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IN THE UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF TEXAS

MARSHALL DIVISION

PSKS, INC., ET AL.	§	
Vs.	§	CIVIL ACTION NO. 2:03-CV-107
LEEGIN CREATIVE LEATHER PRODUCTS, INC.	§	

MEMORANDUM OPINION AND ORDER

The court grants the plaintiffs' motion to limit the testimony of Kenneth G. Elzinga (#42) for the reasons expressed in this order.

1. Introduction.

This antitrust case involves a claim that the defendant's alleged retail price maintenance agreements with its retailers are unlawful under Section 1 of the Sherman Act. At issue is the plaintiffs' motion to limit the testimony of the defendant's expert witness. Under the current state of the law, this case will not accommodate a rule of reason analysis. This is true whether one is assessing directly the reasonableness of the alleged restraint or challenging its per se classification indirectly by urging proof that no antitrust injury has occurred. As such, the court grants the plaintiffs' motion to limit the testimony of the defendant's expert.

2. Factual Background and Procedural Posture.

In this case, two former retailers of Brighton leather goods assert that the manufacturer of

those products, Leegin Creative Leather Products, LLC ("Leegin"), violated Section 1 of the Sherman Act by agreeing with other dealers to fix the minimum retail prices of the Brighton product line. The plaintiffs contend that the defendant sought the plaintiffs' agreement to the pricing arrangement and, when the plaintiffs failed to agree to maintain retail prices, the defendant retaliated by suspending product shipment. The retailers filed this federal antitrust case complaining of Leegin's conduct and appended various supplemental state law claims related to shipping charges.[1]

The parties completed discovery and the various pre-trial tasks. During the course of the proceedings, the defendant designated an expert witness, Dr. Kenneth G. Elzinga, to testify as to various issues raised in this case. All concede Dr. Elzinga to be qualified as an expert on antitrust economics. The plaintiffs dispute, however, the relevance of his opinions and have moved to limit his testimony.

Specifically, Dr. Elzinga's report sets forth various opinions discussing the economics of resale price maintenance, pro-competitive aspects of resale price maintenance, and situations in which resale price maintenance presents potential adverse economic consequences. Dr. Elzinga suggests that resale price maintenance arrangements like the one alleged in this case can be reasonable because they may promote interbrand competition. Dr. Elzinga also notes that resale price maintenance schemes eliminate the "free rider."[2] Dr. Elzinger concludes in this case that

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[1] At the pre-trial conference, the plaintiffs abandoned their state law claims.

[2] A free rider is a retailer who offers little or no services in connection with the sale of merchandise. A consumer obtains assistance with the selection of a product from a full-service retailer, then the consumer purchases the product from the free rider, who has lower costs and is able to sell the product for a lower price. One of the pro-competitive justifications for resale price maintenance is the assurance to the full-service retailer that it will be compensated for providing services at the point of sale and promoting the product by a guaranteed margin on the actual sale of the product itself–should the sale occur. Such assurance incents the full-service

consumers have not been harmed by Leegin's conduct, that the arrangement promotes interbrand competition, and that any particular restraint in this case should be judged by the rule of reason, as opposed to being labeled per se unreasonable. To illustrate, after discussing the evolution of the Supreme Court's treatment of vertical restraints, Dr. Elzinga states:

> To the extent prevailing antitrust law governing non-price vertical arrangements is properly calibrated, this would suggest the rule plaintiffs propose regarding vertical arrangements on price is asymmetric with the economic logic of [*Continental T.V. v. GTE Sylvania, Inc.*]. In other words, if the per se rule is to thwart conduct that is always (or almost always) anticompetitive, then to apply the per se rule to all situations of RPM is to misapply the rule.

(Report of Dr. Kenneth G. Elzinga, at p. 22).[3] The plaintiffs argue that these opinions are irrelevant in this case, because the alleged restraint, if proven, constitutes a per se violation of Section 1. The court agrees.

3. Discussion.

Although Section 1 of the Sherman Act literally prohibits every agreement "in restraint of trade," the Supreme Court has recognized that Congress intended to prohibit only unreasonable restraints. *See, e.g., Arizona v. Maricopa County Medical Soc.*, 457 U.S. 332, 342-343 (1982). As such, most antitrust claims are analyzed under a rule of reason. Under the rule of reason, the finder of fact must decide whether the challenged practice imposes an unreasonable restraint on competition, taking into account a variety of factors, including specific information about the relevant business, its condition before and after the restraint was imposed, and the restraint's history, nature, and effect. 457 U.S. at 343, and n. 13 (*citing Board of Trade of Chicago v. United States*, 246

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retailer to continue to promote the product.

[3] Dr. Elzinga notes that some resale price maintenance schemes are worthy of per se treatment, including those which involve concerted action among horizontal market participants.

U.S. 231, 238, (1918)).

Some types of restraints, however, have such predictable and pernicious anticompetitive effect, and such limited potential for procompetitive benefit, that they are deemed unlawful per se. *Northern Pacific R. Co. v. United States*, 356 U.S. 1, 5 (1958). Per se treatment is appropriate "[o]nce experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it." *Maricopa County, supra*, at 344; *see also Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1, 19, n. 33 (1979). Although the Supreme Court has moved away from the per se rule in other vertical contexts, *Continental T.V. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977), including vertical agreements to maintain *maximum* prices, *State Oil v. Khan*, 522 U.S. 3 (1997), it has not abandoned this classification when assessing vertical minimum price fixing agreements. *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 760-61 (1984); *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960); *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911). Vertical minimum price fixing agreements, like the one alleged in this case, remain per se unlawful. As a result, the court will exclude that portion of Dr. Elzinga's testimony related to the challenged agreement's effect on the market as well as his opinions related to situations in which per se treatment of resale price maintenance arrangements is appropriate.

The defendant also contends that Dr. Elzinga's testimony is relevant to the question of whether the plaintiffs (or consumers generally) suffered any antitrust injury as a result of the alleged resale price maintenance agreement. A private plaintiff may not recover damages under Section 4 of the Clayton Act unless he proves antitrust injury. *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489 (1977). Antitrust injury is injury of the type the antitrust laws were intended to

prevent and that flows from that which makes the conduct unlawful. *Id.* The purpose of the antitrust injury requirement is to ensure that the harm claimed by the plaintiff corresponds to the rationale for finding a violation of the antitrust laws in the first place. *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328 (1990).

In *Atlantic Richfield*, the Court held that even in cases involving per se violations, a private plaintiff suing under the Clayton Act still must demonstrate antitrust injury. In that case, an independent petroleum marketer sued an oil company claiming that the oil company's agreement with its retailers to fix the *maximum* price of petroleum products was a per se violation of Section 1.[4] The oil company had urged its retailers to match the prices set by independent marketers like the plaintiff. When the plaintiff began losing sales because of the alleged agreement, it sued the oil company, claiming a violation of Section 1.

The Court rejected the plaintiff's effort to sue under Section 1 and specifically rejected the plaintiff's argument that the per se nature of the violation absolved the plaintiff of any need to show antitrust injury. The Court noted that the plaintiff, a competitor of the dealers, would have benefited if the pricing practice had channeled business through only a few large dealers or prevented its competitors from offering services desired by customers. Thus, the injury to the plaintiff did not flow from the competition-reducing aspects of the agreement which had led to its per se classification. Moreover, low prices benefit consumers. To the extent the plaintiff was complaining about lost sales resulting from increased competition, it was challenging the very aim of the antitrust laws. As a result, the Court held that the plaintiff lacked standing to sue under the Clayton Act.

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[4] When the Court decided *Atlantic Richfield*, vertical agreements to fix maximum prices were still subject to per se treatment.

It is true that *Atlantic Richfield* held that the per se classification of a practice does not eliminate the requirement that a plaintiff demonstrate antitrust injury. But a dealer who alleges he was terminated because he refuses to acquiesce in a vertical minimum price fixing conspiracy stands on different footing from the independent marketer in *Atlantic Richfield.* The terminated dealer satisfies the antitrust injury requirement without having to demonstrate an adverse effect on the market. *Pace Electronics, Inc. v. Canon Computer Systems, Inc.*, 213 F.3d 118, 124 (3d Cir. 2000).

In *Pace*, the plaintiff alleged that the defendant terminated the plaintiff's wholesale dealership because the plaintiff refused to acquiesce in a vertical minimum price fixing agreement. The district court held that a dealer terminated under such circumstances does not suffer an antitrust injury unless the dealer can demonstrate that its termination had an actual, adverse economic effect on a relevant market. Because the dealer had not alleged such an effect, the district court concluded that the dealer had failed to state an antitrust claim and dismissed the complaint.

The Third Circuit reversed. The court rejected the argument that a terminated dealer must plead an adverse effect on the market. Specifically, the court framed the issue as "not whether the plaintiff's alleged injury produced an anticompetitive result, but, rather, whether the injury claimed resulted from the anticompetitive aspect of the challenged conduct." *Pace*, 213 F.3d at 124. Vertical minimum price maintenance agreements are per se unreasonable because they benefit the manufacturer and punish the dealer "by taking from the latter the power to price competitively." *Pace*, 213 F.3d at 122 (quoting Richard A. Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions*, 75 Colum. L. Rev. 281, 289-90 (1975)). The dealer in *Pace* alleged that its termination caused it to suffer lost profits because the dealer could no longer sell the manufacturer's products at dealer

prices. This allegation was sufficient to satisfy the antitrust injury requirement despite the fact that the plaintiff had not alleged an adverse effect on the market.

In this case, the plaintiffs claim that the defendant's refusals to sell to them deprived them of the opportunity to compete freely and to earn a profit on the sale of Brighton products. This is antitrust injury, and it flows directly from those aspects of the challenged practice which led the court to classify the practice as per se unlawful. As a result, it is not necessary for the plaintiffs to demonstrate–nor is it even relevant–that the challenged agreement resulted in an adverse effect on interbrand competition within a market. As the court put it in *Pace*:

> Were we to accept the defendants' construction of the antitrust injury requirement, we would, in substance, be removing the presumption of anticompetitive effect implicit in the per se standard under the guise of the antitrust injury requirement.

Pace, 213 F.3d at 123.

Although the procedural posture of this case differs from the one in *Pace*, the reasoning of that case is persuasive. To permit the defendant to challenge the per se classification of the restraint indirectly through the antitrust injury requirement would be to undermine the per se classification itself. The court will therefore exclude that portion of Dr. Elzinga's testimony which purports to demonstrate the lack of antitrust injury by showing the lack of adverse market effects.

Finally, the defendant suggests that Dr. Elzinga's opinions are relevant to explain the activities of Leegin and its retailers and to disprove the existence of any agreement. By its express terms, Section 1 prohibits only concerted action. 15 U.S.C. § 1 (requiring a "contract, combination . . . or conspiracy"); *Metro Ford Truck Sales, Inc. v. Ford Motor Company*, 145 F.3d 320, 325 (5th Cir. 1998). The defendant argues that its conduct was unilateral and thus immune from a Section 1 challenge under the *Colgate* doctrine. *United States v. Colgate & Co.*, 250 U.S. 300 (1919).

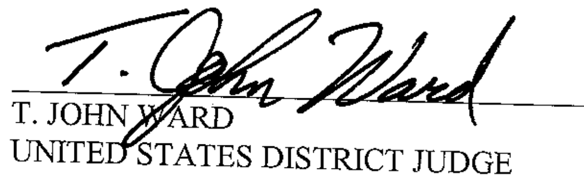
Under the *Colgate* doctrine, so long as a manufacturer acts unilaterally, it may announce its retail prices in advance and then refuse to deal with those who will not sell at the announced prices. The rule is derived from the terms of Section 1 itself and recognizes that Section 1 requires a showing of an *agreement* which unreasonably restrains trade. Success under the *Colgate* doctrine does not depend on the reasonableness or lawfulness of the alleged agreement, it depends on the lack of any agreement at all. Thus, the manufacturer in this case may win by persuading the jury that it behaved unilaterally and that its conduct is therefore outside the scope of Section 1.

Although evidence of the reasonableness of a price fixing agreement is ordinarily inadmissible, *United States v. Socony-Vacuum Oil Co., Inc.*, 310 U.S. 150 (1940), the defendant argues that portions of Dr. Elzinga's opinions would be offered to demonstrate the absence of any agreement and to explain the behavior of Leegin and its retailers. *See Continental Baking Co. v. United States*, 281 F.2d 137, 143 (6th Cir. 1960). The defendant argues that if the plaintiffs' expert is permitted to testify that the facts support a finding of an agreement by Leegin with its retailers to enforce Leegin's policy against retailers who do not follow the policy, then Dr. Elzinga should be permitted to testify as to economic factors that could lead the retailers and Leegin to act independently of one another. The court notes that it has not yet assessed the admissibility of the plaintiffs' proposed expert testimony. At this stage, therefore, the court will limit Dr. Elzinga's testimony to opinions relevant to the existence of any alleged agreement. It is entirely possible, however, that the court might impose additional limitations depending on the scope of expert testimony, if any, that the court allows on the issue whether Leegin and its retailers entered into an agreement to fix retail prices.

4. Conclusion.

The court grants the plaintiffs' motion to limit the testimony of Dr. Elzinga to the extent set forth in this order. The alleged agreement, if proven, is unreasonable per se. Testimony as to the effect on the market is irrelevant and will be excluded, whether such evidence is offered to justify the reasonableness of the restraint or the lack of any antitrust injury. The court will determine after considering the motion to exclude the testimony of Dr. Woods whether Dr. Elzinga's opinions are relevant to the question whether Leegin and its retailers agreed to maintain minimum resale prices.

So **ORDERED** and **SIGNED** this 25 day of March, 2004.



T. JOHN WARD
UNITED STATES DISTRICT JUDGE