

Supreme Court Overturns Century-Old Rule on Setting Minimum Prices

At last, manufacturers can begin considering the wisdom of setting minimum resale prices for their retailers. For nearly a century, the Supreme Court considered it *per se* illegal to do so. Now, anyone who wishes to challenge that practice must prove it creates actual anticompetitive costs that outweigh the competitive benefits – something challengers rarely are able to do.

The new Supreme Court decision is *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705 (2007). Leegin sold purses and other women's accessories. Since its products were neither cheap nor famous, Leegin chose a high-service niche that depended on selling only through specialty shops. It attracted retailers to its relatively unknown products through a retail price maintenance policy designed to give retailers a larger profit margin if they stocked and sold Leegin products. The pricing policy worked. Specialty retailers who were guaranteed a decent margin gave shelf space and special attention to Leegin brands, and customers bought more and more Leegin products.

In 2002, Leegin discovered that Kay's Closet was discounting Leegin's Brighton line of purses by 20%. When Kay's refused to stop, Leegin dropped Kay's as a retailer, triggering a law suit that continued all the way to the Supreme Court.

For the first time in almost 100 years, the Supreme Court agreed with what economists have been saying for decades: retail price maintenance programs can help companies compete without undue anticompetitive effects. Leegin was a perfect example. The company stood little chance of breaking into the market unless it could offer its retailers a handsome profit to compensate for the risk and costs of selling the new products. Retail price maintenance allowed that to happen.

The Supreme Court also agreed that retail price maintenance can be a useful tool for eliminating "free riders" – retailers who let others provide pre- and post-sale services but steal the sale by offering a lower price without incurring those other costs.

Of course, even lawful tools can be misused. The Supreme Court recognized that minimum retail pricing, if instigated by retailers, can mask a *per se* illegal horizontal price fixing scheme. Also, if used by a manufacturer with market

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power, or if the practice predominates in an industry, retail price maintenance can raise prices and reduce output with little compensating competitive benefit. Because of this potential for misuse, the Supreme Court recognized that retail price maintenance policies should remain challengeable under the antitrust laws, but only if the challenger can prove they are being used to restrain trade unreasonably.

Despite the good news, manufacturers should remain cautious. Do not adopt a retail price maintenance policy at the behest of your dealers or you unwittingly may join a *per se* illegal antitrust conspiracy. Also, retail price maintenance may remain illegal in some states, at least until state legislatures or supreme courts reconsider their historical bans on the practice in light of the recent *Leegin* decision. And even if it is legal, it may not create good cause to terminate a disobedient dealer who happens to be protected by a state anti-termination statute.

Manufacturers who dominate their market should be especially cautious about adopting a retail price maintenance policy. *Leegin* did not make retail price maintenance *per se* legal. Agreements that allow a dominant manufacturer to reap monopoly profits (or reduce output) remain illegal, although proving illegality will be much harder.

Consider these questions before deciding whether to adopt a retail price maintenance policy:

Why do I want to impose a minimum retail price? *Leegin's* story is an excellent example of how minimum retail price agreements can help a manufacturer compete and give consumers more product choices. How does your story compare?

Does my business have market power? The greater the market power, the greater the risk that a court will find that a minimum retail price policy will reduce output and raise market prices to consumers.

How concentrated is my industry? If the industry is very concentrated, a minimum retail price policy will impact a larger percentage of retailers than a pricing policy adopted in an unconcentrated industry. *Leegin's* competitors had plenty of ways to get their products to market, so *Leegin's* retail price maintenance policy did not exclude competitors. In contrast, adopting a similar policy in a market with only two competitors would eliminate new entrants who could not afford to guarantee the even larger margins that would be necessary to attract retailers to



their products.

Do my competitors have minimum retail price agreements? If most do, adding another might decrease output or increase entry barriers enough to catch the attention of antitrust regulators.

Is it difficult to enter my industry or to increase supply? If so, courts might decide that a minimum retail price agreement will likely raise prices because competitors cannot easily respond to pricing changes.

Who suggested the policy? If retailers suggested it, you may be helping a retailer cartel.

Leegin offers manufacturers a useful way to make sure their products are priced optimally to compete for consumers. It is welcome news, but not a license to use retail price maintenance programs indiscriminately. If you want to talk about a retail price maintenance policy, please contact a member of the [Commercial and Competition Law Group](#).

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