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RPM - What's All The Ruckus About?

Wednesday, Feb 06, 2008 --- It has been close to a year since the Supreme Court's 5-4 decision in Leegin Creative Leather Products, Inc. v. PSKS, Inc., 127 S. Ct. 2705 (2007), and the furor has yet to subside.

There, the high court discarded a hundred years of antitrust precedent – originating with its Dr. Miles decision, 220 U.S. 373 (1911) – and declared that agreements between manufactures and their distributors to set minimum retail prices would no longer be per se illegal.

Instead, they would be subject to the so-called rule of reason, which allows defendants to dodge antitrust liability if they can provide sufficient justification for their activity.

To many, the Supreme Court's decision provides a free pass to manufacturers and retailers to cozy up with one another to rid the world of those pesky discounters and charge significantly higher prices to consumers. That concern was evident in Justice Breyer's vigorous dissent (joined by Justices Ginsburg, Souter and Stevens) and the protestations of 37 states that argued as amici to retain per se illegality.

It also is what's driving the recent introduction by Senator Kohl (joined by Senators Biden and Clinton) of the so-called Discount Pricing Consumer Protection Act. If enacted, this legislation would overturn Leegin and restore minimum resale price maintenance ("RPM") to what many insist is its rightful place among the per se proscribed.

Is there any basis to this anti-Leegin outcry?

Not really. Those hostile to the decision may very well be correct in their prophecy of higher consumer prices. But the relevant inquiry is not supposed to be about the likelihood of higher prices.

Rather, it is supposed to be about whether RPM is so insidious to competition that it lacks any redeeming competitive virtues. Only then can it fall under the per se umbrella.

In recognizing the pro-competitive possibilities that RPM presents, the high court got it right in freeing the practice from its per se strictures.

The Bogey of Higher Prices

There appears to be little dispute that RPM leads to higher prices. Indeed, as highlighted by Justice Breyer, and by virtually every other critic of Leegin, it

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was exactly this result that led to the first congressional action against RPM.

That was back in 1975 when Congress repealed both the Miller-Tydings Fair Trade Act, 50 Stat. 693 (1937), and the McGuire Act, 66 Stat. 631 (1952).

Those laws allowed individual states to opt out of the Supreme Court's decree forbidding RPM. Many did. Higher prices followed. According to Department of Justice findings, they rose as much as 27 percent.

That was enough for Congress to put an end to state autonomy on the issue. There would be no exceptions to the Supreme Court's absolute ban on RPM.

An empirical link between RPM and higher prices also has been found by the Federal Trade Commission based on several pricing surveys the agency has conducted. Few, if any, economists or attorneys really question this empirical link.

Nor does anyone really challenge the prospect of higher pricing for those products subject to RPM. How could they? RPM is about maintaining a pricing floor; about imposing an artificial barrier to full price competition. With such a constraint, there is no place for prices to go but up.

The inexorable pull towards higher pricing makes for a compelling argument for retaining a per se rule against RPM. After all, the antitrust laws are ultimately about protecting consumers. And, what better way to protect consumers than by ensuring the availability of low pricing? Why not rid the market of a practice that seemingly leads to the central harm the antitrust laws were designed to avoid?

The problem with this vision, and Senator Kohl's proposed legislation, is that it takes too narrow a view of RPM and the antitrust landscape into which it fits. RPM is not simply about maintaining high prices. There are other, more consumer-friendly goals, that can be served by this pricing practice.

Likewise, the antitrust laws are not just about facilitating low prices. Rather, they are designed to protect competition and all that flows from it. In some instances, this may be lower prices. In other instances, however, this could be more choice or simply better products or services.

Senator Kohl's legislation, and the anti-Leegin rhetoric it encapsulates, run roughshod over these economic and legal niceties. More importantly, they ignore the flexibility with which the antitrust laws were purposely designed to deal with these very kinds of subtleties.

The Economics Of RPM

From the outset, it is important to understand the basic economic incentive a manufacturer has to engage in RPM. In short, it has none.

All else being equal, a manufacturer wants its dealers to charge the lowest

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prices possible for its products. The lower the retail prices, the more products will be sold, the better the manufacturer will do against its competitors. High retail pricing, in contrast, will generally lead to fewer sales and ultimately constrain the manufacturer's ability to compete.

The idea that manufacturers can somehow share in the fiscal surplus of high retail pricing is thus, for the most part, an economic fallacy. What this means is that for a manufacturer to willingly engage in RPM, there has to be something more.

There has to be an economic incentive that transcends the competitive downside of giving retail pricing an artificial boost. There are principally two such incentives. Both are good for competition. Both are good for consumers.

One incentive a manufacturer has to engage in RPM is to prevent free-riding. That occurs when one retailer (typically a price discounter) profits from the customer services offered by a competing retailer (typically a high-end establishment) without paying for them.

Think about the consumer that shops for a computer or stereo at a high-end electronics shop, gets educated by the store's highly trained sales staff or elaborate customer displays, and then makes the purchase elsewhere, at a discount store that doesn't offer any of these customer amenities.

The high-end store provides the service. The discount store gets the sale. Not the makings of a healthy market.

Manufacturers have a legitimate interest in curbing this perverse competitive dynamic. Otherwise, the high-end store will cut back or even eliminate its high quality sales and marketing efforts.

This hurts the manufacturer that wants its products sold in this manner. It hurts the consumer that wants this higher level of customer service. And, it hurts competition by reducing choice in the marketplace. Manufacturers and consumers alike would be relegated to a Wal-Mart-like shopping experience, even for those purchases for which expert advice and training is a critical component.

Manufacturers also have a legitimate interest in setting minimum prices to protect their brand. For many types of products, brand plays a very important role in a customer's purchasing decision. It may be the key determining factor. That is why so many manufacturers spend so much money promoting and maintaining their brand.

Selling at discount rates or in low-cost surroundings could lead to significant brand damage for certain types of products. RPM allows a manufacturer to mitigate this risk by providing it with some measure of control over the retail environment in which its products are sold. Manufacturers can distinguish themselves from their competition. Consumers can rely on a favored or

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trusted supplier. Choice in the marketplace is maximized.

Forcing RPM into the per se rubric prevents the flexible approach necessary to account for these pro-competitive outcomes. The pricing practice is condemned outright. There is no room for nuance.

This strict liability approach certainly works well for those practices with no chance of competitive legitimacy (like competitors fixing prices or allocating customers). It does not work well for a practice like RPM for which sound justifications are plausible.

That's where the rule of reason comes in and with it, the room to examine what is really going on.

A Distinction Without A Difference

In any event, the truth is that Leegin will likely have very little real-world effect on the pricing practices of manufacturers and their dealers. That is because to the extent a manufacturer really wanted to impose minimum pricing, it has always had the means to get around the Dr. Miles ban.

With its Colgate decision, 250 U.S. 300 (1919), rendered only a few years after Dr. Miles, the Supreme Court took much of the punch out of its RPM interdiction by holding that it did not apply to unilateral conduct.

For almost 90 years, a manufacturer has thus been permitted to set minimum retail pricing levels unilaterally and cut off any dealers that did not follow them. Dealers have likewise been permitted to pressure manufacturers unilaterally to cut off competing dealers not abiding by the minimum pricing. As long as the manufacturer and dealer did not formally "agree" on the minimum pricing or the dealer termination, their interrelated activity was permitted.

In this way, the so-called Colgate doctrine has always provided a workable way for manufacturers and dealers to sidestep the Dr. Miles ban on RPM. This bypass has grown ever more accessible with the Court's continued whittling away of per se liability and its ever expanding views of what constitutes "unilateral" conduct.

What Leegin has done is to invite manufacturers and dealers to bring out in the open what they have essentially been able to accomplish anyway through a variety of stratagems that disguise concerted action as "unilateral."

The greater transparency that Leegin will hopefully seed should place courts in a better position to assess the true competitive makeup of a particular RPM arrangement. After all, Leegin did not legalize RPM agreements outright. All it did was task courts with the responsibility to carefully evaluate the anti-competitive effects and pro-competitive justifications for the pricing practice.

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Reviewing these arrangements in a more open manner should help courts get to the bottom of whether a particular RPM agreement actually hurts or helps consumers.

It is therefore unlikely that Leegin will increase the prevalence of anti-competitive resale pricing activity. That is certainly borne out in how the legal community has responded to the decision.

Contrary to what many envisaged, corporate counsel have not been directing their clients to a more relaxed approach to manufacturer/retailer pricing practices. Rather, they have counseled vigilance. And, they have warned of the risk of entering into retail pricing arrangements that lack any true procompetitive purpose.

Given the comprehensive (and oft-times unpredictable) nature of rule of reason analysis, this risk of RPM liability is very much still alive.

So, those truly concerned about the aftereffects of Leegin should rest assured. The Supreme Court – at least in this decision – has the interests of consumers well in hand.

Unfortunately, Senator Kohl's proposed legislative override does not. As the Court rightly recognized, with regards to retail pricing practices, the antitrust laws should be enforced with a scalpel, not a hammer. Otherwise, consumers may end up suffering the very ills the antitrust laws were designed to cure.

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