S. HRG. 110–342

THE LEEGIN DECISION: THE END OF THE CONSUMER DISCOUNTS OR GOOD ANTITRUST POLICY?

HEARING

BEFORE THE

SUBCOMMITTEE ON ANTITRUST,
COMPETITION POLICY AND CONSUMER RIGHTS

OF THE

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THE LEEGIN DECISION: THE END OF THE CONSUMER DISCOUNTS OR GOOD ANTITRUST POLICY?

TUESDAY, JULY 31, 2007

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

The Subcommittee met, pursuant to notice, at 10:01 a.m., in room SD–226, Dirksen Senate Office Building, Hon. Herb Kohl, Chairman of the Subcommittee, presiding.

Present: Senators Kohl and Hatch.

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

Chairman KOHL. Good morning to one and all. We welcome you here today. This hearing will be examining an issue with profound implications for the prices consumers pay for everything from clothing to electronics, and to everyone who likes to get a bargain when shopping. Last month, in the *Leegin* decision, a narrow 5–4 Supreme Court majority overturned a century-old ban on a manufacturer setting a minimum price below which a retailer cannot sell the manufacturer's product.

Many fear that allowing manufacturers to set minimum retail prices will threaten the very existence of discounting and discount stores, and lead to higher prices for consumers. For nearly a century the rule against vertical price fixing permitted discounters to sell goods at the most competitive price, and many credit this rule with the rise of today's low-price, discount retail giants—like Target, Best Buy, Wal-Mart, and the Internet site Amazon, which offer consumers a wide array of highly desired products at discount prices.

From my own personal experience in business, I know of the dangers of permitting vertical price fixing. My family started the Kohl's department stores in 1962, and I worked there for many years before we sold the stores in the 1980s. On several occasions, we lost lines of merchandise because we tried to sell at prices lower than what the manufacturer and our rival retailers wanted. For example, when we started Kohl's and were just a small competitor to the established retail giants, we had serious difficulties obtaining the leading brand name jeans. The traditional department stores demanded that the manufacturer not sell to us unless we would

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agree to maintain a certain minimum price. Because they did not want to lose the business of their biggest customers, that jeans manufacturer acquiesced in the demands of the department stores—at least until our lawyers told them that they were violating the rule against vertical price fixing.

So I know firsthand the dangers to competition and discounting of permitting the practice of vertical price fixing. But we do not need to rely on my own experience. For nearly 40 years, until 1975 when Congress passed the Consumer Goods Pricing Act, Federal law permitted States to enact so-called fair trade laws legalizing vertical price fixing. Studies the Department of Justice conducted in the late 1960s indicated that prices were between 18 to 27 percent higher in the States that allowed vertical price fixing than the States that had not passed such fair trade laws, costing consumers at least $2.1 billion per year at that time.

The likely harm to consumers if vertical price fixing were permitted is even greater today. In his dissenting opinion in the *Leegin* case, Justice Breyer estimated that if only 10 percent of manufacturers engaged in vertical price fixing, then the volume of commerce affected today would be $300 billion, translating into retail bills that would average $750 to $1,000 dollars higher for the average family of four every year.

I am particularly worried about the effect of this new rule permitting minimum vertical price fixing on the next generation of discount retailers, the next Sam Walton. If new discount retailers can be prevented from selling products at a discount at the behest of an established retailer worried about the competition, we may very well imperil an essential element of retail competition that is so beneficial to consumers.

In the last few decades, millions of consumers have benefited from an explosion of retail competition from new large discounters in virtually every product, from clothing to electronics to groceries, in both "big box" stores and on the Internet. We will need to carefully examine whether the Supreme Court's abrupt change to the settled antitrust rule forbidding vertical price fixing will threaten today's vibrant competitive retail marketplace and the pocketbooks of consumers, and we need to consider whether legislation will be necessary to protect the continued existence of consumer discounts.

[The prepared statement of Senator Kohl appears as a submission for the record.]

So we look forward to the testimony of our distinguished panel of witness on this important topic, and I now turn to my esteemed colleague, Senator Orrin Hatch, from the State of Utah.

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

Senator HATCH. Well, thank you, Mr. Chairman. We welcome the witnesses here today and, of course, those who are in the audience.

I want to thank you for holding this hearing today. As we all know, we are here to discuss the Supreme Court's recent decision in *Leegin Creative Leather Products* v. *PSKS, Inc...Kay's Kloset*.

But why is that important? Why should a Senate Subcommittee turn its attention to a ruling that states minimum resale price maintenance agreements, or RPMs, should be judged by the rule of reason rather than being per se illegal, as they have been for nearly 100 years?

Simply stated, the seeming dryness of this terminology does not reflect the importance of the *Leegin* decision—a decision which will alter the dynamic by which manufacturers enter into agreements with retailers and the way in which retailers sell their goods to consumers.

Mr. Chairman, a bit of background on this issue I believe is necessary to fully understand the importance of this decision. Nearly 100 years ago, the Supreme Court ruled in *Dr. Miles Medical Co.* v. *John D. Park & Sons* that is was per se illegal, "under Section 1 of the Sherman Act for a manufacturer and its distributor to agree on the minimum price the distributor can charge for the manufacturer's goods." In other words, the RPMs were against the law.

However, this all came to an end last month, when the Court in *Leegin* discarded the per se rule for a test under the rule of reason. Under this new decision, RPMs are permitted as long as they do not constituted an unreasonable restraint on trade. Specifically, the Court has held under the rule of reason "the fact finder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition. Appropriate factors to take into account include specific information about the relevant businesses and restraint's history, nature, and effect."

Now, why did the Court change its mind? The majority argued that the RPMs can stimulate "interbrand competition—the competition among manufacturers selling different brands of the type of product—by reducing intrabrand competition—the competition among the retailers selling the same brand." The Court goes on to further justify this decision by stating, as they held in *Khan*, the "primary purpose of the antitrust laws is to protect [interbrand] competition."

So what is the effect? One of the most important consequences, according to the Court, will be felt in an activity called "free-riding." Free-riding can be described as when a customer takes advantage of the services and information provided by the full-service retailer and then makes the actual purchase of the product, for a lesser price, at a discount retailer. The Court argues that by permitting RPMs, retailers will have less of an ability to compete on price, thereby diminishing the opportunities for free-riding to occur. It is surmised that retailers will then focus their competitive energies on providing better services and shopping environments for the consumer in order to distinguish themselves in the intrabrand competition.

Clearly, the Court in *Leegin* is favoring the manufacturer over the retailer, especially the discount retailer. Not surprisingly, discount retailers argue that this decision will have an adverse effect on their businesses. Specifically, for the first time in 100 years, the manufacturer can enter into a contract with a retailer that prohibits the retailer from selling below a certain price point. Obviously, if a discount retailer does not offer a significant advantage in price, consumers may very well reconsider where they make their future purchases.

Despite these advantages that the Court confers on the manufacturer, a question still persists. Though most economists argue in favor of the adoption of the rule of reason for determining the permissibility of specific RPMs, does the positive effect on the manufacturer outweigh the negative effect on the discount retailer?

That, Mr. Chairman, is one of the central questions that I hope that we are able to answer today, and I look forward to exploring that topic with our witnesses. We have an excellent panel today, and I look forward to listening to all of you.

Thank you, Mr. Chairman.

Senator Kohl. Thank you, Senator Hatch.

Will the witnesses please rise to be sworn in? Do you affirm that the testimony you are about to give before the Committee will be the truth, the whole truth, and nothing but the truth, so help you God?

Ms. HARBOUR. I do.

Mr. PITOFSKY. I do.

Ms. SYMS. I do.

Mr. BOLERJACK. I do.

Ms. MCDAVID. I do.

Chairman KOHL. Thank you so much.

Our first witness today will be Pamela Jones Harbour. Commissioner Harbour is currently a Commissioner at the FTC. Prior to joining the Commission, Ms. Harbour served as a partner at Kaye Scholer, where she handled antitrust matters. Prior to joining Kaye Scholer, Ms. Harbour was New York State Deputy Attorney General, during which time she argued before the U.S. Supreme Court in the landmark price-fixing case *State Oil* v. *Khan*.

Also testifying today will be Robert Pitofsky. Mr. Pitofsky is the Sheehy Professor of Trade Regulation Law at Georgetown University Law Center and also currently serves as counsel for Arnold & Porter in Washington, D.C. Mr. Pitofsky was Chairman of the FTC from 1995 to 2001, where he also served as a Commissioner from 1978 to 1981, and as Director of the Bureau of Consumer Protection from 1970 to 1973. He has co-authored many books and articles on antitrust and trade regulation.

Our next witness will be Marcy Syms. Ms. Syms is Chief Executive Officer of Syms Corporation, a chain of off-price apparel stores. She was one of the first companies to offer designer and name brand clothing at discounted prices. Ms. Syms is a founding member of the Security Syms School of Business at Yeshiva University.

Also testifying today will be Stephen Bolerjack. Mr. Bolerjack is counsel for Dykema in Detroit, Michigan, practicing in the cases of antitrust and trade regulation. Prior to joining Dykema, Mr. Bolerjack worked for the Ford Motor Company, providing antitrust advice on Ford's acquisitions and divestitures. He currently serves as Chairman of the Competition Task Force of the National Association of Manufacturers.

The final witness will be Janet McDavid. Ms. McDavid is a partner at Hogan & Hartson in Washington, D.C. She focuses on antitrust and trade regulation, with particular emphasis on Government investigations. Ms. McDavid has authored or co-authored many books and articles and is widely recognized as a leading authority on antitrust law.

We welcome you all here today, and we will take your testimony. Statements for the hearing have also been submitted by the American Antitrust Institute, Tyler Baker, and Kenneth Elzinga. Without objection, these shall be made part of the record.

Ms. Harbour, we would love to hear your testimony.

STATEMENT OF PAMELA JONES HARBOUR, COMMISSIONER, FEDERAL TRADE COMMISSION, WASHINGTON, D.C.

Ms. HARBOUR. Good morning, Chairman Kohl, Senator Hatch. I appreciate the opportunity to offer my personal views on the proper legal treatment of minimum vertical price fixing. As you may know, based on my "Open Letter" to the Supreme Court in the *Leegin* case, I have strong opinions on this subject, and I would have preferred it if a majority of the Court had adopted Justice Breyer's cogent dissent instead.

I am a Commissioner of the Federal Trade Commission. But let me be very clear: the views I express today are entirely my own.

I have submitted a copy of my Open Letter along with my written remarks, and I will not rehash the *Leegin* decision today. Instead, I want to focus my comments on a fundamental issue of antitrust policy, and that is, what should consumers expect from the American antitrust laws and, consequently, the American retailing system?

The *Leegin* opinion relies on at least two implicit assumptions: first, that manufacturers know what is best for consumers—even better than retailers, or consumers themselves; and, second, that retail competition is not important to the American economy or to consumers.

But these assumptions do not match the reality of the American marketplace. Retailers compete by trying to predict what consumers want and at what prices. Many retailers promote efficiencies, which are passed along in the form of lower prices. Other retailers may charge higher prices, but offer superior service, higher-quality goods or other amenities. Consumers respond to this price and non-price competition by voting with their wallets, depending on their preferred mix of products, services, and quality at a given price.

This is the essence of market-based competition. It is based on consumer choice. And many—if not most—consumers respond strongly to aggressive price competition because we all prefer a bargain. The rise of mass merchandisers like Wal-Mart, Home Depot, and Burlington Coat Factory illustrates my point.

But let's think about the post-*Leegin* world. As a general matter of antitrust law, a person who can "profitably...maintain prices above a competitive level for a significant period of time" is said to possess actionable market power. But the *Leegin* majority articulates a more lenient rule-of-reason standard for minimum vertical price fixing. To quote Justice Kennedy's version of the rule, he said "pricing effects" are not enough to establish market power; the plaintiff must make a "further showing of anticompetitive conduct."

In my mind, this is a virtual euphemism for per se legality because it will be extremely difficult for any plaintiff to make out a case. Therefore, absent congressional intent or action, I envision a post-*Leegin* world where there is no effective check on minimum vertical price fixing.

And what will this look like to consumers? Well, if you were to walk through a mass merchandiser's store, you would see thousands of items produced by hundreds of manufacturers. Each of these manufacturers could require retailers to enter express agreements along the lines of, "you must sell my products at these prices." Manufacturers also would be able to dictate a variety of other aspects of retail sale, such as shelf location, display spacing, and presentation.

Intrabrand and interbrand competition may continue to exist, but only to the extent it benefits manufacturers, not consumers. In short, the American marketplace will no longer be driven by consumer preferences. And, in my opinion, this is wrong.

My Open Letter explains that our Nation has been down the minimum vertical price-fixing road before. Congress enacted the Consumer Goods Pricing Act of 1975 to end a decades-long experiment of its own design. But Congress declared that experiment a failure, finding that minimum vertical price fixing harmed consumers by raising prices, decreasing distributional efficiencies, and deterring new entry, among other things. Had Congress not repealed the fair trade laws in 1975, it is doubtful that mass merchandisers would even exist today.

As Justice Breyer observed in his *Leegin* dissent, the economic arguments in favor of minimum vertical price fixing have not changed appreciably over time. The defendant in *Leegin* made arguments strikingly similar to the ones the Court rejected in the 1911 *Dr. Miles* case and that Congress rejected in 1975. There still is no body of sound empirical economic evidence to show that minimum vertical price fixing is, on balance, more likely than not to benefit consumers.

Congress repeatedly has turned down calls for legislation that would allow minimum vertical price fixing on a national scale. There is no justification for Congress to change course. Yes, minimum vertical price fixing may sometimes be good for consumers, under some limited circumstances. But that is no reason to subject all American consumers to higher prices, which is virtually certain to be the outcome of *Leegin*—unless Congress intervenes.

When it comes to close questions of competitive effect, American consumers deserve the benefit of the doubt. Therefore, I believe Congress should act to shift the burden of proof from the consumer onto the producer who imposes pricing restraints.

In closing, I would be happy to work with the Subcommittee to draft statutory language if you choose to do so. Thank you.

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

Chairman KOHL. Thank you, Ms. Harbour.

Mr. Pitofsky?

STATEMENT OF ROBERT PITOFSKY, SHEEHY PROFESSOR OF ANTITRUST LAW AND REGULATION, GEORGETOWN UNIVERSITY LAW SCHOOL, WASHINGTON, D.C.

Mr. PITOFSKY. Thank you, Mr. Chairman, Senator Hatch. As always, it is an honor to testify before this Committee.

I agree with the suggestion that the 5–4 majority opinion in *Leegin* was wrong, and not just because it is a 95-year-old decision. The Court can make mistakes and rectify them later on. But subsequent decisions of the Court have consistently supported the *Dr. Miles* approach. Congress was aware of that approach and condoned it. In the past, the Court has paid attention to the way Congress felt about the Court's interpretation of the antitrust laws.

Now, I am going to hear the argument that, well, *Dr. Miles* was the Court's statute, they have a right to change it. Of course, they do. But the Sherman Act is Congress's statute, and if Congress thinks the Sherman Act should be interpreted in a certain way, in the past the Court has paid attention to that. This majority did not want to qualify or modify *Dr. Miles*. It wanted to overrule it.

Turning to the merits, the one thing that is clear and really not debatable in this entire issue is if you allow minimum resale price maintenance, consumers pay more. Now, the argument is, yes, they pay more, but they get a good deal. They get things in return that make it worthwhile.

Let me make a general point and then some specific points. Generally, if you look at the briefs, if you look at the majority opinion, if you look at Janet McDavid's excellent presentation today, you will see that the entire case for overruling the per se rule is theoretical economic analysis. It is 95 years later, and they still have not come up with an iota of data, of empirical support, that free riders drive services out of the market, that manufacturers introduce minimum resale price maintenance in order to attract services. It is all Economics 101 theory.

Specifically, what are the services? The one I have always found to be the most persuasive is where you have a new entrant coming into a market where there is tough competition. Maybe the new entrant has to guarantee the distributors some protection in order to get them to take on a less popular product. OK. But there are two answers to that. One is in our system we ask manufacturers to compete for dealers, not to charge consumers a tax to raise the price of the retailers so the manufacturer can attract more dealers. Second, if you really were troubled by that, then it is easy. Then there ought to be an exception for new entrants to the rule about per se illegality. We have exceptions for new entrants in other areas of per se illegality. Why not here? Why overrule the entire structure of distribution?

Second, the argument is that you get a lot of services. Well, if a manufacturer really wants services, they know how to get it. If they want more advertising, they contract for it. If they want a better service department, they contract for it. They pay part of it. What they do not do is raise the minimum resale price in the hope that the retailer will know exactly what services the manufacturer wants and will introduce them automatically without any direction from the manufacturer.

I looked back at the fair trade period to see which were the products that cost consumers $21 billion, that were fair traded and, therefore, a rule of reason applied: cosmetics, toothpaste, pet food, vitamins, hair shampoo, ammunition, blue jeans, men's underwear. What exactly are the services that are invited into the market if you raise the price of toothpaste to consumers? How about shampoo? Men's underwear—what are the services in connection with men's underwear? And besides that, if these products are sold in a store with 100, 500, 1,000 products can anybody really say raising the price of one product changes the ambience of the store? This is a gross exaggeration of the problems that free riders could possibly create.

Briefly, either we could stick with the per se rule—I think that is the right idea—or we could do what we did with horizontal price fixing and have what is called a "BMI preliminary." The defendant has to explain to the court in a quick look why it deserves rule of reason and not per se treatment, and only after that will the court give rule-of-reason treatment.

The irony now is we treat horizontal price fixing in this country—everybody says that is the maximum anticompetitive form of behavior—more leniently than we treat vertical price fixing. No other country in the world does anything like that.

By way of conclusion, one quick point. Judge Posner, a conservative icon and a man with a reputation for being candid about these issues—said the rule of reason in this area of the law is infeasible and unsound. He is right. It cannot work. It takes too long. It is too expensive. The trials go on for 2 or 3 years. And, therefore, he said doing away with *Dr. Miles* is only the first step to where we are really going, which is per se legality. So that the toothpaste, hair shampoo, and men's underwear people can fix minimum resale prices even though services have nothing to do with it.

I think that is where we are going—I think he is right—unless Congress steps in and restores its authority to establish the rules with respect to discounting.

Thank you very much.

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

Chairman KOHL. Thank you very much, Professor Pitofsky.

Ms. Marcy Syms?

STATEMENT OF MARCY SYMS, CHIEF EXECUTIVE OFFICER, SYMS CORP, SECACUS, NEW JERSEY

Ms. SYMS. Good morning, Chairman Kohl, Ranking Member Hatch, and members of the Subcommittee. I am Marcy Syms, the Chief Executive Officer of SYMS. Thank you very much for the invitation to testify today to the Subcommittee. Please be aware that I am neither a lawyer nor an economist, and I will limit the scope of my testimony accordingly.

Let me begin with some background on SYMS. SYMS is an off-price retailer with 33 stores in 13 States that sells designer and brand name clothing at substantial savings to consumers. SYMS began in 1959 by selling garments produced by a select group of manufacturers that supplied it on the condition that it sell their garments with generic labels or remove the brand labels at the time of sale. As SYMS began to grow, manufacturers began to loosen their control over how SYMS could sell to its "Educated Consumers." Today SYMS is able to sell brand name clothing with labels attached, as well as advertise brand names within its stores, on its website, and through customer mailings.

SYMS purchases most of its merchandise directly from manufacturers of brand name and designer clothing. Most of the merchandise is first quality and in season. The availability of this merchandise is the result of overproduction, canceled orders, and other factors. SYMS works on a "mark up" system unique in retail, even among discount sellers and its "off-price" competitors. Instead of paying manufacturers wholesale and selling at a lower markup than its retail competitors, SYMS pays below wholesale prices.

For many years SYMS has relied on the prohibition against RPM agreements mandated by the Federal antitrust laws. It has invested its capital, structured its business, and built customer goodwill in reliance on that prohibition.

Over the years SYMS has occasionally been pressured by manufacturers to stop selling particular merchandise because retail competitors that sell at higher prices have complained about SYMS's prices. But the prohibition on RPM agreements has, I believe, kept in check serious threats to SYMS's ability to sell merchandise according to the pricing approach I have described. That may well change as manufacturer-oriented RPM policies become more prevalent in the clothing industry.

Let me now briefly outline what I predict will be some of the undesirable effects that will attend manufacturer-oriented RPM in the retail clothing industry:

First, the introduction of RPM policies will force discount retailers, especially large ones, to pursue strategies other than price cutting—the provision of rebates, gifts accompanying purchases, and other special offers—in order to compete. As a result, consumers will find it difficult to judge what they are actually paying for the products they desire and the value they are receiving. SYMS's well-known sales approach is that consumers should be able to judge exactly what value they are receiving and to make purchasing choices accordingly.

Second, as other witnesses will likely explain, RPM may facilitate horizontal price-fixing agreements among manufacturers, thereby reducing interbrand competition.

Third, the retail clothing market is characterized by a continually changing and often seasonal product mix. Consumers are accustomed to, and benefit from, deep markdowns on seasonal items. The introduction of RPM policies will lower a retailer's ability to sell end-of-season or out-of-season merchandise by discounting. A related problem will be the inability of retailers to sell poorly performing merchandise that is governed by RPM policies.

Fourth, the introduction of RPM may create opportunities for foreign retailers—or large domestic retailers who set up foreign entities to distribute their products via the Internet or catalogues—to secure a competitive advantage over domestic retailers. This is because foreign retailers will find it easier than their domestic counterparts to escape the legal consequences of violating RPM policies.

Fifth, retailers will face increased costs as a result of having to ascertain and comply with RPM restrictions that may be attached to the products, especially when they purchase products—as they often do—from suppliers other than manufacturers.

Sixth, it is already difficult for off-price discount retailers in the clothing industry to expand their businesses. The limited supply of discount branded products on the wholesale market restricts growth. RPM policies will further restrict the supply of discounted merchandise. Much of the discount merchandise sold by manufacturers consists of off-season or out-of-season merchandise. Increasing the life cycle of an item at full retail will reduce the off-price supply.

That concludes my prepared testimony. I would be happy to answer any questions.

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

Chairman KOHL. Thank you, Ms. Syms.

Mr. Bolerjack?

STATEMENT OF STEPHEN BOLERJACK, ATTORNEY AT LAW, DYKEMA GOSSETT PLLC, DETROIT, MICHIGAN

Mr. BOLERJACK. Thank you, Mr. Chairman and Senator Hatch. I am Steve Bolerjack. I am the Chairman of the Competition Task Force of the National Association of Manufacturers, and it is an honor and appreciated by the National Association of Manufacturers that we have the opportunity to present our views here today.

We believe that the *Leegin* case represents sound antitrust policy. There are primarily three reasons.

First of all, the unvarying rule is that the rule of reason is the accepted standard for antitrust analysis. The per se rule should always be reserved for restraints where the courts are confident that the restraint would be invalidated under the rule of reason all or almost all the time. That is not true of resale price maintenance. Even in dissent, Justice Breyer indicated that sometimes it will have procompetitive effects, sometimes it will have anticompetitive effects. It depends on the facts. *Leegin* will force courts to look at the facts in each case and the competitive effect.

Leegin continues a progression of limiting the per se rule in the vertical area, cases between manufacturers and dealers. You have heard references to the 1977 decision in *Sylvania* overruling a prior per se ruling regarding what we call non-price restraints—a location clause in that case. So the manufacturer could choose to limit sales to an approved location if it did not have an anticompetitive effect.

You have heard references to the 1997 *Khan* case on maximum resale price maintenance. It permits the manufacturer—or seller—to require a maximum resale price, a price ceiling; that can be procompetitive, and it can certainly outweigh any anticompetitive effects, and it overruled almost 30 years of experience under a per se rule that absolutely prohibited that.

Finally, and I think very importantly, *Leegin* requires courts to look at substance. What is the effect of the restraint on competition in a market? Prior to the *Leegin* case, we all spent time in a search for whether or not there was sufficient evidence of an agreement between the manufacturer and the dealer. And I submit they did not at all look at whether or not there was an anticompetitive effect in the market. In the *Leegin* case itself, the per se rule required exclusion of expert testimony that there were procompetitive benefits to the policy *Leegin* was following with its Brighton merchandise. What this case will do is bring back the ability of a manufacturer to use the evidence that it may have available to it showing procompetitive benefits, rather than following the per se rule where it simply is not permitted to defend itself in court using the facts that it would otherwise be able to use.

We think it is also important to note what *Leegin* did not do. Minimum resale price maintenance is not per se legal. This is not going back to the fair trade days. The case did not eliminate the potential for a challenge to a manufacturer's policy if it enters into a minimum resale price maintenance agreement.

What the case says is any of those challenges should be decided under the rules that typically apply in a vertical case. And the Court also drew a very bright line around efforts to use resale price maintenance to enforce horizontal agreements, either amongst manufacturers or amongst dealers. And they said those agreements are and should continue to be per se violations, and to the extent resale price maintenance is being used to enforce it, that would not survive a rule-of-reason challenge. This is not a green light to just raise prices without regard to competitive effects.

So thank you for your time, and later on I would be pleased to answer questions.

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

Chairman KOHL. Thank you, Mr. Bolerjack.

Ms. McDavid?

STATEMENT OF JANET L. MCDAVID, ATTORNEY AT LAW, HOGAN & HARTSON, WASHINGTON, D.C.

Ms. MCDAVID. Good morning, Chairman Kohl, Senator Hatch. It is a pleasure to be here this morning with my friends Bob Pitofsky—who was my antitrust professor—Pamela Jones Harbour and Steve Bolerjack—who is my client—and to meet Marcy Syms. I am a partner at Hogan & Hartson here in Washington, D.C. I am a former Chair of the Antitrust Section of the American Bar Association, and I am here today on behalf of the ABA. My written statement reflects the position of the ABA, and to the extent my remarks today differ from that written statement, those views are my own.

The Supreme Court's recent decision in *Leegin* holding that resale price maintenance should be evaluated under the rule of reason rather than under the per se rule is totally consistent with the views of the American Bar Association. In reaching that decision, the ABA carefully considered the views on both sides of the issue and concluded that because resale price maintenance can be either benign or procompetitive, it should be evaluated under the rule of reason, which is the rule that is applied with respect to virtually all other restraints under the antitrust laws. It concluded that the basis for the *Dr. Miles* decision was largely discredited and should be overturned.

That does not mean that resale price maintenance will always be found to be legal. In circumstances where it produces anticompetitive effects, it will be found unlawful under the rule of reason. Critics, including those here today, seem absolutely confident that there will be anticompetitive effects, but they seem significantly less confident that those effects can be proved under the rule of reason. That seems to me to be inconsistent.

There has always been a tension between the rule in *Dr. Miles* and a decision only a few years later in *Colgate*, where the Court held that a supplier could refuse to sell to dealers that would not charge its resale price as long as it did so wholly unilaterally. The rationale was that, absent an agreement between the manufacturer and the dealer, there was no violation of Section 1 of the Sherman Act. The competitive effects were exactly the same. The only question was whether or not there was an agreement between the manufacturer and the dealer.

Later, the Court applied the rule of reason to a whole range of other vertical restraints, as Mr. Bolerjack has explained. Resale price maintenance, which eliminated only one form of competition at the intrabrand level was per se illegal; whereas, a territorial exclusion clause was evaluated under the rule of reason even though it might have a greater anticompetitive effect than the resale price maintenance arrangement.

My written statement contains a detailed discussion of the economic and legal arguments on this question. I am a practicing lawyer, so I would like to talk to you a little bit about how this works in the real world.

When I advise a client on an antitrust question, the first things I ask are: What are you going to do? And why are you going to do it? That allows me to consider the client's business rationale for the conduct, the competitive dynamics in the industry, and whether there might be a less restrictive way to achieve that objective. But when we counseled in the resale price maintenance area, the rule was always different. Instead of asking why do you want to do this and what is the effect going to be, we spent our time talking about whether there were ways to achieve that objective without an agreement. Could you suggest resale prices? Could you establish a consignment arrangement? Could there be a principal agent relationship? Many of these questions made no business sense to the people whom I was counseling.

If the client wanted resale price maintenance, it could adopt the *Colgate* policy: se resale prices completely unilaterally and simply terminate any dealer who refused to follow that pricing policy. But it had to do so without any discussion with the dealer. It did not matter whether that dealer was a valuable dealer with a long-standing relationship. It simply had to cut them off, because any conversation with the dealer ran the risk of an agreement. And as a consequence, this became a business rule that businesses could not understand.

There was an amicus brief filed in the *Leegin* case by the Ping golf club manufacturer explaining that it had adopted a *Colgate* policy on resale price maintenance because it felt that its club-fitting rules required service by dealers. As a result, it terminated on a zero tolerance basis any dealer who cut prices. Its representatives could not go out and counsel with those dealers. They simply had to cut them off because, otherwise, they risked an agreement.

Concerns by the field representatives were not sent to the marketing department. They were sent to the general counsel's office, which helped decide whether it was appropriate to cutoff the dealer in that circumstance. Ping said it terminated nearly 1,000 dealers over 4 years, with a resulting loss in outlets that were useful to consumers. It is very hard to explain to business people why that rulemakes any sense.

Lawsuits in this area were also different. Instead of thinking about the anticompetitive or procompetitive effects of the conduct at issue, as we do in every other antitrust case, except a cartel, we spent our time discussing whether or not there was an agreement between the manufacturer and the dealer. Did the conduct of regional sales representatives somehow cross the line between persuasion and coercion so that there was an agreement?

Leegin is an example. As has already been stated, the testimony of Ken Elzinga, one of the leading antitrust economists in this country, was excluded from evidence at the trial as irrelevant because the rationale for the arrangement was simply not relevant, and the jury was not allowed to consider the procompetitive rationale.

So cases in this area were always slightly back-assward, and the courts tried to find ways to avoid absurd results. We spent our time focusing not on the competitive effects of these cases, but on whether there was an agreement.

For these reasons, the *Leegin* decision is completely consistent with the views of the American Bar Association. I welcome the opportunity to answer your questions on how this works in the real world, and I hope we will have a chance to talk about some of the factors that a court might apply as it evaluates these cases under a rule-of-reason analysis.

Thank you.

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

Chairman KOHL. Thank you very much.

I would like to start by asking Ms. McDavid and Mr. Bolerjack the following question and the line of reasoning: What problem did *Leegin* fix? It seems to me, aside from the legalities of lawyers and manufacturers, the most important part of—or one of the very most important parts of retail America is that it provides the consumers the most vigorous kind of interaction between themselves and manufacturers and stores with the least kinds of obstructions as we feel we need to insert into the process to maintain some sense of sanity, but that the churning, the interaction is a good thing and not a bad thing. Now, if you disagree with that, then perhaps you want to make your case. But the kinds of restrictions that we want to impose are the least that are necessary.

So if that is true as a premise, and if we had not had minimum price maintenance now for the longest time, why do we have to have it now? I mean, what is there that is occurring that is making it necessary for manufacturers to be able to set a minimum price? As Mr. Pitofsky pointed out, they can now set maximum price, and if they could set minimum price, theoretically they can set those at the same point. And as Mr. Pitofsky pointed out, he thinks maybe that is where we are heading. But legally now they can set a maximum and minimum at the same level.

Now, why is that beneficial to the American retail—to consumers? Why would you then defend that as something that they should have the right to do if they wish if we are thinking about the whole panoply of America and retailing and the interaction that goes on and all the good things that it has provided over the years? Ms. McDavid, would you like to comment on that?

Ms. MCDAVID. Well, as I explained, Senator, there has been resale price maintenance in this country under the *Colgate* doctrine for a long time. The question has always been whether it is imposed by the manufacturer unilaterally, resulting in the termination of any dealer who does not do it, or whether it has been imposed through an agreement. So it has existed, and there are a lot of companies, like Ping, who simply cutoff the discounters.

So this system has existed. The problem has been that it is inefficient because we end up in the kind of inquiries that I have been describing where we do not focus on whether there is something good going on here or is it completely neutral or is there something bad.

Manufacturers want the kind of hurly burly you have been describing, but they want it at the interbrand level. They want Sony and Sharp competing with Matsushita and JVC. They want that to be done as a consequence of being able to go into a store where you can get the kind of service that tells you the difference between those television sets.

Chairman KOHL. Mr. Bolerjack?

Mr. BOLERJACK. I absolutely agree that what the manufacturer is now freed to do in a straightforward fashion rather than by setting up its unilateral policy and spending the time, money, and effort of trying to track down violations of its policy—manufacturers now are free to explain to those who sell its product that we want you to take on my competition, don't take on one another. And they can go forward and set a minimum price floor to try to assure that that does not happen. That may bring advantages to them that they cannot use today in as efficient a manner. This frees the manufacturers to do something like that.

I would also like to point out that the assumption frequently in these matters is that the manufacturer is a large, powerful organization with all the power and abilities to enforce this in the world. And, frequently, that is not the case. It can be a small manufacturer trying to get into numerous outlets. In the case here, you had a manufacturer that made ladies' leather goods and accessories. They finally got into 5,000 different outlets, and for reasons we probably do not need to explore in detail, they wanted to try to assure that a consumer had a very special boutique-type experience. Other manufacturers now might have the ability to undertake this policy. A manufacturer that relies—and I think frequently they do—on discounting and making sure that their entire output is taken and sold will not consider one of these policies. It does not do anything for them, and if they impose one of these policies and they have a significant market position, they are going to have to deal with any litigation that comes up. It is not a free pass.

Ms. MCDAVID. If I could add, Senator, my experience in the very limited time since the *Leegin* decision—but many of us were expecting the *Leegin* decision for the last year or so—is that companies are not jumping at the opportunity to do this. They are thinking about it very carefully. They are thinking about whether it makes sense for their business. And they are also carefully evaluating the risk that their conduct might be found to be unlawful in a rule-of-reason analysis.

I have already advised one client so far that it would be very risky for them to do this because of the circumstances in which they compete, and they have chosen not to proceed in that way, even with a full rule-of-reason analysis. I think that companies are going to make individualized decisions based on the competitive dynamics that they face in their particular space.

Chairman KOHL. Mr. Pitofsky?

Mr. PITOFSKY. Senator, here is the irony. If five retailers got together fixing a minimum price, that is illegal per se. It is a horizontal conspiracy. But if the five retailers manage to go to the manufacturer and say, do me a favor, stop these price wars, give us a minimum price, then, according to the Supreme Court, now you are going to have a rule of reason not illegality per se. And I just want to add, lawyers know, plaintiffs almost never win a rule-of-reason case. A rule-of-reason case means the kitchen sink is relevant, everything is relevant. They take years. Discovery takes years. They are very expensive.

I will give you a piece of data, not theory. Thirty years ago, the Supreme Court went from per se to rule of reason with respect to territorial allocation: you sell in the Bronx, you sell in Queens, you sell in Brooklyn, don't get in each other's way. The Court went to rule of reason, it said, oh, it is only rule of reason.

Four plaintiffs have won territorial allocation cases in the last 30 years, one every 7 years. I think it will be even tougher to win a vertical price-fixing case. I think four cases in 30 years is per se legality, and that is where we are heading.

Chairman KOHL. Ms. Harbour?

Ms. HARBOUR. Let me give you the bottom line. I think the anticompetitive effects of minimum vertical price fixing are virtually certain. Prices will go up and consumers will pay more money. The procompetitive effects that we hear about are theoretical; they are speculative, and they are unproven. And let me tell you why.

None of these empirical studies that we hear about, that we have read about, are definitive. There is an acknowledged empirical vacuum that leaves these competing theories untested. For instance, in 1985, Judge Easterbrook called for more rigorous empirical research, but to date, no studies have found evidence of the procompetitive benefit relating to minimum vertical price fixing.

These studies are theoretical, and these studies are not definitive. But what we do know is that manufacturers will set higher prices, and we know this because in 1975 a congressional study showed that minimum RPM led to a 27- to 37-percent price increase for the American consumer. We know that in that same time period, a Stanford University study showed that fair trade cost consumers, in 1970s dollars, $6.5 billion a year. We know that there was a higher rate of business failure in fair-traded States. These States had a 55-percent higher rate of firm failure.

So these are the things we do know, and I do not think that the per se rule should be thrown out based on theoretical arguments and no empirical data.

Ms. MCDAVID. Mr. Chairman, the case that Chairman Pitofsky described is actually per se illegal. The dealers getting together and asking the manufacturer to impose a price on them is illegal. He brought that case when he was at the Federal Trade Commission against a group of Chrysler dealers who asked Chrysler to boycott discounters who were selling cars on the Internet, and it was found to be per se illegal. And do you know who brought the complaint to the Federal Trade Commission? Chrysler, because it had no incentive to get involved in that kind of a conspiracy.

And the circumstance he posits in which there would have only been four territory allocation cases won by plaintiffs, I wonder if he disagrees with the Supreme Court's *Sylvania* decision. Bob, didn't you think they did it right?

Mr. PITOFSKY. No, I thought the Supreme Court was right about *Sylvania*. It is a different situation. But price has always been treated as different. In *Sylvania*, the majority said this is territorial allocation, that is price, we are not touching price. But now this majority is.

What was your—oh, the dealers. How did the dealers effectuate this business about getting the manufacturer to fix the price for them? First of all, they are smart enough—most of them are smart enough now, not all—not to go as a group to the manufacturer. They can go one at a time. Or they do not have to go at all. They just let their feelings be known that these price wars are killing us and eventually we are going to leave you if you do not stop the price wars.

There is data, actual data, that resale price maintenance is more likely to occur where the dealers are well organized in trade associations than if the dealers are independent. There is nothing like that kind of data, taking the other side of this argument, that free riders drive services out of the market.

Chairman KOHL. Chairman Hatch?

Senator HATCH. Well, I have to add that this has been very interesting to me. I think you have all done a very interesting job, as far as I am concerned.

Chairman Pitofsky, recently you wrote an article that discusses a common example cited by those who support a rule-of-reason analysis. Specifically, I am referring to the example of the audio-visual dealer that assists the consumer with expert advice and then has their sale undercut when the consumer leaves and buys the product from a discount store.

You counter that argument by discussing how such a scenario does not apply to low-value textile goods, but does not—I guess my question is: Does not the Court recognize this in their holding? Simply put, just because one can do something like engage in an RPM does not mean that all manufacturers, especially those who sell "commodity priced" goods, will insist upon them? Will the market itself not work this out?

Mr. PITOFSKY. That is the hypothetical that the conservative side of this argument always uses: you will go to Federated and get an explanation from a fancy service person; then you go across the street to the discounter and buy the product. I have three reactions.

One, how often does that happen? I want to see a study of that.

Two, might we not have a "BMI preliminary"—we can make an exception for that kind of situation. The manufacturer comes in and says—or the dealer does and says, "I am having a lot of problems with this kind of behavior," and the Court, as they do under BMI in horizontal market price fixing, says, "OK. You have persuaded us. Now we will give you a rule of reason. But we are not giving you a rule of reason for men's underwear. That does not make any sense to us at all."

Third, I am going to make a point for the other side. I asked my class, "How many of you people go to Federated, get an explanation, and then go across the street to a discounter and buy the product?" And half the class raised their hands. I said, "You got to be kidding. I did not know that anybody did that sort of thing." So afterwards, students came up and they said, "Well, what we do is we go to Federated and get the explanation,and then we buy it on the Internet." That should have been the argument in favor of getting rid of a per se rule.

But my answer to that is there is a much more constructive way to do it, and that is, simply have a "BMI preliminary." Explain that this is the kind of product, high-tech audio equipment, computers and so forth, where people get the explanation and then buy it somewhere else. Eventually that will drive the explanation out of the market. I accept that. But that, Justice Breyer said, applies to 10 percent of products. I really wonder if it is even 10 percent of products. All I know is that an overwhelming majority of the products have nothing to do with services. It is just that consumers will pay more and retailers will pocket more.

Ms. HARBOUR. May I make a comment?

Senator HATCH. Go ahead.

Ms. HARBOUR. If I might just add to Professor Pitofsky's comments. I believe the Supreme Court's grounds for overturning *Dr. Miles*, were based on either a misstatement or a misunderstanding of the decision. The *Leegin* plaintiffs were wrong when they argued that *Dr. Miles* was based on what they called "prohibiting restraints against alienation." Basically, *Dr. Miles* held that the arrangement between *Dr. Miles* and its 25,000 retailers constrained all downstream pricing. The *Dr. Miles* Court held that this arrangement was the functional equivalent of horizontal price-fixing between the dealers. So, the Supreme Court did not recognize the functional equivalency doctrine. *Dr. Miles* was grounded in traditional antitrust concepts namely, the elimination of competition and subsequent harm to consumers. I think that concept was overlooked by the Supreme Court.

I want to talk about for a moment, though, about the free-rider effect. This effect has been grossly exaggerated in the economic literature. It is implausible in many of the product areas where RPM is used.

If you take a look at the *Leegin* case, and as I had stated in my Open Letter regarding ladies' handbags—what are those extra services that would justify imposing a price increase to consumers? Are ladies' handbags something that would require operational expertise, consumer education or a showroom? I don't think so. So I think there was no real justification for the resale price maintenance scheme in the *Leegin* case.

Ms. SYMS. I would like to add something, if I may.

Senator HATCH. Sure.

Ms. SYMS. I think that this whole concept of free ride really has to be re-examined in the age of the Internet. We all get a free ride. Most of our consumers get their information from the Internet. If they want to get educated about something now very quickly, they do not have to get in a car; they do not have to pay for gas. They just get on their computer, and they get all the information they want. So I don't know if this free-ride idea—actually, up until reading the case, I did not even know there was such a thing. So there you go. I mean, it is very esoteric.

And the truth of the matter is in the merchandise that we sell, even though we are selling 40, 50 percent below what a regular retailer is, almost 70 percent of the merchandise that comes into a Syms store has a hang tag. The manufacturer, the brand—we deal directly with the brands, directly with the designers. We do not use middlemen. We do not use jobbers. And 70 percent of the merchandise has a suggested retail price hanging right on the garment. So we all—the consumer has a guideline; they know. And we have a guideline; we know. But it is not something that has to be regimented. The marketplace takes care of what the price is going to be based on where it is in the seasonality, based on how old the merchandise is. A turtleneck is not going to be the same as a new pocketbook from Coach.

You know, there is a sensibleness to this that kind of gets lost in some of this discussion, and the consumer knows the sense of it.

Senator HATCH. Well, let me give the other side a chance, too. Ms. McDavid, Mr. Bolerjack, if you would care to comment?

Ms. MCDAVID. Well, some manufacturers, even manufacturers of men's underwear, may have chosen to invest to create a premium product. Ms. Syms mentioned Coach handbags. I buy Coach handbags. I consider Coach a premium product. Should a manufacturer be prevented from cutting off someone whom it thinks is undercutting the value of the premium brand it has created?

The ultimate constraint here is going to be the existence of interbrand competition, the choice between a Coach handbag and an off-brand handbag. A consumer who is prepared to pay for a premium product will pay a premium price and perhaps buy a product that is subject to resale price maintenance, or a *Leegin* handbag. A consumer who is price focused will buy a different brand which is not subject to resale price maintenance and is sold at a lesser price. The fact that there are price differences does not mean it is anticompetitive.

Senator HATCH. Professor Pitofsky, you have taught your student well, but she is—

[Laughter.]

Senator HATCH. She is straying from the course.

Mr. Bolerjack?

Mr. BOLERJACK. I would just finish up. I agree with, I believe it was, what Ms. Syms said. The market will take care of this. If a manufacturer goes out and says, I want an arrangement with you as a retailer, I want you to carry this in an attractive store. I want you to have a listening room for stereos, or I want you to have skilled salespeople, I want you to take returns, if the customer is unhappy with my product and wants their money back, I want you to give it to them, I want you to perform warranty work, some of this we can do with agreements. But the situation here is if they have priced that wrong and they get into resale price maintenance, the manufacturer will quickly learn a lesson from his competitors, and he will be taught that he cannot maintain that price. Competition with other manufacturers will take care of that. As Jan said, the interbrand competition.

Ms. HARBOUR. Senator, I wanted to add that when thinking about these issues we must ask this question: Are the retailers the sales agents for the manufacturers? Or are the retailers the purchasing agents for the consumers? I believe it is the latter. Also, I do not believe that consumers really receive the services that are worth the price increases. Or if they do, I think the value of such services should be proven by empirical data, which to date I do not think it has been.

Senator HATCH. Well, I have to say this has been really a very interesting hearing, and all of you have acquitted yourselves very well. I can see why these decisions are so difficult to make and why so few lawyers go into antitrust.

[Laughter.]

Senator HATCH. But this has been very interesting to me, and we will certainly weigh all of your statements very carefully. And I am fortunate to work with the distinguished Chairman here, and we will get together and see what we need to do here.

Chairman KOHL. Thank you, Chairman Hatch.

Senator HATCH. After all, he has been in the business, and I have just been a poor lawyer.

Chairman KOHL. I would like to just pursue what we have been discussing a little further. You know, we have all kinds of varieties of retailing in America. We have the retailers who provide lots of services and many employees and a beautiful store, valet parking, and higher prices. That is how they appeal to their customer.

Then we have people who are providing medium kinds of services, medium kinds of decor, medium kinds of—all kinds of attending kinds, and medium prices.

Then we have people who do it at the lower level. They do it on the basis of price, no overhead or very little overhead, and they pass that on to their consumers.

That is American retailing. It has been, and it is good. I am sure you would defend that. I would like to hope you would defend that. So then why would you say that the manufacturer can do away, in effect, with the discounter, with the lower level, by saying our minimum price is, and you cannot go below that minimum price, which takes away the No. 1 attractiveness of that retailer, who perhaps offers very little else other than his low price? Why would you say—and that person is trying to get the consumer to come in and buy, I mean, representing the consumer, as Ms. Harbour said, why would you say—or why do you say that that kind of retailing in America should be subject to curtailment by the manufacturer? Why would you say that?

Ms. MCDAVID. I think simply, Senator, that the manufacturer should have the choice as to whom it sells. It may say I have a luxury product, I want this sold in the store with the valet parking, the Nordstrom's-type stores. On the other hand, it may say that my brand is not consistent with the discount model, and today the manufacturer has the ability to make that decision as long as it does so unilaterally without an agreement. That is happening today all the time. The Ping golf club example is one of those. But as long as there is an array of products available that compete with that product, then the discount outlets and the medium- priced outlets will all remain. The question is: Where is the consumer going to find the kind of good that it wants to purchase, at the price it wants to purchase, at the quality it wants to purchase? I think we would all agree that a Jaguar car is not sold in a discount outlet, and that is a perfectly legitimate decision for the manufacturer to make.

Ms. SYMS. That is happening today. Syms does not sell Coach handbags, and we do not sell it, and they are able to control their distribution by just saying we do not produce enough to sell to discounters. We sell all of our product and we discount all of our product in our own Coach stores.

And when I referred to one of my points about the foreign aspects of this and that a foreign manufacturer might not be restricted as an American company might be restricted—and that is an issue—many of the larger discounters, like a Wal-Mart, like a Target, can go overseas and they can manufacture and control costs vertically to the consumer. The smaller discounters, the regional discounters, like we are, would not have that advantage. So I think that there is also the possibility that having this price maintenance will be a problem for the smaller discounter, not the larger discounter.

Chairman KOHL. I think so.

Now, again, Ms. McDavid, a Supreme Court ruling is to fix something that needs to get fixed. What is the problem with the way we have the situation now? What is the problem? If they do not want to sell to Syms, they do not have to sell to Syms. Nothing is stopping them. So what was the problem that was so serious that they had to overturn, you know, decades and decades of legalism to say that a retailer can now set a minimum price. If they did not want to sell to Syms, they did not sell to Syms. It was not an issue. They could just say, "We are not going to sell to you." What was the problem?

Ms. MCDAVID. The *Colgate* policies were cumbersome and often did not work in practice. What would happen is the manufacturer would say, "This is the price at which I want my product resold, and if you will not do that, I will not sell it to you."

Now, on paper, that is easy. In practice, it results in the circumstance you had in Ping where the discussions with the dealers were not coming into the marketing department but were coming into the general counsel's office. What would happen in practice—and here I would like to quote my friend Pamela Jones Harbour in one of the first speeches she gave in the Antitrust Section. The policy on paper looked wonderful and complied with the law. But you have a regional sales representative out there who is going out and talking to the folks in the stores. And Pam said that the dialogue went roughly like this:

"Charlie, I love you like a brother, but you're chiseling on the price." And they would have a long discussion about whether Charlie really was chiseling on the price or whether Charlie was going to start complying with the policy, because if Charlie kept chiseling on the price, they were going to cut him off. And that led to an agreement, believe it or not, or a decision to cutoff Charlie, and Charlie sued and said, "They imposed an agreement on me to comply with the policy." And that is where the litigation was. The litigation always involved the question of whether there was an agreement, because the policy itself was fine. It was the implementation that was cumbersome and awkward. I do not think we want marketing decisions being made in the general counsel's office. Frankly, we are not very good at it.

Ms. HARBOUR. Since Jan quoted me—

Chairman KOHL. Another way to say that is we want to make it easier, less cumbersome, less difficult for retailers—for manufacturers to set their price.

Ms. MCDAVID. Exactly.

Chairman KOHL. Beautiful.

Ms. HARBOUR. Chairman Kohl, since—

Chairman KOHL. Beautiful. I could not agree with you more. That is the point of it. But I disagree with it.

[Laughter.]

Chairman KOHL. I do not think you can make the argument that that serves the American consumer. Clearly - and I appreciate that because we have, you know, many parts of the American economy and of our country. It serves the interests of the manufacturer, and that is fine, if you represent that—that is your client and you make the argument, and I appreciate that.

Yes, Ms. Harbour?

Ms. HARBOUR. Senator Kohl, since I was quoted, I will tell the second part of that hypothetical. Yes, it is true that sometimes those *Colgate* policies would fall apart in the marketplace, and, you know, sales reps would say, "Charlie, I love you like a brother, but you got to keep those prices up."

But what Jan did not say, in the second part of my hypo, is that it is possible to have a clean-cut *Colgate* policy. What happens in the marketplace is that sometimes manufacturers get a little cute. They want to implement the "three strikes you are out approach" or structured termination "Well, you know, get those prices up, we will give you one chance." But then when it comes to the second chance, sometimes there is an implicit coerced agreement, and that is where they get into trouble.

So I think that it is possible to have a clean *Colgate* policy. But, the problem occurs when the salesmen are not disciplined and there is a structured termination policy using the "three strikes you are out" structured termination. This is where a lot of the manufacturers get in trouble.

Chairman KOHL. Mr. Pitofsky?

Mr. PITOFSKY. Just a comment on what we have just heard. I am no fan of *Colgate*. It is a mess. But the solution to *Colgate* is not to overrule *Dr. Miles*. I mean, it is a non sequitur. You want to straighten out *Colgate*? Good. We are all for it. We would pitch in on that.

Second, let's be clear that we all agree there should be high-end, middle, and low-end retailers. They should all be protected. But the reason for challenging *Dr. Miles* was to hamper the ability of the low-end discounters to really do their job. And you do that by an epithet. You call them free riders. You call them names. You call them—you say they are not righteous compared to the high end. But the fact of the matter is I have not seen poor services in discount operations. On the contrary, sometimes the services are better.

And, finally, as far as discounters are concerned, it is quite possible the reason they can discount is because they get up earlier, they work harder, they handle their inventory better, they bargain better for prices, and they want to pass their efficiencies along to consumers.

What really upsets me is the argument that the manufacturer has the right to trump the market and prevent the efficient discounter from passing discounts along to consumers. That seems to me inconsistent with what American antitrust is about.

Ms. HARBOUR. And if I might put a fine point on that, Mr. Chairman. There was a study that was done in 1983 by Thomas R. Overstreet. It was titled "Resale Price Maintenance: Economic Theories and Empirical Evidence." And basically what that study found and acknowledged was that traditional wholesalers and retailers had lobbied to legalize minimum RPM, and they did that, and I quote the report, "to shield themselves from new forms of competition." The retailers had argued vigorously that competition and falling consumer prices, in their opinion, were generally bad for the economy and bad for small business, and that motivation is the antithesis of a free and open market economy.

Chairman KOHL. Thank you.

Anybody else want to make a comment? This has been a great hearing.

Ms. MCDAVID. One comment, Chairman Kohl.

Chairman KOHL. Go ahead.

Ms. MCDAVID. No one here today has argued that the absolute per se rule of *Dr. Miles* is the right rule. Chairman Pitofsky has not taken that view. Commissioner Harbour has not taken that view. Certainly we have not taken that view.

Even Commissioner Harbour and Chairman Pitofsky—

[Laughter.]

Ms. MCDAVID.—have said there could be exceptions for new entry there could be exceptions, there could be a *BMI* sort of analysis in which you determine whether the rule of reason applies.

Keep that in mind as you move forward here.

Chairman KOHL. Mr. Pitofsky?

Mr. PITOFSKY. Well, we have a per se rule against horizontal price fixing. It is the toughest rule in the world, and the penalties are extreme. But we also have a softening effect through *BMI* which says if once in a blue moon you have an argument that your horizontal price fixing is efficient, as it turned out it was in *BMI*, we will listen to you, and if you persuade us, we will give you a rule of reason. That does not mean we give the other 97 products a rule of reason. We just back off a little bit and soften the edges of a per se rule. But the value of the per se rule is predictability, certainty, short trials, the ability of private plaintiffs to bring cases like this. It is the staple now of American antitrust enforcement; even though the *BMI* qualification has been added, it did not undermine the horizontal per se rule. And I think a similar approach would have been wiser for the majority in *Leegin*, but they were not interested in preserving the virtues of the per se rule. They were interested in overruling *Dr. Miles*.

Ms. HARBOUR. I absolutely agree with Professor Pitofsky, and if the Chairman is interested, I would give you my proposed wish list for legislation, if you are so interested.

Ms. SYMS. And I just would like to say one thing. Since we have been in business, since 1959, I can recollect in all those years only two times where we were involved in any legal kind of—you know, between a manufacturer and a retailer, and we were one of many. I would make a seventh in my list of predictions. I articulated six. I would make a seventh, that there would be a lot more litigation with the new rule.

Ms. MCDAVID. I would like to comment on the predictability point that Chairman Pitofsky made. These cases were not predictable for the reasons that Commissioner Harbour and I described as to what the dialogue actually looked like in the field between the manufacturer representatives and the dealers. The manufacturers usually did not know that was happening until they actually got sued. There was no predictability at the business level, and the lawsuits—there were thousands of dealer termination cases. They all turned on the question of agreement. Was there enough coercion by that regional sales manufacturer to bring the dealer into the agreement. The dealers won a lot of these cases. The manufacturers won a lot of these cases. But there was lots of litigation, and there was no predictability on the outcome because the manufacturer never knew what was really happening out there. That is why Ping centralized these decisions in the general counsel's office.

Ms. HARBOUR. And that is why Congress can fix this with proposed legislation.

Chairman KOHL. Is this an issue that should never have come before the Supreme—I mean, is this an issue that belongs in Congress?

Ms. HARBOUR. Yes.

Chairman KOHL. Mr. Pitofsky? Professor?

Mr. PITOFSKY. I think the Supreme Court had no need to take this case. It was aware that Congress was comfortable with this rule, and a conservative majority had said 15, 20 years ago that this is price and price is different, as far as we are concerned, so we are going to sit tight and rely on Congress's attitude toward this rule.

So I was surprised they granted cert. Once they granted it, one has a sense that a very conservative Supreme Court might knock off this rule, just as they have found against the enforcement side in antitrust several times now. So I think they should have stayed away from this one. It was working OK.

Ms. MCDAVID. Judges and juries all over the country every day in all antitrust cases except cartel cases weigh all of the facts and circumstances in evaluating whether a particular kind of conduct does or does not have anticompetitive effects. This rule should just be the same as all of the others except cartels.

Mr. BOLERJACK. I agree completely. There is no issue. The Court drew a bright line around cartels. If this is being used to enforce cartel behavior, it will be stopped. I think the Court also laid out that the courts need to be cautious about potential anticompetitive effects. There is no free pass. There is not an expectation that this can go forward and no one will look at it. It can be challenged.

And the final point is one Professor Pitofsky talked about—I believe he said one case every 7 years resulting from the *Sylvania* decision. There are a lot more than that each year dealing with dealer terminations, and they can be used in a variety of ways, sometimes as leverage by a customer who seeks to force a small manufacturer to continue to supply.

Chairman KOHL. I remember during John Roberts's confirmation hearing—perhaps you recall this, too—he made the point that a Supreme Court Justice is really just an umpire. He calls the balls and strikes, and it is pretty much not a matter of judgment, it is just a matter is it a ball or a strike, and virtually anybody looking at it fairly would see most of these issues the same way.

Could we at least agree that that is not entirely true, that smart, intelligent people sitting on the Supreme Court can and do look at issues and see them differently because they are people of different judgments and temperaments, as, for example, this case might indicate?

Ms. MCDAVID. And there are different implications of these policies that can be seen differently by different people.

Chairman KOHL. Absolutely. What else? Anybody else? Ms. Harbour, go right ahead.

Ms. HARBOUR. Just to put another fine point on what Professor Pitofsky said, I do think that the ability to price independently is sacrosanct. Some of the earlier cases held that. I think price is the central nervous system of our American economy. I believe that prices will go up in the wake of *Leegin*. Consumers will pay more money, and that is the bottom line. I believe that the basis for overturning *Dr. Miles*, i.e. the "new" economic learning—is not new. These are the same arguments that were made in 1911. These arguments were rejected by the *Dr. Miles* court. These were the same arguments that were made in 1975. these arguments were rejected by Congress. There is nothing new here. The only thing "new" that has changed is the composition of the Supreme Court and its disregard for congressional will and *stare decisis*.

Chairman KOHL. Well, it has been a great hearing. We have got some obviously very smart people sitting before us, and you have given us all the difference sides of the issue, and let's see where we go from here. So we thank you all for coming this morning.

[Whereupon, at 11:23 a.m., the Subcommittee was adjourned.]

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

QUESTIONS AND ANSWERS

Senator Kohl's Follow-Up Questions for Hearing on
"The Leegin Decision: The End of Consumer Discounts or Good Antitrust Policy?"

For Stephen Bolerjack, representing the National Association of Manufacturers:

1. One of my chief concerns with permitting resale price maintenance is that it will result in higher prices for consumers. Numerous economic studies bear this out. For 40 years prior to 1975, federal law permitted states to enact so-called "fair trade" laws allowing vertical price fixing. These laws were abolished by the passage of the Consumer Goods Pricing Act of 1975. Numerous studies prior to the passage of that law in 1975 documented the fact that retail price maintenance leads to higher prices. Studies conducted by the Department of Justice in the late 1960s indicated that retail prices were between 18 and 27% higher in states that allowed vertical price fixing than those that did not. A 1982 study estimated that allowing vertical price fixing nationally would raise prices on about one-third of consumer products by as much as 20 percent. And, in his dissenting opinion in the Leegin case, Justice Breyer estimated that if just ten percent of products were subject to vertical price fixing, would affect $300 billion dollars in commerce, raising the average bill a family of four would pay for retail goods by $750 to $1000 every year.

Don't these studies establish that allowing resale price maintenance will lead to higher prices? Do you have any evidence to the contrary?

RESPONSE

The studies do not establish that resale price maintenance agreements invariably raise prices to consumers. The studies, prepared decades ago, concern price differences between fair trade and non-fair trade areas. Assessing resale price maintenance agreements under the rule of reason is not the equivalent of a return to fair trade arrangements. In fact, a summary of the studies indicates that fair trade arrangements had mixed effects on prices.

The most important point is that studies concerning the effects of the "fair trade" laws on prices provide no basis to predict the effects of the *Leegin* decision – this is comparing apples and oranges. Under the "fair trade" laws (the Miller-Tydings Act of 1937 and the McGuire Act of 1952) resale price agreements were exempt from Sherman Act challenge if valid under state law. Not so with *Leegin*: resale price agreements may be challenged under federal as well as state laws. Fair trade afforded a "free pass" to engage in resale price maintenance while *Leegin* does not.

Manufacturers are far less likely to require resale price maintenance now than they were when there could be no antitrust liability for doing so. The *Leegin* court drew a bright line continuing to impose liability for horizontal agreements to engage in resale price maintenance by a group of competing retailers or manufacturers. The Court also identified dominant firms using resale price maintenance as potential sources of anticompetitive effects. The Court identified a number of other factors that would raise antitrust concern, such as the source of the restraint and the number of firms using it.

In addition, firms now considering the use of resale price maintenance agreements also face potential liability under state law that did not exist during the fair trade period. While some state antitrust laws provide that state courts should defer to federal interpretations, others do not. Still other states have statutes that can be interpreted to continue *per se* treatment of resale price maintenance agreements. Thus, it is clear that the change to rule of reason treatment offers much less protection from antitrust liability than the absolute exemption under the fair trade laws. This major difference eliminates the basis for using the results of decades-old studies to predict the number or magnitude of price changes by firms choosing to use resale price maintenance agreements.

The ABA's response to this question discusses the findings of the various studies in some detail. The NAM agrees with the ABA's response, and will not repeat their analysis.

2. I am also very concerned about the implications of the Leegin decision for new, competitive discounters. Many people argue that the large, and by now well established, "big box" store like a Walmart, Best Buy or Target, or an internet web site leader like Amazon can "take care of themselves" and get the merchandise they need. But how about the next new discounter, the next Sam Walton, or the next Jeff Bezos? If manufacturers can set retail prices and forbid discounting won't this mean the end of new discount stores in the marketplace, to the detriment of competition and consumers?

RESPONSE

We believe your concern is misplaced. There is no evidence that resale price maintenance will prevent the rise of new and existing discount stores, since these stores provide useful services for manufacturers. Indeed, numerous discount stores thrived during the fair trade era, when resale price maintenance was exempt from antitrust scrutiny.

Leegin will not eliminate consumer discounts. Manufacturers often like discounting, and discount stores can provide useful services to manufacturers. As explained by Marcy Syms at the hearing on July 31, 2007, SYMS has "long established relationships with over 200 of the top designer and brand name manufacturers." They provide a useful service for manufacturers: "Most of the merchandise is first-quality and in-season. The availability of this merchandise is the result of over-production, cancelled orders, and other factors." As stated by now-Circuit Judge Easterbrook: "Most manufacturers want to hold the 'cost of distribution' (the retailer's mark up) as low as possible. The K-Marts of the world do this, to everyone's great benefit. Nothing in restricted dealing threatens the ability of consumers to find low prices." Frank Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 Antitrust L. J. 135, 152-53 (1984).

Discounters thrived during the fair trade period, when resale price maintenance agreements were exempt from antitrust review. "S. S. Kresge (the old K-Mart) flourished during the days of manufacturers' greatest freedom. It flourished because discount stores offer a combination of price and services that many customers value." Easterbrook, supra at 152. Indeed, Ms. Syms testified that the Syms organization was founded in 1959, when the fair trade laws still had 16 years of life left. The rise of discount stores was supported by the willingness of consumers to accept reduced services, a change chronicled by David Halberstam in *The Fifties*, 144-54 (1994) (describing stores started by Eugene Verkauf, which later became the E. J. Korvette chain).

3. Virtually every other western industrialized democracy treats vertical price fixing as per se illegal, including Great Britain, Germany, France and many others. Canada treats it as a criminal offense. What does this experience teach us? And why should the rule in the United States be any different?

RESPONSE

The per se treatment of resale price maintenance in Western Europe and Canada is not an example to be followed because those laws are primarily enforced by government regulators, not private parties, and those laws do not provide the incentive to litigate furnished by the treble damage remedy in the United States. Inflexible rules are more acceptable when enforced by government agencies likely to insist on evidence of injury to competition rather than enforcement by private parties seeking damages for injury to a competitor, not competition. The learning here may be that the American combination of a private right to sue, treble damages, and an inflexible rule assuming anticompetitive effects that existed prior to *Leegin* is a "witch's brew" no other country has yet tasted.

The competition laws of the European Union and its member states are primarily enforced by regulation, not private litigation. A 2004 study (the Ashurst Report) for the European Commission described an "astonishing diversity and total underdevelopment" of private antitrust enforcement across the European Union. The first award of damages for breach of competition law in the United Kingdom was entered in 2004. Moreover, we understand that private parties can not recover treble damages, as they can in the United States.

The experience in Canada, which has criminal penalties for resale price maintenance, is similar. As to criminal enforcement, sometimes the only penalty is an order prohibiting future repetition of the conduct, and the largest fine ever assessed is $250,000. (Competition Bureau website at: http://www.competitionbureau.gc.ca/internet/index.cfm?itemID=2003&lg=e .) The Canadian Competition Act permits private litigation, but only for actual damages, not treble damages. Moreover, our research did not uncover any award of damages in private litigation for violation of this provision. In addition, a complete defense to the violation is provided if the defendant can show that it believed the person supplied: "made a practice of not providing the level of servicing that purchasers of the products might reasonably expect", or used the products as loss-leaders or for attracting customers to the store to sell other products – complaints frequently expressed by manufacturers about discounters.

The relative lack of private litigation and the absence of treble damages in these jurisdictions limit the bad effects of the inflexible per se rule, unlike the situation in the United States prior to *Leegin*.

4. Do you have any ideas for legislation with respect to resale price maintenance, or do you believe that legal rules are correct after the Leegin decision?

RESPONSE

We believe the legal rules are correct after the *Leegin* decision. *Leegin* requires courts to focus on the true issue: whether the effect of the restraint is anticompetitive. It properly limits per se analysis to practices that always or almost always restrict competition or decrease output – which is not true of resale price maintenance. *Leegin* does not immunize resale price maintenance agreements from antitrust challenge, as was the case under the fair trade laws. This decision will permit individualized analysis of complex issues, which a per se or legislative rule precludes.

I and the National Association of Manufacturers appreciate the opportunity to provide our viewpoints on matters of concern.

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Commissioner Pamela Jones Harbour

September 5, 2007

The Honorable Herb Kohl
United States Senator
Chairman, Subcommittee on Antitrust, Competition
Policy and Consumer Rights
Judiciary Committee
330 Hart Senate Office Building
Washington, DC 20510

Re: Responses to Supplementary Questions Regarding the Supreme Court's Decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 127 S. Ct. 2705 (2007).

Dear Senator Kohl:

In your letter of August 23, 2007, you asked me to respond to questions posed by members of Subcommittee on Antitrust, Competition Policy and Consumer Rights as a follow-up to my testimony on July 31, 2007, "The Leegin Decision: The End of Consumer Discounts or Good Antitrust Policy?"

During my testimony I stated that the *Leegin* decision should be legislatively overturned. Members have now asked for a description of legislation that I would recommend. The simple answer is that resale price maintenance should be unlawful.[1] A statute which might accomplish that result would simply state:

> Every contract, combination, or conspiracy within the meaning of Section 1 of the Sherman Act that restrains a vendee of a product or service from reselling such product or service at less than the price stipulated by the vendor or producer shall be illegal.

The form of the proposed statute parallels that of Section 1 of the Sherman Act and incorporates by reference both its jurisdictional reach and the judicial certainty already established by the courts with respect to such underlying issues as what constitutes "agreement" for purposes of

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[1] This letter expresses my personal views and does not express the policy or position of the Federal Trade Commission or any other Commissioner of the FTC.

establishing liability under Section 1. It is in effect a simple directive to the courts of the United States advising that consumers deserve the benefit of the doubt whenever a commercial arrangement precludes merchants from competing with respect to the prices being offered to consumers.

The second question posed by members of the Subcommitte is in reality a series of questions which collectively inquire into whether the Congress rather than the Court was in a better position to decide what legal standards should now apply to resale price maintenance. The questions were prefaced by a brief summary of the history of Congress's repeal of the antitrust exemption for resale price maintenance in 1975, and subsequent occasions when the Congress imposed limitations on the appropriations for the Antitrust Division of the Department of Justice and the Federal Trade Commission which precluded their advocacy of abandoning the rule of *per se* illegality for minimum vertical price fixing. It also observed that the Congress in 1986 had expressly disapproved of the Department of Justice Vertical Restraint Guidelines. I note that those guidelines were subsequently withdrawn by the Department. I will respond separately to each of the questions then posed by your letter.

"Do you believe it was appropriate for the Supreme Court majority to reverse such a well-settled antitrust rule that business and consumers had come to rely on for nearly a century, especially in the face of its repeated reaffirmation by Congress?"

Answer: No, it was not appropriate for the Court to have ignored the fact that there has been substantial reliance on the settled proposition of antitrust law that resale price maintenance was *per se* illegal. Justice Breyer, on behalf of the dissenting Justices in *Leegin*, set forth a stinging refutation of the Court's basis for setting aside well-established legal precedent and Congressional reliance when nothing new had occurred. The business community has relied on the *per se* illegality of resale price maintenance in making substantial investment decisions since 1975. Changing a rule of law which may have profound effects on the structure and performance of the economy as a whole hardly seems appropriate. Indeed, the Court itself had repeatedly relied on the *per se* illegality of resale price maintenance to overturn state regulatory measures. *See, e.g., California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.* 445 U.S. 97 (1980).

"If any changes were needed, shouldn't Congress be the ones to do so rather than five justices of the Supreme Court?"

Answer: In the case of minimum vertical price fixing, only Congress should have changed the standards of illegality for resale price maintenance. Unlike the Court, the Congress has the resources and power to hold legislative hearings and attempt to predict what, if any, changes might occur in the economy as a whole in response to such a change in the law. The Constitution vests legislative discretion in the Congress, not the Court. Devising rules of law based on a broad-based inquiry, as opposed to one bounded by the interests of particular private parties, seems inherently non-judicial. I recognize that Congress has allowed the Sherman Act to grow over time through the accretion of experiential rules crafted by the courts, much in the manner of the common law; that, however, does not grant the Court a license to rewrite the very purposes for which Congress acted in adopting the federal antitrust laws. The Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 80, was adopted with the express Congressional intention that resale price maintenance should be and remain *per se* illegal under Section 1 of the Sherman Act. The Supreme Court itself recognized the prudence of leaving this issue to Congress in its decision in *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" passage of the Consumer Goods Pricing Act of 1975.). The Court should have continued to follow its own *GTE* example.

"Isn't what the Supreme Court did here contrary to Congressional intent."

Answer: Clearly. Justice Kennedy's claim of "respect" for Congressional intent is at best a hollow reed. *Leegin*, 127 S. Ct. at 2724 ("Congress could have set the *Dr. Miles* rule in stone, but it" did not do so.). The claim that failing to adopt an express *per se* rule to memorialize an already *per se* rule is a plea for mindless redundancy that does the Court no credit. Similarly, the Court notes that several limitations on appropriations were only fleeting compromises rather than expressions of Congressional intent; that is akin to claiming blindness when the only cause for not seeing is the fact that the eyes are closed. *Id.* ("The conditions on funding are no longer in place . . . and they were ambiguous at best."). The *Leegin* majority seems only to recognize permanent statutory enactments as expressions of Congressional intent. I urge the Congress to give the Court an expression of intent that cannot be ignored. That is, amend the Sherman Act to state without equivocation that vertical minimum price fixing is illegal.

Respectfully submitted,

Pamela Jones Harbour
Commissioner

Defending Liberty
Pursuing Justice

AMERICAN BAR ASSOCIATION
740 Fifteenth Street, NW
Washington, DC 20005-1022
(202) 662-1000
FAX: (202) 662-1032

Via Messenger

September 7, 2007

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

Dear Chairman Kohl:

Thank you again for inviting me to testify on behalf of the American Bar Association at your Subcommittee's hearing regarding "The *Leegin* Decision: The End of the Consumer Discounts or Good Antitrust Policy" on July 31, 2007 and for asking us to respond to additional questions arising out of the hearing. Enclosed are the responses of the American Bar Association to those questions.

If you have any additional questions, or if we can be of any additional assistance to you and the Subcommittee, please ask your staff to contact me at (202) 637-8780 or Larson Frisby of the ABA Governmental Affairs Office at (202) 662-1098.

Sincerely,

Janet L. McDavid

Enclosure

cc: Margaret Horn (Margaret_Horn@judiciary-dem.senate.gov), w/enclosure
R. Larson Frisby, ABA Governmental Affairs Office (frisbyr@staff.abanet.org), w/enclosure

American Bar Association Response to Senate Antitrust Subcommittee Follow-Up Questions Regarding *Leegin*

1. You asked whether economic studies establish that allowing resale price maintenance will lead to higher prices and whether there is any evidence to the contrary. The studies show that minimum resale price maintenance can have mixed effects—in some instances it can be procompetitive, and in other instances it can have anticompetitive effects that produce higher prices. Because resale price maintenance can be benign or procompetitive, rule of reason analysis is the appropriate way of measuring these mixed effects. If resale price maintenance produces anticompetitive effects, it can be found unlawful under the rule of reason.

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

Several of the studies reviewed by Overstreet showed that resale price maintenance had mixed effects. In a 1938 study of 50 drug products sold by drug retailers in New York State, the data showed that, after passage of fair trade legislation, prices increased for nationally advertised goods sold in discount stores, but fell slightly for the same items sold in non-discount stores.[2] Prices for those items that were not nationally advertised did not seem to be affected.[3]

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

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

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[1] THOMAS R. OVERSTREET, JR., RESALE PRICE MAINTENANCE: ECONOMIC THEORIES AND EMPIRICAL EVIDENCE (F.T.C. 1983).
[2] *Id.* at 107.
[3] *Id.*
[4] *Id.* at 127.
[5] *Id.* at 128.
[6] *Id.* at 137.
[7] *Id.*
[8] *Id.* at 137-38.

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

First, fair trade laws were not equivalent to an antitrust regime that provides rule of reason treatment for resale price maintenance. Resale price maintenance in the post-*Leegin* world depends on the willing acquiescence of both seller and retailer; under the fair trade laws of certain states, a resale price maintenance agreement with one retailer in a state could bind all other retailers, whether they agreed or not.[10] The competitive effects of this regime will obviously be very different from the effects of the agreement that would be permitted in a post-*Leegin* world.

Second, the retail landscape in the U.S. is considerably different today than during the fair trade era, and it is improbable that a manufacturer could impose resale price maintenance on big box discount stores like Wal-Mart, Target or Best Buy. These types of large multi-brand retailers, which account for a significant part of the consumer economy,[11] have buying power that "trumps even the power of a supplier of a major brand."[12] As one commentator has noted, this kind of retail buying power gives the large retailer control over "whether [items] will be *priced* or marketed aggressively," and this, in turn, gives it "substantial leverage in dealing with even the largest producers of strong brands of consumer products."[13] To the extent that empirical studies from the fair trade era indicate that resale price maintenance resulted in higher prices, the findings cannot be extrapolated to support predictions about what the effects would be in the current economy.

Sale of branded goods through off-price discounters has become such a deeply embedded retail channel that off-price discounters, similarly, are not likely to be affected by the change in treatment of minimum resale price maintenance from *per se* to rule of reason. This was suggested in a July 6, 2007 article in USA TODAY that looked at the effect of *Leegin* on the sale of discounted apparel brands, *Discounted Designer Labels Here to Stay; High Court Ruling Unlikely to End Off-Price Retailing.*[14] The authors concluded, after interviewing Marcy Syms and others, that the impact of the Court's decision on off-price retailers is "likely to be slight." According to the authors, "[c]hanges sweeping through the retail industry have been opening new paths for designer clothes to reach consumers at off-price stores. And not much seems likely to slow that trend." Robert D'Loren, the CEO of NexCen Brands, owner of the Bill Blass

[9] *Id.* at 163.
[10] *See* 1A CALLMANN ON UNFAIR COMPETITION, TRADEMARKS AND MONOPOLIES § 6:3 FN.4 (4TH ED. 2007).
[11] Wal-Mart is said, for example, to account for 22% of all toys sold in the U.S. *See* Warren S. Grimes, *Buyer Power and Retail Gatekeeper Power: Protecting Competition and the Atomistic Seller,* 72 ANTITRUST L.J. 563, 580 (2005). According to one of its websites, www.walmartfacts.com/content/default.aspx?id=3, Wal-Mart had 3800 stores in the U.S. as of year-end 2005.
[12] Grimes, *supra* note 10, at 579.
[13] *Id.* (emphasis added).
[14] JAYNE O'DONNELL AND CHRISTINE DOUGLAS, DISCOUNTED DESIGNER LABELS HERE TO STAY, USA TODAY, JULY 6, 2007 AT 1B, *available at:* http://www.usatoday.com/money/industries/retail/2007-07-05-off-price-bargains_n.htm

label, expressed doubt that the ruling will have any far-reaching consequences. He stated that he could not imagine that manufacturers would insist on minimum prices by off-price retailers, which already must agree not to advertise the brands they are offering. He observed that designers cannot afford to alienate them by reducing or eliminating discounts since they are "the lowest point of distribution."

The baseline question is whether consumer welfare will be adversely affected by a change in how minimum resale price maintenance agreements are evaluated under the antitrust laws. While some manufacturers may find it advantageous to use such agreements to ensure that retailers provide amenities (i.e., atmosphere, convenient downtown locations, etc., – all of which are expensive) or services, there is little likelihood that a manufacturer, in Professor Pitofsky's words, will be able to "trump the market" and prevent an efficient retailer from passing discounts on to consumers.[15] If the manufacturer has guessed wrong about product pricing, consumers will vote with their wallets and take their business to competing brands.

2. You asked whether minimum resale price maintenance will mean the end of new discount stores, to the detriment of competition and consumers. There is no basis for thinking that evaluation of resale price maintenance agreements under the rule of reason will doom new entrants. The same claims were made in Congressional Hearings after the Supreme Court decisions in *Monsanto Co., v. Spray-Rite Serv. Corp.,* 465 U.S. 752, 765 (1984) and *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 723 (1988), made it more difficult for plaintiffs to prove resale price maintenance cases.[16] These predictions could not have been more wrong—in the intervening years, new discount stores have thrived while traditional full-service retailers are disappearing.

We are aware of no empirical evidence that the fair trade laws had the effect of stunting or preventing entry by new discount retailers. On the contrary, there is near-consensus that minimum resale price maintenance can be procompetitive in facilitating the introduction of new products or entry by new producers. Justice Breyer observed in his dissent in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 127 S.Ct. 2705 (2007), that resale price maintenance is recognized as a means by which dealers can be encouraged to carry the product of a new market entrant, "thereby helping the new producer succeed." 127 S.Ct. at 2728. Even Professor Pitofsky acknowledges that new entry may be a situation where it would make sense to relax the *per se* rule.[17] New entry ought to be encouraged, and testing resale price maintenance under the rule of reason will serve this objective.

Further, as I testified to at the hearing, resale price maintenance already existed prior to the Supreme Court's decision in *Leegin*, when manufacturers made unilateral decisions to impose resale prices and terminated those distributors or retailers who did not charge those

[15] *The Leegin Decision: The End of Consumer Discounts or Good Antitrust*: Hearing before the Subcomm. on Antitrust, Competition Policy and Consumer Rights, S. Comm. on the Judiciary, 110th Cong. Tr. at 56 (July 31, 2007) (statement of Prof. Robert Pitofsky).

[16] "[T]his decision [*Sharp*] lets retailers and manufacturers act in concert to stifle competition with impunity. The discount industry will suffer, but more importantly, consumers will suffer and so will American competitiveness." *Senate Hearing to Amend Sherman Act Regarding Retail Competition – S.865.* Hearing before the Senate Judiciary Comm., 101st Cong., June 1, 1989 at 5 (Statement of Sen. Warren B. Rudman).

[17] *Leegin Decision Subcommittee Hearing supra* note 15, Tr.at 18 (statement of Prof. Robert Pitofsky).

prices, and its existence has not harmed the growth of competitive discounters, such as the "big box" stores like Walmart, Best Buy, and Target. Under *United States* v. *Colgate & Co.*, 250 U.S. 300 (1919), any manufacturer can make a unilateral decision to establish a resale price program and can terminate retailers and dealers who do not conform to that program. In the absence of communications that could be construed as an "agreement" between the manufacturer and the dealers, these programs were and are considered perfectly legal, despite the fact that they effectively result in resale price maintenance across the board. When litigation arises over a suggested resale price program, usually because a dealer complains about adhering to the suggested resale price or is terminated for refusing to adhere, the resulting litigation focuses on communications between the dealers and the manufacturer, not on the competitive benefit or harm of the arrangement. That approach is inappropriate and counterproductive; the correct focus of the inquiry should be on the competitive benefits or harms of the arrangement, not on whether there was an agreement. *Leegin* simply places the focus on competitive effects, which is where it should be.

3. You asked whether it was appropriate for the Supreme Court majority to reverse such a well-settled antitrust rule as *per se* treatment of resale price maintenance, particularly given Congress' enactment of the Consumer Goods Pricing Act in 1975, its refusal to allow the Department of Justice ("DOJ") to use appropriations for advocating the reversal of *per se* treatment of resale price maintenance in 1983 and 1985, and its reversal of the DOJ Vertical Restraint Guidelines in 1986. In light of developments in economic experience and antitrust doctrine, such a reversal was appropriate and, indeed, in line with the Court's gradual shift away from *per se* rules of antitrust liability to rule of reason analysis in many cases.

The *per se* rule of antitrust liability applies to practices that always or almost always restrict competition and/or decrease output. Because its use forecloses a detailed inquiry into the competitive effect of the practice at issue, the Supreme Court has held that the *per se* rule should be limited to restraints that are "plainly" and "manifestly" anticompetitive. *See Business Elecs.*, 485 U.S. at 723 (citing *Continental T.V., Inc.*, v. *GTE Sylvania, Inc.*, 433 U.S. 36, 50 (1977)). As legal and business experience with the antitrust rules has grown, the Court has slowly rolled back use of the *per se* rule in the vertical context, recognizing that restraints previously thought to be always anticompetitive actually can have procompetitive benefits. *GTE Sylvania* overruled the *per se* prohibition against vertical non-price restraints set by *United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), both *Monsanto* and *Business Elec.*, made it more difficult for a plaintiff to prove a vertical price conspiracy, and *State Oil Co.* v. *Khan*, 522 U.S. 3 (1997) overruled *per se* treatment of maximum vertical price fixing established by *Albrecht* v. *Herald Co.*, 390 U.S. 145 (1965). *Leegin* simply continues the recognition that vertical arrangements are not "manifestly" anticompetitive, but instead can have procompetitive benefits that should be subject to antitrust analysis instead of being summarily condemned.

Rule of reason analysis of resale price maintenance is not contrary to the Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 801, amending 15 U.S.C. §1, 45(a) (1970). As set out in the majority opinion in *Leegin*, "[t]he 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." *Leegin*, 127 S. Ct. at 2724. Congress could have chosen to mandate *per se* illegality, but it did not. Instead it effectively gave the Court the ability to continue to interpret resale price maintenance in light of developing economic theory and commercial reality. That is precisely what the Court did in *Leegin*. In doing so the Court did not mandate *per se* legality to the practice of resale price maintenance, which is what the Consumer Goods Pricing Act prohibits, but simply required that resale price maintenance be analyzed to determine its competitive effect.

Congress' 1983 and 1985 bans on DOJ use of appropriations to advocate a reversal of the prohibition on resale price maintenance and its 1986 reversal of the DOJ Vertical Restraint Guidelines took place over 20 years ago. In light of recent antitrust jurisprudence and economic experience, it is not clear whether Congress would take the same action today.

4. You asked why the U.S. should have a rule for evaluating resale price maintenance that differs from the rule in Great Britain, Germany, France and other nations in which vertical price-fixing is *per se* illegal. The answer is simple: our antitrust laws are not patterned after those of other countries because the U.S. had antitrust laws in place, with a rich and responsive body of judicial decisions, long before these other countries did. Experience has shown that the antitrust laws of the European Union and its member nations have been converging with those of the U.S., not the other way around. One reason is that these other countries can learn from the U.S. experience.

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

The Court's decision in *Leegin* does not depart from the basic tenet that protection of competition is the goal of the antitrust laws. Instead, it has freed one type of restraint -- minimum resale price maintenance agreements -- from a rigid rule that had prevented any inquiry into whether such a restraint could prove beneficial to competition and consumer welfare in certain cases. If other countries continue to follow rigid rules, that is their prerogative, but their experience offers no meaningful guidance on how U.S. antitrust law should be applied. But it is equally possible, and perhaps more likely, that other jurisdictions will follow the lead of the U.S. with respect to resale price maintenance as they have with respect to other antitrust laws.

5. You asked whether we have suggestions on ideas for legislation with respect to resale price maintenance or whether we believe that legal rules are correct after the *Leegin* decision. We believe the post-*Leegin* rules on resale price maintenance are sound. As a result, we do not believe that federal legislation overturning or modifying the Court's decision is necessary or desirable at this time. As I testified, resale price maintenance can have real procompetitive benefits, such as the elimination of free-riding and encouragement of interbrand competition. These procompetitive benefits will benefit consumers, not harm them. Over time, courts will have the opportunity to draw the boundaries between the resale price programs that are beneficial and those that are harmful -- as has been done with other antitrust issues. The courts' interpretations will provide useful guidance to the business community and the bar, as has been true with respect to other antitrust issues.

RESPONSES TO QUESTIONS FROM SENATOR KOHL FOLLOWING-UP ON THE SUBCOMMITTEE'S HEARINGS ON THE LEEGIN DECISION

For Professor Pitofsky

1. At the hearing you argued that the Leegin decision was wrongly decided. Do you advocate legislation to address resale price maintenance? If so, what should that legislation consist of in your view?

Response:

Yes, legislation to restore a per se rule against minimum resale price maintenance is justified. The Leegin decision to overrule Dr. Miles was wrong because it will more freely allow resale price maintenance which in turn will raise prices to consumers. The "service justifications" are weak and shop worn. Also, the alleged justifications which will give benefits to consumers are based entirely on theoretical claims; there is not a shred of evidence in the Leegin record or in virtually all scholarship advocating the abandonment of the Dr. Miles per se rule, that resale price maintenance is intended to or in fact does induce or maintain valuable services in the marketplace.

It is important to recognize that every seller gets the benefit of rule of reason treatment with the overruling of the Dr. Miles per se rule. But the vast majority of sellers can put forth no service justification in connection with their products. When resale price maintenance was legal during the fair trade years, the products most frequently "fair traded" were cosmetics and pharmaceuticals. There is almost no likelihood that services are associated with the sale of such products and yet the sellers, raising the price to consumers, will get the benefit of a long, expensive complicated trial – so expensive and complicated that most private parties would shy away from initiating those kinds of lawsuits.

As to the content of any proposed legislation, I start from the proposition that there probably are some instances of justifiable resale price maintenance. In my view, the most persuasive example involves a new entrant with no present market power attracting dealers in a highly competitive market by offering them protected retail prices. But we have experience with a new entrant – exception to a per se rule. *See* United States v. Jerrold Corp., 187 F.Supp. 545 (E.D.Pa 1960) affirmed per curiam 365 U.S. 567 (1961)). Another alternative is to apply the teaching of Broadcast Music Inc. v. Columbia Broadcasting System, Inc., 441 U.S. 1 (1979) where the Supreme Court, noting plausible justifications for what might otherwise be regarded as price fixing (particularly efficiencies and lowering of costs) remanded so that the Court of Appeals could apply a full rule of reason. Allowing a rule of reason after a defendant has shown a plausible justification makes sense; giving every seller a full rule of reason even though it is clear that most products cannot justifiable be price maintained, does not.

2. One of my principal concerns with the Leegin decision is that, in Leegin, a bare 5-4 majority of the Supreme Court abruptly overruled a 97-year-old well settled antitrust rule. Not only had this rule been in place for nearly a century, but it had been reaffirmed by many different

(#response pitofsky.DOC)

Acts of Congress over the years. In 1975, Congress enacted the Consumer Goods Pricing Act, barring states from passing so-called "fair trade" laws permitting vertical price fixing. On two subsequent occasions in the 1980s – in 1983 and 1985 – Congress expressly forbade the Department of Justice from using appropriations to advocate for a reversal of the ban on resale price maintenance. Additionally, in 1986, Congress expressly reversed the then-recently enacted Justice Department Vertical Restraint Guidelines which would have ended the ban. In the fact of this history, the Supreme Court decision seems to be an unfortunate act of judicial activism and disregards the fundamental rule of precedent.

Do you believe it was appropriate for the Supreme Court majority to reverse such a well-settled antitrust rule that business and consumers had come to rely on for nearly a century, especially in the face of its repeated reaffirmation by Congress? If any changes were needed, shouldn't Congress be the ones to do so rather than five justices of the Supreme Court? Isn't what the Supreme Court did here contrary to Congressional intent?

<u>Response:</u>

I believe the majority of the Supreme Court in its <u>Leegin</u> opinion did not pay adequate attention to the fact that Congress had long been aware of the <u>Dr. Miles</u> per se rule and, to the extent that it has legislated in related areas, appears to have condoned that approach. Justice Powell in his 1977 decision in <u>Continental TV Inc.</u> v. <u>GTE Sylvania, Inc.</u>, 433 U.S. 36 (1977), spoke for a majority in overruling the per se rule against territorial allocation, but noted that the "per se illegality of price restrictions has been established firmly for many years and involves significantly different questions of analysis and policy." The majority in <u>Leegin</u> chose to simply ignore the majority view of Justice Powell in <u>Sylvania</u> that restrictions on price competition is different. ,

If <u>Dr. Miles</u> were clearly wrong, or shown to be wrong by subsequent developments, I accept that the Supreme Court can overrule even longstanding precedents. But we don't know anything today that the Supreme Court has not known through the years about the anti-consumer and anti-discounter impact of allowing minimum resale price maintenance. Certainly it should take fully into account, as the majority in <u>Leegin</u> failed to do, the considered opinions of Congress.

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August 24, 2007

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

Dear Senator Kohl:

I'm so glad that you are continuing to pursue the idea of legislation to help ameliorate the effects of "The Leegin Decision." You asked the right questions!

It would be very unlikely for SYMS to bring an antitrust suit. We would not have the resources, knowledge or a strong enough position in the market place to make such action prudent.

I hope these answers help you to formulate your discussion.

Very truly yours,

Marcy

Marcy Syms

MS:rt

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SUBMISSIONS FOR THE RECORD

Testimony of Stephen Bolerjack
Dykema Gossett, PLLC
On behalf of the National Association of Manufacturers
To the Senate Judiciary Subcommittee on Antitrust, Competition Policy and Consumer Rights
"The *Leegin* Decision: The End of Consumer Discounts or Good Antitrust Policy?"
Tuesday, July 31, 2007

Thank you, Mr. Chairman and members of the Subcommittee. For the record, I am Stephen Bolerjack. I'm a lawyer with Dykema Gossett in Detroit. I chair the Competition Task Force of the National Association of Manufacturers ("NAM"). I and the NAM appreciate the opportunity today to provide the perspective of manufacturers on the Supreme Court's recent *Leegin* decision.

The National Association of Manufacturers is the nation's largest industrial trade association, representing small and large manufacturers in every industrial sector and in all 50 states. The NAM's mission is to enhance the competitiveness of manufacturers by shaping a legislative and regulatory growth environment conducive to U.S. economic growth and to increase understanding among policymakers, the media, and the general public about the vital role that manufacturing plays in America's economic future and living standards.

The National Association of Manufacturers supports the *Leegin* decision as sound antitrust policy:

- *Leegin* follows the guiding rule of modern antitrust jurisprudence that limits the *per se* analysis to practices that "always or almost always tend to restrict competition or decrease output." This is simply not true of minimum resale price maintenance. *Leegin* applies the rule of reason, the accepted standard for antitrust cases, to minimum resale price maintenance agreements;

- *Leegin* reflects the progression of antitrust law for the past thirty years in limiting the scope of the *per se* rule. *Sylvania* in 1977 and *Khan* in 1997 each overruled prior Supreme Court decisions to apply the rule of reason to vertical restraints; and

- *Leegin* requires courts to make decisions based on substance – the effect of the restraint on competition in a market – rather than on formalistic analysis of whether conduct shows an agreement between a manufacturer and a reseller. In addition, it will permit defendants to defend themselves in these cases by proving facts about competitive effects that they were precluded from using under the *per se* rule.

Importantly, *Leegin* does not give manufacturers the green light to enter into minimum resale price agreements without the possibility of challenge; resale price maintenance is not *per se* legal. Resale price maintenance imposed as a result of an agreement with competing suppliers will remain per se illegal.

BACKGROUND

In 1911 the Court decided *Dr. Miles Medical Co. v. John D. Park & Sons Co.,* 220 U.S. 373 (1911). The case held that an agreement between a manufacturer and its distributor on the minimum price the distributor can charge for the manufacturer's goods was *per se* illegal under Section 1 of the Sherman Act. Eight years later, the Court decided, in *United States v. Colgate & Co.,* 250 U.S. 300 (1919), that a manufacturer that refused to deal with retailers that discounted did not violate Section 1, since this was a unilateral policy and there was no agreement as is required to find a violation of Section 1.

Leegin overrules *Dr. Miles* and requires that the rule of reason analysis be applied to minimum resale price maintenance, as is already the rule for maximum resale price maintenance (*State Oil v. Kahn,* 522 U.S. 3 (1997)) and non-price vertical restraints (*Continental T.V. v. GTE Sylvania Inc.,* 433 U.S. 36 (1977)). As discussed below, *Sylvania* and *Kahn* each overruled prior Supreme Court precedent.

***LEEGIN* DECISION**

Leegin Creative Leather Products, Inc. v. PSKS, Inc. __ U.S. __, 2007 WL 1835892 (No. 06-480) (June 28, 2007) overruled *Dr. Miles* and held that minimum resale price maintenance would be judged under the rule of reason on a case-by-case basis. Leegin is a maker of women's leather goods and accessories sold under the Brighton brand. It developed a policy of dealing with boutique stores, and asked retailers to sell the goods at prices Leegin specified. It ultimately grew to supplying over 5,000 retailers, but had a very small share of the total market for women's leather goods and accessories. PSKS discounted Leegin's products, allegedly to compete with other firms discounting the Brighton line. When requested to cease discounting, PSKS refused and Leegin stopped selling product to it. PSKS sued, alleging that Leegin had violated Section 1 of the Sherman Act by entering into agreements with retailers specifying the price at which the goods would be resold. The district court judged the case under the *per se* rule, excluding expert testimony offered by Leegin of the procompetitive effects of its resale pricing practices. The jury awarded PSKS an amount, after trebling, of

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almost $4 million; on appeal Leegin did not dispute that it had entered resale price maintenance agreements, and the Fifth Circuit affirmed on the basis of *Dr. Miles's* holding that the *per se* rule applied.

***Per Se* Rules Should be Reserved for Restraints that Almost Always Would be Invalidated Under the Rule of Reason.**

The majority opinion started by explaining that "the rule of reason is the accepted standard for testing whether a practice restrains trade in violation of §1." 2007 WL 1835892, at *4. "As a consequence, the *per se* rule is appropriate only after courts have had considerable experience with the type of restraint at issue . . . and only if courts can predict with confidence that <u>it would be invalidated in all or almost all instances under the rule of reason</u> . . . ." *Id.* at *5 (emphasis added). After reviewing the potential competitive effects of resale price maintenance, the Court asserted that "it cannot be stated with any degree of confidence that resale price maintenance 'always or almost always tend[s] to restrict competition and decrease output.'" *Id.* at *8. The dissenting opinion by Justice Breyer does not disagree; it describes the procompetitive and anticompetitive effects of resale price maintenance, noting that "as many economists suggest, sometimes resale price maintenance can prove harmful; sometimes it can bring benefits." *Id.* at *17. It concludes however that there are insufficient grounds for overruling a well-established precedent. *Id.* at *15.

The Court supported this conclusion by noting that more recent cases had rejected the rationales underlying *Dr. Miles's per se* holding. *Dr. Mi*les's reliance on the rule against restraints on alienation was deemed irrelevant to the effect of antitrust laws on vertical restraints. In addition, the Court noted that more recent cases had rejected the doctrine of *Dr. Miles* that a vertical agreement between manufacturers and distributors is the equivalent of a horizontal agreement among competing retailers, citing *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 734 (1988) (disclaiming the "notion of equivalence between the scope of horizontal *per se* illegality and that of vertical *per se* illegality").

***Leegin* Continues the Trend of Limiting the Scope of the P*er Se* Rule**

In overruling *Dr. Miles*, the *Leegin* Court continued the progression of antitrust law for the past thirty years in limiting the application of the *per se* rule to vertical restraints. The seminal case in this area is *Continental T.V. v. GTE Sylvania Inc.,* 433 U.S. 36 (1977), which applied the rule of reason to non-price vertical restraints, overruling the *per se* rule announced in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967). In *Sylvania*, the Court explained that vertical restraints have the "potential for a simultaneous reduction of intrabrand

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competition and stimulation of interbrand competition." *Id.* at 51-52. Since there was a potential for procompetitive effects, the Court applied the rule of reason.

The trend of decisions limiting the application of the *per se* rule continued with the decision in *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717 (1988). The Court held that the termination of a price-cutting distributor at the behest of another distributor ("it's him or me") was not illegal *per se*, absent an understanding between the manufacturer and the remaining distributor on the price or price level to be charged.

The progression continued in *State Oil v. Kahn,* 522 U.S. 3 (1997). The Court unanimously overruled its prior decision in *Albrecht v. Herald Co.*, 390 U.S. 145 (1968) that vertical maximum resale price maintenance agreements are *per se* unlawful. The *Kahn* Court held that *per se* treatment is only "appropriate once experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it." *Id.* at 10.

***Leegin* Focuses on the Effect of the Restraint on Competition, Rather than a Formalistic Analysis of Whether an Agreement Exists**

The *Leegin* decision will result in courts examining the substantive issues of the effects of the restraint when analyzing challenges to alleged resale price maintenance. The *per se* rule of *Dr. Miles* foreclosed analysis of the restraint, but restricted courts to a formalistic inquiry of whether a particular manufacturer-dealer arrangement constitutes an agreement on prices.

For almost as long as *Dr. Miles* has existed, there has been a tension with the primary case limiting its reach. In *United States v. Colgate & Co.*, 250 U.S. 300 (1919), the Court made an exception to *Dr. Miles* by asserting a manufacturer's right to announce a unilateral resale pricing policy and to refuse to deal with a dealer that did not follow it. *Colgate* properly confirmed a manufacturer's right to choose its dealers, but, in conjunction with the *Dr. Miles* rule, resulted in an inappropriate focus on evidence of an agreement. While *Monsanto, id.* at 768, limited the breadth of "agreement" (requiring "evidence that tends to exclude the possibility of independent action by the manufacturer and distributor" and "reasonably tends to prove that the manufacturer and others had a conscious commitment to a common scheme designed to achieve an unlawful objective"), it did not eliminate the formalism in the inquiry.

In addition, the *Leegin* case will allow defendants in resale price maintenance cases to use evidence similar to that available to them in other antitrust cases challenging their distribution arrangements – they can now defend themselves with evidence which would be irrelevant if the *per se* rule applies.

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Unlike the *per se* rule, the rule of reason requires the fact-finder to weigh "all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition." *Sylvania, id.* at 49. *Leegin* notes that appropriate factors to take into account include "'specific information about the relevant business and the restraint's history, nature and effect.' Whether the businesses involved have market power is a further, significant consideration." *Id.* at *5 (internal citation omitted.)

LEEGIN DID NOT MAKE RESALE PRICE MAINTENANCE _PER SE_ LEGAL

Leegin does <u>not</u> give manufacturers the ability to enter into minimum resale price agreements without the possibility of challenge. The Court drew a bright line around agreements by a group of retailers or manufacturers to engage in resale price maintenance:

> "A horizontal cartel among competing manufacturers or competing retailers that decreases output or reduces competition in order to increase price is, and ought to be, *per se* unlawful. To the extent a vertical agreement setting minimum resale prices is entered upon to facilitate either type of cartel, it, too, would need to be held unlawful under the rule of reason" *Id.*, at *8.

The Court also identified dominant firms using resale price maintenance as sources of anticompetitive effects, if a dominant retailer seeks to forestall innovation by smaller rivals or when a dominant manufacturer gives retailers incentives not to carry the products of smaller or newer competitors.

The Court described the need to be diligent in eliminating anticompetitive uses of resale price maintenance and identified certain factors relevant to the inquiry. This is not a "free pass" for manufacturers.

Thank you. I would be happy to take any questions.

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Pamela Jones Harbour
Testimony before the Subcommittee on
Antitrust, Competition Policy and Consumer Rights
Senate Judiciary Committee
July 31, 2007

Chairman Kohl and Members of the Subcommittee, I appreciate the opportunity to offer my personal views on the proper legal treatment of minimum vertical price fixing. As you know, based on my "Open Letter" to the Supreme Court[1] in the *Leegin* case,[2] I have strong opinions on this subject, and I would have preferred it if a majority of the Court had adopted Justice Breyer's cogent dissent[3] instead.

I am a Commissioner of the Federal Trade Commission. But let me be very clear: the views I express today are entirely my own. If you were to compare my Open Letter to the government's amicus brief in *Leegin*,[4] it would be obvious that my comments do not reflect the opinions of the Commission or my fellow Commissioners (although I note that Commissioner Leibowitz joined me in voting against the Commission's decision to sign on to the amicus brief).

I have submitted a copy of my Open Letter along with my written remarks, and I will not rehash the *Leegin* decision today. Instead, I want to focus my comments on a fundamental issue of

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1 Pamela Jones Harbour, *An Open Letter to the Supreme Court of the United States ... [Regarding] The* Per Se *Illegality of Vertical Minimum Price Fixing* (Feb. 26, 2007), available at http://www.ftc.gov/speeches/harbour/070226verticalminimumpricefixing.pdf.

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

3 *Id.* at 2726 - 37.

4 *Id.*, Brief for the United States as Amicus Curiae Supporting Petitioner (Jan 22, 2007), *reported at* 2007 WL 173650.

antitrust policy: what should consumers expect from the American antitrust laws and, consequently, the American retailing system?

The *Leegin* opinion relies on at least two implicit assumptions:

- First, that manufacturers know what is best for consumers – even better than retailers, or consumers themselves;[5] and
- Second, that retail competition is not important to the American economy or to consumers.

But these assumptions do not match the reality of the American marketplace. Consumers do not view retailers as mere sales agents for manufacturers. To the contrary, retailers serve an important function on behalf of consumers. Retailers are, in effect, purchasing agents for consumers.[6] Retailers compete by trying to predict what consumers want, and at what price. Many retailers promote efficiencies, which are passed along in the form of lower prices. Other retailers may charge higher prices, but offer superior service or higher quality goods or other amenities. Consumers respond to this price and non-price competition by voting with their wallets, depending on their preferred mix of products, services, and quality at a given price.[7]

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[5] 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) ("Those opposing *per se* rules in this area implicitly assume that the manufacturer knows better than the market what will or will not work in the marketplace.").

[6] *See* RUTH PRINCE MACK, CONTROLLING RETAILERS 91 (1936) ("Control of prices in part determined whether the retailer was the 'selling agent for the manufacturer' or 'the purchasing agent for the consumer.'").

[7] "[A]uthorizing the manufacturer to decide what mix of products and services is desirable, instead of allowing the market to decide that question, is inconsistent with the nation's commitment to a competitive process." Pitofsky, *supra* note 5, at 1493. "Simply put the argument assumes an identity between cost and value and thereby begs the question of the competitive

This is the essence of market-based competition. It is based on consumer choice. And many – if not most – consumers respond strongly to aggressive price competition, because we all prefer a bargain. The rise of mass merchandisers like WalMart, Home Depot, and Burlington Coat Factory illustrates my point.

But let's think about the post-*Leegin* world. As a general matter of antitrust law, a person who can "profitably . . . maintain prices above a competitive level for a significant period of time" is said to possess actionable market power.[8] But the *Leegin* majority articulates a more lenient rule-of-reason standard for minimum vertical price fixing. To quote Justice Kennedy's version of the rule, "pricing effects" are not enough to establish market power; the plaintiff must make a "further showing of anticompetitive conduct."[9]

To my mind, that is a virtual euphemism for *per se* legality,[10] because it will be so difficult for any plaintiff to make out a case. Therefore, absent Congressional action, I envision a post-*Leegin* world where there is no effective check on minimum vertical price fixing.

What will this look like to consumers? Well, if you were to walk through a mass merchandiser's store, you would see thousands of items produced by hundreds of manufacturers.

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marketplace by denying the consumer the right to assign his own value to the intangible asset of trademark or image." H. Rep. 94-341, *Consumer Goods Pricing Act of 1975* at 5 (1975) (quoting FTC Charman Lewis Engman).

8 United States Dep't of Justice and Federal Trade Comm'n, *1992 Horizontal Merger Guidelines (with April 8, 1997 Revisions)* § 0.1, *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,104 (Apr. 8, 1977).

9 *Leegin,* 127 S.Ct. at 2718.

10 *See* Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution:* Per Se *Legality*, 48 UNIV. CHI. L. REV. 6 (1981).

Each of these manufacturers could require retailers to enter express agreements along the lines of, "you must sell my products at these prices." Manufacturers also would be able to dictate a variety of other aspects of retail sale, such as shelf location, display spacing, and presentation.

- Will the store owner be permitted to make any meaningful decisions?
- Who will really be running the store?
- How will retailers compete to offer consumers the best deal?

Intrabrand and interbrand competition may continue to exist, but only to the extent it benefits manufacturers, not consumers. In short, the American marketplace will no longer be driven by consumer preferences. And this is wrong.

As my Open Letter explains, our nation has been down the minimum vertical price fixing road before. Congress enacted the Consumer Goods Pricing Act of 1975[11] to end a decades-long experiment of its own design. The 1937 Miller-Tydings Act[12] had created an antitrust exemption for minimum vertical price fixing authorized under state fair trade laws, after the Supreme Court's *Dr. Miles* decision[13] had held this conduct to be per se illegal under federal law. But in 1975, Congress declared the experiment a failure, finding that minimum vertical price fixing harmed consumers by raising prices, decreasing distributional efficiencies, and deterring new entry, among

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11 Pub. L. No. 94-145, 89 Stat. 80.

12 Miller-Tydings Resale Price Maintenance Act, Pub. L. 314, ch. 690, Title III, 50 Stat. 693 (1937).

13 *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911).

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other things.[14] If Congress had not repealed the fair trade laws in 1975, it is doubtful that mass merchandisers would even exist today.[15]

As Justice Breyer observed in his *Leegin* dissent, the economic arguments in favor of minimum vertical price fixing have not changed appreciably over time.[16] The defendant in *Leegin* made arguments strikingly similar to the ones the Court rejected in *Dr. Miles* and Congress rejected in 1975.[17] There still is no body of sound empirical economic evidence to show that minimum vertical price fixing is, on balance, more likely than not to be beneficial to consumers.[18]

Congress repeatedly has turned down calls for legislation that would allow minimum vertical price fixing on a national scale. There is no justification for Congress to change course. Yes,

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[14] *See Open Letter*, *supra* note 1, at 9-11.

[15] *Leegin*, 127 S.Ct. at 2735 (Breyer, J. dissenting) ("The Consumer Federation of America tells us that large low-price retailers would not exist without *Dr. Miles*; minimum resale price maintenance, 'by stabilizing price levels and preventing low-price competition, erects a potentially insurmountable barrier to entry for such low-price innovators.' Brief for Consumer Federation of America as *Amicus Curiae* 5, 7-9 (discussing, *inter alia*, comments by Wal-Mart's founder 25 years ago that relaxation of the *per se* ban on minimum resale price maintenance would be a ' 'great danger' ' to Wal-Mart's then-relatively-nascent business).").

[16] *Id.* at 2732.

[17] S. Rep. 94-466, *An Act to Repeal Enabling Legislation for Fair Trade Laws* (1975), at 3-4; H. Rep. 94-341, *Consumer Goods Pricing Act of 1975* (1975), at 4-5.

[18] *Compare Leegin*, 127 S.Ct. at 2717 (Kennedy, J.) ("And although the empirical evidence on the topic is limited, it does not suggest efficient uses of the agreements are infrequent or hypothetical.") *with id.* at 2729-30 (Breyer, J. dissenting) ("I have already described studies and analyses that suggest (though they cannot prove) that resale price maintenance can cause harms with some regularity--and certainly when dealers are the driving force. But what about benefits? How often will the benefits to which the Court points occur in practice? I can find no economic consensus on this point. . . . All this is to say that the ultimate question is not whether, but *how much*, 'free riding' of this sort takes place. And, after reading the briefs, I must answer that question with an uncertain 'sometimes.'").

minimum vertical price fixing may sometimes be good for consumers, under some limited circumstances. But that is no reason to subject all American consumers to higher prices, which is virtually certain to be the outcome of *Leegin* – unless Congress intervenes.

When it comes to close questions of competitive effect, American consumers deserve the benefit of the doubt. Therefore, I believe Congress should act to shift the burden of proof from consumers onto the producers who impose pricing restraints. I would be happy to work with the Subcommittee to draft statutory language, and I already have some ideas, if you would like more details.

In closing, in light of the current state of economic research, it remains speculative and theoretical to say that minimum vertical price fixing is almost always good for consumers. On the other hand, it is extremely likely that retail prices for thousands of products will go up in the wake of *Leegin*, with no countervailing benefits – which clearly is not good for consumers. The law should place the burden of proof where it belongs. The consumers I am sworn to protect deserve nothing less.

Thank you for your time today, and I would be pleased to answer any questions.

Federal Trade Commission

An Open Letter to the Supreme Court of the United States
from Commissioner Pamela Jones Harbour[1]

February 26, 2007

Subject: The Illegality of Vertical[2] Minimum Price Fixing

Mr. Chief Justice, and May It Please the Court:

Vertical minimum price fixing is almost always harmful to consumers. It creates no incentive for distributors and retailers to become more cost-effective in the delivery of goods and services to consumers. Indeed, it transfers to consumers the consequences of inefficient business practices: it typically leads to higher prices without bestowing countervailing benefits. A decision by this Court to overrule *Dr. Miles Medical Co.*[3] would wrongly eliminate *per se* illegality for vertical minimum price fixing. Moreover, unless the Court replaces *Dr. Miles* with a clearly articulated legal framework that preserves (at a minimum) a strong presumption of illegality, vertical minimum price fixing will become beyond effective challenge under the federal antitrust laws. This outcome would contradict rational antitrust policy and decrease consumer welfare.

The Court is urged to keep these principles in mind as it considers the case of *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*[4] Leegin is a manufacturer of women's fashion

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1 This letter reflects my own views. It does not purport to represent the views of the Commission or any other Commissioner.

2 A vertical arrangement is one between actors at different levels of the distribution system, such as a retailer and a manufacturer. A horizontal arrangement is one between actors at the same level of the distribution system, including arrangements between competitors.

3 *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911).

4 Docket No. 06-480 (Oct. 4, 2006). This matter is scheduled for oral argument on March 26, 2007.

accessories marketed under the Brighton® name. Leegin entered into vertical minimum price fixing[5] agreements with downstream retailers, primarily specialty boutiques. These types of agreements have been illegal under the Sherman Act[6] since this Court's 1911 decision in the *Dr. Miles* case. At trial, the jury awarded treble damages to PSKS, a former Leegin retailer that had been terminated for defying Leegin's unlawful vertical minimum price fixing scheme and selling Leegin's products at a discount.

Leegin and its *amici* ask the Court to reverse *Dr. Miles* and, in effect, legitimize vertical minimum price fixing, even though consumers inevitably will face higher prices as a result. The United States – with the concurrence of the Federal Trade Commission, acting on behalf of only three of its five Commissioners – has filed an *amicus* brief in support of Leegin's position.[7] I was one of the dissenting Commissioners. I voted against the Commission's decision to join the government's *amicus* brief, and this letter explains why.

As discussed in greater detail below, overruling the decision in *Dr. Miles* case would be:

- bad as a matter of law (Part I);
- bad as a matter of economic policy (Part II);
- expressly contrary to Congressional findings and intent (Part III); and
- unsupported by the facts of the *Leegin* case itself (Part IV).

The Court need not enmesh itself in a debate over the right "label" to apply to the analysis of vertical minimum price fixing agreements (*per se* or rule of reason or something else). Rather, the Court should focus on questions that elevate function over form. When a particular restraint

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5 Vertical minimum price fixing refers to an agreement between a manufacturer and retailers under which the retailers are obligated to sell that manufacturer's products to consumers only at or above the prices specified by the manufacturer. Thomas K. McCraw, *Competition and "Fair Trade": History and Theory*, 16 RES. IN ECON. HISTORY 185, 185 (1996). Those who favor vertical minimum price fixing agreements often refer to them using less pejorative terms, such as resale price maintenance, margin maintenance, or even retailer incentives. *Id.* ("It is no accident that proponents of legalizing resale price maintenance have used 'fair trade' as a synonym, while opponents have preferred terms such as 'vertical price fixing.'"); *see also Leegin*, Brief for Petitioner at 20 (vertical minimum price fixing "may be used by a manufacturer to provide its retailers with incentives to provide service or other promotional activities, where a retailer might otherwise have an inherent bias to rely too much on low prices . . . .").

6 15 U.S.C. § 1 *et seq.*

7 *Leegin*, Brief for the United States As Amicus Curiae Supporting Petitioner (Jan. 22, 2007).

almost always increases prices to consumers, what legal presumptions should be imposed? Upon whom? And with what degree of rigor might those presumptions be rebutted, if at all?

I. Vertical Minimum Price Fixing Is – And Should Remain – Illegal As A Matter Of Law

A longstanding precedent, having celebrated its 95th birthday, should only be overruled if the Court is firmly convinced that the case was wrongly decided. *Dr. Miles* is not such a case. The arguments advanced for overruling *Dr. Miles* appear to be based on a misstatement of the grounds for the decision, as well as a failure to account for historical facts likely known to the Court in 1911 but not reflected in the Court's opinion. The *Dr. Miles* decision remains a vital tool in the public antitrust enforcement arsenal, particularly for state attorneys general. It is not, however, the inflexible impediment to rational marketing portrayed by Leegin. As developed in detail below, the Court's subsequent decisions create a great deal of flexibility and latitude for manufacturers to persuade retailers to abide voluntarily by a manufacturer's sales preferences.

Leegin and its *amici*, argue, incorrectly, that the *Dr. Miles* decision was based on respect for the venerable rule prohibiting restraints on alienation.[8] True, the *Dr. Miles* Court did observe that "restraints upon alienation have been generally regarded as obnoxious to public policy."[9] But the Court explicitly rejected Dr. Miles's claim that it had the inherent right to control subsequent pricing of goods, simply because it had owned the goods at the time of sale and pricing was an incident "derived from the liberty of the producer."[10] As the Court explained, "Whatever right the manufacturer may have to project his control beyond his own sales must depend not upon an inherent power incident to production and original ownership, but upon agreement."[11]

In *Dr. Miles*, the manufacturer did enter into agreements to project its control beyond its own sales, but those agreements were illegal under the antitrust laws.[12] The arrangements between Dr.

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8 *Leegin*, Brief for Petitioner at 9.

9 *Dr. Miles*, 220 U.S. at 383.

10 *Id.*

11 *Id.* at 384.

12 "It is as we have seen, a system of interlocking restrictions by which the complainant seeks to contro not merely the prices at which its agents may sell its products, but the prices for all sales by all dealers at wholesale o retail, whether purchasers or subpurchasers, and thus to fix the amount which the consumer shall pay, eliminating al competition. . . . Thus a combination between the manufacturer, the wholesalers, and the retailers, to maintain price and stifle competition has been brought about." *Id.* at 381 (citations omitted).

Miles and its 25,000 retailers constrained all downstream pricing in the goods; the Court held that this was the functional equivalent of horizontal price fixing agreements among the dealers themselves.[13] The Court deemed such price fixing agreements unlawful, and incapable of being "saved by the advantages which the participants expect to derive from the enhanced price to the consumer."[14] In other words, the Court in *Dr. Miles* grounded its decision on traditional antitrust concepts – elimination of competition and consequent harm to consumers – rather than a policy of disfavoring restraints on alienation.

Leegin and its *amici* further mischaracterize the agreements between Dr. Miles and its 25,000 retailers when they portray the agreements as unilateral policy decisions by Dr. Miles. It is quite likely that Dr. Miles adopted its vertical minimum price fixing policies in order to avoid any adverse effects of the so-called "Tripartite Plan."[15] As described in the Third Circuit's 1906 *Jayne v. Loder*[16] decision, the plan was a joint arrangement entered into by three affiliated trade associations representing almost all of the manufacturers, wholesalers, and retailers of proprietary medicines.[17] The purpose of their agreement was for manufacturers to establish and maintain wholesale and retail prices, at levels deemed adequate by the downstream actors, or risk being boycotted by them.[18] Dr. Miles implemented its so-called "unilateral" pricing actions in that context, of which the Court undoubtedly was aware.[19] In effect, the *Dr. Miles* Court relieved a plaintiff of having to prove the fact of a horizontal price fixing cartel where functional equivalency could be shown. This was neither an imprudent nor novel result.[20]

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13 *Id.* at 384-85 (". . . complainant can fare no better with its plan of identical contracts than could the dealers themselves if they formed a combination and endeavored to establish the same restrictions, and thus to achieve the same result, by agreement with each other. . . . But agreements or combination between dealers, having for their sole purpose the destruction of competition and the fixing of prices, are injurious to the public interest and void.").

14 *Id.* at 385.

15 JOSEPH C. PALAMOUNTAIN, JR., THE POLITICS OF DISTRIBUTION 94 (Greenwood Press 1968) (1955).

16 149 F. 21 (3rd Cir. 1906) (termination of a dealer for "aggressive price cutt[ing]").

17 *Id.*

18 Such cartel disciplinary actions appear to have continued at least into the 1930s. PALAMOUNTAIN, *supra* note 15, at 94, 238.

19 The Court expressly relied upon the decisions relied upon by Justice (then Judge) Lurton in the decision of *John D. Park & Sons Co. v. Hartman*, 153 F. 24 (6th Cir. 1907), which included the *Jayne* decision. 153 F. at 35.

20 Warren S. Grimes, *Spiff, Polish, and Consumer Demand Quality: Vertical Price Restraints Revisited*, 80 CAL. L. REV. 815, 854 (1992) [hereinafter Grimes, *Spiff*] ("The consequences of fixed resale prices are the same whether or not a conspiracy can be proven.").

The 1997 outcome in *State Oil Co. v. Khan* [21] does not weaken the vitality of *Dr. Miles*. In *Khan*, the Court overruled prior precedent regarding vertical maximum price fixing, in part because "neither the parties nor any of the *amici curiae* have called our attention to any cases in which enforcement efforts have been directed solely against the conduct encompassed by [that] *per se* rule."[22] In sharp contrast, the *Dr. Miles* precedent is of continuing utility in public antitrust enforcement.[23] In particular, the rule of *per se* illegality for vertical minimum price fixing has been used by this Court to invalidate a number of state regulatory measures.[24] Those regulations typically promoted manufacturer-administered downstream pricing of products. The laws were held to violate the Sherman Act because the prices set by the manufacturers were not adequately supervised by the state itself.[25] The implicit assumption of those cases – *i.e.*, that manufacturers cannot and should not be trusted to set downstream consumer prices unless the state actively oversees the resulting displacement of competition – cannot easily be squared with the arguments advanced by Leegin and its *amici*. Overruling *Dr. Miles* likely would have an unsettling effect on both antitrust and state regulatory laws.

Finally, if the Court overrules *Dr. Miles* without also overruling (or substantially modifying) precedents that were adopted to mitigate or evade the *Dr. Miles* rule of *per se* illegality, the Court may render vertical minimum price fixing agreements presumptively lawful. Under *Colgate*,[26]

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21 522 U.S. 3 (1997) (abandoning the *per se* rule against vertical maximum price fixing, where the manufacturer specifies a maximum price and prohibits dealers from selling to consumers at a higher price).

22 *Id.* at 18-19.

23 *See, e.g.*, Commissioner Pamela Jones Harbour, Vertical Restraints: Federal and State Enforcement of Vertical Issues, Written Materials Provided for the ALI-ABA Course of Study on Product Distribution and Marketing (Mar. 8-10, 2007), *available at* http://www.ftc.gov/speeches/harbour.htm (listing of recent state and federal government enforcement actions against vertical restraints of trade, at least 27 of which have involved vertical minimum price fixing).

24 *See, e.g.*, *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980); *324 Liquor Corp. v. Duffy*, 479 U.S. 335, 341 (1987) ("Resale price maintenance has been a *per se* violation of § 1 of the Sherman Act since the early years of national antitrust enforcement" (citing *Dr. Miles*; other citations and internal quotation marks omitted)).

25 *See, e.g.*, *324 Liquor*, 479 U.S. at 345 ("New York neither establishes prices nor reviews the reasonableness of the price schedules. . . . New York does not monitor market conditions or engage in any pointed reexamination of the program.") (quotation marks and citations omitted).

26 *United States v. Colgate & Co.*, 250 U.S. 300 (1919) (recognizing right of manufacturer to announce in advance the circumstances under which it will refuse to deal).

Monsanto,[27] and *Business Electronics*[28] (to name a few), it may be virtually impossible to prove even the fact that a vertical minimum pricing restraint has been imposed by a contract, combination or conspiracy.[29] The practical effect of these cases is that an agreement inferred from a course of business conduct between vertical actors faces virtually insurmountable hurdles of proof in order to "exclude the possibility of independent action,"[30] absent an express agreement. Few (if any) economists – let alone antitrust enforcers – would take such a benign view of vertical minimum price fixing.[31]

II. <u>As A Matter of Economic Policy, Vertical Minimum Price Fixing Remains Harmful To Consumers</u>

Leegin and its *amici* claim that modern economic analysis[32] mandates the resuscitation of vertical minimum price fixing, because there might be some instances where vertical minimum price

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27 *Monsanto Co. v. Spray-Rite Corp.*, 465 U.S. 752 (1984) (requiring evidence that tends to exclude the possibility of unilateral action by manufacturer and dealers).

28 *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988) (dealer termination may not be deemed to be based on pricing unless an agreement as to a price or pricing level can be shown to exist between the manufacturer and the remaining dealers).

29 *See* Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a* Per Se *Rule Against Vertical Price Fixing*, 71 GEO. L.J. 1487, 1489 (1983) ("As a result, it is very difficult for a plaintiff (either the government or a private party) to win a rule of reason case. Thus, a determination to adopt a rule of reason approach is not merely a procedural determination affecting the scope of an investigation or trial.").

30 *Monsanto*, 465 U.S. at 768.

31 *Leegin*, Brief of Economists at 16 ("There is some disagreement within the economics literature, and among *amici*, regarding the frequency with which minimum RPM has procompetitive or anticompetitive effects.").

32 Leegin's views reflect the version of modern economic analysis practiced by the most conservative proponents of the so-called Chicago School, who favor a static, rather than dynamic, view of economics. *See, e.g.*, Mark Blaug, *Is Competition Such a Good Thing? Static Efficiency versus Dynamic Efficiency*, 19 REV. INDUS. ORG. 37, 44-47 (2001). "The Chicago school does not deny that there is a case for antitrust law but they doubt that it is a very strong case because most markets, even in the presence of high concentration ratios, are 'contestable' (Bork, 1978). How do we know? We know because [of] the good-approximation assumption: the economy is never far away from its perfectly competitive-equilibrium growth path! Believe it or not, that is all there is to the 'antitrust revolution' of the Chicago School." *Id.* at 47. (The "good-approximation assumption" refers to the intuition that observed prices and quantities may be treated as good approximations of their long-run equilibrium values. *Id.* at 40.)

fixing enhances competition.[33] Leegin's reliance on economic theory is misplaced, however, because Leegin's arguments contradict a fundamental principle of antitrust law. The essence of the Sherman Act, according to this Court's decision in *Reiter v. Sonotone*,[34] "is to ensure fair price competition in an open market."[35] If consumers are treated as advocated by Leegin and its *amici*, consumers will lose many critical benefits of fair price competition in an open market.

Leegin's main economic argument is that the higher retail prices generated by vertical minimum price fixing will lead to extra profits for retailers, which will create incentives for Leegin's dealers to provide additional "services" to consumers. But the actual benefit to consumers is far from clear, especially in this particular product market.[36] It appears that the primary "service" the retailers offer is to steer consumers toward Leegin's products and away from those of other manufacturers, even if an individual customer's needs might be better met by alternative products in the dealer's inventory. The guaranteed margins sponsored by Leegin's vertical minimum price fixing accomplish little more than a consumer-funded bribe to retailers, in return for which the retailers will favor Leegin's merchandise.[37] Leegin's conduct also invites other manufacturers to respond with higher consumer-funded bribes of their own.

Leegin and its *amici* make two simultaneous claims: first, that these added "services" are sufficiently beneficial to consumers to outweigh any possible harm to competition; and second, that consumers prefer to deal with discounters who might offer fewer or different services. Both cannot be true, unless this Court is ready to declare consumer preferences to be market failures. This Court

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33 When Congress passed the Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 80 [hereinafter Consumer Goods Pricing Act] (*see infra* Part III), Congress made it clear that the law was not intended to affect the unilateral ability of manufacturers to suggest retail prices or to chose the parties with whom they would do business (within the meaning of the *Colgate* doctrine). *See* S. Rep. 94-466, *Act to Repeal Enabling Legislation for Fair Trade Laws* (1975), at 3. Accordingly, the question in this case is limited to whether manufacturers should be permitted to enter into *express* vertical minimum price fixing agreements.

34 442 U.S. 330 (1979).

35 *Id.* at 342.

36 *See infra* Part IV (in the factual context of this product market – ladies handbags and other fashion accessories – any "services" provided to consumers are of particularly dubious value).

37 *See* Warren S. Grimes, *Brand Marketing, Intrabrand Competition, and the Multibrand Retailer: The Antitrust Law of Vertical Restraints*, 64 ANTITRUST L. J. 83, 109-110 (1995) (noting that unlike commercial bribes, consumer-funded higher margins may be inexpensive for the manufacturer, but are, nonetheless, as capable as a bribe of causing economic injury by distorting the allocation of goods).

is asked to affirm Leegin's utter lack of faith in an economy where consumers are able to express their preferences with their pocketbooks (Brighton®-branded or otherwise).[38]

A review of the 1936-37 issues of the *Trade Regulation Review: A Bulletin on Economics and Law of Business Co-operation* [39] shows that most of the same arguments for or against vertical minimum price fixing were being advanced then as are being advanced today. The so-called new wisdom of modern analysis is not much more than repackaged old chestnuts. Indeed, many of the current arguments appear in the *Dr. Miles* opinion itself.[40] Furthermore, as discussed more fully below,[41] the United States experimented with vertical minimum price fixing at the state level for over forty years. In response to this economic learning, Congress ultimately declared the experiment a failure by passing the Consumer Goods Pricing Act of 1975, which banished vertical minimum price fixing on a national scale.

Sound economic policy grounded in the well-being of consumers should favor lower consumer prices and greater efficiency in the distribution and sale of consumer goods.[42] Vertical minimum price fixing, by itself, promises neither. In many (if not most) cases, vertical minimum price fixing will lead to prices that provide a margin of comfort for a manufacturer's *least* efficient

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[38] "[A]uthorizing the manufacturer to decide what mix of products and services is desirable, instead of allowing the market to decide that question, is inconsistent with the nation's commitment to a competitive process." Pitofsky, *supra* note 29, at 1493. "Simply put, the argument assumes an identity between cost and value and thereby begs the question of the competitive marketplace by denying the consumer the right to assign his own value to the intangible asset of trademark or image." H.Rep. 94-341 at 5 (quoting FTC Chairman Lewis Engman).

[39] TRADE REGULATION REVIEW: A BULLETIN ON ECONOMICS AND LAW OF BUSINESS COOPERATION, Vol. 1-7 (Reinhold Wolff, Dec. 1936 - Nov. 1937)

[40] Even in 1911, manufacturers and retailers favoring vertical minimum price fixing cited the need to create incentives (via margin enhancement) to stock the product, provide pre-sale product promotion, avoid competition from discounters, and protect the product's reputation and value image. *Dr. Miles*, 220 U.S. at 375 (noting that the complaint alleged that ". . . druggists . . . cannot[] realize sufficient profits by the sale of the medicines at the cut-prices, . . . and therefore are unwilling to, and do not keep the medicines in stock, or, if kept in stock, do not urge or favor sales thereof, but endeavor to foist off some similar remedy or substitute, and from the fact that in the public mind an article advertised or announced at cut or reduced price . . . suffers loss of reputation and becomes of inferior value and demand.") (internal quotes omitted). The "new" economic learning has over a century's worth of history attached.

[41] *See infra* Part III.

[42] *State Oil Co. v. Khan*, 522 U.S. 3, 15 (1997) ("Low prices, we have explained, benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition. . . . Our interpretation of the Sherman Act also incorporates the notion that condemnation of practices resulting in lower prices to consumers is especially costly because cutting prices to increase business often is the very essence of competition.") (internal quotations and citations omitted)).

retailers.[43] In addition, the higher dealer profits yielded by vertical minimum price fixing are likely to fund benefits that create as much or more value for Leegin's interbrand *competitors* than for consumers. Creating a more attractive shopping venue in a multiproduct store, for instance, benefits Leegin's interbrand competitors who are able to free-ride on Leegin's initiative.

Proponents of vertical minimum price fixing often assign belittling labels – such as "knaves"[44] and "free-riders"[45] – to efficient retailers who share the fruits of their efficiency with consumers. But these labels do not necessarily convey antitrust meaning. The "knaves" and "free-riders" may provide better sales locations, consumer services, and information than their higher-priced competitors. If so, vertical minimum price fixing only serves to block distribution and retailing efficiencies that otherwise would reach consumers and enhance competition.

If *Dr. Miles* is reversed and vertical minimum price fixing becomes more prevalent, consumers likely will suffer the following outcomes:

- higher prices set by manufacturers;[46]

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43 *See* Robert L. Steiner, *Intrabrand competition – stepchild of antitrust*, 36 ANTITRUST BULL. 155, 177 (1991) ("[Vertical] restraints have often sheltered an anachronistic, high-cost group of retailers against the entry of new and more efficient types of distributors."); Robert L. Steiner, *How Manufacturers Deal With The Price-Cutting Retailer: When Are Vertical Restraints Efficient?*, 65 ANTITRUST L. J. 407, 419-25 (1997) (describing the effect on incumbent retailers of the emergence of more efficient retailers who provide a different service package which is equal or superior to those being provided by incumbents).

44 "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." *Dr. Miles*, 220 U.S. at 386 (Holmes, J., dissenting) (emphasis supplied).

45 The concept of the free-rider is generally ascribed to the work of Professor Telser. *See* Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86 (1960). "To sum up, the free-rider justification of resale price maintenance has severe limitations. Its plausibility is palpably low in many product areas where RPM is used." FREDERIC M. SCHERER & DAVID ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 554 (3d ed. 1990). Indeed, the efficiency claims for vertical minimum price fixing made by Bork, and others, reflect "a special case not applicable under many circumstances. The Bork argument should not be accepted by the Court as a general principle." *Leegin*, Brief for Comanor & Scherer at 5. ("The Bork argument" refers to the proposition that vertical price fixing promotes "higher margins which promote enhanced consumer welfare and efficiency." *Id.* at 4.)

46 Pitofsky, *supra* note 29, at 1488 (". . . minimum vertical price agreements lead to higher, and usually uniform, resale prices); H. Rep. 94-341, *Consumer Goods Pricing Act of 1975*, at 3 (1975) ("From the consumers' point of view, 'fair trade' laws have one effect – higher prices."). The same page of the report cited studies showing that vertical minimum price fixing led to price increases as high as 27-37.4%. The report also cited a Library of Congress study performed for Senator Brooke, finding that fair trade cost consumers $3 billion a year, and a Stanford study that put the annual cost at $6.5 billion a year.

- reduced efficiency in distribution and retailing;[47]
- lower levels of retail sales per outlet;[48]
- higher rates of business failure;[49]
- reduced opportunities for effective entry by new competitors and products;[50]
- distortion of retailer incentives to provide objective comparisons of competing brands on their shelves;[51]
- diminished levels of competition between competing brands of goods;[52] and

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47 *See, e.g.*, Pitofsky, *supra* note 29, at 1493 ("To deny the sellers access to products because they are aggressive in pricing (and perhaps more efficient as well) hardly seems to be a service to consumers, or a vote of confidence in the competitive process."); Statement of Senator Brooke, 121 CONG. REC. 1339 (Jan. 27, 1975) ("The crux of the problem of resale price maintenance, is whether the consumer should reap the benefits of the most efficient forms of retailing or . . . should be forced to pay more in order to make retailing . . . a more comfortable occupation.") (quoting an editorial from *Consumers Union*)).

48 "It has been established by a U.S. Department of Justice study prepared by Dr. Leonard Weiss in 1969, that stores in fair trade States almost universally have a significantly lower volume of retails sales than stores in free trade areas . . . sales volume per store is systematically lower under fair trade." Statement of Senator Brooke, 121 CONG. REC. 38,050 (Dec. 2, 1975).

49 S. Rep. 94-466, *supra* note 33, at 3 (" . . . 'fair trade' States with fully effective laws have a 55 percent higher rate of firm failures than free trade states.").

50 *See* H. Rep. 94-341, *supra* note 46, at 5; Warren S. Grimes, *Brand Marketing, Intrabrand Competition, and the Multibrand Retailer: The Antitrust Law of Vertical Restraints*, 64 ANTITRUST L.J. 83, 98 (1995) ("Preserving entry opportunities for new retailers and new retailing approaches is a critical component to the dynamic growth of our economy. Intrabrand competition serves this goal by preserving one of the new entrant's most potent competitive tools: the ability to discount popular branded items that draw customers.").

51 "The consumer . . . has little reason to suspect that a retailer will promote a particular brand for reasons other than its merits. In short, consumers often may view retailers as neutral, advice-giving marketers, raising the risk that consumers will accept the retailer's self-interested purchase advice." Grimes, *Spiff*, *supra* note 20, at 830 (further noting that retailer competition keeps margins down for all products – limiting the incentive to promote one product over another).

52 H. Rep. 94-341, *supra* note 46, at 3-4 (citing the testimony of Keith Clearwaters, Dep. Ass't Attorney General, Antitrust Division, U.S. Dep't of Justice).

- increased competition by manufacturers for the loyalty of their dealers, the costs of which will be borne by consumers.[53]

It is no wonder, therefore, that most industrialized nations of the world treat vertical minimum price fixing as *per se* illegal – sometimes even subject to penalties – while non-price vertical restraints are treated more leniently.[54]

III. Congress Intends Vertical Minimum Price Fixing To Be *Per Se* Unlawful

The Court is asked, in effect, to repeal the Consumer Goods Pricing Act of 1975, in which Congress expressed its clear support for a *per se* rule against vertical minimum price fixing. Congress repeatedly has declined to reverse its position. The Court should respect Congressional intent.

Congress passed the Miller-Tydings Resale Price Maintenance Act[55] in 1937, twenty-six years after the Court issued its *Dr. Miles* opinion. In deference to so-called "fair trade" laws passed by various states early in the Depression,[56] the Miller-Tydings Act amended the Sherman Act to create an exemption for vertical minimum price fixing agreements that were promoted under state fair trade laws.[57] Thus, until the mid-1970s, Congress sponsored an economic experiment at the state

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53 Indeed, competitive responses in some industries could result in upward-spiraling price escalations to attract dealer loyalty.

54 *See, e.g.*, Ittai Paldor, *The Vertical Restraints' Paradox: Justifying the Different Legal Treatment of Price and Non-price Vertical Restraints* at 3-4 (Jan. 24, 2007), *available at* http://ssrn.com/abstract=951609 (listing the United States, Canada, the United Kingdom, the European Union, and Australia as countries with a rule of *per se* illegality for vertical minimum price fixing, and noting their generally more lenient treatment of non-price vertical restraints); Australian Competition & Consumer Comm'n News Release, *Topfield distributor penalised $238 000 for resale price maintenance* (Dec. 13, 2006), *available at* http://www.accc.gov.au/content/index.phtml/itemId/773132/fromItemId/2332.

55 Miller-Tydings Resale Price Maintenance Act (Act of Aug. 17, 1937, Pub. L. 314, ch. 690, Title III, 50 Stat. 693) [hereinafter Miller-Tydings Act]; *see also* McGuire-Keogh Fair Trade Enabling Act (Act of July 14, 1952, Pub. L. 543, ch. 745, 66 Stat. 631) (expanded exemption to cover so-called non-signor statutes invalidated by this Court in *Schwegmann Bros. v. Calvert Distillers Corp*, 341 U.S. 384 (1951) [hereinafter McGuire Act]. Subsequent citations to the Miller-Tydings Act are intended to refer to the McGuire Act as well.

56 SCHERER & ROSS, *supra* note 45, at 556 ("The U.S. federal fair trade law was born during the Great Depression of the 1930s. It died in the recession of 1975.").

57 Prior to 1937, Congress had refused to pass legislation permitting vertical price fixing every session since 1914, and President Roosevelt had opposed passage of the Miller-Tydings Act. *See* PALAMOUNTAIN, *supra* note 15, at 236; *Deadlock in the Resale Price Movement*, TRADE REG. REV. (July 1937), at 2 ("Endeavors to extend price

level, permitting individual states to test the real-world effects of vertical minimum price fixing.[58] During that time, Congress continued its refusal to adopt federal legislation that would have reversed *Dr. Miles* and allowed vertical minimum price fixing on a national scale.[59]

Ultimately, Congress declared the states' experiment with vertical minimum price fixing a failure.[60] Recognizing that the fair trade laws were "anachronistic" in a modern economy, Congress passed the Consumer Goods Pricing Act of 1975, which repealed the Miller-Tydings Act. Congress found that vertical minimum price fixing served little purpose other than raising prices to consumers.[61] Congress examined and rejected various justifications for vertical minimum price fixing, including: the provision of additional services; the protection of small businesses; and providing entry opportunities for new businesses.[62] Congress also found that legalized vertical

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fixing of branded [goods] over a nation-wide area came to a standstill when President Roosevelt, early in May, sidetracked the Tydings-Miller Resale Price Maintenance Bill."). Professor Kramer claims that the Miller-Tydings Act was enacted in no small measure because the National Association of Retail Druggists ("NARD") made a significant cash "payoff" to "a high official in the [Roosevelt] administration." Victor H. Kramer, *Legislating fair trade by foul means (1937-1939)*, 36 ANTITRUST BULL. 81, 87 (1991). Palamountain noted that similar tactics were used to secure state statutes permitting vertical price fixing. PALAMOUNTAIN, *supra* note 15, at 238 n.12 (noting that a Connecticut grand jury found that bribes jointly funded by NARD and McKesson & Robins, a drug wholesaler, had been used to get Connecticut's fair trade law adopted).

58 *See New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting) ("It is one of the happy incidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.").

59 During the floor debate on the Consumer Goods Pricing Act, Representative Van Deerlin noted that the "move in Congress in the 1960's to enact a national fair trade law . . . never reached the mark-up stage in our House Commerce Committee." 121 CONG. REC. 23,661 (1975). In that same statement, Van Deerlin said that fair trade was not fair to consumers; "referred to the benefits to manufacturers and retailers;" provided "good profits for the retailers and bad prices for consumers;" and created "no evidence that the failure rates for small businessmen have been any higher in States lacking the dubious benefits of fair trade laws." Van Deerlin concluded his statement by saying, "Clearly, fair trade is an idea whose time has gone." *Id.*

60 "[O]ur economy has evolved to the point that it no longer requires and no longer is served by resale price maintenance under the fair trade laws. . . . Moreover, the fair trade laws have been abused. . . . [T]he fair trade laws have clearly become anti-consumer. In an economic system built on the principle of competition, they are an anachronistic anomaly whose repeal is long overdue." *Id.* at 23,662 (statement of Rep. Seiberling). "[T]he seriously depressed economy of the 1930's exists no longer and the [fair trade] laws should now be repealed to aid the consumer." *Id.* at 38051 (statement of Sen. Hruska).

61 *See supra* note 46 (noting Congressional findings of significantly higher prices in states permitting vertical minimum price fixing).

62 S. Rep. 94-466, supra note 33, at 3-4; H. Rep. 94-341, supra note46, at 4-5 (". . . it finds no real support in the facts, [and] . . . 'fair trade laws can actually work to stifle market entry by new small retail businesses,[such that] . . . resale price maintenance could not be justified.").

minimum price fixing provided a cover and invitation for *horizontal* price fixing as well.[63] President Ford recognized the *per se* illegality of vertical minimum price fixing when he signed the Consumer Goods Pricing Act into law.[64]

Congress had no reason to suspect that vertical minimum price fixing would survive the 1975 legislation, or that Congress might need to specify a liability standard for vertical minimum price fixing conduct. After all, vertical minimum price fixing already was *per se* unlawful under *Dr. Miles*. In addition, the Court had made clear its aversion to inquiries about the reasonableness of fixed prices,[65] and Congress therefore had no reason to suspect that the Court might wish to encourage such inquiries in the future.

This Court expressly found, in its 1977 *GTE Sylvania*[66] decision, that Congress intended vertical price fixing to be *per se* unlawful.[67] That same footnote in the *GTE Sylvania* opinion also endorsed Justice Brennan's observation in *White Motor Co.*[68] that minimum vertical price fixing tends to reduce both interbrand and intrabrand competition.[69]

63 *Id.* at 3-4.

64 2 PUB. PAPERS 724 (Dec. 12, 1975).

65 *See, e.g., United States v. Trenton Potteries*, 273 U.S. 392, 397-98 (1927) ("The reasonable price fixed today may through economic and business changes become the unreasonable price of to-morrow. . . . Agreements which create such potential power may well be held in themselves unreasonable or unlawful restraints, without the necessity of minute inquiry whether the particular price is reasonable or unreasonable as fixed and without placing on the government in enforcing the Sherman Law the burden of ascertaining from day to day whether it has become unreasonable through the mere variation of economic conditions.").

66 *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977).

67 *Id.* at 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); *see also* Statement of Rep. Jordan, 121 CONG. REC. 23,659 (Jul. 21, 1975) ("Together, the Miller-Tydings and McGuireActs constituted special interest legislation that legitimized what, without the exemption granted by those acts, would be per se violations of the antitrust laws.").

68 *White Motor Co. v. United States*, 372 U.S. 253 (1963).

69 *Id.* at 268 (Brennan, J., concurring) ("Resale price maintenance is not only 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.").

On four subsequent occasions, Congress re-emphasized its belief in a *per se* rule for vertical minimum price fixing. Congress explicitly forbade the use of federal antitrust enforcement appropriations to advocate for the reversal of *per se* illegality for such conduct.[70]

Leegin in effect asks the Court to resolve a political question: should retailers function solely as the sales agents for manufacturers, to the substantial exclusion of any role as purchasing agents for consumers?[71] Leegin implicitly favors the sales agent model, but this model would deprive consumers of competition between retailers, including any efficiencies that competition might produce. This is not what Congress intended. When Congress repealed the exemptions that permitted vertical minimum price fixing, Congress believed this otherwise unlawful pricing practice had been ushered into oblivion, never to trouble consumers further. Leegin and its *amici* now urge the Court to make expressly contrary findings. The Court should not authorize its own economic experiment, on a far grander scale than Congress ever permitted.[72]

IV. **The *Leegin* Facts Do Not Support Overruling *Dr. Miles***

Leegin adopted its vertical minimum price fixing regime to insulate its own stores from competition from its other dealers. Even if there were a case to be made for more lenient treatment of restraints imposed by a manufacturer to control identifiable market failures in product distribution, this case hardly presents compelling facts to support that outcome.

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70 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 this act expressly cited *Dr. Miles* with approval, and the then-just-released Department of Justice Vertical Restraint 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. [DOJ's now-withdrawn Vertical Restraint Guidelines are available at 4 TRADE REG. REP. (CCH) ¶ 13,105 (1985)]); Continuing Appropriations for Fiscal Year 1987, § 605, Pub. L. No. 99-500, 100 Stat. 1783-73 (1986); Continuing Appropriations, Fiscal Year 1988, § 605, 101 Stat. 1329-38 (1987). *Compare with Leegin*, Brief for Petitioner at 35 ("For example, in the mid-1980s, Congress *twice* prohibited the Department of Justice from using appropriations to advocate for a reversal of the *per se* rule against resale price maintenance.") (emphasis added).

71 *See* RUTH PRINCE MACK, CONTROLLING RETAILERS 91 (1936) ("Control of prices in part determined whether the retailer was the 'selling agent for the manufacturer' or 'the purchasing agent for the consumer'.").

72 A Court-sponsored experiment in vertical minimum price fixing would be on a grander scale because it would permit vertical minimum price fixing on a national rather than state-by-state basis. It also would be undisciplined by a rule of *per se* illegality to guard the boundaries of the experiment.

First, the restraints at issue in this case cannot be characterized as purely vertical, because they are substantially horizontal as well. Leegin operates seventy of its own retail stores. These stores compete directly with approximately 5,000 independent retailers, including plaintiff PSKS, who also sell Leegin's goods.[73] Leegin appears to have crafted a horizontal price fixing agreement to protect its own stores from competition with other retailers. Leegin does not explain why the antitrust laws should not apply to this horizontal price fixing conduct. Indeed, Leegin's own expert condemns its conduct when he argues in favor of *per se* illegality for any agreement that has "any horizontal component."[74]

Second, Leegin misrepresents that it has chosen to market its products through smaller, boutique-type stores, rather than chain stores or department stores, and must engage in vertical minimum price fixing to guarantee that the boutiques earn a sufficient margin to justify carrying Leegin's products.[75] In truth, Leegin sells not only through its own chain of stores, but also through Nordstrom, a major department store chain. The information regarding Nordstrom is disclosed without elaboration in an obscure footnote toward the end of Leegin's expert's report (which was excluded at trial).[76]

Third, Leegin presents a factually inapplicable justification for its vertical minimum price fixing. Leegin claims that if is unable to control the retail prices of its dealers, it might have to integrate into retailing – which, as Leegin's expert posits in his report, would "draw Leegin away from its core competency (creating and manufacturing women's fashion accessories)."[77] But Leegin, with its seventy stores, is already integrated into retailing (albeit not to the exclusion of other retailers). Furthermore, even if the argument were factually applicable, Leegin's expert does not explain how to reconcile it with sensible antitrust policy in light of the following contradiction: why is it preferable for a manufacturer operating outside the scope of its core competency to set the prices charged by retailers, instead of allowing the retailers – operating *within* the scope of their core competency – to determine prices themselves?

Fourth, a legion of coupon-clipping, bargain-hunting consumers in this country would strongly disagree with Leegin's notion of what "benefits" consumers. Leegin argues that it is efficient for a manufacturer to set and enforce uniform prices to be charged by all of its dealers,

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73 *Leegin*, Brief in Opposition to *Certiorari* at 4.

74 *Leegin*, Petition for *Certiorari*, Appendix D at 50a (expert report of Professor Kenneth Elzinga).

75 *Leegin*, Brief for Petitioner at 23.

76 *Leegin*, Petition for *Certiorari*, Appendix D at 50a n.44.

77 *Id.* at 44a.

because the price fixing will relieve consumers of the costs of searching for a bargain, and also eliminate any possible anxiety by consumers who fear having missed a better bargain.[78] Leegin should be embarrassed to make this argument. Common sense dictates – and the Court should recognize – that most consumers would much rather have the opportunity to seek a bargain. These consumers will not be better off if vertical minimum price fixing is treated more leniently.[79] Further, if the Court holds that the elimination of consumer search costs is a cognizable justification for vertical minimum price fixing, the same logic could be used to defend many price fixing schemes among competitors.[80]

Fifth, Leegin's expert makes at least one argument that the Court should reject summarily. He states that if Leegin were to engage in a "suggested retail price" (SRP) policy, which would be "permissible under Colgate, than [sic] it follows that an SRP policy instituted 'by agreement' does nothing more to harm consumers."[81] This argument, like the one rebutted in the preceding paragraph, may be a satisfactory outcome of "modem economic analysis." But reduced to its essence, the argument stands for the following proposition: if the same result could be obtained by either lawful or unlawful means, it does not matter if the law has been broken. This neither represents good public policy nor upholds the basic tenets of a just legal system. It is a slippery slope best avoided.

Leegin fails to identify how its vertical minimum price fixing activities have benefitted consumers. Leegin suggests that vertical minimum price fixing might lead to more retail outlets carrying the product, outlets maintaining greater inventories, greater point-of-sale services, particularized sales expertise, more effective signaling of product quality, a more ideal shopping

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78 *Id.* at 48a.

79 It is not even necessarily true that manufacturer-fixed, uniform consumer prices would lead to lower consumer search costs. Suppose that Leegin and other manufacturers engaged in vertical minimum price fixing. It is plausible to suppose that they also would impose minimum stocking and display requirements on their dealers. These additional requirements, in turn, might lead each retailer to carry fewer competing brands per store. As a consequence, each consumer might have to visit a substantially greater number of stores, perhaps distributed over a broader geographic area, in order to find the "right" product (in terms of price, quality, and other factors). Therefore, it is equally likely that Leegin's pricing scheme, if adopted widely in the market, would *raise* consumer search costs.

80 Every form of non-market price fixing (horizontal, vertical, or regulatory) is capable of eliminating consumer search costs. This argument proves too much and represents a frontal assault on competition itself. If elimination of consumer search costs were a general justification for restraints of trade, bargain hunting would become a waste of consumers' time and effort. Indeed, if manufacturer-administered pricing were to become widespread, it might also promote forms of price coordination between manufacturers that are beyond the reach of the antitrust laws, such as acts that are merely consciously parallel. Phillip E. Areeda & Herbert Hovenkamp, VI Antitrust Law § 1417g at 115 (2003) ("At all events, it seems clearly established that mere parallelism is insufficient to get to the jury.").

81 *Leegin*, Petition for *Certiorari*, Appendix D at 49a n.43.

experience, and the avoidance of free-riding.[82] Leegin's own expert concedes, however, that ladies handbags and other fashion accessories are not "high tech, information-intensive consumer durables."[83] Ladies handbags are not technological wonders requiring extensive operational expertise and consumer education. Ladies handbags do not require acoustically optimized demonstration rooms. Ladies handbags do not require extensive post-sales servicing, or inventories of repair and replacement parts. Ladies handbags do not require special climate-controlled storage to prevent health risks. The only real "service" at issue appears to be steering the consumer to purchase Leegin's products,[84] to the benefit of the manufacturer and the agreeing retailers. The benefit to consumers is not self-evident.

The free-riding argument, in particular, is a red herring in this case.[85] PSKS's only alleged fault was discounting. Leegin did not claim that PSKS was allocating insufficient shelf space to Leegin's products. Leegin did not claim that PSKS was providing any less service than other dealers. PSKS's "free-riding" was nothing more than its success in gaining market share, at the expense of price-fixing retailers who had agreed not to respond to PSKS's competitive threat. Leegin asks this Court to provide the enforcement muscle for its price fixing agreement. The Court should not bless this flawed free-riding argument.

V. <u>Conclusion: Where Should The Law Go?</u>

Dr. Miles was good law when decided and remains good law today. Sound antitrust policy condemns restraints, such as vertical minimum price fixing, whose necessary and inevitable tendency is to raise prices to consumers.[86] A rule of continued *per se* illegality for vertical minimum

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[82] Brief for Petitioner at 3-4, 20-21, and 22-24.

[83] *Id.* at 26a.

[84] Even if consumers did need and value some additional services when purchasing ladies fashion accessories, increasing dealer margins hardly would ensure that such services will be provided. "After all, there is no guarantee that the dealer, once its resale price is raised, will know exactly what kind and amount of service the manufacturer has in mind. If the distributor is a multiproduct outlet – for example, a supermarket, drug store, or department store carrying hundreds or even thousands of items – the idea that the manufacturer can induce better services or more amenable surroundings by raising the retail price is ridiculous. In any event, there are far more appropriate and less restrictive methods of insuring the availability of services." Pitofsky, *supra* note 29, at 1493.

[85] Free-riding might, of course, be a legitimate concern in other markets, or under different factual circumstances.

[86] *See, e.g.*, Commissioner J. Thomas Rosch, Monopsony and the Meaning of "Consumer Welfare": A Closer Look at *Weyerhaeuser*, Address at the 2006 Milton Handler Annual Antitrust Review (Dec. 7, 2006), available at http://www.ftc.gov/speeches/rosch/061207miltonhandlerremarks.pdf. "In my view the antitrust laws protect

price fixing accords with judicial precedent and Congressional intent. Most importantly, the facts of this particular case do not justify overturning *Dr. Miles*. Accordingly, the judgment below should be affirmed.

That being said, other vertical cases may present the Court with a better opportunity to refine the legal analysis of vertical minimum price fixing under *Dr. Miles* and its progeny. This Court certainly does not condone total knee-jerk adherence to a bright-line rule of *per se* illegality in the area of horizontal price fixing.[87] Nor need it do so in the vertical price fixing area. The Court may, in a future case, wish to specify ways in which parties might make *factual* showings of countervailing evidence that would support the legality of specific vertical conduct.

If a case arises that warrants more lenient treatment of vertical pricing restraints, the Court should still begin with a firm presumption that vertical minimum price fixing is unlawful. That presumption should only be rebuttable by a *factual*, case-specific showing that (1) vertical minimum price fixing is necessary to deliver identifiable net consumer benefits (2) in a quantity at least as great as the amount by which prices have been raised, and (3) such benefits could not be delivered by less-restrictive, alternative means.

A sufficient showing could be based, for example, on empirical analyses or simulations[88] using robust models. But these models *must* accurately portray actual market conditions. They should not rely on representations of market conditions achievable only via simplifying (and unverifiable) assumptions of fact, such as an assumption that downstream markets are perfectly

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consumers – and by "consumers" I mean consumers who buy the output in the relevant market. . . . To me, "consumer welfare" means just that – the welfare of those who are confronted by actual or threatened exercises of seller market power in the output market." *Id.* at 6-7 (emphasis in original). *See also State Oil Co. v. Khan*, 522 U.S. 3, 15 (1997) (discussed *supra* note 42).

87 *See, e.g., Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1 (1979).

88 "The paucity of empirical evidence on RPM's effects exacerbates the problem of choosing between efficiency and market-power explanations. Moreover, the existing evidence tends to be interpreted according to preconceived beliefs." Thomas K. McCraw, *Competition and "Fair Trade": History and Theory*, 16 RES. IN ECON. HIST. 185, 227 (1996); *see also* Pauline M. Ippolito & Thomas R. Overstreet, Jr., FTC Staff Report, *Resale Price Maintenance: An Economic Study of the FTC's Case Against the Corning Glass Works* (Jan. 1994), at 70 ("Until recently, the problems of product distribution have not received much serious economic study, in part, because features of an effective distribution system are often difficult to articulate and to measure. . . . Additional empirical studies . . . would . . . help . . . generate more serious consideration of . . . antitrust policy [for] . . . vertical business practices.").

competitive and reflect a complete pass-through of manufacturing costs.[89] Steiner and others reject this assumption both theoretically and empirically.[90]

In order to rebut the presumption of illegality for vertical minimum price fixing, the factual showing should also detail the comparative losses and gains by marginal and inframarginal consumers.[91] Consistent with *Daubert*,[92] such a showing would have to consist of more than a recital

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89 Pamela Jones Harbour, *An enforcement perspective on the work of Robert L. Steiner: why retailing and vertical relationships matter*, 49 ANTITRUST BULL. 985, 987 (2004) ("Most economic models of consumer goods markets completely ignore retail activities, based upon an assumption that retail markets are perfectly competitive. According to this view, distribution is characterized as an undifferentiated pass-through for manufacturing costs, competitive conditions, and the like."); Pitofsky, *supra* note 29, at 1492 n.22 ("But 'perfect competition' rarely occurs in the real world. Even when a manufacturer has a relatively small market share, it can extract higher prices from consumers if the product is brand differentiated in their minds.") (citing LAWRENCE A. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST 379 (1977)).

90 *Id.* "Furthermore, to the best of *amici*'s knowledge, no one has rebutted their proof that the Bork result is a special case not applicable under many circumstances. The Bork argument should not be accepted by the Court as a general principle." *Leegin*, Brief for Comanor & Scherer at 5. *See also* SCHERER & ROSS , *supra* note 45, at 558 ("On the other hand, Chicagoans' claim that strictly vertical RPM cannot impair economic efficiency are plainly wrong, and their estimates of the benefits from RPM are correspondingly exaggerated.").

91 Comanor and Scherer would allow the presumption to rise or fall based on whether vertical minimum price fixing was "instigated" by the manufacturer or retailers. *Id.* at 9. Their distinction would be elusive in the best of times. Even if vertical minimum price fixing were clearly the sole product of a manufacturer at its inception, the likelihood that it would remain so is far more problematic. Even as an initial matter, if the purpose of the restraint is to incentivize retailers to engage in desired activity, the primary focus is on retailer wants and needs more so than manufacturer wants and needs. Additionally, once in place, it would be virtually impossible as a factual matter to tell whether the manufacturer or the retailers were in control of the restraint going forward. Assuming the universe of agreeable retailers included almost all available outlets, how many manufacturers would have the wherewithal to engage in a pointed re-examination of the policy, and change directions as a "unilateral" matter, without brokering a deal with the retailers? At what point would such an arrangement change from being manufacturer-instigated to being a horizontal dealer agreement adopted and enforced by the manufacturer? The test proposed by Comanor and Scherer is an interesting analytical exercise, but seems potentially impractical and difficult to administer. It appears to depend on formalistic distinctions. In addition, the facts of actual cases are unlikely always to lend themselves to easy characterizations of manufacturer- versus dealer-instigated. Finally, it may generate a rule that is too inaccessible to business managers. If a business adopted a vertical minimum price fixing strategy in response to expressions of dealer outrage – some by groups of dealers, and some by individual dealers – would that restraint be instigated by the dealers or the manufacturer?

92 *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993) (expert testimony must be based on scientifically valid reasoning or methodology that can be applied to the facts at issue in a valid and proper manner). It is unclear whether an economist's review of the theoretical literature could ever pass muster under this standard. *See, e.g., Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1055-57 (8th Cir. 2000) (plaintiff antitrust verdict reversed because expert testimony should have been excluded for failing to include all relevant circumstances, ignoring inconvenient facts, and failing to separate lawful from unlawful conduct).

of theoretical literature positing potential benefits. The showing would have to factually demonstrate that all conditions necessary to achieve those benefits actually exist. In short, the required proofs would have to demonstrate "actual market realities"[93] – something more than an expert report hypothesizing the existence of an ambiguous range of alternative outcomes.

The United States has been down the vertical minimum price fixing road before. Congress put manufacturer-administered retail pricing to the test, and the manufacturers failed. Leegin and its *amici* ask the Court to ignore Santayana's *dictum*: "Those who cannot remember the past are condemned to repeat it."[94]

Respectfully submitted,

Pamela Jones Harbour
Commissioner
Federal Trade Commission

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93 *See Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451, 466 (1992).

94 JOHN BARTLETT, FAMILIAR QUOTATIONS 588 (Justin Kaplan ed., 16th ed. 1992) (quoting *The Life of Reason [1905-06], vol. 1, Reason in Common Sense*); *see also* THUCYDIDES, HISTORY OF THE PELOPONNESIAN WAR 48 [bk. 1, sec. 22] (413 B.C., Rex Warner trans., Penguin Books 1972) ("It will be enough for me, however, if these words of mine are judged useful by those who want to understand clearly the events which happened in the past and which (human nature being what it is) will, at some time or other and in much the same ways, be repeated in the future.").

Statement

United States Senate Committee on the Judiciary

The Leegin Decision: The End of the Consumer Discounts or Good Antitrust Policy?

July 31, 2007

The Honorable Herbert Kohl
United States Senator , Wisconsin

STATEMENT OF SENATOR HERB KOHL
SENATE JUDICIARY COMMITTEE
HEARING ON "THE LEEGIN DECISION: THE END OF CONSUMER DISCOUNTS OR GOOD ANTITRUST POLICY"
JULY 31, 2007

Good morning. Today's hearing examines an issue with profound implications for the prices consumers pay for everything from clothing to electronics, and to everyone who likes to get a bargain when shopping. Last month, in the Leegin decision, a narrow 5-4 Supreme Court majority overturned a century old ban on a manufacturer setting a minimum price below which a retailer cannot sell the manufacturer's product.

Many fear that allowing manufacturers to set minimum retail prices will threaten the very existence of discounting and discount stores, and lead to higher prices for consumers. For nearly a century the rule against vertical price fixing permitted discounters to sell goods at the most competitive price. Many credit this rule with the rise of today's low price, discount retail giants – stores like Target, Best Buy, Walmart, and the internet site Amazon, which offer consumers a wide array of highly desired products at discount prices.

From my own personal experience in business I know of the dangers of permitting vertical price fixing. My family started the Kohl's department stores in 1962, and I worked there for many years before we sold the stores in the 1980s. On several occasions, we lost lines of merchandise because we tried to sell at prices lower than what the manufacturer and our rival retailers wanted. For example, when we started Kohl's and were just a small competitor to the established retail giants, we had serious difficulties obtaining the leading brand name jeans. The traditional department stores demanded that the manufacturer not sell to us unless we would agree to maintain a certain minimum price. Because they didn't want to lose the business of their biggest customers, that jeans manufacturer acquiesced in the demands of the department stores – at least until our lawyers told them that they were violating the rule against vertical price fixing.

So I know first hand the dangers to competition and discounting of permitting the practice of vertical price fixing. But we don't need to rely on my own experience. For nearly 40 years until 1975 when Congress passed the Consumer Goods Pricing Act, federal law permitted states to enact so-called "fair trade" laws legalizing vertical price fixing. Studies the Department of Justice conducted in the late 1960s indicated that prices were between 18-27 % higher in the states that allowed vertical price fixing than the states that had not passed such "fair trade" laws, costing consumers at least $ 2.1 billion per year at that time.

The likely harm to consumers if vertical price fixing were permitted is even greater today. In his dissenting opinion in the Leegin case, Justice Breyer estimated that if only 10 % of manufacturers engaged in vertical price fixing, the volume of commerce affected today would be $ 300 billion dollars, translating into retail bills that would average $ 750 to $ 1,000 dollars higher for the average family of four every year.

I am particularly worried about the effect of this new rule permitting minimum vertical price fixing on the next generation of discount retailers, the next Sam Walton. If new discount retailers can be prevented from selling products at a discount at the behest of an established retailer worried about the competition, we may imperil an essential element of retail competition so beneficial to consumers.

In the last few decades, millions of consumers have benefited from an explosion of retail competition from new large discounters in virtually every product, from clothing to electronics to groceries, in both "big box" stores and on the internet. We will need to carefully examine whether the Supreme Court's abrupt change to the settled antitrust rule forbidding vertical price fixing will threaten today's vibrant competitive retail marketplace and the pocketbooks of consumers, and consider whether legislation will be necessary to protect the continued existence of consumer discounts.

I look forward to the testimony of our distinguished panel of witness on this important topic.

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AMERICAN BAR ASSOCIATION
GOVERNMENTAL AFFAIRS OFFICE • 740 FIFTEENTH STREET, NW • WASHINGTON, DC 20005-1022 • (202) 662-1760

STATEMENT OF

JANET L. MCDAVID

ON BEHALF OF THE

AMERICAN BAR ASSOCIATION

before the

SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS

of the

COMMITTEE ON THE JUDICIARY

of the

UNITED STATES SENATE

concerning

"THE *LEEGIN* DECISION: THE END OF CONSUMER DISCOUNTS OR GOOD ANTITRUST POLICY"

JULY 31, 2007

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Good morning Chairman Kohl, Senator Hatch, and members of the Subcommittee. My name is Janet McDavid, and I am a partner at Hogan & Hartson in Washington. I am also a former Chair of the Section of Antitrust Law of the American Bar Association and as such, I have been authorized to testify on behalf of the association. Thank you for inviting me to testify before you today concerning the Supreme Court's recent decision concerning resale price maintenance.

I. INTRODUCTION

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

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

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

In a 5-4 decision issued on June 28, 2007, the United States Supreme Court overruled a nearly century-old precedent and held that vertical agreements between a supplier and its distributor or retailer on the minimum resale prices for the supplier's products will be evaluated under the antitrust rule of reason, not the per se rule. In *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), the Court had held that such agreements are per se violations of Section 1 of the Sherman Act. Only eight years after *Dr. Miles,* however, the Court in *Colgate* generally allowed a supplier *unilaterally* to adopt and enforce a policy of refusing to deal with discounters because such a unilateral decision did not involve the agreement necessary for a Section 1 violation. *United States v. Colgate & Co.,* 250 U.S. 300, 307 (1919). The Court's recent decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 75 U.S.L.W. 4643 (U.S. June 28, 2007) (No. 06-480) 2007 WL 1835892, overrules *Dr. Miles* and brings the law on *minimum* vertical resale price agreements in line with both non-price vertical restraints and *maximum* vertical resale price agreements, which have been subject only to the rule of reason since the Court's decision in *State Oil v. Kahn,* 522 U.S. 3 (1997). The Court's *Leegin* decision is consistent with the position adopted by the ABA.

II. THE *LEEGIN* DECISION

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

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

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

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

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

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

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

III. ABA POSITION

The American Bar Association supports the position that, under the Sherman Act and analogous State and territorial antitrust law, agreements between a buyer and seller setting the price at which the buyer may resell a product or service purchased from the seller should not be illegal per se.

The Sherman Act and the many State and territorial antitrust laws that are modeled on the Sherman Act contain language prohibiting every agreement in restraint of trade, but the Supreme Court has interpreted this language to prohibit only unreasonable restraints and has formulated two modes of analysis to determine whether a particular restraint should be considered unreasonable. "[M]ost antitrust claims are analyzed under a 'rule of reason,' according to which the finder of fact . . . tak[es] into account a variety of factors, including specific information about the relevant business, its condition before and after the restraint was imposed, and the restraint's history, nature, and effect." *State Oil Co. v. Khan, supra.* "Some types of restraints, however, have such predictable and pernicious anticompetitive effect, and such limited potential for procompetitive benefit, that they are deemed unlawful *per se.*" *Id.* Today, there "is often no bright line" separating rule of reason from *per se* analysis; the rule of reason encompasses a range of analysis, extending from an abbreviated "quick look" to a "plenary market examination," and even where the rule of reason is not applied, "a 'considerable inquiry into market conditions' may be required before the application of any so-called '*per se*' condemnation is justified." *California Dental Ass'n v. FTC,* 526 U.S. 756, 779 (1999), *quoting National Collegiate Athletic Ass'n,* 468 U.S. 85, 104, n. 26 (1984).

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

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

At one time, the rule of per se illegality applied not only to minimum resale price maintenance, but to most vertical resale restraints between buyers and sellers, including both price restraints and non-price restraints. *See United States v. Arnold, Schwinn & Co.,* 388 U.S. 365, 380 (1967). Incrementally, however, the Supreme Court has abandoned this standard, 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.*, 433 U.S. at 51-52. Manufacturers and other sellers impose vertical restraints "to induce retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their products" which otherwise, "[b]ecause of market imperfections such as the so-called 'free rider' effect, . . . might not be provided . . . ." *Id.* at 55.

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

Addressing price-related vertical restraints, the Court has held that the rule of per se illegality does not apply to bona fide consignment sales, maximum resale price maintenance, or agreements between a buyer and a seller for the seller to stop doing business with buyers that resell below a particular price. *Simpson v. Union Oil Co.*, 377 U.S. 13 (1964); *State Oil Co. v. Khan*, 522 U.S. 3 (1997); *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988). At the same time, lower courts have declined to apply the per se rule to agreements against advertising at prices that are less than an agreed level. *See, e.g., Illinois Corporate Travel, Inc. v. American Airlines, Inc.*, 806 F.2d 722, 728-29 (7th Cir. 1986), *cert. denied,* 495 U.S. 919 (1990); *see also In re Advertising Checking Bureau,* 109 F.T.C. 146 (1987).

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

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

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

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

The economic literature weighs heavily against condemning all minimum resale price agreements to per se illegality. 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,* 485 U.S. at 727 n.2 ("[r]etail market power is rare" *citing* Baxter, *The Viability of Vertical Restraints Doctrine,* 75 Calif. L. Rev. 933, 948-49 (1987)).

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

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

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

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

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

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

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

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

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

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

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

A. Elevating Prices to Consumers

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

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

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

B. Facilitating Coordination or Collusion Among Sellers

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

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

In *Continental T. V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 52 n.18 (1977), the Supreme Court observed: "The *per se* illegality of price restrictions has been established firmly for many years and involves significantly different questions of analysis and policy [than nonprice restrictions]. . . . [S]ome commentators have argued that the manufacturer's motivation for imposing vertical price restrictions may be the same as for nonprice restrictions. There are, however, significant differences that could easily justify different treatment. In his concurring opinion in *White Motor Co.,* [372 U.S. 253 (1963),] MR. JUSTICE BRENNAN noted that, unlike nonprice restrictions, '[r]esale price maintenance is not designed to, but almost invariably does in fact, reduce price competition not only *among* sellers of the affected product, but quite as much *between* that product and competing brands.' 372 U.S. at 268. Professor [now Judge] Posner also recognized that 'industrywide resale price maintenance might facilitate cartelizing.' Posner, [*Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions,* 75 COLUM. L. J. 282 (1975)] at 294 (footnote omitted)."

But is this sufficient reason to deny every seller the ability to enter into minimum resale price maintenance agreements with buyers, regardless of the nature of the product and the circumstances of its distribution? Plainly, this has not been a rhetorical question, but manufacturers engaging in horizontal collusion risk fines under the Sherman Act of $100 million or more and individuals participating in such collusion risk fines of $1 million and ten years in prison, which provides appreciable deterrence without applying a rule of per se illegality to every instance of minimum resale price maintenance. For all these reasons, the ABA does not agree that applying a rule of reason analysis to minimum resale price maintenance agreements will facilitate coordination or outright collusion among manufacturers and other sellers to fix the wholesale prices at which they sell their products to dealers.

C. <u>Facilitating Collusion Among Buyers</u>

A further criticism of minimum resale price maintenance that the ABA considered, but ultimately rejected, is that it can facilitate collusion among buyers to maintain supracompetitive prices. As noted earlier, this was a consideration in the original *Dr. Miles* decision. However, this not only would run counter to the interests of the seller, but would require the complicity of resellers of other brands, if there are any. *See R. J. Reynolds Tobacco Co. v. Cigarettes Cheaper!,* 2006-2 Trade Cas. (CCH) ¶ 75,393 (7th Cir. 2006) (why a seller would be drawn into a buyers' cartel "is a mystery" because it would be hurt thereby at least as much as would consumers). In any event, this phenomenon appears to be sufficiently rare as not to justify perpetuation of a rule of per se illegality. *Business Electronics Corp. v. Sharp Electronics Corp.,* 485 U.S. at 727 n.2 ("[r]etail market power is rare"). Moreover, if a seller is drawn into a price fixing conspiracy among buyers, this still would be subject to the rule of per se illegality, not as a vertical conspiracy but as a horizontal one. *See United States v. General Motors Corp.,* 384 U.S. 127 (1966).

D. <u>Congress Has Not Supported Efforts to Overrule the Per Se Rule</u>

The ABA also considered, but was not persuaded by, the argument that the per se rule of illegality for resale price maintenance should be maintained because Congress has not previously supported efforts to overturn it. 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.*, 485 U.S. at 731-32.

VI. CONCLUSION

In sum, 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 analyzed under a rule of reason analysis. The ABA also believes that the Supreme Court's recent decision in *Leegin* is consistent with that position. The ABA appreciates the opportunity to appear before the Subcommittee to discuss this important issue of U.S. antitrust law, and I look forward to your questions

TESTIMONY OF
ROBERT PITOFSKY

SHEEHY PROFESSOR OF ANTITRUST LAW
AND REGULATION
GEORGETOWN LAW SCHOOL
AND OF COUNSEL, ARNOLD & PORTER LLP

Before the Subcommittee on Antitrust, Competition Policy, and
Consumer Rights of the Senate Judiciary Committee

The Leegin Decision: End of Consumer
Discounts or Good Antitrust Policy?

Tuesday, July 31, 2007
10:00 a.m.
Room 222, Dirksen

(#1918554_1.DOC)

Mr. Chairman and members of the Committee. As always, it is an honor to testify before this Committee, and I want to compliment the Committee in holding hearings so promptly on the important question of control by manufacturers of retailer discounting under the antitrust laws.

Only a few weeks ago, the United State Supreme Court, in a hotly-debated 5-4 decision,[1] overruled the ninety-five year old Supreme Court decision in *Doctor Miles*[2] which declared that agreements between upstream manufacturers and downstream dealers or retailers to maintain uniform minimum prices was illegal *per se*. I believe the majority decision was wrong and that otherwise healthy competition at the retailer level will be impaired. Virtually all agree that minimum resale price maintenance, if allowed, will result in higher prices to consumers. Arguments that the higher prices are worth it because consumers will receive desirable services are entirely speculative and lacking any empirical support. I have spelled out my reasons for that conclusion in a recently-published article that I have attached to this opening statement.[3]

One of the most striking features of the decision to overrule (not just modify or qualify) a 95-year old precedent is that many Supreme Court decisions had affirmed the original decision; Congress was aware of the decision and never moved to modify it, and to the extent that Congress addressed the issues in *Dr. Miles*, it appeared to condone its approach.

I look forward to an opportunity to discuss these issues more fully with members of the Committee.

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[1] *Leegin Creative Leather Products v. PKS Inc. d/b/a Kay's Kloset*, _____ S.Ct. _______ (2007).

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

[3] The article can be found in Volume 21, Number 2 of Antitrust Magazine (Spring 2007).

SUPREME COURT DEVELOPMENTS: LEEGIN

Are Retailers Who Offer Discounts Really "Knaves"?: The Coming Challenge To the *Dr. Miles* Rule

BY ROBERT PITOFSKY

IT IS NOTEWORTHY WHEN THE U.S. Supreme Court agrees to review an antitrust policy announced in 1911 and followed without exception for the ensuing 95 years (the "*Dr. Miles* rule").[1] The *Dr. Miles* rule declares that agreements between upstream manufacturers, and downstream dealers or retailers, to maintain uniform minimum prices is illegal per se—that is without concern for market power or purpose of the seller, market effect, alleged business justifications, or presence or absence of less restrictive alternatives to achieve any business justifications that are claimed.

But that is not all this case is about. In the petition for certiorari, *Leegin*, the losing party below, asserts often that "modern economic analysis" (i.e., mostly the more conservative version of Chicago School doctrine) establishes that a per se rule should not apply because there are so many instances where vertical minimum resale price maintenance enhances competition. That is the same sort of "modern economic analysis" that was relied on by the Supreme Court majority in 2004 to suggest that Section 2 of the Sherman Act should be applied cautiously against monopoly behavior because the opportunity to charge monopoly prices, at least for a short period, is what attracts "business acumen," induces risk taking, and produces innovation and economic growth. Also, the *Trinko* majority advised that Section 2 should be applied with caution because there have been so many "false positives" in Section 2 enforcement.[2]

Robert Pitofsky is Professor of Law, Georgetown University Law Center and former Chairman of the Federal Trade Commission.

It is true that monopoly power in itself has never been illegal under Section 2 and clear evidence of unreasonably exclusive behavior is required. Thus, the result in *Trinko* was right. It's the commentary in the majority opinion that is troublesome. A generally benign view of monopoly behavior and skeptical view of enforcement is probably not what Congress had in mind, but is a growing view of "modern economic analysis." The coming attack on the *Dr. Miles* rule, like the comments about Section 2 enforcement, can be seen as an effort to confirm conservative economic analysis (static as opposed to dynamic views, superiority of free market decisions over antitrust enforcers)—at least to all corners of analysis of vertical restrictions.

PHOTO: GETTY IMAGES

The Case

According to the unpublished opinion of the Fifth Circuit Court of Appeals, Leegin manufactured women's belts and other accessories and sold its popular Brighton Line of women's clothing and accessories nationwide through more than 5,000 specialty outlets.[3] Leegin also sold at retail through over 70 wholly or partly owned retail outlets, at least one of which competed directly with the plaintiff.[4] Kay's Kloset, the plaintiff, is a retail outlet in Lewisville, Texas, and had been a retailer for Leegin since 1995. In 1997, Leegin announced a minimum resale price maintenance policy, said it would not do business with those who would not comply and later extracted pledges from retailers to follow the resale price maintenance rule.

In 2002, Leegin learned that Kay's Kloset had sold below required minimum prices and suspended shipments. Documents show management concerns that if resale price maintenance were not enforced, discounters would introduce "chaos" into the retail market (dreaded competition?) and discounts would "spread like cancer."[5] Leegin enforced its minimum resale price maintenance policy and Kay's Kloset sued. At trial Leegin did not challenge the allegation that the policy was pursuant to "agreement." The jury found for Kay's Kloset and Leegin appealed claiming the failure to apply a full rule of reason was error.[6] The court of appeals rejected the argument on grounds that the Supreme Court and lower courts had consistently applied a per se rule to minimum resale price maintenance since 1911 and cited with apparent approval Justice Brennan's comment in *Monsanto* that the per se rule had been around for (then) 73 years, Congress was aware of it and in several contexts had implicitly approved.[7] Leegin asked for review by the Supreme Court arguing that it was a relatively small competitor and that elimination of discounting was procompetitive for the following reasons:

One thing is clear about minimum resale price maintenance—if successfully pursued at the retail level, consumer prices will increase. Virtually all studies support that conclusion. It remains unclear whether the consumer really gets advantages worth the increased price.

(1) consumers were confused and adverse to discounting because, if they bought too early or too late, they resented paying the higher price; (2) minimum resale price maintenance created incentives for retailers to provide superior service and focus upon the sale of the manufacturer's products; and (3) discounts undermined the image that the manufacturer was trying to establish, degrading its brand image.[8] These and other common procompetitive justifications for minimum resale price maintenance will be discussed below. Before turning to the justifications, however, let's look at the anticompetitive effects.

Anticompetitive Aspects of Minimum Resale Price Maintenance

In its petition for certiorari, Leegin argues that the *Dr. Miles* opinion found minimum resale price maintenance illegal because it violated the rule against "a general restraint upon alienation."[9] Petitioners are right in the sense that reference to the rule about restraints on alienation was an unfortunate basis for the decision (at least the Court could have referred to "unreasonable restraints" upon alienation) and long ago lost any persuasive authority in the antitrust field. But that was not the only basis for the decision. The *Dr. Miles* Court noted that minimum resale price maintenance produced horizontal price effects at the dealer level, and thus was the equivalent of a horizontal dealer cartel.[10]

A second anticompetitive effect occurs at the upstream level and, in my view, is secondary. Minimum resale price maintenance may be a facilitating practice that stabilizes a manufacturers' cartel. Assuming a horizontal price-fixing agreement at the manufacturer level, some members of the cartel may be induced to cheat by offering price concessions to selected retailers to increase overall sales volume. But if all manufacturers engage in minimum resale price maintenance, the dealer or other retailer cannot pass on the wholesale price cut to consumers and would have little choice but to pocket the wholesale price discount. Thus there is no incentive for the price-fixing manufacturer to break ranks with its fellow price fixers.[11]

In the *Leegin* matter, there is a third anticompetitive effect not invariably present with resale price maintenance schemes, but hardly unique. Leegin is not just a manufacturer selling at wholesale to retailers, but is itself a substantial retailer wholly or partly owning over 70 stores.[12] Thus, its minimum price applies to retailers that are its direct competitors; as a result, there is a significant horizontal effect. Even if Kay's Kloset were not a significant direct competitor, Leegin executives seem to believe that if Kay's Kloset were allowed to discount, the practice would spread and other retailers who are direct competitors of Leegin would take up the nefarious practice, soon cutting into Leegin's retail profits.

One thing is clear about minimum resale price maintenance—if successfully pursued at the retail level, consumer prices will increase. Virtually all studies support that conclusion.[13] It remains unclear whether the consumer really gets advantages worth the increased price. The most common justifications are discussed below.

Procompetitive Justifications

Opponents of the *Dr. Miles* per se rule must concede that there will be anticompetitive effects, but claim these effects are outweighed by procompetitive justifications.

1. Inducing Desired Services. The most common argument relied upon by opponents of a per se rule against minimum resale price maintenance is that protection of dealer profits, by eliminating competition at the dealer level, will induce retailers to engage in the kind of services that will help sell the manufacturer's product. The best example, commonly cited, involves complicated audio and video equipment, where dealer demonstrations or explanations are necessary to explain why a particular manufacturer's product is superior. Some consumers may take advantage of the free demonstration or explanation and then buy from a second dealer across the street at a lower price. The free rider argument assumes that, if the manufacturer cannot prevent the no-frills discount operation, services essential to the competitive success of the manufacturer will not be provided. Eventually, the theory proceeds, the discounters will drive the services out of the market.

The dealer/service explanation is hardly a justification in all situations. During the period in which state fair trade statutes authorized RPM agreements,[14] minimum resale price maintenance was instituted with respect to cosmetics and over-the-counter pharmaceuticals, along with many other products, including pet food, vitamins, hair shampoo, ammunition, blue jeans, and men's underwear. I've yet to see a description of services induced by minimum resale price maintenance with respect to men's underwear or most of the other fair traded products.[15] As to the demonstration and explanation situation, that is more persuasive, but not a reason to do away with a per se rule. There are instances in which horizontal price fixing probably does more good than harm, but as long as those instances are few and far between, the horizontal per se rule justifiably remains in effect.

There are other reasons why inducing services is a less than persuasive justification for minimum resale price maintenance. It is hard to believe that many manufacturers protect their retailer profits to induce services. How do they know that the dealer won't just pocket some or all of the extra profits and let someone else worry about the services? Or provide the wrong services? If the dealer is a multi-product outlet such as a supermarket, drug store, department store, or woman's clothing store carrying hundreds of items, the idea that the manufacturer can induce better store-wide services or more amenable surroundings by raising the retail price on one item is absurd. And, if the manufacturer really has in mind particular services, the common commercial practice is to contract separately for them with the retailer, i.e., advertising support, warranty programs, and so forth. Those opposing per se rules in this area implicitly assume that the manufacturer knows better than the retailer or the market what will or will not work in the marketplace.[16] They also assume that competition will automatically drive the retailer to use its additional profits to provide the right kind and amount of service—a highly theoretical and speculative approach at odds with the realities of the business world.

It is interesting to consider who these discounters really are. Justice Holmes, the sole dissenter in *Dr. Miles*, referred to them as "knaves" who undermine reasonable prices and impair or destroy sale of the articles.[17] The free-rider argument is a modern variation on the "knaves" comment by Justice Holmes. It conjures up the image of unprincipled scoundrels taking advantage of the honest investments of more righteous businessmen by lowering price and taking a free ride on the existing services. But suppose the company offering the lower price works harder, handles inventory better, eliminates wasteful services, stays open longer hours, and seeks to pass along its efficiencies of operation to consumers. The manufacturer does not have to deal with such outlets in the first place,[18] but is it sensible antitrust policy to give the manufacturer the right to cut off the dealer precisely because the dealer seeks to pass along its efficiencies to consumers.

Finally, on the question of inducing services, Ward Bowman, a distinguished economist, noted in 1955 that resale price maintenance is more likely to be a method used by organized dealers to force unwilling manufacturers to protect dealer profit margins.[19] Of course, that is always hard to prove. But in the *Leegin* case, there is an easier and more obvious explanation. The manufacturer is also a significant retailer and by imposing minimum resale price maintenance, it protects its own profits at the retail level. Inducing dealer services is a less plausible explanation.

Unlike the usual challenge to the *Dr. Miles* per se rule, Leegin makes little of driving services out of the market and more about affecting incentives of its retailers.

2. Attracting Retailers. A new entrant might very well introduce minimum resale price maintenance in order to persuade retailers to invest in the expansion of market share against incumbent rivals. That is unlikely to be Leegin's justification because it already had over 5,000 dealers, so it turned to a variation on that argument. It has argued that it decided to protect retailer profits to insure loyal and attractive presentation and customer service of its products. Of course, retailer preference for a particular line does not serve the consumer interest—that is a service to the manufacturer. Either way—attract dealers or attract loyal and effective dealers that prefer the manufacturer's product—the answer is the same. Why can't the manufacturer compete for dealers or for loyal dealers by lowering its wholesale price? That should protect or increase dealer profits and persuade them to concentrate on the sale of the manufacturer's product. Instead, opponents of the *Dr. Miles* rule would legalize manufacturers increasing or protecting retailer profits at the expense of consumers—essentially a tax on consumers for the benefit of the manufacturer. If there is a "free rider" in this picture, it's the manufacturer who raises price to consumers to advance its own interests.

3. Degradation of Product. Finally, *Leegin* argues that "on and off sale degrades a manufacturer's brand" and offends customers who feel cheated if they buy too early or too late to take advantage of the sale.[20] The argument seems to be that modern retail outlets, including high-end retailers, are making a serious mistake in constantly offering products at sale prices all year long but especially between Thanksgiving and Christmas. I'd be interested to see the data that supports the argument that many or most consumers are hostile to the idea of receiving products on sale or at a discount for a fixed period of time.

A Brief Comment on Case Law

The principal cases on which *Leegin* relies to argue that the *Dr. Miles* opinion has already been rejected are *State Oil Co. v. Khan*,[21] and *Continental T.V., Inc. v. GTE Sylvania, Inc.*[22]

Khan is easily distinguished. It sensibly rejected a per se rule outlawing maximum resale price maintenance. Maximum price fixing can hardly have cartel effects, either at the retailer or the manufacturer level. An argument previously advanced to justify maximum resale price maintenance is that it could de facto become the minimum over time. But

Because anticompetitive and anticonsumer effects of minimum resale price fixing are virtually certain, and procompetitive effects theoretical and speculative, a per se rule remains justifiable.

that could be detected in a rule of reason analysis examining whether all of the dealers ended up at a uniform minimum price.

Distinguishing *Sylvania* is a more serious challenge. It applied a full rule of reason to vertical territorial and customer allocation. In the face of extensive academic criticism of the earlier *Schwinn* decision, similar to the criticism of *Dr. Miles* but more unanimous, the Court overruled the per se rule adopted in *United States v. Arnold Schwinn & Co.*[23] Of course Schwinn was decided ten years before *Sylvania*, not 95 years earlier, and enjoyed no express or even implicit Congressional approval.[24] But that's not the only issue. The point is that horizontal price fixing and horizontal market division have generally been treated much the same through the entire history of U.S. antitrust; therefore, if vertical market allocation is subject to a rule of reason, the anti-*Dr. Miles* scholars argue, why should not the same rule apply to vertical minimum resale price maintenance?

There are several reasons why different rules can apply. As the majority noted in *Sylvania*, minimum resale price maintenance and nonprice vertical restrictions "involve significantly different questions of analysis and policy."[25] Thus, resale price maintenance "almost invariably reduces price competition" not only among retailers of the affected product, but because it is a facilitating practice between the manufacturer and competing brands. Second, if dealers are assigned Area A and directed to stay out of other areas, it does not follow that prices in Area A will be uniform. In assigned territories, there are usually more than one, and indeed more than a few, outlets carrying the same brand (think retailers of shoes, liquor, TVs, men's underwear) and these retailers are free to compete against each other and lower price within their area to their heart's content. With minimum resale price maintenance, the typical intrabrand effect is unvarying minimum prices. *Sylvania* did put a stamp of approval on valid free-rider justifications for vertical restrictions, but it ought not follow that *Dr. Miles* should, as a result of that decision, be overruled. The Court in *Sylvania* expressly rejected that result.

Petitioner's Brief on the Merits

After this piece was submitted for publication, the petitioner's brief on the merits was submitted to the Supreme Court. The brief adheres fairly closely to the petition for writ of certiorari,[26] with a few interesting departures.

1. The petitioner's brief never addresses the fact that Leegin was a dual distributor and the minimum resale prices it sets is the price of a direct or indirect competitor of its own marketing operation.

2. The petitioner deals with the fact that the *Dr. Miles* rule has been on the books for 95 years, Congress was clearly aware of it and, in several ways, implicitly approved. The petitioner notes, however, that Congress never "mandated" application of a per se rule to minimum resale price maintenance—suggesting that Congress's attitude can be ignored unless it directly legislates. That would be a departure from the clear teaching of both *Monsanto* and *Sylvania*.[27]

3. Finally, the petitioner leaps to the conclusion that because sales of Leegin's women's accessories increased during the period of minimum resale price maintenance, it must have been because of the higher retail prices. It never addresses the possibility that Leegin had a high-quality product that succeeded in the market place, that total sales of women's accessories increased during prosperous times, that the company had able management or good locations, or any of the dozen or so other reasons why output may have increased.

Conclusion

Because anticompetitive and anticonsumer effects of minimum resale price fixing are virtually certain, and procompetitive effects theoretical and speculative, a per se rule remains justifiable. The fact that there may be some formidable free-rider effects in some circumstances (as noted earlier: explanation and demonstration of high-tech equipment) does not undermine that conclusion. The per se rule is accepted to achieve judicial efficiency and to give a bright-line rule to the private sector, even if in a few instances out of every 100 it would turn out that the practice is procompetitive if all the facts were known.[28]

The alternative advocated by Leegin in its petition for certiorari is a full rule of reason. It is worth asking what that approach would look like. It would require a measure of market power (i.e., defining relevant product and geographic market), examination of distribution practices by all direct rivals, consideration of barriers to entry, examination of alleged business justifications, consideration of whether a less restrictive alternative could achieve the same justifications in a less anticompetitive way, and, finally, a balancing process examining pro- and anticompetitive effects. This would be accompanied by a clash of creative experts on both sides, dueling to produce ever more complicated explanations of what happened and why. It is plausible that abandonment of a per se approach to minimum resale price maintenance would lead to a very generous and difficult to enforce full rule of reason and eventually to de facto per se legality. That is consistent with the analysis of Judge Richard Posner in a 1981 article, where he noted that rule of reason approach in the vertical distribution area was "infeasible and unsound," and concluded that per se legality was the correct result.[29]

It is relevant that in the eight years of the Reagan Administration and the six years of Bush II, when the per se rule against minimum resale price maintenance was disdained, the result at the federal level was not rule of reason enforcement over per se—it was no enforcement at all. Thus, the proper question is whether, under a full rule of reason analysis, or resulting de facto per se legality, large numbers of anticompetitive and anti-consumer vertical price schemes, with no plausible service or other pro-consumer effects, would escape challenge.

If the Court concludes that there are more than a few instances of procompetitive or neutral uses of minimum resale price maintenance, there is a compromise that could preserve the benefits of the per se rule and yet offer an escape valve for any instances of procompetitive effect—the same sort of escape valve that the Supreme Court applied to horizontal cartel enforcement in the *BMI* decision.[30] A similar approach could be introduced here. If the defendant can demonstrate on a quick look extreme free-rider problems or is a new entrant seeking dealer investment in establishing a reputation for a product in a highly competitive sector of the economy, full rule of reason may be the right approach. My own view is that the free-rider explanation for vertical restrictions has been grossly exaggerated,[31] but perhaps easing the per se rule at the edges would be sensible.

Donald Turner, Harvard Law Professor and head of the Department of Justice Antitrust Division, predicted in 1986 that the Supreme Court was unlikely to overrule *Dr. Miles* but suggested, apparently with approval, that the Court might grant appropriate exceptions.[32] The Court's *BMI* decision, preserving the benefits of a per se rule against horizontal price fixing after a quick look preliminary, shows how that can be done. As a result, incentives to improve efficiencies in distribution (characterized unfairly in 1911 as the behavior of "knaves") would be maintained. ■

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

[2] Verizon Communications Inc. v. Law Office of Curtis V. Trinko LLP, 540 U.S. 398, 414 (2004).

[3] See PSKS, Inc. v. Leegin Creative Leather Prods., Inc., 171 F. App'x 464, 465 (5th Cir. 2006); Petition for a Writ of Certiorari at 3, Leegin Creative Leather Products, Inc. v. PSKS, Inc., No. 06-480 (2006) [hereinafter Petition for Writ of Certiorari].

[4] See Brief in Opposition to Petition for a Writ of Certiorari at 4, Leegin Creative Leather Products, Inc. v. PSKS, Inc., No. 06-480 (2006) [hereinafter Brief in Opposition].

[5] Brief in Opposition, *supra* note 4, at 5–6 (citing to record documents P. Ex. 74 and P. Ex. 67).

[6] *See* Petition for a Writ of Certiorari, *supra* note 3, at 5.

[7] Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 769 (1984) (Brennan, J., concurring). In *Sylvania*, Justice Powell writing for the majority also noted that Congress had expressed its approval of a per se rule against vertical minimum price restrictions by repealing fair trade laws that allowed minimum price fixing at the discretion of individual states. Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 52 n.18 (1977). Fair trade was an exception to the per se rule and Congress was aware when it repealed the fair trade laws in 1975 that it was restoring per se treatment. A more recent and even stronger indication of Congressional will occurred in 1984. The Department of Justice had submitted an amicus brief in the *Monsanto* case asking that *Dr. Miles* be overruled. Congress responded by enacting a bill barring the Justice Department from spending any funds "to overturn or alter the per se prohibition on resale price maintenance in effect under federal antitrust laws," thus dramatically requiring the head of the Antitrust Division to decline to respond to direct questioning from the Justices. See Pub. L. No. 98-166, § 510, 97 Stat. 1071, 1102–03 (1983). A clearer indication of Congressional awareness and approval of an antitrust rule is hard to imagine.

[8] See Petition for a Writ of Certiorari, *supra* note 3, at 2–3.

[9] *Id.* at 7.

[10] *See Dr. Miles*, 220 U.S. at 399–400.

[11] This distinction was relied on by the majority in *Sylvania* to justify rule of reason treatment for vertical territorial allocation and the continuation of per se illegality for minimum resale price maintenance. See *Sylvania*, 433 U.S. 36 n.18.

[12] See Brief in Opposition, *supra* note 4, at 4.

[13] *See Hearings on S. 408, Subcommittee on Antitrust and Monopoly of the Senate Judiciary Committee*, 94th Cong., 1st Sess. 174 (1975). That conclusion should not be controversial because the claim of those seeking more lenient treatment of minimum resale price maintenance is to raise prices at the retail level in order, at least theoretically, to preserve or induce valuable services in the market.

[14] See *supra* note 7.

[15] Robert Pitofsky, *Why Dr. Miles Was Right*, AEI J. ON GOV'T & SOC'Y REG. 27, 29 (Jan.–Feb. 1984).

[16] See Robert Pitofsky, In Defense of Discounters, *The No-Frills Case for a Per Se Rule Against Vertical Price Fixing*, 71 GEO. L.J. 1487 (1983) (elaborating on these arguments).

[17] See *Dr. Miles*, 220 U.S. at 412 (Holmes, J., dissenting).

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

[19] Ward Bowman, *The Prerequisites and Effect of Resale Price Maintenance*, 22 U. CHI. L. REV. 825, 830–31 (1955).

[20] See Petition for a Writ of Certiorari, *supra* note 3, at 3.

[21] 522 U.S. 3 (1977).

[22] 433 U.S. 36 (1977).

[23] 388 U.S. 365 (1967).

[24] See references to Congressional awareness and apparent approval of *Dr. Miles'* per se rule *supra* note 7.

[25] *Sylvania*, 433 U.S. at 52 n.18.

[26] *Supra* note 3.

[27] See *supra* note 7.

[28] See Pitofsky, *supra* note 16, at 1489 (elaborating on the point).

[29] *See* Richard Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6, 9 (1981).

[30] In *Broadcast Music, Inc. v. Columbia Broadcasting System*, 441 U.S. 1 (1979), the Court engaged in a preliminary "characterization" to see if a per se rule was justified, looking into such questions as the effect of the horizontal arrangement on price, substantiality of efficiencies, and whether the arrangement facilitated the introduction of a new product.

[31] For example, Judge Posner on a quick look found that the alleged free-rider explanation in *General Leaseways Inc. v. National Truck Leasing Association*, 744 F.2d 588 (7th Cir. 1984), was not valid. And Judge Wood in *Toys "R" Us, Inc. v. FTC*, 221 F.3d 928 (7th Cir. 2000), closely examined the purported free-rider justification and came to the same conclusion.

[32] Robert Levy, Donald Turner, Robert Weinbaum & Walter Winslow, *Counseling Your Client on Horizontal and Vertical Restraints: Panel Discussion*, 55 ANTITRUST L.J. 293 (1986).

Written Testimony of Marcy Syms, Chief Executive Officer of SYMS Corp
Senate Subcommittee on Antitrust, Competition Policy and Consumer Rights
The Leegin Decision: The End of Consumer Discounts or Good Antitrust Policy?

July 31, 2007

Chairman Kohl, Ranking Member Hatch, and Members of the Subcommittee:

I am Marcy Syms, the Chief Executive Officer of SYMS Corp (SYMS). Thank you very much for the invitation to testify before the Subcommittee on the issue of whether Congress should amend the antitrust laws to overrule the Supreme Court's recent decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.* and to restore the long-standing *per se* rule governing retail price maintenance (RPM) agreements. That is an issue of great significance to SYMS, many other "discount" and "off-price" retailers, and consumers.

My testimony today will focus principally on SYMS' reliance on the *per se* rule and the practical consequences that *Leegin* will have for SYMS and, more generally, the clothing industry. Please be aware that I am neither a lawyer nor an economist, and I will limit the scope of my testimony accordingly.

* * *

Before turning to SYMS' reliance on the prohibition against RPM agreements and the practical consequences that will attend *Leegin*, let me begin with some background on SYMS. SYMS is an "off price" retailer with 33 stores in 13 states that sells designer and brand name clothing at substantial savings to consumers. Syms was founded in 1959 by my father, Sy Syms, who today serves as the Chairman of SYMS' Board of Directors.

SYMS began by selling garments produced by a select group of manufacturers that supplied it on the condition that it sell their garments with generic labels or remove the brand labels at the time of sale. As SYMS' business began to grow and manufacturers learned to appreciate SYMS' commitment to maintaining the integrity of their brand by not advertising the labels it carried, its knowledge of the garments, and its respect for its customers, they began to loosen their control over how SYMS could sell to its "Educated Consumers." Today SYMS is able to sell brand name clothing with labels attached, as well as advertise brand names within its stores, on its website, and through customer mailings.

SYMS purchases most of its merchandise directly from the manufacturers of brand name and designer clothing. Most of the merchandise is first-quality and in-season. The availability of this merchandise is the result of over-production, cancelled orders, and other factors. Sometimes SYMS also places "up front" orders with a manufacturer. Occasionally SYMS sells irregulars or seconds (which it marks as such), but at no time does that represent more than 3% of the merchandise sold at SYMS.

SYMS works on a "mark up" system unique in retail, even among discount sellers and its "off-price" competitors. Instead of paying manufactures wholesale and selling at a lower mark-up than its retail competitors, SYMS pays below wholesale prices. An in-store SYMS announcement explains the concept to customers this way:

> At SYMS we want you to know that we are not discounters. Discounters pay the same wholesale price as a regular department store, and then take a smaller markup. At SYMS we have long established relationships with over 200 of the top designer and brand name manufacturers. We pay less than the wholesale price and sell to you at less than the normal retail markup so you pay within 10% of the manufacturer's wholesale price.

* * *

SYMS has relied for many years on the prohibition of RPM agreements mandated by the federal antitrust laws. It has invested its capital, structured its business, and built customer goodwill in reliance on that prohibition. (I commend to the Subcommittee to the section of the dissenting opinion in *Leegin* in which Justice Breyer makes just that point.)

Over the years SYMS has occasionally been pressured by manufacturers to stop selling particular merchandise because retail competitors that sell at higher prices (department stores in particular) have complained about SYMS' prices. But the prohibition on RPM agreements has, I believe, kept in check serious threats to SYMS' ability to sell merchandise according to the pricing approach I have described. That may well change as manufacturer-originated RPM policies become more prevalent in the clothing industry.

* * *

Let me now briefly outline what I predict will be some of the undesirable effects that will attend manufacture-originated RPM in the retail clothing industry:

First, interference with consumer choice: The introduction of RPM policies will force discount retailers (especially large ones) to pursue strategies other than price-cutting—the provision of rebates, gifts accompanying purchases, and other special offers—in order to compete. As a result, consumers will find it difficult to judge what they are actually paying for the products they desire and the value they are receiving. SYMS's well-known sales approach—reflected in its slogan "An Educated Consumer Is Our Best Customer"—is that consumers should be able to judge exactly what value they are receiving and to make purchasing choices accordingly.

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Second, facilitation of horizontal price-fixing agreements at the manufacturer level: As others will likely point out in greater detail, RPM may well facilitate (unlawful) horizontal price-fixing agreements among manufacturers, thereby reducing interbrand competition.

Third, restrictions on the sale of seasonal merchandise: The retail clothing market is characterized by a continually changing and often seasonal product mix. Consumers are accustomed to, and benefit from, deep markdowns on seasonal items. The introduction of RPM policies will lower a retailer's ability to sell end-of-season or out-of-season merchandise by discounting. A closely related problem will be the inability of retailers to sell poorly performing merchandize governed by RPM policies.

Fourth, advantaging foreign retailers: The introduction of RPM may create opportunities for foreign retailers—or large domestic retailers who set up foreign entities to distribute their products via the internet or catalogues—to secure a competitive advantage over domestic retailers. This is because foreign retailers will find it easier than their domestic counterparts to escape the legal consequences of violating RPM policies.

Fifth, increased transaction costs: Retailers will face increased costs as a result of having to ascertain and comply with RPM restrictions that may be attached to the products, especially when they purchase products (as they often do) from suppliers other than the manufacturer. Another source of transaction costs will result from the need to comply with state law: While federal law may allow RPM, state antitrust laws may forbid them. These increased transaction costs will of course disadvantage smaller retailers more so than large retailers.

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Sixth, limitations on off-price retailer growth: It is already difficult for off-price discount retailers in the clothing industry to expand their businesses. The limited supply of discount branded products on the wholesale market restricts growth. RPM policies will further restrict the supply of discounted merchandise: Much of the discount merchandise sold by manufacturers consists of off-season or out-of-season merchandise. Increasing the lifecycle of an item at full retail will reduce the off-price supply.

* * *

That concludes my prepared testimony. I would be very happy to answer any questions about my testimony or any other questions that the Subcommittee may have.

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