

# The CPI Antitrust Journal

## January 2010 (2)

### A Civil Conflict: Can the States Overturn *Leegin*?

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### I. INTRODUCTION

Overturing a 96-year-old rule, the United States Supreme Court held in *Leegin*<sup>2</sup> that minimum resale price maintenance (“RPM”) agreements would no longer be considered illegal per se under Section 1 of the Sherman Act, but instead would be evaluated under the more lenient “rule of reason.” A number of states immediately objected to the change, vowing to legislatively reverse *Leegin*. Maryland has already done so and other states may follow.

This flurry of legislative activity raises the question: Can a state overturn *Leegin* consistent with the United States Constitution? The answer to that question is no, at least to the extent the state regulates conduct that is wholly outside its borders.

### II. LEEGIN AND ITS HOLDING

In *Leegin*, Kay’s Kloset was a retailer of Leegin’s Brighton brand products. Leegin’s policy was to sell Brighton accessories only to independently-owned stores that offered high-quality service, and only to stores that agreed not to sell below a minimum price. When Kay’s Kloset began selling Brighton-brand products at a discount, Leegin stopped shipping to the store. Kay’s Kloset sued, claiming that Leegin’s minimum resale price agreements with retailers were per se violations of Section 1 of the Sherman Act. Kay’s Kloset prevailed in the district court and the court of appeals, both of which applied the per se rule.

The Supreme Court reversed. Writing for a five-justice majority, Justice Anthony M. Kennedy noted that “a restraint must have ‘manifestly anticompetitive’ effects’ to be per se illegal.” The Court held that the per se rule is not appropriate for RPM agreements because they are not restraints that “would always or almost always tend to restrict competition and decrease output.”<sup>3</sup> The Court stated that RPM agreements have a number of potential pro-competitive effects, including eliminating intrabrand price competition and encouraging retailers to invest in the brand, increasing consumer choice among brands along a price and quality continuum, curtailing free riding, and facilitating market entry for new firms and brands.<sup>4</sup> These potential pro-competitive effects convinced the majority that the analyzing RPM agreements on a rule of reason basis, taking into account of the facts and circumstances of each case, would enhance efficiency and consumer welfare.

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<sup>2</sup> *Leegin*<sup>2</sup> *Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007).

<sup>3</sup> 551 U.S. at 886 (quoting *Business Electronics Corp.*, 485 U.S. 717, 723 (1988)).

<sup>4</sup> *Id.* at 890-92.

### III. EFFORTS BY THE STATES TO OVERTURN LEEGIN

*Leegin* did not hold that RPM agreements were per se lawful, but a number of attorneys general and state legislators immediately vowed to overturn the decision. On April 14, 2009, Maryland became the first state to adopt legislation making RPM agreements per se illegal. The Maryland law, which took effect October 1, 2009, classifies RPM agreements as an unreasonable restraint of trade under the Maryland Antitrust Act.<sup>5</sup>

Attorneys general in some states, including New York, Connecticut, Illinois, Ohio, and California, have claimed that their existing state law makes RPM agreements illegal per se despite *Leegin*. Following the Supreme Court's decision, New York, Illinois, and Michigan prosecuted Herman Miller, Inc., alleging that its RPM agreements with retailers violated the states' antitrust laws.<sup>6</sup> Although the three states did not explicitly allege that the RPM agreements were a per se violation, the absence of any allegation by the states of a relevant market or market power suggests that the states believed the agreements were per se violations.

### IV. THE CONVENTIONAL WISDOM ON ANTITRUST PREEMPTION

Any state law that makes RPM agreements a per se violation obviously conflicts with *Leegin*. The very purpose of Maryland's RPM statute is to overturn existing federal antitrust law. Many assume that nothing prohibits Maryland or any other state from enacting statutes that flatly contradict *Leegin*. Those that do usually rely on *ARC America Corp.*,<sup>7</sup> a case in which the Supreme Court held that the federal antitrust laws, which *Illinois Brick*<sup>8</sup> interpreted not to permit indirect purchaser actions, did not preempt state statutes that permitted them.<sup>9</sup> These commentators assert that ARC "ma[kes] clear that state antitrust law is not preempted even when the state statute or state judicial or agency interpretations are inconsistent with prevailing federal law."<sup>10</sup>

ARC does not support such a sweeping conclusion. ARC applied traditional preemption doctrines and held that a state procedural rule regarding who may file a claim that was recognized under both federal and state law did not conflict with an important federal interest. State statutes overruling *Leegin* as a matter of state law, however, reject the federal rule, articulated in *Leegin*, that the Sherman Act does not prohibit every RPM agreement. Whether or not the *Leegin* decision and anti-*Leegin* state laws squarely conflict with each other, given the volume of ink spent arguing about *Leegin* and its potential effects, it is difficult to maintain that the case does not set forth an important federal interest that could potentially preempt contrary or incompatible state antitrust laws.

### V. COMMERCE CLAUSE CONCERNS

The Supremacy Clause may be the least concern for states enacting laws banning RPM agreements. Maryland's statute poses other significant constitutional problems. The Commerce Clause of the United States Constitution "limits the power of the States to erect barriers against interstate trade."<sup>11</sup> If a state law discriminates against interstate commerce, it is virtually invalid per

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<sup>5</sup> MD. CODE ANN., Com. Law §§ 11-201 et seq.

<sup>6</sup> See State of New York, et al. v. Herman Miller, Inc., No. 08-cv-2977 (S.D.N.Y. Mar. 25, 2008).

<sup>7</sup> California v. ARC America Corp., 490 U.S. 93 (1989).

<sup>8</sup> Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977).

<sup>9</sup> See HERBERT HOVENKAMP, ANTITRUST LAW ¶2403a at 318-19, n.1(2006).

<sup>10</sup> *Id.* at 318.

<sup>11</sup> Dennis v. Higgins, 498 U.S. 439, 446 (1991) (internal quotations omitted).

se. The same goes for a state law that attempts to regulate extraterritorial commerce. Furthermore, a nondiscriminatory state statute may nonetheless be unconstitutional if it imposes “an undue burden on interstate commerce.”<sup>12</sup> In determining whether a burden is “undue,” a reviewing court “must weigh and assess the State’s putative interests against the interstate restraints to determine if the burden imposed is an unreasonable one.”<sup>13</sup>

On its face, Maryland’s statute does not appear to discriminate against interstate commerce. Whether it attempts to regulate extraterritorial commerce, however, is less clear. That depends on whether it applies to commerce that is “wholly outside” Maryland. If so, it would not survive constitutional scrutiny. In *Brown-Forman*,<sup>14</sup> the Court struck down a New York law requiring that every liquor distiller or producer selling to wholesalers within the state to affirm that their prices were no higher than those charged for the same product sold in any other state during the relevant time period. The Court held that the statute had the effect of regulating out-of-state transactions: “Once a distiller has posted prices in New York, it is not free to change its prices elsewhere in the United States during the relevant month. Forcing a merchant to seek regulatory approval in one State before undertaking a transaction in another directly regulates interstate commerce.”<sup>15</sup>

Similarly, in *Healy v. Beer Institute*,<sup>16</sup> the Court struck down a Connecticut statute that required out-of-state beer shippers to affirm that their posted prices for products sold to Connecticut wholesalers were, as of the moment of posting, no higher than the prices at which those products were sold in the states bordering Connecticut. The Court relied on the “price gridlock” that would arise if other states enacted similar legislation.<sup>17</sup> The Court emphasized “the Constitution’s special concern both with the maintenance of a national economic union unfettered by state-imposed limitations on interstate commerce and with the autonomy of the individual States within their respective spheres.”<sup>18</sup>

Unfortunately, defining what is “wholly outside the state” is often difficult. At the extremes, the task is relatively easy. If the transaction is negotiated and consummated in Maryland, the transaction is wholly inside the state. If, on the other hand, the transaction is negotiated and consummated outside the state, the transaction is wholly outside the state. Thus, in *Dean Foods*,<sup>19</sup> Wisconsin prohibited milk purchasers from paying dairies a volume premium. An Illinois milk purchaser refused to purchase milk in Wisconsin, instead requiring that Wisconsin dairies ship the milk to him. He then paid the shipper upon receipt of the milk. The Seventh Circuit held that Wisconsin could not regulate the transaction because it took place “wholly” outside the state. The court specifically rejected that the milk purchaser’s contacts with Wisconsin—soliciting business and arranging to have the dairies bring their products to Illinois—were not enough to let Wisconsin regulate the sale transaction.

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<sup>12</sup> *Dean Milk Co. v. City of Madison*, 340 U.S. 349, 353 (1951); see *Pike v. Bruce Church*, 397 U.S. 137, 142 (1970).

<sup>13</sup> *Bendix Autolite Corp. v. Midwesco Enterprises, Inc.*, 486 U.S. 888, 891 (1988).

<sup>14</sup> *Brown-Forman Distillers Corp. v. New York State Liquor Authority*, 476 U.S. 573 (1986).

<sup>15</sup> *Id.* at 582.

<sup>16</sup> *Healy v. Beer Institute, Inc.*, 491 U.S. 324 (1989).

<sup>17</sup> *Id.* at 340.

<sup>18</sup> *Id.* at 335-36.

<sup>19</sup> *Dean Foods Co. v. Brancel*, 187 F.3d 609 (7th Cir. 1999).

Similarly, *Carolina Trucks*,<sup>20</sup> a South Carolina law, forbade auto manufacturers from “sell[ing], directly or indirectly, a motor vehicle to a consumer in [South Carolina].” A South Carolina resident bought a car directly from Volvo in Georgia, and a South Carolina Volvo dealer alleged that the sale violated South Carolina’s statute. The Fourth Circuit held that the statute’s reach was ambiguous and interpreted it only to apply to sales taking place in South Carolina because the statute otherwise would violate the dormant commerce clause.

In both *Dean Foods* and *Carolina Trucks*, the sale took place outside the state. What if an out-of-state seller sells to an in-state buyer at the minimum resale price; in other words, what if the transaction arguably occurs across state lines? While the rules are not crystal clear, courts would probably permit a state to apply its *Leegin* repealer to the transaction, but only to the extent it was not regulating conduct “wholly outside” the state. For example, in *A.S. Goldmen*<sup>21</sup> the court held that New Jersey’s securities laws could be applied to bar a dealer in securities located in New Jersey from arranging over the telephone to sell securities to a resident of another state, even when the sale was to take place in the other state. Both states, the court found, had a stake in the interstate transaction, but New Jersey could only “regulate its half of the transaction—the offer that occurs entirely within the state.” Because the offeror was in New Jersey, it was subject to the state’s regulations.

This extraterritoriality analysis is complicated somewhat by state statutes permitting indirect purchaser actions. Assume a transaction between a manufacturer and a retailer that occurs in a state that has not enacted a *Leegin* repealer statute. Assume further a subsequent transaction at the minimum resale price between the retailer and a purchaser in a state that has enacted a *Leegin* repealer statute. The first sale (wholesale) occurs outside the state, while the second sale (retail) occurs within the state. The state RPM statute would permit an action by the purchaser against the retailer because that transaction occurred within the state, and it, coupled with the indirect purchaser statute, would permit an action by the purchaser against the manufacturer.

Both actions may be unconstitutional. The action against the manufacturer would require the purchaser to argue that Maryland’s law forbade the manufacturer from entering into a contract in a state that permitted the contract. In other words, the purchaser would be arguing for extraterritorial application of Maryland’s RPM statute, which would violate the commerce clause.

The analysis of the purchaser’s action against the retailer is more complicated. The purchaser would have to argue that Maryland’s law forbade an in-state retail sale because of the retailer’s out-of-state commercial activity—entering into an RPM agreement in a state where those agreements are lawful. The mere fact that an out-of-state RPM agreement requires the retailer to sell the product at the manufacturer’s chosen price arguably does not give Maryland power to prohibit the retailer’s out-of-state activity. “[T]he Commerce Clause precludes the application of a state statute to commerce that takes place wholly outside of the State’s borders, whether or not the commerce has effects within the State.”<sup>22</sup>

That said, the purchaser in that case would likely have non-frivolous arguments why Maryland’s law was being applied only to in-state conduct, especially if some steps in the process of forming the RPM agreement occurred within the state. In any event, even if a court were to find that an out-of-state RPM could make a retailer liable to an in-state purchaser—that is, if the court

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<sup>20</sup> *Carolina Trucks & Equip., Inc. v. Volvo Trucks of N. Amer., Inc.*, 492 F.3d 484 (4th Cir. 2007).

<sup>21</sup> *A.S. Goldmen & Co., Inc. v. New Jersey Bureau of Sec.*, 163 F.3d 780 (3d Cir. 1999).

<sup>22</sup> *Healy v. Beer Institute*, 491 U.S. 324 (1989) (emphasis added).

concluded there was no extraterritorial application of the Maryland RPM statute to an in-state retail sale—the purchaser’s action may still pose an undue burden on interstate commerce, inasmuch as the purported local benefits are outweighed by the sizable burden on interstate commercial activity.

## **VI. CONCLUSION**

While many assume that a state such as Maryland may “repeal” *Leegin*, it may not do so if it is regulating commerce outside its borders. It may, however, apply the per se rule to transactions that occur “wholly” within its borders. Of course, attempting to define what occurs “wholly” within its border will probably only lead to years of litigation.