

# Examining *Dr. Miles'* Proscription On Retail Price Maintenance

For almost 100 years, the Supreme Court has prohibited manufacturers from setting the minimum price at which retailers can sell their products. Under this rule, a company that manufactures flat screen televisions (we'll call the company "Soony")

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cannot directly require its retailers (we'll call them "Better Buy" and "Circuit Metropolis") to sell Soony televisions for a preset minimum price. Instead, Better Buy and Circuit Metropolis are free to establish the prices for Soony televisions as they see fit without direct interference from Soony. If Circuit Metropolis wants to price its Soony televisions a little higher than the competition and offer additional services for which consumers are willing to pay extra, so be it. Likewise, if Better Buy wants to gain market share by discounting the price of its Soony televisions, it can do so. While Soony can suggest retail prices for its televisions, Soony is not permitted to dictate the prices Circuit Metropolis or Better Buy charge their customers. As a result, Soony televisions may sell for lower prices than Soony desires or Better Buy may end up with the lion's share of Soony customers' business despite Circuit Metropolis' more significant investment in customer service.

In March, the Supreme Court heard oral argument in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, a case that could substantially alter the rule against minimum retail price maintenance (the law for the better part of the past century). Leegin, the manufacturer of Brighton women's accessories, argued that the Supreme Court should reverse the holding in *Dr. Miles Medical Co. v. John D. Park & Sons Co.* declaring minimum retail price maintenance a *per se* violation of the antitrust laws. Leegin, which was supported in its position by the United States arguing as *amicus curiae*, contended that courts should analyze minimum retail price maintenance agreements using the more flexible rule of reason test which requires a plaintiff to show the agreement adversely impacted competition.

Since the Supreme Court's ruling could dramatically change the way manufacturers and retailers distribute and sell their products, it is important to be aware of the arguments supporting and opposing this proposed change in antitrust law as well as the practical effect that such a change could have on manufacturers and retailers.

Over the past three decades, the Supreme Court has gradually permitted manufacturers to more directly affect how retailers sell manufacturers' products by approving a wide variety of so-called vertical restraints under the rule of reason. For example, in 1977, the Supreme Court held that non-price restraints imposed by manufacturers on their retailers would no longer be deemed *per se* illegal in *Continental T.V., Inc. v. GTE Sylvania Inc.* The Court concluded that vertical, non-price restraints are often good for interbrand competition. This decision permitted manufacturers to dictate how retailers sold their products, except for what prices they charged, without fear that a complaining retailer would drag them to trial on an antitrust claim. Manufacturers were given the green light to establish exclusive sales territories for their retailers and to contractually mandate their retailers to provide particular services in connection with the sale of their products. Manufacturers were also allowed to enforce these mandates by threatening to discontinue the retailers' supply of products or, under some circumstances, by charging higher wholesale prices to retailers that refused to adhere to these contractual mandates.

In 1997, the Supreme Court gave manufacturers additional control by allowing manufacturers to legally impose maximum price ceilings on their products. *State Oil Co. v. Khan* reversed a twenty-nine year old Supreme Court decision declaring vertical maximum price-fixing *per se* illegal. In reversing this rule, the Supreme Court noted that since maximum retail price maintenance tends to keep prices to consumers low, the practice should be invalidated only upon a showing of harm to competition. As a result of *Khan*, manufacturers can

now explicitly dictate the highest price that retailers may charge for manufacturers' products without running afoul of a *per se* claim.

Proponents of minimum retail price maintenance insist that reversing *Dr. Miles* will lead to significant pro-competitive effects. They contend that allowing manufacturers to set retailers' minimum prices will spur retailers' promotional activities, compel retailers to develop expanded services in exchange for the higher prices they will be able to charge, and in the end stimulate interbrand competition. They also argue that minimum price maintenance will discourage the "free rider" problem where one retailer eliminates its frills (promotions, fancy showrooms, specialized services, etc.) in order to deliver its products at the lowest possible prices while taking advantage of the marketing, frills and services provided by other retailers. For example, a customer may shop for a new Soony television at Circuit Metropolis because Circuit Metropolis has an elaborate showroom and very knowledgeable salespeople. However, after selecting the television she wants, the customer may actually purchase the television from Better Buy because Better Buy offers a lower price (because it did not invest in a fancy showroom or knowledgeable staff). In this example, even though Circuit Metropolis made a more significant investment to better service its Soony television customers, Better Buy (by "free riding") reaped the benefit of that investment and ultimately won the customer's business.

Those in favor of preserving the ban on minimum retail price maintenance contend that such a monumental change in the law would significantly harm consumers. They point out that prices charged to consumers undoubtedly will rise if a manufacturer is permitted to dictate the minimum price at which its products can be sold. They also aver that the "free rider" problem is not nearly as significant as *Dr. Miles*' opponents maintain. To the contrary, they worry that prohibiting a retailer from lowering its prices by eliminating certain services will force consumers to pay for services they do not want. For example, many consumers are willing to engage in a frill-free shopping experience if it means their products will cost less. By requiring all retailers to provide a certain level of service and prohibiting retailers from offering lower prices by trimming extraneous services and frills, in many cases, customers

will be forced to pay for services and frills that they neither want nor need.

While no one knows for sure if the Supreme Court will reverse *Dr. Miles*, savvy companies are in the process of determining how such a decision might impact their business. Unfortunately, this analysis will not prove to be easy. For example, on its face an outright reversal of *Dr. Miles* may seem like a slam-dunk victory for manufacturers. Such a decision, however, does not mean that manufacturers would be absolutely free to enter into minimum pricing agreements with their retailers. To the contrary, it would only require courts to analyze those pricing agreements using a rule of reason test by looking at all of the circumstances as a whole. Such an agreement could still be deemed illegal under the rule of reason standard if multiple retailers worked together to encourage the manufacturer to enter into the agreement or the manufacturer was deemed to have market power.

In addition, it is possible that the Supreme Court will modify rather than overrule *Dr. Miles* by creating the presumption that minimum retail price maintenance is illegal unless the manufacturer can demonstrate tangible pro-competitive effects. Either way, manufacturers must remain mindful of their pricing decisions in a post-*Dr. Miles* world. In addition, retailers will face significant changes if *Dr. Miles* is reversed. Since they will no longer be able to compete against other same-brand retailers based strictly on price, retailers will need to find new ways to differentiate themselves from their competitors. Accordingly, a strong focus on promotional activities and customer service will be essential.

Although the road ahead for manufacturers and retailers is not particularly clear at the moment, the one certainty is that to stay competitive companies like Soony, Better Buy and Circuit Metropolis will need to plan ahead, remain flexible and be ready to swallow whatever medicine *Dr. Miles* prescribes.

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