Leegin Creative Leather Products v. PSKS and Vertical Restraints

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LEEGIN CREATIVE LEATHER PRODUCTS V. PSKS AND VERTICAL RESTRAINTS

I. Introduction ............................................................................................................. 569

II. Statement of the Case ............................................................................................. 571
   A. Facts ................................................................................................................... 571
   B. Procedural History ............................................................................................ 572
   C. Holding ............................................................................................................... 573

III. Background Law .................................................................................................... 577
   A. The General Standard of Analysis in Antitrust Law ........................................... 577
   B. Case Law Concerning Vertical Restraints on Trade ........................................... 578
      1. The Beginning – The Dr. Miles Per Se Rule Against Resale Price Maintenance and its Exceptions ............................................................... 578
      2. Albrecht, Khan and Maximum Resale Price Maintenance .............................. 581
      3. Business Electronics, Broadcast Music, GTE Sylvania, and Monsanto – The Court Relaxes the Rules Against Vertical Restraints ............... 584

IV. Analysis .................................................................................................................... 589
   A. Leegin is Consistent With Modern Supreme Court Antitrust Jurisprudence ........ 589
   B. Leegin and Antitrust Values ............................................................................... 592
   C. Analysis of Some of the Court’s Economic Reasoning ..................................... 595
   D. Leegin as Precedent ........................................................................................... 598

V. Conclusion ................................................................................................................. 599

I. Introduction

In the business world, there are devices called "vertical restraints." A vertical restraint is when a seller places a condition on a buyer that regulates how the buyer can dispose of the product. There are many types of vertical restraints; some of the most common types are territorial restraints, tying arrangements,
and resale price maintenance.\textsuperscript{5} For the purposes of antitrust law, one of the most salient divisions between types of vertical restraints is that between vertical price restraints and vertical non-price restraints.\textsuperscript{6} The basic arguments in favor of vertical restraints are that they allow a manufacturer to get a dealer to provide more services related to the goods by counteracting the free rider effect; they promote inter-brand competition; and they facilitate the entry of new firms into the market.\textsuperscript{7}

Resale price maintenance is when a manufacturer specifies the price at which distributors can resell goods that they purchase from the manufacturer. The Supreme Court declared the practice illegal per se\textsuperscript{8} in 1911 in \textit{Dr. Miles Medical Co. v. John D. Park & Sons}.\textsuperscript{9} Although the practice was declared illegal per se, it has been allowed under certain circumstances after the \textit{Dr. Miles} decision.\textsuperscript{10} In the recent case \textit{Leegin Creative Leather Products v. PSKS, Inc.},\textsuperscript{11} the Supreme Court overruled \textit{Dr. Miles} and declared that the proper standard for judging resale price maintenance was the rule of reason.\textsuperscript{12}

This Note will discuss and analyze \textit{Leegin}. Part II of this note will set forth the facts, procedural history, and holding of \textit{Leegin}. Part III will discuss the background law. Part IV will analyze the holding in \textit{Leegin}. Part V will conclude that \textit{Leegin} was correctly decided, as the holding will make the Court’s antitrust


\textsuperscript{4} See \textit{RICHARD POSNER \& FRANK EASTERBROOK, ANTITRUST: CASES, ECONOMIC NOTES AND OTHER MATERIALS}, 777-857 (West Pub. Co. 2d ed. 1981) (discussing "Tying Arrangements and Related Practices"). A tying arrangement is a practice whereby a manufacturer will only allow his product to be sold in conjunction with his other products. \textit{See id.}

\textsuperscript{5} \textit{See}, e.g., \textit{HOVENKAMP, supra} note 1, at 183.

\textsuperscript{6} \textit{See}, e.g., \textit{id.} at 186-90.

\textsuperscript{7} \textit{See}, e.g., \textit{id.} at 184-86.

\textsuperscript{8} \textit{See} discussion \textit{infra} Part III (discussing what it means for a practice to be illegal per se under American antitrust law).

\textsuperscript{9} 220 U.S. 373 (1911) (overruled by \textit{Leegin Creative Leather Prods. v. PSKS}, 127 S. Ct. 2705 (2007)); \textit{see} discussion \textit{infra} Part III(B) (discussing the \textit{Dr. Miles} case).

\textsuperscript{10} \textit{See} discussion \textit{infra} Part III (discussing when and under what circumstances the United States Supreme Court has allowed resale price maintenance).

\textsuperscript{11} 127 S. Ct. 2705 (2007).

\textsuperscript{12} \textit{id.} at 2710; \textit{see} discussion \textit{infra} Part III(A) (explaining the rule of reason).
jurisprudence more consistent and will benefit the economy.

II. Statement of the Case

A. Facts

Leegin Creative Leather Products, Inc., (Leegin) "designs, manufactures, and distributes leather goods and accessories." Since 1991, Leegin has sold women's fashion accessories under the brand name Brighton. More than 5000 retail establishments, mostly independent, small boutiques and specialty stores, sell Leegin’s products. Leegin uses smaller retail establishments to sell its products due to the sentiment that smaller retailers “treat customers better, provide customers more services, and make their shopping experiences more satisfactory than do larger, often impersonal retailers.” In the words of Leegin’s president Jerry Kohl: “[W]e want the consumers to get a different experience than they get in Sam’s Club or in Wal-Mart. And you can’t get that kind of experience or support of customer service from a store like Wal-Mart.”

PSKS operated Kay’s Kloset, a women’s apparel store that sold products from “about 75 different manufacturers,” including Brighton products. Kay’s Kloset engaged in various activities to promote Brighton since Brighton accounted for between forty percent and fifty percent of their sales. In 1997, Leegin instituted the Brighton Retail Pricing and Promotion Policy, a minimum resale price program. The purpose of the policy was to provide sufficient margins to retailers, which would enable retailers to engage in the types of customer services that were “central to [Leegin’s] distribution strategy,” and to discourage discounting, which Leegin felt harmed its reputation.

13 Leegin, 127 S. Ct. at 2710.
14 Id.
15 See id.
16 Id. at 2710-11.
17 Id. at 2711 (citation omitted).
18 Id.
19 Leegin, 127 S. Ct. at 2711.
20 Id.
21 Id. (citation omitted).
22 Id.
In December 2002, Leegin discovered that Kay's Kloset had been marking down Brighton's entire line by twenty percent.\textsuperscript{23} Leegin asked Kay's Kloset to stop discounting Brighton products, but Kay's Kloset refused.\textsuperscript{24} Because of the store's refusal to stop discounting, Leegin stopped selling to the retailer.\textsuperscript{25} As a result, Kay's Kloset's profits suffered severely.\textsuperscript{26}

\textbf{B. Procedural History}

PSKS, the operator of Kay's Kloset, filed a lawsuit against Leegin in the United States District Court for the Eastern District of Texas.\textsuperscript{27} PSKS alleged, among other claims, that Leegin had entered into an agreement with other retailers to set a minimum retail price, in violation of section 1 of the Sherman Antitrust Act.\textsuperscript{28} Leegin argued that it had not entered into a price fixing agreement with retailers but had engaged in its price fixing scheme unilaterally, which is legal under the \textit{Colgate} doctrine.\textsuperscript{29} Leegin also attempted to introduce evidence of the pro-competitive effects of its resale price maintenance policy, but the court excluded that evidence.\textsuperscript{30} The Court relied on the rule of \textit{Dr. Miles}\textsuperscript{31} and held that resale price maintenance was per se illegal.\textsuperscript{32} The jury found for PSKS, awarding it $1.2 million.\textsuperscript{33} After trebling the damages and awarding attorney's fees and costs to PSKS pursuant to 15 U.S.C. § 15(a), the total judgment against Leegin amounted to $3,975,000.80.\textsuperscript{34}

On appeal to the Fifth Circuit Court of Appeals, Leegin conceded that it had entered into a minimum resale price

\textsuperscript{23} Id.
\textsuperscript{24} Id.
\textsuperscript{25} \textit{Leegin}, 127 S. Ct. at 2711.
\textsuperscript{26} Id.
\textsuperscript{27} Id. at 2712.
\textsuperscript{28} Id.
\textsuperscript{29} Id.; \textit{see infra} Part III(B)(1) (discussing the \textit{Colgate} doctrine); \textit{see also} U.S. v. Colgate & Co., 250 U.S. 300 (1919).
\textsuperscript{30} \textit{Leegin}, 1275 S. Ct. at 2712.
\textsuperscript{31} \textit{See infra} Part III(B)(1) (discussing \textit{Dr. Miles}, 220 U.S. 373).
\textsuperscript{32} \textit{Leegin}, 1275 S. Ct. at 2712.
\textsuperscript{33} Id.
\textsuperscript{34} Id.
maintenance agreement with its retailers. However, Leegin argued that minimum resale price maintenance agreements should be judged under the rule of reason. The Court held that it was bound by Dr. Miles and subsequent Supreme Court cases to apply the per se rule to minimum resale price maintenance agreements. It therefore held that the District Court correctly excluded the evidence of the pro-competitive effects of resale price maintenance and affirmed the District Court’s judgment.

C. Holding

After discussing the general principles of antitrust analysis, the Court began its opinion by examining Dr. Miles. It began by noting that the Court in Dr. Miles relied on the common law prohibition of general restraints on alienation. It also noted the Dr. Miles Court’s other rationale for treating vertical price restraints as invalid: They were analogous to a horizontal agreement among the dealers to fix prices, which would be per se illegal. As to the first justification, the Court remarked that the Court in Dr. Miles relied on a treatise from 1628. The rule was inapposite; the rule was most closely associated with land and had to do with personal property being removed “from the stream of commerce for generations.” By relying on the old common law rule, the Dr. Miles Court had “justified its decision . . . on ‘formalistic’ legal doctrine rather than ‘demonstrable economic effect.’”

As to the second reason relied on by the Dr. Miles Court, comparing vertical restraints to horizontal restraints, the Court noted that its late jurisprudence had moved away from using rules

35 Id.
36 Id.
37 Id.
38 Leegin, 127 S. Ct. at 2712.
39 Id. at 2712-14.
40 Id. at 2714.
41 Id. (citing Dr. Miles, 220 U.S. 404-05).
42 Id.
43 Id.
44 Leegin, 127 S. Ct. at 2714 (internal citations omitted).
against horizontal restraints when dealing with vertical restraints.\textsuperscript{45} The later cases, according to the Court, have "appreciated differences in economic effect between vertical and horizontal agreements, differences the \textit{Dr. Miles} Court failed to consider."\textsuperscript{46}

Since the Court found the reasons that the \textit{Dr. Miles} Court used to justify the per se rule against vertical minimum price restraints inadequate, it then examined the economic effects of vertical restraints.\textsuperscript{47} The Court began by noting the pro-competitive effects of vertical price restraints.\textsuperscript{48} The first benefit that it acknowledged was that vertical price restraints could stimulate inter-brand competition.\textsuperscript{49} Vertical restraints could do this in two ways. The first would be by decreasing intra-brand competition.\textsuperscript{50} This decrease would enable retailers to provide more services. Absent price restraints, some retailers would be able to "free ride," by allowing other retailers to make investments in services, such as show rooms or knowledgeable staff, and then sell the product for a lower price.\textsuperscript{51} As a result, those services would be underprovided.\textsuperscript{52} Vertical restraints could benefit the manufacturer by allowing customers to learn about the benefits of the product from knowledgeable staff, or by allowing customers to buy the product from a certain store because that store has a reputation for selling high quality merchandise.\textsuperscript{53} Allowing these vertical restraints could also benefit consumers by allowing them to choose between a high cost, high service brand; a low cost, low service brand; or somewhere in between.\textsuperscript{54}

Additionally, the Court stated that resale price maintenance reduces barriers to entry for new firms.\textsuperscript{55} By ensuring guaranteed margins to retailers, a new manufacturer can convince a distributor

\begin{flushleft}
\textsuperscript{45} \textit{Id.}
\textsuperscript{46} \textit{Id.}
\textsuperscript{47} \textit{Id.} at 2714-15.
\textsuperscript{48} \textit{Id.} at 2715.
\textsuperscript{49} \textit{Id.}
\textsuperscript{50} \textit{Leegin}, 127 S. Ct. at 2715.
\textsuperscript{51} \textit{Id.} (citing Cont'l T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 55 (1977)).
\textsuperscript{52} \textit{Id.}
\textsuperscript{53} \textit{Id.} at 2715-16.
\textsuperscript{54} \textit{Id.} at 2714.
\textsuperscript{55} \textit{Id.} at 2716.
\end{flushleft}
to make the investments that are often required in introducing new
and unfamiliar products to the public.\textsuperscript{56} After all, "[n]ew products
and new brands are essential to a dynamic economy, and if
markets can be penetrated by using resale price maintenance there
is a pro-competitive effect."\textsuperscript{57}

The Court then went on to discuss the possible negative
consequences of vertical resale price maintenance. The Court
noted that vertical resale price maintenance could facilitate the
formation of a manufacturer cartel by helping the cartel to
discover if some manufacturers were cutting prices.\textsuperscript{58} Also, resale
price maintenance could facilitate cartels at the retailer level.\textsuperscript{59} A
group of retailers could form a cartel and force the manufacturer to
e Engage in resale price maintenance.\textsuperscript{60} The retailers would not use
the extra margin to provide more services, but simply to allow
inefficient members of the cartel to survive.\textsuperscript{61} On the other hand,
more efficient retailers would be barred by the cartel with its
artificially wide profit margins from entering into the market by
Introducing price competition.\textsuperscript{62} The court noted that horizontal
cartels are illegal per se and that price fixing vertically would
serve as evidence in such a case.\textsuperscript{63} A dominant retailer might also
be able to use resale price maintenance to keep itself from having
to innovate.\textsuperscript{64} A manufacturer would have little choice but to go
along with the retailer if it needed access to the retailer’s
distribution network.\textsuperscript{65} Lastly, a dominant manufacturer could use
resale price maintenance to discourage retailers from selling the
products of its competitors.\textsuperscript{66}

The Court then looked at some of PSKS’s arguments. It
rejected the argument that administrative convenience and costs

\textsuperscript{56} \textit{Leegin}, 127 S. Ct. at 2716.
\textsuperscript{57} \textit{Id}.
\textsuperscript{58} \textit{Id}.
\textsuperscript{59} \textit{Id}.
\textsuperscript{60} \textit{Id}.
\textsuperscript{61} \textit{Id}.
\textsuperscript{62} \textit{Leegin}, 127 S. Ct. at 2717.
\textsuperscript{63} \textit{Id}.
\textsuperscript{64} See \textit{id}.
\textsuperscript{65} \textit{Id}.
\textsuperscript{66} \textit{Id}.
associated therewith should render resale price maintenance per se illegal.\textsuperscript{67} The Court felt that a per se rule would "increase the total cost of the antitrust system by prohibiting pro-competitive conduct that the antitrust laws should encourage."\textsuperscript{68} The Court then rejected the contention that resale price maintenance should be illegal per se because it leads to higher prices.\textsuperscript{69} It rejected this argument because price surveys do not necessarily say anything about consumer welfare.\textsuperscript{70} It also rejected this argument on the grounds that it had allowed other vertical restraints that tended to increase prices, and that resale price maintenance could reduce prices if the manufacturer switched to it from one of the other more costly vertical restraints that the courts allow.\textsuperscript{71} The Court relied on the fact that manufacturers can do a variety of things that increase price and that are not violations of the antitrust law, such as use higher quality materials or pay for advertising.\textsuperscript{72}

The Court also suggested some factors to be used in the future analysis of resale price maintenance agreements. It suggested that the number of firms in an industry that engaged in the practice was an important consideration.\textsuperscript{73} This is because if more firms engage in the practice, it is more likely that the practice is being used in an anti-competitive manner.\textsuperscript{74} They also suggested that the source of the restraint was an important consideration, because it is more likely being used anti-competitively if initiated by the retailer rather than the manufacturer.\textsuperscript{75} The final guideline the Court suggested was the market power of the firm engaged in the practice; the more powerful the firm, the more likely that resale price maintenance would be abused.\textsuperscript{76}

\textsuperscript{67} Id. at 2718.
\textsuperscript{68} Leegin, 127 S. Ct. at 2718.
\textsuperscript{69} Id.
\textsuperscript{70} Id. at 2718-19.
\textsuperscript{71} Id.; see, e.g., Frank H. Easterbrook, \textit{Vertical Arrangements and the Rule of Reason}, 53 \textit{Antitrust L. J.} 135, 148 (1984) (noting that the manufacturer could assign retailers exclusive territories for dealing, which would allow the retailers to provide more services since there would be no other dealers nearby to free ride).
\textsuperscript{72} Leegin, 127 S. Ct. at 2719.
\textsuperscript{73} Id.
\textsuperscript{74} Id.
\textsuperscript{75} Id. at 2719-20.
\textsuperscript{76} See id. at 2720.
III. Background Law

A. The General Standard of Analysis in Antitrust Law

Section 1 of the Sherman Antitrust Act provides that "every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal." The literal terms of the Sherman Act would seem to bar any agreement between business people. However, "[a]lthough the Sherman Act, by its terms, prohibits every agreement 'in restraint of trade,' [the] Court has long recognized that Congress intended to outlaw only unreasonable restraints." Thus, the prevailing standard of analysis is the so-called "rule of reason." Under the rule of reason, "the finder of fact must decide whether the questioned practice imposes an unreasonable restraint on competition, taking into account a variety of factors, including specific information about the relevant business, its condition before and after the restraint was imposed, and the restraint's history, nature, and effect."

However, certain agreements are said to be illegal per se. After all, "there are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use."

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78 See, e.g., United States v. Joint Traffic Association, 171 U.S. 505, 567-68 (1898) (observing that if the Court interpreted the Sherman Act literally, "there would scarcely be an agreement or contract among business men that could not be said to have, indirectly or remotely, some bearing upon interstate commerce, and possibly restrain it.").
80 GTE Sylvania, 433 U.S. at 49 (citing Standard Oil Co. v. U.S., 221 U.S. 1 (1911)).
81 Khan, 522 U.S. at 10.
83 GTE Sylvania, 433 U.S. at 50 (quoting Northern Pac. R. Co. v. U.S., 56 U.S. 1, 5 (1958)).
Court will only declare a practice to be per se illegal after it has significant experience with the practice.84

B. Case Law Concerning Vertical Restraints on Trade

1. The Beginning – The Dr. Miles Per Se Rule Against Resale Price Maintenance and its Exceptions

In Dr. Miles,85 the Dr. Miles Medical Company manufactured and sold proprietary medicines.86 The Dr. Miles Company had a carefully devised system by which it sought to “maintain certain prices fixed by it for all sales of its products both at wholesale and retail.”87 In order to accomplish its goals, it limited trade in its products to those who became parties to one of two restrictive agreements, either the “Consignment Contract – Wholesale” or the “Retail Agency Contract.”88 The defendant, John D. Park & Sons Co., refused to enter into either of the restrictive agreements. The defendant then obtained Dr. Miles’s products by inducing other companies, who were part of the agreements, to break the terms of the agreements and sell to it.89 Dr. Miles sued them for interfering with the contracts.90 The main issue on appeal to the Supreme Court was whether the agreements that the defendant had interfered with were valid.91

Dr. Miles argued that the contracts created consignment and agency relationships with the other parties to the contract.92 The Court found that under both agreements, the other parties were neither consignees93 nor agents,94 but rather “contemplated

84 Broad. Music v. Columbia Recording Sys., 441 U.S. 1, 9 (1979) (Stevens, J. dissenting) (citing U.S. v. Topco Assoc., Inc., 405 U.S. 596, 607-08 (1972)) (noting that the Court requires considerable experience with certain business relationships to declare a specific practice per se illegal).
85 Dr. Miles, 220 U.S. 373.
86 Id. at 394.
87 Id.
88 Id.
89 Id.
90 Id.
91 Dr. Miles, 220 U.S. at 395.
92 Id.
93 Id. at 396-97.
94 Id. at 398.
purchasers who buy to sell again, that is, retail dealers." 95

The Court relied on three rationales to justify its decision. The first was the common law rule against general restraints on alienation: "The right of alienation is one of the essential incidents of a right of general property in movables, and restraints on alienation have been generally regarded as obnoxious to public policy, which is best served by great freedom of traffic in such things as pass from hand to hand." 96 Another rationale was that vertical restraints were similar to horizontal restraints, which were illegal per se: "The complainant can fair no better with its plan of identical contracts than could the dealers themselves if they formed a combination and endeavored to establish the same restrictions, and thus to achieve the same result, by agreement with each other." 97 The third rationale was what might be called the free market justification: "The complainant having sold its product at prices satisfactory to itself, the public is entitled to whatever advantage may be derived from competition in the subsequent traffic." 98 The Court never conducted any economic analysis of vertical restraints. 99 The Court held the agreements were not valid and declared that vertical price restraints were illegal per se. 100

In the next fifteen years, the Court created two significant exceptions to the per se rule of Dr. Miles, the Colgate and General Electric exceptions. In United States v. Colgate, 101 Colgate announced to its customer resellers that they could not sell particular products below certain prices. 102 It investigated to see if dealers were selling below the prices, sought assurances from dealers who did that they would forgo the practice, and terminated dealers who would not comply. 103 The Court held that the Sherman Act did not prohibit Colgate’s conduct. The Court said,

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95 Id.
96 Id. at 404 (citing John D. Park & Sons Co. v. Hartman, 153 F. 24, 39 (1907)).
97 Dr. Miles, 220 U.S. at 408.
98 Id. at 409.
99 See id.
100 Id.
101 Colgate, 250 U.S. 300.
102 Id. at 303.
103 Id.
"[t]he trader or manufacturer . . . carries on an entirely private business and can sell to whom he pleases." Moreover, in *United States v. General Electric Co.*, General Electric sold products to resellers on a consignment basis. It mandated that the products not be sold for less than a certain price. The Court held that this was not a violation of the Sherman Act.

The *Colgate* rule and the *General Electric* rule were later significantly limited. In *United States v. Parke, Davis & Co.*, Parke Davis announced its resale prices and refused to deal with resellers who would not agree to abide by the prices. When several dealers objected to the resale price policy, Parke Davis terminated them. The Court held that they were in violation of the Sherman Act, and that any firm that did more than announce a suggested resale price and refuse to deal with those which would not comply with it would violate the Sherman Act. In *Simpson v. Union Oil Co. of California*, the Court limited the *General Electric* rule. It held that while selling goods on a consignment basis was not itself a violation of the Sherman Act; it would be a violation if the manufacturer mandated a minimum resale price.

The Court also created a partial exception for vertical non-price restraints in *United States v. Arnold Schwinn & Co.* In that case, Schwinn sold bicycles two ways: On a consignment basis and on a basis where title passed to the reseller. It mandated territories in which its dealers could sell. The Court held that

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104 *Id.* at 307.
105 220 U.S. 476 (1926).
106 See *id.* at 478-79.
107 See *id.* at 481-84.
108 *Id.* at 488.
110 *Id.* at 33.
111 *Id.* at 34.
112 *Id.* at 49.
113 *Id.* at 44.
115 *Id.*
117 *Id.* at 370.
118 *Id.* at 371.
the non-price vertical restraints at issue in the case were a violation of the Sherman Act when title passed to the reseller, but not when the goods were sold to the reseller on a consignment basis.  

There was also a legislatively created exception to the per se ban on resale price maintenance, which allowed the practice to be legal in individual states from 1937 until 1975. During that time, pursuant to the Miller-Tydings Act, states could pass “fair trade” laws that would allow for minimum resale price maintenance in their state. Thirty-six states passed such laws. However, Congress, with the Consumer Goods Pricing Act of 1975, repealed the Miller-Tydings Act, and the Supreme Court ruled that the repeal of the Miller-Tydings Act had re-instituted the Sherman Act’s complete ban on resale price maintenance.

2. *Albrecht, Khan and Maximum Resale Price Maintenance*

The Court has also dealt with restrictions fixing maximum prices. In *Albrecht v. Herald Co.*, Herald published a newspaper, the Globe-Democrat, circulated in St. Louis, Missouri. It distributed the paper by contracting with independent retailers, who “[bought] papers at wholesale and [resold] them at retail.” The retailers had exclusive areas, which would be terminated if they charged a price higher than the paper’s suggested resale price. Albrecht, one of the distributors, charged a price higher than the suggested resale price.

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119 Id. at 382.
120 Id. at 380.
121 Leegin, 127 S. Ct. at 2727.
123 Leegin, 127 S. Ct. at 2727.
124 Id.
128 Id. at 147.
129 Id.
130 Id.
131 Id.
Herald, after objecting to Albrecht’s conduct, engaged Milne Circulation Sales Inc. to solicit customers to receive the paper directly from the Herald for the lower price—about 300 customers switched. Albrecht refused and filed suit in federal court, alleging a violation of section 1 of the Sherman Act.

The Court agreed with Albrecht, holding that “agreements to fix maximum prices, ‘no less than those to fix minimum prices, cripple the freedom of traders and thereby restrain their ability to sell in accordance with their own judgment.’” The Court went on to state “schemes to fix maximum prices, by substituting the perhaps erroneous judgment of a seller for the forces of the competitive market, may severely intrude upon the ability of buyers to compete and survive in that market.” Buyers could be prejudiced by dealers not being able to provide enough services which consumers desire and will pay for; and this might channel distribution into a few large and “specifically advantaged firms.” The Court also rejected the argument that maximum prices were necessary because they granted exclusive areas to distributors, and fixing maximum prices would prevent distributors from engaging in a monopoly. Thus, if that was the only way to protect against monopoly, then the whole scheme would be invalid.

Several decades later, the Court dealt with maximum price restrictions again. In *State Oil Co. v. Barkat U. Khan and Khan, & Assoc., Inc.*, Khan entered into a contract with State Oil “to

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132 Id.
133 *Albrecht*, 390 U.S. at 148.
134 Id.
135 Id. at 152 (quoting Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, 340 U.S. 211, 213 (1950)).
136 Id.
137 Id. at 152-53.
138 Id. at 153-54. The petitioner's argument was that it needed to use one objectionable practice to curb the effects of its using another objectionable practice. Id. Thus, if “the economic impact of territorial exclusivity was such that the public could only be protected by otherwise illegal price fixing itself injurious to the public, the entire scheme must fail under section 1 of the Sherman Act.” Id. at 154.
lease and operate a gas station and convenience store owned by State Oil.\textsuperscript{140} Under the agreement, if Khan sold gasoline at a price above that suggested by State Oil, any excess profit would go to State Oil.\textsuperscript{141} Khan sued State Oil for a violation of the Sherman Act under \textit{Albrecht}.\textsuperscript{142}

The Court allowed State Oil's practice and overturned \textit{Albrecht},\textsuperscript{143} citing numerous reasons. One reason relied on by the Court was the importance and desirability of low prices: "Low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition."\textsuperscript{144} The Court rejected the argument from \textit{Albrecht} that maximum price fixing interfered with dealer freedom: "[T]he ban on maximum resale price limitations declared in \textit{Albrecht} in the name of 'dealer freedom' has actually prompted many suppliers to integrate forward into distribution, thus eliminating the very independent trader for whom \textit{Albrecht} professed solicitude."\textsuperscript{145} The Court also rejected \textit{Albrecht}'s rationale that the price may be too low for the distributor to offer needed or desired services to the customer.\textsuperscript{146} The Court did so on the grounds that such conduct would harm the manufacturer as well and would thus be unlikely to occur.\textsuperscript{147} Additionally, the Court noted that the \textit{Albrecht} Court's concern about distribution by a large, specially advantaged retailer was unlikely to occur and consumers would not be harmed if inefficient retailers were disadvantaged.\textsuperscript{148}

\begin{itemize}
\item \textsuperscript{140} Id. at 7-8.
\item \textsuperscript{141} Id. at 8.
\item \textsuperscript{142} Id.
\item \textsuperscript{143} Id. at 22.
\item \textsuperscript{144} Id. at 15 (quoting Atl. Richfield Co. v. U.S. Petroleum Co., 495 U.S. 328, 340 (1990)).
\item \textsuperscript{145} Khan, 522 U.S. at 16 (citing PHILLIP AREEDA, ANTITRUST LAW 395, ¶ 1635 (1989)).
\item \textsuperscript{146} Id. at 17.
\item \textsuperscript{147} Id.
\item \textsuperscript{148} Id.
\end{itemize}
3. Business Electronics, Broadcast Music, GTE Sylvania, and Monsanto – The Court Relaxes the Rules Against Vertical Restraints

In Business Electronics v. Sharp Electronics the issue was whether “a vertical restraint is per se illegal . . . only if there is an express or implied agreement to set resale prices at some level.” Respondent, Sharp Electronic Corporation, sent out a list of suggested minimum resale prices but did not oblige its dealers to abide by them. Petitioner, Business Electronics, sold calculators at lower prices and with less services than a competitor. The competitor felt that the petitioner was free riding on competitor’s services. The competitor eventually issued an ultimatum to respondent that he would quit distributing its products if it did not drop petitioner as a retailer. The respondent obliged and terminated the relationship.

The Court held that the respondent’s behavior was not a violation of the Sherman Act. In doing so, it relied on Continental T.V. Inc., v. GTE Sylvania Inc. and Monsanto Co. v. Spray-Rite Service Corp.: [T]here is a presumption in favor of a rule-of-reason standard; that departure from the standard must be justified by demonstrable economic effect, such as the facilitation of cartelizing, rather than formalistic distinctions; that inter brand competition is the primary concern of the antitrust laws; and that rules in this area should be formulated with a view towards protecting the doctrine of GTE Sylvania.

150 Id. at 720.
151 Id. at 721.
152 Id.
153 Id.
154 Id.
156 Id. at 735-36.
The Court noted that the practice at issue in the case did not always lead to cartelization. Specifically it noted that cartels are extremely difficult to form, that abuse of superior market power is not a big problem because not many firms have it, and that other retailers should have to prove the presence of inter-brand competition rather than the court assuming it. The Court rejected a formalistic approach, saying that it could not invalidate all vertical restraints that included the word price. It also noted that all vertical restraints could be used to increase price, but more often these restraints simply ensure that dealers are providing adequate services and discouraging free riders. The Court also rejected the argument that a per se rule was justified because allowing the conduct would almost always involve setting minimum prices. It held that it was highly likely that the practice would be used for a legal reason, like encouraging the provision of services.

Monsanto v. Spray-Rite involved "a question as to the standard of proof required to find a vertical price-fixing conspiracy in violation of section 1 of the Sherman Act." Monsanto had several criteria, such as retaining knowledgeable salesmen, which it wished its dealers would follow. Monsanto terminated its contract with Spray-Rite after competing dealers complained that Spray-Rite had not met those criteria. Spray-Rite alleged that there had been a price-fixing conspiracy in violation of section 1 of the Sherman Act. The district court found a price-fixing conspiracy, and the Seventh Circuit affirmed,
holding that the proper standard of proof was that "proof of termination following competitor complaints is sufficient to support an inference of concerted action." 172

The Court began its opinion by noting the difference between unilateral action and concerted action, and the difference between price and non-price vertical restrictions. 173 The Court held that there must be more evidence than complaints by competitors, or evidence of termination in response to complaints. 174 There must be "evidence that tends to exclude the possibility that the manufacturer and the non-terminated distributors were acting independently" to establish liability. 175 The evidence must show that the distributor and the manufacturer "had a conscious commitment to a common scheme designed to achieve an unlawful objective." 176

The reasons for the Court's holding were that it is very difficult to distinguish between unilateral and concerted action, and between price and non-price restraints. 177 There are many legitimate reasons that a manufacturer would be in contact with a distributor and would be concerned about resale prices. 178 When a manufacturer wants to further a particular marketing strategy by means of non-price vertical restraints, which were legal at the time, it would be in contact with its retailers to make sure that it made sufficient margins to be able to provide certain services and to eliminate free riders. 179 The same would be true if it were

172 Id. at 758 (quoting Spray-Rite Service Corp. v. Monsanto Co., 684 F.2d 1226, 1238 (1982)). The Appellate Court also characterized it as "proof of distributorship termination in response to competing distributor's complaints about the terminated distributor's pricing policies is sufficient to raise an inference of concerted action." Id. at 758 n.4. This standard is different because it implies that the termination was the result of the complaint, but the distinction did not make a difference in the Court's opinion. Id. at 759.

173 Monsanto, 465 U.S. at 761. The Court noted that it was unable to consider the contention urged by some amici that there was little difference between price and non-price vertical restraints, and that both should accordingly be treated under rule of reason analysis as the issue was not before the court. Id. at 761 n.7.

174 Id. at 764.

175 Id.

176 Id. (quoting Edward J. Sweeney & Sons v. Texaco, 637 F.2d 105, 111 (1980)).

177 Id. at 762.

178 Id. at 763.

179 Monsanto, 465 U.S. at 763.
engaging in unilateral conduct allowed by the *Colgate* doctrine.\textsuperscript{180} Indeed, any time that a manufacturer seeks to have its dealers provide certain services, it is likely that it will hear complaints about price. This conduct is legitimate and should not be discouraged.\textsuperscript{181} However, since it is so close to conduct that is illegal, if the low evidentiary standard used by the Court of Appeals was maintained, then much legal and desirable conduct will be deterred.\textsuperscript{182} The Court also noted that distributors are a good source of information for manufacturers, and it would be undesirable to prevent a manufacturer from acting just because it got the information from a distributor.\textsuperscript{183}

In *Broadcast Music v. Columbia Broadcasting System*,\textsuperscript{184} Broadcast Music and their codefendants, the American Society of Composers and Producers (ASCAP), issued blanket licenses to copyrighted musical compositions to television and radio stations that wanted to use music to which members held copyrights.\textsuperscript{185} A station thus paid a fee to use copyrighted material, rather than paying the group for rights to individual pieces or negotiating with individual artists or producers. Columbia Broadcasting System alleged that this amounted to price fixing and was thus illegal per se under section 1 of the Sherman Act.\textsuperscript{186}

The Court said that the licenses were price fixing schemes "in the most literal sense."\textsuperscript{187} However, the Court held that although the defendants were price fixing, there was no "per se price fixing."\textsuperscript{188} The Supreme Court, in holding the conduct to be price fixing, felt that the Court of Appeals had been "too literal."\textsuperscript{189} Nevertheless the Court examined the beneficial aspects of the agreement and held that, because there was so much good to be had, and while the defendant's conduct was price fixing, it was not

\textsuperscript{180} Id. at 762-63.
\textsuperscript{181} Id.
\textsuperscript{182} Id.
\textsuperscript{183} Id. at 763-64.
\textsuperscript{184} 441 U.S. 1 (1979).
\textsuperscript{185} Id. at 4.
\textsuperscript{186} Id. at 6.
\textsuperscript{187} Maricopa County Med. Soc'y, 457 U.S. at 363.
\textsuperscript{188} Broad. Music, 441 U.S. at 8-9.
\textsuperscript{189} Id.
an antitrust violation.\textsuperscript{190}

In \textit{Continental v. GTE Sylvania}, the issue was the appropriate analysis of "agreements between manufacturers and retailers . . . barring the retailers from selling franchised products from locations other than those specified in the agreements."\textsuperscript{191} Sylvania adopted a marketing plan whereby it "phased out its wholesaler distributors and began to sell to a smaller and more select group of retailers."\textsuperscript{192} The goal was to attract "the more aggressive and competent retailers."\textsuperscript{193} Sylvania limited the number of franchises in a given area and allowed franchisees only to sell Sylvania products at the store that held the franchise.\textsuperscript{194} "A franchise did not constitute an exclusive territory, and Sylvania retained sole discretion to increase the number of retailers in an area in light of the success or failure of existing retailers in developing their market."\textsuperscript{195} The strategy was successful and allowed Sylvania to more than double its share of the color television market.\textsuperscript{196} The Court also noted that inter-brand competition, as opposed to intra-brand competition, is the primary interest of the antitrust laws.\textsuperscript{197}

The Court acknowledged that vertical restraints are difficult to analyze because they can, at the same time, both lower intra-brand competition and increase inter-brand competition.\textsuperscript{198} It noted that in \textit{Schwinn}, apparently the dichotomy in sale and non-sale transactions originated in the view that sales transactions were so destructive of intra-brand competition that per se illegality was warranted, whereas non-sale transactions were so beneficial to inter-brand competition that they would merit rule of reason

\textsuperscript{190} Id. at 19-21. It may seem odd to discuss \textit{Broadcast Music} in the context of vertical restraints when the conduct in that case was horizontal. However, \textit{Broadcast Music} is important in that it is one of the most representative examples of the shift in the Court's thinking away from condemning conduct based on formalistic categories and towards more economic analysis of challenged practices.

\textsuperscript{191} 433 U.S. at 37.

\textsuperscript{192} Id. at 38.

\textsuperscript{193} Id.

\textsuperscript{194} Id.

\textsuperscript{195} Id.

\textsuperscript{196} Id.

\textsuperscript{197} \textit{GTE Sylvania}, 433 U.S. at 52 n.19.

\textsuperscript{198} Id. at 52-53
It then condemned *Schwinn* as drawing arbitrary lines, reiterating that the concern of the antitrust laws was the economic effect rather than formalism. Among the benefits of vertical non-price restraints that the Court recognized were that new manufacturers could use them to break into the market by “induc[ing] competent and aggressive retailers to make the kind of investment in capital and labor that is often required in the distribution of products unknown to the consumer.” Additionally, for larger, more established firms, vertical restraints can be used “to induce retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their products” by eliminating the free rider problem. The Court also noted that with respect to resale price, manufacturers, like consumers, would be interested in keeping the prices low in order to increase sales volume and hence profits.

IV. Analysis

**A. Leegin is Consistent With Modern Supreme Court Antitrust Jurisprudence**

*Leegin* is the natural outgrowth of the Supreme Court’s jurisprudence of the last thirty years, if not its whole history. It is true that resale price maintenance has been per se illegal for ninety-six years. However, after *Colgate* and *General Electric*, firms could engage in resale price maintenance in all but name. It was not until the 1960s, when *Colgate* was narrowed nearly to the point of elimination by *Parke Davis, General Electric*, and *Simpson* that it became difficult for firms to engage in resale price maintenance.

In the 1960s, firms’ freedom to engage not only in vertical price maintenance, but also in vertical restraints in general, became severely limited. We have already seen how vertical price maintenance was virtually eliminated by *Parke Davis*. Maximum resale price maintenance was eliminated by *Albrecht*.

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199 Id. at 53.
200 Id. at 55.
201 Id.
202 Id. at 56 n.24.
203 *GTE Sylvania*, 433 U.S. at 68.
virtually eliminated vertical non-price restraints.

However, the Court’s views began to change with *GTE Sylvania*. Here, the court recognized the virtues of vertical restraints.\(^{204}\) It recognized that vertical restraints may be used by manufacturers to encourage distributors to introduce new products, engage in promotional activities, hire knowledgeable staff, and provide service and repair.\(^{205}\) It also recognized the importance of vertical restraints in counteracting the free rider effect.\(^{206}\) Moreover, it also recognized that inter-brand, rather than intra-brand, competition was the primary focus of antitrust law.\(^{207}\)

After *GTE Sylvania*, firms were again allowed to use vertical restraints, and the court had recognized all of the arguments for vertical restraints that were relied on in *Leegin*. It is surprising that it took the Court thirty years to get from *GTE Sylvania* to *Leegin*. After *GTE Sylvania*, it was only a matter of time until the Court overruled *Dr. Miles* as Justice White recognized in his concurring opinion in *GTE Sylvania*.\(^{208}\)

After *GTE Sylvania*, the Court chose to value formalism over economic analysis and upheld the use of the per se rule for a case involving resale price maintenance in 1980. It allowed vertical non-price restraints. This allowance is interesting because there is virtually no difference between vertical price restraints and vertical non-price restraints.\(^{209}\) Any vertical restraint will raise prices; the only question is how.\(^{210}\) Vertical price and non-price restraints are used for exactly the same reasons—that is, to get the dealer to provide extra services and to avoid the free-rider effect.\(^{211}\)

What is even more interesting is that the Court knew of this

\(^{204}\) *Id.* at 54-55 ("Vertical restrictions promote inter-brand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products.").

\(^{205}\) *Id.*

\(^{206}\) *Id.* at 55.

\(^{207}\) *Id.* at 52 n.19.

\(^{208}\) *Id.* at 68-71 (White, J., concurring).


\(^{210}\) Easterbrook, *supra* note 71, at 156.

\(^{211}\) *Id.*
similarity, or should have known of it, at the time it decided *GTE Sylvania*. In a footnote, it declared that the distinction between vertical price and non-price restraints was still good law.\(^{212}\) However, Justice White, in his concurrence, showed that the reasoning of the majority could hardly be reconciled with that distinction.\(^{213}\) As Justice White pointed out, the Court cited an article by then Professor Richard Posner five times,\(^{214}\) which stated, “I believe that the law should treat price and non-price restrictions the same and that it should make no distinction between the imposition of restrictions in a sale contract and their imposition in an agency contract.”\(^{215}\)

With *Monsanto*, it became even more odd that vertical price restraints were not allowed. *Monsanto* raised the standard of proof required to establish that a price fixing conspiracy existed.\(^{216}\) The main reason for doing this was because the possible pro-competitive effects of other types of vertical restriction were so important that the court did not want to discourage them.\(^{217}\) With the types of conduct that the Court said were permissible, in conjunction with the *Colgate* doctrine, the Court all but winked its eye at firms as it reiterated that resale price maintenance was illegal.\(^{218}\) The Court also emphasized that it could not consider its legality at the time because the issue was not before the Court.\(^{219}\)

Perhaps the most egregious example of the Court’s formalism is the case of *Broadcast Music*. In *Broadcast Music*, the
challenged practice involved price fixing "in the most literal sense." However, the Court allowed it because of its pro-competitive effects or simply employing the rule of reason to decide a case.

With *Leegin*, the Court's jurisprudence finally became coherent. The empty formalism of allowing every sort of vertical restraint but maintaining resale price maintenance was abandoned. After *Leegin*, all vertical restraints would be judged under the rule of reason. The Court had been on its way to this point ever since *GTE Sylvania*. It is also notable that *Leegin*, like the cases since *GTE Sylvania*, focused heavily on economic reasoning in its analysis.

**B. Leegin and Antitrust Values**

Throughout the history of antitrust law, there has been debate over what the goals or values of antitrust law should be. In the past the Court has recognized the importance of small businesses. Thus, in *Chicago Board of Trade of City of Chicago v. United States*, the Court offered the following as one of its justifications for allowing the Board of Trade to fix prices in certain situations: It increased the number of country dealers engaging in this branch of business; supplied them more regularly with bids from Chicago; and also increased the number of bids received by them from competing market. The high point of small business protectionism came in *Brown Shoe Co. v. United States*, a merger case, with the Court stating that Congress enacted the Sherman Act because it "was desirous of preventing the formation of further oligopolies with their attendant adverse effect upon local control of industry and upon small business." We can even see this sentiment to protect small businesses when the Court says that certain vertical restraints might be acceptable for newer, smaller firms trying to break into a market but not for more established

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221 *Id.*

222 See discussion supra Part II(C).

223 246 U.S. 231 (1918).

224 *Id.* at 240.


226 *Id.* at 333.
The Court has also recognized the free market principle. The Court in *Dr. Miles* mentions this principle when it says that once a manufacturer sells its product, it is then up to the retailer what to do with the product. In other cases, such as *Albrecht*, the Court discusses the free market principle; the Court worried that allowing price ceilings would substitute the judgment of the manufacturer for the judgment of the market. If the retailer believes that a lower price will best suit its interests, then it should be able to charge a lower price. Likewise if a higher price will best suit its interests, then it should be able to charge a higher price. The free market principle would condemn any interference with the judgment of the retailer.

The Court had been moving away from the idea of small business protectionism for some time. *Leegin* considered the argument for small business protectionism and came down against it. It mentions expressly that protection of small, inefficient retailers is not the goal of antitrust—the goal of antitrust is protecting competition. Nevertheless, it is ironic that while disavowing the protection of small business, the Court’s holding is likely to protect small business. Resale price maintenance, like other vertical restraints, allows smaller, inefficient retailers to stay in business in some cases. Also, resale price maintenance (allegedly) helps new firms break into the market by ensuring wide margins on risky products. Moreover, there is evidence to suggest that when resale price maintenance was illegal, many larger firms simply chose to vertically integrate, thereby driving

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227 See, e.g., *GTE Sylvania*, 433 U.S. at 55.
228 *Dr. Miles*, 220 U.S. at 409.
229 *Albrecht*, 390 U.S. at 152-53.
230 See, e.g., id.
232 See *Leegin*, 127 S. Ct. at 2724.
233 Id.
234 See discussion *infra* Part IV(C) (expressing skepticism as to this idea).
235 See *HOVENKAMP*, *supra* note 1, at 184-85.
236 That is, to distribute their products themselves.
smaller firms out of business.\textsuperscript{237}

The Court failed to discuss the third rationale relied on in Dr. Miles—that of the free market. Allowing resale price maintenance has a faintly anti-free market feel to it. As discussed in the preceding paragraph, it will aid smaller, more inefficient firms. The free riders that are condemned by the cases used to be "regarded as the very heart of a free market competitive system."\textsuperscript{238} And it should be pointed out that if manufacturers so desperately desire that certain services be provided with their products, they should just contract separately for them.\textsuperscript{239}

There is a free market argument for allowing vertical price restraints. By allowing resale price maintenance, we are promoting the freedom of the manufacturer.\textsuperscript{240} If the manufacturer wished, it could simply vertically integrate.\textsuperscript{241} Judge (later Chief Justice) Taft recognized this long ago in his opinion in United States v. Addyston Pipe & Steel Co.\textsuperscript{242} In discussing the case of Chicago, St. Louis & N.O.R. Co. v. Pullman Southern Car Co.,\textsuperscript{243} a case involving a sleeping-car company providing sleeping-cars to a railroad, in return for the promise that no other sleeping-car company would be allowed to operate on the same rail line, Judge Taft explained the utility of certain vertical restraints on trade:

The main purpose of such a contract is to furnish sleeping-car facilities to the public. The railroad company may discharge this duty itself to the public and allow no one else to do it; or it may hire someone to do it, and, to secure the necessary investment of capital in the discharge of the duty, may secure to the sleeping-car company the same freedom from competition that it would have itself

\textsuperscript{237} See Hovenkamp, supra note 1, at 33.
\textsuperscript{239} Id.
\textsuperscript{241} See id.
\textsuperscript{242} Id. (citing U.S. v. Addyson Pipe & Steel Co., 85 Fed. 271, 287 (6th Cir. 1898)).
\textsuperscript{243} 139 U.S. 79 (1891).
in discharging the duty. The restraint upon itself is properly proportioned to, and is only ancillary to, the main purpose of the contract which is to secure proper facilities to the public.\textsuperscript{244}

It is in this manner that manufacturers' resale price maintenance gives manufacturers a choice between vertically integrating and hiring separate firms to distribute its products on terms that the firms find acceptable.

\textit{C. Analysis of Some of the Court's Economic Reasoning}

One of the \textit{Leegin} Court's rationales for allowing vertical price restraints is that it stimulates inter-brand competition.\textsuperscript{245} It does this by decreasing competition among the resellers of one brand, allowing that brand to compete with other brands.\textsuperscript{246} Some have criticized this argument on the grounds that when the services are added to the product, it becomes a new product, and thus decreases inter-brand competition.\textsuperscript{247} However, as the Court recognized in \textit{GTE Sylvania}, albeit in relation to another type of vertical restraint, "[t]his argument is flawed by its necessary assumption that a large part of the promotional efforts resulting from vertical restrictions will not convey socially desirable information about product availability, price, quality, and services."\textsuperscript{248}

Another justification is that resale price maintenance encourages retailers to provide extra services and counteracts the free rider effect.\textsuperscript{249} This justification will only apply to items for which more information would actually be helpful. There are many cases, like those involving products that differ little from competing brands and are sold side by side, such as goods in a supermarket, where this justification would be unfounded.

\begin{footnotesize}
\begin{enumerate}
\item Addyston Pipe \& Steel Co., 85 Fed. at 287.
\item Leegin, 127 S. Ct. at 2715.
\item Id.
\item Id.
\item HOVENKAMP, supra note 1, at 184.
\end{enumerate}
\end{footnotesize}
Criticism of this rationale also states that rational buyers who are likely to derive "consumer surplus" from the product are likely well informed anyway; it is only those who are indifferent to purchasing the product that might be influenced by pre-sale services. However, the same objection could be made to advertising; presumably the manufacturer knows its own best interests.

The Court also justifies vertical price restraints by acknowledging that resale price maintenance facilitates market entry for new firms. The idea is that when a firm wishes to enter a market, it can guarantee retailers a sufficient margin to engage in necessary promotional activities. However, if a retailer was unsure about a new product, it is hard to see how forcing it to sell at a certain price would allay its skepticism.

A criticism of resale price maintenance is that it is often used to form cartels, either at the retailer or at the manufacturer level. However, this is not likely to be a problem because cartels rarely use vertical price maintenance. At the retailer level, a cartel would be inefficient because it would not restrain sellers of other similar products. Also, even if the retailers did use resale price maintenance to enforce a cartel, it would be easy for enforcement authorities to detect. As for manufacturers, "the difficulty of negotiating agreeable price differentials among all the retailers and manufacturers," and the proliferation and diversity of high volume discount marketers make resale price maintenance almost impossible as a method of enforcing a manufacturer cartel.

Manufacturers have other ways to police cartels. Resale price maintenance would also be inefficient for manufacturers

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251 Leegin, 127 S. Ct. at 2716.
252 Id.
254 Easterbrook, supra note 71, at 135.
255 BORK, supra note 240, at 292.
256 Id.
257 Id.
258 Id. at 292-93.
since their dealers have differing costs of operation, and this inefficiency for the retailers will result in lost profits to the manufacturer.\textsuperscript{259} Even if a cartel used resale price maintenance, there would still be an incentive to cheat because the lower price could be used by the retailer to give more services.\textsuperscript{260} Additionally, as with a retailer cartel, it would be easy for enforcement authorities to detect a manufacturer cartel that is using resale price maintenance in an anti-competitive way.\textsuperscript{261}

The Court also worried that a dominant retailer could use resale price maintenance to forestall innovation or to encourage retailers not to sell the products of a competitor.\textsuperscript{262} As to the first concern, a dominant retailer might ask for resale price maintenance from a manufacturer in order to keep other retailers from developing new cost-saving methods of innovation.\textsuperscript{263} The second concern might arise when a manufacturer requires its products to be sold at a price that would allow the retailer to realize higher profit margins than it would be able to by selling the products of the manufacturer's competitor.\textsuperscript{264} However, neither concern is likely to be a problem, because market power is extremely rare.\textsuperscript{265} It is important to note that markets are

\textsuperscript{259} Id. at 293.
\textsuperscript{260} Id.
\textsuperscript{261} Bork, \textit{supra} note 240, at 294.
\textsuperscript{262} Leegin, 127 S. Ct. at 2717.
\textsuperscript{263} An example might be helpful. Say firm A, a retailer of widgets, is dominant in the widget retail market. Firm A competes with several other firms, including firm B. Firm B develops a new distribution method that allows it to sell widgets at a lower price than firm A. Firm A subsequently uses its dominant power in the retail market to force firms X, Y and Z, the leading manufacturers of widgets, to insert a provision fixing a minimum resale price into all future widget contracts. Firm B is now disabled from passing along savings realized by its new distribution method to consumers, and firm A is now "saved" from having to innovate.
\textsuperscript{264} Once again, an example may be helpful. Say firm A is a dominant manufacturer of widgets but faces a small amount of competition from firms B and C. Firms X, Y and Z are retailers of widgets. A widget costs a retailer one dollar. After various other costs are included, firms X, Y and Z are able to sell widgets at a price of two dollars, thereby realizing a profit of one dollar per widget. Firm A inserts a provision into its contracts requiring that widgets be sold at three dollars, allowing vendors of widgets to realize a profit of two dollars per widget. Assuming firm A is a dominant manufacturer in the relevant product and geographic markets, retailers will thus be encouraged to sell widgets manufactured by firm A, because they are able to realize a larger profit on them.
\textsuperscript{265} Easterbrook, \textit{supra} note 71, at 142-43.
becoming more concentrated, so this may become a problem in the future.\footnote{Leegin, 127 S. Ct. at 2733 (Breyer, J., dissenting).}

The dissent asserts that resale price maintenance will cause prices to rise.\footnote{Id. at 2727-28 (2007).} Indeed, when resale price maintenance was legal under the state fair trade laws before 1975, prices were higher on items for which resale price maintenance was used.\footnote{Id. at 2728.} However, this objection is somewhat circular—if manufacturers mandate a higher minimum price, of course prices will go up, as that is the whole point of resale price maintenance. Here, prices only rose on items for which resale price maintenance was used. As Frank H. Easterbrook pointed out, "[j]ust why K-Mart's existence is threatened if it can't sell shirts with little crocodile emblems has never been explained. There are lots of other knit shirts in the world."\footnote{Easterbrook, supra note 71, at 152.}

\textit{D. Leegin as Precedent}

The Court lists several factors that may play into a future rule of reason analysis, including "the number of manufacturers that make use of the practice in a given industry," the source of the restraint, and the market power of the firm engaged in the restraint.\footnote{Leegin, 127 S. Ct. at 2719-20.} Given the reasons for and against resale price maintenance, these factors seem logical and well considered.

When examining the number of manufacturers, the Court does not go far enough in its analysis. The Court states that resale price maintenance will only be a problem if the practice is widespread.\footnote{Id. at 2719.} However, the practice would have to be not only widespread but also uniform.\footnote{Easterbrook, supra note 71, at 162-63.} If the practice is not uniform, then a dealer wishing to sell at lower prices can simply buy from a manufacturer that does not impose resale price maintenance.\footnote{Id.}
There is simply no legitimate reason for a dealer to pressure a manufacturer into imposing resale price maintenance. This is not a small concern. Indeed, when resale price maintenance was legal under the state fair trade laws, one of the biggest supporters of resale price maintenance were retail druggists, who conspired to have manufacturers or legislatures impose resale price maintenance laws on them. When the state fair trade laws were repealed in 1975, average profit margins for retail druggists declined from forty percent to twenty percent.

The Court also recognized that market power would also be a useful consideration. This will not normally be a concern, as most firms lack the necessary market power to engage in such behavior. As markets become more concentrated, this could become a very important consideration. For example, among retailers, though the top five food retail outfits in the country controlled less than twenty percent of the market for years, from 1997-2000 the top five increased their collective market share from twenty-four percent to forty-two percent. On the manufacturer side, for instance, “[t]he top eight manufacturers of household laundry equipment” accounted for ninety percent of the market in 1958, compared with ninety-nine percent in 2002.

**V. Conclusion**

*Leegin* correctly overturned the poorly reasoned *Dr. Miles* decision. Moreover, it is in accord with the Court’s recent antitrust jurisprudence. Since the *GTE Sylvania* decision, the trend has been toward liberalization in the area of vertical restraints. The Court has allowed other vertical restraints, which have the same uses and effects as resale price maintenance. If the Court had not overruled *Dr. Miles*, it would have been an exercise in arbitrary line drawing divorced from economic reasoning.

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274 *Leegin*, 127 S. Ct. at 2719.


276 *Id.* at 8.

277 *Id.*

278 *Leegin*, 127 S. Ct. at 2720.

279 Easterbrook, *supra* note 71, at 159.

280 *Leegin*, 127 S. Ct. at 2733 (Breyer, J., dissenting) (quotation omitted).

281 *Id.* at 2734.
The Court's standards for a per se rule do not justify imposing that rule on resale price maintenance. The Court had not had much experience with resale price maintenance when it announced its decision in Dr. Miles and failed to look at the effect of resale price maintenance in that case. It has not had experience with resale price maintenance since Dr. Miles, since the per se rule barred the introduction of evidence on economic effect in litigation involving resale price maintenance. Resale price maintenance has both pro-competitive and anti-competitive effects, and thus is a perfect candidate for the rule of reason. Some have suggested that resale price maintenance be legal per se. However, it would seem wise to wait, as the Court decided to do, until the Court has more experience in the area in accord with the Court's policy on per se rules.

The rule may well lead to the increase of prices. When resale price maintenance was legal under the state fair trade laws, prices were generally higher than in states that did not allow resale price maintenance. However, when goods are affected by resale price maintenance, they become different goods, superior goods, with more services. As the Court recognized, consumer welfare and prices are not always the same.  

Peter M. Ellis

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282 See Easterbrook, supra note 71.
283 Leegin, 127 S. Ct. at 2718.