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Department of Justice Proposes "Structured Rule of Reason" Approach to Resale Price Maintenance Claims

In a significant speech delivered last week to the National Association of Attorneys General, Christine Varney, the Assistant Attorney General for Antitrust at the U.S. Department of Justice, provided some valuable insights regarding how antitrust enforcers are likely to evaluate minimum resale price maintenance (or "RPM") in light of the United States Supreme Court's 2007 decision in *Leegin Creative Leather Products* v. *PSKS, Inc.*[1] The Assistant Attorney General's comments are significant because they indicate a renewed interest in antitrust enforcement against resale price maintenance, and they suggest a roadmap for the way in which the antitrust enforcement agencies—and possibly the courts—will evaluate such conduct in the future. Any manufacturer, distributor, or retailer in an industry where resale price maintenance occurs should consider the potential implications of this new approach for their business practices.

Background: The Supreme Court's *Leegin* Decision

The Supreme Court's 2007 decision in *Leegin* overruled nearly a century of precedent by declaring that minimum resale price maintenance—*i.e.*, agreements between a manufacturer and a reseller setting minimum resale prices—would no longer be deemed *per se* illegal under Section 1 of the Sherman Act.[2] The Court held that such arrangements were instead to be evaluated under the rule of reason, which requires an analysis of a practice's expected benefits and potential anticompetitive effects.

The Supreme Court's *Leegin* decision did not, however, attempt to describe how the rule of reason would apply to resale price maintenance. Instead, the Court suggested that lower courts could "establish the litigation structure to ensure the rule [of reason] operates to eliminate anticompetitive restraints . . . and to provide more guidance to businesses."[3] Among other

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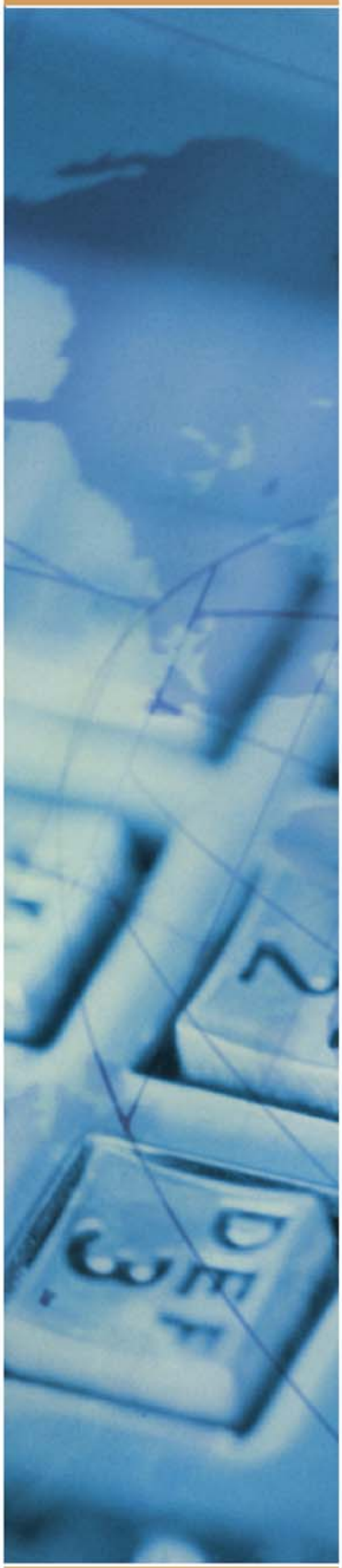
1 *See* Christine A. Varney, Assistant Attorney Gen., U.S. Dep't of Justice, *Antitrust Federalism: Enhancing Federal/State Cooperation*, Remarks before the Nat'l Ass'n of Attorneys General (October 7, 2009), available at http://www.usdoj.gov/atr/public/speeches/250635.pdf.

2 For more background on the *Leegin* decision, see our publication entitled "Supreme Court Overrules *Dr. Miles* and Holds That Vertical Price Restraints Are Not *Per Se* Illegal," available at http://www.paulweiss.com/files/Publication/87325526-26e7-499d-ab15-3ceb0f298cf2/Presentation/PublicationAttachment/245d7926-3596-437e-8624-3ec42fd197b0/03Jul07Memo.pdf.

3 *Leegin*, 551 U.S. 877, 898 (2007).



things, the Court suggested that lower courts could "devise rules over time for offering proof" to make the rule of reason analysis fair and efficient.[4]

The DOJ's "Structured Rule of Reason" Approach

In her speech last week, Assistant Attorney General Varney offered a number of important suggestions regarding how lower courts could provide the "litigation structure" for evaluating RPM claims under the rule of reason. In particular, Varney suggested a burden-shifting approach under which a plaintiff would be required to make a *prima facie* showing that (i) a resale price maintenance agreement exists, and (ii) certain "structural conditions" are present that make the resale price maintenance "likely to be anticompetitive."[5] If a plaintiff makes such a showing, the burden would then shift to the defendant to show that "its RPM policy is actually—not merely theoretically—procompetitive or that the plaintiff's characterizations of the marketplace were erroneous."[6] Varney added that "at a minimum, the defendant would have to establish that it adopted RPM to enhance its success in competing with rivals and that RPM was a reasonable method for accomplishing its procompetitive purposes."[7]

Varney then addressed how this "structured rule of reason" could be applied to four different scenarios in which resale price maintenance might be anticompetitive, identifying the proposed elements of a *prima facie* case for each scenario.

- Manufacturer Collusion: Varney noted that manufacturers might use resale price maintenance to facilitate collusion by providing a means by which cartel members could police adherence to their agreement. Under these circumstances, according to Varney, a *prima facie* case would consist of three elements: (i) a majority of sales in a market are covered by RPM, (ii) structural conditions in the market are conducive to price coordination, and (iii) RPM "plausibly helps significantly to identify cheating."[8]

- Manufacturer Exclusion: Varney also described a situation in which a dominant manufacturer might use resale price maintenance to guarantee large margins to retailers and thereby discourage them from carrying the products of smaller manufacturers or new entrants. In this situation, Varney suggested that a *prima facie* case would require a showing that (i) the manufacturer has a "dominant market position," (ii) the manufacturer's RPM agreements cover "a substantial portion" of distribution outlets, and (iii) the resale price maintenance "plausibly has a significant foreclosure effect that impacted an actual rival." Varney noted that the third element would require the plaintiff to show that the alleged harm is not merely theoretical.[9]

- Retailer Exclusion: Varney then noted that *retailers* might also seek to use resale price maintenance to exclude competition, such as if a retailer with market power (or a group of retailers acting together) coerces manufacturers to implement RPM policies and thereby frustrate competition from discount retailers. Varney suggested that a *prima facie* case under this theory would require a plaintiff to show that (i) the retailer (or retailers acting together) had "sufficient market power" to coerce manufacturers, (ii) such coercion resulted

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4 *Id.* at 898-99.

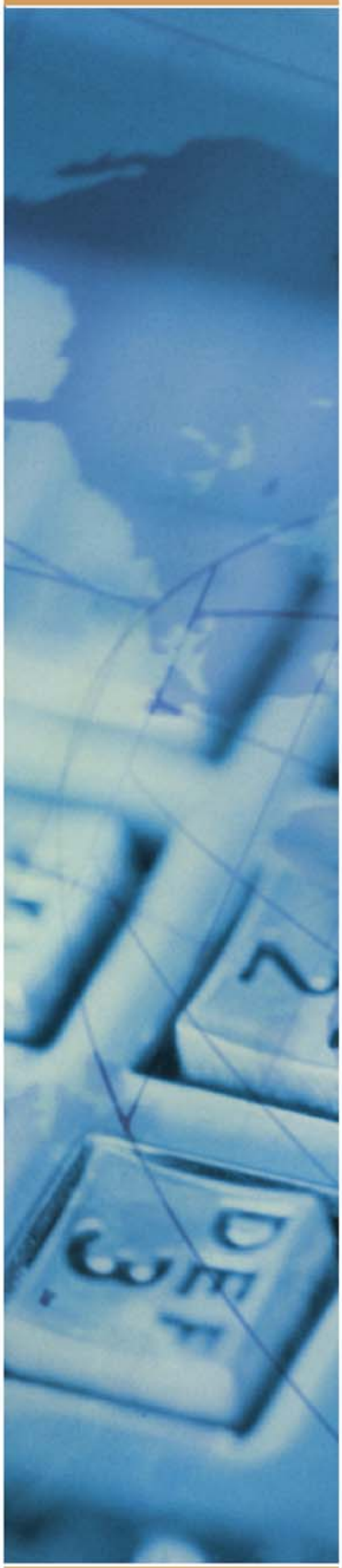
5 Varney, *Antitrust Federalism* at 8.

6 *Id.* at 8-9.

7 *Id.* at 9.

8 *Id.* at 11-12.

9 *Id.* at 12.



in resale price maintenance covering "much of" the market, and (iii) the resale price maintenance plausibly has a "significant exclusionary effect" that impacted an actual rival.[10]

- Retailer Collusion: Finally, Varney explained that retailers might also use resale price maintenance as a means to facilitate collusion—specifically, by coercing manufacturers to use resale price maintenance to help implement and police a retailer cartel. Here again, Varney suggested three elements of a *prima facie* case: (i) that resale price maintenance is used with respect to at least 50% of the sales in the market, (ii) that the RPM was implemented as a result of retailer coercion (not merely "persuasion"), and (iii) that the retailer coercion could not be thwarted by manufacturers (such as by integrating into retailing or sponsoring new retailers).[11]

In conclusion, Varney noted that the DOJ was "not seeking to disrupt the traditional preeminent role of the FTC and the States" regarding RPM, but was instead interested in "supporting a jurisprudential effort to aid the development of federal law under *Leegin*."[12]

Implications of the DOJ's Approach

Although the DOJ's proposed approach to analyzing resale price maintenance is not binding on the courts, it is certainly possible that courts will find the DOJ's recommendations persuasive. In the meantime, State Attorneys General—as well as the Federal Trade Commission—may follow the DOJ's approach when investigating and analyzing RPM arrangements.[13]

As a result, this new approach should be of interest to any manufacturer or retailer that participates (or is considering participating) in a resale price maintenance arrangement.

One of the greatest areas of concern to manufacturers may be the DOJ's "manufacturer collusion" theory because the threshold for making out a *prima facie* case appears to be quite low. Under this theory, for example, it might be possible to show "structural conditions" that are "conducive to price coordination" (the second element) merely by showing that a market is sufficiently concentrated to enable manufacturers to anticipate each other's pricing. If that is the case, it may also be easy for a plaintiff to show that a widespread practice of resale price maintenance would help "identify cheating" (the third element). In light of this, a manufacturer in a concentrated market where RPM is prevalent should make an effort to document the rationale for implementing an RPM policy, as well as any benefits actually achieved as a result of the policy, in case it should ever become necessary to defend the policy in an investigation or litigation.

Similarly, with respect to the DOJ's "manufacturer exclusion" theory, any manufacturer that might be deemed to have a "dominant market position" (a phrase that Varney did not define) may want to evaluate whether it has adopted an RPM policy that might be deemed to have a "significant foreclosure effect" (also undefined) on a rival. If so, it might be worthwhile for the

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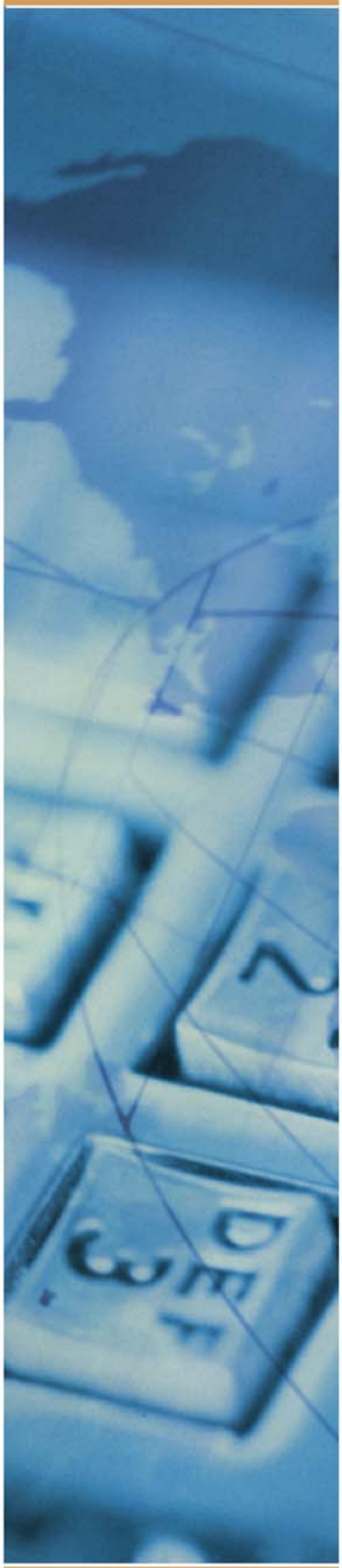
[10] *Id.* at 13.

[11] *Id.* at 13-14.

[12] *Id.* at 14.

[13] The Federal Trade Commission provided some insight into its post-*Leegin* approach to resale price maintenance in its Order Granting in Part Petition to Reopen and Modify Order in *In the Matter of Nine West Group Inc.*, Docket No. C-3937 (May 6, 2008), available at http://www.ftc.gov/os/caselist/9810386/080506order.pdf. Of particular significance is the FTC's suggestion that one way Nine West could demonstrate that its use of RPM would not harm competition would be to show that it lacked market power. *Id.* at 14-15. To the extent the FTC's order thus suggests a safe harbor for RPM when a manufacturer lacks market power, that would appear to be inconsistent with the DOJ's approach, which does not appear to include any such safe harbor.



manufacturer to consider whether the RPM policy can be modified in a way that would help reduce or eliminate such effects. It would also be important for such a manufacturer to carefully consider how it would demonstrate the procompetitive effects of its RPM policy if it were required to do so.

Varney's remarks also make it clear that retailers should also be cautious about attempts (either individually or as a group) to encourage manufacturers to adopt RPM policies. That is because the line between what might be deemed to constitute mere "persuasion" (in Varney's words) on the one hand and "coercion" on the other is unclear, and it may remain so for a period of time while courts consider these issues. Here as well, retailers would be wise to take steps to document the rationales for encouraging a manufacturer to implement an RPM policy, as well as any communications with a manufacturer about a proposed policy.

It is worth noting that Varney's speech leaves open a number of important questions about what would be required for a plaintiff to establish a *prima facie* case in the scenarios described above. For example, it is unclear what is meant the phrases "significant foreclosure effect" and "significant exclusionary effect" in the description of the elements of two of the *prima facie* cases described above.

It is also unclear whether Varney is suggesting that an RPM claim premised on "manufacturer collusion" or "retailer collusion" should withstand a motion to dismiss if the plaintiff plausibly alleges the three elements identified above. If so, Varney's proposed approach may not pass muster in light of the standard for pleading a conspiracy that the Supreme Court articulated in *Bell Atlantic Corp.* v. *Twombly*, 550 U.S. 544 (2007).

Despite these unanswered questions, the DOJ's guidance in this regard is an important initial step that can provide helpful guidance to courts and businesses as they work to evaluate resale price maintenance in the post-*Leegin* world.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues discussed in this memorandum may be addressed to any of the following:

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