

**AMERICAN BAR ASSOCIATION
SECTION OF ANTITRUST LAW
REPORT TO THE HOUSE OF DELEGATES**

RECOMMENDATION

Adopted February 2007*

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

*Note: The "Recommendation," but not the attached "Report," constitutes official ABA policy.

REPORT

I. INTRODUCTION

This report presents the view of the American Bar Association Section of Antitrust Law concerning the standard for determining the legality of minimum resale price maintenance under the Sherman Act, 15 U.S.C. § 1, and comparable state and territorial antitrust laws. The United States Supreme Court granted certiorari in *Leegin Creative Leather Products v. PSKS, Inc.*, No. 06-480, on December 7, 2006, after earlier recalling and staying the mandate of the Court of Appeals for the Fifth Circuit. The Fifth Circuit had applied a rule of per se illegality to the setting of a minimum resale price, and the Supreme Court will address whether minimum resale price maintenance should be subject to that rule.

II. RECOMMENDATION

The Section of Antitrust Law recommends that the American Bar Association support 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.

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*, 522 U.S. 3, 10 (1997). “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.*, 220 U.S. 373 (1911). 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.*, 250 U.S. 300 (1919), 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, 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—as in *Schwinn*—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 ("intra-brand competition") while stimulating competition between different brands ("inter-brand competition") by stimulating resellers of each brand to compete harder. *Continental T. V., supra*, 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., supra*, 433 U.S. 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. *E.g., Illinois Corporate 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 Section of Antitrust law believes 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.*, *supra*, 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.

III. REASONS WHY THE AMERICAN BAR ASSOCIATION SHOULD SUPPORT APPLYING THE RULE OF REASON TO MINIMUM RESALE PRICE MAINTENANCE

There are several reasons to support 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. 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 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)).

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.

IV. REASONS ADVANCED IN SUPPORT OF THE RULE OF PER SE ILLEGALITY AGAINST MINIMUM RESALE PRICE MAINTENANCE

To assure that this Report reaches a sound conclusion, consideration also has been afforded to the reasons that have been advanced for preserving the rule of per se illegality against minimum resale price maintenance, 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-Fixing, Vertical Market Restrictions, and the New Antitrust 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 as well. *See Continental T. V., supra*, 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).

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 out in the open. As a consequence, 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, 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.

C. Facilitating Collusion Among Buyers

A further criticism of minimum resale price maintenance 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.*, *supra*, 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).

D. Congress Has Not Supported Efforts to Overrule the Per Se Rule

In 1983, the Department of Justice filed an *amicus* brief in the *Monsanto* case in favor of overturning the per se rule of *Dr. Miles* and wanted to present oral argument to the same effect, but Congress enacted legislation prohibiting the use of funds “for any activity, the purpose of which is to overturn or alter the per se prohibition on resale price maintenance in effect under the Federal antitrust laws.” Pub. L. 98-166, 97 Stat. 1071. Congress never has endorsed abandonment of the per se rule and, when confronted with an effort to achieve this end, chose to block it, indicating its support for the existing rule. Nevertheless, the per se rule was the creation of the Supreme Court and it is within the Court’s discretion to allow the rule to evolve. As the Court has recognized, the “changing content” of the term “restraint of trade” in the Sherman Act already was “well recognized” when the Act was adopted in 1890, and [i]t would make no sense to create out of the single term ‘restraint of trade’ a chronologically schizoid statute, in which a ‘rule of reason’ evolves with new circumstances and new wisdom, but a line of *per se* illegality remains forever fixed where it was.” *Business Electronics Corp. v. Sharp Electronics Corp.*, *supra*, at 731-32.

V. CONCLUSION

For the reasons described above, the American Bar Association Section of Antitrust Law respectfully requests approval of the proposed resolution.

Respectfully submitted,

Joseph Angland
Chair
Section of Antitrust Law
February 2007

GENERAL INFORMATION FORM

Submitting Entity: Section of Antitrust Law

Submitted by: Joseph Angland
Chair

1. Summary of Recommendation

The recommendation urges the Association to adopt a policy supporting 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.

2. Approval by Submitting Entity

This report with recommendation was approved by the Section Council on October 27, 2006.

3. Has This or a Similar Recommendation Been Submitted to the House of Delegates or Board of Governors Previously?

No similar recommendation has been submitted to the House of Delegates or Board of Governors.

4. What Existing Association Policies are Relevant to This Recommendation and Would They be Affected by its Adoption?

No relevant policies currently exist.

5. What Urgency Exists Which Requires Action at This Meeting of the House?

The Section of Antitrust Law seeks approval of the report and recommendation at this time to support the filing of an Association brief *amicus curiae* in the United States Supreme Court in support of the petitioner in the case of *Leegin Creative Leather Products v. PSKS, Inc.*, No. 04-41243. A petition for a writ of certiorari was filed in that case on October 4, 2006. The deadline for filing such a brief will precede the next meeting of the House of Delegates.

6. Status of Matter

See paragraph 5.

7. Cost to the Association (both direct and indirect costs).

Adoption of the recommendation would not result in additional direct or indirect costs to the Association.

8. Disclosure of Interest

There are no known conflicts of interest with regard to this recommendation.

9. Referrals

This recommendation has been submitted to the Section of Business Law and the Forum on Franchising.

10. Contact Person (prior to meeting)

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EXECUTIVE SUMMARY

Submitting Entity: Section of Antitrust Law

Submitted by: Joseph Angland
Chair

1. Summary of Recommendation

The recommendation urges the Association to adopt a policy supporting 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.

2. Summary of Issue That the Recommendation Addresses

A case pending in the United States Supreme Court, *Leegin Creative Leather Products v. PSKS, Inc.*, No. 04-41243, involves a decision of the Court of Appeals for the Fifth Circuit that applied a rule of per se illegality to agreements between a buyer and seller setting the price at which the buyer may resell a product or service purchased from the seller.

3. Explanation of How the Proposed Policy Position Will Address the Issue

In this Recommendation and Report, the Section of Antitrust Law urges the adoption of policy to support the filing of an ABA brief *amicus curiae* in opposition to application of the rule of per se illegality to such agreements.

4. Summary of Any Minority Views or Oppositions that Have Been Identified

The Section of Antitrust Law is not aware of any minority views or oppositions that are relevant to this recommendation.