On June 28, 2007, the United States Supreme Court issued a landmark (5-4) decision in Leegin Creative Leather Products, Inc. v. PSKS, Inc., No. 06-480, expressly overruling the nearly one-hundred-year-old “Dr. Miles” per se prohibition against minimum resale price maintenance agreements. The “rule of reason” will now apply to such agreements.

Before Leegin, the Supreme Court had repeatedly held that minimum resale price maintenance was illegal per se under Section 1 of the Sherman Act.* Accordingly, courts have focused not on the reasonableness of such a restraint, but on whether it is the product of some kind of “agreement.” The historical prohibition against minimum resale price maintenance resulted in the development of a number of workaround programs, including Colgate programs and minimum advertised pricing programs, whereby a manufacturer unilaterally announces resale prices to its distributors and unilaterally refuses to deal with a distributor that fails to adhere to those prices. However, these programs have proven to be difficult, expensive and risky to enforce. So as to avoid a prohibited “agreement” being found, manufacturers were cautioned not to (1) discuss their “recommended” resale pricing policy with any dealer; (2) solicit or accept a dealer’s agreement to comply with the policy; (3) warn or threaten any dealers for non-compliance; or (4) cease doing business with a non-compliant dealer at the urging of another dealer. The result was that a manufacturer seeking to implement a resale pricing program might terminate longstanding distributors for minor violations without seeking an explanation. In Leegin, the Supreme Court criticized these workaround programs as “creating legal distinctions that operate as traps for the unwary — more than the interests of consumers — by requiring manufacturers to choose second-best options to achieve sound business objectives.”

In Leegin, the majority found that minimum resale price maintenance agreements are not restraints “that would always or almost always tend to restrict competition and decrease output” so as to justify automatic condemnation under the per se rule. The Court, acknowledging several decades worth of economic literature, found that there are several procompetitive justifications for a manufacturer’s use of resale price maintenance, including stimulation of interbrand competition among manufacturers by reducing intrabrand competition among retailers; and that vertical price restraints, while tending to eliminate intrabrand competition, can “stimulate retailer services” that aid the manufacturer’s position as against rival manufacturers. The Court reasoned that absent vertical price restraints, retail services that enhance interbrand competition might be underprovided because discounting retailers (such as internet sellers) can “free ride” on retailers that furnish services that help create the demand. The Court also found that resale price maintenance could also give consumers more options to choose among low-price, low-service brands; high-price, high-service brands; and brands falling in between. Lastly, the Court found that resale price maintenance can also increase interbrand competition by facilitating market entry for new firms and brands and by

*As a precursor to the Supreme Court’s new approach to resale price maintenance, in State Oil Co. v. Kahn, 522 U.S. 3 (1997), the Court expressly overruled the longstanding per se prohibition against maximum resale price maintenance agreements.
encouraging retailer services that would not be provided even absent free riding.

The application of the rule of reason to minimum resale price maintenance agreements will now allow courts to consider such procompetitive justifications when evaluating whether such an agreement is an unreasonable restraint of trade, as it does with other vertical restraints unrelated to price. The Court, however, did caution that setting resale prices can have anticompetitive effects, such as facilitating a manufacturer or retailer cartel. The Court identified the following factors as among those relevant to the rule of reason inquiry: (1) the number of manufacturers using the practice; (2) the source of the restraint; and (3) the manufacturer’s market power.

While the overturning of the nearly one-hundred-year-old per se rule against minimum resale price maintenance agreements is a positive development for manufacturers, it remains to be seen how courts will apply the rule of reason to those agreements. The Supreme Court itself acknowledged the procedural flexibility trial courts will have in undertaking the task:

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