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April 2011

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LEEGIN CASE: RESALE PRICE MAINTENANCE VS. CONSUMER WELFARE

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Abstract

A new approach to vertical price fixing, brought up in *Leegin* by U.S. Supreme Court had triggered various debate and it is still not clear whether resale price maintenance (RPM) can have severe anticompetitive potential or can also be beneficial to competition. Main problem of assessing pro-competitive or anti-competitive effects of RPM is that there is a substantive lack of empirical evidence. Furthermore, there is a room for manipulation where contradictory economic theories are brought. Albeit EU Competition Law is always influenced by U.S. Antitrust policy, however, it can be argued that EU should not follow a liberal approach to RPM made in *Leegin*.

Key words

Leegin case; resale price maintenance; vertical price fixing agreements; pro-competitive; anti competitive effects; EU competition; U.S. Antitrust law;

Introduction

Having in mind that Sherman Act (The Sherman Antitrust Act of U.S) had a major influence in EU's Competition Law evolution, not surprisingly, any important change in U.S. Antitrust law always triggers intense debate in EU. Debates are even more arduous when cases like *Leegin*[1]

[1] Leegin Creative Leather Products, Inc. v. PSKS, Inc., 551 U.S. 877 (2007).

are brought to discussion. In *Leegin*, a precedent of *Dr. Miles*[2] which stated that vertical price fixing was a *per se* restraint of competition, was overturned by U.S. Supreme Court. Court's decision established new policy against vertical price fixing and ruled in favour of the *rule of reason* analysis. In EU, however, resale price maintenance (RPM) like agreements or concerted practices, having as their direct or indirect object the establishment of a fixed or minimum resale price or a fixed or minimum price level to be observed by the buyer, are considered as hardcore restrictions[3]. Obviously, an issue of such difference in regulation in U.S. Antitrust Law and EU Competition Law systems can not be ignored and the main question should be answered – does EU Competition Law needs to follow the new U.S. Antitrust Law approach on vertical price fixing and would this new approach benefit the main purpose of EU - internal market and consumer welfare? In order to answer this question it is necessary to analyse RPM's legal history, its purpose and regulation both in U.S. and EU.

Dr. Miles case

A precedent of *Dr. Miles* was nearly 100 years old and criticism of its approach to RPM was rapidly growing in past years with its conclusion in *Leegin* case. Dr. Miles was a medicine manufacture company which imposed minimum resale price in its contracts with wholesalers and retailers. A claim was brought to court by company of Dr. Miles against a defendant who was not actually a party to any agreement with Dr. Miles, but who was buying medicine products from Dr. Miles wholesalers and sold it in a lower price to consumers. Dr. Miles stated that - "*an actionable wrong was committed by one who maliciously interferes with a contract between two parties*

[2] Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).
[3] Commission notice. Guidelines on Vertical Restraints 10.5.2010 SEC(2010) 411

and induces one of them to break the contract to the injury of the other, and in the absence of an adequate remedy at law equitable relief must be granted"[4], but court held that Dr. Miles was not entitled to any relief because the contract under which they claimed was invalid. Consequently, main argument of Dr. Miles was that the manufacturer may make and sell, or not, as he chooses, he may affix conditions or the prices at which purchasers may dispose of it and the propriety of the restraint is sought to be derived from the liberty of the producer. However, court held that vertical price fixing agreements or combinations between dealers, having for their sole purpose the destruction of competition and the fixing of prices are injurious to the public interest and void. Courts decision established a long standing rule that vertical price fixing agreements were *per se* restraints of competition.

Leegin case and analysis of RPM's effects on competition

As mentioned above, after U.S. Supreme Court's decision in *Dr. Miles*, a hostile approach to RPM was criticized frequently and it can be noticed that the decision in *Leegin* case was a consequence of the endless pressure from economists and legal practitioners. Over the years, courts have increasingly turned to economic principles to guide their interpretation of the antitrust laws[5]. Economists and practitioners have argued that courts should note that RPM have both the anti-competitive and pro-competitive market forces, thus the *rule of reason* should be applied instead of *per se* illegality approach. Firstly, the more fact-based approach and the *rule of reason* were applied in assessing non-price vertical agreements in *Sylvania*[6]. Albeit this case was concerned with franchise

[4] Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).
[5] Competition Law and Economics: Advances in Competition Policy Enforcement in the EU and North America. Abel M. Mateus, Teresa Moreira 2010. p. 150
[6] Continental T. V., Inc. v. Gte Sylvania Inc. 433 U.S. 36 (1977).

location clause in a vertical agreement, but it brought forward further debates on vertical price fixing issue and commentators claimed that the *rule of reason* should also be applied to price fixing agreements, either to maximum price or minimum price fixing.

Other influential opinion, which promoted the application the *rule of reason* to vertical price fixing, was frequently heard from Chicago school in 1970's. Scholars used economic theory to show how price fixing practices and other agreements could be used to generate efficiency gains, and, thus, should be evaluated under the *rule of reason* analysis or even be declared *per se* legal. In addition, they argued that antitrust law should be guided solely by economic efficiency, focusing on the effects of restrictive agreements alone[7].

Consequently, U.S. Supreme Court overturned a precedent of *Dr. Miles* in *Leegin* in 2007. Leegin was a company which produced leather goods and accessories and had a policy of refusing to sell to retailers that discounted its goods below suggested prices. When Leegin stopped selling to retailer's PSKS store, PSKS filed a suit, alleging that Leegin violated antitrust laws by entering into vertical agreements with its retailers to set minimum resale prices[8]. U.S. Supreme court decided, by a weak majority 5 against 4, that RPM had both pro-competitive and anti-competitive effects and that the *rule of reason* should be used when assessing its effects to competition. This U.S. Supreme Court's decision, not surprisingly, is called a landmark decision not only because it overruled 97 years of authority on vertical price fixing, but also because it consisted of the main arguments and economic

[7] . Mark Steiner - Business & Economics 2007 p. 60

[8] Leegin Creative Leather Products, Inc. v. PSKS, Inc., 551 U.S. 877 (2007).

theories which questioned whether RPM is competitively motivated.

Justice Kennedy, in his opinion in *Leegin*, emphasised that minimum or fixed RPM had unequivocal pro-competitive effects. First of all, minimum RPM can stimulate interbrand competition (the competition among manufacturers selling different brands of the same type of product) by reducing intrabrand competition (the competition among retailers selling the same brand). In addition, he stated that minimum or fixed RPM can increase interbrand competition by facilitating market entry for new firms and brands. Furthermore, Justice Kennedy stated that RPM can also increase interbrand competition by encouraging retailer services that would not be provided even absent free riding.

Aforementioned pro-competitive effects of minimum or fixed RPM were not the only ones offered in *Leegin*, but were common object of discussion among practitioners and economists. It was first argued that minimum or fixed RPM can have a positive effect on interbrand competition where a manufacturer implies minimum RPM on its dealership agreements it can avoid a free riding problem. Free riding is a common situation when one or more dealers operating in sales of the same product take an advantage of the investment in better promotion of the product made by other dealers also operating within the same product sales. While one dealer invests into better presentation of a product and, therefore, the price of such product increases, other dealer, which does not promote the same product, has an opportunity to sell it in a lower price. Eventually, this leads to a situation where dealers do not invest in better promotion of product because of "free riders" and overall sales of manufacturer's product decreases. In order to avoid such situation, minimum RPM can be a useful tool to the manufacturer. Manufacturers

can prevent retailers from free riding by adopting a uniform price floor. Indeed, once RPM is imposed, retailers can not cut retail prices below the price floor and, therefore, cannot lure consumers away from other retailers by lowering prices[9]. In addition, minimum RPM induces dealers to invest into better promotion and presentation of a product which can be anything from luxury interior of a store or more qualified personnel. Where retailers supply such services, demand for the manufacturer's products increases. That explains manufacturer's desire for retailers to supply such point-of-sale services[10]. Hence minimum RPM aids manufacturer's position amongst his competitors and therefore stimulates interbrand competition.

Second pro-competitive effect argued by Justice Kennedy in *Leegin* and other enthusiasts of RPM is the facilitation of market entry for new firms and brands. In some markets manufacturers or new brands, in order to entry a market, need extensive assistance of dealers and retailers. Minimum RPM can be an effective tool which can help them to find and persuade competent dealers to invest into promotion of a new product and its market development. Without RPM dealers may be unwilling to make the necessary investments unless they receive some assurance that new dealers who did not incur similar development costs will not be able to compete by charging lower prices, thereby preventing their recoupment of their development costs[11]. Therefore, entry for new brands and products can be easier, leading to an increase in a wider choice of products.

[9] Resale price maintenance: economics call for a more balanced approach. Mart Kneepkens European Competition Law Review 2007
[10] Competitive resale price maintenance in the absence of free-riding. Benjamin Klein. Federal Trade Commission Hearings on Resale Price Maintenance, Washington, D.C., February 17, 2009
[11] Leegin and resale price maintenance - a model for emulation or for caution for the world? Marina Lao. International Review of Intellectual Property and Competition Law. Case Comment. 2008

Other point made in *Leegin* was that it may be difficult and inefficient for a manufacturer to make and enforce a contract with a retailer specifying the different services the retailer must perform. This can be a case of specific products or luxury brands. Strict RPM can be used for the protection of a very well-known and prestigious brand name from widespread use that might deteriorate it[12]. It is a common situation when consumers buy a specific product, not only because of its quality or price, but also because they appreciate promotional services and product's elite image. In order to retain such characteristics of its product, a manufacturer can achieve it by imposing minimum RPM and attract only those dealers or retailers which have sufficient financial abilities and sufficient expertise which, in turn, enables them to sell expensive and prestigious products.

It was mentioned that *Leegin* case was not a unanimous decision and there was a lot of criticism towards its approach to minimum RPM. Justice Breyer, in his dissenting opinion in *Leegin,* had argued that "*antitrust law cannot, and should not, precisely replicate economists' (sometimes conflicting) views. That is because law, unlike economics, is an administrative system the effects of which depend upon the content of rules and precedents only as they are applied by judges and juries in courts and by lawyers advising their clients. And that fact means that courts will often bring their own administrative judgment to bear, sometimes applying rules of per se unlawfulness to business practices even when those practices sometimes produce benefits*"[13].

[12] Resale Price Maintenance and Quality Certification. Howard Marvel & Stephen McCafferty (1984); Market dominance and antitrust policy. Michael Utton, (2003)
[13] Leegin Creative Leather Products, Inc. v. PSKS, Inc., 551 U.S. 877 (2007).

Dissenting opinion in *Leegin* had a lot of support from practitioners and economists. It was first argued that "free riding" is not a widespread phenomenon that can justify most cases of resale price maintenance[14]. In addition, it can be claimed that exceptional promotion and presentation of a product only applies to a few percent of overall product sales, therefore it can not be asserted that RPM can be justified in a majority of cases.

Furthermore, there are number of other anti-competitive effects of RPM that commentators signify. First concern is that RPM can facilitate a "dealer cartel", as well as a "manufacturer cartel". Through RPM the manufacturer becomes the retail cartel enforcer, ensuring that no retailer deviates from the cartel price and in "manufacturer cartel scenario", RPM increases price transparency and thus facilitates easy detection of any deviations from a collusive equilibrium. Generalized RPM can facilitate collusion on retail prices even among a significant number of players, due to its self-enforcing character[15].

Another concern with RPM is its effect on retail market. Discounting prices is one of the most successful marketing strategy which leads to greater sales and consumer welfare. However, it can be often observed that RPM prevents efficient retailers from achieving a higher volume of sales by passing along their cost savings to consumers, and thereby minimizes the incentive for retail innovation[16].

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[14] Competitive resale price maintenance in the absence of free-riding. Benjamin Klein. Federal Trade Commission Hearings on Resale Price Maintenance, Washington, D.C., February 17, 2009.

[15] Resale Price Maintenance in the EU: *in statu quo ante bellum ?* Eric Gippini-Fournier. 36th Annual Conference on International Antitrust Law and Policy, 2009 (B. Hawk ed., 2010) Available at SSRN: http://ssrn.com/abstract=1476443

[16] Resale Price Maintenance: A Reassessment of its Competitive Harms and Benefits. Marina Lao (June 1, 2009). More common ground for

On the top of that, other compelling anti-competitive effect of RPM is its impact on product price. It was mentioned that in decision in *Leegin* and in other views of economists, who advocate pro-competitive effects of RPM, it is argued that, in order to escape "free riding" consequences, it is necessary to impose RPM and thus secure inter-brand competition and retail services. However, it is not convincing that RPM can actually lower consumer prices. Where a manufacturer and retailer or dealer agrees to fix prices it can be a matter of course that their primary goal is to maximise their profits. Nonetheless, it can not be clearly proved that RPM can increase or decrease consumer prices, because product price is influenced by many other factors. In *Leegin,* it is stated that antitrust laws primarily are designed to protect interbrand competition from which lower prices can later result, but would it not be more accurate to declare that antitrust laws are primary designed to protect consumer welfare and ipso facto lower prices, because it can be noticed that interbrand competition can be manipulated by either cartels or different opinions of economists.

Evolution and development of U.S. Antitrust Law on RPM can be defined as controversial. Albeit in *Leegin* Justice Breyer stated that antitrust law cannot, and should not, precisely replicate economists, however, it can come to view that economy reflects fairness and rationality of Competition Law or Antitrust Law and should not be underestimated. Economic approach to RPM had also come to a greater view in EU Competition Law and, in order to answer if EU should follow controversially changing U.S. Antitrust Law, these issues must be discussed.

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international competition law?, Josef Drexl et al., eds, Edward Elgar, Forthcoming. Available at SSRN: http://ssrn.com/abstract=1434984

RPM in EU Competition Law

There is a different approach to RPM in EU Competition Law. It was mentioned that agreements or concerted practices having as their direct or indirect object the establishment of a fixed or minimum resale price or a fixed or minimum price level to be observed by the buyer are considered as hardcore restrictions. Where an agreement includes RPM, that agreement is presumed to restrict competition and thus to fall within Article 101(1). It also gives rise to the presumption that the agreement is unlikely to fulfil the conditions of Article 101(3), for which reason the block exemption does not apply. However, undertakings have the possibility to plead an efficiency defence under Article 101(3) in an individual case[17].

After decision in *Leegin* in U.S., EU Commission was under constant pressure, while drafting it's new Guidelines on vertical restrains of 2010. Practitioners had constantly argued whether the EU still needs a block exemption regulation in the area of vertical restraints. Main arguments were that double presumption that (i) the agreement falls within the scope of Article 101 and (ii) that it is unlikely to be exempted under Article 101(3) means that case-by-case analysis of the particular restraint in its factual, economic and legal context is needed, but rarely conducted. Also, in most cases, national courts and in some cases national competition authorities are reluctant to accept complex economic justifications and treat hard-core restrictions as *per se* infringements[18]. However, new guidelines on vertical restrains affirmed that EU Commission is

[17] Commission notice. Guidelines on Vertical Restraints 10.5.2010 SEC(2010) 411

[18] European Competition Lawyers Forum (ECLF) Comments on the Draft Block Exemption Regulation and Guidelines on Vertical Restraints. September 28, 2009.

willing and encouraging national courts or competition authorities to adopt the more economical approach.

While in practice it may seem that economical approach is the approval of the *rule of reason* in EU Competition Law, however, such instrument would be contrary to EU's legal regulation system. Firstly, the *rule of reason* must be analysed in accordance with the Sherman Act, Section 1, which states that – "*Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal*[19]". This means that the *rule of reason* under which the finder of fact must decide whether the questioned practice imposes an unreasonable restraint on competition, taking into account a variety of factors, could cover any agreement which restrains trade. In comparison, Article 101(1) of TFEU does not state that all agreements, decisions or practices are restraints of competition but only those which have as their object or effect the prevention, restriction or distortion of competition and Article 101(3) excludes agreements which contribute to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit. Therefore, it can be noticed that the Sherman Act and TFEU have different structure and accordingly different methods should be used to apply these acts. The *rule of reason* is necessary for interpretation and application of the Sherman Act. However, TFEU does not need such instrument, because of correlation between Article 101(1) and Article 101(3).

The same conclusion can be made in application of the *per se* principle in regulation of RPM. EU commission,

[19] The Sherman Antitrust Act (Sherman Act July 2, 1890).

in it's Guidelines on vertical restrains[20], states that albeit it is presumed that an agreement which includes RPM is unlikely to fulfil the conditions of Article 101(3), for which reason the block exemption does not apply, undertakings have a possibility to plead an efficiency defence under Article 101(3) in an individual case. Under *per se* principle, however, U.S. courts have identified certain trade restrains as so restrictive to competition that they are condemned as illegal regardless of their actual impact on market. In addition, it would not be necessary so show any effect of anti-competitive conduct. An argument, that the pricing agreement would benefit society or consumers, would not mitigate the illegality of the agreement[21]. So, once again, the difference between EU Competition Law and U.S. Antitrust Law and different methods of regulation and assessment of RPM can be clearly observed.

Furthermore, it is argued that following the U.S. Supreme Court's decision in *Leegin* would radically increase regulation costs. This effect would be caused by shifting of the burden of proof to EU Commission, national courts or local competition authorities when assessing anti-competitive effects of RPM in every case. Under current regulation, the burden of proof, when judging the effects of RPM, is imposed on defendants and those claiming the benefit of Article 101(3)[22]. Opposite situation would mean that EU Commission, national courts or local competition authorities would have to argue negative effects of RPM and such process would lead to an enormous increase in the amount of work in whether EU Commission or local authorities. In addition to this, economic analysis and reassessment of RPM in every case would cause a

[20] Commission notice. Guidelines on Vertical Restraints 10.5.2010 SEC(2010) 411
[21] Antitrust Law Amidst Financial Crises. Ioannis Kokkoris, Kokkoris/Olivares-Caminal, Rodrigo Olivares-Caminal. 2010. p. 15
[22] EU Competition Law: Text, Cases & Materials. Alison Jones , Brenda Sufrin. 4th edition (2010). p. 201

substantive increase in time of proceedings and litigation, because, presumably, when assessing the impact of RPM to competition, a profound analysis of market and price alterations would have to be done. Furthermore, potentially different and conflicting decisions would be made in courts and national competition authorities, because of the vast variations of dealership agreements and different economic environment in every Member state.

Following *Leegin* decision in EU and stating that the *rule of reason* principle should be applied in assessment of RPM would also increase monitoring costs[23]. Presumably, manufacturers would be more willing to impose minimum of fixed price terms in their dealership agreements, because of a softer approach to RPM and this would result in a situation where EU Commission and local competition authorities would have to monitor more agreements and practises and assess the effect on competition in every one of them in order to bring a claim against such agreements. However, it can be argued that EU Commission and local competition authorities are already monitoring and tracking such agreements and that it is the main objective of their work. Even so, U.S. experience had showed that after *Leegin*, manufacturers, ranging from Sony to the lesser-known, are reported to be aggressively policing and enforcing RPM and MAP agreements covering a wide variety of products, usually with help from outside firms that specialize in scouring the internet for non-conforming prices. Even the U.S. discount giant, Wal-Mart, has accepted RPM goods[24].

[23] Resale Price Maintenance in EC Competition Law: The Need for a Standardised Approach. Frederik Van Doorn. (November 6, 2009). Available at SSRN: http://ssrn.com/abstract=1501070

[24] Resale Price Maintenance: A Reassessment of its Competitive Harms and Benefits. Marina Lao (June 1, 2009). More common ground for international competition law?, Josef Drexl et al., eds, Edward Elgar, Forthcoming. Available at SSRN: http://ssrn.com/abstract=1434984

Conclusion

In conclusion, it can be observed that the new approach to vertical price fixing, brought up in *Leegin* by U.S. Supreme Court, had triggered various and intense debate. Although it can be argued that overruling of *Dr. Miles* precedent was a result of self-adjusting of competition in a market, however, it is still not clear whether RPM can have severe anticompetitive potential or also can be beneficial to the competition and, consequently, to consumer welfare. Main problem of assessing the pro-competitive or anti-competitive effects of RPM, as Justice Breyer stated in his dissent in *Leegin*, is that there is a substantive lack of empirical evidence. In addition to this, it can be argued that precedent of *Dr. Miles* and the *per se* illegality approach to vertical price fixing can be justified in cases where there is no actual evidence of pro-competitive effects. Furthermore, it can be stated that there is a room for manipulation where contradictory economic theories are brought in and, in order to ensure consumer welfare, it would be reasonable to wait until those theories would prove to be wrong or right, considering vertical price fixing as *per se* illegal.

Albeit EU Competition Law is always influenced by U.S. Antitrust policy, however, it can be argued that EU should not follow the liberal approach to RPM made in *Leegin*. One of the main reasons is that such instruments as the *per se* principle and the *rule of reason* would be contradictory to regulation of competition in EU and the structure of TFEU, not only because of correlation between Article 101(1) and Article 101(3), but also, because it would bring more confusion and uncertainty. Furthermore, transfer of the burden of proof would disadvantage competition authorities and also could cause different opinions of RPM's pros and cons across Member states. Differentiation is one of the main effects which EU's

internal market policy is trying to avoid and suppress. Consequently, it can be stated that there are still no strong evidence that RPM could benefit the main objective of competition law – consumer welfare.

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