to be interpreted—and reinterpreted—in light of "changed circumstances and the lessons of accumulated experience." *Khan*, 522 U.S. at 20. Congress has never mandated application of a *per se* prohibition on resale price maintenance and has done nothing to modify this Court's

common-law-making function in this area. Accordingly, neither the force of precedent nor congressional action precludes this Court from reconsidering the *per se* rule against resale price maintenance in light of modern economic analysis that was not available to the *Dr. Miles* Court.

4. In addition, contrary to PSKS's argument, the *per se* rule of *Dr. Miles* cannot be justified on the theory that *per se* rules are more "efficient." On that theory, *per se* rules would be the norm rather than the exception in antitrust law. While it may be "efficient" to ignore an analysis of competitive effects when they are not easily ascertained, this Court has never adopted that approach. In any event, replacing the rule of *Dr. Miles* with rule-of-reason treatment might actually reduce the burden on the courts by discouraging the filing of economically groundless antitrust suits challenging procompetitive uses of resale price maintenance and by permitting earlier disposition of economically unsound claims that might otherwise go to a jury on the question of the existence of an agreement. Following *Sylvania,* the lower courts have developed substantial experience applying the rule of reason to vertical nonprice agreements, and the courts could draw upon the principles developed in that analogous context in assessing the competitive effects of resale price maintenance agreements.

5. In the absence of a rigid *per se* rule, the decision below cannot stand. The district court prevented Leegin from introducing any evidence regarding the procompetitive effects of its pricing policy and, relying on *Dr. Miles*, instructed the jury that resale price maintenance agreements are *per se* unlawful.

The decision below should be reversed.

ARGUMENT

I. THE RULE OF *DR. MILES* IS INCONSISTENT WITH THIS COURT'S MODERN ANTITRUST JURISPRUDENCE.

The *per se* rule against resale price maintenance is the lone remaining vestige of an antiquated antitrust regime that cannot be reconciled with either recent antitrust decisions or economic theory. This Court has abandoned the *per se* rules against other vertical arrangements—including vertical maximum price-fixing arrangements and all types of vertical nonprice agreements. Each of those other *per se* rules—like the rule of *Dr. Miles*—was based on the "ancient rule against restraints on alienation" (*United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 380 (1967)), which has no grounding in economics. And each of the other vertical *per se* rules was rejected when the Court applied an approach to antitrust analysis grounded in real-world economics. This Court should likewise overturn the rule of *Dr. Miles*, and resolve a fundamental inconsistency between that outdated and overbroad *per se* rule and the Court's antitrust decisions of the last thirty years.

A. This Court Has Overturned Analogous *Per Se* Rules Against Other Vertical Agreements.

1. Nearly a century ago, this Court in *Dr. Miles* invalidated an agreement that required a manufacturer's dealers to abide by a minimum resale price. Without considering the competitive effect of the practice, the Court held that such arrangements are invalid under the Sherman Act because the "right of alienation is one of the essential incidents of a right of general property" and "restraints upon alienation have been generally regarded as obnoxious to public policy." *Dr. Miles*, 220 U.S. at 404 (internal quotation marks omitted). Equating a resale price maintenance agreement with a prohibited horizontal cartel among dealers, the Court opined that the manufacturer "can fare no better with its plan of identical

contracts than could the dealers themselves if they formed a combination and endeavored to establish the same restrictions." *Id.* at 408. In his dissenting opinion, Justice Holmes rejected the majority's approach and argued that, in many circumstances, the public would "be served best by the company being allowed to carry out its plan" to establish minimum resale prices. *Id.* at 412 (Holmes, J., dissenting).[3]

Following *Dr. Miles*, the Court adopted *per se* rules against other types of vertical arrangements. In *Schwinn*, the Court held that vertical nonprice agreements, namely restrictions on the territories or customers that distributors may serve, are *per se* unlawful. 388 U.S. at 379-80. As in *Dr. Miles*, the Court based this *per se* rule on the "ancient rule against restraints on alienation," rather than on economic analysis. *Id.* at 380 The next year, the Court held that vertical maximum resale price agreements are *per se* unlawful, based on similar concerns for protecting dealer freedom. *See Albrecht v. Herald Co.*, 390 U.S. 145, 152 (1968).

When the Court had occasion to reexamine these *per se* rules in light of modern economic analysis, however, it determined that vertical agreements often have procompetitive effects and are therefore more appropriately evaluated on a case-by-case basis under the rule of reason.

Sylvania is the seminal decision in this area. In *Sylvania*, this Court overturned *Schwinn*'s *per se* rule against vertical nonprice agreements, and expressly rejected the notion that the common-law rule against restraints on alienation could justify a *per se* rule of antitrust liability. *Sylvania*, 433 U.S. at 53 n.21. The Court explained that "the state of the common law 400 or even 100 years ago is irrelevant to the

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3 *See also id.* ("I cannot believe that in the long run the public will profit by this court permitting knaves to cut reasonable prices for some ulterior purpose of their own, and thus to impair, if not to destroy, the production and sale of articles which it is assumed to be desirable that the public should be able to get.").

issue before us: the effect of the antitrust laws upon vertical distributional restraints in the American economy today." *Id.* (internal quotation marks omitted). Instead, "[*p*]*er se* rules of illegality are appropriate only when they relate to conduct that is manifestly anticompetitive." *Id*. at 49-50. The Court made clear that interbrand competition "is the primary concern of antitrust law," and it explained that interbrand competition "provides a significant check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product." *Id.* at 52 n.19. The Court further explained that *per se* analysis is ill-suited to vertical restrictions "because of their potential for a simultaneous reduction of intrabrand competition and stimulation of interbrand competition." *Id.* at 51-52. In light of the potential for procompetitive effects on interbrand competition, the Court concluded that the validity of vertical non-price agreements should be determined under the rule of reason. *Id.* at 59.

Similarly, in *Khan*, this Court unanimously overruled its holding in *Albrecht* that vertical maximum price agreements are *per se* unlawful. As in *Sylvania*, the Court explained that concerns with "dealer freedom" are not an appropriate basis for a *per se* rule of antitrust liability. *Khan*, 522 U.S. at 16-17. Instead, the Court held that *per se* treatment is only "appropriate once experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it." *Id.* at 10 (internal quotation marks and alteration omitted). Building on the critiques of *Albrecht* offered by lower courts and commentators, the Court concluded that the *per se* rule should be rejected because there is "insufficient economic justification for *per se*" treatment of vertical maximum price agreements. *Id.* at 18.

The Court has also relied on *Sylvania* to limit the reach of *Dr. Miles*. In *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988), a case that did not require the Court to address the continued validity of *Dr. Miles* itself, the Court refused to apply the *per se* rule of *Dr. Miles* to an agreement between a manufacturer and a complaining retailer that required the manufacturer to terminate another retailer who was a "discounter," but that did not impose specific prices or price levels on the complaining retailer. *Id.* at 731. The Court recognized that, like the vertical nonprice agreements in *Sylvania*, this agreement was "price affecting"—rather than "price setting"—and thus did not warrant *per se* treatment, and explained that the "rules in this area should be formulated with a view toward protecting the doctrine of *GTE Sylvania*." *Id.* at 726.

2. The reasoning of this Court's decisions in *Sylvania*, *Sharp*, and *Khan* severely undermines the rule of *Dr. Miles*. The Court's focus, nearly a century ago, on "restraints on alienation" is no longer a valid basis for a *per se* rule of antitrust law. Instead, a *per se* rule is appropriate *only* for "conduct that would always or almost always tend to restrict competition and decrease output." *Sharp*, 485 U.S. at 723 (internal quotation marks omitted). This Court has established certain critical prerequisites for deciding whether the high standard for applying a *per se* rule is met. Most importantly, a "departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than . . . upon formalistic line drawing." *Sylvania*, 433 U.S. at 58-59; *see also Sharp*, 485 U.S. at 724. Similarly, *per se* treatment is appropriate only when "experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it." *Khan*, 522 U.S. at 10 (internal quotation marks omitted). The Court has thus "expressed reluctance to adopt *per se* rules with regard to 'restraints imposed in the context of business relationships where the economic impact of certain practices is not immediately obvious.'" *Id.* (quoting *FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447, 458-59 (1986)). As discussed below, the *per se* rule of *Dr. Miles* does not satisfy these criteria.

B. There Are No Demonstrable Economic Effects That Support *Per Se* Treatment Of Resale Price Maintenance.

In both *Sylvania* and *Khan*, this Court examined the economic effects of the vertical agreements at issue, including by considering "scholarly and judicial authority supporting their economic utility." *Sylvania*, 433 U.S. at 57-58; *see also Khan*, 522 U.S. at 15-19. Based on that examination, the Court found "insufficient economic justification" for *per se* treatment of vertical nonprice and vertical maximum price agreements. *Khan*, 522 U.S. at 18; *see also Sylvania*, 433 U.S. at 57-58. An economic analysis of resale price maintenance yields the same conclusion.

Indeed, economic and legal scholars have reached an unusually strong consensus that resale price maintenance has a number of procompetitive uses and effects that, if permitted by the antitrust laws, could enhance consumer welfare. *See, e.g.*, ABA Antitrust Section, *Antitrust Law and Economics of Product Distribution* 76 (2006) (the "bulk of the economic literature on RPM . . . suggests that RPM is more likely to be used to enhance efficiency than for anticompetitive purposes").[4] The predominant view among antitrust economists

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[4] *See also, e.g.*, Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 1611 (2d ed. 2004); Robert H. Bork, *The Antitrust Paradox* 289 (1978); Kenneth G. Elzinga & David E. Mills, *The Economics of Resale Price Maintenance* 1-5 (forthcoming 2007), *at* http://www.virginia.edu/economics/papers/mills/RPM%20for%20ABA.pdf; Roger D. Blair, Jill Boylston Herndon & John E. Lopatka, *Resale Price Maintenance and the Private Antitrust Plaintiff*, 83 Wash. U. L.Q. 657, 659, 697-714 (2005); Richard A. Posner, *Antitrust Law* 172 (2d ed. 2001) [hereinafter Posner, *Antitrust Law*]; David A. Butz, *Vertical Price Controls with Uncertain Demand*, 40 J.L. & Econ. 433, 455-57 (1997); Ralph A. Winter, *Vertical Control and Price Versus Nonprice Competition*, 108 Q.J. Econ. 61, 72 (1993); Andrew N. Kleit, *Efficiencies Without Economists: The Early Years of Resale Price Maintenance*, 59 S. Econ. J. 597, 617 (1993); Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as*

that the *per se* rule of *Dr. Miles* should be overturned is underscored by the *amicus curiae* brief submitted by 25 distinguished economists in support of Leegin's petition for a writ of certiorari, which urged the Court to hold that resale price maintenance should be evaluated under the rule of reason. *See* Cert.-Stage Br. of *Amici Curiae* Economists 1-4.[5] Similarly, the Section of Antitrust Law of the American Bar Association recently adopted a resolution, which was passed unanimously by the Section's Council, stating that the Section "believes that the time has come to extend the rule of reason approach . . . to minimum resale price maintenance" because "minimum resale price maintenance, like other vertical restraints, can stimulate interbrand competition and is not so inevitably pernicious as to warrant per se illegality."[6]

[Footnote continued from previous page]

Contract Enforcement Mechanisms, 31 J.L. & Econ. 265 (1988); William F. Baxter, *The Viability of Vertical Restraints Doctrine*, 75 Cal. L. Rev. 933, 947-49 (1987); Terry Calvani & Andrew G. Berg, *Resale Price Maintenance After* Monsanto*: A Policy Still at War with Itself*, 1984 Duke L.J. 1163, 1180-82, 1187; Frank H. Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 Antitrust L.J. 135, 146-48 (1984); Overstreet, *supra*, at 11.

[5] The *amici* economists included members of the faculties of some of the Nation's leading academic institutions, as well as nine economists who have served as either the Director of the Bureau of Economics of the Federal Trade Commission or Deputy Assistant Attorney General for Economic Analysis at the Antitrust Division of the Department of Justice (the highest-ranking economist at each agency). *See* Cert.-Stage Br. of *Amici Curiae* Economists app. 1a-4a.

[6] *See* ABA Section of Antitrust Law Report to the ABA House of Delegates 2-3 (2006), *at* http://www.abanet.org/antitrust/at-comments/2006/reports/ANTITRUST-RPM-REPORT-12-06.pdf. The recommendation was passed by the Section's Council by a vote of 25-0, with two abstentions and four members not voting. The ABA House of Delegates has not had an opportunity to consider the Section's recommendation as of the time of this filing; accordingly, the recommendation does not constitute the official policy of the ABA.

1. Vertical Price And Nonprice Restraints Often Have Procompetitive Effects On Interbrand Competition.

A simplistic—and incorrect—criticism of vertical restrictions (including both price and nonprice restraints) is that they limit intrabrand price competition, raise retailers' margins, often raise retail prices, and are therefore harmful to consumers. That analysis is wrong as a matter of economics and inconsistent with this Court's analysis of vertical restraints.

In *Sylvania*, the Court recognized that interbrand competition is the "primary concern of antitrust law." 433 U.S. at 52 n.19. The Court also recognized that manufacturers often use vertical restraints to create incentives for their dealers to provide service and promote the manufacturer's product, which, in turn, fosters interbrand competition:

> Vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products. . . . Economists have identified a number of ways in which manufacturers can use such restrictions to compete more effectively against other manufacturers. For example, new manufacturers and manufacturers entering new markets can use the restrictions in order to induce competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer. Established manufacturers can use them to induce retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their products.

433 U.S. at 54-55 (citation and footnote omitted). As the Court noted, "these services might not be provided by retail-

ers in a purely competitive situation" because of "market imperfections such as the so-called 'free rider' effect." *Id.* at 55. The Court recognized that, where free-riding is allowed, dealers lose the incentive to make investments that are valuable to consumers and enhance the competitiveness of the manufacturer's product because the free rider siphons off so many sales that the other retailers are not able to recover their investments in promotional services.

In addition, the Court explained in *Sylvania* that a manufacturer has no interest in overcompensating its retailers by enabling fat retail margins—to the contrary, "a manufacturer would prefer the lowest retail price possible, once its price to dealers has been set, because a lower retail price means increased sales and higher manufacturer revenues." 433 U.S. at 56 n.24 (internal quotation marks omitted). Accordingly, "manufacturers have an economic interest in maintaining as much intrabrand competition as is consistent with the efficient distribution of their products." *Id.* at 56; *see also* Bork, *supra*, at 290 ("No manufacturer or supplier will ever use either resale price maintenance or reseller market division for the purpose of giving the resellers a greater-than-competitive return. . . . The manufacturer shares with the consumer the desire to have distribution done at the lowest possible cost consistent with effectiveness.").

Notably, manufacturers use many tools to enhance their interbrand competitive position that might increase nominal prices to consumers. Manufacturers may engage in national advertising or upgrade their product features, the costs of which get passed through to consumers in the form of increased prices—yet no one would argue that this conduct in a competitive marketplace is an anticompetitive activity. *See* Elzinga & Mills, *supra*, at 8-9; Easterbrook, *supra*, at 141.

The presence of *inter*brand competition ensures that manufacturers' actions to promote their products—including vertical distribution restraints—are geared toward efficiency and procompetitive results. *Sylvania*, 433 U.S. at 52 n.19, 56 n.24. If the manufacturer takes actions that boost prices without promotional benefits that consumers desire, it will lose sales to its interbrand competitors. *Id.*; Overstreet, *supra*, at 48. On the other hand, if the manufacturer's sales increase because consumers are getting more services that they value, then consumers benefit. Elzinga & Mills, *supra*, at 9.[7]

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[7] Moreover, it is not the case that resale price maintenance necessarily leads to higher nominal retail prices. *See*, *e.g.*, Howard P. Marvel & Stephen McCafferty, *The Political Economy of Resale Price Maintenance*, 94 J. Pol. Econ. 1074, 1094 (1986) (concluding that "RPM need not raise prices at retail" and that "[e]ven if prices rise because of RPM, we cannot conclude that the practice is undesirable, for the higher prices . . . reflect the manufacturer's desire to provide information or other services to consumers, thereby increasing the demand for the manufacturer's product"). Indeed, empirical analysis has shown that the practice can, in some situations, actually result in *lower* nominal retail prices, in addition to the proconsumer benefits of increased services stimulated by the practice. *See id.* at 1091-93; Overstreet, *supra*, at 138-40. For example, if resale price maintenance allows a manufacturer to compete more effectively and thereby expand its sales and output, the manufacturer may achieve efficiencies in manufacturing or distribution that could allow it to lower its unit costs and prices. *See* Overstreet, *supra*, at 47-48. In addition, where a manufacturer has assurance that retailers will use a guaranteed minimum margin to provide sales-related services or engage in promotional efforts, a manufacturer may lower its wholesale prices in order to subsidize the increased services borne by retailers. *See* Marvel & McCafferty, *supra*, at 1084. In particular, where it is more efficient for a manufacturer to incent its retailers to provide promotional services than to promote the product itself at the manufacturer level (*e.g.*, through national advertising), resale price maintenance could allow a manufacturer to reduce its own promotional expenditures and channel its efforts through retailers in the form of lower wholesale prices that subsidize the retailers' promotional efforts. *See*, *e.g.*, Baxter, *supra*, at 945; Elzinga & Mills, *supra*, at 13 (describing the example of Coors, which used resale price maintenance to induce retailers to promote its product, but was forced to abandon this strategy and turn to national media advertising following a government challenge to its resale price maintenance policy); *see also Sylvania*, 433 U.S. at 56 n.25 (recognizing that *per se* rules against vertical restrictions are not likely to eliminate promotional ser-

In *Sharp*, the Court emphasized the similar economic effects of vertical price and nonprice restraints. "[V]ertical nonprice restraints only accomplish the benefits" to interbrand competition identified in *Sylvania* "*because they reduce intrabrand price competition* to the point where the dealer's profit margin permits provision of the desired services." *Sharp*, 485 U.S. at 728 (emphasis added). Indeed, "there is a substantial body of economic analysis supporting the view that the distinction" between vertical price and nonprice restraints "is largely illusory." ABA Antitrust Section, *supra*, at 59; *see also Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 762 (1984) ("the economic effect" of "price and nonprice restrictions" is in many cases "similar or identical"). As Justice White explained in his concurrence in *Sylvania*, "[i]t is common ground among the leading advocates of a purely economic approach to the question of distribution restraints that the economic arguments in favor of allowing vertical nonprice restraints generally apply to vertical price restraints as well." 433 U.S. at 69 (White, J., concurring). Accordingly, the procompetitive uses of vertical territorial restraints to reduce intrabrand price competition identified by this Court in *Sylvania* and *Sharp* as supporting rule-of-reason treatment are equally applicable to resale price maintenance. *Id.* at 69-70; Posner, *Antitrust Law*, *supra*, at 184 ("any argument for the legitimacy of exclusive territories applies equally to resale price maintenance").

[Footnote continued from previous page]

vices, but may simply result in "a shift to less efficient methods of obtaining the same promotional effects"). Through the more efficient or effective promotion of its products, the manufacturer becomes a more robust competitor, competition in the interbrand marketplace is enhanced, and any promotional efficiencies may be passed through to consumers in the form of lower retail prices, notwithstanding the guaranteed margin provided to retailers by the resale price maintenance policy.

It is thus untenable that resale price maintenance should continue to be treated under a different legal standard than vertical nonprice agreements. *See* Cert.-Stage Br. of *Amici Curiae* Economists 16-18. By overturning the rule of *Dr. Miles*, this Court can put an end to the inexplicably divergent treatment of these similar vertical arrangements.

2. There Are Many Uses Of Resale Price Maintenance That Can Enhance Interbrand Competition And Consumer Welfare.

It is well-accepted among legal and economic scholars that resale price maintenance, like the vertical nonprice restraints discussed in *Sylvania*, would frequently be used for procompetitive purposes, such as providing incentives to retailers to stock and promote the manufacturer's products. *See*, *e.g.*, Frank Mathewson & Ralph Winter, *The Law and Economics of Resale Price Maintenance*, 13 Rev. Indus. Org. 57, 81 (1998) ("[P]rice floor restraints are used in most cases unilaterally by a manufacturer to change the mix of price and non-price competition among retailers of its product. Restrictions on distribution are a means of competing on product quality."). "[N]o single specific theory explains all instances of [resale price maintenance]"—instead, there are a number of different purposes for which a manufacturer might implement resale price maintenance that are likely to have procompetitive virtues and enhance consumer welfare. Winter, *supra*, at 70. The common thread among these uses is that the manufacturer provides its retailers with a guaranteed margin as a means to enhance the manufacturer's competitive position against interbrand rivals.

The most frequently cited rationale for resale price maintenance is that a manufacturer might impose a price floor to ensure that dealers provide demand-creating services. *See*, *e.g.*, Elzinga & Mills, *supra*, at 3; Overstreet, *supra*, at 49; Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & Econ. 86, 91 (1960). In the absence of resale price restraints, free-rider problems may diminish retailers' incentives to provide these services, harming the manufacturer and dampening interbrand competition. *See, e.g.*, Posner, *Antitrust Law*, *supra*, at 173.

Even outside the classic free-rider situation, resale price maintenance may be used by a manufacturer to provide its retailers with incentives to compete on service or other promotional activities, where the retailer might otherwise have an inherent bias to rely too much on low prices (and not enough on service or promotional activities) to attract customers, which could reduce the manufacturer's overall interbrand competitive position. *See* Winter, *supra*, at 62-64. While a manufacturer might theoretically contract with its retailers to provide certain services, the transaction and monitoring costs associated with such a program can be prohibitive, and it can be more efficient for a manufacturer to encourage retailers to compete on service by limiting intrabrand price competition. *See id.*; Klein & Murphy, *supra*, at 295.

A manufacturer may also use resale price maintenance to encourage retailers to stock its products by guaranteeing a minimum resale margin. Overstreet, *supra*, at 47. The ability to obtain distribution through resale price maintenance can be particularly important for a new or small manufacturer trying to break into the marketplace. *See, e.g.*, Mathewson & Winter, *supra*, at 60 ("In markets where extensive distribution systems are necessary, RPM is often used in the early part of a product's life cycle to aid in the establishment of the distribution system. In this situation, . . . RPM lowers the barriers of entry into upstream markets.").

Similarly, a manufacturer may use resale price maintenance to encourage its retailers to purchase more of its products, particularly in industries in which excess inventory can be subject to heavy discounting. Resale price maintenance ensures that retailers will be protected from a dramatic devaluation of their inventory when demand is unexpectedly low and, consequently, it reduces the chance that risk-averse retailers will purchase too little out of concern for having unsold stockpiles at the end of the season. *See, e.g.*, Butz, *supra*, at 451-52. A manufacturer, in turn, might use resale price maintenance to expand output or introduce more innovative products because retailers would be more willing to carry its products, enhancing interbrand competition and benefiting consumers. *Id.* at 457.

3. The Possibility That Resale Price Maintenance Might Be Used By A Cartel Does Not Justify The Rule Of *Dr. Miles*.

Of course, not every use of resale price maintenance is necessarily procompetitive. It is possible, for example, that resale price maintenance (just like vertical territorial restraints) might be used to enforce a horizontal agreement among dealers or manufacturers. Posner, *Antitrust Law*, *supra*, at 183-85. The conditions in which such a cartel might theoretically operate, however, are not common. Elzinga & Mills, *supra*, at 5-6; Easterbrook, *supra*, at 141-43. And, as demonstrated by empirical studies, instances of resale price maintenance being used for procompetitive purposes are "far more common" than instances in which it is used to facilitate a cartel. Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & Econ. 263, 282 (1991); *see also* Overstreet, *supra*, at 162 (empirical evidence "suggests that neither supplier nor dealer collusion explanations are likely to apply to all or even most instances of price maintenance").

There is neither an empirical nor a theoretical basis to justify a ban on *all* uses of resale price maintenance out of a concern over potential collusive uses of the practice, which could only exist under specific and uncommon market conditions. To the contrary, the empirical evidence "suggest[s] that, on the margin, the dominant effect of a relaxation of the per se prohibition of RPM would be a reduction in the deterrence of noncollusive uses of RPM." Ippolito, *supra*, at 292. Moreover, this Court's precedents do not support applying a *per se* rule that ensnares substantial procompetitive conduct simply out of fear of occasional anticompetitive uses. As discussed above, *per se* rules are appropriate *only* where a practice always, or almost always, results in anticompetitive effects. *See Sharp*, 485 U.S. at 723; Easterbrook, *supra*, at 142-43.

In any event, there is no reason to believe that the existing *per se* rules against horizontal collusion and the methods of detecting and punishing such collusion are so lacking as to justify additional *per se* rules as a prophylactic measure to bolster cartel enforcement. This Court addressed a similar issue in *Sylvania*, in which it noted that "[t]here may be occasional problems in differentiating vertical restrictions from horizontal restrictions originating in agreements among the retailers." 433 U.S. at 58 n.28. The Court concluded, however, that "we do not regard the problems of proof as sufficiently great to justify a *per se* rule." *Id.* The same reasoning requires rejection of the argument that a fear of cartels can support a *per se* rule against resale price maintenance.

4. Leegin's Use Of Resale Price Maintenance Illustrates The Procompetitive Purposes Of The Practice.

The facts of this case powerfully illustrate the competition-enhancing potential of resale price maintenance. Indeed, there is no allegation, or even a realistic possibility, that Leegin's conduct was part of a collusive horizontal scheme. *See* Elzinga Report at 14-18 (Pet. App. 31a-35a). There is also no evidence or suggestion that Leegin had market power. To the contrary, Leegin is but a small player in the fragmented and highly competitive marketplace for women's fashion accessories. *Id.* at 16-20 (Pet. App. 33a-37a).

If consumers are unhappy with the prices for Leegin's products, or if they do not want to pay for the promotional services stimulated by Leegin's pricing policy, they can buy fashion accessories from numerous other manufacturers at numerous other retail outlets. *See* Elzinga Report at 19-20 (Pet. App. 36a-37a). Likewise, if Leegin's retail prices are too high, it will lose sales to its competitors and it will either lower its prices or lose substantial business. *See, e.g.*, *Valley Liquors, Inc. v. Renfield Imps., Ltd.*, 678 F.2d 742, 745 (7th Cir. 1982) ("A firm that has no market power is unlikely to adopt policies that disserve its consumers; it cannot afford to. And if it blunders and does adopt such a policy, market retribution will be swift."). On the other hand, if the combination of price and promotional services that results from Leegin's policy is attractive to consumers, then Leegin will increase its sales, competition will be enhanced, and consumers will benefit. There is simply no plausible scenario in which Leegin's pricing policy will have a substantial adverse effect in any relevant market. *See* Elzinga Report at 26-27 (Pet. App. 43a-44a).

Leegin used resale price maintenance in an attempt to bring new products and services to consumers and to enable small retailers to compete against prominent national brands sold through department stores and other large outlets. *See* Elzinga Report at 10-12 (Pet. App. 27a-29a). This case presents precisely the circumstances in which resale price maintenance can *enhance* interbrand competition and consumer welfare. Indeed, the fact that Leegin's output grew substantially while its pricing policy was in effect indicates strongly that competition was enhanced and that consumers have benefited from the policy. *Id.* at 20 (Pet. App. 37a); *see also* Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. Chi. L. Rev. 6, 21 (1981) ("If [the defendant's] output expanded, the restriction must have made the firm's product more attractive to consumers on balance, thereby enabling the firm to take business from its competitors. This is an increase in interbrand competition and hence in consumer welfare, which is the desired result of competition."); Easterbrook, *supra*, at 163-64. Holding Leegin's conduct to be *per se* unlawful stifles the competitive behavior of a small and innovative company, and thus conflicts with the objectives that this Court has sought to promote in interpreting the antitrust laws.

C. There Is No Judicial Experience With Resale Price Maintenance That Could Enable The Court To Predict With Confidence That The Rule Of Reason Will Condemn It.

This Court has often repeated that a *per se* rule is only appropriate "once experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it." *Khan*, 522 U.S. at 10 (internal quotation marks and alteration omitted); *see also Broadcast Music, Inc. v. Columbia Broadcast Sys.*, 441 U.S. 1, 19 n.33 (1979). Continued adherence to the *per se* rule against resale price maintenance conflicts with this important criterion for the use of *per se* rules.

The rule of *Dr. Miles* was not the product of judicial experience evaluating resale price maintenance under the rule of reason. Indeed, the *Dr. Miles* Court offered no analysis of the practice's effect on competition or consumers, but instead simply applied the common-law prohibition on "restraints upon alienation," pursuant to which a "restraint in the alienation of articles . . . [was] generally held void." 220 U.S. at 404. And in the nearly 100 years since *Dr. Miles* was decided, the *per se* rule against resale price maintenance has prevented lower courts from developing experience in applying the rule of reason to assess resale price maintenance. *See* Ippolito, *supra*, at 268-69. In this case, for example, because of the rule of *Dr. Miles*, the district court conducted no analysis of the competitive effects of resale price maintenance on the marketplace, and it prevented Leegin from introducing any evidence or expert testimony regarding such effects.

Even more significantly, if courts *had* developed experience applying the rule of reason to resale price maintenance, that experience would not have justified a *per se* rule—either at the time of *Dr. Miles* or today. For example, in the late 19th and early 20th centuries, a number of courts evaluated resale price maintenance under the rule of reason and concluded that the practice did *not* harm competition. As the Washington Supreme Court explained:

> In the absence of a monopoly . . . a contract fixing retail prices to the consumer cannot have an effect appreciably inimical to the public interest because it cannot fix prices at an unreasonably high figure without defeating its own purpose by either signally failing to maintain the fixed price, or putting the individual manufacturer out of business. . . . [I]t seems to us an economic fallacy to assume that the competition which, in the absence of monopoly, benefits the public, is competition between rival retailers. The true competition is between rival articles . . . .

Fisher Flouring Mills Co. v. Swanson, 137 P. 144, 148, 151 (Wash. 1913).[8]

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8 *Accord Grogan v. Chaffee*, 105 P. 745, 747 (Cal. 1909) ("There is nothing either unreasonable or unlawful in the effort by a manufacturer to maintain a standard price for his goods. . . . Contracts similar to the one under discussion have been considered in a number of cases, and have generally been upheld . . . ."); *Walsh v. Dwight*, 58 N.Y.S. 91, 93-94 (App. Div. 1899) ("[A] contract by a single manufacturer as to the price at which his goods . . . should be sold . . . would not be a contract by which competition in the supply or price of the commodity would be restrained or prevented. All of the manufacturers could compete with these defendants in the sale of these goods . . . . That such an agreement is not illegal has been settled by a long line of authorities."); *see also* Louis D. Brandeis, *The Competition That Kills*, Harper's Weekly, Nov. 15, 1913, at 11 ("abundant experience establishes that the one-price system . . . [has] greatly increased the efficiency of merchandising not only for the producer, but for the dealer and the consumer as well").

More recently, this Court has pointed to the procompetitive virtues of vertical agreements that enhance interbrand competition and benefit consumers by "reduc[ing] intrabrand price competition to the point where the dealer's profit margin permits provision of the desired services." *Sharp*, 485 U.S. at 728; *see also Monsanto*, 465 U.S. at 762-63 ("The manufacturer often will want to ensure that its distributors earn sufficient profit to pay for programs such as hiring and training additional salesmen or demonstrating the technical features of the product, and will want to see that 'free-riders' do not interfere."). As Justice White recognized in his concurrence in *Sylvania*, this is precisely the same economic effect that is fostered by resale price maintenance, and treating nonprice restraints under the rule of reason thus "call[s] into question" the rule of *Dr. Miles*. *Sylvania*, 433 U.S. at 69-70 (White, J., concurring).[9]

In light of the procompetitive benefits of resale price maintenance—which are the same benefits that motivated this Court in *Sylvania* to apply the rule of reason to nonprice agreements—the Court should hold that such arrangements are to be evaluated under the rule of reason, thus reconciling the conflict between *Dr. Miles*'s *per se* prohibition on resale

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[9] Several lower courts have likewise noted the substantial potential for resale price maintenance to be used for procompetitive purposes, and have questioned the continued *per se* treatment of the practice. *See, e.g.*, *Khan v. State Oil Co.*, 93 F.3d 1358, 1364 (7th Cir. 1996) (noting that the rule of *Dr. Miles* is not "easy to defend in terms of economic theory or antitrust policy"), *rev'd on other grounds*, 522 U.S. 3 (1997); *id.* ("[V]ertical minimum price fixing . . . does not impair any interest that the antitrust laws interpreted in light of modern economics could be thought intended to protect. It increases rather than reduces competition . . . ."); *Pace Elecs., Inc. v. Canon Computer Sys., Inc.*, 213 F.3d 118, 123 n.4 (3d Cir. 2000) (noting that "various scholars have taken issue with the Supreme Court's *per se* treatment of vertical minimum price fixing agreements and argued that these agreements may have significant, procompetitive attributes").

price maintenance and later decisions applying the rule of reason to analogous vertical agreements.[10]

II. CONTINUED ADHERENCE TO THE RULE OF *DR. MILES* WOULD HARM COMPETITION.

1. The *per se* rule of *Dr. Miles* compels manufacturers to resort to other restraints to achieve their desired mix of price and service promotion, such as establishing exclusive territories for dealers to prevent free-riding, integrating forward into distribution by performing wholesaling and retailing functions themselves, or contracting for particular sales-related services. These other tools, however, are not cost-

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[10] If the Court were to conclude that rule-of-reason treatment for all resale price maintenance agreements is inappropriate, and that *per se* treatment is warranted in some circumstances (a conclusion that we believe would be unjustified), the Court should apply such a *per se* rule only where there is a clear likelihood of anticompetitive effects. *See, e.g.*, *Nw. Wholesale Stationers, Inc. v. Pac. Stationery & Printing Co.*, 472 U.S. 284, 298 (1985) ("A plaintiff seeking application of the *per se* rule [against group boycotts] must present a threshold case that the challenged activity falls into a category likely to have predominantly anticompetitive effects."). For example, the Court has limited the *per se* rules against group boycotts and tying arrangements to cases in which the defendants possess market power, because, in the absence of market power, the conclusion that the practices are "virtually always likely to have an anticompetitive effect is not warranted." *Id.* at 296; *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 16-18 (1984); *see also infra* note 19. In contrast, the lower courts in this case applied the inflexible *per se* rule against resale price maintenance, with no analysis of the actual marketplace impact or whether Leegin had market power, no inquiry into Leegin's rationale for the practice, and no opportunity for Leegin to explain the procompetitive consequences of its actions. *See* Pet. App. 5a-6a. In this case, because Leegin is a small manufacturer with no market power and because there is no realistic threat that Leegin's use of resale price maintenance could have had anticompetitive effects, a narrowing of the *per se* rule along the lines of *Northwest Wholesale* or *Jefferson Parish* would require a reversal of the Fifth Circuit's decision.

free, and a legal regime that forces businesses to select second-best tools to achieve their competitive ends is inherently inefficient. *See* Posner, *Antitrust Law*, *supra*, at 185; Butz, *supra*, at 443-46, 457.[11] Continued adherence to the rule of *Dr. Miles* would thus force inefficient choices on businesses that would otherwise compete using resale price maintenance. *See* Butz, *supra*, at 447 (in choosing among options to limit control of their distribution systems, manufacturers "have incentives to adopt the lowest-cost approach"). The increased costs from such inefficiency are ultimately borne by consumers.

This is not to say that manufacturers will invariably employ resale price maintenance or that intrabrand price competition will disappear absent the *per se* rule of *Dr. Miles*. To the contrary, manufacturers will adopt resale price maintenance policies where it is efficient for them to do so to promote their products.[12] And where it is more efficient for manufacturers to encourage intrabrand price competition among their dealers, there is no reason for this form of competition to disappear in the absence of the rule of *Dr. Miles*. The key change is that manufacturers would have the ability

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[11] *See also, e.g.*, *Dr. Miles*, 220 U.S. at 412 (Holmes, J., dissenting) ("The Dr. Miles Medical Company knows better than we do what will enable it to do the best business."); *Krehl v. Baskin-Robbins Ice Cream Co.*, 664 F.2d 1348, 1356-57 (9th Cir. 1982) ("[M]odern economic thought indicates that the invalidation of a distribution system, absent a showing of anti-competitive effect, may actually retard competition. Competition is promoted when manufacturers are given wide latitude in establishing their method of distribution . . . . Judicial deference to the manufacturer's business judgment is grounded in large part on the assumption that the manufacturer's interest in minimum distribution costs will benefit the consumer." (internal quotation marks omitted)).

[12] During the era in which state Fair Trade laws permitted resale price maintenance, economists estimate that "up to 10 percent of all retail products in the United States were subject to resale price floors." Winter, *supra*, at 61; *see also* Overstreet, *supra*, at 6-7 (same).

to select the most efficient and effective means of promoting their products from a menu of options that includes resale price maintenance. There is no reason for antitrust law to constrain that selection process by retaining the *per se* rule against resale price maintenance.

Significantly, the rule of *Dr. Miles* imposes a particularly heavy burden on the many small businesses or new entrants that would use resale price maintenance to compete against larger incumbents. *See, e.g., Sylvania*, 433 U.S. at 65 (White, J., concurring) ("the potential benefits of vertical restraints in promoting interbrand competition are particularly strong where the manufacturer imposing the restraints is seeking to enter a new market or to expand a small market share"). Smaller competitors—such as Leegin—could use resale price maintenance as a valuable tool to encourage retailers to promote their products. Such companies, however, may be unable to bear the added cost of using less efficient tools to achieve their competitive ends. *See*, *e.g.*, Butz, *supra,* at 456-57 ("policies designed to promote intrabrand price competition by restricting vertical price controls may force marginally profitable firms out of business, thereby reducing both product variety and interbrand competition"). By contrast, larger competitors may enjoy sufficient brand recognition and clout with retailers that they do not need to employ resale price maintenance; and where they need to enforce minimum resale prices, they may be better suited to bear the increased costs of alternative solutions (such as integrating forward into distribution) that are not subject to *per se* prohibition. *See*, *e.g.*, Brandeis, *supra*, at 12 ("The great corporation with ample capital . . . can establish its own agencies or sell direct to the consumer, and is in no danger of having its business destroyed by price-cutting among retailers. But the prohibition of price-maintenance imposes upon the small and independent producers a serious handicap."). A *per se* rule that favors larger incumbents at the expense of smaller competitors, new entrants, and innovators; that drives marginal products out of the market and reduces product variety; and that incents manufacturers to integrate forward into distribution, rather than use independent distributors, is antithetical to any rational principle of antitrust law.

2. Contrary to PSKS's position, it is no cure for the ills of *Dr. Miles* that—rather than entering into an agreement with retailers establishing minimum resale prices for its goods—a manufacturer may unilaterally announce a suggested resale price and terminate noncompliant dealers under this Court's decision in *United States v. Colgate & Co.*, 250 U.S. 300 (1919). *See* Br. in Opp. to Pet. for Cert. 9. The *Colgate* doctrine is a blunt instrument that lacks the flexibility provided by a resale price maintenance policy.[13] For example, a manufacturer may find it more efficient to enter into an agreement with its dealers that governs the terms of their

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[13] The same is true with respect to vertical territorial restraints, which eliminate *all* intrabrand competition—a far more drastic reduction of competition than occurs with a restraint on intrabrand price competition. Indeed, resale price maintenance permits—and is often designed to encourage—nonprice competition among multiple sellers of a brand in the same geographic market. *See* Cert.-Stage Br. of *Amici Curiae* Economists 17. Resale price maintenance thus permits a manufacturer to make more finely-tuned adjustments to achieve the optimal level of intrabrand competition among its dealers. *See* Posner, *Antitrust Law*, *supra*, at 185. It makes no sense for the antitrust laws to evaluate a manufacturer's elimination of all intrabrand competition via vertical territorial restraints under the rule of reason, while treating a partial restriction on intrabrand competition via vertical price restraints as *per se* unlawful. Indeed, in *Eastern Scientific Co. v. Wild Heerbrugg Instruments, Inc.*, 572 F.2d 883 (1st Cir. 1978), the court declined to treat a vertical price restraint as *per se* unlawful because it only applied to sales outside the dealer's assigned territory. The court saw "no reason based on substantive economic effect" why *per se* treatment would be appropriate because the restraint was less restrictive than a total ban on sales outside an assigned territory, which was subject to rule-of-reason treatment under *Sylvania*. *Id.*; *see also id.* at 885 (questioning how a price restraint on sales outside an assigned territory "can possibly have a greater anti-competitive effect than a pure policy of territorial restrictions").

relationship, rather than having no option but to terminate noncompliant dealers.

The natural reaction of a manufacturer seeking to enforce a *Colgate* policy with noncompliant dealers is often not simply to terminate the dealers, as is required under *Colgate*, but rather to work with its dealers to find a resolution that enables the parties to continue their business relationship. But in doing so, the manufacturer risks straying across the line between a unilateral policy that is protected by *Colgate* and a *per se* illegal agreement—a line that can be both uncertain and laden with trap doors that are not self-evident to a business person who is not well-schooled in the nuances of the *Colgate* doctrine. As a result, many businesses that rely on *Colgate* run the risk that a jury will later find that they crossed that line. Such a finding can be "based on insignificant—and often fortuitous—facts having little or nothing to do with" any sound principle of economics or antitrust law. Calvani & Berg, *supra*, at 1203; *see also* ABA Section of Antitrust Law, *Antitrust Law Developments* 18 (5th ed. 2002) [hereinafter *Antitrust Law Developments*] (collecting cases).

To mitigate this risk, many businesses spend significant resources hiring antitrust attorneys to implement "*Colgate* compliance" programs—the costs of which ultimately get passed through to consumers. *See* Cert.-Stage Br. of *Amicus Curiae* CTIA—The Wireless Association 12-13. Many other businesses that are deterred by the punitive consequences of the *per se* rule take pains to stay so far from the uncertain line between protected unilateral conduct and *per se* unlawful agreements that they refrain from engaging in procompetitive behavior that should not be deterred under any economically sound theory of antitrust law.

Moreover, the protection for unilateral action that is embodied in the *Colgate* doctrine simply reflects that Section 1 of the Sherman Act applies only to contracts, combinations, or conspiracies among two or more actors—not unilateral action. 15 U.S.C. § 1. The issue at hand is not whether unilateral action in restraint of trade should be subject to liability (Congress has decided that issue), or whether there was an agreement here (the jury has decided that issue), but rather the appropriate standard for determining whether a resale price maintenance agreement is *unreasonable*. The *per se* rule of *Dr. Miles* is an inappropriate standard for making that determination. It does not salvage that erroneous standard to argue that unilateral action is outside the scope of Section 1.

III. THE ARGUMENTS FOR RETAINING THE RULE OF *DR. MILES* ARE INSUFFICIENT TO JUSTIFY ITS CONTINUED EXISTENCE.

PSKS has defended the rule of *Dr. Miles* based on considerations of *stare decisis* and deference to various congressional actions (or inactions) that did not actually require continued *per se* treatment of resale price maintenance. This Court has previously rejected such arguments in overturning analogous *per se* rules, and it should similarly reject these considerations in its evaluation of the rule of *Dr. Miles*.

A. *Stare Decisis* Is Not A Basis For Leaving Outdated *Per Se* Rules In Place.

In *Khan*, this Court expressly rejected the argument that it should leave undisturbed the antiquated and economically unsound *per se* rule against vertical maximum price agreements based on considerations of *stare decisis*. 522 U.S. at 20-21. The Court explained that "*stare decisis* is not an inexorable command" and that, "[i]n the area of antitrust law, there is a competing interest, well-represented in this Court's decisions, in recognizing and adapting to changed circumstances and the lessons of accumulated experience." *Id.* at 20. Similarly, in *Sharp*, the Court recognized that "[t]he Sherman Act adopted the term 'restraint of trade' along with its dynamic potential," and therefore the "line of *per se* illegality" should not "remain[] forever fixed where it was" when the Sherman Act was enacted in 1890. 485 U.S. at 732.

This understanding of the dynamic nature of the Sherman Act is faithful to Congress's intent, and it has been an important part of the Court's antitrust jurisprudence for well over a century. *See*, *e.g.*, 21 Cong. Rec. S2460 (daily ed. Mar. 21, 1890) (statement of Sen. Sherman) (noting that the courts should "determine in each particular case" the "precise line between lawful and unlawful combinations").[14] Indeed, in *Dr. Miles* itself, the Court stated that, "[w]ith respect to contracts in restraint of trade, the earlier doctrine of the common law has been substantially modified in adaptation to modern conditions." 220 U.S. at 406; *accord Khan*, 522 U.S. at 21. Nothing in the Sherman Act or the history of this Court's jurisprudence requires that the "adaptation to modern conditions" be frozen in place in 1911.

B. Congress Has Never Required Adherence To The Rule Of *Dr. Miles*.

PSKS has placed heavy reliance on arguments that the *per se* rule of *Dr. Miles* should be retained because of various actions or inactions by Congress over the course of the last century. Br. in Opp. to Pet. for Cert. 11-15. This argument misconstrues the action that Congress has taken in this area.

Congress's failure to legislatively overturn the rule of *Dr. Miles* warrants little weight. Indeed, this Court expressly

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[14] *See also*, *e.g.*, *Guardians Ass'n v. Civil Serv. Comm'n*, 463 U.S. 582, 641 n.12 (1983) (Stevens, J., dissenting) ("Congress phrased some older statutes in sweeping, general terms, expecting the federal courts to interpret them by developing legal rules on a case-by-case basis in the common law tradition. One clear example of such a statute is the Sherman Act. For that reason, in [*Sylvania*], the doctrine of *stare decisis* did not preclude the Court from overruling its prior decision in [*Schwinn*], even though Congress had not acted in the intervening decade." (citations omitted)); *Tex. Indus., Inc. v. Radcliff Materials, Inc.*, 451 U.S. 630, 643 (1981) (Congress's intent in passing the Sherman Act "to allow courts to develop governing principles of law[] [is] unmistakably clear"); Easterbrook, *supra*, at 136-38.

rejected an argument based on congressional inaction in *Khan*, stating that "we infer little meaning from the fact that Congress has not reacted legislatively to *Albrecht*." 522 U.S. at 19. The Court explained that "the general presumption that legislative changes should be left to Congress has less force with respect to the Sherman Act in light of the accepted view that Congress expected the courts to give shape to the statute's broad mandate by drawing on common-law tradition." *Id.* at 20 (internal quotation marks omitted).[15]

The proper focus is not on any "inaction" by Congress, but whether Congress has taken any action to deny this Court its traditional role of "giv[ing] shape to the [Sherman Act's] broad mandate" in light of "the lessons of accumulated experience." *Khan*, 522 U.S. at 20. Congress has not taken such action with respect to resale price maintenance. In particular, Congress has *never* passed legislation requiring that resale price maintenance be treated as *per se* unlawful. To be sure, resale price maintenance has been a subject of congressional action on several occasions. In 1937 and 1952, Congress passed legislation that removed resale price maintenance contracts from the reach of the Sherman Act if such contracts were valid under state laws. *See* Miller-Tydings Fair Trade Act, Pub. L. No. 75-314, 50 Stat. 693 (1937); McGuire Act, Pub. L. No. 82-542, 66 Stat. 631 (1952). In 1975, Congress repealed these acts. *See* Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 801. The 1975 Act did *not*, however, require that resale price maintenance be deemed *per se* unlawful. Congress simply repealed an antitrust exemption and restored the ordinary state of anti-

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[15] *See also Nat'l Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 688 (1978) ("Congress . . . did not intend the text of the Sherman Act to delineate the full meaning of the statute or its application in concrete situations. The legislative history makes it perfectly clear that it expected the courts to give shape to the statute's broad mandate by drawing on common-law tradition.").

trust law—judicial interpretation of what constitutes an unlawful "restraint of trade." *See* Posner, *Antitrust Law*, *supra*, at 189 ("Congress's action in repealing an antitrust immunity for resale price maintenance was not the same thing as outlawing the practice."); Easterbrook, *supra*, at 139-40. This legislation provides no basis to freeze in place the *per se* rules that existed in 1911, 1975, or any other year.

PSKS has also pointed to a handful of additional measures that Congress has considered or passed in the last three decades; but, again, none of these measures limits this Court's mandate to determine what conduct constitutes an unlawful restraint of trade. For example, in the mid-1980s, Congress twice prohibited the Department of Justice from using appropriations to advocate for a reversal of the *per se* rule against resale price maintenance. *See* Pub. L. No. 99-180, 99 Stat. 1136, 1169 (1985); Pub. L. No. 98-166, 97 Stat. 1071, 1102 (1983). The appropriation provisions were not repeated in the next budget, and they have not been repeated since. That these budgetary restrictions were not renewed, and that no similar restraints have been in place for a number of years, suggests, if anything, that Congress deemed them undesirable after the short period in which they were in place. This hardly seems to be a basis to disrupt this Court's longstanding mandate to interpret the Sherman Act.

That Congress has not enacted legislation to take away this Court's power to interpret the antitrust laws simply underscores the propriety of the approach to the Sherman Act that this Court has pursued for a century. *See* Cert.-Stage Br. of *Amicus Curiae* CTIA—The Wireless Association 17-18. As Chief Justice White wrote in the year that *Dr. Miles* was decided, the Court should continue to interpret the standards for what constitutes an unlawful restraint of trade as its understanding of what makes a restraint "unreasonable" evolves. *Standard Oil Co. v. United States*, 221 U.S. 1, 63-64 (1911).

IV. THE LOWER COURTS ARE FULLY CAPABLE OF APPLYING THE RULE OF REASON TO RESALE PRICE MAINTENANCE AGREEMENTS.

PSKS has argued that the rule of *Dr. Miles* should be retained because it is "clear and easily enforceable." Br. in Opp. to Pet. for Cert. 21. Any efficiency benefits of *per se* treatment, however, cannot justify a sweeping and overbroad rule that condemns a significant amount of procompetitive behavior. As this Court has repeatedly reaffirmed, antitrust *per se* rules must be limited to practices that "always or almost always tend to restrict competition and decrease output." *Broadcast Music*, 441 U.S. at 19-20. That condition is not met here.

Moreover, it is doubtful whether there actually are any efficiency benefits resulting from the rule of *Dr. Miles*. First, overturning the rule of *Dr. Miles* would likely lead to a reduction in the number of resale price maintenance cases that are filed. The *per se* rule encourages disgruntled distributors to bring antitrust lawsuits even where a vertical restraint can have no conceivable negative effect on competition in a relevant market. If distributors were required to demonstrate an effect on competition, it is likely that fewer economically groundless lawsuits attacking vertical pricing practices would be brought, easing any burden on the courts from resale price maintenance cases. *See* Cert.-Stage Br. of *Amicus Curiae* CTIA—The Wireless Association 11.

Second, following *Sylvania*, the lower courts have demonstrated their ability to apply an efficient rule-of-reason analysis to vertical nonprice agreements, which have effects on competition that are analogous to resale price maintenance agreements. *See Monsanto*, 465 U.S. at 762. In doing so, the courts have established a number of criteria that should be guideposts for courts evaluating resale price maintenance agreements under the rule of reason.

For example, plaintiffs challenging vertical nonprice restraints must establish that the restraint had a substantial adverse effect on interbrand competition in a relevant market.[16] Merely establishing some negative effect on intrabrand competition is typically insufficient to demonstrate that a vertical restraint is unreasonable.[17] In examining the effect of a vertical restraint on competition, lower courts take into account the restraint's impact not only on price, but also on service, quality, and other dimensions of competition.[18]

In addition, to establish that the manufacturer has the ability to bring about a substantial adverse effect on interbrand competition through a vertical restraint, lower courts ordinarily have required plaintiffs to make a threshold showing that the manufacturer has market power.[19] Where the

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16 *See, e.g., Schwinn*, 388 U.S. at 374 n.5, 375 ("Our inquiry is whether . . . the effect upon competition in the marketplace is substantially adverse."); *see also Antitrust Law Developments*, *supra*, at 61-62 (collecting cases).

17 *See, e.g., Ryko Mfg. Co. v. Eden Servs.*, 823 F.2d 1215, 1231 (8th Cir. 1987); *Valley Liquors*, 678 F.2d at 745; *Muenster Butane, Inc. v. Stewart Co.*, 651 F.2d 292, 298 (5th Cir. 1981); *see also Antitrust Law Developments*, *supra*, at 155 n.878 (collecting cases).

18 *See, e.g., Valley Liquors*, 678 F.2d at 745; *Muenster Butane*, 651 F.2d at 298.

19 *See, e.g., Assam Drug Co. v. Miller Brewing Co.*, 798 F.2d 311, 316 (8th Cir. 1986) ("Firms lacking market power, if they wish to survive, cannot adopt restraints that have anticompetitive effects. Thus such firms cannot have an effect on interbrand competition. Consequently, a finding of no market power precludes any need to further balance the competitive effects of a challenged restraint."); *see also Murrow Furniture Galleries, Inc. v. Thomasville Furniture Indus., Inc.*, 889 F.2d 524, 529 (4th Cir. 1989); *Ryko Mfg.*, 823 F.2d at 1231; *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 221 (D.C. Cir. 1986); *Valley Liquors*, 678 F.2d at 745; *Muenster Butane*, 651 F.2d at 298; Frank H. Easterbrook, *The Limits of Antitrust*, 63 Tex. L. Rev. 1, 20 (1984) ("Firms that lack [market] power cannot injure competition no matter how hard they try. They may injure a few consumers, or a few rivals, or themselves . . . .

manufacturer does not have a substantial share of the market, courts have regularly granted judgment as a matter of law to the manufacturer because it is unlikely that the limitations on intrabrand competition will impair interbrand competition.[20] As this Court has explained, "when interbrand competition exists . . . it provides a significant check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product." *Sylvania*, 433 U.S. at 52 n.19.

If the plaintiff meets its initial burden to demonstrate a substantial adverse effect on competition in the relevant market, then the defendant may show that the restraint is reasonably necessary to achieve a procompetitive objective, and the court then balances the restraint's negative effects on intrabrand competition and its positive effects on interbrand competition in the relevant market to determine whether the net overall effect on competition is substantially adverse.[21]

Applying this framework to resale price maintenance cases would likely permit a *more* efficient resolution of many such cases than is generated by the *per se* rule of *Dr. Miles*. In particular, where a claim would be subject to judgment as a matter of law for failure to make a threshold showing of

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[Footnote continued from previous page]

When the firms lack market power, though, they cannot persist in deleterious practices. Rival firms will offer the consumers better deals. Rivals' offers will stamp out bad practices faster than the judicial process can.").

[20] *See, e.g., Ryko Mfg.*, 823 F.2d at 1231 & n.14; *Assam Drug*, 798 F.2d at 317-18; *Rothery Storage*, 792 F.2d at 221; *JBL Enters., Inc. v. Jhirmack Enters., Inc.*, 698 F.2d 1011, 1017 (9th Cir. 1983); *Muenster Butane*, 651 F.2d at 298; *see also Antitrust Law Developments*, *supra*, at 156 n.879 (collecting cases).

[21] *See*, *e.g.*, *Sylvania*, 433 U.S. at 51-59; *Valley Liquors*, 678 F.2d at 745; *Krehl*, 664 F.2d at 1356-57; *Muenster Butane*, 651 F.2d at 296-98; *Red Diamond Supply, Inc. v. Liquid Carbonic Corp.*, 637 F.2d 1001, 1005-07 (5th Cir. 1981).

market power or a substantial adverse effect on competition—which is an issue that can often be resolved more easily than a determination whether communications between a supplier and its dealers constitute an "agreement" under Section 1 of the Sherman Act—there would be no need to conduct a trial to determine whether there was in fact an agreement between the manufacturer and its retailers.[22]

The present case vividly illustrates the potential efficiencies to be gained by eliminating the rule of *Dr. Miles*. If PSKS had been required to demonstrate that Leegin's vertical pricing policy had a substantial adverse effect on competition in the market for women's fashion accessories (in which Leegin is a tiny player in a fragmented marketplace), Leegin would have been entitled to judgment as a matter of law on that element of PSKS's claim, and the case would not have gone to trial on the question whether Leegin had entered into a pricing agreement with its distributors.

V. THE COURT SHOULD REVERSE THE DECISION BELOW.

If this Court determines that resale price maintenance agreements should no longer be subject to *per se* treatment, it should reverse the decision below because this case was litigated solely under the *per se* rule of *Dr. Miles*. Indeed, the district court refused to allow Leegin to introduce evidence that its pricing policy promoted competition, it excluded the

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[22] *See, e.g.*, *Bi-Rite Oil Co. v. Ind. Farm Bureau Coop. Ass'n*, 908 F.2d 200, 202 (7th Cir. 1990) (district court found that plaintiff had raised sufficient facts to withstand a summary judgment motion on the conspiracy element of its challenge to vertical nonprice restraints, but granted summary judgment in favor of defendants on the "unreasonableness" element of the claim); *Muenster Butane*, 651 F.2d at 298 ("A requirement that plaintiff prove market power in this case would have saved the litigants and the courts much expense. . . . Whatever vertical restraints Stewart imposed on its dealers, their effect could not have been to raise the price consumers paid for television sets.").

report of Leegin's economic expert on the basis that the conduct at issue was a *per se* unlawful resale price maintenance agreement, it denied Leegin's request for an instruction that the jury apply the rule of reason, and it denied Leegin's motion for judgment as a matter of law based on the rule of *Dr. Miles*. Similarly, the court of appeals affirmed the judgment against Leegin in reliance upon the *per se* rule against resale price maintenance, stating that lower courts "remain bound by [the Supreme Court's] holding in *Dr. Miles*." Pet. App. 4a. In the absence of the *per se* rule applied by the lower courts, the decision below cannot stand.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed.

Respectfully submitted.

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