Setting Resale Prices Following *Leegin*

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If you picked up the newspaper the day after the Supreme Court's term ended this past June, you may have been surprised to find the following headline: "RESALE PRICES CAN BE FIXED, COURT SAYS." Of course, the article was referring to the Court's long-awaited decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, which overruled a 96-year-old precedent that had previously made it per se illegal for manufacturers and distributors to agree on setting minimum resale prices.

But before you rushed to the office to tell your business people to start thinking about how they want to fix the price of your product in the resale market, hopefully you realized that the *Leegin* Court did not hold that minimum resale pricing is inherently lawful. Instead, a narrow 5-4 majority held that a vertical agreement between a manufacturer and its distributor should be judged under the "rule of reason," requiring a case-by-case analysis whereby "the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition." Thus, while the newspaper headline was technically correct, prices can now be fixed, the relevant questions for legal counsel with input into their company's strategic pricing decisions are *how* and *when*.

In explaining how the rule of reason is to be applied with regard to setting resale prices, the Court identified appropriate factors to take into account, including:

- "specific information about the relevant business"
- "the restraint's history, nature, and effect"
- and "[w]hether the businesses involved have market power."

The objective of the analysis is to "distinguish between restraints with anticompetitive effect that are harmful to the consumer and restraints stimulating competition that are in the consumer's best interest."

One way to divine from the *Leegin* opinion how and when resale price maintenance will withstand scrutiny under a rule of reason analysis is to identify those types of pricing programs that the antitrust laws still *will not* allow. For example, to the extent resale price maintenance is used to facilitate a cartel of otherwise competing manufacturers by enabling the cartel to more easily police its members, such a program will not be tolerated by the courts.

Nor, as a manufacturer, will it be acceptable to establish a resale price maintenance program at the request of a group of retailers who are collusively seeking to fix prices to the ultimate consumer. In fact, for this reason, the *Leegin* Court opined that manufacturers with highly concentrated retail distribution markets seeking to take advantage of the Court's ruling by setting resale prices may find themselves a potential target for antitrust plaintiffs, explaining that a vertical agreement on price may be "useful evidence for a plaintiff attempting to prove the existence of a horizontal cartel."

The *Leegin* Court also cautioned against the use of resale price maintenance programs by either powerful manufacturers or powerful retailers. A manufacturer with market power, for example, will not be able to lawfully use resale price maintenance in order to guarantee a sufficiently profitable return to its retailers in exchange for their commitment not to sell the products of the manufacturer's smaller rivals or new entrants.

A dominant retailer should also be wary of requesting a resale price maintenance program from its supplier. A powerful retailer might use such a program to eliminate the ability of an upstart retailer considering an R&D expenditure in the distribution market to later recoup its investment by gaining market share through price cutting. As a result, the vertical price restraint could inhibit innovation in distribution that would otherwise decrease costs. Not only would the retailer asking for the program face antitrust liability under those circumstances, but the manufacturer who accommodates the retailer's demands would also incur antitrust risk, even if that manufacturer believed it had little choice but to consent because it believed it needed access to the complaining retailer's distribution network.

With this background, how does one counsel a manufacturer considering the available options for pricing its product in the wake of the Court's decision in *Leegin*?

Answer – very carefully. Without the bright-line admonition to avoid any agreement on retail price, the best advice one can give at this stage is to proceed with caution. As the *Leegin* dissenters pointed out, one cannot fairly expect judges and juries in the early cases evaluated under the rule in *Leegin* to apply complex economic criteria such as a proper determination of market power without making a considerable number of mistakes. Moreover, where the issue becomes a determination of the manufacturer's or retailer's intent in entering into an agreement to set resale prices, it will undoubtedly be difficult for a proponent of such a program to obtain an early dismissal of any prosecution of its actions when a fact-intensive inquiry is required.

With those words of warning, however, there are some courses of action that are likely to fair better than others, and, though experienced antitrust counsel should still be consulted before any action is taken, the following are some guidelines to consider when assessing the potential use of a resale price maintenance program:

- Identify and document your company's legitimate business justifications for fixing the price of your product sold in the retail market. Justifications to emphasize include (a) the need to stimulate the provision of services at the retail level to educate and inform the buying public about the nature and superiority of your product and (b) the need to better compete with other brands of your product ("interbrand competition") by preventing free-riding.

- Determine who is driving the decision to use a resale price maintenance program. If your client is the manufacturer and your client has independently determined such a program could be advantageous, without the urging of other manufacturers or your existing retailers, the contemplated program is more likely to be acceptable. On the other hand, consider it a significant red flag if your company's business people begin the conversation with you by explaining that some of the retailers have suggested a resale price maintenance program might be a good idea, as there is a greater likelihood the program is being instituted to facilitate a retail cartel or to support a dominant, inefficient retailer.

- Understand your company's share of the relevant market. Although ultimately this analysis will need to be conducted by an economic expert, make an effort to determine the relevant market for the product under consideration for a resale price maintenance program and determine your company's share of that market. If your share is reasonably low, *i.e.* below 20%, and only a few manufacturers in the market have adopted resale price maintenance programs thus far, the likelihood of antitrust risk is lessened, since the practice is more demonstrably unlikely to facilitate a cartel.

The concept that fixing prices is now legal in certain circumstances is likely to be a difficult notion for most business people to swallow, especially in a culture where the severe penalties associated with the antitrust laws have led many companies to utilize extensive antitrust sensitivity training, the highlight of which is often "never discuss price with your competitors." Although the vertical price restraints now subject to the rule of reason under *Leegin* do not, in fact, violate that covenant, you can be sure that the first few years of this new world are likely to be fraught with similar confusion by business people, lawyers, and the courts alike. With the foregoing framework in mind, however, you should be equipped to at least begin the necessary analysis before approving the use of a resale price maintenance program for your company's distribution network.

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