



eSAPIENCE CENTER FOR COMPETITION POLICY

VIEWPOINT:

OBSERVATIONS ON THE *LEEGIN* ARGUMENT

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OBSERVATIONS ON THE LEEGIN ARGUMENT

By

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Judge Harold Leventhal famously remarked that examining legislative history is a bit like looking across a crowded cocktail party in search of your friends – you’re sure to find what you’re looking for. No doubt the same can be said of oral argument analysis. One is likely to infer from the judges’ questions and comments a leaning toward one’s favored position. Accordingly, I am only *cautiously* optimistic about the recent oral argument in *Leegin v. PSKS*, in which the justices of the U.S. Supreme Court appeared inclined to overrule a controversial (and, I believe, misguided) antitrust precedent.

The issue in *Leegin* is the continued vitality of the rule that retail price-setting by manufacturers, or “vertical minimum resale price maintenance” (VRPM), is *per se* unreasonable and thus illegal without inquiry into competitive effect. The Court adopted a *per se* rule against VRPM in its 1911 *Dr. Miles* decision.¹ In recent years, the *per se* rule of *Dr. Miles* has come under attack from numerous economists, who have argued that VRPM can be efficient and should not be automatically condemned.

The primary arguments set forth in the *Leegin* briefs were as follows. The briefs in favor of the Petitioner (the party seeking to overrule *Dr. Miles*) emphasized (1) that the primary competitive harm associated with VRPM – facilitation of a horizontal cartel at the retail level – is unlikely to occur; (2) that VRPM could provide manufacturers a means of encouraging their dealers to provide value-enhancing point-of-sale services that consumers desire; (3) that the various exceptions to the *Dr. Miles* rule permit manufacturers to engage in VRPM, albeit in an inefficient fashion; and (4) that replacing the rule of automatic liability with the “rule of reason,” which involves analysis of actual competitive effect, would still permit courts to punish truly anticompetitive instances of VRPM. On the Respondent’s side, the primary arguments were (1) that *Dr. Miles* is longstanding precedent; (2) that there is some empirical evidence, based largely on the repeal of “fair trade” laws that permitted VRPM, that VRPM may lead to higher consumer prices; (3) that VRPM may mask horizontal conspiracies that are clearly anticompetitive; and (4) that Congress endorsed the *Dr. Miles* rule in its 1975 repeal of an exception sanctioning fair trade laws. The oral presentations addressed these and other arguments and suggested, I believe, that the Court will overrule *Dr. Miles*.

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¹ *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911).

THE ORAL ARGUMENT

The oral argument was delivered in four parts. Former Solicitor General (now private attorney) Ted Olson argued for the Petitioner. He was followed by Deputy Solicitor General Thomas Hungar, who argued for the United States in support of the Petitioner. On the Respondent's side, private attorney Robert Coykendall delivered the primary argument. He was followed by New York Solicitor General Barbara Underwood, who argued in support of the Respondent on behalf of New York and 36 other states. The justices' questions during oral argument addressed the following topics.

Difficulties with a Rule of Reason Approach. Given that the primary anticompetitive danger presented by VRPM is that it might facilitate a horizontal cartel at the retail level, a number of the justices' questions focused on whether a rule of reason approach could adequately address this danger. Justice Ginsburg, for example, opened the questioning by querying whether "it is somewhat difficult to distinguish vertical from horizontal in this context" (p. 4, line 5),² and Justice Breyer later remarked that courts evaluating VRPM agreements "don't know which way the push comes" – i.e., from the manufacturers or the retailers (p. 22, line 2). Mr. Olson and Mr. Hungar responded that dealer-initiated VRPM would be fairly rare and could be identified using standard rule of reason techniques, and there was little follow-up questioning on this point.

Justice Stevens, though, was concerned that affording rule of reason treatment to VRPM arrangements could effectively permit dealers to insulate their cartels by persuading the manufacturer to mandate the agreed-upon pricing scheme (p. 5, line 12; p. 20, line 18). The attorneys replied that a dealer-initiated VRPM scheme would effectively be a horizontal agreement subject to the *per se* rule. Justice Stevens then queried whether the efficiency benefits of VRPM – i.e., enhancement of point-of-sale services – would similarly result from dealer-initiated resale price limitations (p. 20, line 18). Justice Scalia later provided a compelling answer to that question (p. 36, line 23):

I cannot imagine why a horizontal conspiracy among dealers could ever produce consumer welfare. It will be a horizontal conspiracy to get more money out of the consumer; but whereas the manufacturer who wants to impose resale price maintenance, his interest isn't to give the retailer as much – more money than the retailer is now making. He's going to try to keep their margin just as low as it ever was, so that he can sell as many of his products as possible consistent with his desire to sell his product by attaching to it more service, better warranty, more showrooms, whatever.

... [T]he incentives are entirely different. When you're dealing with a manufacturer, it seems to me his incentive is still to keep the price

² Citations are to the official transcript of the oral argument available at http://www.supremecourtus.gov/oral_arguments/argument_transcripts/06-480.pdf.

as low as possible consistent with the additional good that he wants to give consumers to attract those consumers to his product.

In light of that persuasive response, most justices will likely reject Justice Stevens' suggestion that the argument for affording rule of reason treatment to VRPM "proves too much," in that it would also call for rule of reason treatment for dealer cartels.

The View of Economists. Throughout the briefing and oral argument, lawyers for the Petitioner maintained that there is an economic consensus that VRPM generally benefits consumers and should thus be afforded rule of reason treatment. Justice Breyer questioned this so-called "consensus" by noting that some non-Chicago School economists – among them, former FTC official F.M. Scherer – believe that permitting VRPM leads to higher prices for consumers (p. 7, line 25):

What that sounds like is that if at least [Scherer], who is an economist, thinks if you get rid of Dr. Miles, every American will pay far more for the goods that they buy at retail. Now that's one economist, of course. There are others who think differently. So how should we decide this? ... Should we overturn Dr. Miles and run that risk? ... We're supposed to count economists? ... Is that how we decide it?

Based largely on these statements, a number of commentators, including *New York Times* columnist Linda Greenhouse, have predicted that Justice Breyer will vote against overruling *Dr. Miles*. I believe that conclusion is a bit hasty. The *per se* rule is reserved for practices that are always or almost always anticompetitive. A lack of consensus on the economic effect of VRPM suggests that the practice deserves rule of reason treatment – particularly if, as appears to be the case here, the majority of economists believe the practice is usually procompetitive. Justice Breyer, a former antitrust professor, knows this. I believe his "how should we decide this?" question was rhetorical; he knows full well that the rule of reason is the default analysis for restraints of trade and that *per se* treatment is reserved for practices where there's a near consensus that effects are anticompetitive. No other justice questioned the Petitioner's assertion that most economists believe VRPM is procompetitive.

Relevance of the Consumer Goods Pricing Act. In 1937, Congress enacted the Miller-Tydings Act, which permitted states to authorize certain forms of VRPM as part of so-called "fair trade" laws. The 1975 Consumer Goods Pricing Act repealed Miller-Tydings, thereby ending the era of fair trade and restoring antitrust scrutiny of VRPM arrangements. In briefing and at oral argument, the Respondent maintained that the 1975 statute indicates congressional approval of the rule of *Dr. Miles*. At least three of the justices – Chief Justice Roberts and Justices Scalia and Ginsburg – appeared to reject that inference regarding congressional intent.

While Justice Ginsburg did initially note that Congress's repeal of fair trade could indicate endorsement of *Dr. Miles* (p. 9, line 17), she seemed persuaded by Mr. Olson's response that repeal of fair trade simply abrogated a rule of *per se* legality for VRPM arrangements – in other words, it merely restored antitrust scrutiny, without indicating how that scrutiny should proceed. Later in the argument, Justice Ginsburg offered the following response to Ms. Underwood's claim that Congress's repeal of fair trade effectively endorsed *Dr. Miles*: "As Mr. Olson pointed out, under the fair trade laws this was *per se* legal. So that's kind of a different thing." (p. 51, line 22). Chief Justice Roberts displayed a similar understanding of the 1975 statute when he observed that members of Congress "haven't enacted legislation that supports the result you seek" [i.e., adherence to the *per se* rule] (p. 43, line 7; see also, p. 46, line 24). And Justice Scalia observed that Congress, in enacting the 1975 statute, "left the situation where it was, which is that the antitrust law is as determined by this Court, and we had shown our willingness to update the antitrust law when sound economic doctrine suggests it necessary." (p. 46, line 12). No justice advanced arguments that the 1975 statute should control resolution of the matter at hand.

Effect on Discount Retailers. One of the more bizarre portions of the argument considered whether overruling *Dr. Miles* would adversely affect discount retailers like Wal-Mart and Target. While Chief Justice Roberts first raised the issue ("[H]asn't a whole industry of discount stores developed in reliance on the *Dr. Miles* rule?" p. 11, line 10), Justice Souter seemed most interested in the matter. At several points in the argument, he asked about "evidence" (p. 11, line 18) and "empirical evidence" (p. 22, line 23; page 23, line 11) that the repeal of fair trade laws led to the flourishing of discount retailers. The lawyers for the Petitioner seemed puzzled; they were aware of no such evidence. Mr. Hungar responded (quite rightly, I think) that "considerations like[] the opening up of international trade and the development of markets like China to supply low-cost goods have a lot more to do with the success of the Wal-Mart's of the world than a rule like *Dr. Miles*." (p. 23, line 20). Justice Alito later observed that the discount retailers had not filed a brief in this case, which one would have expected if the rule of *Dr. Miles* were crucial to their success: "Is there anything to suggest that the large-scale low-price retailers who were supposedly dependent on *Dr. Miles* are – support its retention? Have they filed amicus briefs here or otherwise suggested that this is essential to their continuing operation?" (p. 31, line 5). Justice Scalia concurred with this reasoning: "I mean, if it was really the case that they were going to be losing, losing profits, I think they would have been here." (p. 31, line 16). No justice besides Justice Souter indicated a concern that overruling *Dr. Miles* would impair the discount retail industry.

The "Settled Precedent" Argument. As noted, one of the Respondent's primary arguments was that *Dr. Miles* is longstanding precedent that ought to be respected under the doctrine of *stare decisis*. Justice Breyer seemed most attuned to *stare decisis* concerns. Early on in the argument, he referred to a 1966 book on resale price maintenance in which five economists had articulated the very arguments the Petitioner is now pursuing. He then asked what had changed since 1966 that would warrant a change

in the law. (p. 12, line 5). The only changes he saw were increased concentration among retailers and empirical evidence of falling prices following the repeal of fair trade laws. These changes, he suggested, called for adherence to the *Dr. Miles* rule. (p. 12, line 16). Mr. Olson responded that other post-1966 changes included both a growing consensus among economists that VRPM may enhance consumer welfare and alterations of the rules governing vertical non-price restraints and vertical *maximum* resale price maintenance (in both cases, the Court moved from a *per se* rule to rule of reason treatment). Later in the argument, Justice Breyer again invoked *stare decisis* concerns: “There are good arguments on both sides. Why should we overrule a case that’s 96 years old, in the absence of any – any – congressional indication that that’s a good idea....” (p. 18, line 9).

Despite his apparent misgivings about altering settled precedent, there were hints that Justice Breyer might be willing to overrule *Dr. Miles*. First, he acknowledged – albeit somewhat begrudgingly – that *Dr. Miles* would have come out different under modern antitrust reasoning. In response to Mr. Hungar’s claim that “it’s not a close question whether this Court under its modern antitrust jurisprudence as an initial matter would impose a *per se* rule in this context,” Justice Breyer initially shot back, “I would think it is quite a close question.” When Mr. Hungar balked, Justice Breyer seemed to concede the point: “All right, even so.” (p. 18, lines 17-25). In addition, several of Justice Breyer’s questions have a rhetorical feel: he acknowledges a split of opinion among experts on whether VRPM is generally procompetitive, and he then asks what the Court should do, given that dispute. (p. 8, line 4; p. 18, line 9; p. 33, line 10). I say these questions are rhetorical because Justice Breyer knows full well that rule of reason treatment is the default analysis for restraints of trade and that the *per se* rule is appropriate only when experience has revealed pretty clearly that the practice at issue is always, or almost always, anticompetitive.

Hopefully, Justice Breyer will not conclude that *Dr. Miles* has achieved the status of “superprecedent” – a status that, if it exists at all, is entirely misplaced in the antitrust context. In evaluating trade restraints, the Supreme Court has expressly adopted an approach designed to harness economic learning: trade restraints are to be judged according to their competitive effect, and only after substantial experience has revealed that a particular restraint is almost always output-reducing should the *per se* rule apply. When the Court determines that experience has in fact revealed such a tendency, *stare decisis* – i.e., past utilization of the rule of reason – is irrelevant. By the same token, the Court should be permitted to “learn” that certain *per se* illegal practices are actually deserving of further scrutiny prior to condemnation. Otherwise, an unfortunate ratchet effect results. As Professor Herbert Hovenkamp recently observed,

Knowledge about the competitive effects of business practices must be regarded as a two-way street. Just as increased judicial experience with a practice can lead judges to conclude that it is virtually always anti-competitive and can be disapproved after a truncated inquiry, judicial experience can also reveal the opposite.”

(Herbert Hovenkamp, *The Antitrust Enterprise: Principle and Execution* 118-19 (2005).)

The “Prices Will Rise” Argument. Much of the Respondent’s economic argument relied on empirical evidence (of perhaps questionable quality) that the elimination of fair trade laws and the consequent reinstatement of *Dr. Miles* led to decreased prices for consumers. The implication is that overruling *Dr. Miles* would contradict antitrust’s primary goal because it would increase consumer prices.

Justice Scalia had little patience for this line of reasoning. Lowering prices, he argued, is not antitrust’s ultimate goal; rather, the ultimate goal is enhancement of consumer welfare, which might be achieved with higher prices accompanied by superior services, warranty terms, etc. Thus, he asserted:

The mere fact that [VRPM] would increase prices doesn’t prove anything. ... If, in fact, it’s giving the consumer a choice of more service at a somewhat higher price, that would enhance consumer welfare, so long as there are competitive products at a lower price, wouldn’t it?

(p. 15, line 11). (See also Justice Scalia’s remarks at p. 28, line 17 (“I just don’t think that all customers want is cheap. I think they want other things besides cheap. I think they want service. I think they want selection. I think they want the ability to view goods and so forth.”).) Not surprisingly, none of the other justices disputed Justice Scalia’s claims that consumer welfare is antitrust’s ultimate goal and that enhanced service at higher prices may be entirely consistent with consumer welfare.

The Relevance of Loopholes. A number of legal doctrines limit the reach of *Dr. Miles*. Most notable is the *Colgate* exception, which permits manufacturers to set retail prices unilaterally – that is, by merely refusing to sell to resellers who depart from the manufacturer’s mandated price. Such unilateral pricing decisions cannot violate Section One of the Sherman Act, the *Colgate* Court reasoned, because they do not involve any *agreement* in restraint of trade.³

On the issue of whether *Dr. Miles* should be overruled, the *Colgate* doctrine sort of cuts both ways. On the one hand, why overrule a longstanding precedent if it is essentially avoidable? On the other hand, doesn’t this very large loophole suggest that the rule of *Dr. Miles* is not crucial to consumer welfare?

The justices’ questioning on the relevance of *Colgate* suggested that they view the doctrine as a reason for overruling *Dr. Miles*. While Chief Justice Roberts did initially articulate the argument that *Colgate* makes it unnecessary to overrule *Dr. Miles* (p. 24, line 7: “[W]hat’s the great benefit then in changing the rule if it’s perfectly legal to

³ *United States v. Colgate & Co.*, 250 U.S. 300 (1919)

achieve the same result already?”), most of the questioning on *Colgate* concerned the difficulty of utilizing the exception. This difficulty exists because *Colgate* itself is subject to a pretty big exception: the manufacturer is not allowed to go beyond mere announcement of its pricing policy, followed by termination of offending dealers. In particular, it is not allowed to threaten, cajole, or criticize offending dealers or warn them of termination if they do not return to compliance. As pointed out in an amicus brief filed by PING, Inc., a manufacturer of custom-built golf products, utilization of the *Colgate* exception to *Dr. Miles* is complicated and expensive. Chief Justice Roberts and Justice Ginsburg seized on this point, highlighting the substantial costs involved in a *Colgate* strategy. (p. 33, line 18 (Roberts); p. 34, line 7 (Ginsburg)). These questions suggest that at least some of the justices view *Colgate* as an unnecessarily costly alternative to overruling *Dr. Miles*. As Chief Justice Roberts observed (p. 44, line 11):

Well, it’s also been settled law for 90 years under the Colgate doctrine that manufacturers can achieve the same results, albeit more inefficiently. Doesn’t it make sense to allow them to adopt the most efficient means to an end that is already completely legal?

READING THE TEA LEAVES

So where does this leave us? Despite Judge Leventhal’s suggestion that I’m seeing what I want to see (which is the overruling of *Dr. Miles*), I remain confident that the Court will hold for the Petitioner and will afford rule of reason treatment to VRPM. I believe the justices will vote as follows:

For Petitioner (in favor of overruling *Dr. Miles*):

Scalia – He displayed a sophisticated understanding of the economics of VRPM and recognizes that it frequently enhances consumer welfare and should not be automatically condemned.

Roberts – He understands the high costs involved in utilizing the *Colgate* exception, and he was insistent that the Consumer Goods Pricing Act did not endorse the rule of *Dr. Miles*. In addition, he recognizes that VRPM can lead to point-of-sale services that could not be guaranteed by vertical non-price restraints. (p. 48, line 25).

Ginsburg – Like the Chief Justice, she was concerned about the high costs of *Colgate* and recognized that the Consumer Goods Pricing Act merely rescinded the rule of *per se* legality in fair trade states. Moreover, she was quite interested in whether the Respondent might prevail on another legal theory. (p. 16, line 15; p. 38, line 15). This suggests she will vote to overrule *Dr. Miles* but will clarify that the Respondent may proceed on alternative grounds. (Look for a concurring opinion.)

Kennedy – He said little during the argument, but he did make one particularly telling remark: he referred to the *per se* rule against VRPM as a “cookie cutter

approach.” (p. 32, line 16). If Justice Kennedy is at all convinced that VRPM offers consumer benefits, such a one-size-fits-all approach would be inappropriate.

Alito – He spoke only to dispute Justice Souter’s argument that overruling *Dr. Miles* would adversely affect discount retailers. (p. 30, line 17; p. 31, line 5).

For Respondent (opposed to overruling *Dr. Miles*):

Stevens – He was most concerned about the use of VRPM to police dealer-initiated cartels. He also raised the point that Congress had, in prior appropriations, precluded the use of appropriated funds for advocating the reversal of *Dr. Miles*. (p. 50, line 16). [Note that Chief Justice Roberts and Justice Scalia retorted that no such limitation currently exists. (p. 51, line 1; p. 51, line 6).]

Souter – He was insistent that repeal of *Dr. Miles* could wreak havoc on the discount retailing industry.

Unknown:

Breyer – This is the toughest call. On the one hand, he was most aggressive in his questioning of the lawyers arguing for overruling of *Dr. Miles*. On the other hand, he did seem to concede that *Dr. Miles* would be decided differently today (p. 18, line 25), and, as noted, a number of his questions had a rhetorical feel: He acknowledged a split in opinion on the competitive effects of VRPM and then queried what the Court should do in light of such disagreement. Of course, he knows the answer. *Per se* treatment is appropriate only when there’s no significant disagreement on competitive effects.

Thomas – Since he did not speak at all during oral argument, one cannot draw inferences based on his remarks. Nonetheless, I predict he will vote to overrule *Dr. Miles*. His recent opinion in the *Weyerhaeuser* decision relied heavily on economic reasoning and suggests he will be persuaded by the near economic consensus that VRPM is the sort of “mixed bag” practice for which rule of reason treatment is appropriate.

THE ULTIMATE PREDICTION

Look for a 7-2 or 6-3 decision in favor of the Petitioner, holding that VRPM should receive rule of reason treatment. The dissent will include Justices Stevens and Souter and maybe Justice Breyer. Justice Scalia will author the majority opinion. Justice Ginsburg will submit a concurring opinion observing that the Respondent may prevail on alternative grounds on remand.