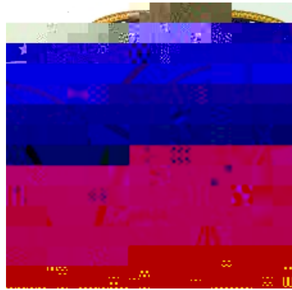

Federal Trade Commission

An Open Letter to the Supreme Court of the United States
from Commissioner Pamela Jones Harbour[1]

February 26, 2007

Subject: The Illegality of Vertical[2] Minimum Price Fixing

Mr. Chief Justice, and May It Please the Court:

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Vertical minimum price fixing is almost always harmful to consumers. It creates no incentive ays h

almost always increases prices to consumers, what legal presumptions should be imposed? Upon whom? And with what degree of rigor might those presumptions be rebutted, if at all?

I. <u>Vertical Minimum Price Fixing Is – And Should Remain – Illegal As A Matter Of Law</u>

A longstanding precedent, having celebrated its 95th birthday, should only be overruled if the Court is firmly convinced that the case was wrongly decided. *Dr. Miles* is not such a case. The arguments advanced for overruling *Dr. Miles* appear to be based on a misstatement of the grounds for the decision, as well as a failure to account for historical facts likely known to the Court in 1911 but not reflected in the Court's opinion. The *Dr. Miles* decision remains a vital tool in the public antitrust enforcement arsenal, particularly for state attorneys general. It is not, however, the inflexible impediment to rational marketing portrayed by Leegin. As developed in detail below, the Court's subsequent decisions create a great deal of flexibility and latitude for manufacturers to persuade retailers to abide voluntarily by a manufacturer's sales preferences.

Leegin and its *amici*, argue, incorrectly, that the *Dr. Miles* decision was based on respect for the venerable rule prohibiting restraints on alienation.[8] True, the *Dr. Miles* Court did observe that "restraints upon alienation have been generally regarded as obnoxious to public policy."[9] But the Court explicitly rejected Dr. Miles's claim that it had the inherent right to control subsequent pricing of goods, simply because it had owned the goods at the time of sale and pricing was an incident "derived from the liberty of the producer."[10] As the Court explained, "Whatever right the manufacturer may have to project his control beyond his own sales must depend not upon an inherent power incident to production and original ownership, but upon agreement."[11]

In *Dr. Miles*, the manufacturer did enter into agreements to project its control beyond its own sales, but those agreements were illegal under the antitrust laws.

Monsanto,[27] and *Business Electronics*[28] (to name a few), it may be virtually impossible to prove even the fact that a vertical minimum pricing restraint has been imposed by a contract, combination or conspiracy.[29] The practical effect of these cases is that an agreement inferred from a course of business conduct between vertical actors faces virtually insurmountable hurdles of proof in order to "exclude the possibility of independent action,"[30] absent an express agreement. Few (if any) economists – let alone antitrust enforcers – would take such a benign view of vertical minimum price fixing.[31]

II. <u>As A Matter of Economic Policy, Vertical Minimum Price Fixing Remains Harmful To Consumers</u>

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fixing enhances competition.[33] Leegin's reliance on economic theory is misplaced, however,

is asked to affirm Leegin's utter lack of faith in an economy where consumers are able to express their preferences with their pocketbooks (Brighton®-branded or otherwise).[38]

A review of the 1936-37 issues of the *Trade Regulation Review: A Bulletin on Economics and Law of Business Co-operation* [39] shows that most of the same arguments for or against vertical minimum price fixing were being advanced then as are being advanced today. The so-called new wisdom of modern analysis is not much more than repackaged old chestnuts. Indeed, many of the current arguments appear in the *Dr. Miles* opinion itself.[40] Furthermore, as discussed more fully below,[41] the United States experimented with vertical minimum price fixing at the state level for over forty years. In response to this economic learning, Congress ultimately declared the experiment a failure by passing the Consumer Goods Pricing Act of 1975, which banished vertical minimum price fixing on a national scale.

Sound economic policy grounded in the well-being of consumers should favor lower consumer prices and greater efficiency in the distribution and sale of consumer goods.[42] Vertical minimum price fixing, by itself, promises neither. In many (if not most) cases, vertical minimum price fixing will lead to prices that provide a margin of comfort for a manufacturer's *least* efficient

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[38] "[A]uthorizing the manufacturer to decide what mix of products and services is desirable, instead of allowing the market to decide that question, is inconsistent with the nation's commitment to a competitive proce347w6leSpan <</MCI

- reduced efficiency in distribution and retailing;[47]
- lower levels of retail sales per outlet;[48]
- higher rates of business failure;[49]
- reduced opportunities for effective entry by new competitors and products;[50]
- distortion of retailer incentives to provide objective comparisons of competing brands on their shelves;[51]
- diminished levels of competition between competing brands of goods;[52] and

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[47] *See, e.g.,* Pitofsky, *supra* note 29, at 1493 ("To deny the sellers access to products because they are aggressive in pricing (and perhaps more efficient as well) hardly seems to be a service to consumers, or a vote of confidence in the competitive process."); Statement of Senator Brooke, 121 CONG. REC. 1339 (Jan. 27, 1975) ("The crux of the problem of resale price maintenance, is whether the consumer should reap the benefits of the most efficient forms of retailing or . . . should be forced to pay more in order to make retailing . . . a more comfortable occupation.") (quoting an editorial from *Consumers Union*)).

[48] "It has been established by a U.S. Department of Justice study prepared by Dr. Leonard Weiss in 1969, that stores in fair trade States almost universally have a significantly lower volume of retails sales than stores in free trade areas . . . sales volume per store is systematically lower under fair trade." Statement of Senator Brooke, 121 CONG. REC. 38,050 (Dec. 2, 1975).

[49] S. Rep. 94-466, *supra* note 33, at 3 (" . . . 'fair trade' States with fully effective laws have a 55 percent higher rate of firm failures than free trade states.").

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- increased competition by manufacturers for the loyalty of their dealers, the costs of which will be borne by consumers.[53]

It is no wonder, therefore, that most industrialized nations of the world treat vertical minimum price fixing as *per se* illegal – sometimes even subject to penalties – while non-price vertical restraints are treated more leniently.[54]

III. **Congress Intends Vertical Minimum Price Fixing To Be *Per Se* Unlawful**

The Court is asked, in effect, to repeal the Consumer Goods Pricing Act of 1975, in which Congress expressed its clear support for a *per se* rule against vertical minimum price f

level, permitting individual states to test the real-world effects of vertical minimum price fixing.[58] During that time, Congress continued its refusal to adopt federal legislation that would have reversed *Dr. Miles* and allowed vertical minimum price fixing on a national scale.[59]

Ultimately, Congress declared the states' experiment wit.o 96 0 0 6.9PalbRBT/T18 0 uj lf*Q54677 28P8

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First, the restraints at issue in this case cannot be characterized as purely vertical, because they are substantially horizontal as well. Leegin operates s

because the price fixing will relieve consumers of the costs of searching for a bargain, and also eliminate any possible anxiety by consumers who fear having missed a better bargain.[78] Leegin should be embarrassed to make this argument. Common sense dictates – and the Court should recognize – that most consumers would much rather have the opportunity to seek a bargain. These consumers will not be better off if vertical minimum price fixing is treated more leniently.[79] Further, if the Court holds that the elimination of consumer search costs is a cognizable justification for vertical minimum price fixing, the same logic could be used to defend many price fixing schemes among competitors.[80]

Fifth, Leegin's expert makes at least one argument that the Court should reject summarily. He states that if Leegin were to engage in a "suggested retail price" (SRP) policy, which would be "permissible under Colgate, than [sic] it follows that an SRP policy instituted 'by agreement' does nothing more to harm consumers."[81] This argument, like the one rebutted in the preceding paragraph, may be a satisfactory outcome of "modern economic analysis." But reduced to its essence, the argument stands for the following proposition: if the same result could be obtained by either lawful or unlawful means, it does not matter if the law has been broken. This neither represents good public policy nor upholds the basic tenets of a just legal system. It is a slippery slope best avoided.

Leegin fails to identify how its vertical minimum price fixing activities have benefitted consumers. Leegin suggests that vertical minimum price fixing might lead to more retail outlets carrying the product, outlets maintaining greater inventories, greater point-of-sale services, particularized sales expertise, more effective signaling of product quality, a more ideal shopping

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78 *Id.* at 48a.

79 It is not even necessarily true that manufacturer-fixed, uniform consumer prices would lead to lower consumer search costs. Suppose that Leegin and other manufacturers engaged in vertical minimum price fixing. It is plausible to suppose that they also would impose minimum stocking and display requirements on their dealers. These additional requirements, in turn, might lead each retailer to carry fewer competing brands per store. As a consequence, each consumer might have to visit a substantially greater number of stores, perhaps distributed over a broader geographic area, in order to find the "right" product (in terms of price, quality, and other factors). Therefore, it is equally likely that Leegin's pricing scheme, if adopted widely in the market, would *raise* consumer search costs.

80 Every form of non-market price fixing (horizontal, vertical, or regulatory) is capable of eliminating consumer search costs. This argument proves too much and represents a frontal assault on competition itself. If elimination of consumer search costs were a general justification for restraints of trade, bargain hunting would become a waste of consumers' time and effort. Indeed, if manufacturer-administered pricing were to become widespread, it might also promote forms of price coordination between manufacturers that are beyond the reach of the antitrust laws, such as acts that are merely consciously parallel. Phillip E. Areeda & Herbert Hovenkamp, VI Antitrust Law § 1417g at 115 (2003) ("At all events, it seems clearly established that mere parallelism is insufficient to get to the jury.").

81 *Leegin*, Petition for *Certiorari*, Appendix D at 49a n.43.

experience, and the avoidance of free-riding.[82] Leegin's own expert concedes, however, that ladies handbags and other fashion accessories are not "high tech, information-intensive consumer durables."[83] Ladies handbags are not technological wonders requiring extensive operational expertise and consumer education. Ladies handbags do not require acoustically optimized demonstration rooms. Ladies handbags do not require extensive post-sales servicing, or inventories of repair and replacement parts. Ladies handbags do not require special climate-controlled storage to prevent health risks. The only real "service" at issue appears to be steering the consumer to purchase Leegin's products,[84] to the benefit of the manufacturer and the agreeing retailers. The benefit to consumers is not self-evident.

The free-riding argument, in particular, is a red herring in this case.[85] PSKS's only alleged fault was discounting. Leegin did not claim that PSKS was allocating insufficient shelf space to Leegin's products. Leegin did not claim that PSKS was providing any less service than other dealers. PSKS's "free-riding" was nothing more than its success in gaining market share, at the expense of price-fixing retailers who had agreed not to respond to PSKS's competitive threat. Leegin asks this Court to provide the enforcement muscle for its price fixing agreement. The Court should not bless this flawed free-riding argument.

V. <u>Conclusion: Where Should The Law Go?</u>

Dr. Miles was good law when decided and remains good law today. Sound antitrust policy condemns restraints, such as vertical minimum price fixing, whose necessary and inevitable tendency is to raise prices to consumers.[86] A rule of continued *per se* illegality for vertical minimum

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[82] Brief for Petitioner at 3-4, 20-21, and 22-24.

[83] *Id.* at 26a.

[84] Even if consumers did need and value some additional services when purchasing ladies fashion accessories, increasing dealer margins hardly would ensure that such services will be provided. "After all, there is no guarantee that the dealer, once its resale price is raised, will know exactly what kind and amount of service the manufacturer has in mind. If the distributor is a multiproduct outlet – for example, a supermarket, drug storefct mple

price fixing accords with judicial precedent and Congressional intent. Most importantly, the facts of this particular case do not justify overturning *Dr. Miles*. Accordingly, the judgment below should be affirmed.

That being said, other vertical cases may present the Court with a better opportunity to refine the legal analysis of vertical minimum price fixing under *Dr. Miles* and its progeny. This Court certainly does not condone total knee-jerk adherence to a bright-line rule of *per se* illegality in the area of horizontal price fixing.[87] Nor need it do so in the vertical price fixing area. The Court may, in a future case, wish to specify ways in which parties might make *factual* showings of countervailing evidence that would support the legality of specific vertical conduct.

If a case arises that warrants more lenient treatment of vertical pricing restraints, the Court should still begin with a firm presumption that vertical minimum price fixing is unlawful. That presumption should only be rebuttable by a *factual*, case-specific showing that (1) vertical minimum price fixing is necessary to deliver identifiable net consumer benefits (2) in a quantity at least as great as the amount by which prices have been raised, and (3) such benefits could not be delivered by less-restrictive, alternative means.

A sufficient showing could be based, for example, on empirical analyses or simulations[88] using robust models. But these models *must* accurately portray actual market conditions. They should not rely on representations of market conditions achievable only via simplifying (and unverifiable) assumptions of fact, such as an assumption that downstream markets are perfectly

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consumers – and by "consumers" I mean consumers who buy the output in the relevant market. . . . To me, "consumer welfare" means just that – the welfare of those who are confronted by actual or threatened exercises of seller market power in the output market." *Id.* at 6-7 (emphasis in original). *See also State Oil Co. v. Khan*, 522 U.S. 3, 15 (1997) (discussed *supra* note 42).

[87] *See, e.g., Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1 (1979).

[88] "The paucity of empirical evidence on RPM's effects exacerbates the problem of choosing between efficiency and market-power explanations. Moreover, the existing evidence tends to be interpreted according to preconceived beliefs." Thomas K. McCraw, *Competition and "Fair Trade": History and Theory*, 16 RES. IN ECON. HIST. 185, 227 (1996); *see also* Pauline M. Ippolito & Thomas R. Overstreet, Jr., FTC Staff Report, *Resale Price Maintenance: An Economic Study of the FTC's Case Against the Corning Glass Works* (Jan. 1994), at 70 ("Until recently, the problems of product distribution have not received much serious economic study, in part, because features of an effective distribution system are often difficult to articulate and to measure. . . . Additional empirical studies . . . would . . . help . . . generate more serious consideration of . . . antitrust policy [for] . . . vertical business practices.").

competitive and reflect a complete pass-through of manufacturing costs.[89] Steiner and others reject this assumption both theoretically and empirically.[90]

In order to rebut the presumption of illegality for vertical minimum price fixing, the factual showing should also detail the comparative losses and gains by marginal and inframarginal consumers.[91] Consistent with *Daubert*,[92] such a showing would have to consist of more than a recital

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[89] Pamela Jones Harbour, *An enforcement perspective on the work of Robert L. Steiner: why retailing and vertical relationships matter*, 49 ANTITRUST BULL. 985, 987 (2004) ("Most economic models of consumer goods

of theoretical literature positing potential benefits. The showing would have to factually demonstrate that all conditions necessary to achieve those benefits actually exist. In short, the required proofs would have to demonstrate "actual market realities"[93] – something more than an expert report hypothesizing the existence of an ambiguous range of alternative outcomes.

The United States has been down the vertical minimum price fixing road before. Congress put manufacturer-administered retail pricing to the test, and the manufacturers failed. Leegin and its *amici* ask the Court to ignore Santayana's *dictum*: "Those who cannot remember the past are condemned to repeat it."[94]

Respectfully submitted,

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93 *See Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451, 466 (1992).

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