INTELLECTUAL PROPERTY

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Licensees and Intellectual Property Owners Affected by Supreme Court Abandoning Century-Old Per Se Rule Against Resale Price Maintenance

> "[I]t is a flawed antitrust doctrine that serves the interests of lawyers — by creating legal distinctions that operate as traps for the unwary — more than the interests of consumers — by requiring manufacturers to choose second-best options to achieve sound business objectives."
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> *Leegin Creative Prods., Inc. v. PSKS, Inc.*, No. 06-480 (June 28, 2007).

In a decision of significance to manufacturers and retailers and to intellectual property owners and licensees, the U.S. Supreme Court has jettisoned a century-old rule that it is per se illegal, under Section 1 of the Sherman Act, for manufacturers to require their resellers to sell at or above agreed-upon resale prices. In *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, No. 06-480 (June 28, 2007), the Court held that all such vertical price restraints are to be judged by the rule of reason. Under the rule of reason, a vertical price restraint will be found to violate federal antitrust law only if, after weighing all the circumstances, a fact-finder concludes that its anticompetitive impact outweighs its procompetitive effects. In sum, while all such restraints may not survive antitrust scrutiny, they are no longer deemed illegal on their face and may be justified as fostering, rather than impeding, competition.

The decision is of particular interest to intellectual property owners because of its potential impact on the marketplace prices set by licensees. As is true of other vertical relationships, a licensor of intellectual property rights is no longer absolutely forbidden from arranging with its licensees to maintain minimum resale prices, and may advance procompetitive justifications for such agreements such as quality control, provision of retailer services, or encouraging market entry by new firms. These arrangements will now be evaluated on their individual merits, not prohibited wholesale.

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Background on the *Leegin* Dispute

PSKS, the plaintiff in *Leegin*, operated a retail store under the name "Kay's Kloset." Kay's purchased Brighton brand women's belts and other accessories from Leegin. Leegin told Kay's (and its other retailers) that it would only do business with retailers that followed its suggested resale prices for Brighton products. When Kay's started selling Brighton products at prices below those suggested by Leegin, Leegin suspended all shipments to Kay's. Kay's sued Leegin alleging that its pricing policy, which was incorporated into marketing agreements with retailers, violated § 1 of the Sherman Act, 15 U.S.C. § 1.

Leegin contended that its policy was procompetitive because it encouraged retailers to promote the Brighton brand and protected the brand by not allowing discount pricing to cause some consumers to feel cheated when others obtained the product at a lower "sale" price. The trial court refused to allow Leegin the opportunity to defend its policy on these grounds based upon the Supreme Court's nearly century-old holding in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), that vertical minimum resale price maintenance agreements are per se antitrust violations. A jury indeed found that Leegin's policy violated the per se ban on resale price maintenance and awarded $3.6 million in damages and $375,000 in attorneys' fees. After the United States Court of Appeals for the Fifth Circuit affirmed, on the basis of *Dr. Miles*, Leegin asked the Supreme Court to review the case in order to consider whether *Dr. Miles* should be overruled.

In another early twentieth century decision, *United States v. General Electric Co*, 272 U.S. 476 (1926), involving a patent license, the Court had established a different rule for intellectual property. There, the Court, after considering the application of *Dr. Miles* to a license between General Electric and Westinghouse, upheld the license's validity, including an agreement under which Westinghouse would follow General Electric's price terms. *General Electric* has not been followed in recent years, in part because of precedent applying *Dr. Miles*. Indeed, in the Antitrust Guidelines for the Licensing of Intellectual Property, the United States Department of Justice and Federal Trade Commission stated that they would enforce the per se rule against resale price maintenance in the intellectual property context. The *Leegin* decision will institute a rule of reason approach to licensor-licensee pricing arrangements — certainly per se rules are likely not to be applied by the antitrust agencies when analyzing such arrangements.

The Majority's Decision to Abandon the Per Se Rule

Writing for a five-Justice majority, Justice Kennedy explained that the Court has reserved the per se rule for restraints that in all or almost all instances have predominantly anticompetitive effects. *Dr. Miles*' per se ban on vertical price restraints flunks this test. Its ban was premised on a "formalistic" application of the common-law rule against restraints on alienation, rather than on application of economic theory.

Economics literature, the Court explained, shows that there are many procompetitive justifications for a manufacturer's — or a licensor's — use of minimum resale prices. Among others, vertical resale price restraints may encourage retailers to invest in services or promotional efforts that aid the manufacturer or licensor in competing against rival brands. In the intellectual property context, it can help distinguish the patent holders' product from that of its competitors. Resale price maintenance also can give consumers more options among brands that cost more but provide greater service and those that cost less but offer fewer services. Vertical price restraints also can help a manufacturer or licensor to attract and retain competent resellers, which can facilitate market entry by new brands. Thus, even where a vertical price restraint results in increased prices, consumers ultimately may be better off through increases in choice among brands and services levels.

The Court acknowledged, however, that vertical price restraints may have anticompetitive effects. Not all such agreements will pass antitrust muster. They can be used to facilitate a manufacturer cartel by allowing the cartel to police compliance with the cartel's price fixing agreement. Vertical price restraints also can be used to assist cartels at the reseller level by employing the manufacturer as the enforcer

of the cartel's unlawful agreements. The Court emphasized that "[a] horizontal cartel among competing manufacturers or competing retailers [and by implication, competing patent holders] that decreases output or reduces competition in order to increase prices is, and ought to be, per se unlawful." Vertical price agreements entered into to facilitate such cartels, the Court stated, "would need to be held unlawful under the rule of reason."

The Court also cautioned lower courts "to be diligent in eliminating [the] anticompetitive uses [of resale price maintenance] from the market" and suggested several factors that are relevant to determining whether the practice was being used in an anticompetitive manner. First, resale price maintenance should be given greater scrutiny if many competing manufacturers engage in the practice. Where resale price maintenance policies are industrywide there is a greater risk that the practice is being used to facilitate a manufacturer cartel. Second, the source of the restraint is an important consideration. Vertical price restraints imposed "independent of retailer pressure," the Court explained, are less likely to promote anticompetitive conduct than one resulting from reseller insistence, which may suggest the policy is being used to aid a reseller cartel. Third, the Court noted that abuse of resale price maintenance "may not be a serious concern unless the relevant entity has market power." In the absence of reseller market power, manufacturers can turn to other resellers and in the absence of manufacturer market power, resellers and consumers can turn to rival brands.

The Dissent: A Prediction of "Legal Turbulence"

Justice Breyer, also writing for Justices Stevens, Souter, and Ginsburg, dissented. The dissenting Justices did not find persuasive the arguments for abandoning the long-established rule, which they view as part of the legal landscape on which market participants rely. They predict that the decision will raise prices and create "legal turbulence," as lower courts are now required to examine the competitive circumstances rather than automatically condemning resale price maintenance as unlawful.

Practical Considerations in Light of the Decision

As a practical matter, *Leegin* clears one significant obstacle in the path of sellers' ability to set minimum resale prices, or of licensors to control the prices set by their licensees, but some legal risk remains. The magnitude of that risk depends on a variety of market circumstances, but the following considerations are important to keep in mind when considering the legal risks of adopting a resale price maintenance program.

- **Market power**. If neither the manufacturer nor its resellers have market power, the chance that a seller-mandated or licensor-mandated resale maintenance program will be found in violation of the Sherman Act is likely low.

- **Seller-imposed policy**. Resale price maintenance policies imposed unilaterally by sellers, that is, absent agreement with resellers or licensees, are more likely to be found lawful. As the Court's decision makes clear, any resale price agreement that results from retailer "impetus" is at greater risk of being found unlawful under the rule of reason because it is more susceptible of reducing output and competition. Additionally, horizontal agreements among resellers — or licensees — not to compete on price remain per se unlawful, and evidence that a manufacturer or licensor adopted policies to aid such an agreement creates a risk that the manufacturer or licensor will similarly be held to have committed a per se violation.

- **Prevalence of the practice**. The Court's decision also suggests that where a large number of manufacturers in a given industry employ resale price maintenance programs, those programs should be given greater scrutiny. While this might create some incentive to adopt a resale price maintenance policy before others in the industry, a court examining whether the policy is unlawful may consider whether others in the industry subsequently adopted similar policies. Thus, the "first mover" may not obtain much advantage in defending the policy. At all events, sellers should not discuss the benefits of such policies with their competitors, since any discussions could later be found suggestive of a cartel.

- **State law**. State law, either state antitrust law or industry-specific state regulations, may limit a seller's ability to command resale prices above set minimums. Thirty-seven states filed *amicus* briefs requesting that the Court reaffirm *Dr. Miles*' per se rule. Given that position, it is unclear whether states will follow *Leegin* when applying their own state antitrust laws.
- **Contractual and common-law limitations**. Existing distribution contracts or promises made to one's distributors and existing licenses made with licensees may limit one's ability to impose immediately a minimum resale price maintenance program.

For these reasons and because there will often be business reasons for not requiring a uniform resale price, sellers or licensors that believe a resale price maintenance program would be beneficial should consider carefully the full array of legal and business issues before undertaking such any program.

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