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Supreme Court Overrules *Dr. Miles* and Holds That Vertical Price Restraints Are Not *Per Se* Illegal

On June 28, 2007, the United States Supreme Court issued a decision overruling a nearly century-old antitrust precedent and holding that agreements setting minimum resale prices are not *per se* illegal under Section 1 of the Sherman Act.[1] Although the Court's decision gives manufacturers, distributors, and retailers additional flexibility to reach vertical price agreements, it does not mean that all such agreements are permissible. Instead, businesses considering such an agreement will need to evaluate whether it would pass muster under the rule of reason, which requires an analysis of its expected benefits and potential anticompetitive effects. Businesses must also exercise caution to ensure that discussions concerning such vertical price agreements do not — either directly or indirectly — give rise to horizontal agreements between competitors that could constitute *per se* antitrust violations.

The Supreme Court's decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, No. 06-480, concerned a manufacturer of leather goods that adopted a marketing policy requiring certain retailers to pledge not to sell its products below the manufacturer's suggested retail prices. A retailer that was terminated for violating that policy sued the manufacturer, claiming that the policy resulted in agreements setting minimum resale prices that constituted *per se* violations of Section 1 of the Sherman Act. After a jury trial, the district court entered judgment against the manufacturer, and the United States Court of Appeals for the Fifth Circuit affirmed. Both courts relied on the Supreme Court's 1911 decision in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373, which established that it was *per se* illegal under Section 1 for a manufacturer and distributor to agree on the minimum price the distributor could charge for the manufacturer's goods. The Fifth Circuit explained that, "[b]ecause the [Supreme Court] has consistently applied the *per se* rule to such agreements, we remain bound by its holding in *Dr. Miles*."[2]

In its decision last week, the Supreme Court expressly overruled *Dr. Miles* and held that vertical price restraints are not *per se* illegal, but are instead to be evaluated under the rule of reason. The Court explained that its more recent antitrust jurisprudence had rejected the rationales on which *Dr. Miles* was based and had instead focused on significant "differences in economic

[1] Under the *per se* rule, certain types of restraints that are recognized to have manifestly anticompetitive effects are summarily condemned without any inquiry into their competitive effects.

[2] 171 Fed. App'x 464, 466 (5th Cir. 2006) (*per curiam*).

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effect between vertical and horizontal agreements" that *Dr. Miles* failed to consider. Among other things, the Court noted that "[m]inimum resale price maintenance can stimulate interbrand competition — the competition among manufacturers selling different brands of the same type of product — by reducing intrabrand competition — the competition among retailers selling the same brand." Vertical price restraints, the Court explained, can thus "encourage[ ] retailers to invest in tangible or intangible services or promotional efforts that aid the manufacturer's position as against rival manufacturers" and may "give consumers more options" to choose between brands offering different prices and levels of service.

The Court acknowledged that minimum resale price agreements can have anticompetitive effects. For example, the Court explained that a vertical price agreement may facilitate manufacturer cartels by helping them identify price-cutting manufacturers. They may also be used to organize a price-fixing cartel among a group of retailers that "compel a manufacturer to aid the unlawful arrangement with resale price maintenance." Indeed, the Court expressly noted that an agreement setting minimum resale prices may "be useful evidence for a plaintiff attempting to prove the existence of a horizontal cartel."

Despite this potential for anticompetitive effects, the Court concluded that "it cannot be stated with any degree of confidence" that resale price maintenance "always or almost always tend[s] to restrict competition and decrease output" such that it should be condemned as *per se* illegal. At the same time, however, the Court cautioned that lower courts must diligently scrutinize vertical price restraints under the rule of reason. The Court identified several factors that may be relevant to this inquiry, including whether many or only a few manufacturers make use of vertical price restraints in a given industry, whether a manufacturer adopted the restraint independently or as a result of retailer pressure, and whether the manufacturer or a particular retailer has market power.

In light of the Supreme Court's decision in *Leegin*, firms at virtually every level of the supply chain — from manufacturers to retailers — should evaluate the extent to which vertical price restraints might impact their businesses. Manufacturers, for example, may want to explore whether adopting such restraints might enable them to achieve some of the potential benefits identified by the Supreme Court in its decision. Retailers, on the other hand, may want to consider how to respond if suppliers begin imposing vertical price restraints. In every instance, businesses should bear in mind that, although vertical price restraints are no longer *per se* illegal, they may still be deemed unlawful in particular situations under a rule of reason analysis; as a result, businesses should seek legal advice and carefully analyze such restraints before adopting them. Businesses should also be aware that vertical price restraints might be used improperly to orchestrate *per se* illegal horizontal price-fixing agreements, and that communications between firms about adopting such restraints might be cited by plaintiffs as evidence of horizontal collusion. Accordingly, businesses should seek legal advice concerning the types of communications that may be appropriate and those that may be potentially problematic from an antitrust perspective.

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This memorandum is not intended to provide legal advice with respect to any particular situation and no legal or business decision should be based solely on its content. If you have questions regarding the foregoing, please contact any of the following:

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