

CORPORATE
LAW ISSUES

The Corporate Law Department at Murtha Cullina is pleased to provide clients and friends with information about topics of interest in the corporate law area.

If you have questions about the issues addressed in this newsletter, or any other matters involving corporate law issues, please feel free to contact the following attorneys:

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SUPREME COURT LIFTS BAN ON
RESALE PRICE MAINTENANCE



H. Kennedy Hudner

The 96-year old prohibition against setting minimum resale prices is dead. In a contentious, even bitter 5-4 decision, the Supreme Court ruled on June 28, 2007 that agreements between producers and dealers setting the minimum resale price of goods will no longer be automatically considered illegal.

Such agreements will now be analyzed by courts under the “rule of reason,” a test under which the fact finder “weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition.”

In other words, it just got a *lot* easier for a producer to control the price at which dealers sell the manufacturer’s goods. And for upstart discounters and Internet sellers, it just got much harder to circumvent the manufacturer’s pricing policies.

BRAVE NEW WORLD FOR MANUFACTURERS

The case, *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, overruled the famous *Dr. Miles Medical Co.* case of 1911, which held that resale price maintenance was *per se* illegal. The *Leegin* holding does not affect other rulings that prohibit price fixing among horizontal competitors. Horizontal price fixing and horizontal market division are still *per se* illegal.

The majority decision in *Leegin* was based on economic studies and treatises that have suggested resale price maintenance may promote *interbrand* competition (competition among manufacturers selling different brands of the same type of product) by reducing *intra*brand competition (the competition among retailers selling the same brand). The basic notion is that by enforcing minimum resale prices, it allows stores which want to provide additional services or advertising to protect their profit margins from “free riding” discounters.

Leegin is the latest of several Supreme Court cases which have been moving away from *per se* treatment for distribution restraints in recognition of evolving economic theory. In recent years the Court has dropped *per se* treatment of maximum resale price maintenance, applied the rule of reason test to non-price vertical restraints such as exclusive territories, and done away with the presumption of market power for tying arrangements involving patented products.

RESALE PRICE MAINTENANCE CAN STILL BE ILLEGAL UNDER SOME CIRCUMSTANCES

But while resale price maintenance is not *per se* illegal anymore, it does not mean that it is *always* legal, either. The Supreme Court took care to point out that there are at least two situations in which vertical agreements setting minimum resale prices could still trigger liability.

Manufacturer Cartels: If the market is concentrated, with only a few producers, there might be a temptation for all dominant producers to protect themselves against price cutting by tacitly agreeing among themselves as to the resale price for their competing goods, and then establishing a matrix of vertical price agreements with retailers to implement the conspiracy. In other words, you have a horizontal conspiracy among competing manufacturers masquerading as parallel vertical price agreements with retailers. This is a classic horizontal cartel, which could very well be *per se* illegal.

Retailer Cartels: The flip side of this is agreements among competing retailers to control price competition through the mechanism of vertical resale price agreements with the manufacturer. This uses the vertical price agreement with the producer to hide the horizontal price fixing conspiracy. This could occur when you have a market with a very limited number of dominant retailers and, probably, some local barriers to entry that inhibit new retailers from offering either the same or competing products.

In any event, resale price agreements will always receive closer scrutiny whenever the manufacturer, on the one hand, or the retailer, on the other, has “market power” (i.e., a large share of the relevant market).

The Court wryly acknowledged that this new rule will cause a lot of confusion: “As courts gain experience considering the effects of these restraints by applying the rule of reason over the course of decisions, they can establish the litigation structure to ensure the rule operates to eliminate anticompetitive restraints from the market and to provide more guidance to businesses.”

Translation: The next few years are going to be chaotic, as the lower courts try to determine the difference between good and bad resale price maintenance practices. Eventually some clear patterns and rules will emerge. Until then, tread carefully. If you are a manufacturer or producer, you will want to plan out your resale price requirements carefully and be very careful not to get pulled into “horizontal” competition politics among your retailers.

If you have questions, feel free to call Kennedy Hudner (860-240-6029), John Wyman (617-457-4041) or Bill Pinney (860-240-6016).

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