

Client Alert

U.S. Supreme Court Loosens Antitrust Review Standard for Manufacturer Resale Price Maintenance Practices

On June 28, 2007, adding another chapter to this term's pro-business antitrust rulings, the U.S. Supreme Court in *Leegin Creative Leather Products v. PSKS, Inc.* 2007 WL 1835892 (Jun. 28, 2007) overruled the almost 100-year old precedent established in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911) (Dr. Miles), which held that it was *per se* illegal under Section 1 of the Sherman Act for a manufacturer and a retailer to agree on resale prices that the retailer would charge. The holding in *Leegin* now subjects resale price maintenance, or vertical price restraints, to a "rule of reason" analysis, which examines the legality of the pricing restraint on a case-by-case basis, and which requires the fact finder to weigh the totality of the circumstances, including specific information about the relevant business, and the restraint's history, nature, and effect.

Background

Leegin is a manufacturer, designer and distributor of leather goods and accessories. In 1991, *Leegin* began selling belts, and later other accessories, under the "Brighton" brand name. Brighton was sold nationwide in over 5,000 retail establishments, primarily small, independent boutiques and specialty stores. *Leegin* sought to provide consumers a different experience and level of support than would be found in a big-box retailer or large department store.

PSKS, Inc. (PSKS) operated Kay's Closet (Kay's), a women's apparel store in Lewisville, Texas. Kay's bought from about 75 different manufacturers and was selling the *Leegin* brand. It promoted the brand heavily, running advertisements and having special "Brighton days" in the store. Kay's became a destination retailer in its area for Brighton brand products.

In 1997, *Leegin* began a retail pricing and promotion policy where it refused to sell to retailers that discounted Brighton goods below suggested prices. *Leegin* adopted the policy to give its retailers sufficient margins to provide customers the level of service that *Leegin* felt was central to its distribution strategy. *Leegin* also perceived discounting as harmful to the brand's image and reputation.

One year later, *Leegin* developed a marketing strategy called the "Heart Store Program." To become a Heart Store, retailers pledged to sell Brighton at *Leegin*'s suggested retail prices. Kay's became a Heart Store, but lost this status when *Leegin* became dissatisfied with the attractiveness of the store. Nevertheless, Kay's continued to increase its sales of Brighton products.

In December 2002, *Leegin* discovered that Kay's was marking down the Brighton line by 20 percent, competing with other retailers who also were not following *Leegin*'s suggested retail prices. *Leegin* requested that Kay's stop discounting; Kay's refused, and *Leegin* stopped selling to Kay's. The loss of the brand had a considerable negative impact on Kay's sales.

PSKS sued *Leegin* in U.S. District Court alleging that *Leegin* violated Section 1 of the Sherman Act because it "entered into agreements with retailers to charge only those prices fixed by *Leegin*."

Leegin planned to introduce expert testimony describing the procompetitive effects of its pricing policy, but the district court denied this request, relying on the *per se* rule of Dr. Miles. At trial, PSKS argued that the Heart Store program, among other things, demonstrated that *Leegin* and its retailers had agreed to fix prices. *Leegin* responded that it simply was engaging in a unilateral pricing policy that could not violate Section 1 because it didn't involve concerted action.

The jury agreed with PSKS and awarded damages of \$1.2 million, which was trebled to over \$3.9 million. On appeal, the Fifth Circuit Court of Appeals affirmed, ruling that the district court did not abuse its discretion by excluding the testimony of *Leegin's* economic expert, for the *per se* rule of Dr. Miles rendered irrelevant any procompetitive justifications for *Leegin's* pricing policy. On appeal, Supreme Court reversed and remanded.

Implications of the Ruling

Leegin will likely allow manufacturers more freedom and flexibility in their discussions with retailers. However, *Leegin* does not provide carte blanche for manufacturers to engage in resale price maintenance. What the ruling does is change the standard under which these practices will be analyzed, thus bringing it in sync with other acceptable restraints that some manufacturers may impose on dealers. Resale price maintenance may still violate Section 1, and would still be subject to treble damages and attorneys' fees. The manufacturer must still provide a reasonable, pro-competitive justification for the practice, and now has an opportunity in court to advance reasons why the pricing policy is good for competition. It is likely that time, and litigation, will test the scope and boundaries of the type of conduct that will be held to violate Section 1 under a rule of reason analysis.

The ruling may also impact the dynamics of litigation. *Per se* cases are easier for plaintiffs to bring, and require a narrower scope of discovery than rule of reason cases. For that reason they are cheaper to litigate, require less pre-filing investigation, and give the plaintiff significantly increased settlement leverage.

While meritorious cases can now still be brought, the cost and timetable of getting relief (or a settlement) are less favorable to the plaintiff than before. While *Leegin* thus now protects against the "false positives" of the *per se* rule, it also will have the effect of suppressing litigation over some of the "true positives" because it has magnified the transaction costs of such litigation for plaintiffs.

The typical justification for *per se* rules is that the claim is so frequently a true injury to competition (i.e., so few "false positives"), that it is better policy to just impose a *per se* rule across the board so as to lessen the litigation-cost drag on corrective action being taken. The question *Leegin* leaves us to "wait and see" is whether the increased litigation-cost drag on corrective action will end up discouraging too many of the kind of meritorious claims that in a perfect world should be brought.

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Washington, DC

William S. D'Amico	+1 (202) 974-5616	wd'amico@chadbourne.com
David T. Blonder	+1 (202) 974-5731	dblonder@chadbourne.com

New York

Robert A. Schwinger	+1 (212) 408-5364	rschwinger@chadbourne.com
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