BYE BYE BARGAINS? RETAIL PRICE FIXING, THE LEEGIN DECISION AND ITS IMPACT ON CONSUMER PRICES

HEARING

BEFORE THE

SUBCOMMITTEE ON COURTS AND COMPETITION POLICY

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

APRIL 28, 2009

Serial No. 111–37

Printed for the use of the Committee on the Judiciary

Available via the World Wide Web: http://judiciary.house.gov

U.S. GOVERNMENT PRINTING OFFICE

49–387 PDF WASHINGTON : 2010

For sale by the Superintendent of Documents, U.S. Government Printing Office
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APRIL 28, 2009

BYE BYE BARGAINS? RETAIL PRICE FIXING, THE LEEGIN DECISION AND ITS IMPACT ON CONSUMER PRICES

TUESDAY, APRIL 28, 2009

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COURTS AND
COMPETITION POLICY
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 3:04 p.m., in room 2141, Rayburn House Office Building, the Honorable Honorable Henry C. "Hank" Johnson, Jr. (Chairman of the Subcommittee) presiding.

Present: Representatives Johnson, Sherman, Coble, Chaffetz, Sensenbrenner, and Goodlatte.

Mr. JOHNSON. This hearing is now in session. I want to thank everybody for being here. This issue has been around from before I was born. It is great to be in the time where we can deal with this particular issue and other similar issues, especially given the economic crisis that has, in part, been caused by laissez-faire attitudes.

And so I am glad to be here today. Got some serious issues, of course. One of our big concerns is how our previous policies have impacted certain groups, particularly consumers, and have we ended up with a situation where prices that consumers pay are artificially set, or are those subject to the "free marketplace," as has been our financial industry.

Even former President Ronald Reagan condemned retail price fixing because it stifles competition, and adds to inflation. His view was that it was completely lacking in any kind of benefits to the consumer. Justice Kennedy has stated in the *Leegin* decision that, if we continue to operate as we have been doing, it will cost the average consumer anywhere from about $750 to $1,000 extra. And so, of course, inflation has taken that cost even further for our consumers who can now least afford to bear the brunt of our economic crisis that they had a very minor role in causing.

And so what is the benefit to the consumers? This Congress has consistently stated over almost the past 100 years that, if there is no benefit to consumers, then allowing manufacturers to set retail pricing is disfavored.

After assurances that the Administration had no intention of changing the longstanding policy, a dramatic policy shift took place in the last Administration. And I believe it harms consumers. Of course, I am always ready to listen and be educated on all sides of an issue, and I look forward to us doing that, starting today.

While some may argue that there are some competitive justifications for resale price maintenance agreements that benefit consumers, I am not yet convinced that that justification is actually the most prudent one for today's times.

Will manufacturers take advantage of recent court decisions and increasingly dictate minimum retail prices? Why would they not do that? The consumer is kind of like a drowning person, who just reaches out, and it doesn't matter who they grab hold to. We have a lot of desperation, quite frankly, that has already been felt by the average consumer, and it continues.

So we really must be careful in making sure that, as we try to save the victim who is drowning, that we don't get pulled down and drown ourselves.

So our respected colleagues in the Senate have already introduced legislation that would overturn the *Leegin* decision and, once again, make minimum retail price fixing illegal. Not that the House follows necessarily in lock-step the Senate. Sometimes we would really love for our friends in the Senate to yield to us and do what we want them to do. However, it is not always possible, but I remain hopeful in that regard.

Now, thank you all for listening to my comments. And now I will turn it over to my colleague, our esteemed Ranking Member, Mr. Howard Coble.

Mr. COBLE. Mr. Chairman, thank you for elevating me to the "esteemed" status. I am not sure I deserve that, but I appreciate that, nonetheless.

Good to have you all with us, folks.

Mr. Chairman, thank you for calling the hearing of the Courts and Competitive Competition Policy Subcommittee. Since 1911, the Supreme Court has held the agreements between a manufacturer and their retailer to set the minimum price that the retailer can sell the manufacturer's good, also know as resale price maintenance, are a per se violation of the antitrust laws.

However, in the 98 years since this decision, the Supreme Court has moved away from most per se standards to a rule of reason standard. Under the rule of reason standard, both the plaintiff and the defendant put forth evidence of the relative pro and anti-competitive effects of a given practice and the courts decide whether the challenged practice constitutes an unreasonable restraint of trade.

By contrast, under a per se standard, once the plaintiff proves the basic elements of its claim, that the manufacturer did, in fact, enter into a price agreement with a retailer, then the liability, as I understand it, Mr. Chairman, automatically attaches.

In 2007, in a case called *Leegin v. PSKS,* the Supreme Court continued its trend away from per se rules and held that resale price maintenance would be evaluated under the rule of reason. The decision was not without controversy. The Bush administration's Department of Justice, along with the Federal Trade Commission, filed an amicus brief in favor of the position ultimately adopted by the Supreme Court.

However, some 37 states filed an amicus brief in favor of retaining the per se standard. Following the Supreme Court's decision, Senator Kohl introduced a bill to legislatively repeal the *Leegin* decision. He has reintroduced the bill this year. And I would note, as best I can tell, Mr. Chairman, there is no similar or companion bill in the House, at least at this juncture.

Prior to going back to a per se standard, this Committee and the court should take a hard look at the actual facts supporting resale price maintenance, it seems to me. It may be that there are some occasions where it is justified and some where, conversely, it is not. That is where the rule of reasoning comes in. It allows the courts to conduct the kind of detailed fact-finding necessary to determine the actual harm and benefits to consumers of resale price maintenance.

Whatever the methodology, we benefit when competition is protected and promoted. After only 2 years of rule of reason analysis, I am not sure that the record has been established to warrant a return to the old rule. However, I trust that this Committee will continue to keep an eye on the situation to ensure that consumers are seeing a benefit from this treatment of resale price maintenance.

And with that, I will conclude and join you, Mr. Chairman, and welcome our witnesses today. And I yield back the balance of my time.

Mr. JOHNSON. Thank you for your opening statement, my good friend, Mr. Coble.

And now, we shall recognize my colleague from California. And don't be fooled by the hairstyle that he is employing right now, because he is younger than I am.

So I want to give my friend, Mr. Brad Sherman, an opportunity to make an opening statement.

Mr. SHERMAN. It is so nice to be younger than someone. As to my hairstyle, I actually cut it this way to facilitate the fact that I hand out plastic combs throughout my district. And given this hairstyle, people then remember the plastic comb. So I actually——

Mr. JOHNSON. I do appreciate you giving me mine, also.

Mr. SHERMAN. Absolutely. And I would ordinarily have as much use for it as the gentleman from Utah, except for the fact that, in order to raise my name ID in my district, I cut it distinctively.

Now, as to the matter at hand, there are two sides to this argument. The side against resale price maintenance is simple, but might very well be compelling, and that is discounts mean lower prices.

The arguments against a per se rule are more complex. One of those isn't just government should be laissez-faire. One counter to that is maybe manufacturers should be laissez-faire and let retailers have the freedom to do what they want.

The second is that, in the absence of true vertical integration, the manufacturers' interests are not necessarily hostile to those of the consumer. The manufacturer wants to move as many products as possible, and if they believe that, with resale price maintenance, they get the full panoply of services provided to the ultimate consumer, then they may be allied with the consumers' arguable long-term interest.

The argument put forward most commonly is the free rider, that consumers will learn about a product, see a demonstration, get advice on which model to buy and how to use it from one retailer, and then go online or down the street and buy it from a discounter. Even if we were to believe that resale price maintenance provides consumers with more service, that still may mean that we decide, on balance, they would rather have the lower prices.

One could say, if you want a consultant, hire one. Pay them by the hour. Don't make everybody in your community pay a higher price for this or that product just because some consumers want some advice on how to use the product. We don't necessarily have to bundle services and advice on the one hand with the physical product on the other.

We have a number of routes we can take here in Congress. One is to go back to sleep and let the courts decide everything. It is easier that way, but I think that is an abdication of our responsibilities. I think it is Congress, rather than the courts, that can best decide what is really in the interests of consumers.

A second approach is to just go with a per se rule. That is what we had in this country for many years, perhaps imposed by the courts, but we in Congress could resurrect that rule that, as the Chairman points out, has been pretty much the rule for our lifetimes, even his longer lifetime.

And another approach would be to see if there are particular industries where the advantage of resale price maintenance outweighs its disadvantage, allow it in those few industries or those few products, and prohibit it with the rest.

I would point out that the product we buy most that needs the most service, the most demonstration, is the automobile, and there we do not see—I have not seen an unwillingness of retailers to take me out on a test drive even though there was no resale price maintenance. There is a franchise governing a certain territory, but the fact that most of us live in urban areas means that we can easily go to any of the other franchisees, and now we can go online as well.

So one wonders whether we really need to get away from decades of discounting being legal when I have had no trouble getting people to want to sell me a car and to spend all the time that I ask for showing me how to use it, comparing it to their other products, et cetera.

So I don't know whether the old rule actually deprived us of the service, the advice, the attention that consumers want. I do know that the old rule maximized discounts for consumers. And I look forward to learning more about this issue.

I yield back.

Mr. JOHNSON. Thank you, Mr. Sherman, for your opening statement.

And next, we will have an opening statement from my good friend, Jason Chaffetz, newly elected out of Utah. And I am going to take Chairman's privilege to reveal some confidential communications that he and I have been engaged in. And I know that you would not be offended if I were to reveal—I must disclose, as a matter of fact, he and I have talked about so many things, but I tell you, the biggest thing that I have learned from Jason thus far is the products that he uses, Mr. Sherman, to ensure that he makes a good appeal to his constituents as well.

So without any further ado—don't believe his hair, either, because he has done a good job of his public relations projection. So without any further ado, Mr. Chaffetz, please?

Mr. CHAFFETZ. Well, thank you, Mr. Chairman. I simply wanted to say thank you for calling this hearing. It is an important topic in which we need to dive deep, and I do appreciate all of you that have contributed to this. I wanted to thank the Chairman for recognizing that and this important issue and calling this hearing.

I would note for the record that I have never owned a comb in my life, and especially since I learned about the miracle of hair styling gel, which has come to serve me well. So, for the record, so noted.

And I appreciate it, and look forward to listening and hearing from you rather than being heard. So thank you.

Mr. JOHNSON. Thank you, my good friend. By the way, to clarify our discussions, though they have included Brylcreem and those kind of things, we have also been talking about the Just For Men kind of thing. So that is what I really appreciate you for, for enlightening me on that, so I appreciate it. Thank you.

Let me introduce our witnesses for today's hearing. First is Commissioner Pamela Jones Harbour of the Federal Trade Commission. Ms. Harbour was sworn in as a commissioner of the FTC on August 4, 2003. Commissioner Harbour was previously a partner at the law firm Kaye Scholer, LLP, and she also spent 11 years as a New York State deputy attorney general, during which time she argued before the Supreme Court in a number of cases, including *State Oil v. Khan,* which has been a landmark antitrust price fixing case.

Commissioner Harbour received her law degree from Indiana University School of Law, and she obtained her bachelor's degree in music from the Indiana University School of Music. Welcome, ma'am.

Next is Mr. Thomas Hungar, a partner in the Washington, DC office of Gibson, Dunn & Crutcher. Mr. Hungar served as a US deputy solicitor general from 2003 to 2008, and he has argued 24 times before our Supreme Court. And in fact, he was intimately involved as one of the attorneys in the *Leegin* case on behalf of the petitioners.

Mr. Hungar previously clerked for Justice Kennedy and is a graduate of Willamette University and also Yale Law School. Welcome, sir.

Next is Mr. Tod Cohen, who is vice president, deputy general counsel for government relations at eBay. Prior to eBay, Mr. Cohen was the vice president and counsel of New Media for the Motion Picture Association of America. And before that, he was European legal counsel and vice president for the Business Software Alliance.

Upon graduating from the University of Utah, Mr. Cohen served as a congressional aide prior to attending George Washington University law school. We appreciate you being here today, Mr. Cohen.

And finally, we have Mr. Richard Brunell, who is the director of legal advocacy for the American Antitrust Institute. Mr. Brunell is a guest lecturer at Boston College Law School, and he wrote one of the amicus briefs in *Leegin*.

Mr. Brunell is a graduate of Swarthmore College and also the Harvard Law School, where he was an editor of the Harvard Law Review, just like our newly elected President.

I want to thank you all for your willingness to come today and participate in our hearing because, quite frankly, we have found it difficult to have—we want to have—well, our goal is to always have equality in terms of the views that are expressed, because it is an educational process for us. But unfortunately, we were unsuccessful at twisting the arms of some interests to take a stand today.

And I am sure that they have stands that they have taken. And I am sure that they are watching everything that is going on regarding this issue, particularly my appearance here today, mine in particular, of course. So I expect that we would be in full discussions about things as we proceed, and we will have other hearings where we are going to hear more views than we will hear today.

So without objection, your written statements will be placed into the record, and we would ask that you limit your oral remarks to 5 minutes. And you will note that we have a lighting system that starts with a green light. And at 4 minutes, it turns yellow.

I know that real connection between green and yellow. I learned that in pre-K, I guess, in terms of mixing the paint and everything.

And of course, somewhere about a minute later, you will see that ominous red light that appears. And so I know a lot of folks don't particular—you get wound up and everything, but we shall assist you as best we can in that regard.

So I appreciate, once again, you all coming. And after each witness has presented his or her own testimony, Subcommittee Members will be, of course, permitted to ask questions subject to the 5-minute rule.

Commissioner Harbour, please proceed with your testimony.

TESTIMONY OF PAMELA JONES HARBOUR, COMMISSIONER, FEDERAL TRADE COMMISSION, WASHINGTON, DC

Ms. HARBOUR. Thank you.

Chairman Johnson, Ranking Member Coble and Members of the Subcommittee, I appreciate this opportunity to share with you my personal views on minimum vertical price fixing, sometimes referred to as resale price maintenance ("RPM"), or margin maintenance.

During my oral remarks, there are three points that I would like to make.

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

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

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

The Supreme Court's 2007 *Leegin* decision gave manufacturers the right to set minimum resale prices for consumer goods, guaranteeing higher consumer prices. This is bad economic and legal policy. It gives excessively short shrift to consumer preferences, the supposed driving force behind the market.

Post-*Leegin* and absent action by Congress, consumer preferences will be subordinated to the interests of manufacturers and merchants of branded consumer goods. In these tough economic times, it is especially wrong to saddle consumers with higher prices for daily necessities while providing no countervailing benefit.

RPM advocates essentially ask us to believe that consumers are better off when they pay higher prices for the daily necessities of life because the benefits to manufacturers and retailers eventually will trickle down to consumers. According to the logic of the *Leegin* court, it is preferable to maximize the welfare of conspiring manufacturers and merchants even though the antitrust laws are designed to put consumers' interests first.

The *Leegin* decision cannot be reconciled with the legislative history of the antitrust laws. Congress has never adopted nor endorsed a preference for RPM at the Federal level.

Congress did create an antitrust exception for RPM under the state fair trade statutes. However, Congress ultimately graded its 37-year natural experiment with RPM as a monumental failure. In fact, in 1975, the fair trade exemptions were repealed in favor of per se illegality. Congress did so because RPM had been a dismal, if not disastrous, detour from sound public policy.

RPM raised consumer prices by as much as 37 percent. It lowered sales levels. It increased the frequency of business failures. It created entry barriers. It distorted retailer incentives, and it generally retarded retail competition.

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

And we know who is paying for this experiment. Sadly, it is the American consumer. Both intra-brand competition and inter-brand competition provide important benefits to consumers. Existing case law, however, consistently denigrates the importance of intra-brand competition.

Justice Powell's footnote in GTE Sylvania declaring the primacy of inter-brand competition, finds no support in the legislative history of the antitrust laws, but the courts routinely, even rotely, cite it as authority.

In GTE Sylvania, the court was rebelling against the Warren's court's alleged formalistic line drawing to support liability. Yet the *Leegin* opinion, the *Leegin* majority, appears to have drawn similarly formalistic lines to short-circuit the RPM inquiry in the opposite direction and, in doing so, has effectively created the very presumption of per se legality that the court purports to disclaim.

This court's line drawing is devoid of substance. Labels have again replaced rigorous analysis, and the law and the American consumer are suffering because of it.

The *Leegin* court claimed that it intended the rule of reason to weed out competitively harmful uses of RPM, but good intentions will not cure a bad rule of law. The rule of reason tends to be a euphemism for the absence of liability. Potentially good RPM cases are already being dismissed without any hearing on the merits. These threshold presumptions must be established before the rule of reason can become a workable tool for combating harmful uses of RPM.

There are economic theories praising RPM and other theories condemning it, but none of theories on either side of the aisle are supported by any systematic body of empirical evidence. At best, we have strongly held beliefs about the effects of RPM, sometimes bordering on the almost religious, but we are missing facts, which are the building blocks of litigation.

The realities of litigation dictate that, when the facts are equally probative of guilt or innocence, depending on which theory is adapted to advocate them, then usually the party that has the burden of proof loses. If full-blown rule of reason analysis is applied in RPM cases, the burden of proof would be placed on the victims, or the burden of proof will be placed on the victim, but it won't be placed on the defendants who impose the RPM policy.

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

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

Thank you.

[The prepared statement of Ms. Harbour follows:]

PREPARED STATEMENT OF PAMELA JONES HARBOUR

Pamela Jones Harbour
Commissioner, Federal Trade Commission

Testimony before the Subcommittee on Courts and Competition Policy, House of Representatives, Judiciary Committee

April 28, 2009

I. INTRODUCTION

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

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

I believe this outcome is contrary to good economic and legal policy. It gives excessively short shrift to consumer preferences, which are supposed to be the driving force behind healthy,

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

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

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

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

competitive markets. Post-*Leegin*, and absent action by Congress, consumer preferences will be subordinated to the interests of manufacturers and merchants of branded consumer goods.

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

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

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

A. Economic Theory

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

First, Smith noted that consumers are best off when they can purchase the goods they desire at the cheapest price. Indeed, he went so far as to observe that this proposition was so self-evident that it would never have been questioned, "had not the interested sophistry of merchants and

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

manufacturers confounded the common sense of mankind."[5] I would argue that the *Leegin* majority opinion reflects just such sophistry.

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

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

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

B. <u>Legislative History of the Antitrust Laws</u>

With that economic background in mind, I next turn to the legislative history of the federal antitrust laws themselves. This history strongly corroborates my belief that the antitrust laws are intended to promote the interests of consumers over those of manufacturers. There is virtually no credible support for any assertion that Congress intended to prioritize producer welfare over consumer welfare.[7]

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

[6] *Id.* at 625.

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

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

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

- ➢ caused consumers to pay as much as 37 percent higher prices;
- ➢ reduced levels of sales per outlet;
- ➢ produced significantly higher rates of business failures;
- ➢ provided fewer entry opportunities for new products or manufacturers;
- ➢ distorted retailer incentives to provide consumers with objective comparisons of the competing products on their shelves; and

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PARADOX 20-21 (1978).

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

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

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

- diminished competition both within a brand (intrabrand competition) and between competing brands (interbrand competition).[11]

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

Beyond its repeal of the fair trade laws, Congress has affirmatively expressed its distaste for RPM on at least four other occasions. Speaking in the dialect of appropriations, Congress has imposed limits on the budgets of the federal antitrust enforcement agencies, prohibiting them from spending any funds to advocate for the reversal of *per se* illegality for RPM. Language in one appropriations bill expressly criticized the Department of Justice's *Vertical Restraint Guidelines* because their lenient approach to vertical restraints did not accurately reflect federal antitrust law or good competition policy.[13]

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

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

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

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

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

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

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

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

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

[14] GROUNDHOG DAY (Sony Pictures 1993).

will pay for this experiment, which seems just as likely to fail as the last one? The American consumer.

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

A. Existing Case Law May Rest On Flawed Foundations

The antitrust laws promise consumers the ability to buy goods and services in competitive markets, at competitive prices. Both interbrand and intrabrand competition contribute to fulfilling that promise.[15] Existing case law, however, obfuscates the importance of intrabrand competition, which is the type of competition that RPM virtually eliminates. In a footnote in the Court's 1977 *GTE Sylvania* opinion, Justice Powell stated that interbrand competition is the primary focus of the antitrust laws.[16] This bald proposition was devoid of any citation of authority, and was not supported by any legislative history. Yet, the Court repeatedly has relied on Justice Powell's phrase (and no more) to justify its holdings in subsequent cases.[17]

Rote recitations of other, supposedly unquestionable aphorisms from *GTE Sylvania* have been included in most of the Court's recent RPM cases, even when they did not actually apply to

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

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

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

the pending case.[18] Most notably, virtually every opinion, including *Leegin*, invokes free-riding by discounters who do not provide "necessary" additional services. In reality, however, none of these cases seem to have involved free-riding problems.[19] In *Leegin*, for example, the plaintiff (Kay's Kloset) appeared to be an otherwise acceptable distributor in every way, except for the fact that it discounted.[20]

Ideally, and as I will discuss in further detail later in my remarks, additional scholarship would be devoted to establishing whether the underlying principles articulated in *GTE Sylvania* are correct or not. At the very least, the courts should not rely "on unthinking recitations of tired language that may have no relevance to competitive analysis"[21] when analyzing RPM. Otherwise, no matter what legal standard is applied to RPM in the post-*Leegin* era, the courts will never get it right. In *GTE Sylvania*, the Court was rebelling against the Warren Court's alleged formalistic line-drawing to support liability. The current Court appears to have drawn similarly formalistic lines to short-circuit the RPM inquiry in the opposite direction and to suggest a presumption of legality. When line-drawing is devoid of substance, and labels replace rigorous analysis, the law suffers – as do consumers.[22]

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

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

[20] *Id.* at 480.

[21] *Id.*

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

B. Rule of Reason Treatment Is Insufficient To Protect Consumers

Technically, the *Leegin* Court did not foreclose the possibility that RPM might be anticompetitive under some circumstances.[23] The *Leegin* Court noted that it intended for the lower courts to be diligent in their application of the rule of reason to weed out competitively harmful uses of RPM.[24] But good intentions will not cure a bad rule of law. Throughout antitrust law, the rule of reason tends to be a euphemism for the absence of liability.[25] So too with respect to RPM, the rule of reason is quickly beginning to prove itself to be incapable of sorting out the good and bad

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Act aims at substance.").

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

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

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

uses of RPM, and consumers will be the poorer for it. Threshold presumptions must be established to draw workable contours for rule-of-reason analysis of RPM.[26]

1. Lack of Empirical Research

The lack of empirical research regarding the effects of RPM is a further complication, especially under a rule of reason standard.[27] There are economic theories praising RPM, and other theories condemning it, but none of these theories (on either side) are supported by any systematic body of empirical evidence. At best, we have strongly held beliefs about the effects of RPM, sometimes bordering almost on the religious. But we are missing facts, which are the building blocks of litigation.

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

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

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

2. The Commission's RPM Workshops

President Truman once asked for a "one-armed economist" because he was frustrated by the tendency of economists to hedge their conclusions with "on the one hand...on the other hand" disclaimers.[28] Likewise, the Commission cannot rely on a mythical one-armed economist to provide us with a definitive answer regarding the proper legal treatment of RPM. Therefore, the Commission is doing its best to further the development of real-world facts about the effects of RPM.

The Commission recently initiated a series of workshop sessions to explore the economic and legal realities of RPM. I have annexed a copy of the Federal Register Notice announcing the workshops, as well as a copy of my opening remarks during the first workshop session. As these documents explain, the Commission seeks empirical insight into when consumers are more or less likely to be helped, or harmed, by RPM.[29]

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

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

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

IV. CONCLUSION

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

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

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

I began my testimony today by quoting lawyers in Brussels. In closing, let me suggest that the Europeans may have better ideas about RPM than the *Leegin* Court. Under EC law, RPM is presumed unlawful, and thus prohibited, unless the RPM proponent can show that the "restriction is indispensable to the attainment of clearly defined pro-competitive efficiencies *and* that consumers demonstrably receive a fair share of the resulting benefits."[30] American consumers are entitled to the same benefit of the doubt.

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

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

ATTACHMENT 1

consumer perceptions versus actual experiences. Although consumer recollection may be imperfect, its invocation is a common and accepted practice in survey research. Moreover, the FTC is surveying consumers about their relatively recent experiences when exercising their FACT Act rights. Their recollections should be relatively fresh, and the FTC believes it is appropriate to rely on them in this consumer research.

CDIA further asserted that the FTC's reliance on consumers who have reported data to the FTC's ID theft clearinghouse will skew the results because such consumers will not be representative of the general population. The FTC believes that reliance on consumers who have previously communicated with the agency is the only economically feasible means to generate a sample of identity theft victims and to gather information. The 2006 FTC Identity Theft Survey found that 3.7% of Americans had been victims of identity theft in the previous year. In order for a survey of the general population to reliably contact 4,000 identity theft victims,[2] over 100,000 consumers would have to be surveyed. The cost of such a large survey would be prohibitive. Sending the survey only to consumers who have reported data to the FTC's ID theft clearinghouse allows the FTC to reach the same number of identity theft victims for a fraction of the cost.

The FTC acknowledges that the survey will not be representative of the general population, and will not attempt to project its results beyond consumers who have reported to the FTC. Instead, the Commission will use the survey to examine the kinds of problems, if any, that such consumers experience while exercising their FACTA rights. The FTC thus intends to utilize a survey sample from consumers who have previously communicated with the agency and not incur the cost and burden of finding a sample from the general population.

Pursuant to the OMB regulations that implement the PRA (5 CFR Part 1320), the Commission is providing this second opportunity for public comment while seeking OMB clearance for the survey. All comments should be filed as prescribed in the **ADDRESSES** section above, and must be received on or before December 5, 2008.

1. Description of the collection of information and proposed use

The Fair Credit Reporting Act ("FCRA") provides identity theft victims with certain rights, such as the ability to place fraud alerts on their credit files, designed to assist them in avoiding or mitigating the harms they suffer as a result of the crime.

The Commission intends to use consumer survey research to advance its understanding of the experiences of identity theft victims who interact with CRAs and who seek to avail themselves of their FCRA remedies. The consumer research will include focus group interviews of 30 consumers, to be followed by a pretesting phase consisting of phone interviews of another 30 consumers, and then mail surveys sent to individual consumers. The Commission seeks information from consumers who have been victims of identity theft and who have contacted one or more of the three nationwide CRAs for assistance. The information from consumers will be collected on a voluntary basis and will be kept anonymous. The FTC staff will identify consumers to be contacted for each phase of the research from a random selection of consumers who have communicated with the FTC's Identity Theft Data Clearinghouse database between January 1, 2008 and May 30, 2008. Staff is seeking approximately 1,000 returned surveys because that input would enable it to project the results from the sample to the population from which the sample was drawn with a maximum error rate of 3%. Assuming a response rate of about 25%–30%, this would require staff to mail the survey to approximately 3,000–4,000 individuals.

Questions to identity theft victims in the research will address several topics, including but not limited to: their experiences when they contacted one or more CRAs and whether they received the required notice of rights from CRAs; their access to free credit reports; and their ability to place fraud alerts on their files, dispute inaccurate information, and block information due to identity theft. The results of the focus groups and mail surveys will assist the Commission in assessing the experiences of identity theft victims when they interact with CRAs. This assessment will help to inform and guide the FTC's future efforts to enforce provisions of the FCRA and to educate consumers and the consumer reporting industry of their rights and obligations under the FCRA.

2. Estimated hours burden

Absent public comments on the FTC's previously stated burden analysis, the FTC is retaining and restating here for further comment its prior burden estimates. The FTC staff proposes to interview 30 consumers divided into three separate focus groups of 10 persons each, and estimates that each consumer will spend approximately one hour to participate. Thus, the estimated total burden imposed by the focus groups will be approximately 30 hours. Staff estimates that respondents to the mail survey will require, on average, approximately 8 minutes to answer the survey (based on anticipated variations among consumers when they interacted with CRAs). Staff will pretest the survey through phone interviews of approximately 30 respondents to ensure that all questions are easily understood. The pretest will total approximately 4 hours cumulatively (30 respondents x 8 minutes each). For the full survey, the staff intends to mail 3,000–4,000 surveys and anticipates receiving a response rate as high as 30% of the consumer recipients (i.e., 900–1,200 responses). Assuming 1,200 consumers respond to the survey, staff further estimates the final survey will require approximately 160 hours to complete (1,200 respondents × 8 minutes each). Thus, cumulative burden hours for the clearance would total 194 hours.

3. Estimated cost burden

The cost per respondent should be negligible. Participation is voluntary and will not require start-up, capital, or labor expenditures by respondents.

William Blumenthal,
General Counsel.

[FR Doc. E8–26405 Filed 11–4–08; 8:45 am]
BILLING CODE 6750–01–S

FEDERAL TRADE COMMISSION

Consumer Benefits and Harms: Distinguishing Resale Price Maintenance that Benefits Consumers From Resale Price Maintenance that Harms Consumers; Public Workshops; Comment Request

AGENCY: Federal Trade Commission.

ACTION: Notice of Public Workshops and Opportunity for Comment.

SUMMARY: The Federal Trade Commission ("FTC" or "Commission") will hold a series of public Workshop sessions at one or more locations to explore how best to distinguish between uses of resale price maintenance (RPM)[1]

[2] As explained further in the ensuing discussion of the proposed collection of information, staff anticipates mailing the survey to approximately 3,000 to 4,000 individuals.

[1] RPM is typically an agreement between a manufacturer and retailer setting the prices at which the retailer will resell the manufacturer's goods to consumers. If the agreement requires the retailer to sell only at or above the price established by the manufacturer, it is said to be minimum RPM. Conversely, if the agreement requires the retailer to sell only at or below the price directed by the

that benefit consumers and those that do not, for purposes of enforcing Section 1 of the Sherman Act, 15 U.S.C. § 1, and Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45 (hereinafter "Sections 1 and 5"). Among other things, the Workshops will examine when and whether particular market facts or conditions make it more or less likely that the use of RPM will be procompetitive or neutral, and when or whether RPM may harm competition and consumers.

The FTC expects to focus on legal doctrines and jurisprudence, economic research (both theoretical and empirical), as well as business and consumer experiences. The FTC is soliciting public comment from lawyers, economists, marketing professionals, the business community, consumers groups, law enforcement officials, academics (including business and economic historians), and all other interested persons on three general subjects:

(1) The legal, economic, and management principles relevant to the application of Sections 1 and 5 to RPM, including the administrability of current or potential antitrust or other rules for the application of these laws;

(2) The business circumstances regarding the use of RPM that the FTC should examine in the upcoming Workshops, including examples of actual conduct; and

(3) Empirical economic studies or analyses that might provide better guidance and assistance to the business and legal communities regarding RPM enforcement issues.

With respect to the request for examples of real-world conduct, the FTC is soliciting discussions of the business reasons for, and the actual or likely competitive effects of, the use of RPM, including actual or likely efficiencies, as well as the theoretical underpinnings for whether the conduct had or has pro- or anticompetitive effects. When each individual Workshop session is announced, the FTC will solicit additional submissions regarding the topics to be covered at that particular session.

The FTC encourages submissions from businesses or business consultants from a variety of unregulated and regulated markets, recognizing that market participants can offer unique insights into how RPM affects competition, and that the effects of RPM may differ depending on industry context and market structure. The FTC seeks this practical input to provide a real-world foundation of knowledge upon which to draw as the Workshops progress. Respondents are encouraged to respond on the basis of their actual experiences.

The goal of these Workshops is to promote dialogue, learning, and consensus building among all interested parties with respect to the analysis of RPM under Sections 1 and 5, both for purposes of law enforcement and to provide practical guidance to businesses with respect to antitrust compliance. The FTC plans to hold four to six half-day Workshop sessions between January and March 2009. The FTC plans to publish a more detailed description of the topics to be discussed before each session and to solicit additional submissions about each topic. The sessions will be transcribed and placed on the public record. Any written comments received also will be placed on the public record. After the conclusion of the Workshops, the Commission may prepare a public report that incorporates the findings of the Workshops, as well as a description of other research that might be undertaken by the Commission or others.

DATES: Any interested person may submit written comments responsive to any of the topics addressed in this **Federal Register Notice.** Respondents are encouraged to provide comments and requests to participate in the workshops as soon as possible, but in any event no later than the final Workshop session. However, to assist the FTC in planning the Workshop sessions, respondents are encouraged to provide initial comments regarding the three general questions raised in the Summary above, as well as requests to participate in the workshops, to the FTC on or before December 12, 2008.

ADDRESSES: Interested parties are invited to submit written comments or requests to participate in the public workshop electronically or in paper form. Comments and requests should refer to "Resale Price Maintenance Workshop, P090400" to facilitate their organization. Please note that comments will be placed on the public record of this proceeding—including on the publicly accessible FTC website, at (*http://www.ftc.gov/os/publiccomments.shtm*)—and therefore should not include any sensitive or confidential information. In particular, comments and requests should not include any sensitive personal information, such as an individual's Social Security Number; date of birth; driver's license number or other state identification number, or foreign country equivalent; passport number; financial account number; or credit or debit card number. Comments and requests also should not include any sensitive health information, such as medical records or other individually identifiable health information. In addition, comments and requests should not include any "[t]rade secrets and commercial or financial information obtained from a person and privileged or confidential. . . .," as provided in Section 6(f) of the FTC Act, 15 U.S.C. 46(f), and FTC Rule 4.10(a)(2), 16 CFR 4.10(a)(2) (2008). Comments and requests containing material for which confidential treatment is requested must be filed in paper form, must be clearly labeled "Confidential," and must comply with FTC Rule 4.9(c).[2]

Because paper mail addressed to the FTC is subject to delay due to heightened security screening, please consider submitting your comments and requests in electronic form. Comments filed in electronic form should be submitted by using the following weblink: (*https://secure.commentworks.com/ftc-resalepricemaintenanceworkshop/*) (and following the instructions on the web-based form). To ensure that the Commission considers an electronic comment, you must file it on the web-based form at the weblink: (*https://secure.commentworks.com/ftc-resalepricemaintenanceworkshop/*). Additionally, you may inform the FTC of your desire to participate in the Workshop by emailing information regarding your interest in participation, as well as the issue(s) you might wish to address, to the FTC at *rpmworkshop@ftc.gov*. You may also visit the FTC website at *http://www.ftc.gov* to read the Notice and the news release describing it.

A comment or request filed in paper form should include the reference to "Resale Price Maintenance Workshop, P090400" both in the text and on the envelope, and should be mailed or delivered to the following address: Federal Trade Commission/Office of the Secretary, Room H-135 (Annex R), 600 Pennsylvania Avenue, NW, Washington, DC 20580. The FTC is requesting that any comment filed in paper form be sent by courier or overnight service, if

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manufacturer, it is said to be maximum RPM. Thomas K. McCaw, *Competition and "Fair Trade": History and Theory*, 16 Res. In Econ. Theory 185, 186 (1996).

[2] FTC Rule 4.2(d), 16 CFR 4.2(d). The comment or request must be accompanied by an explicit request for confidential treatment, including the factual and legal basis for the request, and must identify the specific portions of the comment or request to be withheld from the public record. The request for confidential treatment will be granted or denied by the Commission's General Counsel, consistent with applicable law and the public interest. *See* FTC Rule 4.9(c), 16 CFR 4.9(c) (2008).

possible, because U.S. postal mail in the Washington area and at the Commission is subject to delay due to heightened security precautions.

The Federal Trade Commission Act ("FTC Act") and other laws the Commission administers permit the collection of public comments and requests to participate to consider and use in this proceeding as appropriate. The Commission will consider all timely and responsive public comments and requests that it receives, whether filed in paper or electronic form. Comments and requests received will be available to the public on the FTC website, to the extent practicable, at (*http://www.ftc.gov/os/publiccomments.shtm*). As a matter of discretion, the Commission makes every effort to remove home contact information for individuals from the public comments and requests to participate it receives before placing them on the FTC website. More information, including routine uses permitted by the Privacy Act, may be found in the FTC's privacy policy, at (*http://www.ftc.gov/ftc/privacy.shtm*).

The workshop will be open to the public, and there is no fee for attendance. For admittance to the building, all attendees will be required to show a valid photo identification, such as a driver's license. Pre-registration is not required for attendees, but persons desiring to participate as panelists must submit a request to participate and file a comment. Members of the public and press who cannot attend in person may view a live webcast of the workshop on the FTC's website. The workshop will be transcribed, and the transcript will be placed on the public record.

The workshop venue will be accessible to persons with disabilities. If you need an accommodation related to a disability, call Carrie McGlothin at (202) 326-3388. Such requests should include a detailed description of the accommodations needed and a way to contact you if we need more information. Please provide advance notice of any needs for such accommodations.

FOR FURTHER INFORMATION CONTACT: James C. Cooper, Deputy Director, Office of Policy Planning, 600 Pennsylvania Ave., N.W., Washington, DC 20580, telephone 202-326-3367, or John Yun, Staff Economist, Antitrust I Division, Bureau of Economics, 600 Pennsylvania Ave., N.W., Washington, DC 20580, telephone 202-326-2433; or by email at *rpmworkshop@ftc.gov*. Detailed agendas for the Workshops will be available on the FTC Home Page (http://www.ftc.gov).

SUPPLEMENTARY INFORMATION: Section 1 of the Sherman Act condemns "every contract, combination, in the form of trust or otherwise, or conspiracy in restraint of trade and commerce among the several States, or with foreign nations,"[3] which includes violations of the Sherman Act.[4] Although the FTC does not directly enforce Section 1 of the Sherman Act, Section 5 of the FTC Act condemns "unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce."[5] In 1911, two U.S. Supreme Court decisions held, respectively, that RPM agreements were illegal as a matter of law (*Dr. Miles*);[6] and that Section 1 of the Sherman Act prohibited restraints of trade that are "unreasonably restrictive of competitive conditions" (*Standard Oil*).[7] Except to the extent that RPM was exempted from federal antitrust liability by the Fair Trade Laws from 1937 to 1975,[8] minimum RPM was treated as *per se* illegal under the antitrust laws until the Supreme Court decided the *Leegin*[9] case in June 2007.[10]

Leegin overruled the *Dr. Miles* decision, finding that the Court's more recent decisions were inconsistent with rationales upon which *Dr. Miles* was based.[11] The Court directed that the legality of minimum RPM would be determined under the rule of reason; however, the Court did not specify the contours of the rule of reason analysis that would be necessary or appropriate in all cases. Rather, it observed that:

> As courts gain experience considering the effects of these restraints by applying the rule of reason over the course of decisions, they can establish the litigation structure to ensure the rule operates to eliminate anticompetitive restraints from the market and to provide more guidance to businesses. Courts can, for example, devise rules over time for offering proof, or even presumptions where justified, to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints and to promote competitive ones.

Id. at 2720.

In the *Nine West* matter,[12] the Commission recently confronted the Court's lack of specificity, as follows:

> As it abandoned the *per se* prohibition of *Dr. Miles*, the Court cautioned that it was not declaring RPM to be *per se* legal. *Leegin* summarized some of the possible procompetitive and anticompetitive consequences of resale price maintenance. The Court explained that RPM might stimulate interbrand competition and have a procompetitive effect on competition, so that RPM does not meet the *per se* illegality standard of a practice that "always or almost always tends to restrict competition and decrease output." At the same time, after reviewing the potential anticompetitive effects of RPM, the Court said, "[a]s should be evident, the potential anticompetitive consequences of vertical price restraints must not be ignored or underestimated." In light of these potential adverse effects, the Court further observed that "[i]f the rule of reason were to apply to vertical price restraints, courts would have to be diligent in eliminating their anticompetitive uses from the market."
>
> The Court's comments about the possible harms of RPM, and its caution to lower courts "to be diligent in eliminating their anticompetitive uses from the market," can usefully be understood in the context of the debate between the *Leegin* majority and the dissent about the wisdom of abandoning the *per se* ban of *Dr. Miles*. The dissent argued that the majority had slighted the potential anticompetitive consequences of RPM. The majority's recitation of examples of some of the possible competitive harms and its call for "diligent" efforts by the lower courts to be attentive to these harms can be seen as an attempt to provide assurances that the Court foresaw a

[3] 15 U.S.C. §1.

[4] *See Fed. Trade Comm'n v. Motion Picture Advert. Serv. Co.*, 344 U.S. 392, 394-95 (1953) (stating that Section 5 of the FTC Act "condemn[s] as 'unfair methods of competition' existing violations of " the Sherman and Clayton Acts).

[5] 15 U.S.C. §45

[6] *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911). Subsequent cases referred to RPM as being *per se* illegal.

[7] *Standard Oil of New Jersey v. United States*, 221 U.S. 1, 58 (1911)

[8] McCraw, *supra* note 1, at 187.

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

[10] The Supreme Court subjected maximum RPM to the rule of reason in 1997. *State Oil Co. v. Khan*, 522 U.S. 3 (1997).

[11] *Id.* at 2712-25 (*citing, inter alia*, Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977) ("*GTE Sylvania*"); Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717 (1988); and State Oil Co. v. Khan, 522 U.S. 3 (1997)).

[12] *Nine West Group, Inc.*, Docket No. C-3937 (Apr. 11, 2000), Order Granting In Part Petition to Reopen and Modify Order Issued April 11, 2000 (May 6, 2008), available at: (*http://www.ftc.gov/os/caselist/9810386/080506order.pdf*.)

useful role for continued antitrust scrutiny of RPM.

* * *

At this early stage of the application of *Leegin* by the lower courts and the Commission, the *Leegin* factors can serve as helpful guides to begin an assessment of when RPM deserves closer scrutiny. Through the Commission's own enforcement work, research, and external consultations such as workshops, we anticipate further refinements to this analysis, including the further specification of scenarios in which RPM poses potential hazards and those in which it does not.

Nine West, *supra* n. 11 at 9-14 (citations omitted).

By holding these Workshops, the FTC hopes to identify the market facts, circumstances, and conditions under which the use of RPM is likely to be procompetitive or benign, as opposed to anticompetitive and harmful to consumers. The Commission believes that an appropriate antitrust approach to RPM requires the means for distinguishing permissible from impermissible conduct in varied circumstances. Moreover, those means should provide reasonable guidance to businesses attempting to evaluate the legality of proposed conduct before undertaking it. The development of clear standards that both protect consumers and enable businesses to adopt strategies that comply with the antitrust laws presents some of the most complex issues facing the Commission, the courts, and the antitrust bar.

Given this challenge—and because antitrust analysis must reflect the particular market facts and circumstances within which a restraint has been adopted—the FTC encourages commenters to describe actual examples of RPM that the FTC should consider in the context of the Workshop, discuss the business reasons for the conduct, and the actual or likely competitive effects of the conduct.

Illustrative Questions for Consideration With Respect to the RPM Usages That the Commenter Discusses. Commenters should indicate whether responses would change if the conduct is an express RPM agreement or an RPM arrangement that achieves its outcome under a *Colgate* policy.[13] Commenters should also indicate whether responses would differ if the arrangement were directed toward different industry levels (*e.g.*, retail, wholesale, or manufacturer).

1. How should the structure of the market and the market shares of participants be taken into account in analyzing RPM?

2. Are there other specific market facts or circumstances that might have an impact on the likely competitive effects of RPM under the circumstances described? Without limiting the scope of this question, commenters are specifically invited to comment on the effect on marginal and inframarginal consumers.

3. What are the business reasons (*e.g.*, management, marketing, financial, etc.) for the use of RPM? Are there alternative business strategies available to achieve the same results? What factors, including any cost savings, entered the decision to use RPM to achieve the desired result?

4. To what extent does uncertainty regarding the legality of RPM under state law affect the decision to use RPM?

5. What are the likely procompetitive and anticompetitive effects of RPM under the circumstances described?

6. What strategies might competitors use to respond to a loss of sales to a firm that uses RPM?

7. Under what market conditions is the use of RPM likely either to promote or hinder market entry by other manufacturers or retailers?

8. Are there industries where the use of RPM is prominent?

9. Are there any original theoretical, analytical or empirical studies on the nature or competitive effects of RPM or alternatives to RPM that should be brought to the attention of the Commission?

10. What tests or standards should courts or enforcement agencies use in assessing whether particular conduct violates Sections 1 or 5? Commenters are specifically requested to assess whether the test or standard applicable to a particular usage of RPM might vary based on particular market facts or circumstances. Additionally, are there particular market facts and circumstances where the approach established by the Court of Appeals for the District of Columbia Circuit in *Polygram Holding, Inc. v. Fed. Trade Comm'n*, 416 F. 3d (D.C. Cir. 2005), would or would not be appropriate?

By direction of the Commission.

Donald S. Clark,

Secretary.

[FR Doc. E8–26404 Filed 11–4–08: 8:45 am]

BILLING CODE 6750–01–S

GENERAL SERVICES ADMINISTRATION

Multiple Award Schedule Advisory Panel; Notification of Public Advisory Panel Meeting/SUBJECT≤

AGENCY: U.S. General Services Administration (GSA).

ACTION: Notice.

SUMMARY: The U.S. General Services Administration's (GSA) Multiple Award Schedule Advisory Panel (MAS Panel), a Federal Advisory Committee, meeting scheduled for October 27, 2008 was cancelled.

Dated: October 30, 2008.

David A. Drabkin,

Deputy Chief Acquisition Officer, Office of the Chief Acquisition Officer, General Services Administration.

[FR Doc. E8–26323 Filed 11–04–08; 8:45 am]

BILLING CODE 6820–EP–S

DEPARTMENT OF HEALTH AND HUMAN SERVICES

National Institute for Occupational Safety and Health; Decision To Evaluate a Petition To Designate a Class of Employees at the Linde Ceramics Plant, Tonawanda, NY, To Be Included in the Special Exposure Cohort

AGENCY: National Institute for Occupational Safety and Health (NIOSH), Department of Health and Human Services (HHS).

ACTION: Notice.

SUMMARY: The Department of Health and Human Services (HHS) gives notice as required by 42 CFR 83.12(e) of a decision to evaluate a petition to designate a class of employees at the Linde Ceramics Plant, Tonawanda, New York, to be included in the Special Exposure Cohort under the Energy Employees Occupational Illness Compensation Program Act of 2000. The initial proposed definition for the class being evaluated, subject to revision as warranted by the evaluation, is as follows:

Facility: Linde Ceramics Plant.

Location: Tonawanda, New York.

Job Titles and/or Job Duties: All employees.

[13] A manufacturer uses a *Colgate* policy when it does not ask retailers for any agreement regarding resale prices; rather, the manufacturer announces in advance that it will only sell its products to retailers that resell those products at or above the prices it specifies, and then enforces the policy by deciding unilaterally that it will refuse to make any future sales of its products to any retailer who has violated its pricing policies. These arrangements take their name from the Supreme Court's decision in *United States v. Colgate & Co.*, 250 U.S. 300, 307-8 (1919) (distinguishing *Dr. Miles* on the ground that the "unlawful combination [in that case] was effected through contracts which undertook to prevent dealers from freely exercising the right to sell").

ATTACHMENT 2

Consumer Benefits and Harms from Resale Price Maintenance: Sorting the Beneficial Sheep from the Antitrust Goats?[1]

Commissioner Pamela Jones Harbour

Opening Remarks
Resale Price Maintenance Workshop
February 17, 2009

I. INTRODUCTION

Good morning. It is my great pleasure to welcome you to the first session of the Federal Trade Commission's Workshop on Resale Price Maintenance.

As most of you know, the Supreme Court's 2007 opinion in the *Leegin* case reversed the Court's 1911 *Dr. Miles* decision,[2] overruling almost a century of *per se* illegality for resale price maintenance. We are here today because, to be frank, the *Leegin* decision set the ship of antitrust law adrift on a sea of uncertainty. No one really knows how to apply the rule of reason to resale price maintenance, which is a form of price-fixing. Courts and enforcement agencies – including this agency – have no experience in assessing the antitrust "reasonableness" of retail prices that are established by manufacturers, rather than being set unilaterally by retailers themselves.

A principal purpose of this workshop series, therefore, is to explore the legal, economic, and business significance of resale price maintenance ("RPM") under a variety of market circumstances, so that we can better understand how those different circumstances might affect an analysis of RPM under the rule of reason. The workshop will bring together some of the best and brightest minds in

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[1] Leegin Creative Leather Products, Inc. v. PSKS, Inc., 127 S. Ct. 2705, 2729 (2007) (Breyer, J., dissenting) ("How easy is it to separate the beneficial sheep from the antitrust goats?").

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

this field, and I am hopeful that together the participants can begin to craft an appropriate framework for the analysis of RPM. I am excited to be part of this process, and I am grateful that you have all taken the time to attend, either in person or via webcast.

We are privileged to begin our workshop with today's distinguished panel of economic and antitrust scholars. They will examine various theories of how the use of resale price maintenance might enhance competition and benefit consumers. I will let our moderator, Dan O'Brien from the FTC's Bureau of Economics, provide introductions of the speakers. But before we begin today's session, I would like to take a few minutes to set the stage by describing the scope and focus of the workshop series, and by providing some insights into what the Commission hopes to accomplish by holding these sessions.

II. OUTLINE OF WORKSHOP PANELS

We are currently planning at least six panels addressing various aspects of resale price maintenance. The second panel is scheduled for this Thursday, February 19th; that panel will explore various theories of how the use of resale price maintenance can harm competition and consumers. A panel will be scheduled later this spring to explore the body of empirical evidence regarding the economic effects of resale price maintenance. We are also planning a panel, comprised mostly of businesspeople, to gather real-world industry perspectives on the use of RPM.

We anticipate holding three panels covering the legal treatment of resale price maintenance. One panel will focus on the history and evolution of the law of resale price maintenance in the United States prior to *Leegin*. In effect, this panel will survey American antitrust law on RPM, from the 1911 *Dr. Miles* decision up through the 1997 *Khan* decision,[3] which eliminated *per se* liability

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[3] State Oil Co. v. Khan, 522 U.S. 3 (1997).

for vertical maximum price fixing. I expect that this panel also will assess the U.S. experience with resale price maintenance beginning in 1937 under the so-called Fair Trade Laws,[4] and the effect on consumers when, in 1975, the Congress repealed the antitrust exemptions for the Fair Trade Laws and made resale price maintenance unlawful again.[5]

Another panel will look at the antitrust treatment of resale price maintenance in other jurisdictions around the world. In our highly globalized economy – characterized, in part, by the growth of multi-national manufacturers and retailers – it is critical that we gain an international perspective. Details are being finalized, but we expect that panel to take place in Europe.

A final panel will closely examine the Supreme Court's decision in *Leegin*, and its impact thus far.

- What lessons have we learned from the lower courts' application of *Leegin*?
- Should the legal treatment of vertical price restraints under the rule of reason be the same as that for vertical non-price restraints?
- Under what circumstances might it be appropriate to apply legal presumptions regarding the use of resale price maintenance?
- Does the likelihood of Type-I or Type-II errors vary with the stringency of the rule of reason analysis applied – for example, quick-look vs. full-blown rule of reason?
- To what extent should the rule of reason account for the elimination of intrabrand competition?

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[4] The Fair Trade Laws refer to state statutes permitting resale price maintenance agreements. These agreements were only enforceable because Congress created federal antitrust exemptions for them by enacting the Miller-Tydings Resale Price Maintenance Act (Act of Aug. 17, 1937, Pub. L. 314, ch. 690, Title III, 50 Stat. 693) and the McGuire-Keogh Fair Trade Enabling Act (Act of July 14, 1952, Pub. L. 543, ch. 745, 66 Stat. 631).

[5] The Consumer Goods Pricing Act of 1975, Pub. L. 94-145, 89 Stat. 80.

- What should be the relationship between federal and state law? In states whose laws still condemn RPM as a *per se* violation, should *Leegin* preempt state law?

These are some of the questions that will be tackled during the final panel.

III. *LEEGIN* AND ITS AFTERMATH

In my mind, one of the most interesting things about *Leegin* is that the case provoked both strong disagreement *and* a surprising amount of agreement. The majority and dissent disagreed on many fundamental points – for example:

- whether to retain the *per se* rule for minimum resale price maintenance;[6]
- the role of *stare decisis* in antitrust analysis;[7]
- the extent to which investors have relied on the *Dr. Miles* rule, and the extent to which this reliance should be accommodated;[8]
- the extent and frequency of free riding, as well as its economic and legal significance;[9]
- the lessons to be drawn from this country's experiment with resale price maintenance from 1937 to 1975;[10] and

[6] *Compare Leegin*, 127 S. Ct. at 2725 (Kennedy, J.) *with id.* at 2734 (Breyer, J., dissenting).

[7] *Compare id.* at 2723 (Kennedy, J.) *with id.* at 2734 (Breyer, J., dissenting).

[8] *Compare id.* at 2724 (Kennedy, J.) *with id.* at 2735 (Breyer, J., dissenting).

[9] *Compare id.* at 2716 (Kennedy, J.) *with id.* at 2730 (Breyer, J., dissenting).

[10] *Compare id.* at 2724 (Kennedy, J.) *with id.* at 2731-32 (Breyer, J., dissenting).

- the equally important lessons to be drawn to be drawn from our experience since the 1975 repeal of the fair trade antitrust exemptions – including lower consumer prices and the rapid expansion of discount retailing.[11]

That is a significant list of disagreements, which will continue to fuel a great deal of discussion and debate. But I was even more impressed by the number of points on which the majority and dissent agreed.

It appears that both sides would have modified the *per se* rule to some extent. The dissent seemed willing to consider relaxation of the *per se* rule, at least temporarily, to facilitate "new entry."[12]

Both the majority and the dissent agreed that minimum resale price maintenance can be harmful to competition and consumers.[13] Indeed, the majority's explicitly recognized this harm, and therefore expressly disclaimed any suggestion that rule of reason analysis should become a *de facto* rule of *per se* legality.[14] The majority further directed that courts applying the rule of reason "would have to be diligent in eliminating . . . anticompetitive uses [of resale price maintenance] from the market,"[15] and predicted that courts might "devise rules over time for offering proof, or even presumptions where justified, to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints and to promote competitive ones."[16]

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[11] *Compare id.* at 2725 (Kennedy, J.) *with id.* at 2735-36 (Breyer, J., dissenting).

[12] *Id.* at 2731 (Breyer, J., dissenting).

[13] *Id.* at 2717 (Kennedy, J.), 2724 (Breyer, J., dissenting).

[14] *Id.* at 2724 (Kennedy, J.).

[15] *Id.* at 2719 (Kennedy, J.).

[16] *Id.* at 2720 (Kennedy, J.).

Finally, both the majority and the dissent conceded a lack of rigorous empirical support, on either side of the debate.[17] Economists frequently put forth theories to predict the likelihood of competitive harm, or benefit, when minimum resale price maintenance is used in retail markets. But as I see it, both of the *Leegin* opinions took these economists to task and called their bluff. The truth is, there is very little empirical evidence to support any of these conflicting economic theories of benefit or harm.

IV. MORE EMPIRICAL WORK IS NEEDED

This lack of empirical support is a major focus of the FTC's workshop. In antitrust circles these days, it has become axiomatic that economics should inform antitrust enforcement. I support that statement in principle. But facts, not theories, are supposed to be the grist for the law enforcement mill. What happens when economists do not agree on a theoretical basis for an antitrust rule – AND cannot offer evidence to support their conflicting theories? Under those circumstances, economics is not helpful to law enforcers, legal counselors, or antitrust tribunals, because it cannot serve as a meaningful basis for the development of real-world antitrust rules or sound enforcement policy. My good friend, and former Director of the Commission's Bureau of Economics, Michael Baye, once likened the resale price maintenance debate to discussions of religion. There are many fervently held beliefs, both for and against the use of resale price maintenance in the market. But there are few, if any, objective facts to provide policy guidance.

I am one of many public officials charged with a duty to make law enforcement decisions that benefit consumers. I, for one, am discomforted (to say the least) by the absence of an objective basis for making law enforcement decisions about resale price maintenance. Faced with too few economic

[17] *Id.* at 2717 (Kennedy, J.), 2729-30 (Breyer, J., dissenting).

facts, decisions must be based on what we believe to be true regarding resale price maintenance, based on our reconciliation of conflicting theories, all shaped by our reading of antitrust law and policy as reflected by case law and Congressional intent.

The Commission wrestled with this dilemma last year, when Nine West asked the Commission to reopen and modify a 2000 order that prohibited Nine West from engaging in resale price maintenance. The Commission granted this request, in part.[18] As the Commission recognized, Nine West could not provide the Commission with any factual basis for believing that its prospective use of resale price maintenance would benefit consumers more than it would harm them. Instead, the Commission looked closely at the factors, identified by the *Leegin* majority, that might warrant more stringent scrutiny of RPM, including:

- whether the manufacturer or retailers were the impetus for the use of resale price maintenance;
- whether either the manufacturer or the retailers possessed market power in a relevant antitrust market; and
- Whether Nine West's use of resale price maintenance was part of, or likely to facilitate, a horizontal cartel at any level of the distribution chain.

Id. at 14-15.

The Commission found nothing in the record to warrant either more stringent scrutiny of Nine West's actions, or the use of a highly structured version of the rule of reason. Therefore, the Commission granted in part Nine West's request for relief from the order, subject to a periodic

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[18] Nine West Group, Docket No. C-3937, Order Granting in Part Petition to Reopen and Modify Order Issued April 11, 2000 (May 6, 2008), *available at* http://www.ftc.gov/os/caselist/9810386/080506order.pdf.

reporting requirement. These reports should provide the Commission with market details regarding the effects of Nine West's future use of resale price maintenance. *Id.* at 17.

In the meantime, this RPM workshop series will help the Commission explore the various theories of competitive harm and benefit from resale price maintenance, including the assumptions upon which the theories rely. Ideally, our panelists will help us identify testable propositions regarding these theories – the kinds of propositions that might be well-suited to empirical study. Additionally, we hope to gather evidence from the marketplace about the expectations of businesspeople regarding the use of RPM in retail markets, and whether the actual effects of RPM are consistent with those expectations. This process will not only provide the Commission with valuable insights to shape its law enforcement decisions, but also, hopefully, will inform business counseling and decisionmaking.

V. <u>RETAILING: COMPLEMENT OR SUBSTITUTE?</u>

Going back to Mike Baye's religion analogy, and given that I have this nice spot at the pulpit for a few more minutes, I cannot resist the opportunity to preach about a few of my own beliefs on RPM.

The following general principle is well-accepted in antitrust law: combining substitutes is bad, and combining complements is good, absent evidence to the contrary.[19] But I am not sure how helpful this theorem is when we assess vertical relationships in general, and resale price maintenance

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[19] Daniel P. O'Brien, *The Antitrust Treatment of Vertical Restraints: Beyond the Possibility Theorems*, *in* REPORT: THE PROS AND CONS OF VERTICAL RESTRAINTS 40, 80 (Konkurrensverket, Swedish Competition Authority, 2008), *available at* http://www.konkurrensverket.se/upload/Filer/Trycksaker/Rapporter/Pros&Cons/rap_pros_and_cons_vertical_restraints.pdf (last visited Feb. 18,2009).

in particular. I am concerned that its use is likely to overgeneralize on the one hand, and undervalue on the other.

The problem is this: retailers and retailing may be categorized as either a complement or a substitute, especially in this age of Internet merchandising. From the viewpoint of the manufacturer, retailing is a complementary service – one that is useful and necessary to bring consumer goods to market. In agency terms, manufacturers tend to view retailers as their sales agents. But from the viewpoint of a consumer, retailing may be seen as providing alternative sources for competitively-priced goods. In other words, consumers tend to view retailers as their purchasing agents.

Both the sales and purchasing functions provide consumer benefits, and the antitrust treatment of resale price maintenance should recognize this. But at the end of the day, I naturally lean toward the outcome that encourages lower prices for consumers. Therefore, absent empirical evidence to the contrary, I believe the antitrust laws should prioritize retailers' role as purchasing agents for consumers. According to this view, we should cast a skeptical eye upon minimum resale price maintenance, because it tends to suppress discounting.

My current view is based, in part, on Adam Smith's admonitions: first, that consumers are generally better off when the goods they need are cheaper;[20] and second, that promoting consumption, not production, should be the primary object of our mercantile system and is in the best interest of consumers.[21] My current view is bolstered by my enduring belief that the primary purpose of the antitrust laws is to prohibit the transfer of consumer surplus to persons with market power.[22]

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[20] Adam Smith, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 461 (Edwin Cannan ed., The Modern Library 1937) (1776).

[21] *Id.* at 625.

[22] Robert H. Lande, *Chicago's False Foundation: Wealth Transfers (Not Just Efficiency) Should Guide Antitrust*, 58 ANTITRUST L.J. 631 (1989).

And of course, it is based on my own experience as a shopper who knows and appreciates the value of a discount.

As I have tried to make clear, however, these are only my beliefs. I am not an economist. I cannot predict what the empirical evidence might actually show, were it to be systematically gathered and evaluated. I am actually somewhat agnostic regarding the outcome of the ongoing RPM debate among economists. Rather, my primary goal is to see the debate expand upon a more rigorous empirical foundation. Over the course of this workshop, I keenly anticipate an exchange of competing viewpoints, and I expect to gain a richer appreciation for all of these perspectives.

VI. CONCLUSION

Again, thank you all for being here today, and for taking this journey with me.

At this time, I will turn the microphone over to Dan, our moderator, who will introduce the participants in today's program.

Mr. JOHNSON. Thank you.

And now we will move on to Mr. Hungar. You ready, sir?

TESTIMONY OF THOMAS G. HUNGAR, PARTNER, GIBSON, DUNN & CRUTCHER, LLP, WASHINGTON, DC

Mr. HUNGAR. Thank you, Chairman Johnson, Ranking Member Coble and Members of the Committee. It is a great honor to testify before you today on the subject of resale price maintenance, or RPM.

I note that I am pretty seriously outnumbered on this panel by opponents of RPM, but it is important to remember that among those in the best position to understand the true effects of RPM, namely economists who have actually studied the issue, there is an even more lopsided breakdown, except it runs in the opposite direction. There is a widespread consensus among economists that RPM can achieve pro-competitive ends and advance the interests of consumers in obtaining better services, more information, and wider selection.

The evidence is overwhelming that RPM can, and often does, have pro-comprehensive effects that benefit consumers. It can encourage inter-brand competition, prevent free riding, facilitate brand entry, ensure that retailers provide costly but beneficial point-of-sale services, encourage retailers to maintain adequate inventories despite uncertain demand, and give customers peace of mind.

In fact, Pauline Ippolito, who currently heads the Bureau of Economics at Commissioner Harbour's agency, did an extensive study of RPM a few years ago and concluded that the principal anti-competitive explanation for RPM, namely that it can facilitate or conceal cartel activity, lacks explanatory power for the vast majority of RPM uses, while the pro-competitive, service and sales enhancing explanations, potentially explain the vast majority of RPM uses.

She concluded, "These findings are consistent with the view that a relaxation of the broad per se standard prohibiting RPM was warranted." And again, she is the acting head of the Bureau of Economics at the FTC.

Most of the counter-arguments advanced by my fellow panelists today rest at bottom on the unstated assumption that, as a result of the *Leegin* decision, RPM will become universal, or at least widespread in the economy. But there isn't the slightest reason to believe that is true. Wal-Mart, Costco, Amazon.com and other large discounters dominate the retail scene in today's economy, and that is not going to change.

Where consumers value price over service, discount strategies will thrive and RPM strategies will fail, along with those manufacturers that adopt them. But in those markets where RPM is an efficient means of meeting the demands of a particular segment of the consuming public, there is no basis, in logic or experience, for denying that flexibility to a manufacturer.

Arguments against RPM also fail to take account of the fact that manufacturers could achieve the same price effects through other means, even under the old Dr. Miles rule: through Colgate policies or vertical integration. So the effect of *Leegin* is only to make it possible for manufacturers to achieve the same results more efficiently, and efficiency gains are pro-competitive by any measure.

Commissioner Harbour and other opponents complain that it will be too difficult for parties challenging RPM to satisfy the rule of reason test under *Leegin*, but, if true, that is merely a concession that RPM can't be shown to be anti-competitive, which is hardly a good reason for banning or restricting it. Under the rule of reason, a plaintiff can meet its burden either by showing actual anti-competitive effects or by means of a market analysis.

And plaintiffs, including the FTC, do prevail in challenging vertical practices under the rule of reason. Even the cases cited by Mr. Brunell show that plaintiffs don't always lose.

There is no basis for departing from the rule of reason approach that the courts use to analyze all other vertical restraints, especially since it is undisputed that non-price restraints can have the same price effects as RPM. Congress should not legislate hastily on the basis of rhetoric and speculation rather than actual experience and evidence.

I urge you to preserve the flexibility of the Sherman Act, and let the courts do their jobs and gain experience judging RPM under the rule of reason.

Thank you.

[The prepared statement of Mr. Hungar follows:]

PREPARED STATEMENT OF THOMAS G. HUNGAR

Testimony of Thomas G. Hungar*
before the
Subcommittee on Courts and Competition Policy
Committee on the Judiciary
United States House of Representatives
April 28, 2009
Room 2141, Rayburn House Office Building

Mr. Chairman and Members of the Committee, thank you for the opportunity to appear before you to testify about resale price maintenance (RPM). The views stated in my written and oral testimony are my own, and do not necessarily reflect the views of my law firm.

INTRODUCTION.

As you know, an RPM agreement is a contract between a manufacturer and a distributor that guarantees a minimum profit margin to the distributor by setting a retail price floor. From 1911, when the Supreme Court decided *Dr. Miles Medical Co. v. John D. Park & Sons Co.*,[1] until 2007, when the Supreme Court overruled the *Dr. Miles* decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc*,[2] RPM agreements were subject to a *per se* ban that rendered them automatically illegal under the Sherman Act.

In this written testimony, I will first discuss the numerous procompetitive justifications for RPM arrangements. I will then explain why proposals to re-impose the *Dr. Miles* rule, in whole or in part, through legislation are misguided and premature.

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* Partner, Gibson, Dunn & Crutcher LLP, Washington, D.C.; former Deputy Solicitor General of the United States.

1 220 U.S. 373 (1911).

2 127 S. Ct. 2705 (2007).

I. THERE ARE EXTENSIVE AND WELL-SUPPORTED PROCOMPETITIVE JUSTIFICATIONS FOR RPM.

In *Leegin*, the Supreme Court recognized that economic literature is "replete with procompetitive justifications for a manufacturer's use of resale price maintenance."[3] The Court named several examples: (1) RPM can encourage competition and differentiation between different brands; (2) RPM can eliminate the "free rider" problem that occurs when customers require significant assistance to shop for a product but can then purchase the product elsewhere; (3) RPM can help allow new brands to break into a market by encouraging retailers to advertise and display them; and (4) even absent free-riding, RPM can be the most effective way of ensuring that retailers provide certain services. As explained below, these and other procompetitive justifications for RPM demonstrate that RPM can serve a variety of legitimate, efficiency-enhancing goals that strengthen inter-brand competition and benefit consumers as well as manufacturers. Accordingly there is no plausible basis for condemning RPM across the board.

At the outset, it is important to understand that RPM is only one of several indisputably legal and procompetitive techniques that manufacturers can use to encourage retailers provide their customers with favorable combinations of prices and services. These techniques include territorial arrangements, franchising arrangements, exclusive dealing arrangements, direct payment to retailers for promotional efforts, unilateral price policies, and vertical integration, as well as RPM. Underlying all of these methods is the fact that manufacturers generally want to keep distribution costs and retail mark-ups low, to pass lower costs on to consumers and thereby increase demand and gain market share. Manufacturers are not in the business of increasing retailer profits, and have no interest in doing so; a manufacturer's interest is instead to incentivize

[3] *Id.* at 2714.

its retailers to market its product in the most effective way, thereby maximizing inter-brand competition and increasing the manufacturer's sales. Accordingly, when we see a manufacturer using vertical agreements to influence its retailers through any of these techniques, the most plausible explanation is that the manufacturer is using the technique to compete with other brands and gain market share, not to enrich its retailers.

A. RPM Can Encourage Competition and Differentiation Between or Among Different Brands.

A manufacturer naturally seeks to make additional sales by better serving consumers' interests. Contrary to the apparent belief of some critics of RPM, however, consumers are not interested solely in low prices. Rather, consumers may also be interested in (and willing to pay for) a variety of other factors such as access to product demonstration and service; convenience of store hours and location; flexible and generous return policies; and knowledgeable, pleasant, well-trained, and efficient sales personnel. In order to satisfy those consumer interests, a manufacturer must either be vertically integrated (so that it owns and controls its own retail outlets) or must rely on independent retailers to help it achieve its goals. But it is well established that the interests of retailers and manufacturers do not always coincide. In many circumstances, of course, manufacturers will benefit most from dealer efforts to increase sales by lowering retail prices, and in those circumstances the adoption of RPM would be economically unwise and detrimental to the manufacturer's interests (and as a result, manufacturers that adopt RPM will not succeed in the marketplace). For other manufacturers, however, sales efforts focused on factors other than price may be more effective at serving the interests of consumers and thereby differentiating the manufacturer's product from those of its competitors. In those circumstances, dealers may have no incentive to expend the additional resources necessary to satisfy those customer desires, because those additional expenditures would reduce their own profits.

RPM addresses this mismatch between manufacturer and dealer incentives by guaranteeing the retailer a certain minimum resale margin over the cost of the good to the dealer. This minimum margin encourages retailers to compete aggressively to sell the RPM manufacturer's product because they are assured additional profit per unit sold on the RPM brand. Thus, RPM encourages retailers to promote the RPM brand as against other brands—a procompetitive goal. Indeed, as Justice O'Connor recognized for a unanimous Supreme Court in *State Oil Co. v. Khan*,[4] "the primary purpose of the antitrust laws is to protect interbrand competition." The Antitrust Section of the American Bar Association has explained the practice of RPM this way: "[r]esale price maintenance, like other vertical restraints, is typically a response to a supplier's problem of inducing distributors to provide adequate levels of distribution for its products."[5] In other words, by limiting intra-brand price competition (*i.e.*, competition among retailers with respect to the same manufacturer's product), the manufacturer may induce its distributors to provide promotional services and sales efforts that meet consumer needs or desires and thereby increase the attractiveness of the product. Or, as Professor Marvel of The Ohio State University

[4] 522 U.S. 3, 15 (1997).

[5] Section of Antitrust Law, ABA, Antitrust Law and Economics of Product Distribution 58 (2006); *see* Pauline M. Ippolito & Thomas R. Overstreet, Jr., *Resale Price Maintenance: An Economic Assessment of the Federal Trade Commission's Case Against the Corning Glass Works*, 39 J. L. & Econ. 285, 322-325 (1996) (concluding that RPM challenged by the FTC was most likely employed to increase distribution of the products).

Department of Economics put it in his recent presentation before the FTC, a manufacturer can use RPM to "induce [its] dealers to target dealers of rival products, not each other."[6]

B. RPM Can Prevent Free Riding.

As both the majority and dissenting Justices in *Leegin* recognized, RPM can help solve what is referred to as the retailer free-rider problem. The RPM solution to the free-rider problem is widely accepted by economists. Indeed, in *Leegin*, some 23 prominent economists filed a friend-of-the-Court brief stating: "There is a consensus in the economic literature that minimum RPM can, in certain circumstances, remedy a free-riding problem and thereby increase competition and enhance consumer welfare."[7]

As the Court explained in *Leegin*, "discounting retailers can free ride on retailers who furnish services and then capture some of the increased demand those services generate. Consumers might learn, for example, about the benefits of a manufacturer's product from a retailer that invests in fine showrooms, offers product demonstrations, or hires and trains knowledgeable employees."[8] Opportunistic retailers may seek to free-ride on full-service retailers by refusing to offer the high level of services themselves. Not having invested in the necessary services, the opportunistic retailer can offer discounted prices to consumers, and "the high-service retailer will lose sales to the discounter, forcing it to cut back its services to a lower level than consumers

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[6] Howard P. Marvel, Remarks at the Fed. Trade Comm'n, The Benefits of Resale Price Maintenance 17 (Feb. 17, 2009), *available at* http://www.ftc.gov/opp/workshops/rpm/docs/hmarvelppt0217.pdf.

[7] Brief of *Amici Curiae* Economists in Support of Petitioner at 5, *Leegin*, 127 S. Ct. 2705 (2007) (No. 06-480) (Economists' Br.).

[8] *Leegin*, 127 S. Ct. at 2715 (citing Richard Posner, Antitrust Law 172–73 (2d ed. 2001)); *see id.* at 2729 (Breyer, J., dissenting).

would otherwise prefer."[9] RPM is one solution to that problem "because it prevents the discounter from undercutting the service provider. With price competition decreased, the manufacturer's retailers compete among themselves over services."[10]

The free-riding justification for RPM was vividly explained by Ping, Inc., a relatively small golf club manufacturer, in its *amicus* brief in *Leegin*.[11] According to Ping, "custom fitting has been a key to [its] competitive success" against larger manufacturers.[12] "Over the years Ping has developed, and improved upon, numerous processes and products that assist a retailer in properly fitting a golfer with Ping equipment tailored to that golfer's individual game, regardless of his or her skill level."[13] Ping invested heavily in its custom fitting business model: "Ping has

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[9] *Id.* at 2716.

[10] *Id.* Similarly, manufacturers may use RPM to make it attractive for "prestige" retailers to carry the manufacturer's product. Prestige retailers have invested money and effort in developing a reputation for stocking only the highest quality or most fashionable goods, and some consumers find it efficient and beneficial to rely on the purchasing decisions made by such retailers to guide their own purchasing decisions. Such quality certification could be frustrated by free riding, however, if discount retailers seek to free ride on the prestige retailers' reputations and purchasing judgment by stocking and selling the same products at a discount. RPM thus provides an incentive for prestige retailers to carry products when free riding might otherwise make it unprofitable for them to do so. Howard P. Marvel, *The Resale Price Maintenance Controversy: Beyond the Conventional Wisdom*, 63 Antitrust L.J. 59, 65–67 (1994); Howard P. Marvel & Stephen McCafferty, *Resale Price Maintenance and Quality Certification*, 15 Rand J. Econ. 346 (1984); Ronald N. Lafferty, *et al.*, *Impact Evaluations of Federal Trade Commission Vertical Restraints Cases* 34–35 (FTC 1984); Thomas R. Overstreet, Jr., *Resale Price Maintenance: Economic Theories and Empirical Evidence* 56–62 (FTC 1983).

[11] Brief of Ping, Inc. as *Amicus Curiae* in Support of Petitioner at 9, *Leegin*, 127 S. Ct. 2705 (2007) (No. 06-480) (Ping Br.).

[12] *Id.* at 6.

[13] *Id.*

trained thousands of retailers, bringing them to its Phoenix, Arizona, factory to attend custom-fitting courses. Ping also devotes enormous time and resources to educating retailers about PING products, new technologies, and its custom fitting manufacturing process and quality controls."[14] These investments have succeeded in satisfying customers: "[a]s a result of these efforts, consumer surveys have repeatedly ranked Ping as the leader in custom fitting."[15]

But free riding threatened to undermine Ping's successful business model. "Several years ago, free rider activity and other retail behavior, exacerbated by internet sales, began to threaten the hard-earned reputation of the Ping brand, diminishing the demand for its products, and harming Ping consumers."[16] Ping's experience reflected the progressive unraveling of customer service discussed above. "For example, some price-cutting Ping retailers were advising consumers to visit a retailer that had invested in Ping's custom-fitting program, request a custom-fitting session, and then take the specifications for the custom-made Ping clubs back to the discounter for a 'great deal,' financed by the investments and efforts of the servicing dealer that performed the custom fitting."[17] The natural consequences followed: "Ping recognized that if such activities were allowed to continue unabated, most, if not all, of Ping's retailers would lose any incentive

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[14] *Id.*

[15] *Id.*

[16] *Id.* at 7.

[17] *Id.*

to perform custom fittings and other services that are key to the Ping brand and its ability to compete in the marketplace. By 2004, Ping's revenues reflected these harmful activities."[18]

Economists agree that RPM can be one of the most effective procompetitive ways a company like Ping can address its free-rider problem. "Minimum RPM agreements can ameliorate the free-rider problem by helping ensure that retailers that do not provide service cannot underprice the retailers that do."[19] And curtailing free-riding through RPM "generally increase[s] overall consumer welfare."[20] When RPM is legal, and assuming there are not other anticompetitive factors, a company like Ping can agree on a minimum price with all of its dealers to ensure (1) that all of them have a high enough profit margin to offer the important services, and (2) that they will not lose sales to "discount" dealers that do not provide the services.[21]

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[18] *Id.*

[19] Economists' Br., *supra* note 7, at 8.

[20] *Id.* (citing G. Franklin Mathewson & Ralph A. Winter, *The Incentives for Resale Price Maintenance Under Imperfect Competition*, 21 Econ. Inquiry 337, 347 (1983) and Kenneth G. Elzinga & David E. Mills, *The Economics of Resale Price Maintenance*, in Issues in Competition Law and Policy 7–9 (ABA Antitrust Section, Wayne Dale Collins, ed., 2007)).

[21] As discussed below (Part II.B, *infra*), Ping in fact adopted a different solution to this problem prior to *Leegin*, by announcing its suggested retail price, policing all of its retailers to determine whether they sold below that price, and then immediately terminating any offending dealers. Ping Br., *supra* note 11, at 8, 10. That practice was legal even under preexisting law, and would continue to be legal even if RPM were legislatively banned. In Ping's case the practice allowed it to achieve the same results as RPM, albeit in an economically inefficient and costly manner, because Ping's only option for enforcing its preferred pricing was to terminate offending dealers without notice, disrupting carefully-established relationships. Any effort to preserve dealer relationships by seeking to persuade dealers to abide by the manufacturer's retail price could have given rise to potential antitrust liability and treble damages under *Dr. Miles*.

C. RPM Can Facilitate Brand Entry.

Another way in which RPM can benefit consumers and advance procompetitive goals is by helping new brands break into markets. The Supreme Court has repeatedly acknowledged that "new manufacturers and manufacturers entering new markets can use [vertical] restrictions in order to induce competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer."[22] Indeed, even the dissenting Justices in *Leegin* agreed that this was a valid, procompetitive reason for imposing RPM. As Justice Breyer wrote, "a newly-entering producer wishing to build a product name might be able to convince dealers to help it do so—if, but only if, the producer can assure those dealers that they will later recoup their investment."[23] RPM provides an additional guaranteed profit margin for the retailer that already-established brands do not provide (generally because their brand recognition gives them added bargaining power vis-à-vis the retailers). As a result, RPM gives retailers an incentive to invest the necessary resources in providing shelf space for the new brand, learning its features and benefits, and informing customers who desire those features and benefits about the new product rather than an established brand that might not meet their needs as well. One important aspect of this justification recognized by the *Leegin* dissent is that it expressly encourages competition by helping new brands break into the marketplace. It is a method of RPM used by up-and-comers, not by established market giants.

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[22] *Leegin*, 127 S. Ct. at 2716 (quoting *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 55 (1977) and citing Marvel & MCafferty, *Resale Price Maintenance and Quality Certification*, 15 Rand J. Econ. 346, 349 (1984)).

[23] *Leegin*, 127 S. Ct. at 2728 (Breyer, J., dissenting).

Interestingly, the defendant in *Leegin* itself adopted RPM in part for this very purpose. Leegin offered a relatively small line of women's leather clothing accessories that was competing with established national brands, such as Coach. Leegin adopted RPM in part to associate its brand image with "quality, value, and customer service . . . by giving retailers incentives to provide special attention and service to prospective [Leegin] customers."[24] In that case, RPM allowed increased product diversity and more consumer choice, thereby enhancing inter-brand competition and benefiting consumers.

D. RPM Can Ensure That Retailers Provide Beneficial Services.

Separate and apart from the free-riding justification, RPM may be one of the most effective and economically efficient ways for a manufacturer to ensure that its retailers are providing the full range of point-of-sale services sought by consumers. As the Supreme Court explained in *Leegin*, "[i]t may be difficult and inefficient for a manufacturer to make and enforce a contract with a retailer specifying the different services the retailer must perform."[25] Value-enhancing sales efforts are not limited to factors such as product exhibition and demonstration, on which other retailers can free ride. Consumers often value features of the retail experience that can only be provided by the retailer, not the manufacturer, such as attractive and conveniently located retail stores and speedy and efficient completion of customer transactions (factors that do not lend themselves to free riding by other retailers).[26] A familiar example of such customer-

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[24] Brief for Petitioner at 3, *Leegin*, 127 S. Ct. 2705 (2007) (No. 06-480) (Pet. Br.).

[25] *Id.* at 2716.

[26] *See* Frank Mathewson & Ralph Winter, *The Law and Economics of Resale Price Maintenance*, 13 Rev. Indus. Org. 55, 67–69, 72–73 (1998); Ralph A. Winter, *Vertical Control and Price Versus Nonprice Competition*, 108 Q.J. Econ. 61 (1993).

driven, distributor-provided service was Coors Brewing Company's commitment to keep its beer cold at all stages from brewing through customer purchase. It was likely extremely difficult for Coors to provide the right set of incentives to its distributors and retailers to ensure they complied with the "always cold" promise. Procompetitive practices like the Coors "always cold" service are among the types of distributor-provided services that some manufacturers might use RPM to encourage and to fund. RPM can provide the necessary incentives for retailers to incur the costs of providing such features in the manner best calculated to attract customers. For example, it might be extremely inefficient or impossible for a manufacturer to inspect each of its retailers' stores to ensure that those stores are attractive, whereas it would be much easier to enforce an RPM contract which, if followed, would both encourage each retailer to keep the store attractive and ensure that each retailer has sufficient profit margin to do so.

E. RPM Can Protect Dealers and Manufacturers from Uncertain Demand.

RPM can also enhance competition and benefit consumers by encouraging retailers to stock the manufacturer's product at desirable levels in the face of uncertain consumer demand that might otherwise cause retailers to purchase and stock lower quantities of the product. By preserving retailer margins during times of low demand, RPM may reduce the likelihood of price increases during periods of increased demand. Moreover, the margin protection afforded by RPM may induce retailers to carry larger inventories, thereby benefiting consumers by assuring the continued availability of the product during times of high demand.[27]

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[27] *See* Raymond Deneckere et al., *Demand Uncertainty and Price Maintenance: Markdowns as Destructive Competition*, 87 Am. Econ. Rev. 619 (1997); Raymond Deneckere et al., *Demand Uncertainty, Inventories, and Resale Price Maintenance*, 111 Q.J. Econ. 885 (1996).

In the absence of RPM, if a manufacturer misjudges the consumer demand for its product, retailers may find themselves carrying excess inventory and may be tempted to take deep losses just to clear inventory, dumping the product on the market and causing serious harm to other retailers and to the brand image. According to Professor Marvel, in his recent oral remarks to the FTC,[28] that is precisely what happened to Atari's videogame console in the early 1980s. Atari anticipated high holiday demand, and retailers stocked high levels of the console. When demand turned out to be lower than expected, retailers were stuck with large inventories, dumped Atari's products, and took deep losses. Atari rapidly developed a low-quality brand image due to the low prices; and retailers, feeling burned by the losses they were forced to take, became reluctant to carry future Atari products. Atari never recovered. If an RPM policy had prevented retailers from dumping Atari's products following the holiday season, Atari, retailers, and consumers might all have been better off in the long run.

F. RPM Can Give Customers Peace of Mind.

Another procompetitive justification for RPM, not mentioned by the Supreme Court, is customer peace-of-mind. The defendant in *Leegin* explained that, in its view, "the typical retail strategy of putting products on and off 'sale' degrades a manufacturer's brand by causing customers to feel cheated when they buy at the wrong moment."[29] Leegin wanted to give its customers peace-of-mind by providing them with an "everyday fair price."[30] General Motors appealed to the same consumer desires through its advertised "no haggle" car pricing policy for

[28] *See* Marvel, *supra* note 6 (oral remarks).

[29] Brief of Petitioner at 3, *Leegin Creative Leather Prods. v. PSKS, Inc.*, No. 06-480 (Jan. 22, 2007).

[30] *Id.*

Saturn automobiles. As Kenneth Elzinga, Professor of Economics of the University of Virginia, put it in his expert report in the *Leegin* case, economic reasoning supports this goal: "by maintaining one price for each product, [the manufacturer] relieves customers of the search costs of learning if a particular retailer's offered price is too high. The policy also alleviates any concern that a markdown is imminent and consumers will be left . . . 'holding the bag.'"[31] Stress reduction is a real benefit manufacturers can confer upon consumers: "[o]ne need only think of the stress some shoppers encounter in certain transactions (e.g., buying an automobile) to understand the value to the consumer of such a guarantee."[32]

Two aspects of this justification for RPM are worth emphasizing. First, it is entirely driven by perceived consumer desires and does not necessarily raise average price even for that product; it may merely reduces price volatility. Second, these brands (Leegin's leather clothing accessories and Saturn automobiles) exist in diverse marketplaces in which many other manufacturers have a different view about what customers want and cater to different customer demands. Thus, Saturn's "no haggle" policy did not lead to across-the-board minimum price agreements through the automobile industry, but it did serve to meet the needs and preferences of a particular segment of automobile customers. Nor did Leegin's RPM policies lead to pervasive RPM in women's clothing accessories. RPM policies designed to reduce price volatility and increase customer peace-of-mind *increase* the range of customer choices because customers can choose a potentially less-expensive brand that will require considerable shopping around to find the best

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[31] Kenneth G. Elzinga, An Economic Analysis of the Antitrust Issues in *PSKS, Inc. d/b/a/ Kay's Kloset, Kay's Shoes;and Toni Cochran, L.L.C., d/b/a/ Toni's v. Leegin Creative Leather Products, Inc.*, (E.D. Tex. Jan 12, 2004) (No. 2-03-CV-107-TJW), Petition for a Writ of Certiorari at 48a, *Leegin*, 127 S. Ct. 2705 (2007) (No. 06-480).

[32] *Id.*

price, or can instead choose a brand that guarantees that it will available for the same price everywhere. More consumer choices means more competition and more consumer benefit, not less.

II. SUGGESTIONS TO REIMPOSE THE *PER SE* BAN ON RPM IN WHOLE OR IN PART ARE MISGUIDED AND PREMATURE.

A. Critics of the *Leegin* Decision Exaggerate Its Impact.

Contrary to the implications of some of *Leegin*'s critics, the overruling of *Dr. Miles* does not mean that RPM is now automatically legal in all circumstances. Instead, *Leegin* means only that courts will scrutinize RPM arrangements on a case-by-case basis, using the same "rule of reason" that (as the Supreme Court has repeatedly emphasized) applies by default to antitrust lawsuits.[33] There is no dispute about this point: FTC Commissioner Harbour, in her opening remarks at the recent FTC workshops, said that the *Leegin* majority "expressly disclaimed any suggestion that rule of reason analysis [for RPM] should become a *de facto* rule of *per se* legality."[34] Lower courts will not hesitate to ferret out anticompetitive uses of RPM under the rule of reason, because the Supreme Court has instructed them "to be diligent in eliminating . . . anticompetitive uses [of RPM] from the market."[35] If RPM's effects in any specific case are as harmful as RPM's critics contend they are likely to be, enforcement agencies and private plaintiffs will easily prove those anticompetitive effects under the rule of reason.

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[33] *Leegin*, 127 S. Ct. at 2712 ("The rule of reason is the accepted standard for testing whether a practice restrains trade in violation of § 1" of the Sherman Act.).

[34] Pamela Jones Harbour, Comm'r, Fed. Trade Comm'n, Opening Remarks at the Resale Price Maintenance Workshop 5 (Feb. 17, 2009), *available at* http://www.ftc.gov/speeches/harbour/090217rpmwksp.pdf.

[35] *Leegin*, 127 S. Ct. at 2719; *see* Harbour, *supra* note 34, at 5.

Furthermore, even when RPM is not automatically illegal, most manufacturers will not practice it. History and economic learning show that only some participants in any given industry will engage in RPM.[36] It is extremely unlikely to become pervasive in any industry.

B. Even Under *Dr. Miles*, Manufacturers Could Achieve the Same Economic Results as Those Produced by RPM, Only in More Costly and Less Efficient Ways.

Banning RPM would not prohibit manufacturers from achieving many of the same ends through other, less efficient means. In particular, through unilateral action and vertical integration, manufacturers could enforce minimum retail prices even under the *Dr. Miles* rule. The legality of these methods shows that *Leegin*'s impact will not be nearly as significant as its critics predict (because manufacturers have been using these less efficient and more costly alternatives to RPM for years). It also shows that it makes little sense to reimpose the *Dr. Miles* rule when these other methods will indisputably remain legal.

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[36] During the era in which state "Fair Trade" laws permitted resale price maintenance, economists estimate that "up to 10 percent of all retail products in the United States were subject to resale price floors." Ralph A. Winter, *Vertical Control and Price Versus Nonprice Competition*, 108 Q.J. Econ. 61, 61 (1993); *see also* Thomas R. Overstreet, Jr., Bureau of Econ., Fed. Trade Comm'n, Resale Price Maintenance: Economic Theories and Empirical Evidence 6–7 (1983) (same). Similarly, in a report issued in 1945, the FTC "estimated that price-maintained goods amounted to only 5 percent of all sales" during the 1930s. Thomas K. McCraw, *Competition and "Fair Trade": History and Theory*, 16 Research in Econ. Hist. 185, 210 (1996). Consumers Union "estimated that the peak year [for RPM under the Fair Trade laws] was 1959, when price-maintained goods accounted for 10 percent of sales." *Id.* at 233 n.44. And it is important to remember that the Fair Trade era was more conducive to RPM than the rule-of-reason regime adopted by the Supreme Court in *Leegin*, because RPM was automatically *legal* under the Fair Trade laws, whereas *Leegin* permits consumers to challenge particular RPM policies in those circumstances where they may have anticompetitive effects.

One method, unilateral action, is commonly called the *Colgate* rule.[37] Under that rule, although a manufacturer cannot *agree with* its retailers to adhere to minimum retail prices, the manufacturer can *unilaterally* terminate any retailer it believes is discounting too deeply. As long as there is no agreement and no communication about its reasons, a manufacturer may cut off discounting retailers without violating *Dr. Miles*—and may thus, over time, reduce the prevalence of discounters. But companies with *Colgate* policies must invest huge amounts of administrative time and legal fees to ensure they do not do anything that could later be interpreted by a court as an "agreement" on minimum prices, and must be prepared to terminate retailers and disrupt carefully built-up retail relationships without explanation or further negotiation.

The Ping *amicus* brief explains the elaborate administrative and legal methods Ping had to use in implementing a *Colgate* polity to ensure that its customers received the correct level of service from its retailers without violating *Dr. Miles*. According to its brief, in order to comply with the *Colgate* rule, Ping "drastically restrict[ed] employees' communications with the retailers to whom they sell and, worse, summarily terminate[d] retailers for even the smallest policy violations, without considering whether the violation was intentional or why it occurred. Ping employ[ed] as many as 12 full-time people who work[ed] on the [*Colgate*-compliant] Pricing Policy and related matters and has spent millions of dollars on the administration of the Policy since 2004."[38]

Another method of legally setting minimum retail prices is vertical integration: manufacturers can expand into distributing their own products; or large distributors can purchase small-

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[37] *See United States v. Colgate & Co.*, 250 U.S. 300 (1919).

[38] Ping Br., *supra* note 11, at 10.

label manufacturers, turning them into private label products. Vertically-integrated manufacturers directly set retail prices for their products because they themselves are the retailer.

Vertical integration is pervasive in many markets, possibly because the *Dr. Miles* rule encouraged it for so long. For example, one cannot buy CharterClub women's clothing from anyone but Macy's. Nor can one buy Abercrombie & Fitch clothes anywhere but from an Abercrombie & Fitch retail store. But vertical integration can add inefficiency to the market (and thereby increase prices) by forcing companies to work outside their expertise: clothes-making requires a different set of skills than real estate management and sales staffing of retail outlets, for example. The *Dr. Miles* rule encouraged manufacturers that wanted to achieve the procompetitive goals of RPM to integrate vertically into retail sales, even when vertical integration was not the most economically efficient means of achieving those goals.

A regime favoring vertical integration also disproportionately benefits larger manufacturers. It is only large, well-established manufacturers that will have the necessary capital and resources to invest in an internal distribution and retail network. Smaller companies, like Leegin itself, have almost no chance of using vertical integration to ensure that their customers receive the appropriate level of care and service.

With so many other options available to manufacturers to meet the same goals and achieve similar results (through *Colgate* policies and vertical integration, as well as exclusive dealing, direct payments, territorial division, and the like), the fact that some manufacturers nevertheless desire to use RPM creates a strong inference that RPM is the most efficient means of achieving those goals in some circumstances. Why would a manufacturer choose to use RPM if it could achieve the same desired retailer behavior through direct payments, for example? It would not. If a manufacturer (such as Leegin) seeks to adopt RPM despite the availability of the other methods, the logical inference is that RPM is likely to be the most efficient method for that manufacturer's product to compete aggressively against other brands in the same market. Gains in distribution efficiencies achieved through adoption of RPM policies, like other efficiency gains, are likely to be passed on to consumers.[39]

Both *Colgate* policies and vertical integration allow manufacturers legally to approximate the pro-competitive effects of RPM agreements, but at a cost of reduced efficiency that hurts manufacturers and consumers alike. There is no reason to reimpose the *Dr. Miles* rule when manufacturers can evade it by adopting other means to achieve the same ends, nor is there any reason to encourage inefficient and wasteful *Colgate* policies and inefficient vertical integration when the same goals can be achieved more efficiently through RPM. The market itself will generally ensure that manufacturers do not adopt or maintain RPM policies that do not enhance inter-brand competition, because a manufacturer's customers can simply "vote with their feet" by switching to another brand if they do not value the non-price benefits that the manufacturer sought to foster through use of RPM.

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[39] The nature of RPM agreements does not prevent the pass-through of efficiency gains. RPM seeks to provide a guaranteed *margin* to retailers by setting a minimum markup over wholesale. If wholesale prices fall because of efficiency gains, the retail price can also fall while the margin remains the same. As a simple example, a manufacturer in a *Colgate* regime might sell its product at a wholesale price of $100 per unit and expect retailers to sell at a retail price of $300 (a $200 markup). If the manufacturer drops the inefficient *Colgate* system and adopts RPM, it could use the efficiency gains and overhead reduction to reduce its wholesale price to $90 while maintaining the same markup margin (to ensure the requisite customer services), resulting in a new consumer price of $290. The $10 per unit RPM efficiency gains would have been passed directly to the consumer.

C. Legislatively Banning or Restricting RPM Would Be Bad Antitrust Policy and Would Harm Consumers.

1. *The current judicially-crafted rule of reason procedure is the best method to detect and prevent anticompetitive uses of RPM.*

An overwhelming majority of economists who have studied the uses and effects of RPM agree that RPM can—and often does—have procompetitive justifications that enhance inter-brand competition and benefit consumers. The fact that RPM can have procompetitive uses and can benefit consumers is not open to serious debate in the economic community, as demonstrated by the *amicus* brief signed by 23 leading economists, including 8 economists who formerly held the top economic positions at the FTC or Department of Justice during both Democratic and Republican administrations.[40] Outlawing all uses of a practice that can benefit consumers in many circumstances just because it might harm competition in others is fundamentally inconsistent with the antitrust laws. The thorough "rule of reason" antitrust analysis is the proper method to distinguish "good" RPM from "bad" RPM. "Bad" RPM should be dealt with through detection and enforcement—by the FTC, DOJ, and private litigants—not through a blanket legislative prohibition that would simultaneously cut off "good" RPM as well.

It is possible that as an alternative to outright prohibitions on RPM, some advocates may urge the enactment of a special framework that would mandate greater scrutiny for RPM agreements than that given to other vertical agreements in antitrust suits. But that would be unwise. The genius of the Sherman Act is the flexibility it gives the courts to tailor legal rules to the cir-

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[40] *See* Economists' Br., *supra* note 7, at 5 ("There is a consensus in the economics literature that minimum RPM can, in certain circumstances, remedy a freeriding problem and thereby increase competition and enhance consumer welfare. There is some dispute in the literature about how commonly and under what circumstances RPM has such effects, but the literature does not suggest that this is a rare or aberrational effect of RPM.").

cumstances of each case, and to reflect changing economic realities and growing economic understanding. Senator Sherman himself expected the courts to "determine in each particular case" the "precise line between lawful and unlawful combinations."[41] Federal courts have decades of experience applying, interpreting, and developing the nation's antitrust laws. As they gain experience with economic arrangements, courts have developed sensible presumptions and burden-shifting procedures tailored to specific situations. For example, in the 1984 *NCAA* decision, the Supreme Court created an exception to the usual doctrine that horizontal output-reducing agreements were *per se* illegal.[42] The Court recognized that some industries, such as sports leagues, require such horizontal agreements to function at all. The Court did not need a statute to create a specific, custom-tailored antitrust review process. Similarly, the D.C. Circuit recognized that a truncated antitrust analysis was appropriate in the *Polygram* case.[43] No legislation was needed to allow the court to condemn the anticompetitive music marketing agreements in that case without a full-blown rule of reason analysis.

These examples support three conclusions about judicially-created antitrust procedures. First, courts are quite capable of creating appropriate procedures and presumptions and already have sufficient flexibility to "get it right." Second, the fact that RPM was *per se* illegal until very recently means that courts have not had time to develop expertise and refine antitrust analy-

[41] 21 Cong. Rec. S2460 (daily ed. Mar. 21, 1890) (statement of Sen. Sherman).

[42] *NCAA v. Bd. of Regents*, 468 U.S. 85 (1984).

[43] *Polygram Holding, Inc. v. FTC*, 416 F.3d 29 (D.C. Cir. 2005).

sis in the RPM field—a point made by Commissioner Harbour herself.[44] In the coming years, without legislative involvement imposing rigid procedures on the basis of little or no information, courts may very well develop their own abbreviated analytical methods for certain types of RPM agreements (similar to the *Polygram* analysis) as they develop experience with the real-world effects of RPM. It will take time and careful case-by-case analysis to develop that experience, and courts are on the front lines of gaining that experience as they decide actual cases based on real examples with (or without) real competitive effects.

Third, it is universally accepted that horizontal agreements are far more likely to harm competition than are vertical arrangements. It would be incongruous and inappropriate for Congress to mandate detailed antitrust procedures for a specific *vertical* arrangement while leaving *horizontal* antitrust procedures entirely to the courts. The fact that Congress already trusts courts to police the most dangerous forms of anticompetitive behavior—horizontal agreements—should be a sign that courts can also be trusted to deal with less risky vertical agreements as well. And at the very least, the courts should be given an opportunity to consider these issues before any serious consideration is given to congressional action. To legislate a "solution" now, in the absence of any meaningful real-world data or experience that would provide a basis for informed congressional action, would be a grave mistake. Congress should allow the courts and the enforcement agencies to do their jobs, and develop experience with real RPM agreements in real markets.

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[44] Harbour, *supra* note 34, at 1.

2. *Banning RPM would harm consumers and competition.*

Banning RPM (in whole or in part) would not be a neutral act. There would undoubtedly be harmful consequences from such action, because it would interfere with manufacturers' desires to reduce free riding, to break into new markets, to protect dealers from uncertain demand, and to accomplish any of the other procompetitive goals of RPM. Even if there is some "bad" RPM mixed with the "good," overdeterring RPM across the board will harm consumers and competition.

A vivid example of overdeterrence, described by Professor Marvel in the recent FTC workshop, is that of Salton Corporation and the Foreman Grill. As Professor Marvel wrote, "Salton did not invent the contact grill, but it promoted and popularized its model as the George Foreman grill and dominated the market."[45] Resale price maintenance was apparently part of Salton's marketing and distribution strategy, and eventually New York and 48 other states sued Salton for its RPM arrangements that were *per se* illegal under the *Dr. Miles* rule. As a result of the suit, Salton agreed to end its RPM arrangements. Consequently, retailers dumped their inventory of Foreman Grills on the market, and consumer demand plummeted as consumers apparently began to view Foreman Grills as inferior products. Customers turned to more expensive and apparently more prestigious brands of grills, such as those offered by Cuisinart. The inferior reputation, based on market dumping, soon bankrupted Salton. Higher-priced contact grills still dominate the market, but there is now one fewer brand to compete with. In this case, the elimination of the RPM agreements reduced brand selection and reduced competition. As Professor Marvel pointed out, in hindsight, Salton's RPM agreements were procompetitive; but New York

[45] Marvel, *supra*, note 5, at 37.

and the other States discovered that fact only as a result of Salton's death and autopsy. There is no question that banning RPM would create more examples, like Salton's, of consumer harm.

3. *Price is not the only factor important to consumers.*

Commissioner Harbour has argued that practices that can result in higher consumer prices should be viewed with particular suspicion.[46] But RPM will not always lead to increased consumer prices. As already discussed, RPM can be a more efficient method of ensuring customer service than other legal vertical techniques, and manufacturers using RPM are likely to pass those efficiency gains on to consumers in the form of lower prices.[47]

Furthermore, price is not the only factor that is important to consumers. Some customers desire high levels of service, such as expert and knowledgeable sales staff, well-organized products, quality sales facilities, wide selection, or good post-sale service.[48] Retailers compete for consumers on all of these grounds, not on price alone. RPM arrangements can help cater to these customers who focus on factors other than price, and offer them choices they might not otherwise have. RPM is not inherently suspicious just because it can lead to some brands having higher prices. The market becomes more competitive, not less, when brands are able to compete on dimensions other than price in order to meet consumer desires. Thus, any legislative effort to ban RPM merely because it can lead to higher prices (and ensure enhanced levels of service) would not reflect a true concern for the benefit of consumers, but rather a paternalistic view that

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[46] Harbour, *supra* note 34, at 9.

[47] *See supra* note 39.

[48] *See* Ralph A. Winter, Remarks at the Fed. Trade Comm'n, Resale Price Maintenance With and Without Free-riding 4 (Feb. 17, 2009), *available at* http://www.ftc.gov/opp/workshops/rpm/docs/rwinter0217.pdf.

consumers cannot be trusted to make their own choices regarding the proper trade-off between price and service.

Moreover, suppliers engage in many other activities that may raise prices to consumers but that no one would consider banning in our open economic society. Product advertising is a means of promoting products that can lead to increased prices. We are not inherently suspicious of advertising, nor would we think of prohibiting it with our antitrust laws, merely because it can increase a manufacturer's overhead and lead to higher consumer prices. Likewise, we would not consider *per se* bans on direct payments by suppliers to retailers for shelf space and enhanced displays, despite the fact that such costs are likely to be passed on to consumers. Nor would we think of banning manufacturer contracts that require retailers to provide minimum levels of service, despite the fact that the costs of administering those contracts will likely be passed on to consumers. Why should we be suspicious of RPM when it is merely another means—one that may or may not affect price—of accomplishing the same goals as these other practices that do not arouse suspicion?

Similarly, many non-price vertical restraints can lead to increased prices in some circumstances. As the Supreme Court has acknowledged, "all vertical restraints, including the exclusive territory agreement[s] [we have] held not to be per se illegal . . ., have the potential to allow dealers to increase 'prices' and can be characterized as intended to achieve just that."[49] Indeed, "vertical nonprice restraints only accomplish the benefits identified" for them "because they reduce intrabrand price competition to the point where the dealer's profit margin permits provision

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49 *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 728 (1988).

of the desired services."[50] RPM simply accomplishes directly what non-price vertical restraints accomplish indirectly.[51] Given the potential for non-price vertical restraints—which are judged under the rule of reason—to lead to increased prices in some circumstances, it makes no sense to subject RPM to a *per se* ban merely because it can have the same effects.

Some opponents of RPM attack it because they believe it squelches development of new retailing methods. They argue, for example, that "warehouse" discount retailers or online discounters have been a positive development and that RPM policies would hamper other such developments. But this argument rests on the false assumption that when RPM is legal it will be omnipresent. The fact that RPM arrangements will be evaluated under the rule of reason, like other vertical restraints, does not mean that RPM will be adopted by most or even many manufacturers. We know this from our experience with *Colgate* policies and vertical integration, which are substitutes for RPM. Some manufacturers have *Colgate* policies—but most do not.

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[50] *Ibid.*; *see, e.g.*, *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 54–55 (1977) ("Vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products. . . . Economists have identified a number of ways in which manufacturers can use such restrictions to compete more effectively against other manufacturers. For example, new manufacturers and manufacturers entering new markets can use the restrictions in order to induce competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer. Established manufacturers can use them to induce retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their products. Service and repair are vital for many products, such as automobiles and major household appliances. The availability and quality of such services affect a manufacturer's goodwill and the competitiveness of his product.") (citation and footnote omitted).

[51] *See Monsanto Corp. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 762 (1984) ("the economic effect of all of the conduct described above—unilateral and concerted vertical price-setting, agreements on price and nonprice restrictions—is in many, but not all, cases similar or identical"); Frank H. Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 Antitrust L.J. 135, 156 (1984).

Some manufacturers are vertically integrated—but most are not. It is in our current *Colgate*/vertical integration world that warehouse stores and online retailing have flourished. The fact that consumers cannot buy Tiffany silverware below the price set by Tiffany (because it is vertically integrated) does not prohibit other silver manufacturers from making competing brands of silverware available at Sam's Club. The fact that Ping uses a *Colgate* policy does not mean that other brands of discount golf clubs are not available on eBay. Innovative retail methods can flourish even when some brands set minimum prices, whether by *Colgate* policies, vertical integration, or RPM.

CONCLUSION.

With so many procompetitive justifications for RPM, there is simply no plausible justification for banning the practice, in whole or in part. We continue to operate under a regime in which truly anticompetitive conduct can be detected, enjoined, and sanctioned (by means of punitive treble damages) under the existing antitrust laws. As the Supreme Court has repeatedly stated, practices should not be automatically condemned unless *experience* has shown us that those practices always or almost always harm competition.[52] There is simply no such body of experience for RPM. To the contrary, there are several examples of RPM or RPM-like agreements that have enhanced competition. Neither the courts nor Congress have the experience necessary to "predict with confidence" that RPM agreements will be invalidated under the rule of reason.[53] I therefore urge Congress to allow manufacturers to innovate and create ways of meet-

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52 *See Leegin*, 127 S. Ct. at 2713.

53 *Id.*

ing customers' desires, and to allow courts to develop experience in the field by deciding actual cases under the rule of reason.

Mr. Chairman and Members of the Committee, thank you for the opportunity to address this issue.

Mr. JOHNSON. Thank you, Mr. Hungar.

Now, Mr. Cohen, will you proceed, sir?

TESTIMONY OF TOD COHEN, VICE PRESIDENT, DEPUTY GENERAL COUNSEL FOR GOVERNMENT RELATIONS, eBAY INCORPORATED, SAN JOSE, CA

Mr. COHEN. Chairman Johnson, Ranking Member Coble and Members of the Subcommittee, my name is Tod Cohen, Vice President and Deputy General Counsel for Government Relations for eBay. Thank you for the invitation to speak today about the negative impact of the Supreme Court's *Leegin* decision, in particular on small and mid-size retailers who use the Internet and whose benefits to help consumers are being crippled by the very visibility created by the Internet.

We support Congress legislatively intervening and reinstating a per se rule prohibiting retail price fixing.

Founded in 1995, eBay connects hundreds of millions of people around the world every day. The company's online platforms empower individuals and small businesses to meet and engage in open trade on a local, national and international basis.

We believe that the efficiency and consumer benefit to the open Internet can be immense. Businesses use it to offer lower prices, greater choice, and great values to consumers. Consumers use it to more easily find, compare and purchase products.

Unleashed, it is a game-changer, and we are still in the innovation stage of retail on the Internet, with new retail business models benefiting consumers, retailers and the overall economy. The Internet is part of every serious 21st century retail strategy, whether massive brick-and-click retailers with websites and big box stores, large remote Internet and catalog retailers with nationally known brand names or small businesses who are building new Internet businesses or integrating the Internet into an existing small shop to survive and grow in today's highly competitive retail environment.

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

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

On one side are established networks of manufacturers and retailers who want to reinforce or enhance established and highly profitable retailing business models. They are threatened by the Internet when it is harnessed to offer consumers better deals and more information outside the established incumbent retail networks.

On the other side are innovators with new business models. They are almost always small to medium-size businesses. They use new technologies to offer consumers better deals, more information, and new services.

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

EBay's own experiences confirm that many large, established businesses attempt to limit low price intra- and inter-brand competition by continually scanning our platforms to identify sellers offering their products at lower prices. They then use a range of tools to identify these sellers and stop low-price competition using different tactics, depending on the circumstances of the sellers. The *Leegin* decision has clearly been interpreted as a legal green light to more aggressively thwart low-price competition.

Established retailers and manufacturers attempting to enforce traditional business models contend that innovative Internet retailers are able to offer lower prices to consumers because they "free ride" on their traditional retail counterparts.

The truth is that the Internet turns the traditional free-rider justification for RPM on its head. Internet retailers and services provide significant pre-sale price information to consumers. The open Internet has completely revolutionized the consumer information experience.

Consumers regularly turn to the Internet to search for product information, make product comparisons, and check prices before visiting and purchasing from established retailers. In fact, it could even be argued that the largest and most established retailers and their largest retailer partners are free riding on the tremendous consumer information tools created by Internet innovators.

From a competition policy and consumer benefit perspective, the traditional rider free argument for RPM policies as applied to the Internet should be put to rest. Innovation Internet retail models simply expose incumbents to new competitive threats and more innovative forms of retailing.

Protection from new and innovative retail models was always a likely reason for RPM, and we think it is even more true in the Internet age. Therefore, we ask this committee to aggressively scrutinize the *Leegin* decision and adopt appropriate measures to protect consumers and retail innovators.

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

[The prepared statement of Mr. Cohen follows:]

PREPARED STATEMENT OF TOD COHEN

TESTIMONY OF TOD COHEN, VICE PRESIDENT AND DEPUTY GENERAL COUNSEL, GOVERNMENT RELATIONS, EBAY BEFORE THE UNITED STATES HOUSE OF REPRESENTATIVES, COMMITTEE ON THE JUDICIARY, SUBCOMMITTEE ON COURTS AND COMPETITION POLICY

April 28, 2009

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

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

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

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

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

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

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

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

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

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

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

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

They then use a plethora of tools to identify the seller and enforce their minimum prices. The tools used to enforce these minimum prices are varied and often depend on the circumstances of the seller and the relationship with the manufacturer. For these businesses, the *Leegin* decision has clearly been interpreted as a legal "green light" to more aggressively thwart low-price competition by legitimate sellers.

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

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

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

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

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

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

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

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

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

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

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

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

is unlikely these manufacturers would see value in a strategy that ostensibly encourages its very occurrence.

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

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

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

Finally, I understand that a recent study involving Internet retailing and examining the abolition of RPM in the UK book industry found that it increased industry productivity.[3] According to the study, abolishing RPM resulted in strong growth in new retail channels of distribution for books including through Internet retailers with both the total industry sales volume as well as the number of titles published increasing. A key finding of the study was that the new retail channels of distribution had different business models typically based on lower costs and innovation. Evidence of this kind should be especially helpful to this Committee in better understanding Internet retailing and RPM.

Thank you Mr. Chairman and members of the Subcommittee.

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

Mr. JOHNSON. Thank you, Mr. Cohen.

And last but not least, we will ask Mr. Brunell to commence your opening statement.

TESTIMONY OF RICHARD M. BRUNELL, DIRECTOR OF LEGAL ADVOCACY, AMERICAN ANTITRUST INSTITUTE, NEWTON, MA

Mr. BRUNELL. Chairman Johnson, Ranking Member Coble and Members of the Subcommittee, I am Richard Brunell, director of legal advocacy for the American Antitrust Institute. Thank you for this opportunity to present the views of AAI on the *Leegin* decision.

We believe that consumer welfare and economic innovation are best served when retailers are free to engage in discounting, and therefore we urge Congress to restore some version of the per se rule. We have had 22 months since the *Leegin* decision, and we have learned a few things since then.

As expected, the use of resale price maintenance programs appears to have increased even though antitrust counselors have advised caution because some state attorneys general have taken the position that RPM remains per se illegal under state laws, and other states have passed, or may pass, their own *Leegin* repealer bills.

We also believe that there has been a greater use of Colgate policies and minimum advertised price policies to enforce minimum resale prices. Allowing manufacturers to forestall discounting by legitimate retailers is problematic at any time, but we agree that it is particularly unfortunate during this time of deep recession when consumers depend on discounts to make ends meet, and manufacturers may be more pressured than ever to use RPM to forestall retail price wars.

Another thing we have learned in the 22 months since *Leegin* is that the so-called rule of reason adopted by the Supreme Court is, in effect, a rule of virtual per se legality. Now, the court said that RPM agreements were to be evaluated on a case-by-case basis, and courts would have to be diligent in eliminating anti-competitive uses from the market.

However, in most of the cases decided since the *Leegin* decision, the lower courts have summarily dismissed the complaints because the alleged relevant markets were said to be too narrow as a matter of law. Plaintiffs were not even allowed to try to prove their cases.

Now, the problem with the rule of reason is not just that it requires a plaintiff to prove a relevant market, to prove that the defendant has market power, which is a difficult and expensive proposition even if the plaintiff gets by a motion to dismiss. The problem is that the Supreme Court fundamentally misunderstood the nature of the anti-competitive harm from resale price maintenance.

The court and its Chicago School supporters look at higher prices that result from RPM and they say, "So what?" They assume that the manufacturers' and consumers' interests are congruent. The manufacturer would prefer its retailers to sell at lower prices, and therefore, if the manufacturer adopts RPM, well, it must be because it will somehow increase demand for its product, notwithstanding the higher prices.

Under this view, higher prices are only anti-competitive when they result from collusion among manufacturers or retailers. And if that is the anti-competitive theory, then no plaintiffs will ever win a resale price maintenance case.

The critics of RPM, notably including Congress when it repealed the fair trade laws in 1975, look at higher prices, and they see harm to consumers. When a manufacturer announces that it will not permit prices to fall below a certain level, they are rightly suspicious. They know that manufacturers are not fond of retail discounting when it puts downward pressure on wholesale prices, and that a fixed retail price on one product can put a floor under the price of competing products that are not even subject to RPM.

So when they see higher prices that result from RPM, they, and Commissioner Harbour and many others, say, “Show me the consumer benefit.” Yet, the business justifications generally offered for RPM, including those suggested by Mr. Hungar, provide no real benefits to consumers. Economists may see a theoretical benefit, but, in reality, there are no real benefits.

A common justification is that RPM allows a manufacturer to buy better distribution or shelf space from retailers that carry competing brands. But while this may increase the manufacturer’s sales, it does not benefit consumers. On the contrary, it can give retailers an incentive to push the product with the largest margin protected by RPM even when the product may be inferior to competing products.

Another common justification, of course, is the free rider theory. But even if this is a plausible concern in some cases, RPM is a poor mechanism for addressing it.

RPM is also frequently touted as a tool to maintain the brand image of high-end products. And if one looks at the *Wall Street Journal* in the series they have had on RPM, you see that a lot of the manufacturers that are interested in RPM are the high-end manufacturers of fashion products.

Let me just conclude by noting that, even where RPM could have some possible justifications, it has one anti-competitive effect that is universal. And that is it tends to prevent more efficient retailers, who have expert local knowledge of the needs and shopping behavior of their customers, from passing on the benefits of their lower costs to consumers.

This centralization of decision-making not only harms consumers in the short run, it slows down innovation and productivity in the retail sector by impairing this essential competitive tool for innovative retailers to gain market share.

Thank you, and I look forward to answering your questions.

[The prepared statement of Mr. Brunell follows:]

PREPARED STATEMENT OF RICHARD M. BRUNELL

Statement of

RICHARD M. BRUNELL

DIRECTOR OF LEGAL ADVOCACY, AMERICAN ANTITRUST INSTITUTE

Before the

HOUSE JUDICIARY COMMITTEE

SUBCOMMITTEE ON COURTS AND COMPETITION POLICY

Regarding

"BYE BYE BARGAIN? RETAIL PRICE FIXING, THE *LEEGIN* DECISION,

AND ITS IMPACT ON CONSUMER PRICES"

APRIL 28, 2009

Chairman Conyers, Ranking Member Smith, and members of the Subcommittee, I am Richard Brunell, Director of Legal Advocacy for the American Antitrust Institute ("AAI"). Thank you for this opportunity to present the views of the AAI as you consider Congress's response to the Supreme Court's *Leegin*[1] decision which, by a vote of 5-4, overturned the venerable *Dr. Miles*[2] case and the *per se* rule against resale price maintenance ("RPM"), which Congress had long endorsed. AAI is an independent non-profit research, education, and advocacy organization that supports the strong and sensible enforcement of our antitrust laws to ensure that markets are competitive for the benefit of consumers and the economy as a whole.[3] We believe that consumer welfare and economic innovation are best served when retailers are free to engage in discounting, and therefore urge this committee to take action to restore some version of the *per se* rule.[4]

Executive Summary

What have we learned in the almost two years since the *Leegin* decision? It appears that, as expected, the use of resale price maintenance programs has increased, even though antitrust counselors have advised caution because some state attorneys general have taken the position that RPM remains *per se* illegal under some state laws and other states have passed or may pass

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

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

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

[4] AAI has been actively involved in the debate over RPM. We filed an *amicus* brief in *Leegin* urging the Court not to overturn *Dr. Miles*, submitted comments in the FTC's *Nine West* matter opposing Nine West's petition to lift resale price restrictions, provided written testimony to the Senate Judiciary Committee in support of Senator Kohl's Discount Pricing Consumer Protection Act, and testified before the Maryland legislature in support of legislation reaffirming the *per se* rule under Maryland antitrust law. All of these submissions are available on AAI's website. Many of the points discussed here are elaborated in Richard M. Brunell, *Overruling* Dr. Miles: *The Supreme Trade Commission in action*, 52 ANTITRUST BULL. 475 (2007).

"*Leegin* repealer" bills. Anecdotally, we also believe there has been greater use of "*Colgate* policies" and minimum advertised pricing (MAP) policies to enforce minimum resale prices. Allowing manufacturers to forestall discounting is problematic at any time, but it is particularly unfortunate during this time of deep recession when consumers depend on discounts to make ends meet and manufacturers may be more pressured than ever to use RPM to forestall price wars.

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

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

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

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

Introduction

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

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

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

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

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

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

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

The Practical Importance of the *Per Se* Rule

AAI believes that the *Leegin* decision was wrong as a matter of jurisprudence and policy for many of the same reasons articulated by Justice Breyer in his powerful dissent on behalf of four Justices.[5] As Justice Breyer explained:

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

> The *per se* rule forbidding minimum resale price maintenance agreements has long been "embedded" in the law of antitrust. It involves price, the economy's "'central nervous system.'" [citation omitted]. It reflects a basic antitrust assumption (that consumers often prefer lower prices to more service). It embodies a basic antitrust objective (providing consumers with a free choice about such matters). And it creates an easily administered and enforceable bright line, "Do not agree about price," that businesses as well as lawyers have long understood.[6]

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

First, two years have passed since *Leegin* was decided, and we can observe the early returns: not unexpectedly, numerous press reports indicate that the ruling has resulted in increased use of resale price maintenance agreements[7] and "soft" RPM programs such as "*Colgate* policies" and minimum advertised price (MAP) policies.[8] Under a *Colgate* or "unilateral" minimum price policy, a manufacturer obtains compliance with minimum retail prices, not by explicit agreement, but by threatening to cut off noncompliant dealers. Under a MAP policy, a manufacturer prevents retailers from advertising below a minimum price. Manufacturers have favored these "soft" RPM programs because many states, including California and New York, may con-

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

[6] 127 S. Ct. at 2736.

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

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

tinue to treat RPM agreements as *per se* illegal under state antitrust laws;[9] accordingly, antitrust counselors have advised caution in adopting express RPM agreements, at least on a national basis.[10] While *Colgate* policies have always been lawful in theory, prior to *Leegin* manufacturers were often inhibited from adopting such policies because implementing a *Colgate* program was perceived by many to be draconian, costly, and impractical; it required a manufacturer to terminate otherwise-valued noncompliant retailers and to refrain from price discussions with any retailers.[11] After *Leegin*, however, antitrust lawyers have been advising manufacturers that *Colgate* policies may be more flexible because the consequences of running afoul of the *Colgate* limitations are not as severe.[12] Similarly, prior to *Leegin*, MAP policies were typically limited to

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

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

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

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

manufacturer-financed (co-op) advertising and allowed significant "leakage" in discounting.[13] After *Leegin*, so-called "bald" MAP policies (i.e., those that apply regardless of whether the manufacturer pays for the advertising) that leave less room for discounting are less risky.[14]

Second, the fact that many states *may* continue to treat RPM as *per se* illegal does not undercut the need for Congress to restore the *per se* rule under the Sherman Act. Commentators have generally concluded that it is unclear how courts will interpret existing state statutes, even if attorneys general favor a *per se* rule. Most state antitrust statutes are construed in harmony with federal law. Only one state – Maryland – has amended its statute in light of *Leegin* to expressly adopt the *per se* rule.[15] And some have suggested that state laws that adopt a *per se* rule might be preempted by the Sherman Act.[16] In any event, a state-by-state approach will offer no protection to consumers in states that follow federal law and, perhaps most significantly, will not permit the federal enforcers to bring RPM cases on a *per se* basis.

Third, while it is true that *Leegin* did not make RPM *per se* legal, and the Court offered that "courts would have to be diligent in eliminating their anticompetitive uses from the market" under the rule of reason,[17] the way that the courts have interpreted *Leegin* so far suggests that the rule of reason will devolve into a rule of virtual *per se* legality, as it has with nonprice vertical restraints. Several lower courts (including the lower court on remand in *Leegin*) have dismissed

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

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

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

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

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

RPM complaints on motions to dismiss for failing sufficiently to allege a relevant market, not even permitting plaintiffs to *try* to prove a rule of reason violation, even though the cases involved allegations of market power and dual distribution (i.e., manufacturers that sell at retail, in competition with their dealers, as well at wholesale).[18] Indeed, even the FTC interpreted *Leegin* to permit RPM in a case where the leading manufacturer of women's fashion shoes (albeit with "only a modest market share") engaged in dual distribution, RPM practices appeared to be widespread in the industry, and its purported procompetitive efficiencies were "unproven."[19]

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

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

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

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

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

Leegin is Bad Jurisprudence

Thirty-four years ago, the Subcommittee on Monopolies and Commercial Law held hearings on H.R. 2384, the bill that was enacted as the Consumer Goods Pricing Act of 1975.[21] The law repealed the so-called "fair trade" amendments to the Sherman Act – the Miller-Tydings Act of 1937 and the McGuire Act of 1952 – which had authorized states to legalize resale price maintenance agreements.[22] The Subcommittee, headed by Representative Peter Rodino, heard testimony from numerous witnesses, including the Deputy Assistant Attorney General, Keith Clearwaters, and the Chairman of the Federal Trade Commission, Lewis Engman, both of whom testified in favor of restoring the *per se* rule of *Dr. Miles*.[23] The Senate Judiciary Committee also held seven days of hearings with 23 witnesses, including the Assistant Attorney General for Antitrust, Thomas Kauper, who testified to the same effect.[24] The Committee reports show that Congress believed that RPM was pernicious and should be banned. The Committees heard the

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

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

[22] The Miller-Tydings Act is the only substantive amendment to Section 1 of the Sherman Act in its entire history.

[23] *See Fair Trade: Hearings on H.R. 2384 Before the Subcomm. on Monopolies and Commercial Law of the H. Comm. on the Judiciary*, 94th Cong. 3, 109 (1975) [*House Hearings*].

[24] *See Fair Trade Laws: Hearings on S. 408 Before the Subcomm. on Antitrust and Monopoly of the S. Comm. on the Judiciary*, 94th Cong. 176-77 (1975).

arguments, similar to those made today, that resale price maintenance could be procompetitive in some circumstances, yet rejected any exceptions to the *per se* rule.[25]

Congress passed the Consumer Goods Pricing Act with overwhelming, bipartisan support, and President Ford enthusiastically signed it into law.[26] In 1977, when the Supreme Court in *GTE Sylvania* adopted the rule of reason for nonprice vertical restraints, it expressly stated that different treatment of resale price maintenance was justified in part because Congress had approved the *per se* rule.[27] After the Reagan Administration's Justice Department sought to overturn the *per se* rule in *Monsanto*,[28] Congress passed appropriations measures in 1983, 1985, 1986, and 1987 preventing the Department from using appropriated funds for this purpose.[29] Such measures were no longer needed when the (first) Bush Administration came to office and promised to enforce *Dr. Miles*.[30] Between 1990 and 2000, the FTC and Department of Justice brought about 14 RPM cases; the States also brought numerous cases.[31]

[25] For a review of this history, see Brunell, *supra*, at 487-88.

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

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

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

[29] *See* H.R. Rep. No. 237, 102d Cong., 1st Sess. 4 (1991) ("With the possible exception of merger policy, there is probably no area of antitrust where Congress has displayed such an explicit and abiding intent to set policy for the courts and enforcement agencies as the area of resale price maintenance ('RPM')."

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

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

There matters stood until the Roberts Court granted certiorari in *Leegin* to reconsider the *Dr. Miles* rule, notwithstanding that there was no great hue and cry demanding that *Dr. Miles* be reversed. On the contrary, the bipartisan Antitrust Modernization Commission had declined to study the topic, noting that there was "a relatively low level of controversy on the subject."[32]

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

> The text of the Consumer Goods Pricing Act did not codify the rule of *per se* illegality for vertical price restraints. It rescinded statutory provisions that made them *per se* legal. Congress once again placed these restraints within the ambit of § 1 of the Sherman Act. And, as has been discussed, Congress intended § 1 to give courts the ability "to develop governing principles of law" in the common-law tradition. [citations omitted] Congress could have set the *Dr. Miles* rule in stone, but it chose a more flexible option. *We respect its decision* by analyzing vertical price restraints, like all restraints, in conformance with traditional § 1 principles, including the principle that our antitrust doctrines "evolve with new circumstances and new wisdom." [citations omitted][33]

With all due respect, we believe, like the dissenters,[34] that by ignoring the obvious purpose of the Consumer Goods Pricing Act to extend the *per se* rule, the Court failed to respect Congress's will. Indeed, the Court's "common law" approach to the Sherman Act – unconstrained by congressional intent and its own precedent – reflects an ominous trend in judicial lawmaking. The Court has set itself up as the principal antitrust policymaker for the country, a "Supreme Trade Commission," except that unlike the Federal Trade Commission, it is staffed with law clerks rather than antitrust experts, has no ability independently to gather data, and is not subject to agency oversight by Congress. Just as Congress had to enact the Clayton Act in

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

[33] 127 S. Ct. at 2724 (emphasis added).

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

1914 in response to the Court's narrowing of the Sherman Act in *Standard Oil*, and the Cellar-Kefauver Act in 1950 after the Court limited the Sherman Act again in *Columbia Steel*, Congress must once again rein in the Court and reestablish its primacy in making national competition policy for the benefit of consumers.

***Leegin* is Bad Policy**

The Court's repeal of the *per se* rule against RPM is bad policy for several reasons. First, the Court's standard for determining when to apply a *per se* rule was wrong. The Court concluded that the *per se* rule was not appropriate for RPM because, "[n]otwithstanding the risks of unlawful conduct, it cannot be stated with any degree of confidence that resale price maintenance 'always or almost always tends to restrict competition and decrease output.'"[35] However, while that standard has been asserted in some cases,[36] it is the wrong test. Justice Breyer acknowledged that resale price maintenance can have procompetitive effects ("the proponents of a *per se* rule have always conceded as much"),[37] but "before concluding that courts should consequently apply a rule of reason, I would ask such questions as, how often are harms and benefits likely to occur? How easy is it to separate the beneficial sheep from the antitrust goats?"[38] Modern decision theory dictates that the proper focus is not simply on the frequency with which a practice is anticompetitive or procompetitive, but also on the magnitude of the harms or benefits and, given error costs, whether an alternative rule would generally improve consumer welfare and the administration of the antitrust laws. As Professors Areeda and Hovenkamp have said, "It is thus not enough to suggest that a class of restraints is sometimes or even often beneficial or harmful.

[35] 127 S. Ct. at 2717, *quoting* Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 723 (1988).

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

[37] *Leegin*, 127 S. Ct. at 2732.

[38] *Id.* at 2729.

The critical questions are always ones of frequency and magnitude relative to the business and legal alternatives."[39]

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

The Anticompetitive Effects of Resale Price Maintenance

The Court recognized that resale price maintenance "does have economic dangers."[40] What are those dangers?

Higher prices. The function of resale price maintenance is to raise resale prices to consumers, and there is little dispute that resale price maintenance generally has that effect.[41] This

[39] 8 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶1628b, at 292 (2d ed. 2004); *see also* Arndt Christiansen & Wolfgang Kerber, *Competition Policy With Optimally Differentiated Rules Instead of "Per se Rules vs. Rule of Reason"*, 2 J. COMP. L. & ECON. 215, 238 (2006) (explaining "error cost approach" in law and economics, and observing that to justify abandoning prohibition of RPM, "it is not sufficient to show that that there are cases in which resale price maintenance can lead to positive welfare effects"); Edward Iacobucci, *The Case for Prohibiting Resale Price Maintenance*, WORLD COMP. L & ECON. REV., Dec. 1995, at 71, 102 (advocating *per se* rule because "the number of cases where RPM is efficient will probably be rather small, while the cost involved from switching from RPM to alternatives is likely to be minimal [and] the cost of a rule-of-reason review is likely to be significant if it is to be done properly.").

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

[41] *See* 8 AREEDA & HOVENKAMP, *supra*, ¶ 1604b, at 40 (resale price maintenance "tends to produce higher consumer prices than would otherwise be the case. The evidence is persuasive on this point."). Even the majority seemed to acknowledge this, *see* 127 S. Ct. at 2718 ("'price surveys indicate that [resale price maintenance] in most cases increased the prices of products sold'") (quoting THOMAS R.

would seem enough to make resale price maintenance competitively suspect,[42] and was the main reason Congress repealed the fair trade laws.[43] Studies of the fair trade era showed that prices of items subjected to fair trade in fair trade states were significantly higher than in states where resale price maintenance was illegal, and that fair trade cost consumers *billions* of dollars a year.[44] More recently, music companies' efforts to restrain resale prices of CDs was estimated by the FTC to have cost consumers as much as $480 million.[45]

The Court, however, was not impressed with the argument that resale price maintenance raises prices to consumers, "absent a further showing of anticompetitive conduct."[46] The Court suggested that since the high prices may be accompanied by more dealer services, it is not necessarily the case that resale price maintenance reduces consumer welfare.[47] Was Congress therefore misguided when it saw higher prices in fair trade states as being harmful to consumers? In the absence of other information, is it unreasonable to *presume* that higher prices resulting from resale price maintenance are indicative of consumer harm? I think not.

OVERSTREET, JR., RESALE PRICE MAINTENANCE: ECONOMIC THEORIES AND EMPIRICAL EVIDENCE 160 (FTC Bureau of Economics Staff Report 1983)) (alteration in original), although the Court went on to say that resale price maintenance "may reduce prices if manufacturers have resorted to costlier alternatives of controlling resale prices that are not *per se* unlawful." *Id.*

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

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

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

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

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

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

According to the Court, focusing on higher prices overlooks that a manufacturer ordinarily benefits from *low* resale prices. "As a general matter, therefore," the Court said, "a single manufacturer will desire to set minimum resale prices only if the 'increase in demand resulting from the enhanced service . . . will more than offset a negative impact on demand of a higher retail price.'"[48] However, an alignment between manufacturers' and consumers' interests cannot be generalized.[49]

Any congruence of manufacturer and consumer interests evaporates if the manufacturer adopts resale price maintenance at the behest of its retailers. Indeed, the Court noted, "If there is evidence that retailers were the impetus for a vertical price restraint, there is a greater likelihood that the restraint facilitates a retailer cartel or supports a dominant, inefficient retailer."[50] The Court acknowledged that the risk of resale price maintenance being used to facilitate dealer collusion is a "legitimate concern."[51] Moreover, the Court recognized that, even without dealer collusion, a "manufacturer might consider that it has little choice but to accommodate [a powerful] retailer's demands for vertical price restraints if the manufacturer believes it needs access to the retailer's distribution network."[52] But while recognizing the anticompetitive retailer-power explanation for resale price maintenance, the Court seemed oblivious to the changes in the econ-

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

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

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

[51] *Id.* at 2717.

[52] *Id.*

omy that have heightened the risk of retailer-induced resale price maintenance. For example, the Court emphasized that a single retailer cannot "abuse" resale price maintenance without "market power," and quoted the old saw from *Business Electronics* that "[r]etail market power is rare, because of the usual presence of interbrand competition and other dealers."[53] However, common sense says otherwise. Retail buyer power is common[54] and is increasing along with retail concentration.[55] As Justice Breyer pointed out, increased concentration in retailing "may enable (and motivate) more retailers, accounting for a greater percentage of total retail sales volume, to seek resale price maintenance, thereby making it more difficult for price-cutting competitors (perhaps internet retailers) to obtain market share."[56]

Lower retail prices may sometimes be in the manufacturer's interest, but sometimes the manufacturer can maximize its profits when RPM is used to *jointly* maximize the profits of the manufacturer and its retailers, or the manufacturer and its competitors. The Court conceded the danger that resale price maintenance might be used to facilitate a manufacturer cartel[57] but, significantly, failed to recognize that resale price maintenance may also facilitate oligopolistic pricing that may not itself be illegal.[58] The Court also did not acknowledge Justice Breyer's point

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

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

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

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

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

[58] *See* 8 AREEDA & HOVENKAMP, *supra*, ¶ 1606d-f, at 86-92 (resale price maintenance reinforces manufacturer coordination, whether express or tacit, by reducing utility of wholesale price cuts and increasing

that "[i]ncreased concentration among manufacturers increases the likelihood that producer-originated resale price maintenance will prove more prevalent today than in years past, and more harmful."[59] Further, RPM may be used strategically to dampen interbrand price competition at the retail level even when competing manufacturers do not use RPM; competing single-brand retailers and multibrand retailers may respond to a manufacturer's use of RPM by raising the price of other brands.[60]

The Court also failed to recognize manufacturers' incentive independently to adopt resale price maintenance in order to protect their own wholesale margins. Retail discounting is often harmful to the manufacturer because it puts pressure on the manufacturer to reduce its wholesale prices.[61] As a Wal-Mart executive stated when Wal-Mart was the new discounter on the block, "I don't have any question but that competitive pricing at the retail level creates more pressure on manufacturers' factory prices than is present when they're able to set retail prices as well . . . ."[62]

Reduced efficiency and innovation. In addition to raising prices, resale price mainte-

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visibility of prices; "danger is more than theoretical"). Justice Breyer recognized that facilitation of tacit collusion was the main anticompetitive risk at the producer level. *See Leegin*, 127 S. Ct. at 2727.

[59] *Id.* at 2734.

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

[61] *See, e.g.*, 8 AREEDA & HOVENKAMP, *supra*, ¶ 1606c, at 85-86 (noting "instances in which intense price competition at the dealer level has led to price cuts at the manufacturing level"); Robert L. Steiner, *How Manufacturers Deal With the Price-Cutting Retailer: When Are Vertical Restraints Efficient?*, 65 ANTITRUST L. J. 407, 441-42 (1997) (explaining that resale price maintenance may be used to tame the exercise of countervailing retail power).

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

nance has a tendency to reduce innovation and efficiency in retailing. As Justice Breyer noted, resale price maintenance agreements "can inhibit expansion by more efficient dealers whose lower prices might otherwise attract more customers, stifling the development of new, more efficient modes of retailing . . . ."[63] The majority recognized this effect when it noted, "Retailers with better distribution systems and lower cost-structures would be prevented from charging lower prices by the [RPM] agreement."[64] But while the majority was referring to resale price maintenance that is used to organize a retailer cartel,[65] the effect is inherent in resale price maintenance regardless of the purpose for which it is employed. The importance of this exclusionary theory of anticompetitive harm is highlighted by a recent study on the effect of eliminating RPM on books in the United Kingdom in the mid 1990s. In a report last year prepared for the Office of Fair Trading, researchers concluded that the abolition of RPM contributed to the entry and rapid growth of innovative forms of book retailing, namely Internet sellers and supermarkets.[66]

The Procompetitive Justifications for Resale Price Maintenance

Declaring that the "economics literature is replete with procompetitive justifications for a manufacturer's use of resale price maintenance,"[67] the Court identified three procompetitive jus-

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

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

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

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

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

tifications,[68] each of which is problematic.

Free rider theory. The principal theory discussed by the Court and relied upon by resale price maintenance advocates is the "free rider" theory, under which resale price maintenance can benefit consumers because the higher prices may induce retailers to provide pre-sale services that promote interbrand competition and otherwise would not be provided. Prominently featured in *Sylvania*, this theory (dating back at least to Telser in 1960) was well known to Congress in 1975 but nonetheless was rejected as a basis for permitting resale price maintenance.[69] As Justice Breyer noted, free riding is common in our economy; the real issue is "how often the 'free riding' problem is serious enough significantly to deter dealer investment."[70] Professors Comanor and Scherer in their *amicus* brief to the Court indicated "there is skepticism in the economic literature about how often" resale price maintenance "is needed to prevent free-riding and ensure that desired services are provided.[71] Klein and Murphy have noted that the standard free-rider theory for resale price maintenance is "fundamentally flawed" because it is based on "the unreal-

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

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

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

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

istic assumption that the sole avenue of nonprice competition available to retailers is the supply of the particular services desired by the manufacturer."[72] They have shown that, "[e]ven if the manufacturer fixes the retail price and does not permit price competition, retailers still have an incentive to free ride by supplying nonprice services that are not desired by the manufacturer but are of value to consumers,"[73] such as free gifts, free delivery, discounts on bundled products, rewards programs, and so forth. "No matter how large a margin is created by resale price maintenance, there appears to be no incentive for competitive free-riding retailers to supply the desired . . . services."[74]

The "quality certification" version of the free-rider theory cited by the Court[75] is even more problematic because the discounters are not even expected to offer the services of the prestige retailers, and thus have higher margins with which to continue to "free ride" by offering non-price inducements to attract customers from prestige retailers.[76] Furthermore, even if resale price maintenance is used to prevent free riding and increase output, there is no *a priori* reason to believe that consumers as a whole benefit, because most consumers may prefer the lower-priced

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

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

[74] *Id.*

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

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

product without the services.[77] As Justice Breyer noted, insofar as resale price maintenance agreements encourage dealers to compete on service instead of price, they threaten "wastefully to attract *too many* resources into that portion of the industry."[78]

Services without free-riding. The Court also maintained that resale price maintenance "can also increase interbrand competition by encouraging retailer services that would not be provided even absent free riding" because it "may be difficult and inefficient for a manufacturer to make and enforce a contract with a retailer specifying the different services the retailer must perform."[79] The Court was apparently referring to Klein and Murphy's "contractual fidelity" theory, which is not so much about the difficulty of contractual specification, but rather about giving dealers excess profits to provide an incentive "for faithful performance of all the dealers' express or implied obligations."[80] Under this theory, the threat of termination or other contractual sanction may be an inadequate incentive against shirking by retailers if they are making only normal profits.[81] Putting aside the issue of why competition among retailers in the absence of free-riding would not be sufficient to ensure adequate dealer services,[82] this theory suffers from

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

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

[79] *Id.* at 2716.

[80] 8 AREEDA & HOVENKAMP, *supra*, ¶ 1614e, at 172; *see also* Mathewson & Winter, *supra*, at 74 ("The role of resale price maintenance in the Klein-Murphy explanation is to protect retailer quasi-rents against erosion by retail price competition, to ensure that contract termination has sufficient value as a threat.").

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

[82] Justice Breyer did not credit this theory because, he said, "I do not understand how, in the absence of free-riding (and assuming competitiveness), an established producer would need resale price maintenance. Why, on these assumptions, would a dealer not 'expand' its 'market share' as best that dealer sees fit, obtaining appropriate payment from consumers in the process? There may be an answer to this question. But I have not seen it. And I do not think that we should place significant weight upon justifications that the parties do not explain with sufficient clarity for a generalist judge to understand." *Leegin*, 127 S. Ct. at 2733. In fact, the contractual-fidelity theory does rely on a form of free riding or externality, either

several flaws. First, as with the standard free-rider theory, this theory is undermined by nonprice competition, which should have a tendency to eliminate the excess dealer profits on which the theory is predicated.[83] Second, as with any resale price maintenance scheme designed to raise dealer margins, the result is likely to harm consumers of multibrand retailers insofar as those retailers steer consumers to high-margin, price-maintained products regardless of their competitive merits.[84] Third, if the goal is merely to increase the rents earned by dealers, then there are less restrictive alternatives, such as lump-sum payments.[85] Finally, it is not obvious that this theory has any empirical significance; how many manufacturers in the real world look to provide supranormal profits to their distributors so that the threat of termination in the case of noncompliance is meaningful?

New entrant theory. The third procompetitive justification discussed by the Court is the "new entrant" justification.[86] Quoting *Sylvania*, the Court suggested that resale price mainte-

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between dealers as under the traditional theory, or between the manufacturer and the retailer. *See* Klein & Murphy, *supra*, at 281 (noting that dealer may free ride on manufacturer's reputation). The theory responds to the criticism of the traditional free-rider theory that RPM is unnecessary if (and ineffective unless) manufacturers can contractually require retailers to provide services. Klein and Murphy suggest that contractual specification may not be enough to motivate dealers or may not be practical. For a further discussion of the specification point, see *infra*.

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

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

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

[86] The majority mentioned a fourth theory by way of citing Raymond Deneckere et al., *Demand Uncertainty, Inventories, and Resale Price Maintenance*, 111 Q. J. ECON. 885 (1996), which the Court described as "noting that resale price maintenance may be beneficial to motivate retailers to stock adequate inventories of a manufacturer's goods in the face of uncertain consumer demand[]." *Leegin*, 127 S. Ct. at 2716. Under this theory, RPM assures dealers that if demand turns out to be low they will not be forced to liquidate their inventory at fire-sale prices, which induces the dealers to stock sufficient inventory to

nance can facilitate new entry by "'induc[ing] competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer.'"[87] This theory has been questioned by scholars because other tools (such as restricted distribution) are usually more effective in ensuring that "Johnny-come-lately" stores will not siphon off the rewards that pioneering dealers need for their "missionary work."[88] And whatever benefits there may hypothetically be from RPM inducing new entry, it is quite likely substantially outweighed by the ability of RPM-controlled retailers to block new retailer entry, where price discounting is a traditional and frequently used strategy. In any event, this rationale, if convincing, could easily be accommodated by a limited exception to the *per se* rule, as Justice Breyer suggested,[89] although such an exception was expressly rejected by Congress in 1975.[90]

Brand image. Notably, the Court did not include preservation of "brand image" as a pro-

cover a high demand. This theory does not necessarily benefit consumers, as the authors note, because it deprives consumers of the surplus that would be obtained in the low demand state absent RPM, which may exceed the surplus with RPM. *See* Deneckere et al., *supra*, at 887 ("[I]n contrast to other efficiency-based theories of RPM . . . in which manufacturer and consumer interests roughly coincide, we show that manufacturer benefits can often come principally from consumer surplus."). Moreover, it assumes that the alternative of paying dealers for unsold inventory in the event of low demand is more costly than enforcing RPM, which is questionable. *See* Paldor, *supra*, at 211-21 (critiquing demand uncertainty hypothesis).

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

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

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

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

competitive justification, notwithstanding that it is often cited by manufacturers, including Leegin itself.[91] As Professors Areeda and Hovenkamp explain, "Manufacturers often say that price discounting 'cheapens' their product image and thereby destroys the goodwill that the manufacturer has developed for its product through skillful advertising and marketing. . . . [But u]nless connected with dealer services . . . the claim does not appear to be a powerful one."[92] This theory rests on the generally implausible assumption that the demand for the good is upward sloping, although particular retailers are able to increase output by lowering price.[93] Insofar as this assumption is based on the proposition that consumers erroneously believe that a higher price itself reflects higher quality (or that a lower price itself reflects lower quality), then it amounts to a frontal assault on the basic policy of the Sherman Act and the Federal Trade Commission Act, which is that consumers are sovereign and must be assumed, when reasonably informed, to make rational decisions in a competitive marketplace. Indeed, Congress rejected this theory as a justification for fair trade because "the marketplace should be allowed to judge the value of a 'brand image' without the restraints imposed by resale price maintenance."[94] Even if "snob appeal," or conspicuous consumption, might support an upward-sloping demand curve in some circumstances, such a rationale is not a legitimate justification for RPM because it is difficult to disentangle from the effects arising from deception, and conspicuous consumption offers no intrinsic benefit for consumers. Moreover, a high-price image can be controlled by

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[91] See *Leegin*, 127 S. Ct. at 2711 (Leegin "expressed concern that discounting harmed Brighton's brand image and reputation."). It was also cited by Nine West. *See* Letter from the American Antitrust Institute to Deborah Platt Majoras, Re: Petition of Nine West Footwear Corp. to Reopen and Modify Order, FTC File No. 981-0386 (Dec. 5, 2007), *available at* http://www.antitrustinstitute.org/Archives/9W.ashx ("AAI *Nine West* Letter"); *see also* Henry & Zelek, *supra*, at 8 ("Significant discounting of a product can adversely affect the manufacturer, its resellers and the product itself by eroding brand image . . . .").

[92] 8 AREEDA & HOVENKAMP, *supra*, ¶ 1631a1, at 306; *see id.* ¶ 1633d2(A), at 335 (would reject protection of manufacturer goodwill as a justification for RPM, at least presumptively).

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

[94] H.R. Rep. No. 94-341, at 5 (1975).

setting the wholesale price or by restricting distribution to high-end retailers, without the anti-competitive side effects of RPM.[95]

Empirical Evidence

What of the empirical evidence? The Court concluded, "although the empirical evidence on the topic is limited, it does not suggest efficient uses of the agreements are infrequent or hypothetical" and thus "the [*per se*] rule would proscribe a significant amount of procompetitive conduct . . . ."[96] The dissent disagreed. Justice Breyer could "find no economic consensus" on how often resale price maintenance will be beneficial in practice.[97] The majority cited two "recent" empirical studies of litigated cases.[98] One by Pauline Ippolito, published in 1991, reviewed all cases (public and private) reported between 1976 and 1982 that included resale price maintenance claims.[99] The other by Thomas Overstreet, issued by the FTC in 1983, reviewed the 68 resale price maintenance cases brought by the FTC that were resolved between 1965 and 1982.[100]

Ippolito concluded that the cases were generally not consistent with dealer or manufac-

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

[96] *Leegin*, 127 S. Ct. at 2717-18.

[97] *Id.* at 2729.

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

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

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

turer cartel theories,[101] but Justice Breyer noted that "this study equates failure of plaintiffs to *allege* collusion with the *absence* of collusion – an equation that overlooks the superfluous nature of allegations of horizontal collusion in a resale price maintenance case that would be tried under the *per se* rule, and the tacit form that such collusion might take."[102] Ippolito also concluded that the "special services," or free rider theory, "has the *potential* to be a major explanation for RPM-type practices"[103] based on the fact that 50 percent of the private cases and 42 percent of the government cases involved what she categorized as "complex products," i.e. "products for which quality and use information were nontrivial issues prior to purchase and where the information was not specific to the retailers' goods."[104] This can hardly be described as "evidence" that free riding was involved in any of these cases; at most it suggests that free riding could not be ruled out.

In his study, Overstreet concluded that "RPM was not likely motivated by collusive dealers who had successfully coerced their suppliers into using RPM to facilitate a widespread dealers' cartel" based on the fact that in 47 cases where data were available, over 80 percent involved products with more than 200 dealers.[105] But large numbers do not necessarily indicate low con-

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

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

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

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

[105] OVERSTREET, *supra*, at 80 ("Widespread dealer collusion involving more than 100 (or 200) decision makers seems unlikely to be effective or persistent in the absence of restrictions on entry such as licensing requirements or some mechanism for overt coordination such as an active trade association."). Overstreet

centration or the absence of a dominant dealer or a small number of dominant dealers, and the study does not consider whether resale price maintenance may have been limited to local markets in which dealer concentration was high.[106] Moreover, some of the best-documented instances of resale price maintenance in history, such as those involving retail druggists, involved dealer cartels in highly unconcentrated markets.[107] Overstreet did not look for indications of procompetitive explanations of resale price maintenance,[108] and recognized that the information he used for his study was generally "inadequate to determine rigorously whether the associated economic conditions correspond best with procompetitive or anticompetitive hypotheses about the use of RPM."[109] Neither Ippolito nor Overstreet considered whether dealer pressure without collusion might have accounted for any of the instances of resale price maintenance. In sum, neither of these antiquated "new" studies does much to fill "the dearth of empirical evidence" on the effects of resale price maintenance noted by Ippolito.[110] However, many commentators agree with

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also concluded that manufacturer collusion was an unlikely explanation for most of the cases, since "a good deal of the RPM reflected in FTC cases has occurred among small firms selling in markets that are structurally competitive." *Id.* at 78; *see id.* at 73 (finding only 24.4% of cases had four-firm concentration in excess of 50%, measured using 5 digit S.I.C. product classes).

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

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

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

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

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

Overstreet's later observation that "the historical experience, or practice of RPM [is] largely a sorry record of abuses, in sharp contrast to the contention of RPM's missionaries."[111]

Less Restrictive Alternatives

Perhaps the most glaring flaw in the majority's analysis is its failure to consider whether any procompetitive effects of resale price maintenance can be achieved by less restrictive means that do not prevent efficient retailers from passing on their lower costs to consumers. If so, then the costs of the *per se* rule would be minimal. *Amici* economists recognized that manufacturers may curtail free riding by other means, and that where such means are available, "RPM may not offer an incremental benefit to interbrand competition that would offset the diminution of intrabrand competition."[112] The most obvious way to ensure desired retailer services is to pay retailers for performing those services, using promotional allowances or other marketing techniques.[113] There is no empirical evidence whatsoever that such techniques are more costly or less effective than resale price maintenance in obtaining dealer services,[114] which is perhaps why the Court ignored the point.[115] To be sure, promotional allowances for services may ultimately

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

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

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

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

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

also raise consumer prices to account for the cost of the services, but unlike resale price maintenance, such payments do not prevent discounting that reflects more efficient retailers' lower costs of doing business. As New York's Solicitor General pointed out at oral argument, "It's a question really of what kind of currency a manufacturer can use to buy those retailer services."[116]

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

> The implications of respondent's position are far reaching. Many decisions a manufacturer makes and carries out through concerted action can lead to higher prices. A manufacturer might, for example, contract with different suppliers to obtain better inputs that improve product quality. Or it might hire an advertising agency to promote awareness of its goods. Yet no one would think these actions violate the Sherman Act because they lead to higher prices. The antitrust laws do not require manufacturers to produce generic goods that consumers do not know about or want. The manufacturer strives to improve its product quality or to promote its brand because it believes this conduct will lead to increased demand despite higher prices. The same can hold true for resale price maintenance.[117]

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

<u>Costs of the Rule of Reason</u>

The majority acknowledged that "the *per se* rule can give clear guidance for certain con-

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vices, unless the services themselves are profitable for a retailer, which means that resale price maintenance is not necessary in the first place.

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

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

duct"[118] and "may decrease administrative costs,"[119] but minimized the significance of the issue by asserting that "[a]ny possible reduction in administrative costs cannot alone justify the *Dr. Miles* rule."[120] But no one had argued they did. Justice Breyer contended that the administrative costs of a rule of reason would be significant, and militated strongly in favor of retaining the *per se* rule. And the cost of the rule of reason is not simply uncertainty and adjudication costs, but the "false negatives" that result from making it significantly more difficult to bring a successful resale price maintenance suit.

Although the Court said that the lower "courts would have to be diligent in eliminating . . . anticompetitive uses [of RPM] from the market,"[121] and instructed them to "establish the litigation structure to ensure the rule [of reason] operates to eliminate anticompetitive restraints from the market and to provide more guidance to businesses,"[122] Justice Breyer pointed out that will not be an easy exercise. The Court suggested three relevant considerations for the rule of reason – number of manufacturers using the restraint, source of the restraint, and market power – but the Court's obtuse three paragraphs of instruction offer little guidance and likely will exonerate many anticompetitive uses of resale price maintenance.

The Court said the "number of manufacturers that make use of the practice in a given in-

[118] *Id.* at 2713.

[119] *Id.* at 2718.

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

[121] *Id.* at 2719.

[122] *Id.* at 2720.

dustry can provide important instruction,"[123] for widespread coverage of resale price maintenance may facilitate a manufacturer's cartel,[124] or deprive consumers of meaningful choice.[125] But the Court did not acknowledge the difficulties of determining the extent of coverage when local variation and "informal" resale price maintenance are considered, as they should be.[126] Nor did the Court offer guidance on the extent of market coverage that may be considered problematic. In a concentrated market, coverage need not be extensive to trigger concern about manufacturer coordination.[127] The FTC entirely ignored the "market coverage" factor in its *Nine West* decision, even though Nine West had maintained that one reason it wished to use RPM was that many of its competitors were doing so.[128]

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

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[123] *Id.* at 2719.

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

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

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

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

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

tion,"[129] but Justice Breyer pointed out that "it is often difficult to identify *who* – producer or dealer – is the moving force behind any given resale price maintenance agreement."[130] More fundamentally, one does not need a retailer cartel or a "dominant, inefficient retailer," as the Court suggests,[131] to find retail buyer power or to conclude that RPM is a product of such power rather than an effort to promote distribution efficiencies. The FTC also gave short shrift to this factor in *Nine West* when it apparently accepted at face value Nine West's assertion that "it is responsible for its desire to engage in resale price maintenance."[132]

The Court indicated that market power is important,[133] and some commentators and lower courts have interpreted *Leegin* to adopt a manufacturer market-power screen.[134] However, the absence of traditionally-defined market power (i.e., significant market share) on the part of the manufacturer does not mean that resale price maintenance is harmless.[135] Manufacturers

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

[130] *Id.* at 2730.

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

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

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

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

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

with relatively small market shares but powerful brands may have significant market power.[136] Indeed, it is commonly understood by economists that neither retailers nor manufacturers will engage in resale price maintenance without some interbrand market power.[137] In all events, as Justice Breyer noted, the "Court's invitation to consider the existence of 'market power' . . . invites lengthy time-consuming argument among competing experts, as they seek to apply abstract, highly technical, criteria to often ill-defined markets."[138] Or worse, courts will simply dismiss the complaint out of hand under the restrictive *Twombly* pleading rules because of insufficient allegations of market definition, as I noted at the outset several have already done.

Finally, the Court declined to offer guidance on how courts are to consider the procompetitive side of the rule of reason equation. While the Court identified certain procompetitive theories, it did not suggest how a manufacturer may prove them, perhaps because as Justice Breyer observed, "it is difficult to determine just when, and where, the 'free riding' problem is serious enough to warrant legal protection."[139] Nor did the Court indicate whether less restrictive alternatives should be considered, or how any procompetitive justification should be balanced against anticompetitive effects.

The upshot of the Court's decision, besides leaving businesses and the lower courts largely at sea, is that the private bar and public enforcers will be reluctant to bring cases. As Pro-

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

[137] *See* Ward S. Bowman, Jr., *The Prerequisites and Effects of Resale Price Maintenance*, 22 U. CHI. L. REV. 825, 849 (1955) ("Price maintenance appears to be incompatible with an assumption of pure competition among both sellers and resellers."); 8 AREEDA & HOVENKAMP, *supra*, ¶ 1632c2, at 324-25 ("most products subject to RPM are sufficiently differentiated to enjoy greater pricing discretion than is possible for perfectly competitive products"). Accordingly, the presence of resale price maintenance may itself be some evidence of market power.

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

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

fessor Pitofsky has noted, "rule of reason cases often take years to litigate[,] are extremely expensive" and are "very difficult for a plaintiff (either the government or a private party) to win . . . ."[140] Most commentators agree that the rule of reason, as applied by the lower courts to nonprice vertical restraints, has resulted in a rule of virtual *per se* legality.[141] The early dismissal of RPM claims on the pleadings suggests that the same rule may result for RPM.[142] Even if the lower courts are more diligent about RPM, the cost and uncertainty of undertaking a rule of reason case will no doubt mean that businesses will be more apt to engage in anticompetitive RPM, and many instances of anticompetitive resale price maintenance will go unremedied. Moreover, manufacturers that face pressure from retailers to adopt resale price maintenance will no longer be able to just say "no, it's illegal."[143]

The Dichotomy Between Price and Nonprice Restraints

One of the rationales for the Court's decision was that there is "little economic justification for the current differential treatment of vertical price and nonprice restraints,"[144] notwithstanding that the Court in *Sylvania* had said "[t]here are . . . significant differences that could

[140] Pitofsky, *supra,* at 1489.

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

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

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

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

easily justify different treatment."[145] In fact, different treatment is justified because, as Areeda and Hovenkamp explain, "Nonprice restraints fulfill a wider range of potentially legitimate objectives and threaten fewer harms to competitive interests" than resale price maintenance.[146] The Court in *Sylvania* had noted that unlike nonprice vertical restraints, vertical price agreements "almost invariably" reduce interbrand competition.[147] Indeed, resale price maintenance agreements *are* more likely than nonprice restraints to restrict interbrand competition at both the retailer and manufacturer levels. At the retailer level, only resale price maintenance restricts retailers from competing on price *against other brands*.[148] And resale price maintenance, unlike nonprice restraints, prevents more efficient retailers from passing on the benefits of that efficiency to consumers.[149] Furthermore, by restricting an important competitive tool, resale price maintenance stultifies "interbrand" competition among multibrand retailers, which are generally not susceptible to territorial or customer restraints.[150] As a general matter, "[t]he form of restraint

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

[146] 8 AREEDA & HOVENKAMP, *supra*, ¶ 1630b, at 302; *id.* at 303 ("It is . . . entirely reasonable to regard resale price maintenance as a more pervasive threat to competition than nonprice restraints."). The fact that the Court saw fit to articulate guidelines for the rule of reason that are arguably more stringent than the rule of reason applicable to nonprice restraints underscores that different treatment is warranted.

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

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

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

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

most likely to reflect dealer power is resale price maintenance."[151] The Court in *Sylvania* also distinguished price and nonprice vertical restraints on the ground that price restraints, unlike nonprice restrains, can facilitate a manufacturers' cartel.[152]

Besides doing less harm, nonprice vertical restraints are more likely to have procompetitive benefits than vertical price restraints might have. Nonprice vertical restraints have a wider range of legitimate justifications, including ensuring efficient dealer scale, focusing dealer effort on developing classes of customers or territories, and promoting product quality and safety.[153] Moreover, to the extent that territorial or customer restraints entirely eliminate intrabrand competition, such restraints are more likely than resale price maintenance agreements to solve free-rider problems.[154] In short, it makes sense to apply a more stringent standard to RPM than to nonprice vertical restraints.

The vast majority of advanced industrial countries generally ban minimum RPM and treat it more harshly than nonprice vertical restraints.[155] For example, the European Union, which

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

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

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

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

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

liberalized its treatment of most nonprice restraints, continues to treat minimum RPM as a "hard-core" restraint, equivalent to being almost *per se* illegal.[156] Individual member states, many of which led the Untied States in abolishing fair trade, follow suit.[157] The fact that most of the rest of the advanced industrialized world apparently recognizes the wisdom of some form of *per se* approach underscores the lack of consensus on the *Leegin* rule.[158]

Tension With the *Colgate* Doctrine

The Court thought that the *Colgate* doctrine, which permits manufacturers "unilaterally" to impose RPM by terminating retailers that do not follow its suggested prices, militated in favor of repealing *Dr. Miles*. After all, if the "economic effects of unilateral and concerted price setting are in general the same,"[159] what is the justification for making one *per se* legal and one *per se* illegal? It only pushes manufacturers that wish to set retail prices to adopt wasteful or seemingly irrational measures to get into the former category, according to the Court.[160] Moreover,

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

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

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

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

[160] The Court, citing an *amicus* brief submitted by PING, Inc., a golf-club manufacturer, stated, "Even with the stringent standards in *Monsanto* and *Business Electronics*, this danger [of liability] can lead, and has led, rational manufacturers to take wasteful measures. A manufacturer might refuse to discuss its pricing policy with its distributors except through counsel knowledgeable of the subtle intricacies of the law. Or it might terminate longstanding distributors for minor violations without seeking an explanation.

the *Colgate* doctrine has been widely criticized as distorting the concept of "agreement" under Section 1, which not only sows confusion in the law, but results in immunizing all manner of vertical restraints without any analysis of actual competitive effects. Insofar as the expansion of the *Colgate* doctrine has been driven by the harshness of the *Dr. Miles* rule, as some commentators have suggested, then repealing *Dr. Miles* will permit courts to focus on economic substance rather than *Colgate*'s artificial and formalistic distinctions, or so the argument goes.[161]

This line of argument is unpersuasive. As an initial matter, the Court did nothing to modify the *Colgate* doctrine and as long as it remains good law it will continue to be invoked by defendants seeking immunity (rather than rule of reason treatment) from RPM (and other vertical restraints) claims and continue to bedevil conspiracy jurisprudence.[162] Indeed, as I noted at the outset, it appears that *Colgate* policies have proliferated since the *Leegin* decision. More significantly, however, the premise of this line of argument is that the justification for the *Colgate* doctrine is to "secure the procompetitive benefits associated with vertical price restraints through other methods."[163] This is revisionist history. While the bolstering of the *Colgate* doctrine in *Monsanto* may have been intended by the Court to achieve this result, the *Colgate* decision itself was based on "the long recognized right of trader or manufacturer engaged in an entirely private

The increased costs these burdensome measures generate flow to consumers in the form of higher prices." *Id.* at 2722-23 (citations omitted).

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

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

[163] *Leegin*, 127 S. Ct. at 2722; *see also id.* ("If we were to decide the procompetitive effects of resale price maintenance were insufficient to overrule *Dr. Miles*, then cases such as *Colgate* and *GTE Sylvania* themselves would be called into question."); *id.* at 2721 ("Only eight years after *Dr. Miles*, . . . the Court *reined in* the decision by holding that a manufacturer can announce suggested resale prices and refuse to deal with distributors who do not follow them.") (emphasis added).

business, freely to exercise his own independent discretion as to parties with whom he will deal."[164] In other words, *Colgate* was viewed as an exception to *Dr. Miles* that was "tolerated" by the need to protect a certain degree of manufacturer freedom.[165] The tension between *Colgate* and *Dr. Miles* existed for nearly as long as *Dr. Miles* itself and cannot count as an *independent* justification for overturning *Dr. Miles* any more than for overturning *Colgate*. On the contrary, the case for the latter is stronger, even for those on the fence about *Dr. Miles*.[166] Whether the standard for judging RPM agreements is the rule of reason or some form of *per se* rule, Congress should abolish the *Colgate* exception for "unilateral" RPM programs enforced by threats of termination.[167]

Conclusion

In 1937, Congress embarked on an experiment legalizing fair trade at the option of the states. It did not work and Congress repealed the experiment in 1975 in favor of a universal *per se* rule. Since then, discounting has become a way of life for Americans, eagerly pursued by some retailers, adamantly cursed by others, but diligently demanded by much of the consuming

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

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

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

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

Mr. JOHNSON. You are quite welcome, Mr. Brunell.

At this time, we will begin the questioning, and I will grant myself as much time as I may consume.

I want to ask you all about some written testimony by Mr. Hungar. And Mr. Hungar says that "Sales efforts focused on factors other than price may be more effective at serving the interest of consumers." And if I could get you all to respond to that statement with your concise response, we would appreciate it, starting with Commissioner Harbour, and then to Mr. Cohen, and also Mr. Brunell. And if necessary, we will give Mr. Hungar an opportunity to clarify anything that may need to be clarified.

Proceed.

Ms. HARBOUR. I believe that, in Mr. Hungar's written testimony, the sentence before that talked about how consumers who don't value the services, but would prefer lower prices, would be inclined to shop at discount stores. But there are consumers who would value those services, and then would be willing to pay a higher price.

The consumer should vote with his or her pocketbook. They should not be dictated to about which prices they should buy consumer goods at.

Also, Mr. Hungar talked about how parties—how those who are against RPM basically talked about how the rule of reason was very difficult to satisfy and thought that that was in favor of the argument that it was very difficult and it inured against them. I guess what I would like to say there is there should be a presumption of illegality, and it should be on the part of the manufacturers to overcome that presumption. Let's shift the burden away from the American consumer, away from the victim of the higher prices, and let the manufacturers who are proposing the higher prices have the burden of proof.

Mr. JOHNSON. Thank you, Commissioner.

Before we go to Mr. Cohen, I want to recognize the fact that we have been joined by the distinguished gentleman from Virginia, Mr. Goodlatte. Welcome, sir.

Mr. GOODLATTE. Thank you, Mr. Chairman.

Mr. COHEN. Mr. Chairman, I think that factors other than price, one of the concerns we have is that price uniformity is what exists across for small- and medium-sized companies who want to use and sell goods, they are forced into a price uniformity. Consumers don't get a choice any longer as to where they want to choose, if price is taken out of the equation, and that large retailers have a lower price but may not be able to deliver the services also.

So that at least if we have price transparency and price elasticity and the allowance for people to choose where they want to buy, then that is the key measurement that should occur here. That is what is being limited by retailers and retail price maintenance post-*Leegin*.

Mr. BRUNELL. I would just concur that, when retailers are free to decide what price they will sell at, you end up with a market that has both high service and high-price retailers, and low service and low-price retailers, and that ultimately is for the benefit of consumers.

Mr. JOHNSON. Thank you.

Mr. Hungar, do you wish to be in line for a response or anything?

Mr. HUNGAR. Thank you, Mr. Chairman. Just a couple brief points.

First of all, the concerns that are expressed seem to assume that RPM will be somehow enacted across the entire relevant market, and therefore somehow people's choices will be limited. But of course, the reality is there is no reason to believe that. We saw, even at the height of the fair trade era when the law was much more favorable to RPM than it is under a rule of reason test, at most, 5 to 10 percent of the economy was affected by RPM.

So the idea that consumer choice will be limited because everyone will adopt RPM has yet to be seen. And experience suggests the opposite. And if consumers don't value what the RPM system is producing in terms of extra services, they will go elsewhere, and the RPM manufacturer will fail or change its policy. That is consumer choice.

And then, the other point is, the fact of the matter is, as the economic analysis indicates in some of the testimony before the FTC, retailers and manufacturers have different incentives, and RPM can encourage the retailers to focus on providing the benefits and the services and the promotional activities that will advance the interests of the manufacturer in inter-brand competition.

Thank you.

Mr. JOHNSON. Thank you, Mr. Hungar.

And my dear great-great-great grandmother has always been known as a impulse buyer, and so yesterday she was looking at—shopping on the Internet, as the elderly usually do, and in her spare time while she is home from work. And she came across a deal on a laptop computer, and then that impulse kicked in. Instead of just ordering it online, she put on her tennis shoes and decided, "I am going to go right now to the retail outlet, and I am going to purchase my item there, because I want it now."

And so I have two questions. Tell me who is the free rider, if any, in that instance? And also, isn't it the retail store that is getting the free ride off the Internet? And to use your words, sir, isn't it the service provider free riding off of the discounter, as well?

Mr. HUNGAR. I haven't seen any analysis of the question whether you would call that a free-riding situation. But certainly, that context is one in which the free-rider issue can arise because, although as Mr. Cohen pointed out, there are many circumstances in which there is every reason to think that Internet sales are most advantageous at the lowest price possible, there are certainly circumstances with complex goods, such as a computer, where many consumers value the opportunity to go actually see the product, have it explained to them by a live person rather than by computer-ese, and have an opportunity to touch and feel and decide whether it is the right thing for them.

And of course, the problem is it costs money to do that, and not everyone is an impulse buyer, as you suggested. And so for those people who aren't impulse buyers—and frankly, I have done this myself, go and decide which product you want at the showroom and then purchase it online where it is cheaper. But of course, if enough people do that in enough length of time, then of course it becomes prohibitively expensive to have showrooms, and we are all worse off.

Mr. JOHNSON. Anyone else have a response to Mr. Hungar?

Ms. HARBOUR. Yes, I would like to respond.

Chairman Johnson, I think you hit it exactly on the head. I do think that, when your grandmother went to the Internet——

Mr. JOHNSON. No, no, no, my great-great-great grandmother.

Ms. HARBOUR. Right. Excuse me, so your great-great-great grandmother, when she went to the Internet——

Mr. JOHNSON. Yesterday.

Ms. HARBOUR [continuing]. And she did the research. She probably learned quite a bit about that computer. And then she went to her electronics store and looked at it, and maybe purchased it.

I believe that the electronics store was free riding on the Internet, and that is precisely what Mr. Cohen from eBay was talking about. These forms of innovative retailing, if RPM is allowed to remain in place, I believe that prices on the Internet will be elevated.

There are things called shop-bots that troll the Internet looking for prices, and manufacturers are using these shop-bots to police their pricing. And if they see that a price is below the resale price, they will contact the store and tell them to raise the price of the goods. I don't think that this is in the interests of the American consumer, so I do think it is a free ride, and I agree with you.

Mr. JOHNSON. Thank you.

Mr. Cohen?

Mr. COHEN. Yes. I want to follow up a little bit on what the Commissioner was saying with regard to how they are policing and going after lower price sellers.

One of the concerns we have had was a company called Net Enforcers, which represents brand owners and others and large retailers. They scan our platform and identify sellers who are offering at lower prices.

And last year, the Net Enforcer people attempted to shut down more than 1.2 million listings on eBay claiming that there were trademark or copyright infringements. In general, they were most around the area of copyright infringement on the images that were used by the seller, the text. That is true that those were copyright infringements.

But we have seen an acceleration by those who use these trademark and copyright violation claims when they are asking us to take down the seller pages. When the sellers we examined, the sellers they are going after, they are the sellers that are at the lower prices, not at the MAP prices. And the MAP price sellers who are using the same photos, same copyrights, same trademark, are not being asked to have their listings taken down.

So we are certain that the concern is is that it is a pricing issue. It is not a copyright or trademark issue. And that is where our interest has been in, to show that, post-*Leegin*, aggressive MAP pricing schemes are being attempted across the Internet.

Mr. JOHNSON. All right. Thank you.

And last, Mr. Brunell?

Mr. BRUNELL. I would just point out that this whole free rider argument has been around for a long time, and it was before the Congress in 1975 when Congress outlawed a fair trade.

And the usual response is, well, if services for brick-and-mortar retailers are necessary and important, then why can't the manufacturer just pay the retailers, provide promotional allowances or what have you for those services?

Mr. JOHNSON. Thank you, Mr. Brunell.

And now, I will ask Mr. Coble to commence his questions.

Mr. COBLE. Thank you, Mr. Chairman, and you can call me into a halt whenever you think the time is appropriate, in view of the vote.

Mr. Hungar, you noted a number of justifications for RPM, but you also stated that there could be good RPM and bad RPM. I want to ask you to give us an example of a bad RPM.

And I want to ask you also your opinion as to whether you favor a statute to address those circumstances, or do you believe that the courts are better suited to devise those rules on a case-by-case basis?

Mr. HUNGAR. Thank you.

An example of bad RPM would be resale price maintenance that is used to enforce and permit policing of a manufacturer cartel, where they can easily tell whether there has been any cheating because each of the manufacturers has a stated resale price maintenance policy for its retailers, and so the retailers are all forced to price at the same level, thereby concealing a cartel.

And of course, a horizontal cartel is, per se, illegal, and resale price maintenance in conjunction with that activity would certainly violate the rule of reason.

I don't think that there is any need for a statute, nor is there any basis for legislating at this point. Much of the bad RPM, such as the example I gave, comes in conjunction with activity that the courts are already very well equipped to deal with.

But we have not had sufficient experience with the wide range of RPM policies that can be imposed to make any sort of informed judgment about precisely where, as a legislative matter, to draw the line, which is exactly why we should benefit from the genius of the Sherman Act, which is the flexibility it provides the courts to carefully examine different situations in the particular context in which they arise and determine what the appropriate response is.

And on this line, I would just point out that Commissioner Harbour, in her written testimony, actually has, I think, a very forthright admission that is very probative on the point that this is not the time for Congress to legislate. She says, "The lack of empirical research regarding the effects of RPM is a further complication." And she says, "There are economic theories praising RPM and other theories condemning it, but none of these theories on either side are supported by any systematic body of empirical evidence."

Now, I would say there is evidence, such as the Ippolito article I pointed to on the side that RPM is not generally or primarily anti-competitive. But putting that aside, she says, "At best, we have strongly held beliefs about the effects of RPM, sometimes bordering almost on the religious, but we are missing facts, which are the building blocks of litigation."

Well, I would submit that facts should also be the building blocks of legislation. And it would be unwise and inappropriate and premature for this body to act until sufficient facts have been generated, and the judicial system is the best forum for doing that.

Mr. COBLE. Thank you.

Commissioner Harbour, let me put a quick question to you, in view of the time. If a prominent manufacturer of handbags engages in RPM, does not that give an incentive to other handbag manufacturers to enter that market and sell their goods for a little below that which the RPM manufacturer is selling his goods? Does this not, in fact, enhance competitive between brands for sales of handbags?

Ms. HARBOUR. Not if you are a woman who loves a particular brand of handbag, and I will call it Handbag X. If that is the only handbag you want to buy because it is designer, and you only want to carry that, if Handbag Y is selling for less money, you don't want that.

This is called intra-brand competition. Once you decide, as a consumer, what handbag you want, then it doesn't matter what other brands are selling. You are going to buy the one you want. So I disagree with that premise.

But I must respond to Mr. Hungar. He made a few comments that I just feel compelled to respond to.

Mr. COBLE. Well, let me weigh in on your answer.

I guess, because of my frugality, Mr. Chairman, I would opt for the cheaper good, but that is the difference in males and females, I guess.

Ms. HARBOUR. But that is your right as a consumer, and you should be able to do that. But let me just say for the record that this is the time to legislate. You can mischaraterize my testimony however you want to, but I want to make it perfectly clear: it is definitely time to legislate.

There is another thing that Mr. Hungar said that I want to push back on. He basically said that RPM is not going to be enacted across all of the relevant markets, and that it really only affects about 5 to 10 percent of the economy.

Well, back in 1975 when Congress looked at this issue, Congress determined that the dollar amount was in the millions of dollars. That was back in—actually, no, they said it was in the billions of dollars, back in 1975. The effect of RPM was in the billions of dollars.

Now, we are looking at 2009. That is more than 33 years later. So the effect of RPM, if one could do an empirical analysis, would probably be much greater in this day and age. So I wanted to definitely talk about that.

And Mr. Hungar was asked about his opinion of the good uses of RPM. Well, that is what the question is. We know what the anticompetitive effects of RPM are. They are higher prices. What is the pro-competitive benefit of RPM?

Mr. JOHNSON. And I want to stop you right there.

Mr. Coble, along with every other Congressperson, has been called to the floor for three votes. And those three should not take more than about 35 minutes or so for us to get back here. So if you would hang out, we would appreciate it, and we will see you as soon as we can.

We will now take a recess.

[Recess.]

Mr. JOHNSON. We are now back in this hearing, and I am going to turn it back over to the Ranking Member, Mr. Coble, if you have any follow ups or anything like that.

Mr. COBLE. I think I am okay.

Mr. JOHNSON. Okay. All right. Thank you.

So we will now yield the floor to Mr. Brad Sherman.

Mr. SHERMAN. Mr. Hungar, one thing I never thought I would do in Congress is to disagree with someone who used the phrase, "Genius of the Sherman Act." And in fact, we are much better off that that act passed than the regime that applied before.

But you have put forward the genius of the Sherman Act as the concept that we will have the courts decide, and, ultimately, the Supreme Court decide what economic policy is in the interest of consumers. And to have the idea that our economic policy would be determined by an entity that has no economists on staff, that obtains no information except what is presented to them inside their own building, and hears orally from no one except an attorney, that that would be the entity that would devise economic policy is absurd on its face.

In fact, it is one that only lawyers would even think of countenancing. I think it is obvious that Congress has delegated its responsibility and its authority by passing a rather vague statute, and that what we are engaged in here is the idea of perhaps drafting a more precise statute.

And to think that we should defer to an entity that takes pride in the fact that they never talk to real consumers—God forbid a Supreme Court justice should talk to somebody at Costco. That would be ex parte. They would vilify the concept that it could affect them.

We here in Congress are in Costco every day, at least one of us. We talk to real consumers. And oh, by the way, we are accountable to them. And to think that the right form of government is one where nine people who take pride in never talking to any consumer, who take pride in the fact that they are immune from any accountability to any consumer, that that is the body that should make economic policy, that concept is a blot on the Sherman family name.

And the idea here is that, somehow, consumers benefit because, up until the recent court decision, we didn't have legal resale price maintenance agreements. And so if someone wanted higher prices and more service, they might be denied that opportunity.

Now, I, unlike the Supreme Court, talk to a lot of consumers about public policy and have those conversations influence my decision. But I can't talk to all of them. Do you know of any poll or market survey where Americans said, "Damn it, we are being deprived of the opportunity to find some retailer that will charge us higher prices and provide better service?" Is there any evidence that this unavailable, mythical, more-service, higher-price retailer is desired by consumers? They just can't find it?

Mr. HUNGAR. Well, I think, first, on the genius of the Sherman Act, which I continue to adhere to, my point about the genius of the Sherman Act is that Congress did not attempt, in writing the Sherman Act, to proscribe a detailed code of conduct that addresses every particular type of practice.

Mr. SHERMAN. Well, excuse me. Businesses have to deal with a real world where they have to know what the rules are. The vaguer those rules, the higher the attorney's fees and the more vagueness they have to operate with.

And if Congress doesn't provide detailed rules, then either there are no rules and you have to guess at them, or nine people, deprived intentionally of any contact with normal humans in terms of gathering information about public policy, are going to make those rules. And in fact, the antitrust law fills tens of volumes, and the portion of it written by Congress is barely a pamphlet.

So to say that businesses are going to operate without rules is absurd. And to say that those rules should be written by those who we defer to because we are unwilling to do our job, I just hope that concept is not associated with my surname.

Mr. HUNGAR. Well, with all due respect, Section 1 of the Sherman Act, I believe, is one sentence long, and that is what we are talking about here, the fact that——

Mr. SHERMAN. Exactly. And if Congress——

Mr. HUNGAR [continuing]. Of the law.

Mr. SHERMAN [continuing]. Would do its job, it would be several pages long and the rules that business operated under would be decided by democracy instead of an institution that prides itself on being removed from the reach of consumers.

Your theory of government is fundamentally anti-democratic.

Mr. HUNGAR. I am not suggesting that Congress doesn't have the power. Of course it has the power to prescribe detailed——

Mr. SHERMAN. But you praised those who went before us for not exercising that power, for deferring——

Mr. HUNGAR. Well, Congress did exercise the power in the Sherman Act, and the genius of the Sherman Act is that it bans unreasonable restraints on trade. But Congress recognized that you can't possibly identify and try to legislate regarding the infinite number of different possible situations in which different arrangements can be imposed. And therefore the courts, because they can do a case-by-case careful analysis that considers all the facts, that has economists come and testify in the courts, and they do that in all these cases——

Mr. SHERMAN. Well, we are not here—sir, reclaiming my time, we are here dealing with a Supreme Court decision, ultimately the rules. I mean, the rule for a business isn't, "Well, we will go to court, and we will figure it out what it is, because you can't run a business that way.

And the only rule that you can adhere to is one set forth by the highest court in the land. And to say that this anti-democratic institution should be deferred to by the elected representatives of the people is certainly not genius. It is what has happened.

But I would ask you to use my time to address my question, and that is, can you identify a circumstance in which the vast majority of consumers have said, "Well, at least in this circumstance, we are deprived of the opportunity to pay higher prices. We want to pay higher prices, and we want more service than is available at the highest priced retailer in our community."

Mr. HUNGAR. Well, I think that the variety of types of sales efforts made by different types of retailers and manufacturers show that some consumers clearly do value the—service.

Mr. SHERMAN. Oh, clearly. I mean, up until this case, there was a wide variety of different stores offering different levels of service and different prices. We didn't have resale price maintenance agreements. And if I wanted to go to Nordstrom's instead of Shirts 'R Us, I was free to do so.

Do you have proof that 2006 was a terrible year for consumers because they were being deprived of the benefit of greater service and greater information about a product, and greater prices? I mean, what was the matter with 2006? Nordstrom's was there.

Mr. HUNGAR. As Commissioner Harbour said in her testimony, we don't have empirical evidence either way, and therefore there is, in my view, no basis for the Congress to legislate.

Mr. SHERMAN. Ah, but we do, because we are not a court. We actually talk to real people. Got 535 of us. And it may not be a scientific poll, but it is probably better than most real pollsters.

I have never had a constituent complain that prices were too low. I have heard them complain about bad service at this or that store, but they were always aware, and before the decision, that there was a higher-priced store they could go to.

I have received at least 1,000 complaints about high prices, and not a single consumer has ever said, "I want to pay even more than is being charged at the highest-priced store in the San Fernando Valley because I want better service than is being provided at the most exclusive store in the San Fernando Valley," let alone anybody—they could always drive to Beverly Hills if they wanted to.

But even people who were confined to my own community, is there any evidence that 2006 was a year in which consumers could not find the high-price, high-service combination that you say they often want?

Mr. HUNGAR. Well, you need to remember that, even under the Dr. Miles regime, manufacturers could impose minimum retail prices through either vertical integration or through the Colgate policy, which allowed them to terminate any discounting retailer. So it is not really——

Mr. SHERMAN. But the law we had in 2006 is what I am talking about, because we could pass the 2006 Law Restoration Act and put resale price maintenance agreements back where they were in 2006. Is there any evidence that there is any group of consumers that would be disadvantaged by such a policy?

Mr. HUNGAR. Well, again——

Mr. SHERMAN. Given the fact that, in 2006, at least in the San Fernando Valley, there were plenty of high-priced stores with great service.

Mr. HUNGAR. There is no evidence that there would be any group of consumers who would be advantaged, either. Remember that, in 2006, the law was that a manufacturer could impose minimum prices through a Colgate policy and terminate any——

Mr. SHERMAN. In 2006, we went on eBay and we got great prices.

Mr. HUNGAR. And you do today, as well.

Mr. SHERMAN. Ah, but we have, what, Mr. Cohen, how many different things have you been asked to take down?

Mr. COHEN. From the Net Enforcers, just one company that was seeing to enforce MAP pricing on our site, there were 1.2 million listings that they claimed that they sought to have taken down last year in 2008.

Mr. SHERMAN. Hmm.

Now, I would point out that this whole idea of free riding was a concept invented and discussed before the Internet. Now, when I want information, I go to the Internet. When some new company wants to start and they want access to the market, they often start as an e-retailer. And in terms of investing in inventories, which is some justification for retail price—I mean, if you only need one inventory to service the whole country because you are an Internet retailer.

Mr. Cohen, your testimony talks about how the Internet is changing the concept of free riding. Do you have any data that back up the assertion that there has been a change? And is it now the case that, with the Internet, there are ways to get information and to deal with inventory maintenance and market access that substitute for the perceived benefits, or alleged benefits, of retail price agreements?

Mr. COHEN. Congressman Sherman, a *Wall Street Journal* article highlights the new generation of how consumers are benefiting in this, and that they are looking it up online first and then buying it offline.

And the article references that cars, homes, personal computers, medical care, are areas where nearly four out of five shoppers say they gather information on their own from the Web before buying—92 percent of the respondents said that they had more confidence in the information they seek out online than anything coming from the traditional sales clerk or the offline. So—that there is even more value to the information they find online, and that nearly 70 percent of Americans say they consult product reviews or consumer ratings before they make their buying decisions, and spend at least 30 minutes online every week to help them decide what and whether to buy.

I would ask the Chairman and the Ranking Member to submit to the record the article that has the background data that was used by the *Wall Street Journal* in this article.

Mr. SHERMAN. So moved. I assume there is no objection and it will be made part of the record.

Mr. JOHNSON. Without any objection, so ordered.

[The information referred to follows:]

THE WALL STREET JOURNAL.
WSJ.com
JANUARY 6, 2009

New Info Shoppers

By MARK PENN

With E. Kinney Zalesne

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

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

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

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

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

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

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

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

THE WALL STREET JOURNAL.
WSJ.com

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

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

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

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

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

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

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

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

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

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

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

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

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Mr. SHERMAN. Now, a lot of this Internet information is not free rider in the sense that I am going to one retailer, getting all this wonderful information that they paid thousands of dollars to put up on the Internet, and then going to another retailer. Usually, at least in my case, I am going to a manufacturer's website, or I am going to articles that are written.

When you describe this gathering of information, is much of it a circumstance where one retailer is providing the information and another retailer is getting the sale?

Mr. COHEN. It is literally every possible permutation you can think of. So for example, people use our sites to gather pricing information, right? They will search on eBay. They will search on shopping.com to find all the different prices that are available for the product that they want.

They will use Amazon to look at product reviews, and then purchase off of eBay. They will purchase on Amazon. So there is both—within different Internet retailers, within different marketplaces, we all have the example of doing it ourselves to go online to gather up information.

We know from our own empirical evidence that a staggering percentage of people that come and use our site never purchase on our site. So there is some information that they are gathering from that that they are finding useful in their purchasing decision. And we can also submit to the record some of that information, too.

Mr. SHERMAN. Mr. Brunell, is there any way to identify particular niches of products where perhaps we should the current court's decision to persist, or must we paint with a broad brush here and have one rule for golf tees and computers?

Mr. BRUNELL. I don't really think there is a basis to have a separate rule for different industries, but there may be instances, for example the one that Justice Breyer cites in the dissent in *Leegin*, of resale price maintenance as being used by a new entrant in a business as being an example where he suggests that perhaps you should have an exception to the per se rule.

So there might be particular instances where Congress could define specific types of instances where a different rule might apply, but there is no basis for treating industries differently.

Mr. SHERMAN. So whether it is CAT scan machines or nuclear—there is no particular product which you are convinced, "Aha, there we need the manufacturer to control," although usually there is not a retailer for a nuclear plant.

Mr. BRUNELL. The answer is typically that there are other tools that manufacturers can use to ensure that services are provided, promotional allowances and so forth that are, indeed, quite common so that the purported benefit of resale price maintenance, even under the Chicago School theory, is not so much that the services are provided under their theory, but that it might be, in their view, perhaps more costly for a manufacturer to pay for promotional services, let's say, rather than have resale price maintenance. There is no evidence, of course, that that is the case, but that is the theory.

Mr. SHERMAN. Commissioner Harbour, I have got an unusual question for you. Were you appointed by President Bush?

Ms. HARBOUR. I am an Independent, and I was nominated by the majority leader, Senator Daschle at the time, Majority Leader Daschle. Then, my name went to the White House, and President

Bush passed on it. And then, my name went to Congress, and I was confirmed by the full Congress.

Mr. SHERMAN. That is a process that might have yielded a different result if President Bush had simply selected without Mr. Daschle's input. And I think in this case, the process was quite successful.

I will yield back.

Mr. JOHNSON. Thank you, Mr. Sherman.

And do we have any more questions coming from any of our many Members of the panel who are here today? Seeing nobody, and hearing from no one, Mr. Coble, do you have any objections to us concluding this hearing at this time?

Mr. COBLE. Much to the satisfaction of probably the witnesses, I have no objection at all, Mr. Chairman.

Mr. JOHNSON. Well, I agree. I think they have been tortured long enough, and not by any one particular person, but just by being here as long as you have. And we do sincerely appreciate your coming today.

This hearing is adjourned.

[Whereupon, at 5:09 p.m., the Subcommittee was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Office of Commissioner
Pamela Jones Harbour

June 4, 2009

The Honorable Henry C. Johnson, Jr.
United States Congressman
Chairman, Subcommittee on Courts and
Competition Policy of the House
Committee on the Judiciary
2138 Rayburn House Office Building
Washington, DC 20515-6216

Re: Supplemental Testimony for Hearing on "Bye Bye Bargain? Retail Price Fixing, the Leegin Decision, and Its Impact on Consumer Prices."

Dear Chairman Johnson:

Your letter of May 12, 2009, requested that I supplement my testimony of April 28, 2009, at the above hearing by responding to two questions propounded by Representative Sheila Jackson Lee, a Member of the Subcommittee. I understand that my answers will be included in the final hearing record.

Question #1 by Representative Lee: "In your testimony, you raised the question of whether we were doomed to endlessly repeat the same mistakes over and over again. Please expound on these "mistakes." Also, what do you feel will be the ramifications if Congress does not take action to reverse the *Leegin* decision?"[1]

The *Leegin* decision commits a fundamental mistake by sacrificing the interests of American consumers to the interests of manufacturers of branded consumer goods.

The same mistake was made back in 1937, when Congress exempted state fair trade laws from condemnation by the federal antitrust laws. In 1975, the Congress declared that experiment to have been a failure. At pages 4 and 5 of my April 28th written testimony, I detail the injuries that Americans consumers suffered under the fair trade laws. Each one of those enumerated injuries reflects a mistake that might now recur as a result of the Supreme Court's new experiment with minimum vertical price fixing. For example, the *Leegin* Court invites mistakes

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

including, at a minimum: higher consumer prices; fewer entry opportunities for new businesses and products; reduced sales levels; less efficiency in the distribution and sale of consumer goods; higher rates of business failure; less candid and reliable product evaluations from retail merchants; and diminished competition both between and within brands. No one has provided a cogent reason for us to believe that the Court's current experiment will be any more successful than the fair trade experiment of the 20th century.

If Congress fails to overrule the *Leegin* decision, losses of even greater magnitude are possible, even beyond the mistakes identified above and in my earlier testimony. Competition typically is a dynamic process. Minimum vertical price fixing, in contrast, glorifies the *status quo*, making it the weapon of choice for manufacturers and retailers battling against the tide of retail innovation. Minimum vertical price fixing hobbles competition by preventing the unsettling intrusion of new or better competitors who might challenge incumbent retailers. As a result, the next generation of efficient retailers will be denied the opportunity to emerge and prosper.

During the course of the 20th century, consumers benefitted from each new generation of more efficient retailers, such as department stores, catalog merchants, chain retailers, buyers' clubs, and big-box retailers. Consumers reaped the benefits of lower prices, enhanced services, and a greater choice among various price-value-service options. Today, we are on the cusp of a new explosion of retailing innovation and consumer cost savings, if creative uses of the Internet are allowed to develop and evolve. But just as the rocket of innovative Internet commerce has been readied for launch, the *Leegin* Court's actions threaten to douse the flames. Absent Congressional action, *Leegin* will make it far more difficult for the next generation of retail innovators to overcome the resulting inertia. Incumbent manufacturers and merchants will benefit – at the expense of American consumers, who should not have to pay for the loss of creative, dynamic retail competition on the Internet. Indeed, in the long run, this cost may even dwarf the other, more-immediate consumer losses flowing from the *Leegin* decision.

Question #2 by Representative Lee: "How does the growth of discount chains at the expense of high-end specialty stores support your belief that consumers are very unlikely to gain any countervailing benefit in result of RPM?"

This question appears to be based on an either/or proposition, with which I cannot agree. The question presumes that high-end specialty stores can prosper only as long as we prohibit discounting "knaves"[2] from competing at "unfairly" low prices. At best, this proposition is a red

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[2] Dr. Miles Med. Co. v. John D. Park & Sons Co., 220 U.S. 373, 412 (1911) (Holmes, J., dissenting) ("I cannot believe that in the long run the public will profit by this court permitting knaves to cut reasonable prices for some ulterior purpose of their own, and thus to impair, if not to destroy, the production and sale of articles which it is assumed to be desirable that the public

herring. High-end specialty stores and discount chains can, and do, co-exist successfully.

Both Wal-Mart and Nieman Marcus experienced remarkable expansion and growth in the immediate aftermath of Congressional repeal of the fair trade laws. In 1975, each company was a comparatively small regional retail chain (Wal-Mart in Arkansas, Nieman Marcus in Texas). By the year 2000, both firms had grown to become substantial, coast-to-coast retailers.

Nieman Marcus and Tiffany & Co. epitomize high-end specialty retailers. Wal-Mart and Target are among the most readily-identifiable discounters. Yet, all four of these firms experienced substantial growth and expansion during the period when minimum vertical price fixing was *per se* illegal. History demonstrates that the viability of high-end specialty stores does not require the absence of discounters. Rather, the success of high-end retailers depends on their ability to deliver an attractive bundle of goods and services, in a manner that signals value to consumers, in an unconstrained and competitive market.

Even before the *Leegin* decision, a manufacturer did not need to control retail prices in order to maintain its brand image or guarantee that customers would be provided with a high-end specialty shopping experience. The Supreme Court in *Colgate* clearly stated that a manufacturer has the right "freely to exercise his own independent discretion as to the parties with whom he will deal" and the terms and conditions under which such dealing will occur.[3] Accordingly, if a manufacturer wants its brands sold only in high-end specialty stores, at prices that reflect the costs of high-end retailing, the manufacturer has total freedom to structure its product distribution system to accomplish its goals. This choice, however, comes with collateral consequences: the inability to mass merchandise, which includes the inability to have one's products appear on the shelves of every retailer who deals in that line of products. The claimed "need" for minimum vertical price fixing only arises when a manufacturer seeks the best of both worlds: the brand caché and higher margins of specialty retailing *plus* the broad market access of mass merchandising. The *Leegin* Court gives manufacturers a get-out-of-jail-free monopoly card[4] to avoid the consequences of their own brand-image decisions.

I consider myself to be an average shopper. Sometimes I want a bargain, and nothing else will do. Sometimes I prefer to visit a high-end specialty store, where I will enjoy ingratiating services at a higher price point – and nothing else will do then, either. The point is, I have that

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should be able to get.").

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

[4] *See, e.g.,* 

choice – at least, for now. If we really agree with Adam Smith (as I do) that consumer interests are the organizing principal around which our mercantile system should be structured, then we must be willing to let each consumer vote with her pocketbook, and let the chips fall where they may. Consumer sovereignty means that consumers are entitled to seek out their own value proposition, deciding for themselves how much they are willing to pay for a given mix of goods and services. In the absence of a legitimate public health or safety issue, the range of choices available to consumers should be determined by freely competitive markets. Consumer choices should not be delivered in gerrymandered markets that primarily reflect the preferences of manufacturers and some of their merchants.

Individual freedom gives each of us the right to decide how best to satisfy our own daily needs. Our economy should respect those rights – and our antitrust laws should promote, rather than retard, them.

Respectfully submitted,

Pamela J. Harbour

Pamela Jones Harbour
Commissioner

May 27, 2009

The Honorable Hank Johnson
Chairman, Subcommittee on Court and Competition Policy
Committee on the Judiciary
B-352 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Johnson:

Per your request, this letter responds to questions submitted for the record by Representative Sheila Jackson-Lee for your recent hearing, "Bye-Bye Bargain: Retail Price Fixing, the Leegin Decision, and its Impact on Consumer Prices."

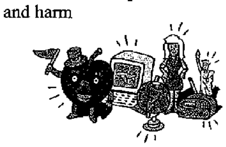
What do you feel that competition policy can, and should do, to afford consumer better protection?

Robust competition policy should offer consumers unlimited choice in the retail marketplace. In our view, more competition is always a better thing – it leads to increased selection and lower prices for consumers. When consumers have many options of how and where to make purchases, whether it be through the Internet, in an established discount store, or directly from the manufacturer, their interests are protected because they can vote with their feet or with a click of the mouse.

What role do you think RPM can play in the encouragement of competition and differentiation between or among different brands?

It is our view that Retail Pricing Fixing stifles retail competition, reduces consumer choice, and leads to higher prices. The retail ecosystem should continue to be varied and open to many different kinds of retail entities offering distinct retail experiences. Manufacturers use RPM to discipline and eliminate discount sellers. This ignores the fact that some resellers offer better prices because they are simply more efficient. Consumers should have the opportunity to choose whether they want the exclusive feel and increased service of a boutique shopping experience, or the value and convenience of more "mass-market" shopping options, whether online or offline. Consumers will choose what is best for them given their individual circumstances.

More importantly, there is a presumption that lower prices equate with "less service" or a degraded customer experience. This is wrong, and based on pre-Internet economic folklore. It ignores that fact that innovative business models and technology can provide consumers with both lower prices and better service simultaneously. Retail Price Fixing does nothing but stifle innovation, protect status quo business models, and harm consumers with higher prices and less choice.



Once again, thank you for the opportunity to testify on the impact of the *Leegin* decision on eBay's business model. If you have any questions regarding these answers, please feel free to contact Amanda Pedigo in my Washington D.C. office. She can be reached at (202) 551-0081.

Sincerely,

Tod Cohen

Defending Libe
Pursuing Just

AMERICAN BAR ASSOCIATION

740 Fifteenth Street, NW
Washington, DC 20005-1022
(202) 662-1000
FAX: (202) 662-1032

May 5, 2009

The Honorable Henry C. Johnson
Chairman, Subcommittee on Courts
and Competition Policy
Committee on the Judiciary
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Howard Coble
Ranking Member, Subcommittee on Courts
and Competition Policy
Committee on the Judiciary
U.S. House of Representatives
Washington, D.C. 20515

Re: Hearing on "Bye Bye Bargains? Retail Price Fixing, the *Leegin* Decision, and Its Impact on Consumer Prices," held on April 28, 2009

Dear Chairman Johnson and Ranking Member Coble:

On behalf of the American Bar Association ("ABA"), which has over 400,000 members, I write to express our views concerning the subject of the Subcommittee's April 28 hearing titled "Bye Bye Bargains? Retail Price Fixing, the *Leegin* Decision, and its Impact on Consumer Prices." As Chair of the ABA Section of Antitrust Law, I have been authorized to express the ABA's views on this important topic. In particular, I would like to express the association's support for the United States Supreme Court's decision in *Leegin Creative Leather Products v. PSKS, Inc.*, 127 S. Ct. 2705 (2007). After considering a record that included voluminous factual evidence and economic analysis, the Supreme Court held squarely that minimum resale price maintenance agreements will be evaluated under the antitrust rule of reason, not the per se rule, under the Sherman Act 15 U.S.C. §1. In addition, the ABA opposes federal legislation, such as S. 148, which would effectively reverse the Supreme Court's decision in *Leegin*. We ask that this letter be included in the official record of the Subcommittee's April 28, 2009 hearing

In February 2007 the ABA House of Delegates adopted a resolution proposed by the Section of Antitrust Law, recommending that:

> the Sherman Act, 15 U.S.C. §1 . . . should not be interpreted to apply a rule of per se illegality to agreements between a buyer and seller setting the price at which the buyer may resell goods or services purchased from the seller.[1]

The ABA derived this position from the basic principle of antitrust jurisprudence that the "rule of reason" identified in *Standard Oil of Ohio v. United States*, 220 U.S. 1, 60-68 (1911), is the

[1] ABA Resolution 101, adopted by the ABA House of Delegates in February 2007, and the related background Report are both attached to this letter.

fundamental standard that governs the evaluation of all restraints of trade. *Continental T. V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 49 (1977). Any departure from the rule of reason standard must be based upon "demonstrable economic effect rather than . . . formalistic line drawing". *Id. at* 58-59. Only when a specific type of restraint produces a "predictable and pernicious anticompetitive effect" and has limited potential for procompetitive benefit will the Supreme Court deem it unlawful per se. *State Oil Co. v. Khan,* 522 U.S. 3, 10 (1997).

The Supreme Court's decisions over nearly a century since adopting the rule of reason standard have carefully examined the procompetitive and anticompetitive effects of specific practices to determine whether they warrant treatment as anticompetitive under all circumstances, and thus classification as per se illegal. Through consideration of their identifiable economic effects, the Court has recognized that non-price resale restrictions and maximum resale price agreements often produce substantial procompetitive effects by encouraging resellers to undertake promotional efforts and provide additional services to customers. *See id.*; *Continental T. V., Inc. v. GTE Sylvania Inc.,* 433 U.S. 36, 58-59 (1977). Like these restraints, minimum resale price agreements may stimulate competition among resellers in ways that produce material benefits to consumers, which would not be available i sellers were unable to introduce some degree of price restriction through their agreements with their resellers.

As outlined in the Report accompanying ABA Resolution 101 that explained the basis for the ABA' policy position, a rule of reason analysis for resale price maintenance agreements is appropriate for the following reasons:

- Most of the significant economic literature regards minimum resale price maintenance as more likely to be used by manufacturers to achieve efficiencies in distribution of their products than to enable dealers to maintain significant margins. ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW AND ECONOMICS OF PRODUCT DISTRIBUTION 37-76 (2006 When dealers are forced to compete without cutting prices, they "vie with one another to provide presale services," which benefits both the manufacturer and the consumers. Richard A. Posner, *Legal Narratology,* 64 U. CHI. L. REV. 737, 738 (1997).

- Empirical studies of minimum resale price maintenance have not established that the practic is invariably anticompetitive. The available evidence has not shown that agreements between an individual manufacturer or distributor and its resellers increased the market power of any individual brand or distorted market-wide competition. Recent empirical stud of the effects of minimum resale price maintenance by Federal Trade Commission personne found no basis for concluding that minimum resale price maintenance is invariably anticompetitive. 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).

- Manufacturers and suppliers have developed practices of achieving effective minimum resal price maintenance without actually entering into any agreements on resale pricing. A

The Honorable Henry C. Johnson
The Honorable Howard Coble
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Page 3

manufacturer's unilateral announcement that it will not sell to discounters and will terminate dealers that resell at less than its suggested resale prices can suppress discounting of its products. *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). No evidence has been developed to show that this common practice has increased any manufacturer's market power or has curtailed interbrand competition.

- The per se prohibition on minimum resale price maintenance in force for several decades has had the effect of enhancing the market power of very large scale retailers that carry a wide variety of products. These large retailers may sell certain products at loss leader prices that smaller retailers specializing in those products cannot match. This unrestrained advantage eventually will result in the disappearance of such outlets for those products. The use of minimum resale price maintenance agreements would provide opportunities for the manufacturer to retain a larger array of outlets and for those businesses to continue serving consumers.

For these reasons, the ABA supports the position that under the federal antitrust laws—and analogous state and territorial antitrust law—agreements between a buyer and seller setting the price at which the buyer may resell a product or service purchased from the seller should not be illegal per se. Instead, these agreements should be evaluated under a rule of reason analysis. The ABA further believes that the Supreme Court's recent decision in *Leegin* is consistent with that position. Accordingly, the ABA opposes proposed legislation, such as S. 148, which would effectively reverse the *Leegin* decision.

Thank you for considering the views of the ABA on this very significant issue. If the ABA or its Section of Antitrust Law can be of further assistance, please contact me at (614) 464-5606 or the ABA's senior legislative counsel for antitrust law issues, Larson Frisby, at (202) 662-1098.

Sincerely,

James A. Wilson, Chair
ABA Section of Antitrust Law

Attachment

cc: All Members of the House Judiciary Subcommittee on Courts and Competition Policy

AMERICAN BAR ASSOCIATION

ADOPTED BY THE HOUSE OF DELEGATES

February 12, 2007

RECOMMENDATION*

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

*NOTE: The "Recommendation," but not the related background "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 ("intrabrand competition") while stimulating competition between different brands ("interbrand 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

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Hon. Henry "Hank" C. Johnson, Jr.
Chairman
Subcommittee on Courts and Competition Policy
Committee on the Judiciary
U.S. House of Representatives
2138 Rayburn House Office Building
Washington, D.C. 20515-6216

Re: *Questions submitted by Representative Sheila Jackson Lee regarding the April 28, 2009 hearing on "Bye Bye Bargain? Retail Price Fixing, the Leegin Decision, and Its Impact on Consumer Prices"*

Dear Chairman Johnson:

Thank you again for inviting me to testify at the April 28, 2009, hearing on resale price maintenance ("RPM"), and for this opportunity to respond to the questions submitted by Representative Sheila Jackson Lee. As was the case with respect to my earlier written and oral testimony, my views on this topic do not necessarily represent those of my law firm or its clients.

Question 1. *How do you believe that RPM agreements can help cater to those customers who focus on factors other than price, and what choices may they be presented with that they may not have previously had?*

To address the second part of this question first: Some customers undoubtedly want better services, and are willing (within limits, of course) to purchase higher-priced goods in order to obtain the benefit of those better services. The possible choices that could be presented to consumers in this regard are as varied as the interests and preferences of the hundreds of millions of consumers who make up the free market, but some specific examples might include: test drives for automobiles; expert, well-trained sales staff for electronic equipment; custom fitting for golf clubs; or well-organized, attractive clothing stores with highly attentive, knowledgeable staff and ample fitting rooms. Some customers may also want the peace of mind that comes

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from having a stable price that does not fluctuate across retailers or over time; a stable price can itself be a form of service.

Manufacturers may reasonably believe that their products perform best when sold together with these services, and may therefore seek methods to influence retailers to provide them. But manufacturers may find it difficult to supervise all of their many retailers to ensure that each is providing the services that customers find important (and/or may find it difficult to identify and specify the types of services that should be provided across an array of retailers and regions). And each retailer may attempt to cut its price by cutting those services, hoping that customers will obtain the services (*e.g.*, the test drive or the custom fitting) elsewhere, but come to the low-price/low-service retailer when ready to purchase. An RPM agreement is one method (and sometimes may be the most efficient method) of encouraging retailers to provide the necessary services, thereby helping satisfy the demand of customers who desire such services.

My written testimony provides additional examples and explanation, at pages 5–8, 10–11, and 12–14. One concrete example of a manufacturer desiring to ensure such services through RPM is Ping, Inc., which submitted an *amicus* brief in the *Leegin* decision.[1] Professors Mathewson and Winter have also written articles discussing this issue in much greater detail.[2]

Question 2. *Why do you feel that banning RPM would interfere with manufacturers' desires to reduce free riding, to break into new markets, to protect dealers from uncertain demand, and to accomplish any of the other procompetitive goals of RPM?*

In some cases, an RPM agreement may be the most efficient method of achieving a manufacturer's service goals.

- *Reducing free riding.* It can be very difficult for manufacturers to supervise their retailers to ensure they are not cutting services in order to free ride (and permit consumers to free ride) on the costly services provided by other retailers. For example, if RPM were *per se* illegal, a manufacturer might be forced to spend resources sending agents across the country to inspect its retailers to verify they are providing the services.

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1 Brief of Ping, Inc. as Amicus Curiae in Support of Petitioner at 9, *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705 (2007) (No. 06-480).

2 See Frank Mathewson & Ralph Winter, *The Law and Economics of Resale Price Maintenance*, 13 Rev. Indus. Org. 55, 67–69, 72–73 (1998); Ralph A. Winter, *Vertical Control and Price Versus Nonprice Competition*, 108 Q.J. Econ. 61 (1993).

- *Breaking into new markets.* Manufacturers, particularly smaller companies and new entrants, may find it difficult to convince retailers to carry new brands and new products. As Justice Breyer wrote for the dissenting Justices in *Leegin*, "a newly-entering producer wishing to build a product name might be able to convince dealers to help it do so—if, but only if, the producer can assure those dealers that they will later recoup their investment."[3] Without RPM, manufacturers might be forced to resort to costly and potentially inefficient methods of obtaining shelf space, such as making direct cash payments to retailers. With RPM, new market entrants can assure retailers an above-average profit per item sold, thus providing retailers the incentive to give the product the shelf space, advertising, and promotional efforts necessary to make it a success.

- *Protecting dealers from uncertain demand.* When a manufacturer inadvertently overestimates demand, retailers may find themselves with high levels of inventory. If any one retailer cuts prices dramatically to clear inventory, the others will be forced to follow, reducing profits or even taking losses. As a consequence, retailers may feel burned by the manufacturer, and the products may permanently suffer an inferior brand image among customers. RPM agreements can prevent this from happening directly (by preventing fire sales) and indirectly (since the guaranteed mark-up margin helps pay for the cost of storage). In this way, RPM can preserve a manufacturer's relationships with its dealers and can preserve the brand's image.[4]

My written testimony provides additional examples and explanation, at pages 5–12, 15–18, and 22–23.

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[3] *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705, 2728 (2007) (Breyer, J., dissenting); *see* Marvel & McCafferty, *Resale Price Maintenance and Quality Certification*, 15 Rand J. Econ. 346, 349 (1984).

[4] *See* Raymond Deneckere et al., *Demand Uncertainty and Price Maintenance: Markdowns as Destructive Competition*, 87 Am. Econ. Rev. 619 (1997); Raymond Deneckere et al., *Demand Uncertainty, Inventories, and Resale Price Maintenance*, 111 Q.J. Econ. 885 (1996).

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I hope these answers are helpful.

Sincerely yours,

Thomas G. Hungar