LEVETT ROCKWOOD
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NEWSLETTER
A Courtesy To Our Clients and Friends

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RESALE PRICE MAINTENANCE AGREEMENTS NO LONGER *PER SE* ILLEGAL UNDER FEDERAL LAW

The United States Supreme Court recently did away with the longstanding antitrust rule that agreements to set resale prices are illegal *per se*. The decision reverses 96 years of precedent. Under federal law, manufacturers now may include explicit resale price terms in agreements with distributors. However, the legality of such agreements will still be subject to antitrust review – now under the "rule of reason" which requires case-by-case review to determine whether a particular agreement unreasonably harms competition. Also, state laws may vary.

BACKGROUND

The old rule against resale price agreements was established in 1911 in *Dr. Miles Medical Co. v. John d. Park & Sons, Co.* The manufacturer in *Dr. Miles* imposed strict resale price restrictions. A discounting retailer obtained supplies from another dealer for less than the agreed resale price. The manufacturer sued the discounter for inducing a breach of the resale price agreement.

The Supreme Court, concerned about the risk of price cartels among retailers masquerading as price decisions of the manufacturer, ruled in favor of the discounter: "The [manufacturer] having sold its product at prices satisfactory to itself, the public is entitled to whatever advantage may be derived from competition in the subsequent traffic."

The business community adapted to the *per se* prohibition with alternative arrangements such as "suggested resale prices" and policies of not selling to discounters. In addition, manufacturers used non-price restrictions such as exclusive territories and requirements for certain levels of customer service. The rationale was to facilitate development of a viable distribution network and to maintain the prestige and image of a brand.

Critics of the *per se* prohibition long argued that the rule made no sense because (a) antitrust law should focus on interbrand competition between different products rather than intrabrand competition for the same product, (b) various permissible non-price restraints, such as exclusive territories, often have similar effects to prohibited price restraints, and (c) without the protection of resale price agreements, manufacturers and resellers who provide full service are undercut and injured by discounters who "free ride" by letting customers get educated in the full-service/price store and then buy from the discounter.

THE NEW RULE

In *Leegin Creative Leather products, Inc. v. PSKS, Inc.*, the Supreme Court overruled *Dr. Miles*. In so doing, the Court openly embraced the concern about "free riders" as a major justification for abandoning the *per se* rule.

Despite overruling *Dr.* Miles, the Court held that resale price agreements can still be unlawful if they unreasonably harm competition. Unreasonable harm may be found, for example, if an agreement lacks a pro-competitive justification or if it results from horizontal collusion either among manufacturers to set prices of their competing products or among resellers to stifle competition in the resale market for the same product.

In other words, to survive scrutiny under the "rule of reason," a resale price agreement must have a rational, pro-competitive justification and it also must be a bona fide *vertical* agreement between actors at different levels in the distribution chain – for example, a manufacturer and a retailer – not a horizontal agreement between parties primarily engaged in competition with each other at the same level of the market.

WHAT DOES IT ALL MEAN?

Under federal law, manufacturers concerned about maintaining product image or requiring quality service among retailers can now use (and enforce) express resale price agreements with distributors and retailers as long as the agreements have a legitimate justification and are not the product of a horizontal arrangement with other manufacturers or among resellers.

Special care should be taken to avoid situations where powerful resellers insert resale price terms into contracts, especially if they appear to act in concert with competitors. When in doubt, traditional forms of "suggested" resale prices and non-price restraints on territory, etc. may be less risky. Also, state law must be considered. Many states follow federal interpretation of antitrust, but some may choose to keep the *per se* rule.

If a resale price agreement is challenged, the parties can also take some comfort in the Supreme Court's recent ruling in *Bell Atlantic Corp. v. Twombly*, which raised the bar for plaintiffs to state a federal antitrust claim. The Court held that mere parallel action (*e.g.*, competitors using resale price agreements) combined with a bare assertion of conspiracy is ***not*** enough to state a claim. To survive a motion to dismiss, a plaintiff must allege additional facts tending to exclude independent, self-interested conduct as an explanation for the parallel action.

As a result, a plaintiff trying to allege that a vertical resale price agreement between a manufacturer and a retailer really reflects a horizontal agreement among competing manufacturers or retailers must set forth enough specific facts to plausibly suggest the existence of horizontal collusion under federal law. Absent such specific factual allegations, the complaint will be subject to dismissal for failure to state a claim. Again, state law may be stricter in some cases. For additional information, please contact Ed Chansky of our office. echansky@levettrockwood.com.

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