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Resale Price Maintenance And The World After Leegin

Thursday, February 22, 2007 --- Sometime this spring or early summer, businesses should consider policies on resale price maintenance.

For nearly the last 100 years, any agreement permitting a manufacturer, supplier, or licensor to control the price at which others would resell its products has been illegal. Indeed, it is "per se" illegal. That is, automatically illegal, with no possible defense.

Ten years ago, the Supreme Court eliminated that rule for maximum prices, and now the Court is expected to announce a new rule for minimum resale price agreements.

Although the content of the yet-to-be-issued opinion obviously is not yet known, it is not too early for businesses to start thinking about what kind of changes they may want to make to distribution practices.

* Background *

Back in 1911, the Supreme Court said in the Dr. Miles case that it was illegal to restrain a reseller's pricing. But in the Colgate case eight years later, the Supreme Court also confirmed that there was no antitrust violation unless there was an "agreement" between the supplier and its reseller.

The Sherman Act only forbids agreements that restrain trade, not unilateral practices, even though they may have the same practical effect. So a mere suggestion of a resale price—with no evidence of agreement—was not an "agreement" in restraint of trade.

Manufacturers were free to provide Manufacturer's Suggested Resale Prices (MSRPs) and other market intelligence to their resellers, as long as they didn't "agree" on a reselling price.

Many manufacturers took this a step further and adopted what came to be called "Colgate policies." The manufacturer announced the minimum resale prices that it wanted to see, and announced a policy that it would not deal with discounters.

In other words, at any given time reseller would be free to sell its existing inventory at whatever price it chose, but a manufacturer could refuse to resupply a reseller it discovered to be discounting below MSRP.

The Dr. Miles rule of per se illegality originally applied to nonprice vertical agreements that could have a significant effect on price, but the Supreme

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Court's 1977 GTE Sylvania case changed that.

A nonprice restraint (e.g., a requirement that a store have a minimum space devoted to the manufacturer's product, or that the store have a certain number of on-floor personnel trained in the manufacturer's product and able to provide information) could provide a direct benefit to consumers.

Or it could simply provide an incentive for the reseller to provide a higher level of pre-sale services. For example, granting a reseller an exclusive territory might give the reseller a sufficient assurance that consumers would buy from that reseller, rather than going down the street to the discounter who had not borne the expense of providing pre-sale services.

So, the Supreme Court decided that nonprice vertical restraints should be evaluated under the "Rule of Reason."

The per se approach conclusively presumes that the condemned conduct always or almost always has a net negative effect on competition. For example, a price-fixing agreement between competing manufacturers will, if successful, raise prices to consumers, and it can never have a net positive effect on competition.

In contrast, the Rule of Reason requires courts to examine the specific agreement and evaluate its actual effects on competition. That agreement is unlawful only if it has a net negative effect on competition.

In its 1997 State Oil v. Khan case, the Supreme Court chipped more directly at the Dr. Miles rule.

In Khan, the Court held that maximum vertical price agreements—that is, fixing the maximum price at which the manufacturer's products could be resold—would no longer be judged as illegal per se, but would instead be judged under the Rule of Reason. But the case did not involve minimum resale price agreements.

* Leegin v. PSKS *

In December 2006, the Supreme Court granted review in Leegin Creative Leather Products, Inc. v. PSKS, Inc. dba Kay's Kloset…Kay's Shoes.

Leegin was a small, start-up manufacturer of women's accessories such as handbags, shoes, and jewelry. It was trying to compete with larger, established manufacturers and with department stores and other retail chains.

Leegin adopted a Retail Pricing and Promotion Policy — a Colgate policy stating that it would sell its Brighton-branded products only to retailers that followed Leegin's MSRPs. But then, as can often happen with Colgate policies, Leegin took one step too many and crossed the line separating unilateral announcement from bilateral agreement.

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Often this happens when an eager salesperson, whose natural desire to sell is bolstered by a commission, confronts a discounter and asks him to comply with the MSRP. When the discounter says "okay," there's an agreement.

Leegin went farther, insisting that all of its retailers "pledge" their compliance with the pricing policy. Kay's pledged, then broke its promise by discounting the entire Brighton line.

Leegin suspended shipments to Kay's, Kay's sales plunged, and Kay's sued. A jury found for Kay's, but only after the trial court excluded Leegin's proffer of expert testimony that the Leegin policy was actually pro-competitive.

* Supreme Court Decision *

At this writing, the Supreme Court has not heard argument, much less decided the case. But let's assume that the Court will overrule Dr. Miles.

This is not an improbable result, because the U.S. Department of Justice and the Federal Trade Commission have filed an amicus brief urging that Dr. Miles be overruled. In addition, Dr. Miles has suffered decades of withering academic criticism.

Let's also assume that there will still be some cases in which liability could be found under the Rule of Reason approach—something that the statement of the Federal Trade Commission (albeit two chairmen ago) in the CD Music cases suggested.

* Some Practical Suggestions for Suppliers *

Whether decided on broad or narrow grounds, the Leegin case is likely to open up a range of business possibilities that the Dr. Miles rule has foreclosed for a century. What are they? And what should businesses be thinking about? Some thoughts:

1. Do Nothing (a). For some suppliers, discounting is not a problem. For example, for companies selling commoditized products with little brand equity (or at least not enough to give them any significant pricing power), discounting may be encouraged. For such suppliers, adopting a "Colgate Policy" (of cutting off discounters) is not necessary or effective. The outcome in Leegin will not change that.

2. Do Nothing (b). If your company already has a Colgate Policy, one option is to continue what you've been doing all along. Leegin may eliminate the risk that your unilateral policy becomes (or is perceived as becoming) an agreement, and you may decide not to take your practices any further.

3. Adopt a Colgate-Leegin Policy. If your company never adopted a Colgate Policy because the perceived risk was too great, now is the time to reconsider that decision. The Leegin decision may well reduce or eliminate

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the biggest risk factor.

4. Revisit Co-Op Advertising Policies. Some companies that don't have a Colgate Policy do have a co-op advertising program that provides full or partial reimbursement for resellers' advertising, but only if the advertisement either mentions only prices at or above an MSRP—or no price at all. Leegin is unlikely to address such programs directly, but it may provide some implications for how far such a program can go.

5. Revise Dealer Agreements. One of the major defects of the Colgate doctrine is that compliance with a manufacturer's unilateral Colgate Policy cannot be made a condition of dealer agreements—otherwise, the policy would be an agreement. Many suppliers have dealer agreements with longer terms and no right for the supplier to terminate without good cause before the end of the term, making Colgate Policies effective only at the end of the term. Companies that choose not to have a Colgate Policy because they could not effectively enforce it should consider whether to adopt a policy.

6. Review License and Franchise Agreements. If you license IP rights to companies that manufacture or resell your products, or if you franchise, consider whether to include a minimum-price policy in license agreements.

7. Preserve Flexibility Today. If you are considering a distribution, dealer, license, or franchise agreement today, think carefully about whether you still want to include some traditional provisions. For example, many distribution agreements expressly provide that the reseller has the right to set its own selling price. If you think your agreement is going to continue for some time into the future, consider a provision that permits you to revisit the resale-pricing clause.

* Some Thoughts for Resellers *

A decision that leads to more Colgate-Leegin programs will also present challenges and opportunities for resellers, including dealers, licensees, and franchisees. Resellers should think about implications for their own business models. For example: How much pre-sale service should the reseller provide, and how many competing brands should it carry?

Resellers should also think about types of programs and agreements that greater flexibility will cause manufacturers to want, and the types of manufacturers with whom the reseller wants to deal.

* Some Risks and Some Cautions *

Whatever the result, Leegin will not be the answer to everything.

First, the Court will decide only what federal law provides; whether private plaintiffs or state attorneys general will seek a different result under state statutes remains to be seen.

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Second, some state laws may prohibit material changes in existing distribution agreements, making it difficult to adopt a new policy, at least in those states.

Third, the remedies for breach of a Leegin agreement may not be terribly attractive; every argument that the manufacturer makes about its reseller's breach of contract and free-riding on the promotional efforts of other distributors will be countered with an argument that the reseller was just trying to bring lower prices to consumers. And which of those arguments is a jury going to buy?

Fourth, some resellers may simply refuse to sign a Leegin agreement. If they are large buyers that account for a significant percentage of your business, you may decide not to press anyone for such agreements.

Finally, whatever the result in Leegin, the strongest defense against free-riding discounters is going to remain what it has always been: the best bet for preventing discounting is to not deal with discounters in the first place.

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