S. HRG. 111–267

# THE DISCOUNT PRICING CONSUMER PROTECTION ACT: DO WE NEED TO RESTORE THE BAN ON VERTICAL PRICE FIXING?

## HEARING

BEFORE THE

SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

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# C O N T E N T S

# THE DISCOUNT PRICING CONSUMER PROTECTION ACT: DO WE NEED TO RESTORE THE BAN ON VERTICAL PRICE FIXING?

**TUESDAY, MAY 19, 2009**

U.S. SENATE,
SUBCOMMITTEE ON ANTITRUST,
COMPETITION POLICY, AND CONSUMER RIGHTS,
COMMITTEE ON THE JUDICIARY,
*Washington, DC*

The Subcommittee met, pursuant to notice, at 2:33 p.m., in room SD–226, Dirksen Senate Office Building, Hon. Herb Kohl, Chairman of the Subcommittee, presiding.

Present: Senators Kohl, Klobuchar, Kaufman, and Hatch.

## OPENING STATEMENT OF HON. HERB KOHL, A U.S. SENATOR FROM THE STATE OF WISCONSIN

Chairman KOHL. Good afternoon. This hearing will come to order.

Today we will examine an issue with far-reaching impact on the prices consumers pay for everything from clothing to electronics, and to everyone who likes to get a bargain when shopping. Two years ago, we held a hearing on the Supreme Court's 5–4 decision in the *Leegin* case in June 2007 which abolished a fundamental antitrust rule that manufacturers cannot set minimum retail prices. At that hearing, we heard warnings that this decision would imperil discount shopping that consumers have learned to take for granted. Our experience since the *Leegin* decision is giving credence to these fears, and it comes at exactly the wrong time—just as millions of consumers face a serious recession and depend on bargain shopping more than ever to balance the family budget. That is why I have introduced legislation to overturn what I believe is this misguided Supreme Court ruling.

For nearly a century, the rule against vertical price fixing permitted discounters to sell goods at the most competitive price. Many credit this rule with the rise of today's low-price, discount retail outlets, stores like Burlington Coat Factory, and the Internet site eBay—both witnesses today—not to mention such retail giants as Target, Best Buy, and Walmart, all of which offer consumers a wide array of highly desired products at discount prices.

We have already begun to see the manufacturers set minimum retail prices resulting in higher prices for consumers. Some antitrust experts suggest that there are an estimated 5,000 companies using minimum pricing policies. Last year, at the outset of the holi-



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day shopping season, Sony announced a no-discount rule prohibiting discount retailers from cutting the price on a number of its most in-demand top end products, including some flat screen TVs as well as digital cameras. The Wall Street Journal has reported that a new business has materialized for companies that scour the Internet in search of retailers selling discount products. When such bargain sellers are detected, the manufacturer is alerted so that it can demand that the discounting stop. Even the discounting of toys at pre-Christmas sales was targeted.

I know from my own experiences in the retail industry decades ago that established retailers can take advantage of vertical price fixing to halt discounting dead in its tracks. In order to eliminate low-price competition from smaller retailers, large retailers can demand that manufacturers forbid discount pricing. These large retailers have the bargaining power with manufacturers to make these demands stick, all to the detriment of upstart discount competitors and consumers.

Our common-sense worry that allowing manufacturers to bar discounting will lead to higher prices is borne out by basic economics. In his dissenting opinion in *Leegin*, Justice Breyer estimated that if only 10 percent of manufacturers engaged in vertical price fixing, retail bills would average $750 to $1,000 higher for the average family of four annually. For this reason, I have introduced the Discount Pricing Consumer Protection Act, cosponsored by Senator Whitehouse. Our bill—which is endorsed by 35 State attorneys general and all major consumers' organizations—will simply make it clear that when manufacturers prohibit discounting, they violate the antitrust laws, and thereby restore a clear legal rule that had stood since 1911.

In the last few decades, millions of consumers have benefited from an explosion of retail competition from new large discounters in virtually every product, from clothing to electronics to groceries, in both "big box" stores and on the Internet. We have all taken for granted our ability to walk into discount retailers and buy brand name products at sharply discounted prices. It is essential that Congress act swiftly to enact my bill to once again make the setting of minimum retail prices illegal.

I look forward to the testimony today of our distinguished witnesses on this important topic.

Our first witness who will be testifying today is Pamela Jones Harbour. Ms. Harbour has been a Commissioner of the FTC since 2003. Prior to joining the FTC, Ms. Harbour served as partner at Kaye Scholer law firm and was the New York State Deputy Attorney General.

Next, we will have Tod Cohen. Mr. Cohen serves as Vice President and Deputy General Counsel of Government Relations at eBay. He began his legal career at the law firm of Covington & Burling and was Vice President and Counsel for New Media for the Motion Picture Association of America before joining eBay.

Our next witness will be Stacy Haigney. Mr. Haigney is an inhouse attorney at Burlington Coat Factory. He has almost 4 years of experience as an antitrust attorney, and he was a founding partner of the firm Kassner & Haigney before working, as he presently does, for Burlington Coat Factory.

And, finally, we will have James Wilson. Mr. Wilson is a partner at Vorys, Sater, Seymour and Pease in Columbus, Ohio, and is the current Chair of the Section of Antitrust Law of the American Bar Association. He testifies today on behalf of the ABA.

Before we swear in our witnesses, I would like to call on the Ranking Member, Orrin Hatch, for any comments he might make.

## STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM THE STATE OF UTAH

Senator HATCH. Well, thank you, Mr. Chairman. It is always a pleasure to work with you, and I really appreciate our friendship and our working together.

Today's topic of vertical price fixing is not new to this Subcommittee. It has been almost 2 years since the Supreme Court reached its 5–4 decision in *Leegin Creative Leather Products* v. *PSKS Inc., Kay's Kloset*, and the Subcommittee held its subsequent hearing on the Court's ruling.

Now, this decision has and will have an important effect on our Nation's economy, and especially on discount retailers. Therefore, Mr. Chairman, with your enormous expertise in this area, I look forward to learning more of your thoughts and perspectives on the issues behind your legislation, S. 148, the Discount Pricing Consumer Protection Act.

To some the topic of vertical price fixing or minimum resale price maintenance is as dry as week-old bread. However, the contrary is true. This is an important topic. At stake is how and at what price consumers will buy a variety of goods and the dynamics by which manufacturers will enter into agreements with retailers.

Mr. Chairman, a bit of background is necessary to fully understand the importance of this issue. Nearly 100 years ago, the Supreme Court ruled in *Dr. Miles Medical Company* v. *John D. Park & Sons* that it was per se illegal "under Section 1 of the Sherman Act for a manufacturer and its distributor to agree on the minimum price a distributor can charge for the manufacturer's goods." In other words, vertical pricing was against the law. However, this all came to an end nearly 2 years ago when the Court in *Leegin* discarded the per se rule for the test under the rule of reason. Under this new decision, vertical price fixing is permitted as long as it does not constitute an unreasonable restraint on trade. Specifically, the Court has held under the rule of reason, "The fact finder weighs all of the circumstances of the case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition. Appropriate factors to take into account include specific information about the relevant businesses and restraints history, nature, and effect."

Now, the Court's majority argued that vertical price fixing can stimulate "inter-brand competition, the competition among manufacturers selling different brands of the same type of product, by reducing intra-brand competition, the competition among retailers selling the same brand."

Now, the Court goes on further to justify this decision by stating, as they held in *Kahn*, the "primary purpose of the antitrust laws is to protect what really amounts to inter-brand competition." The Court appeared to be very concerned about the activity called "free riding." Free riding can be described as when a customer takes advantage of the service as an information provided by a full-service retailer and then makes the actual purchase of the product for a lesser price at a discount retailer. The Court argues that by permitting vertical price fixing, retailers would have less of an ability to compete on price, thereby diminishing the opportunities for free riding to occur.

It is surmised that retailers would then focus their competitive energies on providing better services and shopping environments for the customer in order to distinguish themselves in the intrabrand competition.

Clearly, the Court in *Leegin* is favoring the manufacturer over the retailer, especially the discount retailer. Not surprisingly, discount retailers argue that this decision will have an adverse effect on their businesses since they could have additional difficulties in charging a lower price.

Now, this is a matter with which I am particularly concerned. Will the *Leegin* decision result in the unintended consequence of hindering the development of the next generation of discount retailers by enabling manufacturers to set a minimum price for their goods? And though I do not know the position of Stanford's Thomas Sowell on this issue, I am mindful of the point, albeit in a different context, that he made in his book on economics. He said this: "Lower costs reflected in lower prices is what made A&P the world's leading retail chain in the first half of the 20th century. Similarly, lower costs reflected in lower prices is what enabled other supermarket chains to take A&P's customer away in the second half of the 20th century. And while A&P succeeded in one era and failed in another, what is far more important is that the economy as a whole succeeded in both eras in getting its groceries at the lowest prices possible at the time from whichever company happened to have the lowest prices. So does the economy and consumers succeed in the long run under *Leegin*."

Now, that is the crux of the matter and why I will put the same question to our witnesses today. I will have to do it in writing because of an Intelligence Committee hearing that I have to go to. But I asked that question 2 years. Does the positive effect on the manufacturer competition created by *Leegin* outweigh the negative effect on the discount retailer?

So I look forward to the panel answering that question, and others as well, and, Mr. Chairman, I really appreciate you holding this hearing, and I hope that we can help resolve some of these conflicts and problems that exist in the best interest of everybody.

I am very grateful to have all of you folks here. Welcome to you, and please forgive me for having to run to the Intelligence Committee, but I have got three conflicts right now at 2:30. I am going to, as always, leave it in the hands of my dear Chairman.

Thank you, Mr. Chairman.

Chairman KOHL. Thanks so much, Senator Hatch.

Senator KAUFMAN.

## STATEMENT OF HON. EDWARD E. KAUFMAN, A U.S. SENATOR FROM THE STATE OF DELAWARE

Senator KAUFMAN. Thank you, Mr. Chairman, and thank you for holding this very important hearing. You know, for a long time there has been discussion on the Hill. Conservatives say that it is the judges on the left who engage in activism from the bench. They say conservative judges stick to calling balls and strikes of the law, while more liberal jurists insert their political philosophy into their opinions.

Well, Mr. Chairman, the *Leegin* case proves that activism is in the eyes of the beholder. With respect to vertical price fixing, it was the addition of two conservatives to the Court, Justices Roberts and Alito, that led to the reversal of 96 years of unbroken precedent. This case, plain and simple, represents the elevation of big manufacturers' interests over those of the consumer, and this Court acted because it decided to embrace a different economic theory, not because any facts or circumstances changed. In my book, that is judicial activism.

For too long, we have had complacent antitrust enforcement. During the previous administration, regulators seemed to forget that the consumer should be the beneficiary and was designed to be the beneficiary of our antitrust laws. And with this poorly reasoned and radical departure from precedent in the *Leegin* case, the United States Supreme Court, in my opinion, has itself gotten into the act.

Well, Mr. Chairman, it is time to once again focus ourselves on how antitrust law operates to protect or harm the consumer. It can come as a surprise to no one that the setting of price floors leads to the elevation of consumer prices. It prevents price competition out of the paternalistic notion that consumers, many of whom are struggling to get by, especially in these economic times, do not want the lowest prices possible but would rather have a fancy store, even if it means they cannot pay all their bills. I reject this notion, and I look forward to the testimony from these witnesses on this important issue.

Again, thank you, Mr. Chairman.

Chairman KOHL. Thank you very much, Senator Kaufman.

We will start our testimony after you all are sworn in. Would you rise and raise your right hand? Do you swear the testimony you are about to give before this Committee will be the truth, the whole truth, and nothing but the truth, so help you God?

Ms. HARBOUR. I do.

Mr. COHEN. I do.

Mr. WILSON. I do.

Mr. HAIGNEY. I do.

Chairman KOHL. Thank you so much.

We will start with you, Ms. Harbour, and we request that you and the other witnesses hold your statements please to 5 minutes, and we will put into the record anything else that you may have to say.

Ms. Harbour.

**STATEMENT OF PAMELA JONES HARBOUR, COMMISSIONER, FEDERAL TRADE COMMISSION, WASHINGTON, DC**

Ms. HARBOUR. Thank you. Chairman Kohl and members of the Subcommittee, I appreciate this opportunity to share with you my personal views on minimum vertical price fixing. During my oral remarks, there are three points that I would like to make.

First, the Supreme Court has decided to repeat an already failed experiment with RPM that flaunts congressional intent and harms consumers.

Second, the lower courts' evaluation of RPM under the rule of reason will reward price-fixing merchants and manufacturers and will further punish victims, i.e., consumers and non-conspiring merchants.

Third, RPM should be presumed to be harmful to competition until a manufacturer has factually shown that its use of RPM benefits consumers more than it harms them.

The Supreme Court's 2007 *Leegin* decision gave manufacturers the right to set minimum resale prices for consumer goods, guaranteeing higher consumer prices. This is bad economic and legal policy. It gives excessively short shrift to consumer preferences, the supposed driving force behind the market. Post-*Leegin*, and absent action by Congress, consumer preferences will be subordinated to the interests of manufacturers and merchants of branded consumer goods, and in these tough economic times, it is especially wrong to saddle consumers with higher prices for daily necessities while providing no countervailing benefits.

RPM advocates essentially ask us to believe that consumers are better off when they pay higher prices for the daily necessities of life because the benefits to manufacturers and retailers eventually will trickle down to consumers. According to the logic of the *Leegin* court, it is preferable to maximize the welfare of conspiring manufacturers and merchants, even though the antitrust laws are designed to put consumer interests first. The *Leegin* decision cannot be reconciled with the legislative history of the antitrust laws. Congress never adopted nor endorsed a preference for RPM at the Federal level. Congress did create an exemption, an antitrust exemption, for RPM under State fair trade statutes. However, Congress ultimately graded that a 37-year-old natural experiment—graded it a failure, and in 1975, the fair trade exemptions were repealed in favor of per se illegality. Congress did so because RPM had been a dismal, if not disastrous, detour from sound public policy. RPM raised consumer prices by as much as 37 percent. RPM lowered sales levels. It increased the frequency of business failure. RPM created entry barriers. It distorted retailer incentives, and RPM generally retarded retail competition.

Even if the *Leegin* majority can overlook these congressional findings, I cannot. I ask: Are we falling into a Groundhog Day vortex where we are doomed to endlessly repeat the same mistakes over and over again? Competition policy can and should do a better job of protecting consumers, but I do worry that Congress may someday be called upon to write yet another report detailing the disastrous harms inflicted on consumers during the Court's current experiment with RPM. And we know who is paying for this experiment. Sadly, it is the American consumer.

Indeed, if you believe what you read in the newspapers, consumers already are paying that price. The Court's new experiment has led many consumers to incur RPM price premiums, even in these trying times. Since the Court decided *Leegin*, the number of companies using some version of RPM has increased significantly. The use of third-party monitoring services by manufacturers to identify, police, and then discipline Internet discounting has rapidly expanded. Some discounters have been terminated by as many as 25 percent of their suppliers, and other discounters, like PSKS, the plaintiff in the *Leegin* case, have gone out of business and have been unable to get the courts to consider the merits of their claims under the rule of reason.

Consumers do not realize that they are currently paying substantial RPM premiums. Not surprisingly, the manufacturers who impose these premiums are unlikely to notify customers that the discounts are no longer available, nor are retailers who support the RPM premiums particularly interested in telling their customers that prices were too low before discounting was eliminated.

The *Leegin* Court claimed that it intended the rule of reason to weed out competitively harmful uses of RPM, but good intentions will not cure a bad rule of law. The rule of reason tends to be a euphemism for the absence of liability. Potentially good RPM cases are already being dismissed without any hearing on the merits.

The reality of litigation dictates that when the facts are equally probative of guilt or innocence, then depending on which theory is adopted to evaluate them, then usually the party that has the burden of proof loses. If full-blown rule of reason analysis is applied in RPM cases, the burden of proof will be placed on the victims, not on the defendants who imposed the RPM policies to begin with.

The FTC is doing its best to further the development of the real-world effects and the real-world facts about the effects of RPM by holding a series of workshops, but any answers may be a decade or more away. Consumers need relief today.

In conclusion, when it comes to the RPM debate, one simple fact is indisputable. RPM guarantees that consumers will pay higher prices, and until it is proven otherwise, I will continue to believe that consumers are very unlikely to gain any countervailing benefits in return for these higher prices.

Thank you.

[The prepared statement of Ms. Harbour appears as a submission for the record.]

Chairman KOHL. Thank you, Ms. Harbour.

Mr. Cohen.

**STATEMENT OF TOD COHEN, VICE PRESIDENT AND DEPUTY GENERAL COUNSEL FOR GOVERNMENT RELATIONS, EBAY, SAN JOSE, CALIFORNIA**

Mr. COHEN. Chairman Kohl, I am Tod Cohen, Vice President and Deputy General Counsel for Government Relations at eBay. Thank you for the invitation to speak today about S. 148, the Discount Pricing Consumer Protection Act, and the impact of the Supreme Court's *Leegin* decision in particular on small and mid-size retailers who use the Internet. eBay and our users support your legislation to reinstate a per se rule prohibiting retail price fixing.

Founded in 1995, eBay connects hundreds of millions of people around the world every day. The company's online platforms empower individuals and small businesses to meet and engage in open trade on a local, national, and international basis. We believe that the efficiency and consumer benefits of the open Internet can be immense. Businesses use it to offer lower prices, greater choice, and great values to consumers.

Consumers use it to more easily find, compare, and purchase products. Unleashed, it can be a game changer, and we are still in the innovation stage of retail on the Internet, with new retail business models benefiting consumers, retailers, and the overall economy.

The Internet is part of every serious 21st century retail strategy—whether massive "brick and click" retailers with websites and big box stores, large remote Internet and catalogue retailers with nationally known brand names, or small businesses who are building new Internet businesses or integrating the Internet into an existing small shop to survive and grow in today's highly competitive retail environment.

The Internet is also used by manufacturers, including the most elite and specialized, to reach customers with information, and more and more with products. And the Internet is critical to more consumers every day. It is the greatest source of product information ever created.

I mention these facts because sometimes people paint this issue as being about Internet retailers and discounters on one side and non-Internet retailers on the other. Nothing could be further from the reality. In short, everyone in retail uses the Internet, but there are big differences in how the Internet is used.

On one side are established networks of manufacturers and retailers who want to reinforce or enhance established retail business models. They are threatened by the Internet when it is harnessed to offer consumers better deals and more information outside the established incumbent retail networks. On the other side are innovators with new business models. They are almost always small to mid-size businesses. They use new technologies to offer consumers better deals, more information, and new services.

We believe that the *Leegin* decision is undermining consumer benefits delivered by innovative retailers, especially on the Internet. There is evidence that small and mid-size Internet retailers are a primary target of aggressive RPM policies.

eBay's own experiences confirm that many large established businesses attempt to limit low-price, intra-brand competition by continually scanning our platforms to identify sellers offering their products at lower prices. They then use a range of tools to identify the seller and stop low-price competition. Many eBay sellers have been targeted by manufacturers and large retail partners with various tactics to take down their listings and discredit their sales. The *Leegin* decision has clearly been interpreted by many as a legal "green light" to more aggressively thwart low-price competition.

Established retailers and manufacturers attempting to enforce traditional business models contend that the innovative Internet retailers are able to offer lower prices to consumers because they free ride on their traditional retail counterparts. The truth is that the Internet turns the traditional free-rider justification for RPM on its head. Internet retailers and services provide significant presale information to consumers. The open Internet has completely revolutionized the consumer information experience. Consumers regularly turn to the Internet to search for product information, make product comparisons, and check prices before visiting and purchasing from established retailers. In fact, it could be argued that the most established manufacturers and largest retail partners are free-riding on the tremendous consumer information tools created by Internet innovators.

From a competition policy and consumer benefit perspective, the traditional free-rider argument for RPM policies as applied to the Internet should be put to rest. Innovative Internet retail models simply expose incumbents to new competitive threats and more innovative forms of retailing. Protection from new and innovative retail models was always a likely reason for RPM, and we think that is even more true in the Internet age. This Committee should aggressively scrutinize the *Leegin* decision and enact S. 148 to reinstate a per se rule against retail price fixing and protect consumers and retail innovators.

Thank you, Mr. Chairman and members of the Subcommittee.

[The prepared statement of Mr. Cohen appears as a submission for the record.]

Chairman KOHL. Thank you, Mr. Cohen.

Mr. HAIGNEY.

**STATEMENT OF STACY JOHN HAIGNEY, GENERAL ATTORNEY, BURLINGTON COAT FACTORY, BURLINGTON, NEW JERSEY**

Mr. HAIGNEY. Good afternoon, Mr. Chairman and members of the Subcommittee. I am Stacy Haigney, general attorney at the Burlington Coat Factory. I am personally in charge of our trade regulation. I am very delighted to have this opportunity to come here and express my company's support for S. 148, which will address an extremely serious competitive issue in the market and foster consumer welfare immeasurably.

I believe that the story of Burlington Coat Factory is the best evidence I know for why S. 148 should pass. Burlington Coat Factory was founded by Monroe G. Milstein in 1972. He had one store at that time. It was a discount store. What he did was at that point sold coats 25 percent below what they would be available in department stores. Then in 1975, Congress repealed the so-called fair trade laws. This opened up a world of opportunity for Mr. Milstein and his company. He not only sold coats thereafter; Burlington Coat Factory sold every kind of apparel and accessory that you can think of. And we sold them all according to Mr. Milstein's original philosophy, namely, give the customer full lines of in-season merchandise such as one would find at a department store for 25 percent below, approximately, what was being charged at the full-price retailers. This philosophy was the basis of Burlington Coat Factory's success, and we have gone from the one store in 1972 to approximately 400 today, including at least one in the State of every Senator on this Subcommittee.

But there was no possibility that this approach would have worked had the fair trade laws not been repealed. In fact, there were no retailers like Burlington Coat Factory prior to that repeal—retailers of the size of Burlington Coat Factory.

There is no doubt in my mind—or in Mr. Milstein's mind when he still ran the company, or in Tom Kingsbury's mind, who is now our CEO—that had the *Leegin* case been in force in 1975, we probably would have stayed in one store on Route 130 in Burlington, New Jersey.

Now, I feel that the retail market has done pretty well in the intervening years, and all of a sudden, in the year 2007, apropos of no need that I can see, the Supreme Court decided to deep-six 98 years of antitrust jurisprudence by the *Leegin* decision. And in aid of what? As I understand them, the concept is that maybe if you fix prices at a high level, perhaps the retailer will take some of the extra money the retailer earns and maybe apply it to services which might be of use to the manufacturer. For this, we throw away 98 years of antitrust jurisprudence and what the Congress has stated over and over again. Many times, the question of whether or not this per se rule should remain the rule has come before Congress, as it did in 1975, and on every occasion Congress has adhered to the per se rule. And in 1975, it had tremendous bipartisan support before President Ford signed the bill. And the reason was that the empirical evidence was overwhelming that retail price fixing, as Ms. Harbour pointed out, was a catastrophe for competition and for the consumer.

Now, I have to say that it is grotesque from the point of view of an off-price retailer to even hear someone say that higher prices can lead to more competition. I frankly do not get that point. It certainly is not—in the apparel industry, it is a complete non sequitur.

Finally, let me just state—I see my time is running out—that there are no free riders in the apparel industry. People do not need advance services to help them put on a coat and try on a dress. Our customers are well educated, and what they want is the best bargain available. And that is what Burlington Coat Factory gives them, and that is what S. 148 will guarantee that Burlington Coat Factory will continue to give them in the future.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Haigney appears as a submission for the record.]

Chairman KOHL. Thank you, Mr. Haigney.

Now we call on Mr. Wilson.

**STATEMENT OF JAMES A. WILSON, PARTNER, VORYS, SATER, SEYMOUR AND PEASE LLP, COLUMBUS, OHIO, AND CHAIR, SECTION OF ANTITRUST LAW, AMERICAN BAR ASSOCIATION**

Mr. WILSON. Thank you, Mr. Chairman, members of the Subcommittee. On behalf of the American Bar Association, which has over 400,000 members, I thank you for the opportunity to appear this morning. As Chair of the Antitrust Section of the American Bar Association, I have been authorized to express the views of the ABA on this important issue.

In contrast to the other witnesses this afternoon, Mr. Chairman, the ABA's position is that the *Leegin* decision was correctly decided.

In February of 2007, the House of Delegates of the American Bar Association adopted the resolution proposed by our Section, which stated that Section 1 of the Sherman Act should not be interpreted to apply a rule of per se illegality to agreements between a buyer and a seller setting the price at which a buyer may resell goods or services purchased from the seller.

You may ask: Why did we propose that position? And why did the ABA adopt it? We derived this position from the basic principle of antitrust jurisprudence that the rule of reason identified in *Standard Oil of Ohio* v. *United States* in 1911 is the fundamental standard that governs the evaluation of all restraints of trade. Any departure from the rule of reason standard must be based on a demonstrable economic effect rather than formalistic line drawing. Only when a specific type of restraint produces a predictable and pernicious anti-competitive effect and has limited potential for pro-competitive benefit will and should the Supreme Court deem it unlawful per se.

The Supreme Court's decisions over nearly a century since adopting the rule of reason standard have carefully examined the pro-competitive and anti-competitive effects of special practices to determine whether they warrant treatment as anti-competitive behavior under all circumstances and are thus classified as per se, or if they in some situations show pro-competitive benefits and, therefore, should be evaluated under the rule of reason.

Like many of these vertical restraints that the Supreme Court in recent years—that is, over the last 30 years—has found should be evaluated under a rule of reason test, minimum resale price maintenance agreements may stimulate competition among resellers in ways that produce material benefits to consumers which would not otherwise be available absent the ability of manufacturers and distributors to set resale prices.

As outlined in our report to the House of Delegates, there are several reasons that the Section on Antitrust Law believes that the issue of resale price maintenance should not be a per se violation of the antitrust laws.

First, most of the significant economic literature regarding minimum resale price maintenance finds that it is more likely to be used by manufacturers to achieve efficiencies in distribution of their products rather than to enable dealers to maintain significant margins.

Second, empirical studies of minimum resale price maintenance have not established that the practice is invariably anti-competitive. And I would specifically point to work that was done by the FTC staff in the 1980s and the early 1990s that made that finding that there are many occasions in which resale price maintenance is not anti-competitive.

Third, manufacturers and suppliers have developed practices of achieving the same effects of minimum resale price maintenance without actually entering into agreements on resale pricing. This testimony that I have heard today about the dramatic shift that would be attained by this legislation simply does not square with how the market worked before the *Leegin* decision. The reality is that as long as the *Colgate* doctrine allowing individual manufacturers and distributors to choose to whom they will sell exists, the effects that I have heard from the other witnesses today are unlikely to be achieved.

Finally, the per se prohibition on minimum resale price maintenance, in force for several decades, has had the effect of enhancing the market power of very large-scale retailers that carry a wide variety of products. Conversely, it has harmed smaller retailers who try to compete with those large retailers not on price, where they cannot compete, but on the basis of quality and service. For these reasons, the ABA supports the position that under the Federal antitrust laws, agreements between a buyer and seller setting the resale price should not be per se illegal.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Wilson appears as a submission for the record.]

Chairman KOHL. Thank you, Mr. Wilson.

Senator Klobuchar.

Senator KLOBUCHAR. Thank you very much, Senator Kohl, for holding this interesting hearing, and I know you bring to this hearing your perspective as a retailer yourself, as someone who owned stores. I bring the perspective of a shopper at stores, so I think we make a good pair here looking at this issue. And I think especially now when we have consumers who are so strapped, it is very important, Ms. Harbour, to look at this. And I am very glad the FTC is holding these workshops to try to figure this out because, for a lot of my constituents, every penny counts right now. Every penny saved counts. And so they are looking at these things. Even though they may not understand what the *Leegin* decision is or have understood this idea of vertical price fixing, I think we owe it to them to look at this very carefully.

Ms. Harbour, how much do you know right now about the impact of the *Leegin* decision? Your written statement and in what you said today mentioned that a number of companies engaged in resale price maintenance has significantly increased, and that some suppliers have stopped working with some suppliers. Can you tell us more about what hard evidence you have? And do you think that this financial crisis also, that we have to look at that separately?

Ms. HARBOUR. At this point I do not have any additional hard evidence, but we are at the Federal Trade Commission holding workshops. We will be looking very closely at this issue. Since the *Leegin* decision came down, it has been about 2 years. Maybe we will start seeing some natural experiments where we can look at the effects of this ruling. But what I testified to, we have seen that. There have been some discussions in some of the newspaper articles, the Wall Street Journal, about the use of some of the shopping bots that are trolling and policing the Internet and going back to the manufacturers and letting them know about price, and then those discounters are being disciplined and prices have been increased to the consumer. So the effect that we do know about is that prices to the American consumer have indeed been elevated. As far as additional effects, we will be looking very closely for some of those.

Senator KLOBUCHAR. OK. Mr. Cohen, do you want to talk, adding to what Ms. Harbour said, about just your perspective about prices? Do you have any numbers on the rise of resale price maintenance being used against Internet retailers? And are these numbers different for retailers that are 100 percent based on the Internet like amazon.com versus multi-channel retailer stores that have an extensive Internet presence?

Mr. COHEN. Senator Klobuchar, we have two different examples that we believe show the pernicious effect of the post-*Leegin* world. First is an increase in the number of takedown reports we receive from different companies and agents of rights holders and brand owners in which they have increased the number of complaints we have received to take down lower-price listings. A company called Net Enforcers sent in over 1.2 million notice and takedown requests to our site in which a significant number were based on lower prices. We have seen that, in a post-*Leegin* world, different manufacturers have admitted that the reason why they were seeking information on our sellers was because of a violation of MAP or retail price minimum standards.

We are also engaged in research ourselves to see whether there has been a change in pricing over time in specific categories. We have not completed that research. When that is completed, we will submit that immediately to the Committee.

Senator KLOBUCHAR. Very good. This is when Justice Breyer issued his dissent in the case, I know that this is—I know when he issued his dissent, he talked about that the only safe predictions to make about today's decisions are that it will likely raise the price of goods at retail. And to me, right now when we are in this difficult consumer market, especially when there is actually slashing of prices going on because of the market, if we are seeing increases, I think they could be even worse if we were not in hard economic times. So I think it is important when we look at these numbers we consider that as well.

Mr. Wilson, I listened to your testimony, and I guess I would have one question. If we, in fact, found out that the prices have increased, as Ms. Harbour believes they have, would that be enough for you to believe that we need to reexamine this *Leegin* decision and look at legislation, as Senator Kohl has introduced?

Mr. WILSON. Senator, I guess the question I would ask is whether the prices had increased and the current law was ineffective, because, after all, resale price maintenance is not per se legal today. It is simply evaluated under the standard by which most anti-competitive conduct is evaluated—the rule of reason.

If resale price maintenance is as pernicious as the other witnesses have said, it should be very difficult to present a defense to a rule of reason case. After all, the defense in a rule of reason case is proof that there are pro-competitive effects here.

What I have seen is that the courts since *Leegin*—there have been about 60 decisions citing it, less than half of them in actually applying the rule of reason, but they have not created some awkward or weak rule of reason test here. They have applied a rule of reason test that is consistent with how it is applied in other areas. We look forward as a Section to offering our comments to the FTC in their workshops on exactly that area.

Senator KLOBUCHAR. And I appreciate that, that the courts may have been reasonable in doing their rule of reason. But I think our role here and our duty and the FTC's duty is beyond that, and it is really looking at if there has been a bad effect on consumers because of this. And right now, my view is we just cannot hit on consumers anymore, that they have had it. They are having very difficult economic times, and so that is why I think the workshops that the FTC does and other evidence that we have here is very important, because if—you know, this was a very close Supreme Court decision with a vigorous dissent, and this is really in the end a policy matter for the Congress to consider.

So I appreciate what you have said about the rules, but I think if we saw some pattern here of increased prices, as we saw back in—who was bringing up 1975 and what had happened? Mr. Haigney.

Mr. HAIGNEY. Yes, in 1975, there was extensive empirical evidence presented to the Congress to show—and I think Ms. Harbour actually cited the figures—to show a drastic increase in prices in States that continued to free trade, so-called, and a diminution in sales in those States. These were hard-core numbers, not just economic——

Senator KLOBUCHAR. Do you think it would be useful if we want to have that kind of clear, empirical comparison? Maryland has just passed their law and gone back to the old way. Do you think it would be useful to have more States do this?

Mr. HAIGNEY. It would certainly be better than nothing, but I would much prefer——

Senator KLOBUCHAR. You would prefer it done nationally, federally. It would be a lot easier than creating a national study for us to look at.

Mr. HAIGNEY. That is right.

Senator KLOBUCHAR. OK. Anyone want to add to any of that?

Mr. WILSON. Senator, if I could, I would just point out that if you adopt the rule that the legislation proposes, then pro-competitive effects are no longer considered. And so you have in effect lost any pro-competitive effects that exist today.

Ms. HARBOUR. May I address the pro-competitive effects and the statement about the empirical evidence that is out there and also the Federal Trade Commission and some of the empirical work it has done as well.

None of the empirical studies to date are definitive, and there is an acknowledged empirical vacuum that leaves all of these competing theories untested. It was referenced about a Federal Trade Commission study. It was done by a very well-respected economist, Pauline Ippolito. That study basically found that there was no basis for concluding that minimum RPM is anti-competitive. But I want to note that Pauline Ippolito herself acknowledged that her study did very little to fill the empirical vacuum, and her study did not test for the hypothesized consumer benefits directly. So it did not test for the consumer benefits. It only determined whether the pro-competitive explanations had what she said "limited plausibility."

So, basically, these studies are not definitive, and also Justice Breyer in the *Leegin* dissent discounted the study by saying that it equated the failure of plaintiffs to allege collusion with the absence of collusion, and basically it overlooked the tacit form that collusion may take. So these studies are not definitive, and they have been cited as being so, but they are not.

Senator KLOBUCHAR. All right. Thank you very much. I appreciate that.

Thank you, Senator Kohl.

Chairman KOHL. Thank you very much, Senator Klobuchar.

Well, you all know where I am coming from on this piece of legislation, obviously. I am the sponsor of it. But I want to take a look at it from another point of view, and that is the point of view of the manufacturer who goes to great pains and at great length and at great expense to build a product and a brand into something that is desired by consumers, in many cases regardless of the high price, but the manufacturer has done such a good job of appealing to consumers on the basis of the quality of his brand that consumers go way out of their way to find that product and buy it, regardless of its price. And that adds to the manufacturer's prosperity as well as to the store that is selling it because they are not discounting it. But it is a model, a way of doing business, you know, it is a free country, and people have a right to do that. They can be successful.

Now, under our legislation, what is likely to happen? Well, discounters will buy the merchandise and beat the hell out of the price, you know, and draw customers thereby, but also make it very, very difficult for the traditional retailer to maintain their price and for the manufacturer to have the price maintained as he or she might wish to do; after all, it is their product.

And the manufacturer, by virtue of, let's say, discounters selling maybe 10 percent of the brand, but driving the price so low in the minds of customers and thereby making it very difficult for traditional retailers to carry that brand at a maintained price, that the manufacturer could lose an enormous amount of business just by virtue of the fact that a very limited amount of discount retailers are driving the price of that particular brand, merchandise on that brand, a category in that brand, right down into the basement.

Now, is that fair? Is that fair to the manufacturer, you know, who, after all, built his business, certain ideas, certain concepts, does business with traditional retailers who maintain the price, and here he is in a position whereby a limited amount of discounters can almost kill that category for the manufacturer at a profitable price? Is that fair? Doesn't the manufacturer have a right, once he produces a product, to have that product sold at a price that he regards as fair? What is wrong with that, Mr. Haigney.

Mr. HAIGNEY. Well, Mr. Chairman, long before *Leegin* was decided, the Supreme Court decided the case of *Sylvania*, and in that case it gave the manufacturer all the power anyone could reasonably want to control its distribution. The only power that it did not give to the manufacturer was the power to control price. But it overruled the *Schwinn* case, which had made vertical restraints per se violation, and the *Sylvania* case made effectively all vertical restraints except price fixing into per se legal restraints.

The result is that the manufacturers, if they want their merchandise sold in only the fanciest stores, just sell to the fanciest stores, cutoff dealers who try and depart from this distribution scheme. There is nothing wrong with it under *Sylvania*, and there are plenty of products out there that Burlington Coat Factory cannot have because those manufacturers want to maintain the snob appeal of their product. Perfectly legitimate, and I have no argument with it. But the important point is that this right was given to the manufacturers by *Sylvania* in 1977. The *Leegin* case is a complete non sequitur. The additional power to fix the price adds nothing to the powers of vertical restraint that were given to the manufacturers by *Sylvania*.

Chairman KOHL. All right. But let me follow that up. So you are saying that even prior to *Leegin*, manufacturers had a way of keeping their goods out of the hands of discount retailers if that is what they wanted to do?

Mr. HAIGNEY. That is correct, Mr. Chairman.

Chairman KOHL. And yet you said during your testimony that had *Leegin* been in effect, Burlington would not be here today. But what is the difference? If manufacturers had the power prior to *Leegin* to keeping whatever merchandise they want out of the hands of discount retailers, then what did *Leegin* do except to certify that?

Mr. HAIGNEY. Well, first of all, Mr. Chairman, they had the power, they had the right, but they did not exercise it. They wanted to sell—there are a few manufacturers who do not want to see their merchandise in off-price stories, and that is their right. But most do want to see—most people are very happy to sell us their merchandise. We pay the same price as any full-price retailer, and most manufacturers are happy to get that price, particularly in a time like the present. And so, yes, they could have, theoretically, prevented us from getting the merchandise, but they did not because they did not want to.

Chairman KOHL. Well, they do not have to, even under *Leegin*. What has changed?

Mr. HAIGNEY. Absolutely. They could still——

Chairman KOHL. I guess what I am trying to understand from the point of view of a retailer, if prior to *Leegin* the manufacturer could keep the merchandise out of the hands of a discounter and now that we have *Leegin* they can still keep their merchandise out of the hands of the discounter, what has changed?

Mr. HAIGNEY. Well, what has changed is that those manufacturers, who are the majority, who do sell to stores like Burlington Coat Factory would have the power suddenly—or have the power under *Leegin* to fix our retail prices. Now we are an "off-price retailer." Our entire competitive philosophy is based on giving value and low prices. So if the manufacturer can now, in addition, he can let us have the merchandise, but we must sell it at the same price that it is carried at a full-price retailer, that would put us out of business, at least with respect to that line of goods.

Chairman KOHL. Yes, but—and I do not want to push this too far. I just want to make it clear. Prior to *Leegin*, he still, as you have said, could decide not to sell the merchandise to a discounter.

Mr. HAIGNEY. That is right, or to anybody.

Chairman KOHL. Yes, Ms. Harbour, what has changed? Why is *Leegin* such a poisonous thing if prior to *Leegin* that merchandise could still be kept out of the hands of a discounter by a manufacturer acting in an intelligent way?

Ms. HARBOUR. What is poisonous about *Leegin* is that going forward there will be no more Burlington Coat Factories. There will be no more Costcos. There will be no more Walmarts.

Chairman KOHL. OK.

Ms. HARBOUR. That is the danger. These innovators, these low-cost retailers, these Internet innovators, they will not exist now because they will not have the opportunity to enter the market. That is what has changed.

Chairman KOHL. That is a good point. You are saying *Leegin* cuts off or seriously damages the possibility of the new discounter even getting a foothold.

Ms. HARBOUR. For instance, if you are on the Internet and you want to sell a branded product below cost to get a consumer following, the manufacturer can cut you off at the knees, and you never can get a toehold into the market. That is what is so pernicious about *Leegin*.

Chairman KOHL. That is a good point.

Mr. Cohen.

Mr. COHEN. Mr. Chairman, I also think that the internet created the very visibility and price transparency that manufacturers need to police the internet in a way that would have been impossible in the pre-*Leegin* world. We believe the ability to see pricing every day in real time has put a dampening effect on inflation, and really drives prices down. But that has also allowed people who want to enforce their pricing schemes to go after discounters and, more importantly from our perspective, find out where there were leaks in their distribution chain. Manufacturers are under intense pressure from other larger retailers to not allow any discounting, and then, therefore, they go after our small sellers and try to find out exactly who those small sellers are, which they would not have been able to do in a pre-*Leegin* world.

Chairman KOHL. Mr. Wilson.

Mr. WILSON. Yes, Senator. I guess I do not fully agree with the economic premise that the other witnesses have suggested exists here.

First of all, let us remember that this manufacturer in your hypothetical is presumably working in a competitive marketplace. Therefore, that manufacturer has to make certain decisions as to how they are going to go to market. Are they going to go to market as the lowest cost, or are they going to try to create the perception of quality in your hypothetical? If it is the latter, then their perception of quality gives every other manufacturer either the incentive to increase their quality or decrease their price. So overall in the marketplace, in your hypothetical, prices should decrease or quality should increase or both.

With respect to the notion of what difference does *Leegin* make in this, where I believe it makes a difference is it allows the manufacturer to continue the relationship with the discounting retailer. Under the pre-existing law, the manufacturer in effect had to execute the death penalty in its relationship with that retailer. It had to say, "You have sold at below the prices I have suggested. I am no longer going to do business with you, period." And those manufacturers were at risk if they did that and then reestablished a relationship because courts would presume an agreement from that back-and-forth relationship.

After *Leegin*, what the relationship is in effect is that the manufacturer can again say, "You do not have my permission to do that. You have violated our agreement. We have a contractual dispute here. I can terminate you or I can simply have a contractual dispute with you and continue to do business with you."

Chairman KOHL. Ms. Harbour.

Ms. HARBOUR. May I address that? I think that RPM protects inefficient retailers. If you have a minimum resale price policy, you could have Retailer 1 selling a quality good, but Retailer 2, because they would be protected in that intra-brand competition, the quality could be sub-par, yet they could still charge the resale price, maintained price, and not in effect keep the product at top quality. So I think it has the potential to protect retailers who are not selling top-quality intra-brand merchandise.

Chairman KOHL. Mr. Cohen.

Mr. COHEN. Mr. Chairman, may I submit to the record a letter one of our sellers received from a company called Captive Works, where they said, "Dear David, Please do not list the receiver less than $149; otherwise, it will be reported and taken off. We need to have a steady price from all the sellers so everybody will be making money. Your prices were less than everybody else, and if you see someone else with a lower price, be sure that they will be taken down soon. Thanks. Raffi."

So that is the real-world experience that our sellers are experiencing every day, rather than the hypothetical and theoretical viewpoint of antitrust experts about inter-brand versus intra-brand competition. We have to live with the reality that lower prices are not being able to be delivered to buyers.

Chairman KOHL. Yes, Mr. Haigney.

Mr. HAIGNEY. Yes, Mr. Chairman, just quickly to respond to Mr. Wilson, his hypothetical does not coincide with the real world that I know, at least speaking in the apparel off-price world. He said that the manufacturer could fix a high price with the consent of the retailer and go on and do business afterwards. And the reality is that when your principal means of competition is low prices, you simply cannot continue to do business with that person. I mean, the fact of the matter is Burlington Coat Factory cannot sell at those prices and be Burlington Coat Factory. And I do not think any other off-price merchants who roughly have our business model could either.

I also question the whole idea that the manufacturer's notion of distribution should always be paramount and that retailers—who, after all, are the ones who actually sell the product and know the customers—somehow under the *Leegin* majority, our views are not considered legitimate. Only the manufacturer has the right to determine what is going to happen to a product, which is our property by the time that we are reselling it to the public.

Chairman KOHL. You know, Mr. Wilson, historically we have been a consumer-driven society, a consumer-driven economy—we still are; 80 percent of our economy are—people who are buying goods on a daily basis, and competition has very much defined the growth of the American economy. It very much defines capitalism, competition. Naturally, people who are in a position to try and do business without having to deal with competition, that is the way they want it. But in our capitalistic society we try to encourage competition, thinking that is the best way, although not perfect, the best way to proceed.

And that is what pre-*Leegin*—or if we ever get to post-*Leegin*, that is the premise, that competition is the best way to drive the American economy and serve the American consumer while still preserving the rights of all manufacturers to try and make a profit in that kind of a context. And pre-*Leegin*, as we have now established, there is still a way—or was a way or would be a way even under our legislation for a manufacturer to elect not to do business with a discounter as long as they cut off that discounter without saying it is because of price and price only. You know that.

But isn't that a reasonable balance, to encourage competition, to set up rules and regulations that will allow for competition based on price, among other things—service, quality, but also price? But also preserve the right of a manufacturer when he or she decides that they do not want to do business because that person is cutting the price too much? They can find a way not to do business. Isn't that a decent balance? What is your problem with that?

Mr. WILSON. Well, Senator, let me first of all say that our Section and the ABA fully endorsed the notion that competition needs to be the basis for our economy and our society, and I think notwithstanding recent events, we have proven that competition is the best way to have a thriving economy.

Our concern in the legislation is that in establishing a per se test, it eliminates the ability for courts to recognize situations in which the pro-competitive benefits of a particular resale price maintenance arrangement outweigh the anti-competitive effects. In situations where such pro-competitive benefits outweigh the anti-competitive effects, consumers benefit from the resale price maintenance.

The Section and the ABA have never taken the position that resale price maintenance should be per se legal. Our view is simply that the sound rule of antitrust, that the balancing of anti-competitive and pro-competitive effects should apply in this arena as it does in virtually every other arena of our economy.

Chairman KOHL. Ms. Harbour.

Ms. HARBOUR. I would just like to respond to that. Mr. Wilson was talking about the pro-competitive benefit of resale price maintenance. I guess what I would say is then the proponents of them should prove it. That is really all I am asking here. Why put the thumb on the scale on the side of the business that is imposing this RPM? Give the consumer the benefit of the doubt. And that is what we have not seen. We have not seen the proof of the pro-competitive benefits of those manufacturers who are imposing the RPM. What we get is we get theoretical assumptions about what those benefits are. All we are asking, prove it. Even in *Leegin*, the Supreme Court did not make, you know, the proponents of the RPM in *Leegin* to prove what those benefits were for the ladies' handbags. So going forward, if you shift the burden of proof, shift it from the victim, shift it from the consumer. Shift it onto the manufacturer who is imposing the RPM. Let them bear the burden of proof for the elevated prices that they are foisting on the American consumer.

Chairman KOHL. Good. Anybody else have another comment to make?

Mr. Haigney.

Mr. HAIGNEY. Yes, Mr. Chairman, just briefly on the rule of reason now, let me say this: Plaintiffs do not win rule of reason cases in this field. The rule of reason requires the plaintiff to prove an immense amount of economic data. He has to prove what the market is. He has to prove that the defendant has power in that market. He has to prove that competition as a whole within that market was somehow harmed by the individual act harming this plaintiff.

Now, most plaintiffs in these cases are small companies who are starting out trying to get a foothold. They have their most important line cut off because of their unwillingness to live up to a price-fixing agreement.

They go to court. Now, when it was per se, all they had to do was prove the existence of the price-fixing agreement and the fact that they were cut off because they did not follow it, and then add up their damages of how much they lost. That little company could probably bring that lawsuit with the local lawyer, and probably that guy might take it on spec. To win a rule of reason case, that local company would have to hire—I do not know—ten economists, really high-level attorneys, and launch a 2-, 3-, 4-year exploration of whatever market it happened to be. That is, if he could satisfy the very strict pleading requirements of the *Twombly* case and other decisions of the Supreme Court that have pretty much put plaintiffs out of business at the pleading stage.

So the per se rule is not the way to go—I am sorry. The rule of reason is not the way to go. The per se rule is the only way that a small plaintiff could ever get a remedy for RPM's anti-competitiveness.

Chairman KOHL. Thank you.

Anything else, folks?

[No response.]

Chairman KOHL. I think it has been a good hearing. I think we have laid out the pros and cons of the issue, and it is really important to our American economy to try and come up with the right decision on this. In that sense, this hearing has been very informative. I appreciate your coming.

Thank you so much.

[Whereupon, at 3:40 p.m., the Subcommittee was adjourned.]

[Questions and answers and submissions for the record follow.]

# QUESTIONS AND ANSWERS

**American Bar Association Response to**
**Follow-Up Questions from Senator Kohl for Hearing on "The Discount Pricing Consumer Protection Act: Do We Need to Restore the Ban on Vertical Price Fixing?"**

Thank you again for the opportunity to testify on behalf of the American Bar Association in the Subcommittee's hearing. Below I have tried to answer the questions you raised in your letter of June 1, 2009.

*1. You testified that you did not believe that ending the per se ban on vertical price fixing would lead to higher prices. But there is substantial evidence that vertical price fixing in fact leads to higher prices. For 40 years prior to 1975, federal law permitted states to enact so-called "fair trade" laws allowing vertical price fixing. These laws were abolished by the passage of the Consumer Goods Pricing Act of 1975. Numerous studies prior to the passage of that law in 1975 documented the fact that retail price maintenance leads to higher prices. Studies conducted by the Department of Justice in the late 1960s indicated that retail prices were between 18 and 27 % higher in states that allowed vertical price fixing than those that did not. And, in his dissenting opinion in the* Leegin *case, Justice Breyer estimated that if just ten percent of products were subject to vertical price fixing, would affect $ 300 billion dollars in commerce, raising the average bill a family of four would pay for retail goods by $ 750 to $ 1000 every year. What is your response to all of this evidence?*

**Response:** The studies to which you referred are among many that have been conducted on the effects of vertical price fixing, and others studies have reached different results. Collectively, the studies show that minimum resale price maintenance can have mixed effects – in some instances it can be procompetitive, and in other instances it can have anticompetitive effects that produce higher prices. Because resale price maintenance can be benign or procompetitive, rule of reason analysis is the appropriate way of measuring these mixed effects. If resale price maintenance produces anticompetitive effects, it can be found unlawful under the rule of reason.

Many economic studies have reported or predicted that resale price maintenance will lead to higher prices, but those studies that are based on analysis of actual market effects all use data from the fair trade era – from passage of the Miller-Tydings Fair Trade Act in 1937 to passage of the Consumer Goods Pricing Act of 1975. These studies, which include those to which you referred in your question, were summarized in a 1983 staff report of the Federal Trade Commission's Bureau of Economics prepared by Thomas R. Overstreet, Jr.[1] The results are actually far more equivocal than has been portrayed by supporters of a return to the *per se* rule for minimum resale price maintenance.

Several of the studies reviewed by Overstreet showed that resale price maintenance had mixed effects. In a 1938 study of 50 drug products sold by drug retailers in New York State, the data showed that, after passage of fair trade legislation, prices increased for nationally advertised

[1] THOMAS R. OVERSTREET, JR., RESALE PRICE MAINTENANCE: ECONOMIC THEORIES AND EMPIRICAL EVIDENCE (F.T.C. 1983).

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goods sold in discount stores, but fell slightly for the same items sold in non-discount stores.[2] Prices for those items that were not nationally advertised did not seem to be affected.[3]

In a study of the effects of the 1970 repeal of fair trade legislation in Rhode Island, retail prices on five of the nine product lines surveyed were not affected by repeal.[4] For the four product lines that showed price declines, price reductions were not universally implemented. Many smaller retailers simply held their prices unchanged and reduced their inventories and selections from the product line.[5]

In a 1945 FTC study of pricing for drug and food products in selected cities, the data showed that use of resale price maintenance had mixed results. After passage of fair trade laws, prices of vegetable oil shortenings increased in chain and department stores but declined in individual stores.[6] Prices of soap products and cake flour increased in supermarkets but fell in individual stores, and for other grocery products there was no observable change in prices.[7] For products sold through retail drug stores, the data showed that prices decreased at individual stores in medium-sized and large cities.[8]

Overstreet concluded that resale price maintenance can have diverse effects,[9] and the empirical evidence indicates that it did not, during the fair trade era, lead uniformly to higher retail prices for consumers. We question the value of the fair-trade-era studies because they are dated and took place under very different circumstances. They should not, in any event, be used in making predictions about resale price maintenance in the current marketplace, for the following reasons.

First, fair trade laws were not equivalent to an antitrust regime that provides rule of reason treatment for resale price maintenance. Resale price maintenance in today's economy depends on the willing acquiescence of both seller and retailer; under the fair trade laws of certain states, a resale price maintenance agreement with *one* retailer in a state could bind all other retailers, whether they agreed or not.[10] The competitive effects of that regime would obviously be very different from those flowing from a resale price maintenance agreement between a manufacturer and its dealers today.

Second, the retail landscape in the U.S. is considerably different today than during the fair trade era, and it is improbable that a manufacturer could impose resale price maintenance on big box discount stores like Wal-Mart, Target or Best Buy unless the stores were satisfied that the pricing was competitive. These types of large multi-brand retailers, which account for a significant part of the consumer economy,[11] have buying power that "trumps even the power of a

[2] *Id.* at 107.
[3] *Id.*
[4] *Id.* at 127.
[5] *Id.* at 128.
[6] *Id.* at 137.
[7] *Id.*
[8] *Id.* at 137-38.
[9] *Id.* at 163.
[10] *See* 1A CALLMANN ON UNFAIR COMPETITION, TRADEMARKS AND MONOPOLIES § 6:3 n.4 (4th ed. 2007).
[11] Wal-Mart is said, for example, to account for 22% of all toys sold in the U.S. *See* Warren S. Grimes, *Buyer Power and Retail Gatekeeper Power: Protecting Competition and the Atomistic Seller*, 72 ANTITRUST L.J. 563, 580 (2005).

supplier of a major brand."[12] As one commentator has noted, this kind of retail buying power gives the large retailer control over "whether [items] will be *priced* or marketed aggressively," and this, in turn, gives it "substantial leverage in dealing with even the largest producers of strong brands of consumer products."[13] To the extent that empirical studies from the fair trade era indicate that resale price maintenance resulted in higher prices, the findings cannot be extrapolated to support predictions about what the effects would be in the current economy.

Sale of branded goods through off-price discounters has become such a deeply embedded retail channel that off-price discounters, similarly, are not likely to be affected by the change in treatment of minimum resale price maintenance from *per se* to rule of reason. This was suggested in a July 6, 2007 article in USA TODAY that looked at the effect of *Leegin* on the sale of discounted apparel brands.[14] The authors concluded that the impact of the Court's decision on off-price retailers was "likely to be slight," and we have seen no studies or analyses that would suggest that the Court's approval of rule of reason treatment for resale price maintenance has had any effect on availability of goods through off-price retailers, whether selling apparel or other goods.

Nor are there any studies of which we are aware analyzing the effects of resale price maintenance agreements on consumer prices since the *Leegin* decision. One of the witnesses before the Subcommittee, Stacy John Haigney, stated that his employer, Burlington Coat Factory, has experienced no negative impact from the decision.[15] He suggested that the weak economy may have "temporarily divested manufacturers of the power to dictate retail prices,"[16] but, whatever the explanation, there is no empirical evidence that the Court's decision has had any observable impact on retailers.

The baseline question is whether consumer welfare will be adversely affected by a change in how minimum resale price maintenance agreements are evaluated under the antitrust laws. While some manufacturers may find it advantageous to use such agreements to ensure that retailers provide amenities (e.g., atmosphere, convenient downtown locations – all of which are expensive) or services, any such agreements will have their effect on intrabrand competition among those selling a manufacturer's product.

*2. Under the* Colgate *doctrine a manufacturer is free to refuse to allow any retailer to sell its products. This doctrine would be unchanged by S. 148, the Discount Pricing Consumer Protection Act. Doesn't the availability of the* Colgate *doctrine satisfy any concern that reinstating the rule against vertical price fixing would prevent manufacturers from limiting the distribution of their products to store that provide the support and technical expertise that manufacturers require?*

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According to the Corporate Fact Sheet on its website, http://walmartstores.com/FactsNews/FactSheets/, (viewed June 9, 2009), Wal-Mart had 4100 facilities in the U.S. as of July 17, 2008.

[12] Grimes, *supra* note 11, at 579.

[13] *Id.* (emphasis added).

[14] Jayne O'Donnell & Christine Dugas, *Discounted Designer Labels Here to Stay; High Court Ruling Unlikely to End Off-Price Retailing*, USA TODAY, July 6, 2007, at B1.

[15] Statement of Stacy John Haigney at 12 (May 19, 2009).

[16] *Id.*

**Response:** Implicit in the reasoning of the ABA Resolution supporting the application of the rule of reason to resale price maintenance agreements is the view that the availability of the *Colgate* doctrine does not satisfy the concern that a per se rule against vertical price fixing could prevent manufacturers from limiting the distribution of their products to stores that provide the support and technical expertise that manufacturers require. Manufacturers that seek to institute *Colgate* programs are faced with considerable practical difficulties in administering them. These difficulties are largely driven by the necessity of avoiding any conduct that could be seen as being tantamount to an agreement between a manufacturer and a retailer. A useful portrayal of the contortions associated with *Colgate* programs is contained in the *amicus curiae* brief of PING, Inc. ("PING") filed in the *Leegin* proceedings (the "PING Brief"). There, PING, a manufacturer of golf equipment, described the administration of its *Colgate* policy as follows:

> To minimize the risks created by *Colgate*, PING drastically restricts employees' communications with the retailers to whom they sell and, worse, summarily terminates retailers for even the smallest policy violations, without considering whether the violation was intentional or why it occurred. PING employees as many as 12 full-time people who work on the *i*FIT Pricing Policy [which contained PING's *Colgate* policy] and related matters and has spent millions of dollars on the administration of the Policy since 2004.[17]

PING further noted that in order to avoid the possible characterization of any discussion with retailers as an agreement, no PING employees (including sales representatives), with the sole exception of in-house counsel, were permitted to engage in any communication concerning the company's *Colgate* policy. Indeed, PING noted that this created "substantial frustration" for its retail accounts, who were simply unable to communicate with their primary PING contact about any aspect of the policy, and were directed to deal with PING's counsel instead. One of PING's retailers described how this worked in practice:

> And, when [my PING Sales Representative] originally brought this policy to us in 2004(?) it was the most bizarre presentation ever. He handed it to me. I looked at it and tried to ask questions . . . all he kept saying was "I CAN'T TALK ABOUT PRICE" – "I CAN'T TELL YOU ANYTHING ABOUT THAT" . . . about 3 or 4 times. I tried to ask different questions about it, but he couldn't or wouldn't talk about it. I felt left alone to fend for ourselves.[18]

In the event that PING retailers contacted the company's in-house counsel to discuss aspects of the *Colgate* policy, they would often receive the following formalistic response:

> I recognize that the questions you asked, and the information you provided, in your email are not in any way intended to indicate any approval, agreement or any other assurance of compliance with respect to the *i*FIT Pricing Policy. However, if that was in any way your intent, please note that it is, and always will be, expressly rejected by PING. PING specifically provides at Section II of the *i*FIT Pricing Policy that: "PING does not seek, and will not accept, any account's

[17] PING Brief, p. 10.
[18] PING Brief, page 12.

approval, agreement or any other assurance of compliance with respect to this iFIT Pricing Policy and/or the Orange & Blue List." You need to decide on your own what you charge for the PING products you sell.[19]

The arrangements made by PING in dealing with its *Colgate* policy are not unique. Prior to the decision in *Leegin*, many other manufacturers in a broad range of industries had instituted similar measures which, in sum, did not achieve a pro-competitive purpose or enhance consumer choice or efficiency in any way. As a result, it cannot clearly be said that the availability of the Colgate doctrine satisfies the concerns associated with reinstating the rule against vertical price fixing in this regard.

*3. Defenders of the Leegin decision point out that the majority opinion in Leegin still permits antitrust suits against vertical price fixing if the party bringing the suit can prove that the practice was "unreasonable" and harmed competition. This is what is known in antitrust law as the "rule of reason."*

*You are an experienced antitrust lawyer, Mr. Wilson. What kind of showing would a plaintiff have to make to prevail in rule of reason case challenging vertical price fixing?*

*Among other things wouldn't the plaintiff have to show market power of the manufacturer imposing minimum retail prices? Wouldn't the plaintiff have to bring forward extensive economic studies detailing the effect on the market? How realistic is it for a smaller retailer competitor to have the resources to do this?*

**Response:** A plaintiff in a resale price maintenance case must show that the restraint has anticompetitive effects that outweigh any procompetitive effects of the restraint. It is not novel or unrealistic to expect a plaintiff to establish market power or actual anticompetitive effects. Plaintiffs have long been required to meet this burden through economic evidence when challenging other vertical restraints, such as tying, exclusive dealing, territorial restrictions and price discrimination, and the plaintiffs' antitrust bar has shown itself to be well equipped and highly experienced in the use of economics experts.

*4. Mr. Wilson, you represent the American Bar Association. Do you or your organization believe a Supreme Court decision is an appropriate way to reverse a century-old antitrust rule repeatedly reaffirmed by Congress? Does the Supreme Court have the economic expertise and the fact finding capability to make such a change in law, or such a matter better left to the legislative branch?*

**Response:** The ABA has not adopted a position as to whether the courts or Congress is better equipped to weigh and evaluate economic evidence. The ABA Policy upon which I testified was adopted prior to the *Leegin* decision, and supported reversal of *Dr. Miles*, and adoption of a rule of reason test. As noted in my testimony, the economic literature weighs heavily against condemning all minimum resale price agreements to per se illegality. Notable examples include Robert H. Bork, The Antitrust Paradox 32 (1978), and Richard A. Posner, Antitrust Law 189 (2d ed. 2001). *See generally* ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW AND ECONOMICS

[19] PING Brief, page 13.

OF PRODUCT DISTRIBUTION 37-76 (2006) ("the bulk of the economic literature on [minimum resale price maintenance] . . . suggests that [minimum resale price maintenance] is more likely to be used to enhance efficiency than for anticompetitive purposes"). The seminal treatment appears in Lester G. Telser, *Why Should Manufacturers Want Fair Trade,* 3 J. L. & ECON. 86 (1960), which explained why manufacturers would adopt minimum resale price maintenance to assure the efficient distribution and marketing of their products—by encouraging dealers to promote the product without fear of "free riding" by rival dealers of the same brand that cut prices and spend little or nothing on services. As this principle is described by Judge Posner, when dealers are forced to compete without cutting prices, they "vie with one another to provide presale services" and the manufacturer benefits. Richard A. Posner, *Legal Narratology,* 64 U. CHI. L. REV. 737, 738 (1997). The prevailing view among economists is that minimum resale price maintenance is more often adopted to serve the interests of manufacturers in achieving efficiencies in distribution than to serve the interests of dealers in assuring their margins. *See Business Electronics Corp. v. Sharp Electronics Corp., supra,* at 727 n. 2 ("[r]etail market power is rare" *citing* Baxter, *The Viability of Vertical Restraints Doctrine,* 75 Calif. L. Rev. 933, 948-49 (1987)).

*5. Is there any legislation you believe might be appropriate to limit vertical price fixing, or are you completely satisfied with the state of the law following the Leegin decision? Specifically, do you support proposals to retain a rule of reason approach to vertical price fixing, but to apply a presumption against the legality of the restraint?*

**Response:** The ABA has no position on alternate legislation but is prepared to review and perhaps comment on any such legislation that may be introduced. The ABA, and/or the ABA Section of Antitrust Law, as appropriate, plans to provide its input to the Federal Trade Commission as it explores the appropriate rule of reason approach in resale price maintenance cases.

*6. Virtually every other western industrialized democracy treats vertical price fixing as per se illegal, including Great Britain, Germany, France and many others. What does this experience teach us?*

**Response:** ABA has no position on the resale price maintenance rules of other countries, but notes that the standards are not as uniform as the question suggests. In fact, the United Kingdom, France and Germany actually do not apply what the U.S. would consider a per se test in evaluating resale price restraints – the test they apply arises out of European competition jurisprudence, and allows the party imposing the restraint to demonstrate its efficiencies. *See* Luc Pepperkorn, "Resale Price Maintenance and Its Alleged Efficiencies" 4 European Comp. J. 201 (2008). More fundamentally, our antitrust laws are not patterned after those of other countries because the U.S. had antitrust laws in place, with a rich and responsive body of judicial decisions, long before these other countries did. Experience has shown that the antitrust laws of the European Union and its member nations have been converging with those of the U.S., not the other way around. One reason is that because the U.S. antitrust laws have been in place for such a long period of time, these and other countries can learn from the long term U.S. experience.

Over the years, the antitrust laws of many foreign countries have moved closer to U.S. law. For example, the European Commission has adopted rules of antitrust analysis that closely resemble U.S. law, such as with respect to market definition and merger analysis. So has the United Kingdom ("U.K.") Thirty years ago, the U.K. blocked enforcement of U.S. antitrust law (even cartel law) against its nationals. Today, the U.K. prosecutes cartels criminally and has extradited U.K. citizens in the U.S. for criminal prosecution for cartel conduct.

The Court's decision in *Leegin* does not depart from the basic tenet that protection of competition is the goal of the antitrust laws. Instead, it has freed one type of restraint -- minimum resale price maintenance agreements -- from a rigid rule that had prevented any inquiry into whether such a restraint could prove beneficial to competition and consumer welfare in certain cases. If other countries continue to follow more rigid rules than the U.S. regarding resale price maintenance agreements, that is their prerogative, but their experience does not necessarily offer meaningful guidance on how U.S. antitrust law should be applied. But it is equally possible, and perhaps more likely, that other jurisdictions will follow the lead of the U.S. with respect to resale price maintenance as they have with respect to other antitrust laws.



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June 9, 2009

The Honorable Herb Kohl
Chairman, Subcommittee on Antitrust, Competition Policy, and Consumer Rights
Committee on the Judiciary
308 Hart Senate Office Building
Washington, DC 20510

Dear Senator Kohl:

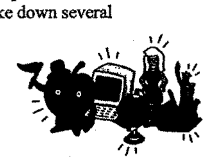
Once again, thank you for your invitation to participate in the Subcommittee's recent hearing entitled, "The Discount Pricing Consumer Protection Act: Do We Need to Restore the Ban on Vertical Price Fixing?" Per your recent request, I have included below answers to your additional questions sent by mail for inclusion in the official record.

***Question 1 – What is the impact of Internet-scanning companies like "NetEnforcers" on eBay?***

eBay's experiences working with sellers and manufacturers confirm that Retail Price Fixing has restricted intra-brand competition, in particular among small and mid-sized Internet retailers, like the ones who sell on the eBay marketplace. As you mentioned, NetEnforcers is a third-party service provider that works for manufacturers to scan the Internet, including the eBay platform, every day to look for sellers offering discounted prices. With the information that NetEnforcers gives them, manufacturers then puts intense pressure on sellers to raise their prices. In cases where our sellers have an authorized relationship with the manufacturer, *Leegin* has provided an immediate fix – authorized sellers are contacted by manufacturers and simply informed that they are contractually obligated to sell their products at a higher price.

The situation is much more interesting for sellers who are not authorized distributors of a certain product, and instead choose to sell on the thriving, value-oriented, and perfectly legal gray market. In these cases, manufacturers do not have the contractual relationship to force a seller to change its prices, so they use any tools at their disposal to enforce their minimum prices. In many cases, this means that manufacturers scour low-priced eBay listings of completely legitimate products (provided courtesy of NetEnforcers) and assert technical copyright violations. They then use this alleged copyright violation to make eBay take down the low-priced product listing. Mission accomplished.

One example I mentioned during the hearing was of a company called CaptiveWorks. This electronic company used false claims of trademark violations to take down several



low-priced eBay listings. When the seller asked CaptiveWorks why it was claiming that his listings were replicas when they were in fact authentic, the company made it clear that it targeted his listings because they were being sold at a lower price. In another case, Laguna Beach Jeans Company went after a seller for selling its products at a discount on eBay, saying simply that it "does not authorize eBay sales," and that selling its products at a lower price "than [it] sells on eBay" would impact its market. For these businesses, the *Leegin* decision has clearly been interpreted as a "green light" to stop low-price competition by legitimate sellers. We are in the beginning stages of research on our marketplace to see how this fact has impacted pricing over time, and we believe that it will show that our eBay community will have fewer low-priced options.

***Question 2 – Is free-riding a legitimate problem in the Internet age?***

Traditional retailers contend that innovative Internet retailers are able to offer lower prices to consumers because they "free-ride" on the promotional investments of their traditional counterparts. The traditional "free-rider" argument contends that rather than providing consumers with pre-sale information through, for example product demonstrations and other methods, small and mid-size Internet retailers depend on competing brick-and-mortar retailers to do this, and then divert "educated" consumers away through offering them lower prices obtained through their cost savings. Traditional retailers claim that only RPM can protect them this unfair competition.

From eBay's perspective there are many problems with this argument. The most significant of these problems is that, as previously described and subsequently elaborated upon, the realities of 21st Century retailing and the Internet turns the traditional free-rider justification for RPM on its head.

Recent data backs up the argument that consumer's retail experience has evolved in the Internet age. A recent Wall Street Journal article described these "New Information Shoppers" using the Internet to gather information on products before they make a purchase. Nearly 70% of Americans now say they consult product reviews or consumer ratings before they make their buying decisions, and spend at least 30 minutes online every week to help them decide what and whether to buy. And, since we know that the percentage of actual transactions that are completed online is much smaller, we must conclude that folks are actually researching product information on-line, but then making their purchases at a brick & mortar store. That is exactly the opposite of what many RPM supporters would have you believe. Internet retail is not actually "free-riding" on the existing retail ecosystem; established retailers are free-riding on the tremendous consumer information tools created by Internet innovators.

***Question 3 – Does eBay support S. 148, the Discount Pricing Consumer Protection Act?***

eBay strongly support S. 148, the Discount Pricing Consumer Protection Act. This bill is urgently needed to correct the mistaken *Leegin* decision and restore nearly 100 years of anti-trust law. It is our view that Retail Pricing Fixing stifles retail competition, reduces consumer choice, and leads to higher prices. The retail ecosystem should continue to be varied and open to many different kinds of retail entities offering distinct retail experiences. Manufacturers use RPM to discipline and eliminate discount sellers. This ignores the fact that some resellers offer better prices because they are simply more efficient. Consumers should have the opportunity to choose whether they want the exclusive feel and increased service of a boutique shopping experience, or the value and convenience of more "mass-market" shopping options, whether online or offline. Consumers will choose what is best for them given their individual circumstances.

If you have any questions regarding these answers or the attached hearing transcript, please feel free to contact Amanda Pedigo in my Washington D.C. office. She can be reached at (202) 551-0081.

Sincerely,

Tod Cohen

Tod Cohen

**Senator Herb Kohl's Follow-Up Questions for 5/26/2009**
**Hearing on the "Discount Pricing Consumer Protection Act:**
**Do We Need to Restore the Ban on Vertical Price-Fixing?"**
**And Answers from Stacy J. Haigney**

1. **How important was the rule against vertical price-fixing to the growth of Burlington Coat Factory? Do you believe your stores would have been able to prosper as discount competitors without it?**

Answer to Question No. 1 -

It is Burlington Coat Factory's firm belief that its growth from a single location, discount coat retailer on Route 130 in Burlington, New Jersey to a nation-wide, off-price chain of over 400 stores offering every kind of apparel and accessories, would have been impossible if vertical price-fixing were not subject to the per se rule when Burlington Coat Factory's business began to grow in the 1970's. The best evidence of this is the historical record: Burlington Coat Factory was confined to a single location from 1972, when it was founded, until after 1975 (the year Congress repealed the Fair Trade Laws, restoring the per se rule in all states) when it began to expand exponentially. By 1981, it had 19 stores; by 1983, nearly 40. It is my understanding that there were no large off-price retailers following a business model comparable to Burlington Coat Factory's (i.e., offering full lines of current, in-season merchandise bearing nationally-known brands at prices at least 25% below that charged by department stores) while the Fair Trade Laws were in effect. Monroe G. Milstein, the man who established Burlington Coat Factory, and who oversaw its growth until 2006, made clear to me on several occasions that he would not have even attempted to transform Burlington Coat Factory into a national retailer if vertical price-fixing had been legal. This makes perfect sense: if full-price retailers were legally permitted to force their suppliers to impose vertical price-fixing schemes on key brands, Burlington Coat Factory would not have been able to employ its most potent competitive tool, low prices.

2. **The majority opinion in Leegin decision argued that the rule against vertical price-fixing is bad policy because of what it called the "free rider" problem. This is the situation of a shopper going to a full service store for advice and service, using the services of the store to examine and inspect the product, and then finding a discount retailer or internet website to purchase the product at a discount.**

**Supporters of the Leegin majority argue that allowing resale-price maintenance would end this situation. Do they have a point? Do you believe that shoppers who go into Burlington Coat Factory stores have first examined similar merchandise at higher priced, full-service department stores, and thus are "free riding" on these stores?**

Answer to Question No. 2 -

I am respectfully of the strong opinion that the supporters of the Leegin majority have no "point" when they urge Congress to accept the so-called "free rider" hypothesis. The "free rider" argument was made to Congress in 1975, in opposition to the legislation which—with massive bi-partisan support and with President Ford's signature—repealed the Fair Trade Laws. Congress and the Ford Administration found the "free rider" allegation to be far less persuasive than the strong empirical showing on behalf of the measure that "Fair Trade" increased prices and hurt competition. Moreover, when the Sylvania Court over-ruled the per se rule against non-price vertical restraints in 1977, it specifically discussed the "free rider" thesis but, nevertheless, adhered to the view that price restraints must remain subject to the per se rule because of their inherent threat to competition and consumers. The "free rider" specter was also raised repeatedly during the 1980's by the Reagan Justice Department in a vain effort to persuade the Supreme Court to abandon the per se rule. This caused Congress to vote to defund all such efforts by the Department of Justice specifically because Congress wanted the per se rule to remain in effect. Thus, every time Congress has been faced with the question, it has rejected the "free rider" hypothesis as an adequate justification for doing away with the per se rule. The Supreme Court was likewise unimpressed with the "free rider" argument until the very recent past when two additional exponents of this Chicago School of Economics theory were added to the Court, giving its proponents a bare majority. Obviously, that majority thinks that the conjurors of the "free rider" theory have a "point," but Congress has never seen that "point" despite numerous attempts by opponents of price-competition to foist that argument on the Senate and the House.

From the point of view of the retail apparel industry, Congress, and until 2007 the judiciary, have been absolutely correct in rejecting the 'free rider" manifesto. There are full-price retailers who justify their higher prices by pointing to their more expensive store decorations, etc. Their business plan is a perfectly legitimate one: attract customers who are willing to pay more to shop in surroundings that enhance the shoppers' self-image. Burlington Coat Factory's business plan is to attract customers who are more interested in bargains than ambience. Of course, there are consumers who shop both kinds of stores to find, depending upon their individual preferences, the best products, the best prices and/or the finest ambience. But it is a logical non sequitur to suggest that a shopper who ends up making her purchase at Burlington Coat Factory is somehow illegitimately taking advantage of the full-price merchant.

I have heard the argument made that the full-price retailers of high-tech products can be disadvantaged by customers who learn all about a product's function from the well-trained, highly-paid sales personnel of such retailers, only to buy the same product from a discounter with unskilled employees. Whether or not this happens with any frequency in high-tech retailing—and I am highly skeptical that this is the case—it most certainly does not happen in apparel retailing. In the high-tech hypothesis, the full-price retailer allegedly adds value to the product by giving the customer sophisticated know-how. There is no such value added by full-price retailers in the apparel business because everyone knows how to try on clothes without technical assistance! The fact that the full-price retailer makes the marketing decision to present the product in expensive, elegant surroundings teaches the consumer nothing upon which to "free ride." The question also implies that the customer only becomes aware of the existence of the product by seeing it at a full-price store. This supposition is groundless in this day and age when consumers acquaint themselves with available products in myriad ways: via the internet, word of mouth, catalogues, advertising, etc. I also note that, under Sylvania, a manufacturer who sincerely wants its product be sold with certain services, ambience, etc., may lawfully require retailers to provide such services or ambience without fixing resale prices. In short, there is no "free rider" problem in the industry I have worked in for nearly 30 years, and I respectfully submit that Congress should adhere to the position it has taken vis-à-vis the so-called "free rider" and the per se rule since 1975.

3. **Defenders of the Leegin decision point out that the majority opinion in Leegin still permits antitrust suits against vertical price-fixing if the party bringing the suit can prove that the practice was "unreasonable" and harmed competition. This is what is known in antitrust law as the "rule of reason."**

**The rule of reason requires the antitrust plaintiff to assemble evidence of the restraint's history, nature, and likely competitive effects, as well as the market power of those engaged in the practice. How likely would Burlington Coat Factory be to bring an antitrust suit challenging vertical price-fixing if you had to assemble evidence and prove the history, nature and likely competitive effect of the practice? Would you have the resources or factual knowledge to bring such a case?**

**Answer to Question No. 3** -

Since the Sylvania case in 1977, all vertical restraints subject to the so-called "rule of reason" – i.e., non-price restraints – have been de facto legal because of the practical impossibility of a plaintiff's financing and/or winning such a case. There is no reason whatever to suppose that vertical price-fixing cases will be any easier to win or less costly under the Leegin standard. The Supreme Court has recently imposed a heightened pleading requirement on antitrust plaintiffs in the Twombley case which, in a rule-of-reason case, would require detailed pleading (with supporting evidence) by the plaintiff of highly sophisticated issues such as market definition. This means that, without any discovery, a plaintiff must undergo the effort and expense of putting together a complex economic analysis of the market, the history of the restraint, the relative market shares of the product and the parties, etc., simply to survive a motion to dismiss. Assuming that this hurdle can be surmounted, the plaintiff would then have to embark upon years of document-rich discovery and motion practice against a well-heeled adversary with numerous depositions, including of multiple experts on both sides. The cost is more than likely to be well into seven figures. Burlington Coat Factory cannot afford that kind of expenditure and disruption of its business in a litigation which—given the fate of vertical "rule of reason" cases in the past and the present composition of the Supreme Court—is far from certain to succeed. Thus, as a practical matter, the Leegin case deprives Burlington Coat Factory of any remedy if it becomes a victim of vertical price-fixing.

4. **Do you support the Discount Pricing Consumer Protection Act, my legislation, to restore the ban on vertical price-fixing? Why or why not?**

**Answer to Question No. 4** -

On behalf of Burlington Coat Factory, I wholeheartedly support the proposed legislation. My company and its customers have thrived in a vibrant retail environment characterized by vigorous price-competition. The Leegin decision threatens to return our economy to the weak competition and high-consumer prices of the Fair Trade era when companies like Burlington Coat Factory did not exist. And it does so on the basis of the utterly flimsy hypothesis that price-fixing might eliminate some "free riders" which in turn might enhance competition in some instances. In other words, the Supreme Court has irresponsibly decided to conduct a Chicago School experiment to see if our already well-functioning retail economy might marginally improve, despite massive empirical evidence that the experiment is bound to fail. Passage of the Discount Consumer Protection Act will ensure that the marketplace will not suffer the unintended -- but all too foreseeable -- consequences of such reckless experimentation.

# SUBMISSIONS FOR THE RECORD

Monday, May 18, 2009

Hon. Herb Kohl
U.S. Senate Committee on the Judiciary
Subcommittee on Antitrust, Competition Policy and Consumer Rights
224 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Kohl:

We write on behalf of the nation's leading consumer rights organizations to offer our strong support for S. 148, the Discount Pricing Consumer Protection Act and we thank you for your leadership in introducing this important measure that will repeal the Supreme Court's decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.* and restore the ban against resale price maintenance ("RPM") agreements. Such agreements, by restricting the freedom of retailers to engage in discounting, harm consumer welfare and economic innovation.

We disagree with the assertion of the American Bar Association that RPM agreements are "likely to be used by manufacturers to achieve efficiencies in distribution of their products" and that "recent" empirical studies support that conclusion. *See* Letter from James A. Wilson, Chair, ABA Section of Antitrust Law, to Hon. Henry C. Johnson, May 5, 2009. The fact that many economists may agree that RPM agreements *can* be "procompetitive" in some circumstances may have persuaded five conservative Justices of the Supreme Court that RPM agreements should always be subject to the rule of reason, but should not deter Congress from restricting such agreements.

It is unequivocal that RPM agreements raise consumer prices, prevent efficient retailers from passing on the benefits of their lower costs to consumers, and tend to retard the development of new forms of retailing. At the same time, the purported benefits to consumers of RPM agreements are dubious and even if such benefits exist they can be achieved by less restrictive business practices.

Except for an unsuccessful experimented with "fair trade" between 1937 and 1975, resale price agreements have been banned for almost the entire history of the Sherman Act – until the Supreme Court overturned the ban in 2007 without an iota of evidence that the ban had done any harm and in spite of clear congressional support for the ban. The outdated and flawed "recent" studies referred to in the ABA letter provide no support for the procompetitive theories of RPM, as the dissent in *Leegin* showed.

Allowing manufacturers to forestall discounting by legitimate retailers is problematic at any time, but it is particularly harmful during this time of deep recession when consumers depend on discounts to make ends meet and manufacturers may be more pressured than ever to use RPM agreements to stop retail price wars.

Accordingly, we urge you to make repeal of the *Leegin* decision a high priority on the legislative agenda for the 111th Congress.

Very truly yours,

Sally Greenberg
President
National Consumers League

Bert Foer
President
American Antitrust Institute

Mark Cooper
Director of Research
Consumer Federation of America

Ellen Bloom
Director of the Washington DC Office
Consumers Union

Ed Mierzwinski
Consumer Program Director
U.S. Public Interest Research Group

**Statement of**

**RICHARD M. BRUNELL**

**DIRECTOR OF LEGAL ADVOCACY, AMERICAN ANTITRUST INSTITUTE**

**Before the**

**SENATE JUDICIARY COMMITTEE**

**SUBCOMMITTEE ON ANTITRUST,
COMPETITION POLICY, AND CONSUMER RIGHTS**

**Regarding**

**THE DISCOUNT PRICING CONSUMER PROTECTION ACT, S. 148**

**MAY 19, 2009**

Chairman Kohl, Senator Hatch, and Members of the Subcommittee:

Thank you for the opportunity to present the views of the American Antitrust Institute ("AAI") on S.148, the "Discount Pricing Consumer Protection Act," which is designed to reverse the Supreme Court's *Leegin*[1] decision and restore the *per se* rule against resale price maintenance ("RPM"). AAI is an independent non-profit research, education, and advocacy organization that supports the strong and sensible enforcement of our antitrust laws to ensure that markets are competitive for the benefit of consumers and the economy as a whole.[2] AAI strongly endorses S. 148. We believe that consumer welfare and economic innovation are best served when retailers are free to engage in discounting, and therefore urge the Judiciary Committee to move this bill forward promptly.[3]

**Executive Summary**

What have we learned in the almost two years since the *Leegin* decision? It appears that, as expected, the use of resale price maintenance programs has increased, even though antitrust counselors have advised caution because some state attorneys general have taken the position that RPM remains *per se* illegal under some state laws and other states have passed or may pass "*Leegin* repealer" bills. Anecdotally, we also believe there has been greater use of "*Colgate* policies" and minimum advertised pricing (MAP) polices to enforce minimum resale prices.

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[1] Leegin Creative Leather Products, Inc. v. PSKS, Inc. 127 S. Ct. 2705 (2007).

[2] Background is available at www.antitrustinstitute.org. AAI's views on a wide range of competition policy issues are set forth in THE NEXT ANTITRUST AGENDA: THE AMERICAN ANTITRUST INSTITUTE'S TRANSITION REPORT ON COMPETITION POLICY TO THE 44TH PRESIDENT. This book has been provided to Subcommittee members and is available on our website.

[3] AAI has been actively involved in the debate over RPM. We filed an *amicus* brief in *Leegin* urging the Court not to overturn *Dr. Miles*, submitted comments in the FTC's *Nine West* matter opposing Nine West's petition to lift resale price restrictions, participated in the FTC's RPM workshops, and testified before the Maryland legislature and House Subcommittee on Courts and Competition Policy. All of these materials are available on AAI's website. Many of the points discussed here are elaborated in Richard M. Brunell, *Overruling* Dr. Miles: *The Supreme Trade Commission in action*, 52 ANTITRUST BULL. 475 (2007).

Allowing manufacturers to forestall discounting is problematic at any time, but it is particularly unfortunate during this time of deep recession when consumers depend on discounts to make ends meet and manufacturers may be more pressured than ever to use RPM to forestall price wars.

We have also learned that, as expected, the so-called "rule of reason" adopted by the Supreme Court for judging RPM agreements amounts to a rule of virtual *per se legality*. The Court said that RPM agreements were to be evaluated on a case-by-case basis, and courts would have to be diligent in eliminating anticompetitive uses from the market. However, in most of the cases decided after *Leegin*, the lower courts summarily dismissed the complaints because the relevant markets alleged by plaintiffs were said to be too narrow as a matter of law; plaintiffs were not even allowed to try to prove their cases. Critics of the *per se* rule forsake their responsibility when they fail to offer a meaningful, structured rule of reason as an alternative, unless they really favor *per se* legality. The problem with using an unstructured rule of reason for RPM is not simply that it ordinarily requires proof of a relevant market and that the defendant has market power, which is difficult and expensive to establish even if one gets past a motion to dismiss. The problem is that the Supreme Court fundamentally misunderstood the nature of the anticompetitive harm from RPM.

The Court and its Chicago-School supporters look at the higher prices that result from RPM and say, "so what." We should assume that the manufacturers' and consumers' interests are congruent; the manufacturer would prefer its retailers to sell at the lowest prices possible in order to increase sales. If the manufacturer adopts RPM, they say, it must therefore be because it will somehow increase the demand for its product notwithstanding the higher prices, perhaps because the RPM will induce retailers to offer services that make the product more attractive to consumers. Higher prices are only anticompetitive, the argument goes, when they are result of collusion among manufacturers or retailers, or perhaps the result of a dominant, inefficient retailer pressuring the manufacturer to adopt RPM.

The critics of RPM, notably including Congress when it repealed the fair trade laws in 1975, look at the higher prices and see harm to consumers. When a manufacturer announces that it will not permit retail prices to fall below a certain level, they are suspicious. They know that manufacturers are not so fond of retail discounting when it puts downward pressure on wholesale prices, and that a fixed retail price on one product can put a floor under the price of competing products that are not even subject to RPM. So when they see the higher prices that result from RPM they say, "show me the consumer benefit." Yet, the business justifications generally offered for RPM provide no real benefit to consumers.

The most common justification is that RPM allows a manufacturer to buy better distribution or shelf space from retailers that carry competing brands, but while this may increase the manufacturer's sales, it does not benefit consumers; on the contrary, it may give retailers an incentive to push the product with the larger margin protected by RPM even when it may be inferior to competing products. Another common justification is that RPM can prevent no-frills retailers from "free riding" on full-service retailers, but even when this is a plausible concern, RPM is a poor mechanism for addressing it. And finally, RPM is often touted as a tool to maintain the brand image of high-end products, but this seems to be more about deceiving consumers than benefitting them. In any event, even if these objectives were thought to be legitimate, there are less restrictive ways for manufacturers to achieve them, such as paying retailers directly for services. The problem with RPM is that, regardless of the purpose for which it is used, it tends to prevent more efficient retailers, who have expert local knowledge of the needs and shopping behavior of their customers, from passing on the benefits of their lower costs to consumers. This centralization of decision-making not only harms consumers in the short run, it slows down innovation and productivity in the retailing sector by impairing an important tool for innovative retailers to gain market share.

**Introduction**

This testimony is organized as follows: First, I will explain why the issue of the *per se* rule is important as a practical matter and requires action by Congress. Second, I will explain why *Leegin* was wrong as a matter of both jurisprudence and policy, including the following:

■ The Court flouted the intent of Congress favoring the *per se* rule and thereby usurped Congress's authority to make national competition policy in an area in which Congress has been intensely involved.

■ The Court underplayed the magnitude of the anticompetitive risks of RPM, including higher prices and reduced efficiency and innovation in retailing, and failed to recognize that those risks have increased with increasing retail concentration.

■ The Court overplayed the possible procompetitive uses of RPM and failed to acknowledge that there is no empirical evidence that such uses are common or important.

■ The Court failed to consider that any procompetitive effects of RPM can be achieved by less restrictive alternatives that do not prevent efficient retailers passing on their lower costs to consumers.

■ The Court erroneously believed that there were no good justifications for treating RPM and nonprice vertical restraints differently.

■ The Court failed to recognize the costs of the rule of reason, including an increased incidence of anticompetitive RPM, increased business uncertainty and litigation expenses.

**The Practical Importance of the *Per Se* Rule**

AAI believes that the *Leegin* decision was wrong as a matter of jurisprudence and policy for many of the same reasons articulated by Justice Breyer in his powerful dissent on behalf of four Justices.[4] As Justice Breyer explained:

[4] AAI is not alone. The academic criticism of *Leegin* has been substantial. *See, e.g.*, Edward D. Cavanagh, *Vertical Price Restraints After* Leegin, 21 LOY. CONSUMER L. REV. 1 (2008); Warren S. Grimes, *The Path Forward After* Leegin: *Seeking Consensus Reform of the Antitrust Law of Vertical Restraints*, 75 ANTITRUST L. J. 467 (2008); Lance McMillian, *The Proper Role of Courts: The Mistakes of*

> The *per se* rule forbidding minimum resale price maintenance agreements has long been "embedded" in the law of antitrust. It involves price, the economy's "'central nervous system.'" [citation omitted]. It reflects a basic antitrust assumption (that consumers often prefer lower prices to more service). It embodies a basic antitrust objective (providing consumers with a free choice about such matters). And it creates an easily administered and enforceable bright line, "Do not agree about price," that businesses as well as lawyers have long understood.[5]

But before exploring in detail the reasons that *Leegin* was wrongly decided, let me explain why the issue is important as a practical matter and offer four reasons why Congress needs to act now to repeal *Leegin*.

First, nearly two years have passed since *Leegin* was decided, and we can observe the early returns: not unexpectedly, numerous press reports indicate that the ruling has resulted in increased use of resale price maintenance agreements[6] and "soft" RPM programs such as "*Colgate* policies" and minimum advertised price (MAP) policies.[7] Under a *Colgate* or "unilateral" minimum price policy, a manufacturer obtains compliance with minimum retail prices, not by explicit agreement, but by threatening to cut off noncompliant dealers. Under a MAP policy, a manufacturer prevents retailers from advertising below a minimum price. Manufacturers have favored these "soft" RPM programs because many states, including California and New York,

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*the Supreme Court in* Leegin, 2008 WISC. L. REV. 405; Mark D. Bauer, *Whither Dr. Miles*?, 20 LOY. CONSUMER L. REV. 1 (2007).

[5] 127 S. Ct. at 2736.

[6] *See, e.g.*, Joseph Pereira, *Price Fixing Makes Comeback After Supreme Court Ruling*, WALL ST. J., Aug. 18, 2008, at A1 (stating that "[m]anufacturers are embracing broad new legal powers that amount to a type of price fixing" and offering several examples); Joseph Pereira, *Why Some Toys Don't Get Discounted – Manufacturers Set Minimums That Retailers Must Follow Or Risk Getting Cut Off*, WALL ST. J., Dec. 24, 2008, at D1 (in the wake of *Leegin* "many manufacturers have instituted pricing minimums for advertising or sales"); Saul Hansell, *For Sony, No Discounts Means Stress Free Shopping*, NewYork-Times.com, Bits Blog, Nov. 20, 2008, http://bits.blogs.nytimes.com/ 2008/11/20/stressed-sony-says-high-prices-will-help-you-relax/? (describing Sony's "Unified Resale Execution," which barred retailers from discounting certain high-end products).

[7] *See* Joseph Pereira & John R. Wilke, *Instruments, Audio Gear Scrutinized in Price Probe*, WALL ST. J., Oct. 23, 2008, at B1 (noting that manufacturers "have grown more interested in establishing minimum advertised prices since the ruling"); Joseph Pereira, *Discounters, Monitors Face Battle on Minimum Pricing*, WALL ST. J., Dec. 4, 2008, at A1 (describing growth of firms that monitor pricing on the web as a result of proliferation of MAP policies).

may continue to treat RPM agreements as *per se* illegal under state antitrust laws;[8] accordingly, antitrust counselors have advised caution in adopting express RPM agreements, at least on a national basis.[9] While *Colgate* policies have always been lawful in theory, prior to *Leegin* manufacturers were often inhibited from adopting them because they were perceived by many to be draconian, costly, and impractical, requiring a manufacturer to terminate otherwise-valued non-compliant retailers and to refrain from price discussions with any retailers.[10] After *Leegin*, however, antitrust lawyers have been advising manufacturers that *Colgate* policies can be more flexible because the consequences of running afoul of the *Colgate* limitations are not as severe.[11] Similarly, prior to *Leegin*, MAP policies were typically limited to manufacturer-financed (co-op)

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[8] *See* Michael A. Lindsay, *Resale Price Maintenance and the World After* Leegin, 22 ANTITRUST, Fall 2007, at 32.

[9] *See* M. Russell Wofford, Jr. & Kristen C. Limarzi, *The Reach of* Leegin: *Will the States Resuscitate* Dr. Miles?, ANTITRUST SOURCE, October 2007, at 1, http://www.abanet.org/antitrust/at-source/07/10/Oct07-Wofford10-18f.pdf ("[T]houghtful commentators have noted that the continuing uncertainty about the states' treatment of minimum resale price maintenance could slow the business response to *Leegin*.").

[10] *See* Brian R. Henry & Eugene F. Zelek, Jr., *Establishing and Maintaining an Effective Minimum Resale Price Policy: A* Colgate *How-To*, ANTITRUST, Summer 2003, at 8, 8 ("Under *Colgate*, the cautious supplier has but one choice with respect to violators – immediate termination of product purchasing privileges with no warnings, no second chances, and no continued shipments in response to assurances of future compliance – regardless of the size of the violator and the volume of its purchases."). Ironically, the Court cited the cost of implementing a *Colgate* policy as a justification for adopting the rule of reason. *See Leegin*, 127 S. Ct. at 2722-23. In addition to restoring some version of the *per se* rule, Congress should also limit the use of the *Colgate* doctrine as a means of avoiding strictures against RPM, as discussed below.

[11] *See* Lindsay, *supra*, at 36 (noting that "now is the time to reconsider" adopting a *Colgate* policy because "*Leegin* has reduced the exposure that would result if a unilateral policy inadvertently becomes (or is perceived as becoming) an 'agreement.'"); Marie L. Fiala & Scott A. Westrich, Leegin Creative Leather Products: *What Does the New Rule of Reason Standard Mean for Resale Price Maintenance Claims?*, ANTITRUST SOURCE, Aug. 2007, at 9, http://www.abanet.org/antitrust/at-source/07/08/Aug07-Westrich8-6f.pdf (explaining that having a *Colgate* policy is "now less risky than it was in the past"); Thomas B. Leary & Erica S. Mintzer, *The Future of Resale Price Maintenance, Now That* Doctor Miles *is Dead*, 4 N.Y.U. J. L. & BUS. 303, 341 (2007) ("[M]anufacturers with *Colgate* programs[] may be able to discuss their differences with non-compliant retailers, rather than terminating them absolutely as they heretofore have been required to do.").

advertising and allowed significant "leakage" in discounting.[12] After *Leegin*, so-called "bald" MAP policies (i.e., those that apply regardless of whether the manufacturer pays for the advertising) that leave less room for discounting are less risky.[13]

Second, the fact that many states *may* continue to treat RPM as *per se* illegal does not undercut the need for Congress to restore the *per se* rule under the Sherman Act. Commentators have generally concluded that it is unclear how courts will interpret existing state statutes, even if attorneys general favor a *per se* rule. Most state antitrust statutes are construed in harmony with federal law. Only one state – Maryland – has amended its statute in light of *Leegin* to expressly adopt a *per se* rule.[14] And some have suggested that *Leegin* repealers might be preempted by the Sherman Act.[15] In any event, a state-by-state approach offers no protection to consumers in states that follow federal law and, perhaps most significantly, does not permit federal enforcers to bring RPM cases on a *per se* basis.

Third, while it is true that *Leegin* did not make RPM *per se* legal, and the Court offered that "courts would have to be diligent in eliminating their anticompetitive uses from the market" under the rule of reason,[16] the way that the courts have interpreted *Leegin* so far suggests that the rule of reason will devolve into a rule of virtual *per se* legality, as it has with nonprice vertical restraints. Several lower courts (including the lower court on remand in *Leegin*) have dismissed

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[12] Indeed, where minimum advertised pricing policies are tantamount to RPM because discounting is effectively precluded, the FTC had said it would consider them to be *per se* illegal. *See* In re Sony Music Entertainment, Inc., No. C-3971, 2000 WL 1257799 (F.T.C.).

[13] *See* Lindsay, *supra*, at 36. *But see* New York v. Herman Miller, Inc., 08-CV 2977 (S.D.N.Y. 2008) (complaint by attorneys general of New York, Michigan and Illinois challenging "bald" MAP policy as resale price maintenance agreement under state and federal law where the advertised price was the price at which a consumer purchased the product).

[14] *See* 2009 Md. Laws c. 44 (approved by the governor April 14, 2009), *available at* http://mlis.state.md.us/2009rs/chapters_noln/Ch_44_hb0657T.pdf.

[15] *See, e.g.*, Lindsay, *supra*, at 33.

[16] *Leegin*, 127 S. Ct. at 2719.

RPM complaints on motions to dismiss for failing sufficiently to allege a relevant market, not even permitting plaintiffs to *try* to prove a rule of reason violation, even though the cases involved allegations of market power and dual distribution (i.e., manufacturers that sell at retail, in competition with their dealers, as well at wholesale).[17] Indeed, even the FTC interpreted *Leegin* to permit RPM in a case where the leading manufacturer of women's fashion shoes (albeit with "only a modest market share") engaged in dual distribution, RPM practices appeared to be widespread in the industry, and its purported procompetitive efficiencies were "unproven."[18]

Fourth, Congress should not wait to act for the completion of the FTC's workshops on RPM. While the FTC (Commissioner Harbour in particular) is to be commended for undertaking to study RPM, it is not clear when or what the end product of the workshops will be. As discussed below, empirical studies in the past have been inconclusive. And insofar as the FTC offers policy prescriptions or guidelines for courts, such recommendations will be constrained by the *Leegin* decision.

To be sure, *Leegin* is not going to mean the end of consumer discounts, even if the courts effectively legalize RPM. Manufacturers often like retail discounting, and discount chains are a well-established, significant part of retailing.[19] As the Court noted, even in the fair trade era when resale price maintenance was generally legal, only a small fraction of goods was fair traded. However, as Justice Breyer countered, that small fraction would translate into significant

[17] *See* PSKS, Inc. v. Leegin Creative Leather Products, Inc., 2009 WL 938561 (E.D. Tex. 2009); Spahr v. Legin Creative Leather Products, Inc., 2008 WL 3914461 (E.D. Tenn. 2008) (consumer class action); Jacobs v. Tempur-pedic Int., Inc., 2007 WL 4373980 (N.D. Ga. 2007) (consumer class action). *But see* Babyage.com v. Toys "R" Us, Inc., 558 F. Supp. 2d 575 (E.D. Pa. 2008) (denying motion to dismiss).

[18] In re Nine West Group Inc., FTC Dkt. C-3937, Order Granting in Part Petition to Reopen and Modify Order Issued April 11, 2000 (May 6, 2008) ("FTC *Nine West* Order").

[19] One ominous development however is Wal-Mart's apparent acceptance of price-maintained goods. *See* Joseph Pereira, *State Law Targets "Minimum Pricing,"* WALL ST. J., Apr. 28, 2009, at D1.

dollar amounts in today's retail marketplace of more than $3 trillion.[20] Moreover, increasing retail concentration and buyer power suggest that the risk of anticompetitive, retailer-induced RPM has increased significantly since the fair trade era. And during this time of deep recession, it is particularly important that consumers not be forced to pay higher unnecessarily high prices, even as manufacturers may be more tempted than ever to use RPM to forestall price wars.[21]

**_Leegin_ is Bad Jurisprudence**

Thirty four years ago, this Committee held seven days of hearings on S. 408, the bill that was enacted as the Consumer Goods Pricing Act of 1975.[22] The law repealed the so-called "fair trade" amendments to the Sherman Act – the Miller-Tydings Act of 1937 and the McGuire Act of 1952 – which had authorized states to legalize resale price maintenance agreements. This Committee, headed by Senator Hart, heard testimony from over 23 witnesses, including the head of the Antitrust Division, Thomas Kauper, and the chairman of the Federal Trade Commission, Lewis Engman, both of whom testified in favor of restoring the *per se* rule of *Dr. Miles.*[23] The House Judiciary Committee also held two days of hearings with seven witnesses, including the Deputy Assistant Attorney General for Antitrust, who testified to the same effect.[24] The commit-

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[20] Justice Breyer estimated that if prices on goods subject to resale price maintenance rose by the same rate that occurred in the fair trade era, retail bills would increase by an average of roughly $750 to $1000 for a family of four. 127 S. Ct. at 2736.

[21] *Cf.* Christina Binkley, *On Style: Death to Discounts? The Designers Rebel*, WALL. ST. J., Apr. 16, 2009 (noting that "high-end retail's carefully tended pricing structure began to collapse" in a matter of weeks when department stores slashed prices around Thanksgiving, much to the chagrin of fashion brands).

[22] Pub. L. No. 94-175, 89 Stat. 801 (1975).

[23] *See Fair Trade Laws: Hearings on S. 408 Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary*, 94th Cong., 1st Sess. 170-172 (1975) [*Senate Hearings*] (Engman testifying that "fair trade laws are little more than anticompetitive price fixing, unadorned with any redeeming features"); *id.* at 172-177 (Kauper making strong case against "resale price fixing" in any circumstances).

[24] *Fair Trade: Hearings on H.R. 2384 Before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary*, 94th Cong., 1st Sess. 121-124 (1975) [*House Hearings*] (testimony of Keith Clearwaters, Deputy Ass't Attorney General) (fair trade laws "legalize a certain type of price fixing").

tee reports show that Congress believed that RPM was pernicious and should be banned.[25] The Committees heard the arguments, similar to those made today, that resale price maintenance could be procompetitive in some circumstances, yet rejected any exceptions to the *per se* rule.[26]

Congress passed the Consumer Goods Pricing Act with overwhelming, bipartisan support, and President Ford enthusiastically signed it into law.[27] In 1977, when the Supreme Court in *GTE Sylvania* adopted the rule of reason for nonprice vertical restraints, it expressly stated that different treatment of resale price maintenance was justified in part because Congress had approved the *per se* rule.[28] After the Reagan Administration's Justice Department sought to overturn the *per se* rule in *Monsanto*,[29] Congress passed appropriations measures in 1983, 1985,

[25] *See* S. REP. NO. 94-466, at 1 (1975) ("The purpose of the proposed legislation is to repeal Federal antitrust exemptions which permit States to enact fair trade laws [which are] legalized price-fixing. . . Without these exemptions the agreements they authorize would violate the antitrust laws."); *id.* at 2 (repeal "will prohibit manufacturers from enforcing resale prices."); H.R. REP. NO. 94-341, at 2 (1975) ("An agreement between a manufacturer and a retailer that the retailer will not resell the manufactured product below a specified price is ... *per se* illegal under section 1 of the Sherman Act").

[26] The report of this committee rejected the dealer services case for RPM as follows: "Opponents were primarily service-oriented manufacturers who claimed retailers would not give adequate service unless they were guaranteed a good margin of profit. However, the manufacturer could solve this problem by placing a clause in the distributorship contract requiring the retailer to maintain adequate service. Moreover, the manufacturer has the right to select distributors who are likely to emphasize service." S. REP. NO. 94-466, at 3; *see also* H.R. REP. NO. 94-341, at 4 ("[T]o the extent that ... the retailer charges a higher price because he is providing more services to his customers, consumers should have the freedom to choose between paying more for those services and buying nothing but the unadorned product at a lower price from a competitor."); *id.* at 5 (rejecting "new product" exemption); *see also House Hearings, supra*, at 32 (quoting Bork's free-rider explanation for RPM).

[27] Statement by President Gerald R. Ford Upon Signing the Consumer Goods Pricing Act of 1975 (law "will make it illegal for manufacturers to fix the prices of consumer products sold by retailers").

[28] Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 51 n.18 (1977) ("Congress recently has expressed its approval of a *per se* analysis of vertical price restrictions by repealing those provisions of the Miller-Tydings and McGuire Acts allowing fair-trade pricing at the option of the individual States" but "[n]o similar expression of congressional intent exists for nonprice restrictions.").

[29] Monsanto Co. v. Spray-Rite Service Corp., 465 U.S. 752 (1984). The Court declined to reach the issue. *See id.* at 760 n. 7; *see also id.* at 769 (Brennan, J., concurring).

1986, and 1987 preventing the Department from using appropriated funds for this purpose.[30] Such measures were no longer needed when the (first) Bush Administration came to office and promised to enforce *Dr. Miles*.[31] Between 1990 and 2000, the FTC and Department of Justice brought about 14 RPM cases; the States also brought numerous cases.[32]

There matters stood until the Roberts Court granted certiorari in *Leegin* to reconsider the *Dr. Miles* rule, notwithstanding that there was no great hue and cry demanding that *Dr. Miles* be reversed. On the contrary, the bipartisan Antitrust Modernization Commission had declined to study the topic, noting that there was "a relatively low level of controversy on the subject."[33]

What did the Court have to say about the legislative history showing Congress's endorsement of the *per se* rule? The Court responded:

> The text of the Consumer Goods Pricing Act did not codify the rule of *per se* illegality for vertical price restraints. It rescinded statutory provisions that made them *per se* legal. Congress once again placed these restraints within the ambit of § 1 of the Sherman Act. And, as has been discussed, Congress intended § 1 to give courts the ability "to develop governing principles of law" in the common-law tradition. [citations omitted] Congress could have set the *Dr. Miles* rule in stone, but it chose a more flexible option. *We respect its decision* by analyzing vertical price restraints, like all restraints, in conformance with traditional § 1 principles, including the principle that our antitrust doctrines "evolve with new circumstances and new wisdom." [citations omitted][34]

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[30] *See* H.R. REP. NO. 102-237, at 4 (1991) ("With the possible exception of merger policy, there is probably no area of antitrust where Congress has displayed such an explicit and abiding intent to set policy for the courts and enforcement agencies as the area of resale price maintenance ('RPM')."

[31] *See* Speech by Ass't Attorney General James F. Rill, 57 Antitrust & Trade Reg. Rep. (BNA) 671, Nov. 9, 1989 (stating that the Antitrust Division would not advocate change to the *per se* rule and would "not hesitate to bring a resale price maintenance case, contingent only on evidence sufficient to establish a genuine resale price conspiracy and facts showing a significant regional impact"); *see also Interview With Former Assistant Attorney General James F. Rill*, 63 Antitrust & Trade Reg. Rep. (BNA) 254 (Aug. 27, 1992) (favoring "a *per se* illegality principle applied to resale price maintenance").

[32] *See* Brunell, *supra,* at 479 & n.22 (listing cases).

[33] Antitrust Modernization Commission Single-Firm Conduct Working Group, Memorandum at 16 (Dec. 21, 2004), at http://www.amc.gov/pdf/meetings/Single-FirmConduct.pdf.

[34] 127 S. Ct. at 2724 (emphasis added).

With all due respect, we believe, like the dissenters,[35] that by ignoring the obvious purpose of the Consumer Goods Pricing Act to restore the *per se* rule, the Court failed to respect Congress's will. Indeed, the Court's "common law" approach to the Sherman Act – unconstrained by congressional intent and its own precedent – reflects an ominous trend in judicial lawmaking. The Court has set itself up as the principal antitrust policymaker for the country, a "Supreme Trade Commission," except that unlike the Federal Trade Commission, it is staffed with law clerks rather than antitrust experts, has no ability independently to gather data, and is not subject to agency oversight by Congress, which is directly responsible to the American people. Just as Congress had to enact the Clayton Act in 1914 in response to the Court's narrowing of the Sherman Act in *Standard Oil,* and the Cellar-Kefauver Act in 1950 after the Court limited the Sherman Act again in *Columbia Steel*, Congress must once again rein in the Court and reestablish its primacy in making national competition policy for the benefit of consumers. Indeed the Bush Administration all but invited Congress to act if it was not satisfied with the Court's ruling.[36]

**_Leegin_ is Bad Policy**

The Court's abolition of the *per se* rule was not based on a careful cost-benefit analysis or on empirical studies of the effects of the rule.[39] Rather, it was based on the simple conclusion

[35] *See id.* at 2732 ("Congress fully understood, and consequently intended ... to make minimum resale price maintenance *per se* unlawful."); *see also* Herbert Hovenkamp, *Chicago and its Alternatives*, 1986 DUKE L.J. 1014, 1020 n.34 ("I am persuaded ... that Congress has sanctioned the *per se* rule for resale price maintenance, and that we should feel obliged to comply with it until Congress tells us otherwise.").

[36] In its *amicus* brief urging the Supreme Court to overturn *Dr. Miles*, the Bush Administration told the Court that Congress "retains the full ability to address RPM legislatively. If *Dr. Miles* cannot survive as a matter of stare decisis ... it should no longer skew any congressional debate concerning RPM." Brief for the United States As Amicus Curiae Supporting Petitioner at 22, *Leegin*, 127 S. Ct. 2705.

[39] Contrary to the assertion of the ABA, the record before the Supreme Court did not include "voluminous factual evidence and economic analysis." Letter of James A. Wilson, Chair, ABA Section of Antitrust Law, to Hon. Henry C. Johnson, May 5, 2009 [ABA Letter]. Rather, the factual record of the case itself was limited (because it was tried under the per se rule), and the Court was necessarily restricted to con-

that the *per se* rule is not appropriate for RPM because, "[n]otwithstanding the risks of unlawful conduct, it cannot be stated with any degree of confidence that resale price maintenance 'always or almost always tends to restrict competition and decrease output.'"[40] However, while the "always or almost always" standard has been asserted in some cases,[41] it is the wrong test, and certainly not one Congress is obliged to follow. Justice Breyer acknowledged that resale price maintenance can have procompetitive effects, but "before concluding that courts should consequently apply a rule of reason, I would ask such questions as, how often are harms and benefits likely to occur? How easy is it to separate the beneficial sheep from the antitrust goats?"[42] Indeed, modern decision theory dictates that the proper focus is not simply on the frequency with which a practice is anticompetitive or procompetitive, but also on the magnitude of the harms or benefits and, given error costs, whether an alternative rule would generally improve consumer welfare and the administration of the antitrust laws. As Professors Areeda and Hovenkamp have said, "It is thus not enough to suggest that a class of restraints is sometimes or even often beneficial or harmful. The critical questions are always ones of frequency and magnitude relative to the business and legal alternatives."[43]

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sidering the briefs of the parties and *amici* curiae, which contained little that was new. Justice Breyer noted, "Petitioner and some *amici* have also presented us with newer studies that show that resale price maintenance sometimes brings consumer benefits. But the proponents of a *per se* rule have always conceded as much. What is remarkable about the majority's arguments is that *nothing* in this respect *is new*." 127 S. Ct. at 2732 (citations omitted).

[40] 127 S. Ct. at 2717, *quoting* Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 723 (1988).

[41] *But see GTE Sylvania*, 433 U.S. at 50 n.16 ("Cases that do not fit the generalization may arise, but a *per se* rule reflects the judgment that such cases are not sufficiently common or important to justify the time and expense necessary to identify them.").

[42] *Leegin*, 127 S. Ct. at 2729.

[43] 8 PHILLIP E. AREEDA & HEBERT HOVENKAMP, ANTITRUST LAW ¶1628b, at 292 (2d ed. 2004); *see also* Arndt Christiansen & Wolfgang Kerber, *Competition Policy With Optimally Differentiated Rules Instead of "Per se Rules vs. Rule of Reason"*, 2 J. COMP. L. & ECON. 215, 238 (2006) (explaining "error cost approach" in law and economics, and observing that to justify abandoning prohibition of RPM, "it is not sufficient to show that that there are cases in which resale price maintenance can lead to positive welfare effects"); Edward Iacobucci, *The Case for Prohibiting Resale Price Maintenance*, WORLD COMP. L &

Besides applying the wrong test, the Court erred in its evaluation of the anticompetitive and procompetitive effects of RPM. While giving some credence to the anticompetitive effects of RPM, the Court understated the magnitude of the risks. And the Court ignored the fact that abandoning the *per se* rule in favor of the rule of reason will inevitably lead to an increased incidence of anticompetitive RPM, as well as increased uncertainty for business and greater litigation expenses. Moreover, the Court failed to show that the *Dr. Miles* rule harmed consumer welfare. The evidence that procompetitive uses of RPM are common or important is exceedingly thin. And insofar as RPM has procompetitive uses in theory, the evidence that less restrictive alternatives are more costly or less effective is *nonexistent.*

**The Anticompetitive Effects of Resale Price Maintenance**

The Court recognized that resale price maintenance "does have economic dangers."[44] What are those dangers?

Higher prices. The function of resale price maintenance is to raise resale prices to consumers, and there is little dispute that resale price maintenance generally has that effect.[45] This

ECON. REV., Dec. 1995, at 71, 102 (advocating *per se* rule because "the number of cases where RPM is efficient will probably be rather small, while the cost involved from switching from RPM to alternatives is likely to be minimal [and] the cost of a rule-of-reason review is likely to be significant if it is to be done properly.").

[44] *Leegin*, 127 S. Ct. at 2719; *see id.* at 2717 ("[T]he potential anticompetitive consequences of vertical price restraints must not be ignored or underestimated."); *id.* at 2716 ("[U]nlawful price fixing, designed solely to obtain monopoly profits, is an ever present temptation.").

[45] *See* 8 AREEDA & HOVENKAMP, *supra*, ¶ 1604b, at 40 (resale price maintenance "tends to produce higher consumer prices than would otherwise be the case. The evidence is persuasive on this point."). Even the majority seemed to acknowledge this, *see* 127 S. Ct. at 2718 ("'price surveys indicate that [resale price maintenance] in most cases increased the prices of products sold'") (quoting THOMAS R. OVERSTREET, JR., RESALE PRICE MAINTENANCE: ECONOMIC THEORIES AND EMPIRICAL EVIDENCE 160 (FTC Bureau of Economics Staff Report 1983)) (alteration in original), although the Court went on to say that resale price maintenance "may reduce prices if manufacturers have resorted to costlier alternatives of controlling resale prices that are not *per se* unlawful." *Id.*

would seem enough to make resale price maintenance competitively suspect,[46] and was the main reason Congress repealed the fair trade laws.[47] Studies of the fair trade era showed that prices of items subjected to fair trade in fair trade states were significantly higher than in states where resale price maintenance was illegal, and that fair trade cost consumers *billions* of dollars a year.[48] More recently, music companies' efforts to restrain resale prices of CDs was estimated by the FTC to have cost consumers as much as $480 million.[49]

The Court, however, was not impressed with the argument that resale price maintenance raises prices to consumers, "absent a further showing of anticompetitive conduct."[50] The Court suggested that since the high prices may be accompanied by more dealer services, it is not necessarily the case that resale price maintenance reduces consumer welfare.[51] Was Congress therefore misguided when it saw higher prices in fair trade states as being harmful to consumers? In the absence of other information, is it unreasonable to *presume* that higher prices resulting from resale price maintenance are indicative of consumer harm? I think not.

According to the Court, focusing on higher prices overlooks that a manufacturer ordinarily benefits from *low* resale prices. "As a general matter, therefore," the Court said, "a single

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[46] *See* Nat'l Soc'y of Prof'l Engineers v. United States, 435 U.S. 679, 692 (1978) ("[p]rice is the 'central nervous system of the economy'") (quoting United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 226 n.59 (1940)).

[47] The 1975 Act itself is entitled, "An Act To amend the Sherman Antitrust Act to provide lower prices for consumers." 89 Stat. 801 (1975).

[48] *See* H. REP. NO. 94-341, at 3 (1975); *see also* F.M. Scherer, *Comment on Cooper et al.'s "Vertical Restrictions and Antitrust Policy"*, COMP. POLICY INT'L, Autumn 2005, at 65, 71-74 (reviewing studies showing substantial consumer savings from termination of resale price maintenance in light bulb, retail drug, blue jeans, and other sectors).

[49] *See* Press Release, Fed. Trade Comm'n, Record Companies Settle FTC Charges of Restraining Competition in CD Music Market (May 10, 2000), http://www.ftc.gov/opa/2000/05/cdpres.htm.

[50] *Leegin*, 127 S. Ct. at 2718.

[51] *See id.* ("price surveys 'do not necessarily tell us anything conclusive about the welfare effects of [resale price maintenance] because the results are generally consistent with both procompetitive and anticompetitive theories'") (quoting OVERSTREET at 106) (alteration in original).

manufacturer will desire to set minimum resale prices only if the 'increase in demand resulting from the enhanced service . . . will more than offset a negative impact on demand of a higher retail price.'"[52] However, an alignment between manufacturers' and consumers' interests cannot be generalized.[53]

Any congruence of manufacturer and consumer interests evaporates if the manufacturer adopts resale price maintenance at the behest of its retailers. Indeed, the Court noted, "If there is evidence that retailers were the impetus for a vertical price restraint, there is a greater likelihood that the restraint facilitates a retailer cartel or supports a dominant, inefficient retailer."[54] The Court acknowledged that the risk of resale price maintenance being used to facilitate dealer collusion is a "legitimate concern."[55] Moreover, the Court recognized that, even without dealer collusion, a "manufacturer might consider that it has little choice but to accommodate [a powerful] retailer's demands for vertical price restraints if the manufacturer believes it needs access to the retailer's distribution network."[56] But while recognizing the anticompetitive retailer-power explanation for resale price maintenance, the Court seemed oblivious to the changes in the economy that have heightened the risk of retailer-induced resale price maintenance. For example, the Court emphasized that a single retailer cannot "abuse" resale price maintenance without "market

[52] *Id.* at 2719 (quoting Frank Mathewson & Ralph Winter, *The Law and Economics of Resale Price Maintenance*, 13 REV. IND. ORG. 57, 67 (1998)) (alteration in original).

[53] *See* Toys "R" Us, Inc. v. Fed. Trade Comm'n, 221 F.3d 928, 938 (7th Cir. 2000) (noting that rationale for permitting restricted distribution policies "depends on the alignment of interests between consumers and manufacturers. Destroy that alignment and you destroy the power of the argument.") (internal quotes omitted). Professor Cavanagh maintains that the argument that the manufacturer acts as a surrogate for the consumer "smacks of putting the fox in the chicken coop to protect the hens." Cavanagh, *supra*, at 20.

[54] *Leegin*, 127 S. Ct. at 2719 (citing Brief for William S. Comanor & Frederic M. Scherer as *Amici Curiae* Supporting Neither Party, 2007 WL 173679, at 7-8, which states, "there are no arguments in economic analysis supporting restraints arising from distributor actions or pressures. In such circumstances, RPM and similar restraints lead to higher consumer prices with no demonstrated redeeming values . . . .").

[55] *Id.* at 2717.

[56] *Id.*

power," and quoted the old saw from *Business Electronics* that "[r]etail market power is rare, because of the usual presence of interbrand competition and other dealers."[57] However, common sense says otherwise. Retail buyer power is common[58] and is increasing along with retail concentration.[59] As Justice Breyer pointed out, increased concentration in retailing "may enable (and motivate) more retailers, accounting for a greater percentage of total retail sales volume, to seek resale price maintenance, thereby making it more difficult for price-cutting competitors (perhaps internet retailers) to obtain market share."[60]

Lower retail prices may sometimes be in the manufacturer's interest, but sometimes the manufacturer can maximize its profits when RPM is used to *jointly* maximize the profits of the manufacturer and its retailers, or the manufacturer and its competitors. The Court conceded the danger that resale price maintenance might be used to facilitate a manufacturer cartel[61] but, significantly, failed to recognize that resale price maintenance may also facilitate oligopolistic pricing that may not itself be illegal.[62] The Court also did not acknowledge Justice Breyer's point that "[i]ncreased concentration among manufacturers increases the likelihood that producer-originated resale price maintenance will prove more prevalent today than in years past, and more

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[57] *Id.* at 2720 (quoting Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 727 n.2 (1988)) (alteration in original).

[58] *See, e.g.*, 8 AREEDA & HOVENKAMP, *supra*, ¶ 1604d3, at 48, 49 ("Multibrand dealers' ability to substitute other brands gives the dealers considerable leverage.").

[59] *See, e.g.*, Kris Hudson, *States Target Big-Box Stores -- Maine if First to Require that Wal-Mart, Rivals Undergo Impact Studies*, WALL ST. J., June 29, 2007, at A8 (reporting that in 2006, the ten largest U.S. retailers accounted for 25% of the nation's retail purchases, excluding cars, up from 18% in 1996).

[60] *Leegin*, 127 S. Ct. at 2733.

[61] *See id.* at 2716; *see also* Brief of *Amici Curiae* Economists in Support of Petitioner, *Leegin*, 2007 WL 173681, at 13 (objection "had some traction historically"); OVERSTREET, *supra*, at 22 ("The economics literature contains several examples of possible collusion among manufacturers which may have been facilitated by RPM.").

[62] *See* 8 AREEDA & HOVENKAMP, *supra*, ¶ 1606d-f, at 86-92 (resale price maintenance reinforces manufacturer coordination, whether express or tacit, by reducing utility of wholesale price cuts and increasing visibility of prices; "danger is more than theoretical"). Justice Breyer recognized that facilitation of tacit collusion was the main anticompetitive risk at the producer level. *See Leegin*, 127 S. Ct. at 2727.

harmful."[63] Further, RPM may be used strategically to dampen interbrand price competition at the retail level even when competing manufacturers do not use RPM; competing single-brand retailers and multibrand retailers may respond to a manufacturer's use of RPM by raising the price of other brands.[64]

The Court also failed to recognize manufacturers' incentive independently to adopt resale price maintenance in order to protect their own wholesale margins. Retail discounting is often harmful to the manufacturer because it puts pressure on the manufacturer to reduce its wholesale prices.[65] As a Wal-Mart executive stated when Wal-Mart was the new discounter on the block, "I don't have any question but that competitive pricing at the retail level creates more pressure on manufacturers' factory prices than is present when they're able to set retail prices as well . . . ."[66]

Reduced efficiency and innovation. In addition to raising prices, resale price maintenance has a tendency to reduce innovation and efficiency in retailing. As Justice Breyer noted, resale price maintenance agreements "can inhibit expansion by more efficient dealers whose

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[63] *Id.* at 2734.

[64] *See* Greg Shaffer, *Slotting allowances and resale price maintenance: a comparison of facilitating practices*, 22 RAND J. ECON. 120 (1991) ("legalizing RPM is tantamount to allowing retailers to commit to prices"). A recent study of Toyota's no-haggle pricing policy in Canada provides some empirical support for this phenomenon. *See* Xiaohua Zeng et al., The Competitive Implications of a "No-Haggle" Pricing Policy: The Access Toyota Case (Sep. 9, 2008) (unpublished manuscript), http://management.ucsd.edu/faculty/seminars/2008/papers/weinburg.pdf (finding that Toyota's uniform no-haggle pricing policy not only raised Toyota's retail prices in provinces where it was used, but Honda's as well).

[65] *See, e.g.*, 8 AREEDA & HOVENKAMP, *supra*, ¶ 1606c, at 85-86 (noting "instances in which intense price competition at the dealer level has led to price cuts at the manufacturing level"); Robert L. Steiner, *How Manufacturers Deal With the Price-Cutting Retailer: When Are Vertical Restraints Efficient?*, 65 ANTITRUST L. J. 407, 441-42 (1997) (explaining that resale price maintenance may be used to tame the exercise of countervailing retail power); H. R. REP. NO. 94-341, at 3 (1975) (RPM "is good for the manufacturer, who need not worry that price competition in his products will lead to pressure from his customers to lower his prices").

[66] S. Robson Walton, *Antitrust, RPM, and the Big Brands: Discounting in Small-Town America (II)*, 15 ANTITRUST L. & ECON. REV. No. 2, at 11, 16 (1983).

lower prices might otherwise attract more customers, stifling the development of new, more efficient modes of retailing . . . ."[67] The majority recognized this effect when it noted, "Retailers with better distribution systems and lower cost-structures would be prevented from charging lower prices by the [RPM] agreement."[68] But while the majority was referring to resale price maintenance that is used to organize a retailer cartel,[69] the effect is inherent in resale price maintenance regardless of the purpose for which it is employed. The importance of this exclusionary theory of anticompetitive harm is highlighted by a recent study on the effect of eliminating RPM on books in the United Kingdom in the mid 1990s. In a report last year prepared for the Office of Fair Trading, researchers concluded that the abolition of RPM contributed to the entry and rapid growth of innovative forms of book retailing, namely Internet sellers and supermarkets.[70]

**The Procompetitive Justifications for Resale Price Maintenance**

Declaring that the "economics literature is replete with procompetitive justifications for a manufacturer's use of resale price maintenance,"[71] the Court identified three procompetitive justifications,[72] each of which is problematic.

Free rider theory. The principal theory discussed by the Court and relied upon by resale

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[67] *Leegin*, 127 S. Ct. at 2727; *see* 8 AREEDA & HOVENKAMP, *supra*, ¶ 1632c4, at 320 ("When resale prices are not fixed, price competition among dealers favors the expansion of those with efficient scale and methods, thus lowering the cost of distribution.").

[68] *Leegin*, 127 S. Ct. at 2717.

[69] *See id.* (also noting that "dominant retailer . . . might request resale price maintenance to forestall innovation in distribution that decreases costs").

[70] *See* OFFICE OF FAIR TRADING, AN EVALUATION OF THE IMPACT UPON PRODUCTIVITY OF ENDING RESALE PRICE MAINTENANCE ON BOOKS (Feb. 2008), *available* at http://oft.gov.uk/shared_oft/economic_research/oft981.pdf; *see also* Emanuele Givannetti & David Stallibrass, Three Cases in Search of a Theory: Resale Price Maintenance in the UK (2009) (unpublished manuscript) (noting that "study suggests that this growth of innovative book retailing in the UK would have been substantially slower absent the ability to offer discounted prices").

[71] *Leegin*, 127 S. Ct. at 2714.

[72] Justice Breyer said that the majority had listed just two theories, free rider and new entry. He did not accept the majority's contractual-fidelity theory, discussed *infra*.



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price maintenance advocates is the "free rider" theory, under which resale price maintenance can benefit consumers because the higher prices may induce retailers to provide pre-sale services that promote interbrand competition and otherwise would not be provided. Prominently featured in *Sylvania*, this theory (dating back at least to Telser in 1960) was well known to Congress in 1975 but nonetheless was rejected as a basis for permitting resale price maintenance.[73] As Justice Breyer noted, free riding is common in our economy; the real issue is "how often the 'free riding' problem is serious enough significantly to deter dealer investment."[74] Professors Comanor and Scherer in their *amicus* brief to the Court indicated "there is skepticism in the economic literature about how often" resale price maintenance "is needed to prevent free-riding and ensure that desired services are provided.[75] Klein and Murphy have noted that the standard free-rider theory for resale price maintenance is "fundamentally flawed" because it is based on "the unrealistic assumption that the sole avenue of nonprice competition available to retailers is the supply

[73] *See, e.g.*, S. REP. NO. 94-466, at 3 (1975) (noting that manufacturer could solve services problem "by placing a clause in the distributorship contract requiring the retailer to maintain adequate service. Moreover, the manufacturer has the right to select distributors who are likely to emphasize service."); *House Hearings, supra*, at 32 (statement of Thomas A. Rothwell, Executive Director and General Counsel of Marketing Policy Institute, quoting Bork's efficiency explanation for RPM).

[74] *Leegin*, 127 S. Ct. at 2729.

[75] Brief for William S. Comanor & Frederic M. Scherer as *Amici Curiae* Supporting Neither Party, *Leegin*, 2007 WL 173679, at 6; *see also* F. M. SCHERER & DAVID ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 552 (3rd ed. 1990) ("relatively few products qualify . . . under Telser's free-rider theory"); 8 AREEDA & HOVENKAMP, *supra*, ¶ 1601e, at 13 ("[U]nrestrained intrabrand competition does not lead to substantially detrimental free riding when dealers provide no significant services (such as drugstores selling toothpaste), the services they do provide cannot be utilized by customers who patronize other dealers (luxurious ambience), the services are paid for separately (post-sale repair), the services provided are not brand specific and are fully supported by a wide range of products (high-quality department store), the services can be provided efficiently by the manufacturer (advertising), or a sufficient number of consumers patronize the dealers from whom they receive the service."); *id.* ¶ 1611f, at 134 ("[F]or most products, low-service discounting dealers do not impair the viability of full-service dealers; both exist side by side.").

of the particular services desired by the manufacturer."[76] They have shown that, "[e]ven if the manufacturer fixes the retail price and does not permit price competition, retailers still have an incentive to free ride by supplying nonprice services that are not desired by the manufacturer but are of value to consumers,"[77] such as free gifts, free delivery, discounts on bundled products, rewards programs, and so forth. "No matter how large a margin is created by resale price maintenance, there appears to be no incentive for competitive free-riding retailers to supply the desired . . . services."[78]

The "quality certification" version of the free-rider theory cited by the Court[79] is even more problematic because the discounters are not even expected to offer the services of the prestige retailers, and thus have higher margins with which to continue to "free ride" by offering non-price inducements to attract customers from prestige retailers.[80] Furthermore, even if resale price maintenance is used to prevent free riding and increase output, there is no *a priori* reason to believe that consumers as a whole benefit, because most consumers may prefer the lower-priced product without the services.[81] As Justice Breyer noted, insofar as resale price maintenance agreements encourage dealers to compete on service instead of price, they threaten "wastefully to

[76] Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J. LAW & ECON. 265, 266 (1988). Klein and Murphy were part of the group of *amici* economists supporting the reversal of *Dr. Miles*. *See* Brief of *Amici Curiae* Economists in Support of Petitioner, *supra*, App. 2a.

[77] Klein & Murphy, *supra*, at 266.

[78] *Id.*

[79] Under this version, discount retailers free ride on the reputation of prestige retailers for carrying only high-quality products. *See Leegin*, 127 S. Ct. at 2715-16 ("[C]onsumers might decide to buy the product because they see it in a retail establishment that has a reputation for selling high-quality merchandise.").

[80] *See* Iacobucci, *supra*, at 80-82; *see also* 8 AREEDA & HOVENKAMP, *supra*, ¶ 1613d-g, at 156-65 (maintaining that quality certification theory is "relatively weak" largely because elite dealers' services are unlikely to be driven from the market since they are not brand specific and the ambience of elite dealers is not subject to free riding; "distribution restraints in this context reflect the power of elite dealers rather than the manufacturer's desire").

[81] *See* Brief for William S. Comanor & Frederic M. Scherer, *supra*, at 4-5; *see also* Brief of *Amici Curiae* Economists, *supra*, at 10 (noting that Scherer & Ross have shown "that RPM may reduce both consumer and social welfare under a plausible hypothesis regarding the impact on demand for the product").

attract *too many* resources into that portion of the industry."[82]

Services without free-riding. The Court also maintained that resale price maintenance "can also increase interbrand competition by encouraging retailer services that would not be provided even absent free riding" because it "may be difficult and inefficient for a manufacturer to make and enforce a contract with a retailer specifying the different services the retailer must perform."[83] The Court was apparently referring to Klein and Murphy's "contractual fidelity" theory, which is not so much about the difficulty of contractual specification, but rather about giving dealers excess profits to provide an incentive "for faithful performance of all the dealers' express or implied obligations."[84] Under this theory, the threat of termination or other contractual sanction may be an inadequate incentive against shirking by retailers if they are making only normal profits.[85] Putting aside the issue of why competition among retailers in the absence of free riding would not be sufficient to ensure adequate dealer services,[86] this theory suffers from several flaws. First, as with the standard free-rider theory, this theory is undermined by nonprice

[82] *Leegin*, 127 S. Ct. at 2727 (emphasis added).

[83] *Id.* at 2716.

[84] 8 AREEDA & HOVENKAMP, *supra*, ¶ 1614e, at 172; *see also* Mathewson & Winter, *supra*, at 74 ("The role of resale price maintenance in the Klein-Murphy explanation is to protect retailer quasi-rents against erosion by retail price competition, to ensure that contract termination has sufficient value as a threat.").

[85] Klein & Murphy, *supra*, at 268-69 (many dealers "make insufficient manufacturer-specific investments to insure dealer performance solely through the threat of losing the return on these specific investments").

[86] Justice Breyer did not credit this theory because, he said, "I do not understand how, in the absence of free-riding (and assuming competitiveness), an established producer would need resale price maintenance. Why, on these assumptions, would a dealer not 'expand' its 'market share' as best that dealer sees fit, obtaining appropriate payment from consumers in the process? There may be an answer to this question. But I have not seen it. And I do not think that we should place significant weight upon justifications that the parties do not explain with sufficient clarity for a generalist judge to understand." *Leegin*, 127 S. Ct. at 2733. In fact, the contractual-fidelity theory does rely on a form of free riding or externality, either between dealers as under the traditional theory, or between the manufacturer and the retailer. *See* Klein & Murphy, *supra*, at 281 (noting that dealer may free ride on manufacturer's reputation). The theory responds to the criticism of the traditional free-rider theory that RPM is unnecessary if (and ineffective unless) manufacturers can contractually require retailers to provide services. Klein and Murphy suggest that contractual specification may not be enough to motivate dealers or may not be practical. For a further discussion of the specification point, see *infra*.

competition, which should have a tendency to eliminate the excess dealer profits on which the theory is predicated.[87] Second, as with any resale price maintenance scheme designed to raise dealer margins, the result is likely to harm consumers of multibrand retailers insofar as those retailers steer consumers to high-margin, price-maintained products regardless of their competitive merits.[88] Third, if the goal is merely to increase the rents earned by dealers, then there are less restrictive alternatives, such as lump-sum payments.[89] Finally, it is not obvious that this theory has any empirical significance; how many manufacturers in the real world look to provide supranormal profits to their distributors so that the threat of termination in the case of noncompliance is meaningful?

New entrant theory. The third procompetitive justification discussed by the Court is the "new entrant" justification.[90] Quoting *Sylvania*, the Court suggested that resale price mainte-

[87] *See* Ittai Paldor, Rethinking RPM: Did the Courts Have it Right All Along? 199-202 (June 25, 2007) (unpublished S.J.D. thesis, University of Toronto) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=994750.

[88] *See* 8 AREEDA & HOVENKAMP, *supra*, ¶ 1614a-d, at 165-71 (rejecting dealer goodwill as justification for RPM because providing multibrand retailers with higher margin to push particular brand leads to deception of consumers and reflects retailer power); LAWRENCE A. SULLIVAN & WARREN S. GRIMES, THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK § 6.3c2, at 343 (2006) (noting multibrand retailers' incentives to steer consumers away from brands that offer lower margins even if those brands are competitively superior).

[89] *See* Paldor, *supra*, at 204-08; Iacobucci, *supra*, at 88.

[90] The majority mentioned a fourth theory by way of citing Raymond Deneckere et al., *Demand Uncertainty, Inventories, and Resale Price Maintenance*, 111 Q. J. ECON. 885 (1996), which the Court described as "noting that resale price maintenance may be beneficial to motivate retailers to stock adequate inventories of a manufacturer's goods in the face of uncertain consumer demand[]." *Leegin*, 127 S. Ct. at 2716. Under this theory, RPM assures dealers that if demand turns out to be low they will not be forced to liquidate their inventory at fire-sale prices, which induces the dealers to stock sufficient inventory to cover a high demand. This theory does not necessarily benefit consumers, as the authors note, because it deprives consumers of the surplus that would be obtained in the low demand state absent RPM, which may exceed the surplus with RPM. *See* Deneckere et al., *supra*, at 887 ("[I]n contrast to other efficiency-based theories of RPM . . . in which manufacturer and consumer interests roughly coincide, we show that manufacturer benefits can often come principally from consumer surplus."). Moreover, it assumes that the alternative of paying dealers for unsold inventory in the event of low demand is more costly than enforcing RPM, which is questionable. *See* Paldor, *supra*, at 211-21 (critiquing demand uncertainty hypothesis).

nance can facilitate new entry by "'induc[ing] 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.'"[91] This theory has been questioned by scholars because other tools (such as restricted distribution) are usually more effective in ensuring that "Johnny-come-lately" stores will not siphon off the rewards that pioneering dealers need for their "missionary work."[92] And whatever benefits there may hypothetically be from RPM inducing new entry, it is quite likely substantially outweighed by the ability of RPM-controlled retailers to block new retailer entry, where price discounting is a traditional and frequently used strategy. In any event, this rationale, if convincing, could easily be accommodated by a limited exception to the *per se* rule, as Justice Breyer suggested,[93] although such an exception was expressly rejected by Congress in 1975.[94]

Brand image. Notably, the Court did not include preservation of "brand image" as a procompetitive justification, notwithstanding that manufacturers, including Leegin itself, often cite it.[95] As Professors Areeda and Hovenkamp explain, "Manufacturers often say that price dis-

[91] *Leegin*, 127 S. Ct. at 2716 (quoting Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 55 (1977)). Interestingly, this theory is not typically one of the procompetitive justifications offered by economists. *See, e.g.*, Brief of *Amici Curiae* Economists, *supra* (citing free-rider, contractual-fidelity, and demand-uncertainty theories).

[92] Steiner, *supra*, at 430; *see also* Warren S. Grimes, *Spiff, Polish, and Consumer Demand Quality: Vertical Price Restraints Revisited*, 80 CALIF. L. REV. 817, 849 (1992) (maintaining that less restrictive alternatives are available for new entrants to gain dealer loyalty); 8 AREEDA & HOVENKAMP, *supra*, ¶ 1617a3, at 195-96 (while new-entry rationale makes sense as a justification for exclusive territories, it "seems presumptively inapplicable to resale price maintenance").

[93] *See Leegin*, 127 S. Ct. at 2731 (Justice Breyer stating that if he were starting from scratch, he "might agree that the *per se* rule should be slightly modified to allow an exception for the more easily identifiable and temporary condition of 'new entry.'") (citing Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a Per Se Rule Against Vertical Price Fixing*, 71 GEO. L.J. 1487, 1495 (1983)).

[94] *See* H. REP. NO. 94-341, at 5 (1975).

[95] See *Leegin*, 127 S. Ct. at 2711 (Leegin "expressed concern that discounting harmed Brighton's brand image and reputation."). Nine West also cited it. *See* Letter from the American Antitrust Institute to Deborah Platt Majoras, Re: Petition of Nine West Footwear Corp. to Reopen and Modify Order, FTC File No. 981-0386 (Dec. 5, 2007), *available at* http://www.antitrustinstitute.org/Archives/9W.ashx [AAI *Nine*

counting 'cheapens' their product image and thereby destroys the goodwill that the manufacturer has developed for its product through skillful advertising and marketing. . . . [But u]nless connected with dealer services . . . the claim does not appear to be a powerful one."[96]

This theory rests on the generally implausible assumption that the demand for the good is upward sloping, although particular retailers are able to increase output by lowering price.[97] Insofar as this assumption is based on the proposition that consumers erroneously believe that a higher price itself reflects higher quality (or that a lower price itself reflects lower quality), then it amounts to a frontal assault on the basic policy of the Sherman Act and the Federal Trade Commission Act, which is that consumers are sovereign and must be assumed, when reasonably informed, to make rational decisions in a competitive marketplace. Indeed, Congress rejected this theory as a justification for fair trade because "the marketplace should be allowed to judge the value of a 'brand image' without the restraints imposed by resale price maintenance."[98] Even if "snob appeal," or conspicuous consumption, might support an upward-sloping demand curve in some circumstances, such a rationale is not a legitimate justification for RPM because it is difficult to disentangle from the effects arising from deception, and conspicuous consumption offers no intrinsic benefit for consumers. Moreover, a high-price image can be controlled by setting the wholesale price or by restricting distribution to high-end retailers, without the anticompetitive side effects of RPM.[99]

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*West* Letter]; *see also* Henry & Zelek, *supra*, at 8 ("Significant discounting of a product can adversely affect the manufacturer, its resellers and the product itself by eroding brand image . . . .").

[96] 8 AREEDA & HOVENKAMP, *supra*, ¶ 1631a1, at 306; *see id.* ¶ 1633d2(A), at 335 (would reject protection of manufacturer goodwill as a justification for RPM, at least presumptively).

[97] *See id.* ¶ 1613c, at 156 (postulated upward-sloping demand curve has little empirical support).

[98] H.R. REP. NO. 94-341, at 5 (1975).

[99] *See* OVERSTREET, *supra*, at 61 n.1 ("[I]n the snob appeal case it is not obvious why RPM would be necessary because the manufacturer could insure high prices without RPM."); Pitofsky, *supra*, at 1494.

Other theories. The ABA offers another justification for RPM not mentioned by the Supreme Court or the *amici* economists: the prevention of "loss leaders." According to the ABA, large retailers that carry a wide variety of products "may sell selected certain products as loss leader prices that smaller retailers specializing in those products cannot match. This unrestrained advantage eventually will result in the disappearance of such outlets for those products."[100] This justification harkens back to the original justification for the fair trade laws – to protect "Mom and Pop" retailers from "unfair" competition by discount chains – which Congress rejected in passing the Consumer Goods Pricing Act of 1975,[101] and which cuts against the grain of modern antitrust's policy of "protecting competition, not competitors." Absent a violation of Section 2, or perhaps the Robinson-Patman Act, it is not clear how consumers are harmed by loss-leader pricing, which is often used by new entrants to gain market share. Areeda and Hovenkamp are critical of this theory, noting that "no one has yet adduced any empirical evidence that that the hypothesized evils of loss-leader selling occur with any frequency. Vague complaints of 'unfair loss-leader tactics' are much more common than actual examples of consumer acceptance being destroyed, rival dealers ruined, or manufacturers prejudiced."[102]

**Empirical Evidence**

What of the empirical evidence? The Court concluded, "although the empirical evidence on the topic is limited, it does not suggest efficient uses of the agreements are infrequent or hypothetical" and thus "the [*per se*] rule would proscribe a significant amount of procompetitive

[100] ABA Letter, *supra*, at 3.

[101] *See* S. REP. NO. 94-466, at 3; *see also Senate Hearings*, *supra*, at 16-17 (testimony of Thomas Kauper, Assistant Attorney General, rejecting loss leader argument).

[102] 8 AREEDA & HOVENKAMP, *supra*, ¶ 1619, at 206; *see id.*, ¶ 1633d at 335 (would reject preventing loss leaders as a justification for RPM, at least presumptively).

conduct . . . ."[103] The dissent disagreed. Justice Breyer could "find no economic consensus" on how often resale price maintenance will be beneficial in practice.[104] The majority cited two "recent" empirical studies of litigated cases.[105] One by Pauline Ippolito, published in 1991, reviewed all cases (public and private) reported between 1976 and 1982 that included resale price maintenance claims.[106] The other by Thomas Overstreet, issued by the FTC in 1983, reviewed the 68 resale price maintenance cases brought by the FTC that were resolved between 1965 and 1982.[107]

Ippolito concluded that the cases were generally not consistent with dealer or manufacturer cartel theories,[108] but Justice Breyer noted that "this study equates failure of plaintiffs to *allege* collusion with the *absence* of collusion – an equation that overlooks the superfluous nature of allegations of horizontal collusion in a resale price maintenance case that would be tried

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[103] *Leegin*, 127 S. Ct. at 2717-18. The ABA goes further, stating, "Most of the significant economic literature regards minimum resale price maintenance as more likely to be used by manufacturers to achieve efficiencies in distribution of their products than to enable dealers to maintain significant margins." ABA Letter, *supra*, at 2. Yet even the economists' *amicus* brief notes, "There is some disagreement within the economics literature, and among *amici*, regarding the frequency with which minimum RPM has procompetitive or anticompetitive effects." Brief of *Amici Curiae* Economists in Support of Petitioner, *supra*, at 16.

[104] *Id.* at 2729.

[105] *Id.* at 2715, 2717.

[106] *See* Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence From Litigation*, 34 J. LAW & ECON. 263, 266 (1991) [Ippolito, *RPM*]. Ipppolito's work was originally published as a staff report of the Federal Trade Commission Bureau of Economics. *See* PAULINE M. IPPOLITO, RESALE PRICE MAINTENANCE: ECONOMIC EVIDENCE FROM LITIGATION (FTC Bureau of Economics Staff Report 1988) [IPPOLITO, STAFF REPORT]. Her sample consisted of 73 cases brought by federal or state enforcement agencies and 130 private cases, about 30% of which involved maximum RPM claims. *See* Ippolito, *RPM*, *supra*, at 268-69. Information about the cases came from judicial opinions and consents reported in the CCH Trade Cases reporter. *See id.* at 266.

[107] *See* OVERSTREET, *supra* note 97, at 63. Many of the FTC cases reviewed by Overstreet are also in the Ippolito sample. *Compare id.* at 92-100 *with* IPPOLITO, STAFF REPORT, *supra*, at Table A1.

[108] *See* Ippolito, *RPM*, *supra* note 148, at 281 (noting that only 13% of the sample included allegations of horizontal price fixing). *But see* IPPOLITO, STAFF REPORT, *supra*, at 53 (45% of RPM cases brought by DOJ involved allegations of horizontal price fixing).



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under the *per se* rule, and the tacit form that such collusion might take."[109] Ippolito also concluded that the "special services," or free rider theory, "has the *potential* to be a major explanation for RPM-type practices"[110] based on the fact that 50 percent of the private cases and 42 percent of the government cases involved what she categorized as "complex products," i.e. "products for which quality and use information were nontrivial issues prior to purchase and where the information was not specific to the retailers' goods."[111] This can hardly be described as "evidence" that free riding was involved in any of these cases; at most it suggests that free riding could not be ruled out.

In his study, Overstreet concluded that "RPM was not likely motivated by collusive dealers who had successfully coerced their suppliers into using RPM to facilitate a widespread dealers' cartel" based on the fact that in 47 cases where data were available, over 80 percent involved products with more than 200 dealers.[112] But large numbers do not necessarily indicate low concentration or the absence of a dominant dealer or a small number of dominant dealers, and the study does not consider whether resale price maintenance may have been limited to local markets

[109] *Leegin*, 127 S. Ct. at 2732 (citing HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY § 11.3c, at 464 & n.19 (3d ed. 2005)) (making similar criticism). Ippolito's assumption was that "if the plaintiff had any evidence that the practice at issue in the litigation was used to support collusion, we would expect to see horizontal price-fixing allegations in these cases, in addition to the RPM allegation." Ippolito, *RPM, supra*, at 281. This raises the question of the validity of drawing any inferences about the actual *practice* of RPM from private cases with RPM *allegations*, when RPM may not have been present at all in many of the cases. *See* Brunell, *supra*, at 509 n.151.

[110] Ippolito, *RPM, supra,* at 285 (emphasis added).

[111] *Id.* at 283; *see id.* at 284 (categorizing as complex such products as printing, funeral insurance, and television sets).

[112] OVERSTREET, *supra*, at 80 ("Widespread dealer collusion involving more than 100 (or 200) decision makers seems unlikely to be effective or persistent in the absence of restrictions on entry such as licensing requirements or some mechanism for overt coordination such as an active trade association."). Overstreet also concluded that manufacturer collusion was an unlikely explanation for most of the cases, since "a good deal of the RPM reflected in FTC cases has occurred among small firms selling in markets that are structurally competitive." *Id.* at 78; *see id.* at 73 (finding only 24.4% of cases had four-firm concentration in excess of 50%, measured using 5 digit S.I.C. product classes).

in which dealer concentration was high.[113] Moreover, some of the best-documented instances of resale price maintenance in history, such as those involving retail druggists, involved dealer cartels in highly unconcentrated markets.[114] Overstreet did not look for indications of procompetitive explanations of resale price maintenance,[115] and recognized that the information he used for his study was generally "inadequate to determine rigorously whether the associated economic conditions correspond best with procompetitive or anticompetitive hypotheses about the use of RPM."[116] Neither Ippolito nor Overstreet considered whether dealer pressure without collusion might have accounted for any of the instances of resale price maintenance. In sum, neither of these antiquated "new" studies does much to fill "the dearth of empirical evidence" on the effects of resale price maintenance noted by Ippolito.[117] However, many commentators agree with Overstreet's later observation that "the historical experience, or practice of RPM [is] largely a sorry record of abuses, in sharp contrast to the contention of RPM's missionaries."[118]

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[113] *See id.* at 80 ("Whether local dealer collusion (or monopsony) could explain particular instances of RPM cannot presently be determined from the general information in the case files.").

[114] *See* Thomas R. Overstreet Jr. & Alan A. Fisher, *Resale Price Maintenance and Distributional Efficiency: Some Lessons from the Past*, 3 CONTEMP. POL'Y ISSUES 43, 49-50 (1985) (noting that, contrary to predictions of economic analysis, retail druggists cartel "achieved virtually universal compliance with a price-fixing policy–despite very large numbers and an extremely unconcentrated market").

[115] *See* OVERSTREET, *supra*, at 66-68. The Court quoted Overstreet's conclusion that "'[e]fficient uses of [resale price maintenance] are evidently not unusual or rare,'" *Leegin*, 127 S. Ct. at 2715 (alteration in original), but this conclusion seems to be based on his determination that his study and the prior studies that he reviewed did not show that dealer and manufacturer collusion always or almost always explained RPM, rather than any studies affirmatively demonstrating efficient uses of RPM. *See* OVERSTREET, *supra*, at 165-67.

[116] *Id.* at 66. Indeed, Overstreet noted that the case records "generally contain only limited information concerning the scope of particular RPM programs and the extent to which they were enforced," *id.*, and most files had "no description of the RPM practices of competitors." *Id.* at 67.

[117] Ippolito, *RPM, supra*, at 293 ("The current dearth of empirical evidence on the use of vertical restraints and of RPM in particular seriously limits the development of economic understanding of these practices.").

[118] Overstreet & Fisher, *supra*, at 45; *see also* Brunell, *supra*, at 511 n.160 9 (citing additional sources).

**Less Restrictive Alternatives**

Perhaps the most glaring flaw in the majority's analysis is its failure to consider whether any procompetitive effects of resale price maintenance can be achieved by less restrictive means that do not prevent efficient retailers from passing on their lower costs to consumers. If so, then the costs of the *per se* rule would be minimal. *Amici* economists recognized that manufacturers might curtail free riding by other means, and that where such means are available, "RPM may not offer an incremental benefit to interbrand competition that would offset the diminution of intrabrand competition."[119] The most obvious way to ensure desired retailer services is to pay retailers for performing those services, using promotional allowances or other marketing techniques.[120] There is no empirical evidence whatsoever that such techniques are more costly or less effective than resale price maintenance in obtaining dealer services,[121] which is perhaps why the Court ignored the point.[122] To be sure, promotional allowances for services may ultimately also raise consumer prices to account for the cost of the services, but unlike resale price maintenance, such payments do not prevent discounting that reflects more efficient retailers' lower

[119] Brief of *Amici Curiae* Economists, *supra*, at 9.

[120] *See, e.g.*, Toys "R" Us, Inc. v. Fed. Trade Comm'n, 221 F.3d 928, 933, 938 (7th Cir. 2000) (rejecting free-rider argument because services performed by retailer, such as advertising, warehousing and full-line stocking, were compensated by manufacturer).

[121] *See* 8 AREEDA & HOVENKAMP, *supra*, ¶ 1632b at 318 ("there are few documented instances of significantly impaired distribution" as a result of ban on RPM).

[122] The Robinson Patman Act is no impediment to reimbursing retailers for services that benefit the supplier. *See* Richard M. Steuer, *Dysfunctional Discounts*, ANTITRUST, Spring 2005, at 75, 79. *Amici* economists maintained that paying dealers for services may not be as efficient as RPM "*under some circumstances*" because "it may be difficult to specify completely all of the services that the retailer must perform and the level at which it must perform them," or because it is "possible that the retailer, rather than the manufacturer, knows which retail-level services will be the most effective in maximizing the competitiveness of the product, or that the most effective services will be discovered only through experience with the market and will be more apparent to the retailer than to the manufacturer." Brief of *Amici Curiae* Economists, *supra*, at 9 (emphasis added). However, no evidence was offered as to the empirical significance of these possibilities. It is not apparent why a retailer would choose to provide services that the manufacturer has not even asked for when other retailers are not also required to provide such services, unless the services themselves are profitable for a retailer, which means that resale price maintenance is not necessary in the first place.

costs of doing business. As New York's Solicitor General pointed out at oral argument, "It's a question really of what kind of currency a manufacturer can use to buy those retailer services."[123]

The Court missed this simple truth, as is evident in its critique of the argument that resale price maintenance should be considered anticompetitive merely because it raises prices:

> The implications of respondent's position are far reaching. Many decisions a manufacturer makes and carries out through concerted action can lead to higher prices. A manufacturer might, for example, contract with different suppliers to obtain better inputs that improve product quality. Or it might hire an advertising agency to promote awareness of its goods. Yet no one would think these actions violate the Sherman Act because they lead to higher prices. The antitrust laws do not require manufacturers to produce generic goods that consumers do not know about or want. The manufacturer strives to improve its product quality or to promote its brand because it believes this conduct will lead to increased demand despite higher prices. The same can hold true for resale price maintenance.[124]

But the difference between resale price maintenance and these other quality-enhancing activities that also raise prices is that, even assuming that resale price maintenance in theory can be used to increase demand, it comes with an anticompetitive weight attached: it always prevents more efficient retailers from cutting prices based on their lower costs. And, of course, these other activities raise demand directly, and only indirectly raise prices, while resale price maintenance raises prices directly and only indirectly may lead to the hoped-for benefits.

**Costs of the Rule of Reason**

The majority acknowledged that "the *per se* rule can give clear guidance for certain conduct"[125] and "may decrease administrative costs,"[126] but minimized the significance of the issue by asserting that "[a]ny possible reduction in administrative costs cannot alone justify the *Dr.*

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[123] Transcript of Oral Argument, *Leegin*, 2007 WL 967030, at 48 (Mar. 26, 2007) (Barbara Underwood).

[124] *Leegin*, 127 S. Ct. at 2719.

[125] *Id.* at 2713.

[126] *Id.* at 2718.

*Miles* rule."[127] But no one had argued they did. Justice Breyer contended that the administrative costs of a rule of reason would be significant, and militated strongly in favor of retaining the *per se* rule. And the cost of the rule of reason is not simply uncertainty and adjudication costs, but the "false negatives" that result from making it significantly more difficult to bring a successful resale price maintenance suit.

Although the Court said that the lower "courts would have to be diligent in eliminating . . . anticompetitive uses [of RPM] from the market,"[128] and instructed them to "establish the litigation structure to ensure the rule [of reason] operates to eliminate anticompetitive restraints from the market and to provide more guidance to businesses,"[129] Justice Breyer pointed out that will not be an easy exercise.[130] The Court suggested three relevant considerations for the rule of reason – number of manufacturers using the restraint, source of the restraint, and market power – but the Court's obtuse three paragraphs of instruction offer little guidance and likely will exonerate many anticompetitive uses of resale price maintenance.

The Court said the "number of manufacturers that make use of the practice in a given industry can provide important instruction,"[131] for widespread coverage of resale price mainte-

[127] *Id.* The Court pointed out that *per se* rules "can increase the total cost of the antitrust system by prohibiting procompetitive conduct the antitrust laws should encourage." *Id.* And, gilding the lily, added, "They also may increase litigation costs by promoting frivolous suits against legitimate practices." *Id.* Of course, if the practice is deemed *per se* illegal, then it is not legitimate under the law and suits challenging it can hardly be considered frivolous. The nature of *per se* rules is that they are overinclusive and lead to false positives. The Court seemed to think that the rule of reason leads to more accurate results, but that is not necessarily the case, as noted in the text.

[128] *Id.* at 2719.

[129] *Id.* at 2720.

[130] Professor Hovenkamp notes, "Justice Breyer's dissent is certainly correct about one thing: lower courts are going to have difficulty fashioning a rule of reason for resale price maintenance." PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW, ¶ 1620.1 (Supp. 2008) [AREEDA & HOVENKAMP SUPP].

[131] *Id.* at 2719.

nance may facilitate a manufacturer's cartel,[132] or deprive consumers of meaningful choice.[133] But the Court did not acknowledge the difficulties of determining the extent of coverage when local variation and "informal" resale price maintenance are considered, as they should be.[134] Nor did the Court offer guidance on the extent of market coverage that may be considered problematic. In a concentrated market, coverage need not be extensive to trigger concern about manufacturer coordination.[135] The FTC entirely ignored the "market coverage" factor in its *Nine West* decision, even though Nine West had maintained that one reason it wished to use RPM was that many of its competitors were doing so.[136]

The Court allowed that the "source of the restraint may also be an important considera-

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[132] As noted above, the Court did not acknowledge that resale price maintenance can facilitate oligopoly pricing. If cartel facilitation were the only issue, then it would be difficult to quarrel with the arguments of RPM proponents that RPM needs no independent legal sanction.

[133] *Id.* at 2719 (quoting Scherer and Ross to the effect that widespread coverage of RPM "'depriv[es] consumers of a meaningful choice between high-service and low-price outlets'"); *see also* Brief for William S. Comanor & Frederic M. Scherer, *supra*, at 9 (noting that with widespread market coverage "consumer choice is restricted to goods with bearing high distribution margins" and dealer promotional efforts will "largely cancel each other out in the aggregate, leading to a high-price, high-margin, high promotional cost equilibrium with relatively little if any expansion of demand.").

[134] Areeda and Hovenkamp argue persuasively that "[i]n measuring market coverage, vertically integrated firms should be counted among those using the vertical restraint, along with firms controlling resale prices informally." 8 AREEDA & HOVENKAMP, *supra*, ¶ 1606g6, at 96. But they note the difficulties of determining market coverage "because a suit involving one or a few manufacturers will seldom offer reliable information about other manufacturers' vertical restraints, especially their informal ones." *Id.*, ¶ 1632d2, at 322. Market coverage must be assessed at the local level if consumers' ability to avoid price-maintained products is taken seriously.

[135] *See id.* ¶ 1606g5, at 96 (danger of use of RPM to facilitate manufacturer coordination in concentrated market "does not disappear" at market coverage between 10-50 percent); Brief for William S. Comanor & Frederic M. Scherer, *supra*, at 10 (suggesting presumption of illegality in concentrated markets where RPM is implemented by seller with at least 10 percent market share; "[f]ocusing on oligopolistic sellers' market structure is appropriate because under oligopoly, imitation of one leading seller's marketing strategy by other sellers is more likely").

[136] *See* AAI *Nine West* Letter, *supra*; *see also* Howard P. Marvel, *Resale Price Maintenance and the Rule of Reason*, ANTITRUST SOURCE, June 2008, at 8, http://www.abanet.org/antitrust/at-source/08/06/Jun08-Marvel6=26f.pdf ("The willingness to dismiss the possibility of a manufacturer cartel is somewhat surprising, given the widespread use of RPM in conjunction with the sale of women's shoes.").

tion,"[137] but Justice Breyer pointed out that "it is often difficult to identify *who* – producer or dealer – is the moving force behind any given resale price maintenance agreement."[138] More fundamentally, one does not need a retailer cartel or a "dominant, inefficient retailer," as the Court suggests,[139] to find retail buyer power or to conclude that RPM is a product of such power rather than an effort to promote distribution efficiencies. The FTC also gave short shrift to this factor in *Nine West* when it apparently accepted at face value Nine West's assertion that "it is responsible for its desire to engage in resale price maintenance."[140]

The Court indicated that market power is important,[141] and some commentators and lower courts have interpreted *Leegin* to adopt a manufacturer market-power screen.[142] However, the absence of traditionally defined market power (i.e., significant market share) on the part of the manufacturer does not mean that resale price maintenance is harmless.[143] Manufacturers

[137] *Leegin*, 127 S. Ct. at 2719.

[138] *Id.* at 2730.

[139] According to the Court, "If there is evidence that retailers were the impetus for a vertical price restraint, there is a greater likelihood that the restraint facilitates a retailer cartel or supports a dominant, inefficient retailer. . . . If, by contrast, a manufacturer adopted the policy independent of retailer pressure, the restraint is less likely to promote anticompetitive conduct." *Id.*

[140] FTC *Nine West* Order, *supra*, at 15.

[141] The Court said that under the rule of reason in general, "[w]hether the businesses involved have market power is a . . . significant consideration." *Leegin*, 127 S. Ct. at 2712.

[142] *See* Fiala & Westrich, *supra*, at 4 ("Although the Court in *Leegin* did not expressly sanction the adoption of a market power screen at the pleading stage, there is some support in the opinion for such an approach."); Michael L. Denger & Joshua Lipton, *The Rule of Reason and* 'Leegin *Policies': The Supreme Court's Guidance*, ANTITRUST, Fall 2007, at 45, 46 ("[A] finding of market power is a necessary–but not sufficient–prerequisite to a finding that a single manufacturer's use of resale price maintenance is anticompetitive.").

[143] The Court said that "if a manufacturer lacks market power, there is less likelihood it can use the practice to keep competitors away from distribution outlets," *Leegin*, 127 S. Ct. at 2720, but the use of resale price maintenance to obtain exclusive dealing has never been one of the main concerns of RPM. *See* 8 AREEDA & HOVENKAMP, *supra*, ¶ 1632c, at 319-21. The lack of market power has been thought to be important to resale price maintenance because, in the absence of brand market power at the local level, RPM cannot be used to raise retail prices. In any event, manufacturer market power is irrelevant when RPM is imposed at the behest of retailers. *See* AREEDA & HOVENKAMP SUPP., *supra*, ¶ 1620.1 ("in a

with relatively small market shares but powerful brands may have significant market power.[144] Indeed, it is commonly understood by economists that neither retailers nor manufacturers will engage in resale price maintenance without some interbrand market power.[145] In all events, as Justice Breyer noted, the "Court's invitation to consider the existence of 'market power' . . . invites lengthy time-consuming argument among competing experts, as they seek to apply abstract, highly technical, criteria to often ill-defined markets."[146] Or worse, courts will simply dismiss the complaint out of hand under the restrictive *Twombly* pleading rules because of insufficient allegations of market definition, as I noted at the outset several have already done.

Finally, the Court declined to offer guidance on how courts are to consider the procompetitive side of the rule of reason equation. While the Court identified certain procompetitive theories, it did not suggest how a manufacturer might prove them, perhaps because as Justice Breyer observed, "it is difficult to determine just when, and where, the 'free riding' problem is serious enough to warrant legal protection."[147] Nor did the Court indicate whether less restrictive alternatives should be considered, or how any procompetitive justification should be balanced against anticompetitive effects.

The upshot of the Court's decision, besides leaving businesses and the lower courts

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case of RPM imposed by a powerful dealer, the relevant power is that of the dealer in the market in which it purchases").

[144] *See* SULLIVAN & GRIMES, *supra*, § 7.3a1, at 384-88. Likewise, multibrand retailers with relatively modest market shares may have significant buyer power. *See* Brunell, *supra*, at 499 n.110.

[145] *See* Ward S. Bowman, Jr., *The Prerequisites and Effects of Resale Price Maintenance*, 22 U. CHI. L. REV. 825, 849 (1955) ("Price maintenance appears to be incompatible with an assumption of pure competition among both sellers and resellers."); 8 AREEDA & HOVENKAMP, *supra*, ¶ 1632e2, at 324-25 ("most products subject to RPM are sufficiently differentiated to enjoy greater pricing discretion than is possible for perfectly competitive products"). Accordingly, the presence of resale price maintenance may itself be some evidence of market power.

[146] *Leegin*, 127 S. Ct. at 2730; *see* Pitofsky, *supra*, at 1489 (noting that definition of relevant product and geographic markets is "a complicated and extremely elaborate economic inquiry in itself").

[147] *Leegin*, 127 S. Ct. at 2730.

largely at sea, is that the private bar and public enforcers will be reluctant to bring cases. As Professor Pitofsky has noted, "rule of reason cases often take years to litigate[,] are extremely expensive" and are "very difficult for a plaintiff (either the government or a private party) to win . . . ."[148] Most commentators agree that the rule of reason, as applied by the lower courts to nonprice vertical restraints, has resulted in a rule of virtual *per se* legality.[149] The early dismissal of RPM claims on the pleadings suggests that the same rule may result for RPM.[150] Even if the lower courts are more diligent about RPM, the cost and uncertainty of undertaking a rule of reason case will no doubt mean that businesses will be more apt to engage in anticompetitive RPM, and many instances of anticompetitive resale price maintenance will go unremedied. Moreover, manufacturers that face pressure from retailers to adopt resale price maintenance will no longer be able to just say "no, it's illegal."[151]

**The Dichotomy Between Price and Nonprice Restraints**

One of the rationales for the Court's decision was that there is "little economic justification for the current differential treatment of vertical price and nonprice restraints,"[152] notwith-

[148] Pitofsky, *supra,* at 1489; *see also* AREEDA & HOVENKAMP SUPP., *supra*, ¶ 1620.1 ("[L]itigation under the rule of reason generally is extraordinarily expensive in relation to the size of the interests at stake, and it is likely to be even more costly for a practice as poorly understood and complex as RPM.").

[149] *See, e.g.,* Douglas H. Ginsburg, *Vertical Restraints: De Facto Legality Under the Rule of Reason*, 60 ANTITRUST L.J. 67 (1991). Plaintiffs cannot win nonprice restraints cases not because such restraints are never anticompetitive, but rather because the hurdles for recovery are so high. Not only must plaintiffs jump through the "agreement" hoops that the Court established for resale price maintenance, *see, e.g.,* Parkway Gallery Furn., Inc. v. Kittinger/Pennsylvania House Group, Inc., 878 F.2d 801 (4th Cir. 1989), but lower courts have ordinarily required plaintiffs to make a threshold showing that the manufacturer has market power and "[m]ost cases have made clear that power will not be inferred unless the defendant's market share is significant." 8 AREEDA & HOVENKAMP, *supra*, ¶ 1645c, at 404-05.

[150] Professor Blair concludes that the lack of practical guidance offered by the Court in light of the intractable difficulties of determining when promotional use of RPM advances consumer welfare suggests that "the Court intended to make RPM per se legal without actually saying so." Roger D. Blair, *The demise of* Dr. Miles: *Some troubling consequences*, 53 ANTITRUST BULL. 133, 151 (2008).

[151] *See* 8 AREEDA & HOVENKAMP, *supra*, ¶ 1632b, at 319 ("There is little doubt that per se illegality strengthens the hands of manufacturers in resisting dealer demands for price protection.").

[152] *Leegin*, 127 S. Ct. at 2723.

standing that the Court in *Sylvania* had said "[t]here are . . . significant differences that could easily justify different treatment."[153] In fact, different treatment is justified because, as Areeda and Hovenkamp explain, "Nonprice restraints fulfill a wider range of potentially legitimate objectives and threaten fewer harms to competitive interests" than resale price maintenance.[154] The Court in *Sylvania* had noted that unlike nonprice vertical restraints, vertical price agreements "almost invariably" reduce interbrand competition.[155] Indeed, resale price maintenance agreements *are* more likely than nonprice restraints to restrict interbrand competition at both the retailer and manufacturer levels. At the retailer level, only resale price maintenance restricts retailers from competing on price *against other brands*.[156] And resale price maintenance, unlike nonprice restraints, prevents more efficient retailers from passing on the benefits of that efficiency to consumers.[157] Furthermore, by restricting an important competitive tool, resale price maintenance stultifies "interbrand" competition among multibrand retailers, which are generally not

[153] Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 51 n.18 (1977). The *Leegin* majority dismissed this "footnote" on the basis that "the central part of the opinion relied on authorities and arguments that find unequal treatment 'difficult to justify,'" quoting Justice White's concurring opinion. 127 S. Ct. at 2721. But the *Sylvania* majority expressly referred to Justice White's argument and rejected it. *See Sylvania*, 433 U.S. at 51 n.18.

[154] 8 AREEDA & HOVENKAMP, *supra*, ¶ 1630b, at 302; *id.* at 303 ("It is . . . entirely reasonable to regard resale price maintenance as a more pervasive threat to competition than nonprice restraints."); *see* AREEDA & HOVENKAMP SUPP., *supra*, ¶ 1620.1 ("[T]here is a strong consensus that RPM poses greater threats to competition than do most nonprice restraints, perhaps significantly greater."). The fact that the Court saw fit to articulate guidelines for the rule of reason that are arguably more stringent than the rule of reason applicable to nonprice restraints underscores that different treatment is warranted.

[155] *Sylvania*, 433 U.S. at 51 n.18 (quoting Justice Brennan's concurring opinion in *White Motor*).

[156] Even airtight territorial exclusives, while more restrictive of intrabrand competition, allow restricted dealers to compete fully in their territories against dealers of other brands. But RPM prevents restricted dealers "from engaging resellers of other brands in price competition." 8 AREEDA & HOVENKAMP, *supra*, ¶ 1630b, at 303.

[157] *See* Arthur H. Travers, Jr. & Thomas D. Wright, Note, *Restricted Channels of Distribution Under the Sherman Act*, 75 HARV. L. REV. 795, 801 (1962) (noting that territorial and customer restraints do not have "settled propensity of resale price maintenance to prevent dealers or distributors from passing the benefits of efficient distribution on to consumers by adopting a high-volume, low-markup policy") (cited with approval in White Motor Co. v. U.S., 372 U.S. 253, 268 n.7 (1963) (Brennan, J., concurring)).

susceptible to territorial or customer restraints.[158] As a general matter, "[t]he form of restraint most likely to reflect dealer power is resale price maintenance."[159] The Court in *Sylvania* also distinguished price and nonprice vertical restraints on the ground that price restraints, unlike nonprice restrains, can facilitate a manufacturers' cartel.[160]

Besides doing less harm, nonprice vertical restraints are more likely to have procompetitive benefits than vertical price restraints might have. Nonprice vertical restraints have a wider range of legitimate justifications, including ensuring efficient dealer scale, focusing dealer effort on developing classes of customers or territories, and promoting product quality and safety.[161] Moreover, to the extent that territorial or customer restraints entirely eliminate intrabrand competition, such restraints are more likely than resale price maintenance agreements to solve free-rider problems.[162] In short, it makes sense to apply a more stringent standard to RPM than to nonprice vertical restraints.

The vast majority of advanced industrial countries generally ban minimum RPM and treat

[158] *See* 8 AREEDA & HOVENKAMP, *supra*, ¶ 1604g6, at 65.

[159] *Id.*; *see also id.* ¶ 1630b, at 303 ("Historically . . . price rather than nonprice restraints have been the vehicle chosen by dealer organizations to limit competition among their members.").

[160] *See Sylvania*, 433 U.S. at 51 n.18; *see also* Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 725-26 (1988) (noting that authorities cited by *Sylvania* suggested RPM may assist cartelization, but "[s]imilar support for the cartel-facilitating effect of vertical nonprice restraints was and remains lacking"); 8 AREEDA & HOVENKAMP, *supra*, ¶ 1606h, at 99 ("[M]ost nonprice restraints lack the characteristics that enable resale price maintenance to support price coordination among manufacturers.").

[161] *See id.* ¶ 1647 (reviewing justifications for nonprice restraints); *Sylvania*, 433 U.S. at 55 n.23 (noting that nonprice restraints may be used by manufacturers to ensure compliance with product safety and warranty responsibilities).

[162] *See* SULLIVAN & GRIMES, *supra*, § 6.3b, at 338; Ittai Paldor, The Vertical Restraints Paradox: Justifying the Different Legal Treatment of Price and Non-price Vertical Restraints 36 (Jan. 29, 2007) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=951609. As long as dealers still compete, as they do under resale price maintenance (but not under airtight territorial exclusivity), they have the incentive and ability to free ride on service-providing dealers by offering free shipping, discounts on bundled items, and so forth. Of course, as noted above, territorial exclusives are impractical for multibrand retailers.



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it more harshly than nonprice vertical restraints.[163] For example, the European Union, which liberalized its treatment of most nonprice restraints, continues to treat minimum RPM as a "hard-core" restraint, equivalent to being almost *per se* illegal.[164] Individual member states, many of which led the Untied States in abolishing fair trade, follow suit.[165] The fact that most of the rest of the advanced industrialized world apparently recognizes the wisdom of some form of *per se* approach underscores the lack of consensus on the *Leegin* rule.[166]

**Tension With the *Colgate* Doctrine**

The Court thought that the *Colgate* doctrine, which permits manufacturers "unilaterally" to impose RPM by terminating retailers that do not follow its suggested prices, militated in favor of repealing *Dr. Miles*. After all, if the "economic effects of unilateral and concerted price setting are in general the same,"[167] what is the justification for making one *per se* legal and one *per se* illegal? It only pushes manufacturers that wish to set retail prices to adopt wasteful or seem-

[163] *See* ORGANISATION FOR ECON. CO-OPERATION AND DEV., ROUNDTABLE ON RESALE PRICE MAINTENANCE 2 (2008) [OECD RPM REPORT] (reporting that per se approach to RPM "persists in nearly every OECD country").

[164] EU law creates a strong presumption of illegality, but this presumption is rebuttable if the firm in question establishes the agreement is indispensible to the achievement of substantial efficiencies that benefit consumers. *See* Luc Peeperkorn, *Resale Price Maintenance and its Alleged Efficiencies*, 4 EUR. COMP. J. 201, 203 (2008). In contrast, most vertical nonprice restraints, as well as maximum RPM, are presumptively lawful if undertaken by a supplier with a market share of less than 30%. *See id.* at 202. While an RPM agreement could be legal under EU law, Peeperkorn, the principal administrator of the European Commission's competition directorate, concludes that the "efficiency arguments mentioned in support of RPM are not very strong and that RPM is not an efficient instrument for bringing about these efficiencies." *Id.* at 212. As an alternative a strict *per se* rule, the EU approach is a sensible one.

[165] *See, e.g.*, II ABA SECTION OF ANTITRUST LAW, COMPETITION LAWS OUTSIDE THE UNITED STATES France-42, Germany-33, United Kingdom-56 (2001); *see also* Paldor, *supra*, at 51-52; SCHERER & ROSS, *supra*, at 549-50.

[166] A notable exception may be Canada, which recently decriminalized RPM and required the Competition Tribunal to find an adverse effect on competition before condemning it. *See* Budget Implementation Act (2009) (Can.) § 426, *available at* http://www2.parl.gc.ca/content/hoc/Bills/402/Government/C-10/C-10_1/C-10_1.PDF.

[167] *Leegin*, 127 S. Ct. at 2722.

ingly irrational measures to get into the former category, according to the Court.[168] Moreover, the *Colgate* doctrine has been widely criticized as distorting the concept of "agreement" under Section 1, which not only sows confusion in the law, but also results in immunizing all manner of vertical restraints without any analysis of actual competitive effects. Insofar as the expansion of the *Colgate* doctrine has been driven by the harshness of the *Dr. Miles* rule, as some commentators have suggested, then repealing *Dr. Miles* will permit courts to focus on economic substance rather than *Colgate*'s artificial and formalistic distinctions, or so the argument goes.[169]

This line of argument is unpersuasive. As an initial matter, the Court did nothing to modify the *Colgate* doctrine and as long as it remains good law it will continue to be invoked by defendants seeking immunity (rather than rule of reason treatment) from RPM (and other vertical restraints) claims and continue to bedevil conspiracy jurisprudence.[170] Indeed, as I noted at the outset, it appears that *Colgate* policies have proliferated since the *Leegin* decision. More significantly, however, the premise of this line of argument is that the justification for the *Colgate* doctrine is to "secure the procompetitive benefits associated with vertical price restraints through other methods."[171] This is revisionist history. While the bolstering of the *Colgate* doctrine in

[168] The Court, citing an *amicus* brief submitted by PING, Inc., a golf-club manufacturer, stated, "Even with the stringent standards in *Monsanto* and *Business Electronics*, this danger [of liability] can lead, and has led, rational manufacturers to take wasteful measures. A manufacturer might refuse to discuss its pricing policy with its distributors except through counsel knowledgeable of the subtle intricacies of the law. Or it might terminate longstanding distributors for minor violations without seeking an explanation. The increased costs these burdensome measures generate flow to consumers in the form of higher prices." *Id.* at 2722-23 (citations omitted).

[169] *See* ANDREW I. GAVIL, WILLIAM E. KOVACIC & JONATHAN B. BAKER, ANTITRUST LAW IN PERSPECTIVE 372 (2d ed. 2008) (suggesting that "*Colgate*'s fiction of 'no agreement' . . . arguably would become unnecessary if minimum RPM were also to be judged under the rule of reason").

[170] *See Leegin*, 127 S. Ct. at 2734-35 (Breyer J., dissenting) ("No one has shown how moving from the *Dr. Miles* regime to 'rule of reason' analysis would make the legal regime governing minimum resale price maintenance more 'administrable,' . . . particularly since *Colgate* would remain good law with respect to *unreasonable* price maintenance.").

[171] *Leegin*, 127 S. Ct. at 2722; *see also id.* ("If we were to decide the procompetitive effects of resale price maintenance were insufficient to overrule *Dr. Miles*, then cases such as *Colgate* and *GTE Sylvania* them-

*Monsanto* may have been intended by the Court to achieve this result, the *Colgate* decision itself was based on "the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal."[172] In other words, *Colgate* was viewed as an exception to *Dr. Miles* that was "tolerated" by the need to protect a certain degree of manufacturer freedom.[173] The tension between *Colgate* and *Dr. Miles* existed for nearly as long as *Dr. Miles* itself and cannot count as an *independent* justification for overturning *Dr. Miles* any more than for overturning *Colgate*. On the contrary, the case for the latter is stronger, even for those on the fence about *Dr. Miles*.[174] Whether the standard for judging RPM agreements is the rule of reason or some form of *per se* rule, Congress should abolish the *Colgate* exception for "unilateral" RPM programs enforced by threats of termination.[175]

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selves would be called into question."); *id.* at 2721 ("Only eight years after *Dr. Miles*, . . . the Court *reined in* the decision by holding that a manufacturer can announce suggested resale prices and refuse to deal with distributors who do not follow them.") (emphasis added).

[172] United States v. Colgate & Co., 250 U.S. 300, 307 (1919).

[173] United States v. Parke, Davis & Co., 362 U.S. 29, 44 (1960); *see* Edward H. Levi, *The Parke, Davis-Colgate Doctrine: The Ban on Resale Price Maintenance*, 1960 SUP. CT. REV. 258, 325 ("*Colgate* is caught between the important right to refuse to deal and the antipathy to price fixing"); Leary & Mintzer, *supra*, at 308-09 (*Colgate* and its artificial distinctions are based on "a strong view that people should not be forced to continue business relationships against their will"). The irony of the Court rejecting out of hand the restraints on alienation or "dealer freedom" rationale for *Dr. Miles*, while relying on *Colgate* to overturn it, was apparently lost on the Court. *Cf.* Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 67-69 (1977) (White, J., dissenting) (noting that both *Dr. Miles* and *Colgate* reflect concern for the autonomy of independent businessmen).

[174] The academic critique of the *Colgate* doctrine has been far more severe and universal than the criticism of *Dr. Miles*. *See* SULLIVAN & GRIMES, *supra*, § 7.2c, at 382 n.50 (citing sources).

[175] Notably, foreign jurisdictions do not allow manufacturers to obtain compliance with minimum resale prices by using threatened refusals to deal. *See* OECD RPM REPORT, *supra*, at 28 ("Most if not all other jurisdictions ... have no exception like the *Colgate* doctrine."). For example, the Europe Union prohibits RPM obtained through "indirect means," including "linking the prescribed resale prices to . . . threats, intimidation, warnings, penalties, delay or suspension of deliveries or contract terminations . . . ." Guidelines on Vertical Restraints ¶ 47, 2000 O.J. (C 291) 1, 11 (European Commission).

**Conclusion**

In 1937, Congress embarked on an experiment legalizing fair trade at the option of the states. It did not work and Congress repealed the experiment in 1975 in favor of a universal *per se* rule. Since then, discounting has become a way of life for Americans, eagerly pursued by some retailers, adamantly cursed by others, but diligently demanded by much of the consuming public. The activist Supreme Court has decided that the *per se* rule is bad policy and would have the country try a new experiment with legalized fair trade "sometimes."

The *Leegin* decision is bad law and should be overturned legislatively for the reasons I have articulated above, including: 1) it flouts the intent of Congress; 2) there is no evidence that the *per se* rule did any harm or that overturning it will do consumers any good; 3) conversely, there is every reason to believe that the rule of reason will lead to higher prices, as the incidence of anticompetitive RPM increases, and to increased business uncertainty; 4) and treating RPM more harshly than nonprice restraints, as most countries do, makes sense.

As Justice Breyer concluded, "The only safe predictions to make about today's decision are that it will likely raise the price of goods at retail and that it will create considerable legal turbulence as lower courts seek to develop workable principles."[176] Congress has the prerogative to reject this experiment and AAI urges it do so.

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[176] 127 S. Ct. at 2737.

**TESTIMONY OF TOD COHEN, VICE PRESIDENT AND DEPUTY GENERAL COUNSEL, GOVERNMENT RELATIONS, EBAY BEFORE THE UNITED STATES SENATE, COMMITTEE ON THE JUDICIARY, SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY, AND CONSUMER RIGHTS**

**May 19, 2009**

Chairman Kohl, Ranking Member Hatch, and Members of the Subcommittee, I am Tod Cohen, Vice President and Deputy General Counsel for Government Relations at eBay Inc. Thank you for the invitation to speak today about S. 148, the Discount Pricing Consumer Protection Act, and the impact of the Supreme Court's decision in *Leegin Creative Leather Products, Inc. v. PSKS.* I'd like to begin by acquainting you with eBay and more generally the business that we participate in -- Internet commerce.

Founded in 1995, eBay Inc. connects hundreds of millions of people around the world every day. The company's online platforms empower hundreds of millions of individuals and small businesses to meet and engage in open trade on a local, national and international basis. The eBay Marketplace has 88.3 million active users and there are 160 million live listings on any given day. While known for its auction format, eBay users can also buy and sell through standard pricing formats found within traditional retailers, both in stores and on-line. In 2008, eBay transacted $60 billion worth of goods, or an average $2,000 worth of goods every second. eBay is committed to fair and open competition with the view that it benefits eBay's participants and society overall.

At eBay, we believe that the Internet is a transformational technology platform for increasing business efficiency and effectiveness, enhancing the shopping and purchase experiences of consumers, and facilitating increased competition in trade. Businesses use the Internet in many ways to offer lower prices, greater choice and great values to consumers because of reduced operating costs and increased efficiencies provided by the Internet.

Consumers who use the Internet are able to easily find, compare and purchase products because of their convenient access to vast amounts of information. The Internet also enhances competition through effectively widening and deepening the market for goods and services. Because of the Internet, businesses and consumers are no longer bound by geography and may sell and trade with one another through local, national and global markets. Businesses are able to offer, and consumers are able to compare more products and brands, effectively increasing the depth of the market. These and other benefits inherent in Internet technologies have resulted in new and innovative retail business models and growing retail commerce that brings benefits to consumers, retailers and the overall economy.

Before I move to focus on some of the specific issues surrounding Retail Price Maintenance, commonly known as RPM, I want to note that the Internet is a transformational technology that is part of every serious 21$^{st}$ Century retail strategy. The

Internet is used by every segment in the retail business – from massive "brick and click" retailers with national networks of big box stores integrated with popular web sites, to large "remote" Internet and catalogue retailers with nationally known brand names, to small businesses who are either building new businesses on the Internet or integrating the Internet into an existing small retail business in order to survive and grow in the highly competitive retail environment.

The Internet is also used by manufacturers, from the largest to the most specialized, to reach customers with information, and more and more with products. And the Internet is critical to more consumers every day, both as a retail marketplace and the greatest source of product information ever created. I mention these facts because sometimes people paint this issue, and other retail issues, as being about Internet retailers on one side and non-Internet retailers on the other. Nothing could be farther from the reality of $21^{st}$ Century retail.

Everyone uses the Internet. But, there are big differences in how the Internet is used. The most important distinction to keep in mind is that on one side you have established networks of manufacturers and retailers who want to use technology to reinforce or enhance established retailing business models, without undermining those existing and highly profitable business models. They like the Internet when it is closed and structured to serve their interests, but they are threatened by the Internet when it is harnessed to offer consumers better deals and more information outside the established incumbent retail networks. On the other side are innovators with new business models, almost always small to mid-size businesses, using new technologies to offer consumers better deals, more information and new services. They are the "open Internet," the great force for innovation and change, and they threaten traditional retail networks.

Unfortunately, the recent decision in *Leegin* is beginning to undermine many of the consumer benefits delivered by innovators using the openness of the Internet. *Leegin* empowers those who want to curtail the ability of small and mid-size online retailers to communicate and offer lower prices to consumers. *Leegin* requires that henceforth antitrust challenges to minimum resale price maintenance (RPM) or agreements that fix the minimum price at which a retailer may sell a manufacturer's products are to be analyzed applying the *rule of reason* versus the prior and more strict *per se* standard.

At the time *Leegin* was decided by the Supreme Court, commentators predicted that the decision would lead to an increase in RPM programs and related practices that restrict intrabrand price competition. Anecdotal reports and other information corroborate that this has indeed been the result. These reports further identify Internet retailers as a particular target of the increasing use of RPM.

eBay's own experiences confirm this to be true. For example, a recent report in the Wall Street Journal details how some businesses limit price competition through continually scanning the eBay platform to identify sellers offering their products at a lower price. [1]

[1] Pereira, Joseph (2008), "Discounters, Monitors Face Battle on Minimum Pricing," Wall Street Journal, December 4, available at http://online.wsj.com/article/SB122835660256478297.html

They then use a plethora of tools to identify the seller and enforce their minimum prices. The tools used to enforce these minimum prices are varied and often depend on the circumstances of the seller and the relationship with the manufacturer. In one case, an electronics company called CaptiveWorks used false claims of trademark violations to take down several low-priced eBay listings. When the seller asked CaptiveWorks why it was claiming that his listings were replicas when they were in fact authentic, the company made it clear that it targeted his listings because they were being sold at a lower price. In another case, Laguna Beach Jeans Company went after a seller for selling its products at a discount on eBay, saying simply that it "does not authorize eBay sales," and that selling its products at a lower price "than [it] sells on eBay" would impact its market. For these businesses, the *Leegin* decision has clearly been interpreted as a legal "green light" to more aggressively thwart low-price competition by legitimate sellers.

Small and mid-size Internet retailers have become the particular target of RPM because of the combination of two factors: they often offer lower prices to consumers, and the Internet enables consumers to find those great price deals much easier than ever before. These lower prices are alleged by traditional retailers to be the result of unfair competition. As reported this past year in the Wall Street Journal, "many traditional retailers favor minimum-pricing agreements because they help put a stop to what the stores view as unfair competition from online sellers, which can charge less because they have lower overhead costs."[2]

Traditional retailers contend that innovative Internet retailers are able to offer lower prices to consumers because they "free-ride" on the promotional investments of their traditional counterparts. The traditional "free-rider" argument contends that rather than providing consumers with pre-sale information through, for example product demonstrations and other methods, small and mid-size Internet retailers depend on competing brick-and-mortar retailers to do so. They then divert "educated" consumers away through offering them lower prices obtained through their cost savings. Traditional retailers threaten that unless protected by RPM from Internet retailers' lower prices eventually they will no longer provide pre-sale information; frustrating manufacturers' promotional efforts and harming consumers in the process.

From eBay's perspective there are many problems with this argument. The most significant of these problems is that, as previously described and subsequently elaborated upon, the realities of 21st Century retailing and the Internet turns the traditional free-rider justification for RPM on its head. Indeed, it does so to the point where in many cases it could be argued that the largest and most established retailers are free-riding on the tremendous consumer information tools created by Internet innovators.

With this central point in mind, we urge you to also consider the following more specific points in your deliberations:

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[2] Pereira, Joseph (2008), "Why Some Toys Don't get Discounted: Manufacturers Set Price Minimums That Retailers Must Follow or Risk Getting Cut Off; Shopping Around for 'Rock Band 2,'" Wall Street Journal, December 24, available at: http://online.wsj.com/article_email/SB123007559680631543-lMyQjAxMDI4MzIwNDAyNzQ1Wj.html

1. A small or mid-size Internet retailers' ability to offer lower prices should not be attributed to free-riding. Instead, the Internet enables new and specialized retail business models that can have cost advantages related to distribution, consumer information and market penetration. These are substantial and far more likely to be the reasons behind a small or mid-size Internet retailer's lower prices.

2. Internet retailers provide significant pre-sale information to their customers. In fact, the open Internet has completely revolutionized the consumer information experience. At its core, the Internet is a medium for the communication of information and its capabilities are enormous. Internet businesses including retailers can and do use the Internet to provide valuable pre-sale information to consumers. In fact, consumers are increasingly turning to the Internet to search for product information, make product comparisons and check prices *before* visiting and purchasing from traditional brick and mortar stores – raising the question of who is actually the free-rider.

3. You should also question the contention that an Internet retailer would adopt a strategy of relying on its competitors to generate customer demand for them. Relying on your competitor to generate customers through providing pre-sale information is not only a risky strategy, but is also contrary to the competitive advantage that fuels innovative Internet retailing. At its core this advantage is the ability to provide information that creates value for prospective customers. It is hard to imagine an Internet retailer forgoing the very advantage that is the basis of its business model, let alone relying on competitors who have adopted a different business model to do it for you.

4. Even in the event some consumers obtain the benefit of pre-sale information from one retailer and then continue to shop and eventually purchase from another competitor, it is hard to imagine that it would result in the outcomes predicted by traditional retailers and established manufacturers. For example, how much supposed free riding is necessary for established retailers to abandon a marketing strategy it presumably invested substantially in and one that ostensibly its customers find considerable value.

5. I understand that past real-world evidence regarding the use of RPM has not been explained based on free-riding, but by the motivation of incumbent retailers attempting to avoid the competitive threat of new and more innovative forms of retailing. I believe that this is even more true today in the Internet Age. The largest and most established retailers and manufacturers, who benefit economically from the status quo, are threatened by innovators using the Internet, not the Internet itself.

6. It is also noteworthy that established retailers' calls for RPM based upon free-riding arguments are not limited to innovative Internet retailers. I understand that the same justification has been advanced against value-based brick and mortar retailers who also offer lower prices to consumers. If true, RPM narrowly

targeted at innovative Internet retailers will not cure free riding by these lower-priced retailers.

7. The fact that many manufacturers have found value in the Internet is also contrary to the free-rider argument. Increasingly manufacturers are using the Internet distributing their products through both brick and mortar stores and online sites in what is termed multi-channel distribution. If free riding is a significant problem it is unlikely these manufacturers would see value in a strategy that ostensibly encourages its very occurrence.

8. At the same time, it should be acknowledged that many manufacturers continue to avoid the open Internet. A fair question is whether this is because they view, as some traditional retailers, that free-riding by innovative Internet retailers is a problem or because of other reasons. When considering this question, one important reason that should not be overlooked stems from the Internet's ability to effectively widen and deepen the market for goods. Some manufacturers may wish to avoid the increased competition and ensuing pressure on their upstream prices that results from these effects. By extension, rather than being motivated by concerns for free-riding, manufacturers who do distribute over the Internet may see the uniform prices that result from RPM as a way to reduce these upstream effects. This prospect should not be overlooked.

9. It may also be the case that differences observed in the prices and pre-sale information of the biggest established retailers and innovative Internet retailers are merely the result of efficient market processes rather than free-riding. It is well-known that consumers differ in their information needs and price preferences even for the same product. If established retailers are providing more information and charging higher prices and smaller innovative Internet retailers are providing less information and charging lower prices, this may simply be an efficient response by each to the demands of different customer segments. Marketers call this "target marketing" or the customization of information and price offerings to different customer segments. Unless free-riding can be proven, forcing all consumers to pay the same through RPM actually risks a misallocation of promotional resources rather than increasing it.

These and other problems with the free rider explanation should be considered and adequately explained prior to accepting any justification for Internet retailers being the particular target of RPM.

Finally, I understand that a recent study involving Internet retailing and examining the abolition of RPM in the UK book industry found that it increased industry productivity.[3] According to the study, abolishing RPM resulted in strong growth in new retail channels of distribution for books including through Internet retailers with both the total industry sales volume as well as the number of titles published increasing. A key finding of the

[3] Office of Fair Trading (2007), "An Evaluation of The Impact Upon Productivity of Ending Resale Price Maintenance on Books."

study was that the new retail channels of distribution had different business models typically based on lower costs and innovation. Evidence of this kind should be especially helpful to this Committee in better understanding Internet retailing and RPM.

Thank you Mr. Chairman and members of the Subcommittee.

Senate Judiciary Committee
Subcommittee on Antitrust, Competition Policy and Consumer Rights
"The Discount Pricing Consumer Protection Act: Do We Need to Restore the Ban on Vertical Price Fixing?"

**Written Testimony of Jim Collier**
**President**
**ShortOrder.com**

Chairman Kohl, Members of the Antitrust Committee,

Thank for you for the opportunity to present my views and concerns regarding the current "rule of reason" status of "resale price maintenance" ("RPM"). ShortOrder.com is an on-line retailer of restaurant equipment and has been in existence since 2006. ShortOrder.com's goal is to offer volume pricing to small, independent restauranteurs.

ShortOrder.com's History with RPM

The Supreme Court's Leegin Decision[1] has brought about changes in my industry that have made it difficult for us to compete. Manufacturers with whom we do business have taken liberties with this ruling and created policies that, under the guise of "brand equity", are anti-competitive.

My position is formed not on assumption, but after an exhausting number of phone conversations with the creators of these polices. Formally, I receive statements that the companies are acting unilaterally and in the best interest of their brands. In phone conversations, I hear the reason for the polices is to protect the

[1] Leegin Creative Leather Products, Inc. v. PSKS, Inc. Ct. 2705 (2007)

established chain of distribution from more efficient business models. In some conversations, I am being read emails the manufacturer has received from competing retailers complaining about the "predatory pricing" in the market and being quoted the number of calls of complaint received by the manufacturer within a period of time. These conversation identify that the policies created regarding RPM are not driven by brand equity, but rather, complaints from competing equipment dealers.

In Justice Kennedy's opinion on Leegin, "A group of retailers might collude to fix prices to consumers and then compel a manufacturer to aid the unlawful arrangement with resale price maintenance. In that instance the manufacturer does not establish the practice to stimulate services or to promote it's brand, but to give inefficient retailers higher profits"[2]. "A horizontal cartel among competing manufacturers or competing retailers that decreases output or reduces competition in order to increase price is, and ought to be, per se unlawful." -Justice Kennedy[3].

My opinion is this predicted outcome of RPM has come to pass.

To substantiate my opinion, please find exhibit A. This exhibit is a policy created by one of the parent companies with whom we do business. Exhibit A is an RPM policy. In this case, the policy applies ONLY to Internet Sales. All other sales are not governed by this policy. As Internet sales represent less than 5% of the overall sales for these companies, it is hard to envision how the brand equity can be maintained when the remaining 95% of sales are uncontrolled and allowed to fall below the pricing threshold

[2] Leegin Creative Leather Products, Inc. v. PSKS, Inc. Ct. 2705 (2007), Opinion section B paragraph 2

[3] Leegin Creative Leather Products, Inc. v. PSKS, Inc. Ct. 2705 (2007), Opinion section B paragraph 3

established in the policy.

In an attempt to combat this policy, a group of dealers created a coalition to ask that it be suspended. Exhibit B is that letter. Exhibit C is the response received denying the request. As the monitoring of pricing began and warning letters were sent to parties in violation, the coalition started to fall apart. The main reason for the destruction of the coalition was members were concerned with retaliation from the manufacture's parent company. The end result is prices are now maintained at an equal level and the economies allowed for by the more efficient business models are not allowed to be passed on to the consumers.

## Free Riding/ Service Assumptions

*Free ride:*

Justice Kennedy stated:

"Absent vertical price restraints, the retail services that enhance interbrand competition might be underprovided. This is because discounting retailers can free ride on retailers who furnish services and then capture some of the increased demand those services generate. GTE Sylvania, supra, at 55. Consumers might learn, for example, about the benefits of a manufacturer's product from a retailer that invests in fine showrooms, offers product demonstrations, or hires and trains knowledgeable employees. R. Posner, Antitrust Law 172–173 (2d ed. 2001) (hereinafter Posner). Or consumers might decide to buy the product because they see it in a retail establishment that has a reputation for selling high-quality merchandise. Marvel & McCafferty, Resale Price Maintenance and Quality Certification, 15 Rand J. Econ. 346, 347–349 (1984) (hereinafter Marvel & McCafferty). If the consumer can then buy the product from a retailer that discounts because it has not spent capital providing services or developing a quality reputation, the high-service retailer will lose sales to the discounter, forcing it to cut back its services to a level lower than consumers would otherwise prefer. Minimum resale price maintenance alleviates the problem because it prevents the discounter from undercutting the service provider. With price competition decreased, the manufacturer's retailers compete among themselves over services."[4]

[4] Leegin Creative Leather Products, Inc. v. PSKS, Inc. Ct. 2705 (2007), Opinion section A Paragraph 4

Though this example may be true to some extent, the opposite can be true as well. Exhibit D: "New Info Shoppers" by Mari Penn with E. Kinney Zalesne appeared in the January 2008 Wall Street Journal. This article helps to demonstrate that the free riding condition considered in Justice Kennedy's Leegin opinion is a double edged sword. Exhibit D states that 92% of people surveyed look for information online before making a decision as they trust the information they receive on-line more than they trust the information they receive in a store or showroom. That being the case, Internet retailers spend a tremendous amount of money creating and presenting the information needed to educate buyers. Through costly user reviews and other forms of comparison data, they help establish a brand and increase the brand's equity with buyers. In many cases, only 1-3% of visitors to a web site purchase from the website. I can surmise from that figure a trend exists. On-line retailers create a demand for a product only to lose that offsetting benefit of that sale to a local, brick and mortar establishment. In this scenario, the brick and mortar establishment free rides on the efforts of the on-line, discount retailer. The consumer does not need the showroom or sales staff. The brick and mortar establishment receives the benefit of the sale as they can immediately fulfill the order.

*Service assumptions:*

In addition to a flawed opinion on free riding, I also think an assumption was made regarding a benefit created when retailers compete on service rather than price. It is my opinion that the market sets both the price of an item and the level of services needed to sell that item. When a manufacturer sets the market price and services are added to differentiate retailers in the market, the consumer loses the ability to choose the services they want. The result is they have to pay for services they don't want or need. The ability to choose to buy from a low cost / low service provider is eliminated.

## Shifting the Legal Burden of Proof

One of the negatives presented in the Supreme Court's decision is the shift in the burden on proof. In a "per se" environment, it was the burden of the policy maker to prove that an RPM policy was pro-competitive. In the "rule of reason" environment, the victims of an unfair RPM policy have to bear the burden to prove a policy is anti-competitive. In reviewing the legal options for my company, I learned three things:

1). Cases of this nature are extremely complex and hard to prove from the perspective of one company. As a result, many companies in the same industry are needed to show the anti-competitive affects of RPM policies in their industry.

2). Individual retailers negatively affected by these polices are fearful of getting involved due to potential retribution by the manufacturers on whom their livelihood may depend. The majority of retailers will not get involved as artificially inflated prices equate to additional profits.

3). Other than a minority of retailers, the only other group that can levy a legal test is the consumer. In this case, large quantities of consumers would have to join in a concerted effort to stop the policies. Given the disconnected nature of individual consumers, this effort would be unduly burdensome or impossible to accomplish.

## Summary

The Supreme Court Ruling is flawed. Though the Leegin decision did not make RPM legal, it did in fact, remove any reasonable system of checks and balances that could be used to test the pro-competitive benefits of manufacturer's pricing policies. As a result, manufactures, waiving the Leegin banner, have created polices that inflate prices with no pro-competitive affect. Consumers, at least within my industry, are being forced to pay higher prices. The additional profits created by this ruling are used to fund inefficient business models which will cause negative long-term affects by stifling innovation. It is my firm opinion that the "per se" rule of reason should be re-established. Senator Kohl's bill (S. 146) is the best way to move forward and correct the Supreme Court's flawed interpretation. The Supreme Court underestimated the effects of legal price fixing. Higher prices, reduced efficiency and lost innovation in retailing is the result. Since 1911, price fixing has been "per se" illegal. This is one of the corner stones of our successful economy. It should be reinstated.



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# Exhibit A

ITW Food Equipment Grc
An Illinois Tool Works Co
701 South Ridge Avenue
Troy, Ohio 45374-0001

**ITW Food Equip**

**DATE: February 8, 2008**

**TO: Authorized Hobart, Traulsen and Vulcan Dealers**

**FROM: Jim Cullinane/Tom Szafranski**

We are pleased to announce that effective March 1, 2008, ITW will institute a Pricing Policy for any authorized Dealer conducting sales transactions via internet commerce for Hobart, Traulsen and Vulcan/Wolf branded products. The goals of this policy are the following:

1. Protect the premium brand equity and competitiveness of Hobart, Traulsen, and Vulcan/Wolf branded product by limiting visible price discounting on the internet

2. Extend the ITW philosophy relative to current functional incentive programs (i.e. Specification, Stocking and Preferred DSR Compensation).

We want to assure that our Dealer network retains the ability to offer the additional services we believe are critical to the successful sale of Hobart, Traulsen and Vulcan/Wolf products both now and in the future.

**Program Specifics:**

This policy applies to all Hobart, Traulsen and Vulcan/Wolf products and extends a Minimum Advertised and Resale Price for internet transactions as follows:

Hobart: Current Dealer Net plus 10%

Traulsen: Current Dealer Net plus 10%. Dealers participating in the Traulsen stocking program at no less than current List less 50/10/20.

Vulcan/Wolf: Price book items no less than current Dealer Net (List less 50/5). Platinum products at no less than Platinum cost plus 10%.

This Pricing Policy does not apply to non-internet sales (i.e. phone sales, negotiations in the field or at the Dealer's place of business) or printed catalogs, which under current policy may be sold by the Dealer at any price.

We will be reviewing all internet pricing and commerce via an outside, third party monitoring service to assure consistent adherence to this policy. If and when a deviation of our Minimum Resale Price is noted, the Dealer will be contacted by phone and in writing with a two day notice to make the necessary changes to be in compliance with this policy.

July 25, 2008
ITW - Foodservice Division
Hobart, Traulsen, Vulcan, Berkel
701 South Ridge Avenue
Troy, Ohio 45374

# Exhibit B

ITW Companies:

In light of current pending federal legislation in the US Senate, Bill 2261, we ask that you suspend your vertical price fixing policy until this legislation is resolved. This legislation, introduced and sponsored by Senator Herb Kohl (D – Wisconsin) and co-sponsored by Senators Joe Biden (D – Delaware) and Hillary Clinton (D – New York), will reinstate vertical price fixing as illegal 'per se', rather than on a case-by-case trial basis. In summary, the legislation proposes to add the following text to the Sherman Antitrust Act:

**"Any contract, combination, conspiracy or agreement setting a minimum price below which a product or service cannot be sold by a retailer, wholesaler, or distributor shall violate this act."**
*- SB2261, 110th Congress, 1st Session (attached).*

In addition to the cause mentioned above, we feel suspension of this policy is prudent given the following:

- This policy is illegal in no fewer than thirteen states as each state's antitrust regulations specifically prohibit minimum advertised price / resale price maintenance agreements which supersede federal anti-trust precedence

- A base of jurisprudence in at least twenty-four additional states is developing confirming the illegal nature of this policy

- This policy removes meaningful choice from consumers in the market

- This policy is discriminatory and divisive in nature as it imposes artificial price controls on certain dealer sales channels while allowing uncontrolled market based pricing on the remaining dealer sales channels

- This policy creates ill-will in our industry

- This policy can be easily construed as a response to a vertical retailer cartel

- This policy motivates foreign competitors to enter the marketplace given the weakened USD

In light of the causes listed above, we request the immediate suspension of the minimum advertised price / resale price maintenance polices recently implemented and enforced by your organization(s) until current federal legislation is resolved.

Sincerely,

Concerned Dealers

| | | | |
|---|---|---|---|
| Restaurant Supply | Associates, Inc. | Concept Services Foodservice Equipment | |
| **Carl Gustafson**<br>Vice President | **Fred Clark**<br>President | **Hal Schroeder**<br>President | **Patricia Bible**<br>CEO |
| MISSION Restaurant Supply | REW | SHORT ORDER | |
| **Jack Lewis**<br>President | **Brad Pierce**<br>President | **Jim Collier**<br>President | **Fred Clark**<br>President |

110th CONGRESS
1st Session

S. 2261

To restore the rule that agreements between manufacturers and retailers, distributors, or wholesalers to set the minimum price below which the manufacturer's product or service cannot be sold violates the Sherman Act.

---

IN THE SENATE OF THE UNITED STATES

October 30, 2007

Mr. Kohl (for himself, Mr. Biden, and Mrs. Clinton) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

---

A BILL

To restore the rule that agreements between manufacturers and retailers, distributors, or wholesalers to set the minimum price below which the manufacturer's product or service cannot be sold violates the Sherman Act.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the ``Discount Pricing Consumer Protection Act''.

SEC. 2. STATEMENT OF FINDINGS AND DECLARATION OF PURPOSES.

(a) Findings.--Congress finds the following:

(1) From 1911 in the Dr. Miles decision until June 2007 in the Leegin decision, the Supreme Court had ruled that the Sherman Act forbid in all circumstances the practice of a manufacturer setting a minimum price below which any retailer, wholesaler or distributor could not sell the manufacturer's product (the practice of ``resale price maintenance'' or ``vertical price fixing'').

(2) The rule of per se illegality forbidding resale price maintenance promoted price competition and the practice of discounting all to the substantial benefit of consumers and the health of the economy.

(3) Many economic studies showed that the rule against resale price maintenance led to lower prices and promoted consumer welfare.

(4) Abandoning the rule against resale price maintenance will likely lead to higher prices paid by consumers and substantially harms the ability of discount retail stores to compete. For 40 years prior to 1975, Federal law permitted states to enact so-called ``fair trade'' laws allowing vertical price fixing. Studies conducted by the Department of Justice in the late 1960s indicated that retail prices were between 18 and 27 percent higher in states that allowed vertical price fixing than those that did not. Likewise, a 1983 study by the Bureau of Economics of the Federal Trade Commission found that, in most cases, resale price maintenance increased the prices of products sold.

(More)

(5) The 5-4 decision of the Supreme Court majority in Leegin incorrectly interpreted the Sherman Act and improperly disregarded 96 years of antitrust law precedent in overturning the per se rule against resale price maintenance.

(b) Purposes.--The purposes of this Act are--

(1) to correct the Supreme Court's mistaken interpretation of the Sherman Act in the Leegin decision; and

(2) to restore the rule that agreements between manufacturers and retailers, distributors or wholesalers to set the minimum price below which the manufacturer's product or service cannot be sold violates the Sherman Act.

SEC. 3. PROHIBITION ON VERTICAL PRICE FIXING.

(a) Amendment to the Sherman Act.--Section 1 of the Sherman Act (15 U.S.C. 1) is amended by adding after the first sentence the following: ``Any contract, combination, conspiracy or agreement setting a minimum price below which a product or service cannot be sold by a retailer, wholesaler, or distributor shall violate this Act.''.

(b) Effective Date.--The amendment made by subsection (a) shall take effect 90 days after the date of enactment of this Act.

08/08/2008 09:58 9133171505 **Exhibit C** PAGE 01/01

Illinois Tool Works Inc.
Corporate Headquarters
3600 West Lake Avenue
Glenview, IL 60026-1215
Telephone 847.724.7500
Direct Dial 847.657.4206
Fax 847.657.5206

**James H. Wooten, Jr.**
Senior Vice President, General Counsel
& Secretary

ITW

August 6, 2008

Carl Gustafson
Vice President
Ace Mart Restaurant Supply

Fred Clark
President
Clark Associates, Inc.

Hal Schroeder
President
Concept Services Foodservice Equipment

Patricia Bible
CEO
KaTom Restaurant Supply, Inc.

Jack Lewis
President
Mission Restaurant Supply

Brad Pierce
President
Restaurant Equipment World

Jim Collier
President
Short Order Restaurant Equipment

Fred Clark
President
The WEBstaurant Store

*Re:* July 25, 2008 Correspondence Regarding U.S. Senate Bill 2261

Dear Messrs. Gustafson, Clark, Schroeder, Lewis, Pierce, Collier and Clark and Ms. Bible,

We received your letter attaching U.S. Senate Bill 2261 and asking us to suspend our Internet pricing policy concerning Hobart, Traulsen, Vulcan and Berkel brands in light of that Bill. We appreciate your bringing the Bill to our attention. However, we disagree with your characterization of our Internet policy and believe that our policy meets all applicable legal standards.

We unilaterally determine our policies and the functional incentives we offer with the goal of protecting our premium brand equity and enhancing the competitiveness of our products. While we understand that you disagree with our Internet policy, we must continue to make decisions regarding that policy in accordance with our independent business judgment.

Sincerely,

James H Wooten Jr

James H. Wooten, Jr.

cc: Mr. J. McDonough

Exhibit D



THE WALL STREET JOURNAL.

MICROTRENDS JANUARY 8, 2009

# New Info Shoppers

By MARK PENN

*With E. Kinney Zalesne*

With so much attention on psychological marketing these days -- finding new ways to tap into people's heads -- perhaps the single most neglected trend out there is the move towards more hard-nosed information-based shopping and purchasing.

While elites were busy shoveling money into Madoff's black box these past few years, strapped consumers have been poring over product spec sheets, third-party reviews and expert blog sites. This past holiday season they watched every dollar. A special kind of consumer has taken a major role in the marketplace -- the **new info shopper**. These people just can't buy anything unless they first look it up online and get the lowdown.

These shoppers have the Internet at work, typically hold information-based or office-park jobs, have some college or grad school, and are often making ends meet with two jobs, kids, and pets on a middle or upper-middle-class income.

They have become highly suspicious of many TV ads: in a shoppers survey we did, 78% of them said that ads no longer have enough information they need. So many of them search online for virtually everything. Window shoppers have become "Windows shoppers." They want, in the phrase often attributed to Dragnet's Joe Friday, "just the facts, ma'am."

Of course, there is still a healthy role for big emotional brand appeals and mega-advertising campaigns. For every trend there is a counter trend. But that's not the real new thing in consumer behavior.

A whopping 92% of respondents said they had more confidence in information they seek out online than anything coming from a salesclerk or other source. They believe the information they find, not in the information that is spoon-fed to them, and the vast number of clicks today prove that they really are devoting time and energy to ferreting out detailed info before they buy.

A good example of how information can transform a marketplace is the series of ads a few years ago for the Dyson vacuum cleaner. Founder and inventor James Dyson took a commonplace item and explained how he had transformed it with new scientific principles. Consumers weren't bored with the technical approach. On the contrary, sales took off -- and changed the marketplace for vacuum cleaners.

When we asked shoppers whether they would do online research before buying a vacuum cleaner today, a surprising 58% said that's exactly what they would do. His ads helped turn vacuum-cleaner buying into a largely information-based marketplace.

We have seen many of the big market areas convert to an information-driven model -- cars, homes, personal computers and medical care are areas where nearly 4 in 5 shoppers say they gather information on their own from the Web before buying. "Do-it-yourself doctors" (that is, info patients) show up at their doctor with the Web-derived diagnosis in hand, and a list of the medicines they need prescribed. Customers appear at the car dealership with the wholesale price and the model already picked out.

Information-seeking is not just an activity, it's a way of looking at the world. New info shoppers are proud of the progress they have made in putting facts over pablum. More companies should treat their customers as Dyson did and let them in on the secrets of their unique success. And they should invest more than ever in helping form their consumers into citizen corps, arming them with PCs, cameras and even asking them to use the phone's new video cameras to document their product usage and put them online.

But how many marketers today work back from what this new consumer is thinking and doing? Not many. Based on the advertising budgets in the U.S. where a typical company will spend 60 times as much on advertising than they spend on generating publicity, most lag way behind in creating a new model of consumers and the steps they take before they buy.

Some industries got it right away. Movies and restaurants have huge word of mouth and impulse components, but they are also very information-driven. Zagat's pioneered the concept of survey ratings and reviews, and smart restaurants use them. We're seeing the same in entertainment, where Metacritic and others provide professional and customer ratings of every movie.

Now this trend is spreading down the product chain. In our survey, 24% said they are doing online research before buying shampoo. The Breck Girl is being replaced by a shopping bot.

And they have questions. How does this shampoo work on different hair types, thicknesses and colors? Are the bottles recyclable? Has the product been tested on animals?

It used to be that the only time people expected 30-page, pre-purchase, inspection reports was when they were buying a house. Now some people want them just to buy a tube of toothpaste.

The point is that advertising isn't just moving to the Web, it's got to grapple with an entirely new kind of shopper and way of shopping. Marketers now have to balance traditional media, online media, and content that is generated by experts, bloggers and consumers themselves. An astonishing 70% of Americans now say they consult product reviews or consumer ratings before they make their buying decisions. Sixty-two percent say they spend at least 30 minutes online every week to help them decide what and whether to buy. Among Americans under 45, that number shoots up to 73%. Seventy-three percent -- that's more than four times the percentage in that age group who go to church every week. For some, smart shopping is more than a hobby. It's a religion.

Information aggregation sites – the ones that don't generate content themselves, but link to others' content, weaving a story about the industry and its products – will become even more important. Much as the Drudge Report tells its readers where to find stories they will like, so consumer aggregation sites could grow and do the same for car buyers, PC buyers, and other consumer groups. Most of the sites so far have been too cheesy to really catch on.

Information shopping also means manufacturers have to get back to generating more information on their products, even offbeat factoids that are highly memorable if not always useful. Timex sold a lot of watches by showing its watches were still ticking after being thrown into a washing machine. To catch the eye of the info-shopping consumer, manufacturers should start hauling their wares up to Mt. Everest, drop them out of windows, put them in boiling water and reporting on how they do. In an info-seeking world, facts can again become the great differentiator.

New Info Shoppers are bigger than a microtrend. They represent a broad shift in the marketplace brought about by the Internet, higher education, and changing economic times. But the question is when is the marketplace is going to really catch up to them.

*Penn, Schoen and Berland conducted a New info Shoppers survey of nearly 300 U.S. adults October 15-21. Margin of error is +/- 5.69 points. Detailed Results available at* www.psbresearch.com/files/ResultsOfMicrotrendsNewInfoShoppers.pdf

**Statement of**

**STACY JOHN HAIGNEY**

**GENERAL ATTORNEY, BURLINGTON COAT FACTORY**

**Before the**

**SENATE JUDICIARY COMMITTEE**

**SUBCOMITTEE ON ANTITRUST, COMPETITION POLICY**

**AND CONSUMER RIGHTS**

**Regarding**

**THE DISCOUNT PRICING CONSUMER PROTECTION ACT:**

**DO WE NEED TO RESTORE THE**

**BAN ON VERTICAL PRICE FIXING?**

**May 19, 2009**

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**TESTIMONY TO THE SENATE JUDICIARY COMMITTEE**

**BY STACY J. HAIGNEY, ESQ.**

Good day, Senators. My name is Stacy J. Haigney, General Attorney to Burlington Coat Factory. I greatly appreciate this opportunity to testify in support of S.148 which, if passed, will restore nearly a century of antitrust jurisprudence and greatly benefit American consumers and the economy as a whole.

I have represented Burlington Coat Factory in antitrust matters since 1981. At that time, Burlington Coat Factory was a burgeoning off-price retail chain of approximately 13 stores. We have since grown to a nationwide retailer with nearly 400 stores in 44 states. The Company's success is due to its ability to consistently adhere to the retail philosophy that our founder, Monroe G. Milstein, inaugurated when he started the Company in 1972:

Offer the customer full lines of in-season, nationally-known brands of merchandise at prices that are at



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least 25% below those charged at department stores for the same brands.

As simple as this approach may sound, there are only a handful of retail chains that have been able to implement it successfully. It is a certainty, moreover, that neither Burlington Coat Factory nor any other retailer, employing a comparable off-price structure, would have gotten off the ground in the 1970's if the Leegin court's holding permitting minimum price-fixing had been in force then. We know this because off-price merchants with a business model like Burlington Coat Factory's did not exist until after the so-called "Fair Trade Laws" were repealed. These state laws were permitted by Congress as an emergency measure during the Depression. In essence, the states were granted exemptions from the application of the Supreme Court's 1911 decision in Dr. Miles which forbade vertical price-fixing.

After the Second World War, some states repealed their Fair Trade Laws, but it was not until 1975 that President Ford signed a bill which did away with the exemption altogether. This law was passed after extensive economic studies by Congress conclusively proved that consumer prices were much lower, and retail competition much more intense, in states that had repealed their Fair Trade Laws than in states that hadn't done so.

Promptly following that repeal, Burlington Coat Factory's business took off from one outlet store in Burlington, NJ to the nationwide, retailing giant it has become. It is not difficult to understand why the end of legal resale price-fixing made it possible for Burlington Coat Factory to prosper.

When Burlington Coat Factory's business commenced in 1972, nearly all merchants of branded apparel charged the so-called "keystone mark-up," i.e., they sold their products to the public at double their wholesale cost. Unsurprisingly, many established retailers were less than enthusiastic about Burlington Coat Factory's sale of the same products at 25% below "keystone."

**Accordingly, during the early 1980's, Burlington Coat Factory encountered numerous incidents where department stores pressured vendors to stop selling Burlington Coat Factory because of its low prices.**

**Fortunately for Burlington Coat Factory and its customers, those anticompetitive retailers could not legally coerce their suppliers to impose high-pricing structures throughout the industry once the Dr. Miles prohibition against resale price-fixing was back in force. However, post-Leegin, there is no practical way to stop such retailer-imposed price-fixing schemes from being put in place.**

**I anticipate the objection that Leegin supposedly does not legalize resale price-fixing; it merely renders it subject to the "Rule of Reason." In the real world, this argument is a complete red herring. One of the reasons the United States Supreme Court established the per se rule to govern certain hardcore anticompetitive conduct is that the Court recognized that satisfying the Rule of Reason constitutes an insuperable hurdle**

for a small, non-governmental business entity. To prove a Rule-of-Reason violation requires plaintiff to offer voluminous and sophisticated economic evidence showing that the defendants' conduct materially harmed, not just plaintiff's business, but the entire relevant product and geographical markets.

As the opponents of the per se rule know, very few, if any, companies whose business has been destroyed by anticompetitive behavior can afford a multi-million dollar, multi-year evidentiary analysis of an entire industry. The per se rule, by contrast, has allowed entities of modest means to gain redress merely by proving the existence of the price-fixing scheme and that it harmed plaintiff. To put it plainly: under the Rule of Reason, a modest-sized victim of price-fixing is out of court.

The Leegin case not only brushes aside the time-honored doctrine of stare decisis and nearly a century of antitrust jurisprudence and expressions of congressional intent in the area of vertical restraints, it flies in the face of perhaps the most essential tenet of American antitrust law, i.e., that, at least since the Socony case, price competition is the central nervous system of a free market. Why would a majority of the Supreme Court, after nearly a century of a well-functioning economy subject to Dr. Miles, decide to deep-six this concept in favor of a nebulous "maybe-price-fixing can be beneficial sometimes" theory? It is difficult for one to summarize the "reasoning" behind the Leegin doctrine without sounding like one is mocking its proponents. Nevertheless, let me try and do so, as politely as possible.

Vertical minimum price-fixing -- we are told -- might have pro-competitive results in some circumstances because the retailer might use the extra profit it might earn from artificially-high retail prices to improve the services it offers in connection with sales of the overpriced product. The retailers, Leegin suggests, might offer these services, even though the manufacturer does not require them to do so. The retailer will be all the more apt to do so, the specious reasoning continues, if the retailer knows his prices won't be undercut by that



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inevitable Chicago School of Economics bogey man, the "free rider." Finally, forcing the consumer to pay artificially-high prices, in the Leegin court's view, promotes "consumer welfare." I am not making this up.

Although there are innumerable ways to demonstrate the baselessness of this rationale, I will attempt to confine my comments to my own personal knowledge and experience. In the first place, Burlington Coat Factory's principal means of competing are its low prices. Conceptually, therefore, the argument that artificially-high fixed prices are good for competition and consumers appears grotesque on its face to Burlington Coat Factory.

In addition, unlike the members of the Leegin majority, I have spent the last twenty-eight (28) years in the company of real-life executives, buyers, vendors and consumers (not Chicago School abstractions) in the apparel industry while they are actually conducting business. I have witnessed retail executives and buyers' thought processes unfold while making merchandising decisions.

My observation is that these people make their decisions entirely based on what they think would be in the best interest of the company. If such real-life retailers were to earn a little extra money from a particular product, that money will go to the general coffers of the company to be applied as the company sees fit, very likely as corporate profit, or to make some needed expenditures. It is inconceivable that a flesh-and-blood retailer would, absent a prior agreement with the manufacturer, decide to dedicate the extra profit to the benefit of the manufacturer's business objectives. Thus, to describe the Leegin scenario is to expose it as a fantasy.

What is perhaps most astonishing about the Leegin holding is that – since the Sylvania case of 1977 – manufacturers have been free to contractually require their dealers and retailers to provide whatever services the manufacturer deems desirable. The Leegin court's notion that artificially-inflated retail prices might encourage a retailer to sua sponte provide services is not only illogical, it is a complete non sequitur in light of Sylvania: If a manufacturer wants its product to be sold in a certain manner, in certain surroundings and with certain services, it may lawfully require every retailer to do so. Under Sylvania, all of this can be done lawfully without any reference to retail pricing.

Putting in place such a Sylvania-endorsed distribution program does something else without price-fixing that the Leegin court thinks is important: such a program ipso facto eliminates the "free rider." If only retailers who provide the services required by the manufacturer are permitted to buy the product, there will be no non-service-providing price-cutters to play the "free-rider" role.

Thus, not only is price-fixing unlikely to achieve the benefits envisioned by the Leegin court (e.g., more services), those benefits were obtainable contractually under Sylvania for thirty (30) years before Leegin was decided.

I would like to mention in passing how bizarre the "free-rider" hypothesis appears to people in the apparel business. While I can imagine that certain sophisticated retail services might be desirable from the manufacturers' point of view in connection with the sale of, say, computers, apparel customers know how to choose and wear clothing without any instruction from our sales associates. Some apparel manufacturers wish to enhance the snob appeal of their products by confining their distribution – unmolested by "free riders" – to fancy boutiques and top-of-the-line department stores. They have every right to do that under Sylvania. The Leegin doctrine adds nothing to their right to control distribution and prevent "free-riding."

In short, it turns out that the Leegin majority's counterintuitive notion that price-fixing can be pro-competitive is counterintuitive for a reason. Antitrust doctrine, as developed by Congress and the courts during the Twentieth Century, was based, not on academic theories, but on real-life business



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practices as analyzed in innumerable congressional hearings and judicial proceedings.

It saddens me to see the Leegin court replace all that accumulated wisdom with an academic construct which does not even make sense on its own terms.

In closing, I note that Burlington Coat Factory has yet to feel the negative impact of the Leegin case. This is probably due to the dire economic conditions that the country has experienced since the decision. At the present time, overall weakening in consumer demand seems to have temporarily divested manufacturers of the power to dictate retail prices to companies such as Burlington Coat Factory. However, there is every reason to believe that such abuses will return when prosperity is restored: I doubt very much that the proponents of price-fixing would have spent so much money and energy on lobbying and legal argumentation if they did not plan to avail themselves of Leegin's holding at the first opportunity.

**On behalf of Burlington Coat Factory, I hereby express my company's unequivocal support for S.148 which succinctly but fully addresses this vital issue.**

**Pamela Jones Harbour**
**Commissioner, Federal Trade Commission**

**Testimony before the Subcommittee on Antitrust, Competition Policy and Consumer Rights, Senate, Judiciary Committee**

**May 19, 2009**

## I. INTRODUCTION

Chairman Kohl and Members of the Subcommittee, I appreciate this opportunity to share with you my personal views on minimum vertical price fixing,[1] sometimes also referred to as resale price maintenance, RPM, or margin maintenance.

The Supreme Court's 2007 *Leegin* decision[2] gave manufacturers the right to set minimum resale prices for consumer goods, which typically thwarts discounting and leads to higher prices for consumers. This conduct used to be *per se* illegal under longstanding Supreme Court precedent.[3] The *Leegin* majority in effect legitimized the conduct, even though the Court was given no reasonable assurances that consumers actually benefit from RPM.

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[1] Several other published sources provide a more complete statement of my views on minimum vertical price fixing. *See especially* Pamela J. Harbour, *A Tale of Two Marks, And Other Antitrust Concerns*, 20 LOYOLA CONSUMER L. REV. 32 (2007); Pamela Jones Harbour, Commissioner, Federal Trade Commission, *Open Letter to the Supreme Court of the United States, Subject: The Illegality of Vertical Minimum Price Fixing* (Feb. 26, 2007), *available at* http://www.ftc.gov/speeches/harbour/070226verticalminimumpricefixing.pdf.

This testimony express my personal views. It does not necessarily reflect the position of the Federal Trade Commission or any other individual Commissioner.

[2] Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705 (2007).

[3] Dr. Miles Med. Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).



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I believe this outcome is contrary to good economic and legal policy. It gives excessively short shrift to consumer preferences, which are supposed to be the driving force behind healthy, competitive markets. Post-*Leegin*, and absent action by Congress, consumer preferences will be subordinated to the interests of manufacturers and merchants of branded consumer goods.

Lawyers working for a U.S. firm in Brussels recently observed that the debate over the proper treatment of RPM "has been hijacked by the concerns of the luxury goods industry."[4] I could not agree more, especially since the negative effects on consumers stretch far beyond luxury goods. In these tough economic times, it is especially wrong to saddle consumers with higher prices for daily necessities, with no countervailing benefits.

## II. LESSONS FROM THE PAST: CONSUMER INTERESTS SHOULD BE PARAMOUNT

When we talk about the overarching purpose of the antitrust laws, I think everyone, on all sides of the debate, would agree that the goal is to do what is best for consumers. There is significant disagreement, however, on how to accomplish this objective.

### A. Economic Theory

I turn to Adam Smith, the progenitor of modern economic thought, whose teachings provide a firm foundation for my belief that consumer interests should be paramount in the marketplace. Smith himself made two observations that are particularly relevant to the RPM debate.

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[4] Stephen Kinsella & Hanne Melin, *Who's Afraid of the Internet? Time to Put Consumer Interests at the Heart of Competition*, GCP, THE ONLINE MAGAZINE FOR GLOBAL COMPETITION POLICY 2 (Mar. 12, 2009), *available at* http://www.globalcompetitionpolicy.org/index.php?&id=1607&action=907.

First, Smith noted that consumers are best off when they can purchase the goods they desire at the cheapest price. Indeed, he went so far as to observe that this proposition was so self-evident that it would never have been questioned, "had not the interested sophistry of merchants and manufacturers confounded the common sense of mankind."[5] I would argue that the *Leegin* majority opinion reflects just such sophistry.

Smith's second observation is equally at odds with the *Leegin* decision:

> Consumption is the sole end and purpose of all production; and the interests of the producer ought to be attended to, only so far as it may be necessary for promoting that of the consumer.... But in the mercantile system, the interest of the consumer is almost constantly sacrificed to that of the producer; and it seems to consider production, and not consumption, as the ultimate end and object of all industry and commerce.[6]

Adam Smith seems to have anticipated some of the arguments that we now refer to generally as "supply-side economics," where the focus is on maximizing the welfare of producers, with an assumption that consumers ultimately will receive downstream benefits.

### B. Legislative History of the Antitrust Laws

With that economic background in mind, I next turn to the legislative history of the federal antitrust laws themselves. This history strongly corroborates my belief that the antitrust laws are intended to promote the interests of consumers over those of manufacturers. There is virtually no

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[5] ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 461 (Edward Cannan ed., The Modern Library 1937) (1776).

[6] *Id.* at 625.

credible support for any assertion that Congress intended to prioritize producer welfare over consumer welfare.[7]

With respect to RPM specifically, it is difficult to reconcile the legislative history with the *Leegin* Court's casual disregard for Congressional intent. Congress has *never* adopted or endorsed a preference for RPM at the federal level. Even when faced with intense lobbying pressure by the National Association of Retail Druggists early in the 20th century, Congress did not step in to overturn the Court's 1911 *Dr. Miles* decision.[8]

During the depths of the Great Depression, Congress did create an antitrust exemption for RPM programs governed by state "fair trade" statutes.[9] However, Congress ultimately looked back on the nation's 37-year natural experiment with RPM, graded it a monumental failure, and, in 1975, repealed that exemption to restore a national rule of *per se* illegality under *Dr. Miles*.[10] This decision was based on express factual findings that "fair trade" was fair only to manufacturers and retailers, not to consumers. The Congressional record painted RPM as a dismal, if not disastrous, detour from

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[7] To the extent that the legislative history expresses a desire for "efficiency," legislators were referring to productive efficiency (*i.e.*, how effectively a factory produces widgets), not some sort of "total welfare" approach that weights producer welfare as heavily as consumer welfare. *See* Robert H. Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 HASTINGS L.J. 65, 83 (1982). Even Judge Bork – whose version of "consumer welfare" primarily means producer welfare – cited legislative history that overwhelmingly supports his conclusion that Congress passed the antitrust laws to make consumers better off. *See, e.g.*, ROBERT H. BORK, THE ANTITRUST PARADOX 20-21 (1978).

[8] JOSEPH C. PALAMOUNTAIN, JR., THE POLITICS OF DISTRIBUTION 94 (1968.

[9] Miller-Tydings Resale Price Maintenance Act (Act of Aug. 17, 1937, Pub. L. 314, ch. 690, Title III, 50 Stat. 693); *see also* McGuire-Keogh Fair Trade Enabling Act (Act of July 14, 1952, Pub. L. 543, ch. 745, 66 Stat. 631).

[10] The Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 801.

sound public policy. Specifically, Congress compared economic data from states that had permitted fair trade with data from states that did not. Congress concluded that RPM:

- caused consumers to pay as much as 37 percent higher prices;
- reduced levels of sales per outlet;
- produced significantly higher rates of business failures;
- provided fewer entry opportunities for new products or manufacturers;
- distorted retailer incentives to provide consumers with objective comparisons of the competing products on their shelves; and
- diminished competition both within a brand (intrabrand competition) and between competing brands (interbrand competition).[11]

In short, Congress's negative opinion of RPM in 1975 could not have been clearer.[12]

Beyond its repeal of the fair trade laws, Congress has affirmatively expressed its distaste for RPM on at least four other occasions. Speaking in the dialect of appropriations, Congress has imposed limits on the budgets of the federal antitrust enforcement agencies, prohibiting them from spending any funds to advocate for the reversal of *per se* illegality for RPM. Language in one appropriations bill expressly criticized the Department of Justice's *Vertical Restraint Guidelines*

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[11] *See* H.R. REP. NO. 94-341 (1975); S. REP. NO. 94-466 (1975).

[12] The Consumer Goods Pricing Act of 1975 did not expressly require that RPM be treated as *per se* unlawful – presumably because it was unnecessary, given that RPM already was *per se* unlawful under *Dr. Miles*. Yet, the *Leegin* Court interpreted the lack of an express declaration of *per se* illegality as a deliberate omission, and concluded that Congress did not intend the *per se* rule to apply. This is particularly puzzling, given that the *Leegin* Court liberally cited the Court's *1977 GTE Sylvania* opinion with approval. *GTE Sylvania* expressly held that Congress *did* intend RPM to be *per se* illegal. Continental TV, Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 51 n.18 (". . . Congress recently has expressed its approval of a per se analysis of vertical price restrictions by" the passage of the Consumer Goods Pricing Act.).

because their lenient approach to vertical restraints did not accurately reflect federal antitrust law or good competition policy.[13]

### C. Congress's Justifications for Declaring RPM Illegal in 1975 Are Still Valid Today

I have closely reviewed the factual findings upon which Congress relied in repealing the fair trade exemption in 1975, and I still find those findings extremely persuasive today. How, or why, the *Leegin* majority overlooked this critical part of the legislative record is difficult to understand.

In his *Leegin* dissent, Justice Breyer asked whether any changed circumstances might justify reversal of *Dr. Miles*. He did identify a few things that changed between 1975 and 2007. Retailing became more concentrated. Concentration also increased in manufacturing industries that previously used RPM. Discount marketing expanded tremendously. Justice Breyer concluded – correctly, I believe – that none of these changes supported the Court's decision to reverse course on RPM. Why would the Court believe that a new experiment with RPM would succeed today, where the last one failed?

[13] Departments of Commerce, Justice, and State, the Judiciary, and Related Appropriations Act, 1984, § 510, Pub. L. No. 98-166, 97 stat. 1102-03 (1983); Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriation Act, 1986, § 605, Pub. L. No. 99-180, 99 stat. 1169-71 (1985). The provisions of the latter act expressly cited *Dr. Miles* with approval, and cited the then-just-released Department of Justice Vertical Restraints Guidelines with disfavor. Finding the Guidelines inconsistent with existing law and not in the interests of the business community, the appropriations statute expressly stated that those Guidelines "shall not be accorded any force of law or be treated by the courts of the United States as binding or persuasive," and called for their recall. *Id.* at 99 stat. 1170; Continuing Appropriations for Fiscal Year 1987, § 605, Pub. L. No. 99-500, 100 Stat. 1783–77 (1986); Continuing Appropriations, Fiscal Year 1988, § 605, 101 Stat. 1329-38 (1987).



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## III. LOOKING AHEAD: CONSUMERS NEED RELIEF FROM *LEEGIN*

Are we falling into a *Groundhog Day*[14] vortex, where we are doomed to endlessly repeat the same mistakes over and over again? Competition policy can, and should, do a better job of protecting consumers.

I was struck recently by a cartoon in the March 22nd edition of the Sunday *Washington Post*; the punch line equated "insanity" with "doing the same thing over and over but expecting different results." I worry what will happen if Congress fails to take prompt action to reverse the *Leegin* decision. Congress may, someday, be called upon to write another report detailing the disastrous harm inflicted on consumers during the Supreme Court's newest experiment with RPM. And who will pay for this experiment, which seems just as likely to fail as the last one? The American consumer.

Indeed, if you believe what you read in the newspapers, American consumers already are paying that price. The Court's new experiment has led many consumers to incur RPM price premiums – even in these trying economic times. Since the Court decided *Leegin*:

- ➢ the number of companies using some version of RPM has significantly increased;
- ➢ the use of third-party monitoring services by manufacturers to identify and discipline Internet discount pricing has rapidly expanded;
- ➢ some discounters have been terminated by as many as a quarter of their suppliers; and

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[14] GROUNDHOG DAY (Sony Pictures 1993).

- other discounters, like PSKS, Inc. (the plaintiff in the *Leegin* case), have gone out of business, and been unable to get the courts to even consider the merits of their claims under the rule of reason.[15]

Consumers do not realize that they are paying substantial RPM premiums. Not surprisingly, the manufacturers who impose these premiums are unlikely to notify customers that discounts are no longer available. Nor are retailers, who support and collect the RPM premiums, particularly interested in telling their customers that prices were "too low" before.

In fairness to the *Leegin* Court, the majority correctly noted that RPM sometimes has a beneficial impact on competition, which may offset the harm to consumers. The ultimate question is, when does this happen? When manufacturers impose RPM, how often (if ever) will the value of the beneficial impact exceed the cost of the RPM premium that consumers pay?

### A. <u>Existing Case Law May Rest On Flawed Foundations</u>

The antitrust laws promise consumers the ability to buy goods and services in competitive markets, at competitive prices. Both interbrand and intrabrand competition contribute to fulfilling that promise.[16] Existing case law, however, obfuscates the importance of intrabrand competition, which is the type of competition that RPM virtually eliminates. In a footnote in the Court's 1977 *GTE Sylvania* opinion, Justice Powell stated that interbrand competition is the primary focus of the

[15] *See* PSKS, Inc. v. Leegin Creative Leather Products, Inc., 2009 WL 938561 (ED TX 2009).

[16] LAWRENCE A. SULLIVAN & WARREN S. GRIMES, THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK 322-23 ("But economists as far back as Alfred Marshall recognized that competition at all levels of the distribution system is beneficial to the efficient allocation of goods and services.").

antitrust laws.[17] This bald proposition was devoid of any citation of authority, and was not supported by any legislative history. Yet, the Court repeatedly has relied on Justice Powell's phrase (and no more) to justify its holdings in subsequent cases.[18]

Rote recitations of other, supposedly unquestionable aphorisms from *GTE Sylvania* have been included in most of the Court's recent RPM cases, even when they did not actually apply to the pending case.[19] Most notably, virtually every opinion, including *Leegin*, invokes free-riding by discounters who do not provide "necessary" additional services. In reality, however, none of these cases seem to have involved free-riding problems.[20] In *Leegin*, for example, the plaintiff (Kay's Kloset) appeared to be an otherwise acceptable distributor in every way, except for the fact that it discounted.[21]

Ideally, and as I will discuss in further detail later in my remarks, additional scholarship would be devoted to establishing whether the underlying principles articulated in *GTE Sylvania* are correct or not. At the very least, the courts should not rely "on unthinking recitations of tired

[17] *GTE Sylvania*, 433 U.S. at 52 n.19 ("Interbrand competition is . . . the primary concern of antitrust law.").

[18] *See* Warren S. Grimes, *The Path Forward After* Leegin*: Seeking Consensus Reform of the Antitrust Law of Vertical Restraints*, ANTITRUST L.J. 467, 471-80 (2008).

[19] *Id.* at 504 (". . . *Sylvania* aphorisms . . . are widely used but seldom linked to the facts in the case before the court.").

[20] *See* Warren S. Grimes, *The* Sylvania *Free Rider Justification for Downstream-Power Vertical Restraints: Truth or Invitation for Pretext?*, in HOW THE CHICAGO SCHOOL OVERSHOT THE MARK 192 (Robert Pitofsky ed., Oxford Univ. Press 2008) ("The jury found that Business Electronics was terminated not for free riding but because it was discounting Sharp calculators. Nonetheless, Scalia, writing for the Court, repeatedly referred to *Sylvania* free riding theory as a reason for declining to apply the *per se* rule governing vertical minimum price-fixing.").

[21] *Id.* at 480.

language that may have no relevance to competitive analysis"[22] when analyzing RPM. Otherwise, no matter what legal standard is applied to RPM in the post-*Leegin* era, the courts will never get it right. In *GTE Sylvania*, the Court was rebelling against the Warren Court's alleged formalistic line-drawing to support liability. The current Court appears to have drawn similarly formalistic lines to short-circuit the RPM inquiry in the opposite direction and to suggest a presumption of legality. When line-drawing is devoid of substance, and labels replace rigorous analysis, the law suffers – as do consumers.[23]

### B. <u>Rule of Reason Treatment Is Insufficient To Protect Consumers</u>

Technically, the *Leegin* Court did not foreclose the possibility that RPM might be anticompetitive under some circumstances.[24] The *Leegin* Court noted that it intended for the lower courts to be diligent in their application of the rule of reason to weed out competitively harmful uses of RPM.[25] But good intentions will not cure a bad rule of law. Throughout antitrust law, the rule

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[22] *Id.*

[23] *See GTE Sylvania*, 433 U.S. at 47 (quoting Appalachian Coals, Inc. v. United States, 288 U.S. 344, 360, 377 (1933) (". . . realities must dominate the judgment . . . [the] Anti-Trust Act aims at substance.").

[24] *Leegin*, 127 S. Ct. at 2716-18.

[25] *Id.* at 2719-21. The Court, however, provided no guidance to the lower courts regarding how the rule of reason might be used to weed out the harmful uses of RPM. Basic concepts – such as the nature of the market power inquiry for RPM analysis – went unaddressed. *See* Jessica L. Taralson, Note, *What Would Sherman Do? Overturning the* Per Se *Illegality of Minimum Vertical Price Restraints Under the Sherman Act in* Leegin Creative Leather Products, Inc. v. PSKS, Inc. *Was Not As Reasonable As It Seemed*, 31 HAMLINE L. REV. 549, 590 (2008) ("In summation, had the *Leegin* Court given sufficient weight to market power, both as an element of analysis and as a concept, the Court would have recognized that the amount of market power necessary to impose a minimum vertical price restraint should justify holding all such restraints . . . illegal.").

of reason tends to be a euphemism for the absence of liability.[26] So too with respect to RPM, the rule of reason is quickly beginning to prove itself to be incapable of sorting out the good and bad uses of RPM, and consumers will be the poorer for it. Threshold presumptions must be established to draw workable contours for rule-of-reason analysis of RPM.[27]

**1. Lack of Empirical Research**

The lack of empirical research regarding the effects of RPM is a further complication, especially under a rule of reason standard.[28] There are economic theories praising RPM, and other theories condemning it, but none of these theories (on either side) are supported by any systematic body of empirical evidence. At best, we have strongly held beliefs about the effects of RPM, sometimes bordering almost on the religious. But we are missing facts, which are the building blocks of litigation.

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[26] We already see the beginnings of this problem in the *Leegin* case on remand. Based on the conjunctive use of the Court's *Leegin* decision and the strict antitrust pleading standards articulated by the Court in Bell Atlantic Corp. v. Twombly, 127 U.S. 1955 (2007), PSKS's case against Leegin has been dismissed on the pleadings. Neither the merits of the RPM claim, nor the horizontal price fixing claim raised by PSKS on remand, have ever been reached. PSKS, Inc. v. Leegin Creative Leather Products, Inc., Docket No. 2:03 CV 107 (TJW) (E.D. Tex. Apr. 6, 2009), *citing* Spahr v. Leegin Creative Leather Products, Inc., 2008 WL 3914461 (E.D. Tenn. 2008) (dismissing RPM and dual distribution price fixing claims on a motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6)). *See also* Valuepest.Com of Charlotte, Inc. v. Bayer Corp., 2009 WL 756901 (4th Cir.2009) (court declined to reach merits of RPM claim against defendant manufacturers of termite control chemicals).

[27] Grimes, *supra* note 17, at 492.

[28] Both the majority and dissent in *Leegin* recognized the absence of empirical support for any of the theories that claim RPM harms or benefits competition. *Compare Leegin*, 127 S. Ct. at 2717 ("although the empirical evidence on the topic is limited . . . .") (Kennedy, J.) *with id.* at 2729 ("[h]ow often, for example, will the benefits to which the Court points occur in practice? I can find no economic consensus on this point.") (Breyer, J., dissenting).

The realities of litigation dictate that when the facts are equally probative of guilt or innocence (depending on which theory is adopted to evaluate them), the outcome is heavily determined by the allocation of the ultimate burden of proof. If full-blown rule of reason analysis is applied in RPM cases, the burden of proof will be placed on the victims (or, in some cases, government enforcers working on behalf of the victims), not on the defendants who imposed the RPM policies. In other words, the burden will be borne by the consumer who paid more for the price-fixed goods. The burden will be borne by the terminated discounter who refused to go along with the fixed price. And these plaintiffs likely will lose, because they will be unable to present sufficient factual evidence that RPM has, on balance, harmed competition.

### 2. **The Commission's RPM Workshops**

President Truman once asked for a "one-armed economist" because he was frustrated by the tendency of economists to hedge their conclusions with "on the one hand...on the other hand" disclaimers.[29] Likewise, the Commission cannot rely on a mythical one-armed economist to provide us with a definitive answer regarding the proper legal treatment of RPM. Therefore, the Commission is doing its best to further the development of real-world facts about the effects of RPM.

The Commission recently initiated a series of workshop sessions to explore the economic and legal realities of RPM. I have annexed a copy of the Federal Register Notice announcing the workshops, as well as a copy of my opening remarks during the first workshop session. As these

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[29] *See* TODD G. BUCHHOLZ, NEW IDEAS FROM DEAD ECONOMISTS 34 (2d ed. 2007).

documents explain, the Commission seeks empirical insight into when consumers are more or less likely to be helped, or harmed, by RPM.[30]

I am quite optimistic that our workshop series will make an important contribution to RPM scholarship. Ideally, these workshops will enable the Commission to identify empirical research projects that might be undertaken to prove or disprove the assumptions underlying the various economic theories regarding RPM. But even if the workshops succeed on this front, it will be years, if not a decade or longer, before this research generates any consensus on the proper economic and legal treatment of RPM. Consumers should not have to wait this long to obtain relief from the flawed *Leegin* decision.

## IV. CONCLUSION

When it comes to the RPM debate, one simple fact is indisputable: RPM guarantees that consumers will pay higher prices. Until it is proven otherwise, I will continue to believe that consumers are very unlikely to gain any countervailing benefit in return for these elevated prices. The tremendous growth of discount chains, at the expense of higher-end specialty stores, tends to support my view.

Proponents of RPM say that it benefits consumers more than it harms them. If so, let the champions of RPM prove it. More specifically, if a firm makes a business judgment to use RPM, that firm should bear the burden of proving that consumers will not be harmed. The likely victims of the RPM policy should not shoulder the burden of proving anticompetitive effects.

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[30] Both documents are available on the RPM workshops page of the Commission's website, http://www.ftc.gov/opp/workshops/rpm.



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Given the state of our economy right now – as we wait anxiously for our financial markets to "self-correct" – a general belief in self-correcting markets likely is frayed, at best. I am extremely skeptical, therefore, that markets will self-correct in ways that curb the mistaken uses of RPM in situations that do not benefit consumers. The promise of self-correction ought to be a hard sell to American consumers.

I began my testimony today by quoting lawyers in Brussels. In closing, let me suggest that the Europeans may have better ideas about RPM than the *Leegin* Court. Under EC law, RPM is presumed unlawful, and thus prohibited, unless the RPM proponent can show that the "restriction is indispensable to the attainment of clearly defined pro-competitive efficiencies *and* that consumers demonstrably receive a fair share of the resulting benefits."[31] American consumers are entitled to the same benefit of the doubt.

Thank you. I would be happy to answer your questions.

[31] Kinsella & Melin, *supra* note 4 (emphasis in original).

United States Senate
Committee on the Judiciary

< Return To Hearing

Statement of

# The Honorable Herb Kohl

United States Senator
Wisconsin
May 19, 2009

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Statement of U.S. Senator Herb Kohl
Senate Judiciary Committee
Subcommittee on Antitrust, Competition Policy and Consumer Rights Hearing on May 19, 2009

"The Discount Pricing Consumer Protection Act: Do We Need to Restore the Ban on Vertical Price Fixing?"

Today's hearing examines an issue with far-reaching impact on the prices consumers pay for everything from clothing to electronics, and to everyone who likes to get a bargain when shopping. Two years ago, we held a hearing on the Supreme Court's 5-4 decision in the Leegin case in June 2007 which abolished a fundamental antitrust rule that manufacturers cannot set minimum retail prices. At that hearing, we heard warnings that this decision would imperil discount shopping that consumers have learned to take for granted. Our experience since the Leegin decision is giving credence to these fears, and it comes at exactly the wrong time - just as millions of consumer face a serious recession and depend on bargain shopping more than ever to balance the family budget. That is why I have introduced legislation to overturn this misguided Supreme Court ruling.

For nearly a century, the rule against vertical price fixing permitted discounters to sell goods at the most competitive price. Many credit this rule with the rise of today's low price, discount retail outlets - stores like Burlington Coat Factory, and the internet site eBay - both witnesses today - not to mention such retail giants as Target, Best Buy, and Walmart, all of which offer consumers a wide array of highly desired products at discount prices.

We have already begun to see manufacturers set minimum retail prices resulting in higher prices for consumers. Some antitrust experts suggest that there are an estimated 5,000 companies using minimum-pricing policies. Last November, at the outset of the holiday shopping season, Sony announced a no-discount rule prohibiting retailers from cutting the price on a number of its most in-demand top end products, including some flat screen TVs and digital cameras. The Wall Street Journal has reported that a new business has materialized for companies that scour the internet in search of retailers selling discount products. When such bargain sellers are detected, the manufacturer is alerted so that it can demand that the discounting stop. Even the discounting of toys at pre-Christmas sales was targeted.
- more -

I know from my own experience in the retail industry decades ago that established retailers can take advantage of vertical price fixing to halt discounting dead in its tracks. In order to eliminate low price competition from smaller retailers, large retailers can demand that manufacturers forbid discount pricing. These large retailers have the bargaining power with manufacturers to make these demands stick, all to detriment of upstart discount competitors and consumers.

Our common sense worry is that allowing manufacturers to bar discounting will lead to higher prices is



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borne out by basic economics. In his dissenting opinion in Leegin, Justice Breyer estimated that if only 10% of manufacturers engaged in vertical price fixing, retail bills would average $ 750 to $ 1,000 dollars higher for the average family of four annually. For this reason, I have introduced the Discount Pricing Consumer Protection Act, co-sponsored by Senator Whitehouse. Our bill – which is endorsed by 35 state attorneys general and all major consumers' organizations -- will simply make clear that when manufacturers prohibit discounting, they violate the antitrust laws, and thereby restore a clear legal rule that had stood since 1911.

In the last few decades, millions of consumers have benefited from an explosion of retail competition from new large discounters in virtually every product, from clothing to electronics to groceries, in both "big box" stores and on the internet. We have all taken for granted our ability to walk into discount retailers and buy brand name products at sharply discounted prices. It is essential that Congress act swiftly to enact the Discount Pricing Consumer Protection Act to once again make the setting of minimum retail prices illegal.

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STATEMENT OF

JAMES A. WILSON

ON BEHALF OF THE

AMERICAN BAR ASSOCIATION

before the

SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS

of the

COMMITTEE ON THE JUDICIARY

of the

UNITED STATES SENATE

concerning

"THE DISCOUNT PRICING CONSUMER PROTECTION ACT: DO WE NEED TO RESTORE THE BAN ON VERTICAL PRICE FIXING?"

MAY 19, 2009

Good afternoon Mr. Chairman, Senator Hatch, and members of the Subcommittee. My name is Jim Wilson, and I am a partner at Vorys, Sater, Seymour and Pease LLP in Columbus, Ohio. I am also the current Chair of the Section of Antitrust Law of the American Bar Association and as such, I have been authorized to testify on behalf of the association. Thank you for inviting me to testify before you today concerning the Supreme Court's recent decision in *Leegin Creative Leather Products* and our concerns regarding legislation such as S. 148, the Discount Pricing Consumer Protection Act, which would effectively reverse the Court's decision.

## I. INTRODUCTION

In February 2007, the House of Delegates of the American Bar Association ("ABA") adopted the following resolution:

> RESOLVED, That the American Bar Association recommends that the Sherman Act, 15 U.S.C. § 1, and comparable state and territorial laws should not be interpreted to apply a rule of per se illegality to agreements between a buyer and seller setting the price at which the buyer may resell goods or services purchased from the seller.

This resolution is the official position of the ABA, and it forms the basis for my testimony.

In a 5-4 decision issued on June 28, 2007, the United States Supreme Court overruled a nearly century-old precedent and held that vertical agreements between a supplier and its distributor or retailer on the minimum resale prices for the supplier's products will be evaluated under the antitrust rule of reason, not the per se rule. In *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), the Court had held that such agreements are per se violations of section 1 of the Sherman Act, 15 U.S.C. § 1. Only eight years after *Dr. Miles,* however, the Court in *Colgate* generally allowed a supplier *unilaterally* to adopt and enforce a policy of refusing to deal with discounters because such a unilateral decision did not involve the agreement necessary for a Section 1 violation. *United States v. Colgate & Co.*, 250 U.S. 300,



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307 (1919). The Court's recent decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 75 U.S.L.W. 4643 (U.S. June 28, 2007) (No. 06-480) 2007 WL 2835892, overrules *Dr. Miles* and brings the law on *minimum* vertical resale price agreements in line with both non-price vertical restraints and *maximum* vertical resale price agreements, both of which have been subject only to the rule of reason since the Court's decision in *State Oil v. Kahn*, 522 U.S. 3 (1997). The Court's *Leegin* decision is consistent with the position adopted by the ABA.

## II. THE *LEEGIN* DECISION

Consistent with several of the Court's decisions over recent decades, the majority opinion asserts that "[t]he rule of reason is the accepted standard for testing whether a practice restrains trade in violation of §1." 2007 WL 2835892, at *4. "As a consequence, the per se rule is appropriate only after courts had considerable experience with the type of restraint at issue, . . ., and *only if courts can predict with confidence that it would be invalidated in all or almost all instances under the rule of reason* . . . ." *Id.* at *5 (emphasis added). That is, per se categorizations are reserved for restraints "that would always or almost always tend to restrict competition and decrease output." *Id.* quoting *Business Elec. Corp. v. Sharp Elec. Corp.*, 485 U.S. 717, 723 (1988).

The majority opinion in *Leegin* emphasizes that "[v]ertical agreements establishing minimum resale prices can have either procompetitive or anticompetitive effects, depending upon the circumstances in which they are formed." *Id.* at *8. For example, it recognizes that such agreements may stimulate interbrand competition by encouraging retailers to provide services and promotional efforts on behalf of a supplier's products, by giving consumers greater choices as to product quality, service, and price, and by preventing discounting retailers from "free riding" on services provided by others. *Id.* at *7. At the same time, it recognizes that such agreements may also be used to obtain monopoly profits or to facilitate cartels at the supplier or retailer levels. *Id.* at *8. However, it concludes on balance that "[a]s the [per se] rule would proscribe a significant amount of procompetitive conduct, these agreements appear ill suited for per se condemnation." *Id.* at *9.

Notably, the Supreme Court explicitly recognized the tension between the effects of the *Colgate* decision and application of a per se rule:

> The manufacturer has a number of legitimate options to achieve benefits similar to those provided by vertical price restraints. A manufacturer can exercise its *Colgate* right to refuse to deal with retailers that do not follow its suggested prices. *See* 250 U. S., at 307. The economic effects of unilateral and concerted price setting are in general the same. *See* 2007 WL 2835892, at *12.

As a result of this dichotomy, prior to *Leegin*, suppliers seeking to implement a minimum resale pricing policy have spent considerable time and effort seeking to establish that those programs were not the subject of an explicit agreement or even tacit understanding between them and their distributors.

The majority opinion buttresses its position by concluding that the premises upon which *Dr. Miles* was based no longer apply. Specifically, it concludes that application of the common law rule against restraints on alienation has been rejected in the case of vertical non-price restrictions (*see, e.g., Contintental. T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977)) and should not apply in the case of vertical price restraints either. 2007 WL2835892 at *5-6. Indeed, the majority emphasizes that vertical price restraints may be preferable from a competitive standpoint to reliance on *Colgate* or on vertical non-price restraints in some instances. *Id.* at *12-13. The majority also rejected the premise in *Dr. Miles* that a supplier's vertical agreements with its distributors should be viewed as essentially the same as a horizontal agreement among those distributors and should be similarly condemned. *Id.* at *6.

Justice Breyer's dissent recognizes that vertical resale price agreements may have both procompetitive and anticompetitive effects. *Id.* at *16-18. It concludes, however, that the arguments in favor of applying the rule of reason have been "well known in the antitrust literature for close to half a century" and are insufficient to justify overturning a long-established precedent. *Id.* at *15.

## III. ABA POSITION

The American Bar Association supports the position that, under the Sherman Act and analogous State and territorial antitrust law, agreements between a buyer and seller setting the price at which the buyer may resell a product or service purchased from the seller should not be illegal per se. Because the intention and likely impact of the Discount Pricing Consumer Protection Act would be to effectively overturn the *Leegin* decision and reestablish a rule of per se illegality, the ABA respectful urges Congress not to enact this legislation.

The Sherman Act and the many State and territorial antitrust laws that are modeled on the Sherman Act contain language prohibiting every agreement in restraint of trade, but the Supreme Court has interpreted this language to prohibit only unreasonable restraints and has formulated two modes of analysis to determine whether a particular restraint should be considered unreasonable. "[M]ost antitrust claims are analyzed under a 'rule of reason,' according to which the finder of fact . . . tak[es] 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." *State Oil Co. v. Khan, supra.* "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.*" *Id.* Today, there "is often no bright line" separating rule of reason from *per se* analysis; the rule of reason encompasses a range of analysis, extending from an abbreviated "quick look" to a "plenary market examination," and even where the rule of reason is not applied, "a 'considerable inquiry into market conditions' may be required before the application of any so-called '*per se*' condemnation is justified." *California Dental Ass'n v. FTC,* 526 U.S. 756, 779 (1999), *quoting National Collegiate Athletic Ass'n,* 468 U.S. 85, 104, n. 26 (1984).

The rule of per se illegality against vertical price fixing (*i.e.,* agreements between buyers and sellers setting the resale price) was established by the Supreme Court in 1911 in *Dr. Miles Medical Co. v. John D. Park & Sons Co., supra.* That decision was based, *inter alia,* on the Court's application of the common law rule against restraints on alienation and its concern that minimum resale price maintenance could achieve the same purpose as an agreement among the buyers themselves to fix the prices at which they would resell.

Subsequently, in *United States v. Colgate & Co., supra,* the Court clarified that the Sherman Act does not apply to sellers' unilateral refusals to deal with buyers that fail to charge the resale prices suggested by the sellers, thereby permitting sellers to exercise substantial influence over resale prices so long as they avoid entering into bilateral agreements to this effect. The *Colgate* doctrine was unsuccessfully challenged, on the ground that it was tantamount to minimum resale price maintenance, in *Russell Stover Candies, Inc. v. FTC,* 718 F.2d 256 (8th Cir. 1983), and then was squarely reaffirmed by the Supreme Court in *Monsanto Co. v. Spray-Rite Service Co.*, 465 U.S. 752, 762-63 (1984).

At one time, the rule of per se illegality applied not only to minimum resale price maintenance, but to most vertical resale restraints between buyers and sellers, including both price restraints and non-price restraints. *See United States v. Arnold, Schwinn & Co.,* 388 U.S. 365, 380 (1967). Incrementally, however, the Supreme Court has abandoned this standard,



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except for the per se rule against minimum resale price maintenance, in favor of the rule of reason, under which the procompetitive effects of a restraint are weighed against the anticompetitive effects. The Court has "ma[d]e clear that departure from the rule of reason standard must be based upon demonstrable economic effect rather than...upon formalistic line drawing." *Continental T. V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 58-59 (1977).

The chief reason for this about-face was the recognition that vertical resale restraints simultaneously have the potential to reduce competition between resellers of the same brand ("intrabrand competition") while stimulating competition between different brands ("interbrand competition") by motivating resellers of each brand to compete harder. *Continental T. V.*, 433 U.S. at 51-52. Manufacturers and other sellers impose vertical restraints "to induce retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their products" which otherwise, "[b]ecause of market imperfections such as the so-called 'free rider' effect, . . . might not be provided . . . ." *Id.* at 55.

Thus, the Court overruled application of the per se rule to such non-price resale restraints as location clauses, territorial restraints and customer restraints, holding that these restraints should be judged under the rule of reason. *See Continental T. V.*, 433 U.S. at 36.

Addressing price-related vertical restraints, the Court has held that the rule of per se illegality does not apply to bona fide consignment sales, maximum resale price maintenance, or agreements between a buyer and a seller for the seller to stop doing business with buyers that resell below a particular price. *Simpson v. Union Oil Co.*, 377 U.S. 13 (1964); *State Oil Co. v. Khan,* 522 U.S. 3 (1997); *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988). At the same time, lower courts have declined to apply the per se rule to agreements against advertising at prices that are less than an agreed level. *See, e.g., Illinois Corporate*



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*Travel, Inc. v. American Airlines, Inc.*, 806 F.2d 722, 728-29 (7th Cir. 1986), *cert. denied*, 495 U.S. 919 (1990); *see also In re Advertising Checking Bureau*, 109 F.T.C. 146 (1987).

The ABA supports the Supreme Court's decision that the time has come to extend the rule of reason approach of these earlier decisions to minimum resale price maintenance because the same motives that manufacturers possess for entering into non-price vertical restraint agreements can also explain their motivation for wanting to enter into minimum resale price maintenance agreements. Manufacturers view dealer margins as their cost of distribution and have no economic incentive to overcompensate dealers—if they want to raise prices they need only raise their own wholesale prices to the dealers without limiting the prices at which the dealers may resell. *See Continental T.V.*, 433 U.S. at 56 n.24. As explained further below, minimum resale price maintenance, like other vertical resale restraints, can stimulate interbrand competition and is not so inevitably pernicious as to warrant per se illegality.

## IV. WHY THE AMERICAN BAR ASSOCIATION SUPPORTS APPLYING THE RULE OF REASON TO MINIMUM RESALE PRICE MAINTENANCE

There are several reasons why the ABA supports application of the rule of reason to minimum resale price maintenance, including the following:

### A. The Weight of Economic Analysis Favors Application of the Rule of Reason

The economic literature weighs heavily against condemning all minimum resale price agreements to per se illegality. *See generally* ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW AND ECONOMICS OF PRODUCT DISTRIBUTION 37-76 (2006) ("the bulk of the economic literature on [minimum resale price maintenance] . . . suggests that [minimum resale price maintenance] is more likely to be used to enhance efficiency than for anticompetitive purposes"). The seminal treatment appears in Lester G. Telser, *Why Should Manufacturers Want Fair Trade*, 3 J. L. & ECON. 86 (1960), which explained why manufacturers would adopt minimum resale



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price maintenance to assure the efficient distribution and marketing of their products—by encouraging dealers to promote the product without fear of "free riding" by rival dealers of the same brand that cut prices and spend little or nothing on services. As this principle is described by Judge Posner, when dealers are forced to compete without cutting prices, they "vie with one another to provide presale services" and the manufacturer benefits. Richard A. Posner, *Legal Narratology,* 64 U. CHI. L. REV. 737, 738 (1997). The prevailing view among economists is that minimum resale price maintenance is more often adopted to serve the interests of manufacturers in achieving efficiencies in distribution than to serve the interests of dealers in assuring their margins. *See Business Electronics Corp. v. Sharp Electronics Corp., supra,* at 727 n. 2 ("[r]etail market power is rare" (*citing* Baxter, *The Viability of Vertical Restraints Doctrine,* 75 Calif. L. Rev. 933, 948-49 (1987))).

**B. The "Ancient Rule Against Restraints on Alienation" Does Not Support A Per Se Rule Against Minimum Resale Price Maintenance**

The Supreme Court's ruling in *Dr. Miles* was predicated largely on "the ancient rule against restraints on alienation," a rule that the Court cited again in its since-overturned decision in *United States v. Arnold, Schwinn & Co.,* 388 U.S. 365, 380 (1967). However, there never actually was an unqualified rule against restraints on alienation. "The plain fact is that the common law never proscribed all restraints on alienation, even of land, and that the 'ancient rule' which the Court invokes actually permitted such restraints under a variety of circumstances." Milton Handler, *The Twentieth Annual Antitrust Review—1967,* 53 VA. L. REV. 1667, 1684 (1967). "*Coke on Littleton* cannot provide the answers for the problems that vex[ed] us in the twentieth century," *id.* at 1685, much less the twenty-first century.

C. **Empirical Evidence Under the Fair Trade Laws and Application of the *Colgate* Doctrine Do Not Support Application of a Per Se Rule**

There have been several empirical tests of minimum resale price maintenance, none of which proves that the practice is always destructive. Between 1937, when the Miller-Tydings Fair Trade Act, Pub. L. No. 75-314, 50 Stat. 693, was passed, and 1975, when the Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 801, was adopted, states were empowered to adopt Fair Trade Laws permitting manufacturers and retailers to enter into minimum resale price maintenance agreements. Many states enacted such laws and many manufacturers took advantage of them, fixing the retail prices at which their products could be resold. Empirical studies conducted at the time showed that identical products tended to cost more in Fair Trade states than in other states, but the premise underlying these studies was that minimum resale price maintenance agreements were usually imposed by buyers upon reluctant sellers—a premise that, as noted above, has not won universal acceptance among economists. *See* ABA ANTITRUST SECTION, MONOGRAPH NO. 2, VERTICAL RESTRICTIONS LIMITING INTRABRAND COMPETITION 79-80 (1977). There is no indisputable evidence that such agreements created additional market power for any individual brand or were destructive of market-wide competition. Nevertheless, Congress chose to end the program during the decade when *Schwinn* was still controlling law.

More recently, since the 1984 *Monsanto* decision reaffirmed the *Colgate* doctrine and the right of sellers to stop doing business with discounters, numerous sellers have relied upon this doctrine to announce that they will not sell to discounters and to cut off dealers that resell at less than suggested resale prices. *See, e.g., Euromadas, Inc. v. Zanella, Ltd.*, 368 F.3d 11, 17 (1st Cir. 2004); *Audio Visual Associates, Inc. v. Sharp Electronics Corp.*, 210 F.3d 254, 262 (4th Cir. 2000). The result has been to curtail discounting for the products affected, and as the FTC predicted in *Russell Stover,* the outcome has been very close to the effect of minimum resale price maintenance, but again there is no evidence that the impact has been the augmentation of market power or a diminution in interbrand competition. This has led to criticism that the per se rule against minimum vertical price fixing has become a trap for the unwary, with sophisticated companies accomplishing almost the same result without illegality, but only by jumping through the hoops of the *Colgate* defense, a result that critics consider both inefficient and unfair.

Finally, more recent empirical study conducted into the effects of minimum resale price maintenance by Federal Trade Commission personnel has found no basis for concluding that minimum resale price maintenance is always anticompetitive or for preserving the rule of per se illegality. *See* Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation* (FTC 1988); Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation,* 34 J. L & ECON. 263 (1991). *See also* Thomas R. Overstreet, Jr., *Resale Price Maintenance: Economic Theories and Empirical Evidence* (FTC 1983); Ronald N. Lafferty, Robert H. Lande and John B. Kirkwood, *Impact Evaluation of Federal Trade Commission Vertical Restraints Cases* (FTC 1984); Howard P. Marvel & Stephen McCafferty, *Resale Price Maintenance and Quality Certification,* 15 RAND J. ECON. 346 (1984).

### D. Outlawing Minimum Resale Price Maintenance Has Raised Barriers to Entry and Produced Anticompetitive Effects

The rule of per se illegality against minimum resale price maintenance has had an impact on retail competition today that was not addressed or necessarily foreseen when the Supreme Court decided *Dr. Miles.* Currently, it is possible for large retailers that carry a wide variety of products to sell selected products at very low prices—even at or below cost—in order to attract customers into their stores. The retailer does not need to earn a profit on the sale of such products because it can make up for this by selling other products to the consumers that frequent its stores. This strategy works most effectively by discounting products that are exactly the same at every outlet, so that consumers can easily compare prices. The problem for manufacturers of these products, however, is that retailers specializing in such products cannot match the unremunerative prices because they do not carry the wide variety of other products in their stores. The natural result is the eventual disappearance of more specialized outlets, or their refusal to support the targeted products, leaving manufacturers and consumers with fewer options and eventually leaving the large retailers with less competition and greater market power.

All of these reasons militate against preservation of the rule of per se illegality and in favor of application of the rule of reason, under which minimum resale price maintenance would only be unlawful if, on balance, its anticompetitive effects can be proven to outweigh its procompetitive effects in a relevant market.

## V. WHY THE AMERICAN BAR ASSOCIATION REJECTS THE ARGUMENTS ADVANCED IN SUPPORT OF THE RULE OF PER SE ILLEGALITY AGAINST MINIMUM RESALE PRICE MAINTENANCE

To assure that the ABA reached a sound conclusion, prior to adopting its position it also considered the reasons that have been advanced for preserving the rule of per se illegality against minimum resale price maintenance. In particular, the ABA considered—but ultimately rejected—each of those arguments, including the following:

### A. Elevating Prices to Consumers

A common reason advanced for the rule of per se illegality is that minimum resale price maintenance eliminates the ability of retailers and other resellers to engage in price competition on a local level—for example by providing fewer services or a less costly location in exchange for lower prices—thereby resulting in elevated prices to all consumers, including those who would prefer a less expensive distribution option. *See* William B. Comanor, *Vertical Price-*



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*Fixing, Vertical Market Restrictions, and the New Antirust Policy,* 98 HARV. L. REV. 983, 987 (1985); Robert Pitofsky, *In Defense of Discounters: The No Frills Case for a Per Se Rule Against Vertical Price Fixing,* 71 GEO. L.J. 1487, 1493 (1983). While non-price vertical resale restraints may limit the number of resellers that are allowed to compete for any particular sale, they do not limit the freedom of each competing reseller in a marketplace to adjust its own resale price to local conditions, thereby distinguishing non-price vertical resale restraints from vertical price fixing. Also, while some services may benefit consumers as well as manufacturers, other services provide little or no benefit to consumers even though resale price maintenance can be expected to elevate the price that some consumers pay.

Of course, if minimum resale price maintenance were permitted, and a manufacturer set too high a resale price, sales of its products would suffer. Again, manufacturers have no incentive to increase the margins that their dealers earn on each sale unless the result will be greater sales and greater profits for the manufacturer. *See Continental T. V.,* 433 U.S. at 56 n.24. Furthermore, if minimum resale price maintenance harms competition in a relevant market more than it strengthens competition, it would be subject to condemnation under the rule of reason. *Cf. Business Electronics Corp. v. Sharp Electronics Corp.,* 485 U.S. 717, 726-28 (1988) (agreements to terminate "price cutters" subject to rule of reason). Therefore, the ABA disagrees with those who contend that applying the rule of reason—instead of the rule of per se illegality—to minimum resale price agreements will necessarily lessen competition or raise prices for consumers.

**B. Facilitating Coordination or Collusion Among Sellers**

Another longtime rationale advanced for the per se rule is that minimum resale price maintenance can facilitate coordination or outright collusion among manufacturers and other sellers to fix the wholesale prices at which they sell their products to dealers. Although wholesale prices frequently are not public, making it difficult for one manufacturer to determine the price that another manufacturer is charging to its dealers, retail prices typically are publicly known. As a consequence, the argument goes, the fixing of retail prices would make it easier for a manufacturer to determine whether another manufacturer is "cheating" on an understanding to maintain prices above a particular level.

For example, if gasoline refiners were permitted to enter into agreements with service stations fixing the price at which each service station owner may resell gasoline to consumers, the refiner could assure that the prices at the pump would be the same at all stations reselling its brand (either with variation among states to account for differences in taxes in different states or even without such variation by equalizing the effect of differences in state taxes). This would enable each refiner to know the retail prices that competing refiners are setting and to coordinate its own wholesale and retail pricing accordingly. If there were an actual agreement among the refiners to maintain a particular resale price, it would be easy to detect deviations from that price. Previously, it has been held that refiners may not intentionally disclose their wholesale prices to one another, *In re Petroleum Prods. Antitrust Litigation,* 906 F.2d 432, 445-48 (9th Cir. 1990), *cert. denied,* 500 U.S. 959 (1991), but permitting minimum resale price maintenance could be equally effective in facilitating price uniformity.

In *Continental T. V., Inc. v. GTE Sylvania Inc.,* 433 U.S. 36, 52 n. 18 (1977), the Supreme Court observed: "The *per se* illegality of price restrictions has been established firmly for many years and involves significantly different questions of analysis and policy [than nonprice restrictions]. . . . [S]ome commentators have argued that the manufacturer's motivation for imposing vertical price restrictions may be the same as for nonprice restrictions. There are,



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however, significant differences that could easily justify different treatment. In his concurring opinion in *White Motor Co.,* [372 U.S. 253 (1963),] MR. JUSTICE BRENNAN noted that, unlike nonprice restrictions, '[r]esale price maintenance is not designed to, but almost invariably does in fact, reduce price competition not only *among* sellers of the affected product, but quite as much *between* that product and competing brands.' 372 U.S. at 268. Professor [now Judge] Posner also recognized that 'industrywide resale price maintenance might facilitate cartelizing.' Posner, [*Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions,* 75 COLUM. L. J. 282 (1975)] at 294 (footnote omitted)."

But is this sufficient reason to deny every seller the ability to enter into minimum resale price maintenance agreements with buyers, regardless of the nature of the product and the circumstances of its distribution? Plainly, this has not been a rhetorical question, but manufacturers engaging in horizontal collusion risk fines under the Sherman Act of $100 million or more and individuals participating in such collusion risk fines of $1 million and ten years in prison, which provides appreciable deterrence without applying a rule of per se illegality to every instance of minimum resale price maintenance. For all these reasons, the ABA does not agree that applying a rule of reason analysis to minimum resale price maintenance agreements will facilitate coordination or outright collusion among manufacturers and other sellers to fix the wholesale prices at which they sell their products to dealers.

### C. Facilitating Collusion Among Buyers

A further criticism of minimum resale price maintenance that the ABA considered, but ultimately rejected, is that it can facilitate collusion among buyers to maintain supracompetitive prices. As noted earlier, this was a consideration in the original *Dr. Miles* decision. However, this not only would run counter to the interests of the seller, but would require the complicity of resellers of other brands, if there are any. *See R. J. Reynolds Tobacco Co. v. Cigarettes Cheaper!*, 2006-2 Trade Cas. (CCH) ¶ 75,393 (7th Cir. 2006) (why a seller would be drawn into a buyers' cartel "is a mystery" because it would be hurt thereby at least as much as would consumers). In any event, this phenomenon appears to be sufficiently rare as not to justify perpetuation of a rule of per se illegality. *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. at 727 n.2 ("[r]etail market power is rare"). Moreover, if a seller is drawn into a price fixing conspiracy among buyers, this still would be subject to the rule of per se illegality, not as a vertical conspiracy but as a horizontal one. *See United States v. General Motors Corp.*, 384 U.S. 127 (1966).

## VI. CONCLUSION

In sum, the ABA supports the position that under federal Sherman Act—and analogous state and territorial antitrust law—agreements between a buyer and seller setting the price at which the buyer may resell a product or service purchased from the seller should not be illegal per se. Instead, these agreements should be analyzed under a rule of reason analysis. The ABA also believes that the Supreme Court's recent decision in *Leegin* is consistent with that position. Therefore, the ABA opposes legislation such as S. 148, which would overturn the Court's decision and reestablish the per se rule of illegality for resale price maintenance. The ABA appreciates the opportunity to appear before the Subcommittee to discuss this important issue of U.S. antitrust law, and I look forward to your questions



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