DR. MILES IS DEAD. NOW WHAT?: STRUCTURING A RULE OF REASON FOR EVALUATING MINIMUM RESALE PRICE MAINTENANCE

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ABSTRACT

In Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, the U.S. Supreme Court overruled its 1911 precedent declaring vertical minimum resale price maintenance (RPM) to be per se illegal. The* Leegin *Court held that the practice should instead be examined on a case-by-case basis under antitrust's rule of reason. The Court further exhorted the lower courts to craft a "structured" rule of reason for evaluating RPM. This Article critiques six proposed approaches for evaluating minimum RPM and offers an alternative approach. The six approaches critiqued are: (1) the Brandeisian, unstructured rule of reason; (2) Judge Posner's rule of per se legality; (3) the approach advocated by twenty-seven states in the recent* Nine West *case; (4) the approach adopted by the Federal Trade Commission in that case; (5) the approach advocated by economists William Comanor and F.M. Scherer; and (6) the approach proposed in the Areeda & Hovenkamp* Antitrust Law *treatise. Finding each of these approaches deficient, the Article proposes an alternative evaluative approach that harnesses economic learning and allocates proof burdens in a manner that minimizes the sum of decision and error costs, thereby maximizing the net social benefits of RPM regulation.*

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INTRODUCTION

The U.S. Supreme Court's decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*,[1] marked the end of an era in antitrust. *Leegin* overruled the Court's 1911 *Dr. Miles* decision,[2] which had established that minimum vertical resale price maintenance (RPM)—the fixing of minimum downstream prices by upstream firms[3]—is per se unreasonable.[4] *Leegin*'s holding that instances of RPM must instead be evaluated under antitrust's rule of reason[5] was no great surprise. The Court has repeatedly emphasized that per se illegality is reserved for restraints of trade that are always or almost always anticompetitive.[6] While some of the vast commentary on RPM highlights the practice's anticompetitive potential,[7] numerous economists have demonstrated that RPM may provide important procompetitive benefits.[8] Thus, one thing is clear in the

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1. 127 S. Ct. 2705 (2007).

2. *Id.* at 2710 (overruling Dr. Miles Med. Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911)).

3. For purposes of simplicity, this Article conceives of minimum RPM in terms of a simple two-level distribution scheme in which the manufacturer sets the prices charged by retailers. The existence of intermediate distributors (wholesalers, etc.) would not significantly alter the analysis, which would generally apply anytime an upstream firm sets the prices charged by a downstream distributor.

4. *Dr. Miles*, 220 U.S. at 400-01.

5. *See Leegin*, 127 S. Ct. at 2710.

6. *See, e.g.*, Bus. Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 723 (1988) (noting that resort to per se rules is confined to restraints "'that would always or almost always tend to restrict competition and decrease output'" (quoting Nw. Wholesale Stationers, Inc. v. Pac. Stationary & Printing Co., 472 U.S. 284, 289-90 (1984))).

7. *See*, *e.g.*, F.M. SCHERER AND DAVID ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 541-48 (3d ed. 1990); William S. Comanor, *Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy*, 98 HARV. L. REV. 983, 984 (1985); Warren S. Grimes, *The Seven Myths of Vertical Price Fixing: The Politics and Economics of a Century-Long Debate*, 21 SW. U. L. REV. 1285, 1287 (1992); Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a* Per Se *Rule Against Vertical Price Fixing*, 71 GEO. L.J. 1487, 1487 (1983); F.M. Scherer, *The Economics of Vertical Restraints*, 52 ANTITRUST L.J. 687, 697 (1983).

8. *See, e.g.*, Ward S. Bowman, Jr., *The Prerequisites and Effects of Resale Price Maintenance*, 22 U. CHI. L. REV. 825, 848 (1955); David A. Butz, *Vertical Price Controls with Uncertain Demand*, 40 J.L. & ECON. 433, 434-36 (1997); Raymond Deneckere, Howard P. Marvel & James Peck, *Demand Uncertainty and Price Maintenance: Markdowns as Destructive Competition*, 87 AM. ECON. REV. 619, 620 (1997); Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J.L. & ECON. 265, 295-

academic literature on RPM: the practice is, at worst, a "mixed bag" in terms of competitive effects. Mixed bags should not be deemed unreasonable per se.[9]

While the academic literature is replete with accounts of RPM's competitive effects, there is little commentary addressing how exactly courts should go about judging the "reasonableness" of any particular instance of RPM. This makes sense, of course, because *Dr. Miles* precluded courts from inquiring into the reasonableness of specific RPM agreements, and such commentary would therefore have been rather pointless.[10] But in the post-*Leegin* era, in the face of a proliferation of RPM arrangements,[11] courts must develop means of distinguishing pro- from anticompetitive RPM agreements. Indeed, the *Leegin* Court expressly contemplated that the lower courts would craft a structured approach for sorting instances of RPM. It explained:

> As courts gain experience considering the effects of these [RPM] 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. Courts can, for example, devise rules over time for offering proof, or even presumptions where justified, to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints and to promote procompetitive ones.[12]

This Article aims to assist courts with this assignment by proposing a structured rule of reason for evaluating the legality of

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96 (1988); Howard P. Marvel & Stephen McCafferty, *The Welfare Effects of Resale Price Maintenance*, 28 J.L. & ECON. 363, 371 (1985); Howard P. Marvel & Stephen McCafferty, *Resale Price Maintenance and Quality Certification*, 15 RAND J. ECON. 346, 347 (1984); Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86, 90-92 (1960).

9. *See supra* note 6 and accompanying text.

10. There is one notable pre-*Leegin* proposal for a structured rule of reason, which is set forth in the *Antitrust Law* treatise. *See* 8 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1633, at 328-39 (2d ed. 2004). The treatise authors likely included this thorough proposal, despite the governing per se rule, to illustrate that rule of reason treatment is workable and would be superior to per se treatment. For a summary and critique of this treatise's laudable and visionary analysis, see *infra* Part II.E.

11. *See* Joseph Pereira, *Price-Fixing Makes Comeback After Supreme Court Ruling*, WALL ST. J., Aug. 18, 2008, at A1 (reporting a marked increase in RPM following *Leegin*).

12. Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705, 2720 (2007).

RPM agreements. Part I lays the foundation by summarizing the economic learning on RPM's competitive effects. Part II then describes and critiques six evaluative approaches that have been proposed for evaluating the legality of specific instances of RPM. Part III proposes an alternative evaluative approach. Under this approach, a party challenging an instance of RPM could prevail only if it either (1) produced convincing evidence that the RPM resulted in an output reduction that could not be attributed to another cause or (2) both demonstrated the existence of all the prerequisites to one of RPM's potential anticompetitive harms and rebutted any claim that the RPM was imposed as the most efficient means of securing a procompetitive end. The proposed approach would maximize the net benefits of RPM regulation by minimizing the sum of decision costs and error costs.

I. RPM AND COMPETITION

Crafting a rational scheme for separating pro- from anticompetitive instances of RPM requires an understanding of how RPM may enhance or diminish competition. We thus begin with a consideration of RPM's competitive effects. Possible anticompetitive harms, examined in Part I.A, include the facilitation of collusion by dealers and manufacturers and the erection of barriers to entry by manufacturers.[13] Potential procompetitive benefits, the focus of Part

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13. RPM has also been accused of causing certain "noncompetition" harms. The *Dr. Miles* Court itself, for example, focused primarily on RPM's creation of a restraint on alienation and its interference with dealer freedom. *See* Dr. Miles Med. Co. v. John D. Park & Sons Co., 220 U.S. 373, 404 (1911) ("But because a manufacturer is not bound to make or sell, it does not follow that in case of sales actually made he may impose upon purchasers every sort of restriction. Thus a general restraint upon alienation is ordinarily invalid."); *id.* at 407-08 (observing that a manufacturer's interest in RPM is not "one which he is entitled to secure by agreements restricting the freedom of trade on the part of dealers who own what they sell").

Neither of these noncompetition concerns justifies restricting the use of RPM. The doctrine disfavoring restraints on alienation would not reach RPM. As the *Leegin* Court observed, "The general restraint on alienation, especially in the age when then-Justice Hughes used the term, tended to evoke policy concerns extraneous to the question that controls here. Usually associated with land, not chattels, the rule arose from restrictions removing real property from the stream of commerce for generations." *Leegin*, 127 S. Ct. at 2714. Moreover, the common law doctrine disfavoring restraints on alienation was not absolute; such restraints were permitted if they were reasonable and necessary to facilitate efficiency enhancing transactions. *See* Mitchel v. Reynolds, 1 Peere Wms. 181, 184 (Ch. 1711). To the extent RPM enhances distributional efficiency, it would pass muster even if it came within the ambit of

I.B, include the enhancement of distributional efficiency, the facilitation of entry into the upstream market, and the facilitation of the marketing of products for which consumer demand is uncertain.

A. Potential Anticompetitive Harms

RPM's potential anticompetitive harms result from its ability to facilitate collusion and to foreclose new entrants from available marketing outlets. Collusion, which the Supreme Court has dubbed "the supreme evil of antitrust,"[14] is, fortunately enough, difficult to accomplish.[15] First, the parties to any collusive arrangement must reach an understanding on how they will limit competition amongst themselves. For example, if the collusive agreement is price fixing, what price will be charged?[16] Agreements of this sort among multiple parties are always a challenge to negotiate, and, because collusion is generally illegal,[17] the parties to any cartel must do so in a clandestine fashion. In addition, the parties to a cartel must somehow police it—that is, they must monitor their coconspirators' compliance with the agreed-upon terms and punish violators. Secretly policing illegal, heavily sanctioned agreements not to compete can be quite difficult.

RPM may disrupt this fortuitous state of affairs by making collusion easier for both dealers and manufacturers. As Part I.A.1 explains, RPM may facilitate collusion at the dealer level by assisting with both the establishment and the enforcement of a price

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the traditional rule limiting restraints on alienation.

The argument that RPM improperly restricts dealer freedom also fails. Manufacturers, who typically want their dealers to be as effective as possible, routinely dictate aspects of the dealers' operations. The law has assumed most of those intrusions on dealer freedom to be valid, *see* 8 AREEDA & HOVENKAMP, *supra* note 10, ¶ 1609, at 114-15, and limiting manufacturers' freedom to impose such restrictions would simply encourage vertical integration into distribution—an outcome that certainly would not be in the interest of dealers. Thus, a mere infringement on dealer autonomy cannot justify restricting RPM.

14. Verizon Commc'ns, Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 408 (2004).

15. *See* Bus. Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 727 (1988) ("Cartels are neither easy to form nor easy to maintain.").

16. *Id.* ("Uncertainty over the terms of the cartel, particularly the prices to be charged in the future, obstructs both formation and adherence by making cheating easier.").

17. *See* 15 U.S.C. § 1 (2008) (prohibiting collusive agreements among competitors).

fixing agreement. Part I.A.2 considers how RPM may facilitate the enforcement of manufacturer-level collusive agreements. Finally, Part I.A.3 considers how manufacturers may employ RPM as an exclusionary device aimed at thwarting competition from new entrants in the manufacturing market.

1. Facilitating Dealer Collusion

Dealers can avoid the difficulty of secretly negotiating a fixed supracompetitive resale price for a product if they can convince the manufacturer of that product to require all dealers to charge such a price. They may, for example, complain to the manufacturer—either individually, as a group, or via some trade association—about discounting dealers that are somehow injuring brand equity. The manufacturer might then respond to their complaints by setting minimum resale prices and thereby essentially establishing the retailer cartel. In addition, the manufacturer, which is in constant contact with its dealers and whose interactions with the competing dealers do not typically raise red flags, may take the lead in enforcing the price fixing agreement by punishing (that is, refusing to supply to) dealers that diverge from the fixed price.[18] RPM thus may permit colluding retailers to overcome the two main hurdles to a price fixing conspiracy: establishment and enforcement.

Of course, manufacturers must agree to participate in this sort of scheme, and it is not immediately obvious why they would do so. The retail markup—the difference between the price the manufacturer collects from the retailer and the price the retailer charges the end user consumer—is the cost the manufacturer must incur to distribute its goods via retailers.[19] A manufacturer would presumably seek to keep that cost as low as possible and would thus refuse retailer requests to impose minimum RPM (unless the guaranteed retail markup somehow enhanced consumer demand for the manufacturer's products, in which case the RPM would be efficiency

18. For example, evidence suggests that the RPM at issue in *Dr. Miles* was procured by retail dealers seeking to enlist manufacturer assistance in enforcing their retailer-level cartel. *See* HERBERT HOVENKAMP, THE ANTITRUST ENTERPRISE: PRINCIPLE AND EXECUTION 186 (2005) ("Retail druggists were fixing prices and using manufacturers as their 'enforcer.'").

19. If the manufacturer were to directly distribute its goods to consumers, it could charge the higher consumer price itself, thereby pocketing any retail markup.

enhancing).[20] In theory, though, a manufacturer might accede to RPM demands from dealers or groups of dealers that possess market power in the market for retail distribution. If, for example, a trade association representing a majority of available retail outlets in a geographic market demanded on behalf of its members that a manufacturer set minimum resale prices for its goods, and if the manufacturer could not easily integrate forward into retail distribution in the relevant geographic market, the manufacturer might give in to the association's demands.[21] Similarly, dealers might exercise their collective power in an unconcerted manner if a number of prominent dealers, representing a substantial percentage of available retail outlets in an area, independently demanded imposition of RPM.[22] Even the pressure of a single dealer could conceivably motivate a manufacturer to impose RPM if the dealer represented a large percentage of available marketing outlets, and switching to other dealers or forward integration into retailing was likely to prove costly.[23]

2. Facilitating Manufacturer Collusion

Whereas RPM can, at least in theory, assist with both the establishment and the enforcement of dealer-level collusion, the theories of anticompetitive harm based on facilitation of manufacturer coordination focus only on RPM's ability to enforce pre-established manufacturer-level cartels. In theory, RPM can assist with the enforcement of such cartels in two ways. First, it may reduce cheating by the manufacturers by reducing both the likelihood that dealers will request discounts and the manufacturers' expected benefits from granting such requests. In addition, it may increase the detectability of any cheating that does occur.

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20. For a discussion of this possibility, see *infra* Part I.B.1.

21. 8 AREEDA & HOVENKAMP, *supra* note 10, ¶ 1604d1, at 46 (discussing exercise of dealer power via trade associations).

22. *Id.* ¶ 1604d1, at 46-47 (explaining how dealers could make independent demands in a manner that would preclude an inference of conspiracy).

23. *Id.* ¶ 1604d2, at 47-48 (discussing how a powerful individual dealer could successfully demand RPM).

a. Reducing Incentives To Cheat

The more intense the price competition faced by dealers, the more likely it is that they will petition their manufacturers for price cuts. Moreover, if price competition at the dealer level is intense so that failure to grant a requested discount may result in a dealer's failure or abandonment of the manufacturer's brand, a manufacturer may be particularly inclined to grant the discount request.[24] If one manufacturer caves in to dealer pressure to reduce dealer prices from supracompetitive levels, competing manufacturers are likely to follow suit, and a manufacturer-level cartel will unravel. Coordinating manufacturers could reduce this risk by each imposing RPM so as to prevent dealer initiated price competition and the consequent demands for dealer price cuts.[25]

In addition, RPM may reduce the benefit a manufacturer gains from acquiescing to demands for discounts. In most cartels, each participant faces a constant temptation to usurp sales from its coconspirators by lowering its price from the fixed level.[26] Such cheating has caused many a cartel to unravel. But when manufacturers that have coordinated on the price they charge dealers also employ RPM, any price break a cheating manufacturer grants its dealers cannot be passed along to consumers in the form of lower retail prices and is thus unlikely to enhance appreciably the

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24. The manufacturer may reason that it will lose less from granting the discount than from losing the dealer. *See id.* ¶ 1606c, at 85.

25. *Id.* at 85-86. As an example of price competition at the dealer level leading to price cuts at the manufacturer level, Areeda & Hovenkamp point to gasoline price wars, in which intense dealer-level competition frequently leads to manufacturer discounts in the form of "temporary competitive allowance[s]." *Id.* at 86.

26. *See* Kenneth G. Elzinga & David E. Mills, *The Economics of Resale Price Maintenance*, *in* 3 ISSUES IN COMPETITION LAW AND POLICY 1841, 1846 (Wayne D. Collins ed., 2008) ("Once cartelists reach an agreement to raise prices, each of them has a strong incentive to cheat on that agreement by secretly cutting price and expanding output.").

cheating manufacturer's total sales.[27] RPM may therefore reduce the benefit of cheating on a manufacturer-level cartel.

b. Making Cheating More Visible

RPM may also facilitate a manufacturer-level cartel by making cheating more detectable. Manufacturers are more likely to diverge from coordinated prices if they can keep their price cuts a secret. Because the price any manufacturer charges particular dealers is normally private, maintaining such secrecy might not be especially difficult. By employing RPM to set retail prices, which are typically public, manufacturers can better detect reductions on the prices charged dealers.[28] Dealers who are given price reductions may respond by lowering their retail prices somewhat below the fixed level. Absent RPM, fluctuation in retail prices might result from retailers' independently varying their margins. With industry-wide RPM, however, a drop in the retail price of one brand gives rise to an inference that the manufacturer of that brand has discounted to

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27. *See* RICHARD A. POSNER, ANTITRUST LAW 88 (2d ed. 2001) (noting that a manufacturer subject to RPM "will gain no additional sales by granting a secret discount to a dealer except insofar as the discount will operate as a bribe to induce the dealer to push the supplier's brand over that of competing brands"). Of course, even if retailers cannot pass along price cuts to consumers, manufacturers would still seem to have an incentive to cheat on a conspiracy fixing the prices charged to retailers because doing so could lead retailers to switch purchases from the complying manufacturers to the cheating ones. Still, RPM may *reduce*, though perhaps not *eliminate*, the temptation to cheat. While a cheating manufacturer might benefit from more dealer purchases (offset by lower purchases from competing manufacturers), the incremental gain in purchases would not be as great as if total sales were increased by lower prices to end-user consumers. Moreover, manufacturer cheating leading to higher dealer purchases from the cheater and lower dealer purchases from other manufacturers is likely to be detected. If a dealer cuts back on its purchases from noncheating suppliers, they are likely to inquire as to the reason for the cutback, so the cheating manufacturer likely will be detected. In addition, if manufacturers sell through single-brand dealers and the manufacturers have set resale prices the dealers may charge, then there is little incentive for the manufacturers to cheat on the price they charge the dealers. Doing so will not increase total sales to consumers (so retailers will not have any need to buy more in response to a lower price; manufacturers will just give away some of their profits to retailers). Also, it may be difficult for dealers to switch to the manufacturers who have lowered prices to dealers. The price reductions are necessarily secret, so other dealers will not know about them, and there may be high "brand switching" costs for dealers who handle only one brand of a product.

28. *See id.* at 172 ("[C]olluding manufacturers may wish to fix retail rather than just wholesale prices ... in order to make it easier to detect cheating, the retail price being more easily ascertained than the wholesale price.").

its dealers or, at a minimum, has failed to enforce its RPM policy.[29] In either case, some sort of reprimand is in order. In short, RPM may facilitate the policing of manufacturer-level price coordination by increasing the visibility or transparency of wholesale prices.[30]

There are, however, reasons to doubt that manufacturers would often employ RPM to strengthen coordination by enhancing price transparency. Any RPM that increases dealer margins (as all minimum RPM will do unless it provides for a retail markup that precisely mirrors the incremental cost of retailing) raises the cost manufacturers pay for distribution.[31] Manufacturers thus will impose RPM to shore up manufacturer coordination only if the incremental collusive gains the RPM can be expected to provide exceed its obvious costs.[32] The incremental gains created by RPM's "wholesale price-revealing" function are probably minimal. First, for goods sold through multibrand retailers, coordinating manufacturers could learn of other manufacturers' price cuts by communicating with the retailers, with whom the noncheating manufacturers have regular contact; this implies that many instances of manufacturer cheating could be discovered even without costly RPM.[33] For goods sold through single-brand retailers, it would not be possible to learn of manufacturer price cuts from the retailers. But such goods tend to be highly differentiated, and that differentiation renders price coordination, particularly of the tacit variety, quite difficult and rather unlikely.[34] Moreover, the sort of cheating that is likely to disrupt coordinated manufacturer pricing would be relatively widespread discounts to dealers representing a significant share of sales

29. *See* Elzinga & Mills, *supra* note 26, at 1847.

30. *See generally* 8 AREEDA & HOVENKAMP, *supra* note 10, ¶ 1606e, at 88-91.

31. *Cf.* POSNER, *supra* note 27, at 88 (observing that RPM's enhancement of dealer margins "will be a pure windfall to the dealer").

32. *Id.*

33. *See* 8 AREEDA & HOVENKAMP, *supra* note 10, ¶ 1606e2, at 89 ("[U]nless dealers handle only a single brand, each manufacturer can learn rival wholesale prices from the multi-brand dealers who buy from them and talk to all of them. Their wholesale prices are thus visible enough for monitoring express or tacit coordination without regard to resale price maintenance."). For reasons they do not state, Areeda and Hovenkamp conclude that this argument is "not persuasive." *Id.*

34. *See* Elzinga & Mills, *supra* note 26, at 1847 ("Product differentiation engenders all kinds of nonprice competition among the cartel members that would be difficult for a cartel to squash, especially in an environment where contracts cannot be enforced in a court of law.").

of the relevant product; the occasional discount to one or a few smaller dealers would be far less likely to disturb the coordination. The relatively widespread discounts, though, would likely be detectable by the other price-coordinating manufacturers even without RPM.[35] Thus, it is not clear that RPM, which is undoubtedly costly to manufacturers, provides sufficient "collusive benefit" to justify its use as a wholesale price revealing mechanism.

3. RPM-Augmented Foreclosure

The *Leegin* Court acknowledged a third anticompetitive harm that may result from instances of RPM: in theory at least, RPM might facilitate the foreclosure of nondominant brands, particularly those of new entrants, from a dominant manufacturer's market.[36]

Imposition of RPM permits a manufacturer to control its dealer's profit margins.[37] A dominant manufacturer might implicitly bargain with its dealers that it will impose RPM to guarantee them an attractive profit margin on its products in exchange for their refusal to distribute (or promote) the brands of competitors and/or new entrants.[38] If dealers choose not to jeopardize their attractive RPM-protected profit margins by handling (or promoting) other brands, competing manufacturers and new entrants may find themselves foreclosed from marketing outlets or, at a minimum, relegated to less desirable channels of distribution. Thus, RPM might be "exclusionary" in that it causes market foreclosure or raises rivals' costs.[39]

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35. *See* 8 AREEDA & HOVENKAMP, *supra* note 10, ¶ 1606e2, at 89 ("[T]he widespread reductions on a single brand that would trouble [coordinating manufacturers] would presumably be attributed to a cut in the wholesale price.").

36. Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705, 2717 (2007) ("A manufacturer with market power ... might use resale price maintenance to give retailers an incentive not to sell the products of smaller rivals or new entrants." (citing Marvel & McCafferty, *The Welfare Effects of Resale Price Maintenance*, *supra* note 8, at 366-68)).

37. *See supra* note 31 and accompanying text.

38. *See* Elzinga & Mills, *supra* note 26, at 1847 (noting that RPM "might facilitate an implicit contract between the manufacturer and [its] retailers of the following nature. The manufacturer ensures retailers of an attractive profit margin on sales of its own brand in exchange for their refusing to take on the distribution of competing brands, including brands offered by new entrants.").

39. A number of business practices, such as exclusive dealing and tying, receive antitrust scrutiny because of their ability to foreclose rivals from marketing outlets. *See generally*

Of course, for such exclusionary effect to occur, the RPM agreements must cover a sufficiently large portion of available marketing outlets; if competitors have access to sufficiently attractive alternative distribution channels, there can be no competitive harm. RPM by a nondominant manufacturer, whose market share would not be large enough for the RPM to cause substantial foreclosure, could not have this anticompetitive effect.[40] Moreover, as explained below, RPM may actually facilitate new entry by providing entrants with a means to reward dealers that will carry the entrants' untested products.[41]

B. Potential Procompetitive Benefits

While RPM may, at least in theory, harm consumers by reducing competition, it may also benefit consumers by enhancing competition among different brands of a product. Specifically, it may increase interbrand competition by enhancing manufacturers' distributional efficiency, facilitating entry by new manufacturers, and increasing product offerings for which there is uncertain consumer demand.

1. Enhancing Distributional Efficiency

To see how RPM may enhance the efficiency of the distributional process, consider how it provides a sort of "middle ground" vertical integration. As Ronald Coase famously observed, the inputs a firm uses in producing its end products may be purchased on a market or produced internally, and a firm will opt for internal production (in other words, will "vertically integrate" into input-production)

HOVENKAMP, *supra* note 18, at 198-206. Foreclosure arguments are particularly strong when cast in terms of "raising rivals' costs" of distribution. *See* HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE § 10.9a2, at 436-37 (3d ed. 2005) ("Many of the foreclosure theories of exclusive dealing become more robust if one views them, not as excluding rivals from a market altogether, but as raising rivals' costs by relegating them to inferior distribution channels.").

40. *See* Elzinga & Mills, *supra* note 26, at 1847 ("This [RPM-augmented foreclosure] theory cannot apply where manufacturer competitors and entrants retain access to the market via competing retailers or alternative channels of distribution. Nor can it apply where the manufacturer using RPM does not control a large share of the relevant market in spite of using this practice.").

41. *See infra* notes 67-68 and accompanying text.

when the inevitable efficiency loss from allocating productive resources via managerial fiat rather than market forces[42] is less than the transaction costs of acquiring the input on the market.[43] Vertical integration, then, is generally an efficiency enhancing strategy.

Because the process of getting one's products to end users is ultimately an input, manufacturers always confront a "make or buy" decision with respect to distribution services. Each manufacturer may "buy" distribution services by selling at a discount to distribution specialists, who will then resell at a markup to consumers.[44] Alternatively, the manufacturer may "make" distribution services by expanding its operations to include retail sales to end-user consumers. As Coase explained, the manufacturer's decision of whether to bring distribution services within the firm depends on the relative cost of these two options, costs which change with technological development.[45]

Both options involve trade-offs for the manufacturer. The upside of a "buy" approach is that the professional distributor can specialize in distribution services (for example, sales to end-user consumers in the case of retail distributors) and can thus achieve some productive efficiencies. The downside is that the distributor may shirk (for example, a multi-brand retailer may not adequately promote the manufacturer's brand). As for the "make" decision, the upside is that the manufacturer can better control how much effort is put into promoting its products. The downside is that the manufacturer, which does not specialize in distribution, may be less efficient at distributing its products to end-users in a manner that makes the products most attractive and thus maximizes total sales.

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42. On the relative inefficiency of resource allocation by centralized planning versus resource allocation via market exchanges guided by prices, see generally F. A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519 (1935).

43. R. H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386, 394-95 (1937).

44. The "price" the manufacturer pays for this service is the difference between the price it charges the initial reseller and the higher price ultimately charged to consumers, a price it could collect if it provided distribution services itself.

45. Coase, *supra* note 43, at 394-97; *see also* OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING 85-86 (1985); OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS, A STUDY IN THE ECONOMICS OF INTERNAL ORGANIZATION 114 (1975).

Selling to distributors subject to minimum RPM agreements provides a "middle ground" means by which a manufacturer may secure most of the benefits and avoid many of the costs of both the buy and make options. Because the manufacturer is selling its products to middlemen, it can take advantage of their superior distribution and product promotion skills. RPM, though, allows the manufacturer to retain *some* control over the distribution process and thus to minimize the downside of buying distribution services. In particular, the use of RPM enables manufacturers to encourage point of sale services that could be subject to free riding[46] and to enforce unspecified "agreements" about how products will be distributed.[47] These benefits explain the odd fact that many manufacturers voluntarily impose minimum RPM, even though doing so effectively raises the retail markup, which is ultimately the price the manufacturers are paying for distribution services.[48]

a. Encouraging Retail Services by Eliminating Free Riders

The demand for a manufacturer's product is frequently affected by the retail services that accompany that product.[49] Such services may include, among other things: pre-sale display and demonstration; the provision of product-specific information, such as training in how to use the product; convenient store hours; assurance of adequate inventory; postsale service; a quality or prestige stamp that comes from the retailer's reputation as certifier of high quality products;[50] comfortable retail facilities; and other shopping amenities.[51] Because customers value retail services, the provision of more and better services enhances consumer demand. Indeed, these desirable point of sale services may leave consumers better off even if they result in higher consumer prices. Provision of the services is

46. *See infra* notes 51-62 and accompanying text.

47. *See infra* notes 66-73 and accompanying text.

48. *See supra* note 19 and accompanying text.

49. *See generally* Elzinga & Mills, *supra* note 26, at 1842 (discussing retail services that may enhance demand for a supplier's products).

50. Retailers known for carrying high-quality merchandise provide what has been called a "quality certification" service to manufacturers. *See generally* Marvel & McCafferty, *Resale Price Maintenance and Quality Certification*, *supra* note 8.

51. *See supra* note 48.

efficient when the cost of the services is less than the value they create.

To the extent point of sale services enhance sales (by increasing sales volume and/or per unit prices) enough to cover the cost of the services, one might expect retailers to provide those services voluntarily. After all, retailers as well as manufacturers would stand to benefit from such enhanced sales. Voluntary provision of demand-enhancing point of sale services may not occur, however, if some retailers are able to free ride off the efforts of other retailers.[52] Suppose, for example, that one dealer of a high-end stereo system provides customers with a knowledgeable sales staff and fancy listening rooms where the equipment can be tested, and that a nearby dealer provides no such services. A customer could easily go to the former dealer to take advantage of the point of sale services but then purchase the product from the latter dealer, which is able to charge lower prices since it need not pay for those expensive services.[53] If such free riding is extensive, the high service dealer will find that it cannot profitably continue to offer costly point of sale services and will cease to do so.[54] The absence of such services

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52. *See* Robert H. Bork, *The Rule of Reason and the Per Se Concept: Price-Fixing and Market Division*, 75 YALE L.J. 373, 430-34 (1966); Telser, *supra* note 8, at 91-93.

53. *See* HOVENKAMP, *supra* note 39 § 11.3a, at 456 (discussing similar example involving automobile dealers).

54. *See* Telser, *supra* note 8, at 91. Golf club manufacturer Ping, Inc. provided a similar example of free riding in its amicus brief in support of the petitioner in *Leegin*. *See* Brief of Ping, Inc. as Amicus Curiae in Support of Petitioner, Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705 (2007) (No. 06-480). Ping, long a leader in custom-fitting of golf clubs, has invested substantial resources in training retailers on the complicated custom-fitting process, a process that "requires 30 to 60 minutes to evaluate properly each golfer's physical characteristics and swing in arriving at the golf club specifications unique to that golfer." *Id.* at 6-7, n.2. Ping explained that free riding among discounters was injuring its brand (and consumers of the brand):

> Several years ago, free rider activity and other retail behavior, exacerbated by internet sales, began to threaten the hard-earned reputation of the PING brand, diminishing the demand for its products, and harming PING consumers. For example, some price-cutting PING retailers were advising consumers to visit a retailer that had invested in PING's custom-fitting program, request a custom-fitting session, and then take the specifications for the custom-made PING clubs back to the discounter for a "great deal," financed by the investments and efforts of the servicing dealer that performed the custom fitting. PING recognized that if such activities were allowed to continue unabated, most, if not all, of PING's retailers would lose any incentive to perform custom fittings and other services that are key to the PING brand and its ability to compete in the marketplace. By 2004, PING's revenues reflected these harmful activities.

will injure the manufacturer by reducing demand for its products. In addition, consumers will suffer if, in fact, the point of sale services originally provided were valued more than they cost to produce.

This free rider problem could be addressed several different ways. First, retailers might be able to sell separately those aspects of retail service that enhance demand for the manufacturer's product. For example, the stereo retailer could charge a small fee for expert consultation and/or admittance to a listening room.[55] While these sorts of fees are not unheard of (for example, tennis shops often charge a slight fee for use of a "demo" racquet), they are relatively uncommon, presumably because of the high transaction costs they entail.[56] Alternatively, manufacturers could address the free rider problem by requiring their dealers to adhere to nonprice restraints—either geographical restrictions that would separate dealers so that consumers could not easily free ride or quality standards dictating which retail services must be provided.[57] These sorts of restraints, which are relatively common and have been subject to rule of reason scrutiny since 1977,[58] are somewhat limited in their ability to remedy free rider problems. Geographic restraints cannot perfectly prevent free riding in an age in which consumers travel extensively and Internet commerce is pervasive.[59] Moreover, such restraints may be difficult to enforce. Quality standards are difficult both to specify and to enforce, as explained below.[60]

Id. at 7.

55. *See* Elzinga & Mills, *supra* note 26, at 1843 (noting that RPM may not be necessary to combat free-riding if retailers can "separate those aspects of retail service that build demand for the manufacturer's product from other retailer activities and 'sell' them to consumers, or the manufacturer, on a stand-alone basis").

56. *Id.* ("In many instances, transaction costs appear to prevent separate service sales from eliminating all free riding.").

57. *Id.* (observing that "allowable nonprice vertical restraints" may be used to combat freeriding).

58. *See* Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 59 (1977) (holding that vertical nonprice restraints are to be judged under the rule of reason).

59. For example, a retailer in one region could provide no service and sell lots of cheap goods to a local consumer, who could then resell the products via the Internet. The reselling consumer would have no contractual relationship with the manufacturer and thus could not be subject to territorial restraints.

60. *See infra* notes 62-64 and accompanying text.

RPM provides an alternative means of addressing the free rider problem. If a manufacturer sets a minimum resale price beneath which retailers may not price their products, retailers who otherwise might attempt to free ride lose the ability to offer the discounts that permit them to usurp business from their higher service rivals.[61] Moreover, by setting the minimum retail price at a particular level, the manufacturer may exercise some indirect control over the level of point of sale services provided. When competing retailers selling the manufacturer's products are precluded from competing on price, they will attempt to win business by competing on nonprice aspects of the deal, chiefly point of sale services.[62] Thus, the higher the minimum resale price the manufacturer sets, the greater the level of point of sale services retailers will likely provide. Of course, there are limits to which a manufacturer can raise resale prices to enhance the desirability, and thus the total sales, of its product.[63] If the point of sale services provided by retailers competing because of RPM are valued less by consumers than the incremental price increase occasioned by RPM, then the RPM strategy will reduce total sales, to the detriment of the manufacturer.

b. Enforcing Unspecified Agreements

While the "avoidance of free riding" rationale for RPM is probably the most commonly articulated procompetitive justification for the

61. *See generally* Telser, *supra* note 8, at 91 (setting forth the free-rider justification for RPM).

62. For an example of how limits on price competition lead to enhanced service competition, contrast today's bare-bones service in air travel to the lavish service provided during the era of airline regulation, when air fares were set by the government. Precluded from competing on price, airlines competed vigorously on service, leading to a much more luxurious—albeit more expensive—flying experience. CONGRESSIONAL BUDGET OFFICE, POLICIES FOR THE DEREGULATED AIRLINE INDUSTRY 9 (1988) (noting that, following deregulation, service competition decreased as price competition was liberalized); KEITH LOVEGROVE, AIRLINE: IDENTITY, DESIGN AND CULTURE (2000) (highlighting airline amenities prior to deregulation). Of course, the government, unlike a manufacturer that imposes RPM, has no incentive to maximize total sales.

63. *See* Elzinga & Mills, *supra* note 26, at 1843-44 ("Needless to say, a product whose quality is low cannot survive long in the marketplace just because it carries a high retail price and appears in reputable retail stores. An RPM policy does not enable a manufacturer to make a silk purse out of a sow's ear.").

practice, it has some important limitations. As an initial matter, RPM is frequently observed in situations in which widespread free riding on point of sale services seems implausible.[64] In addition, it is unlikely that RPM actually eliminates the incentive to free ride on other retailers' provision of services the manufacturer desires. For example, even if a manufacturer sets a minimum resale price at a level that would provide a margin sufficient to cover desired point of sale services, individual retailers could still send customers to other retailers to attain those services and then use the markup provided by RPM to provide customers with some other desired amenity, such as a discount on a complementary product.[65] If retailers took that tack, they could win business from the high service retailers who bore the cost of the point of sale services, and those high service retailers would eventually curtail their efforts. Finally, the free rider explanation seems particularly implausible when consumers, prior to purchase, cannot detect retailer services that affect product quality, such as the regular rotation of items possessing a limited shelf life.[66]

Motivated by these limitations of the free rider rationale for RPM, Benjamin Klein and Kevin Murphy articulated an alternative theory of how RPM may enhance the efficiency of the distributional system. Klein and Murphy conceived of RPM as a means by which manufacturers can secure retailers' compliance with incomplete performance contracts aimed at inducing retail services that enhance demand for the manufacturers' products.[67]

Because some of the benefit stemming from a retailer's product promotion efforts inures to the manufacturer, retailers are not perfectly motivated to provide an optimal level of retail service (in other words, service to the point at which the incremental cost of the

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64. Klein & Murphy, *supra* note 8, at 265 ("It is now generally recognized that there are many cases of vertical restraints that do not fit the standard 'consumer free riding on special services' theory.").

65. *Id.* at 266 (observing that the elimination of free riders argument relied upon "the unrealistic assumption that the sole avenue of nonprice competition available to retailers is the supply of the particular services desired by the manufacturer").

66. *Id.*

67. *Id.* at 266-67 (setting forth "an alternative theory of how vertical restraints operate to induce desired dealer services," under which "[m]anufacturers are assumed to induce desired dealer services through a private enforcement mechanism by which active manufacturer monitoring and the threat of manufacturer termination assures dealer performance").

service, borne entirely by the retailer, equals the full incremental benefit, some of which is captured by the manufacturer).[68] Accordingly, manufacturers need some way to encourage the optimal provision of services. One option would be to employ complete, express contracts: the manufacturer could exhaustively specify the precise services the retailer must provide.[69] The problem with this approach is the difficulty of ex ante specification and enforcement.[70] It would be prohibitively costly to specify all the elements of dealer performance in a way that would permit determination of breach and measurement of damages.[71] In addition, monitoring and enforcing a dealer's performance obligations along multiple service dimensions would require substantial effort. Using explicit contracts to align the incentives of the manufacturer and its retailers is thus difficult.[72]

RPM can provide an alternative means by which a manufacturer may secure services that enhance demand for its products. If the manufacturer generally observes its retailers' performance, retains a liberal right to terminate underperformers, and provides an attractive retail margin as an incentive to avoid termination, then

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68. *See* Elzinga & Mills, *supra* note 26, at 1844 ("Economic theory indicates that a manufacturer cannot rely on the retailer to provide optimal retail service when the manufacturer captures some of the benefits of that service."). For an explanation of the divergence between a manufacturer's and its retailers' incentives to promote retail sales of the manufacturer's products, see Benjamin Klein, *Competitive Resale Price Maintenance in the Absence of Free-Riding*, Fed. Trade Comm'n Hearings on Resale Price Maintenance (Feb. 17, 2009), *available at* http://ftc.gov/opp/workshops/rpm/docs/bklein0217./pdf.

69. *See* Elzinga & Mills, *supra* note 26, at 1844 ("The manufacturer, hypothetically, might enter into a contract with the retailer that specifies exhaustively what services the retailer must provide ....").

70. *Id.*

71. Indeed, one of the reasons manufacturers "buy" distribution rather than "make" it is that they do not possess expertise on exactly how their products can best be promoted to end users.

72. As Klein & Murphy observe:

> [I]t is generally recognized that it is uneconomic to create a complete contingent contract to govern the employment relationship. A complete contingent contract entails large transaction costs, rigidities, and hold-up potentials associated with initial contractual negotiation and renegotiation in the face of changing market conditions. In addition, many elements of performance, such as the energy and enthusiasm the worker devotes to a particular task, are essentially unmeasurable (although not unobservable) and must remain unspecified and unenforceable in court.

Klein & Murphy, *supra* note 8, at 294.

the manufacturer can motivate its retailers to provide demand-enhancing point of sale services without specifying them exhaustively. As Klein and Murphy explain:

> The potential loss of this future quasi-rent stream [in other words, RPM's margin guarantee] takes the place of a potential court-imposed sanction in assuring dealer performance. If the expected present discounted value of the future quasi-rent stream earned by an honest dealer exceeds the expected value of the gain to a dealer who shirks on the supply of desired services, then the capital loss that can be imposed on a dealer by manufacturer termination will be sufficient to assure dealer performance.[73]

Thus, RPM's role in enhancing distributional efficiency (to the benefit of manufacturers and consumers alike) extends well beyond the context of point of sale services that are susceptible to free riding.[74]

2. Facilitating Entry

New entrants into markets with large and established incumbent firms—the very markets in which entry is most beneficial to consumers—face difficulties. The incumbent firms have multiple marketing advantages. For example, their brands are instantly recognized without retailer promotion or extensive advertising. Moreover, well-established, dominant brands are practically ensured desirable shelf space, for consumers know and want the brands, and retailers find that they "must" carry them and display them prominently in order to respond to their customers' desires. By contrast, new entrants, who have neither widespread brand recognition nor brand loyalty, need all the retailer promotion they can get and cannot assume that they will attain favorable shelf space.

RPM may provide much needed assistance to new entrants facing these disadvantages. By giving retailers protection against discount-

73. *Id.* at 268.

74. *See* Frank Mathewson & Ralph Winter, *The Law and Economics of Resale Price Maintenance*, 13 REV. INDUS. ORG. 57, 72 (1998).

ing and thus a guaranteed profit margin, RPM creates an incentive for retailers to carry a new brand, display it prominently, and perhaps even engage in more aggressive promotion efforts.[75] Thus, RPM may benefit consumers by facilitating entry into markets with strong brands. Because of this benefit, the dissent in *Leegin* conceded that, if it were writing on a blank slate, it might create a narrow exception to the per se rule against minimum RPM for use of the practice by new entrants.[76]

3. Facilitating the Marketing of Products with Unpredictable Demand

For many products such as books or musical recordings, consumer demand is uncertain at the time the retailer must order the product from the manufacturer. If consumer demand for a product turns out to be strong, a retailer who carries it will do well, but if demand is slack, the retailer may find itself with excess inventory. To dispose of that inventory, it may offer deep discounts. Other retailers carrying that product will similarly have to lower their prices as the deep discounts reduce the market-clearing price.

Given the potential for precipitous price declines, retailers may decline to stock products for which demand is uncertain, choosing instead to wait for products to prove themselves in the marketplace.[77] If enough retailers take that route, untested products will have access to few retail outlets in which to establish their commercial viability. The result may be that high quality products that could have become commercial successes had they gained access to enough retail outlets never have the opportunity to prove them-

75. *See* Elzinga & Mills, *supra* note 26, at 1848 ("To secure entry, a new entrant may seek to gain retail distribution by offering independent retailers protection against discounting, in the hope that margin protection will induce retailers to market and promote the new product.").

76. *See* Leegin Creative Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705, 2731 (2007) (Breyer, J., dissenting) ("[I]f forced to decide now, at most I might agree that the *per se* rule should be slightly modified to allow an exception for the more easily identifiable and temporary condition of 'new entry.'") (citing Pitofsky, *supra* note 7, at 1495).

77. Indeed, this is the strategy utilized by many discount retailers. *See* 8 AREEDA & HOVENKAMP, *supra* note 10, ¶ 1601h, at 15 (observing that "deep discounters offer significantly lower markups on books and CDs, but also a much narrower inventory largely limited to titles whose popularity has already been proven").

selves. Consumers will be injured if those products cannot be marketed.

A manufacturer may use RPM to address this problem. By setting a minimum retail price, the manufacturer may prevent precipitous price declines during periods of slack demand. By reducing price volatility, the manufacturer will encourage retailers to take a chance on untested products and to order larger inventories of such products than they otherwise would order.[78] This benefits both the manufacturers of such products and consumers who otherwise might be deprived of unproven products that turn out to be commercial successes.

II. PROPOSALS FOR EVALUATING RPM UNDER THE RULE OF REASON

Given that minimum RPM may create anticompetitive harms of the types identified in Part I.A, the sorts of procompetitive benefits discussed in Part I.B, or some combination of benefit and harm, the *Leegin* Court wisely ruled that the practice should not be per se illegal.[79] The open issue now is how exactly courts should go about evaluating particular instances of RPM. Given that RPM's per se illegality rendered that question moot, the issue has received far less attention in the academic literature than has the matter of RPM's general effects on competition. Nonetheless, a few proposals have been suggested. This Part sets forth and critiques the leading proposals for evaluating the legality of RPM agreements. Part III, then, proposes an alternative approach.

A. Two Nonstarters: An Unstructured Rule of Reason and a Rule of Per Se Legality

Before analyzing the structured rules of reason that have been proposed for evaluating minimum RPM, we should briefly consider two possible evaluative approaches that may be rejected out of hand: an unstructured rule of reason and a rule of per se legality. Both approaches are troubling as a matter of policy, and neither is

78. *See* Butz, *supra* note 8, at 433-36; Deneckere, Marvel & Peck, *supra* note 8, at 622.
79. *See supra* notes 4-5 and accompanying text.

consistent with the Supreme Court's instructions on how to evaluate RPM.

1. An Unstructured Rule of Reason

Under the classic statement of the rule of reason, courts are directed to conduct a broad and free-wheeling inquiry into the purpose and effect of a restraint of trade and to decide whether, on balance, society is better off with the restraint than without it.[80] That version of the rule of reason, set forth by Justice Brandeis in *Chicago Board of Trade v. United States*[81] and frequently quoted in both judicial opinions[82] and jury instructions,[83] states:

> The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts.[84]

Applied to minimum RPM, this version of the rule would direct the fact-finder to determine, all things considered, whether the total mix of goods and services resulting from RPM is more desirable

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80. *See* HOVENKAMP, *supra* note 18, at 105 (observing that because the classic statement of the rule of reason "never defines what it is that courts are supposed to look for," it has led courts to "engage[ ] in unfocused, wide-ranging expeditions into practically everything about the business of large firms in order to determine whether a challenged practice was unlawful"); *see also* Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6, 14 (1981) (observing that the classic statement of the rule of reason "invites an unlimited, free-wheeling inquiry").

81. 246 U.S. 231 (1918).

82. A Westlaw search reveals 242 federal opinions quoting the bulk of Justice Brandeis's version of the rule.

83. Posner, *supra* note 80, at 15 (referring to "[t]he common practice of including in jury instructions the passage ... from the *Chicago Board of Trade* opinion, often as the only guide to the concept of unreasonable restraint that is offered to the jury").

84. *Chicago Board of Trade*, 246 U.S. at 238.

than the total mix that would result from unfettered price competition among dealers.

Such an inquiry is likely to be entirely indeterminate. Minimum RPM generally results in higher prices for a manufacturer's product but also enhanced point of sale services. The fact-finder thus would have to decide whether the post-RPM outcome of higher prices with more or better services is more or less desirable than the pre-RPM outcome of lower prices with fewer or inferior services. Absent some entirely arbitrary presumption that a low price is better than a high level of service (or vice versa), there is simply no way to make that decision.[85] One might think that the overall desirability of one outcome versus the other could be determined by looking at total sales—that is, if the manufacturer's total sales increased when dealer price competition was restrained, then the RPM is desirable; if not, then it is not.[86] But even putting aside the difficulties inherent in that inquiry, a focus on total sales cannot answer the question posed by the Brandeisian version of the rule of reason, namely, whether total social utility is higher with the restraint than without it.

Examination of RPMs' effect on total sales cannot answer the Brandeisian question because it is theoretically possible for RPM to enhance a manufacturer's total sales *and yet* reduce total welfare.[87] To the extent RPM increases total sales of a manufacturer's products, it does so by inducing services that make the product at issue more desirable to the consumers who are "on the fence" as to whether to buy the product or not. If the incremental services resulting from RPM increase those marginal consumers' willingness to pay for the product at issue more than it raises the product's price, then RPM will result in a greater number of total sales,

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85. Posner, *supra* note 80, at 19.

86. Judge Posner recommends this approach to determine if any instance of RPM is procompetitive, where competition is defined not as the *process* of rivalry but as the output-maximizing *outcome* that results from vigorous rivalry that involves neither collusion nor predation. *Id.* at 21. Notably, he does not contend that this approach could answer the determinative question posed by the Brandeisian version of the rule of reason—that is, whether the outcome with an instance of RPM is more desirable than without the RPM.

87. *See generally* Don Boudreaux & Robert B. Ekelund, Jr., *Inframarginal Consumers and the Per Se Legality of Vertical Restraints*, 17 HOFSTRA L. REV. 137 (1988); Comanor, *supra* note 7; Marvel & McCafferty, *supra* note 8; A. Michael Spence, *Monopoly, Quality and Regulation*, 6 BELL J. ECON. 417 (1975).

despite the higher prices. But the additional services that attract new buyers may not be of value to many consumers who value the product more than marginal consumers and would be willing to pay more than the market clearing price, even without the additional services occasioned by RPM.[88] For those "inframarginal" consumers, RPM results in a higher price that is not offset by additional *valuable* services.[89] This means that their consumer surplus—their wealth gain from buying the product at issue—is reduced by RPM. Thus, even if a fact-finder were to focus solely on whether an instance of RPM had increased a manufacturer's sales (a difficult enough inquiry), it could not answer the Brandeisian question of whether the RPM led to a more desirable state of affairs unless it could determine, for all consumers of the product at issue, whether and to what extent they really valued the incremental services. That task is impossible in practice, and attempts to perform it will result in verdicts that are no more than hunches.

Given its breadth and the lack of any determinative criterion, the unstructured rule of reason is both costly to administer (because proof must be taken on so many issues) and unpredictable (because the outcome will depend largely on the fact-finder's hunches). Employing such an unpredictable rule would tend to chill even procompetitive uses of RPM, because businesses would not want to risk an adverse treble damages verdict in order to secure RPM's benefits.[90] As explained below, most instances of RPM are likely

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88. *See* Marvel & McCafferty, *supra* note 8, at 370:

> Manufacturers, in their desire to maximize profits, focus on the margin, while allocative efficiency incorporates effects on inframarginal customers .... The additional customers attracted by the services must be better off as a result of the service provision. But if some of the additional receipts are derived from higher prices charged to inframarginal customers who do not value the services, the benefits to society of the services provided need not justify their cost.

89. For example, if RPM results in a greater provision of product demonstration and customer education services on, say, a computer with special graphic design capabilities, consumers who are on the fence about buying that computer may be more willing to do so, as they can easily learn of the product's functionality and other features. Those additional demonstration and education services may not be of value, however, to business purchasers that know the product well (or have their own information technology departments), use it to generate revenue, and thus value it more than the typical noncommercial purchaser. The RPM that generates the services valued by marginal noncommercial purchasers will simply reduce the surplus inframarginal commercial purchasers receive from buying the product.

90. If a defendant supplier's RPM is deemed to violate the antitrust laws, the plaintiff is entitled to treble damages. 15 U.S.C. § 15(a) (2006).

procompetitive,[91] so the chilling effect of evaluating RPM under an unstructured rule of reason would be undesirable as a matter of policy.

Such an approach would also be legally infirm. The *Leegin* Court expressly contemplated a more structured inquiry into the reasonableness of particular instances of RPM. After cataloguing specific factors courts should consider—the pervasiveness of RPM in the manufacturer market,[92] the source of the restraint (whether it was sought by dealers or imposed unilaterally by the manufacturer),[93] and the market power of any dominant manufacturer or dealer[94]—the Court called for the lower courts to develop a structured approach to evaluating RPM. It challenged them to "establish the litigation structure to ensure the rule operates to eliminate anticompetitive restraints from the market and to provide more guidance to businesses,"[95] and it suggested that they do so by "devis[ing] rules over time for offering proof, or even presumptions where justified, to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints and to promote procompetitive ones."[96] This is a far cry from the open-ended inquiry invited by the unstructured rule of reason set forth by Justice Brandeis.

In addition, the free-wheeling inquiry invited by the unstructured rule of reason is inconsistent with the Court's more recent teachings on the rule. While many courts—including the Supreme Court—continue to quote Justice Brandeis's classic statement,[97] the Supreme Court has in recent years narrowed the rule of reason

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91. *See* discussion *infra* Part IV.A.

92. Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705, 2719 (2007) ("[T]he number of manufacturers that make use of the practice in a given industry can provide important instruction. When only a few manufacturers lacking market power adopt the practice, there is little likelihood it is facilitating a manufacturer cartel, for a cartel then can be undercut by rival manufacturers.").

93. *Id.* ("The source of the restraint may also be an important consideration. If there is evidence retailers were the impetus for a vertical price restraint, there is a greater likelihood that the restraint facilitates a retailer cartel or supports a dominant, inefficient retailer.").

94. *Id.* at 2720 ("[T]hat a dominant manufacturer or retailer can abuse resale price maintenance for anticompetitive purposes may not be a serious concern unless the relevant entity has market power.").

95. *Id.*

96. *Id.*

97. *See, e.g.*, State Oil Co. v. Kahn, 522 U.S. 3, 10 (1997); Federal Tr. Comm'n v. Indiana Fed'n of Dentists, 476 U.S. 447, 458 (1986); Arizona v. Maricopa County Med. Soc'y, 457 U.S. 332, 343 n.13 (1982).

inquiry to focus solely on a restraint's effects on *competition*, not its effects generally.[98] Thus, it would be improper for courts to consider noncompetition matters such as the extent to which the additional services induced by an instance of RPM are really "valuable" to different groups of consumers (specifically, whether the utility gains to marginal consumers exceed the losses to inframarginal consumers). It would also be improper for courts to determine whether an instance of RPM has increased or decreased competition by balancing the intrabrand competition loss resulting from the RPM against the accompanying gain in interbrand competition. Such an inquiry, which equates competition with the process of rivalry, would be completely indeterminate.[99] If competition was instead defined in terms of market-wide output (that is, a restraint has enhanced competition if it has increased overall output), then a court might properly apply the focused rule of reason by asking whether an instance of RPM has increased or decreased the manufacturer's total sales.[100] Such an output-based inquiry is, however, difficult to conduct in practice,[101] and courts would benefit from an alternative legality test that is easier to apply. The structured rule of reason proposed in Part III suggests a more administrable evaluative approach that could be used as an alternative to the theoretically sound but difficult to apply output-based approach.[102]

2. Per Se Legality

A second approach that may be rejected out of hand is a rule of per se legality for RPM agreements. Judge (then Professor) Richard Posner set forth this approach in a 1981 law review article entitled *The Next Step in the Antitrust Treatment of Restricted Distribution:*

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98. *See, e.g.*, Nat'l Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679, 688 (1978) ("Contrary to its name, the Rule [of reason] does not open the field of antitrust inquiry to any argument in favor of a challenged restraint that may fall within the realm of reason. Instead, it focuses directly on the challenged restraint's impact on competitive conditions.").

99. *See* Posner, *supra* note 80, at 19.

100. *See id.* at 21. Indeed, this Article's proposed evaluative approach endorses this sort of output-based inquiry as an acceptable, albeit difficult-to-implement, means of applying the rule of reason to challenged instances of RPM. *See infra* notes 253-54 and accompanying text.

101. *See* Posner, *supra* note 80, at 19.

102. *See* discussion *infra* Part III.B.

Per Se Legality.[103] Putting aside the fact that *Leegin*'s holding forecloses a rule of per se legality,[104] Posner's approach may be infirm on policy grounds. His conclusion that per se legality is the optimal evaluative approach followed from two premises, both of which are questionable.

First, Posner argued that the rule of reason is inevitably so vacuous that determinations under it will be so unpredictable as to chill the use of RPM, which is usually procompetitive.[105] He observed that the Brandeis version of the rule "invites an unlimited, free-wheeling inquiry,"[106] and he asserted that even if the inquiry is focused solely on the competitive effects of a practice (not all its effects), "the trier of fact is left in the dark as to how to decide whether a challenged practice is substantially anticompetitive."[107] Because most fact-finders are ill-equipped to engage in an in-depth inquiry into competitive effect, the risk of mistake—most likely, the risk of false positives—is great. In short, Posner concluded, "[a] standard so poorly articulated and particularized, applied by tribunals so poorly equipped to understand and apply it, places at considerable hazard any restriction that a manufacturer imposes on its dealers and distributors."[108] Application of the rule of reason, then, is likely to chill procompetitive instances of RPM.

Posner's second premise was that scrutiny of minimum RPM itself provides little incremental benefit.[109] He reasoned that in the primary situations in which RPM could cause or exacerbate anticompetitive harm—dealer cartels and manufacturer cartels—the conventional rules applicable to horizontal conspiracies could adequately protect against such harm.[110] He explained:

> [C]ases in which dealers or distributors collude to eliminate competition among themselves and bring in the manufacturer to

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103. Posner, *supra* note 80.

104. *See* Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705, 2710 (2007) (holding that instances of minimum RPM must be evaluated under rule of reason).

105. *See* Posner, *supra* note 80, at 14-18.

106. *Id.* at 14.

107. *Id.* at 15.

108. *Id.* Posner further observed that where courts had articulated steps for evaluating nonprice restraints, there had been "no *rule* for deciding such cases," rather merely "a checklist of factors to which different triers of fact give different weights." *Id.* at 18.

109. *Id.* at 22.

110. *Id.*

> enforce their cartel, or in which vertical restrictions are used to enforce a cartel among manufacturers, can be dealt with under the conventional rules applicable to horizontal price-fixing conspiracies. They are not purely vertical cases, and they would be decided the same way even if purely vertical restrictions were legal per se.[111]

Concluding that the regulation of RPM could cause affirmative harm (premise one) without providing any significant incremental benefit (premise two), Posner determined that the optimal rule for RPM agreements would be one of per se legality.[112]

Both of Posner's premises are contestable. The first assumes that the rule of reason must be open-ended and ignores the possibility of a structured rule of reason under which a fact-finder would make subsidiary findings that generate an ultimate conclusion. If the structured rule of reason were tailored to minimize false positives and to include reliable safe harbors, businesses could continue to engage in procompetitive RPM, but anticompetitive (and presumably rare) instances of the practice could still be punished (and thus deterred). If the subsidiary findings demanded of the fact-finder involved manageable inquiries, the administrative costs of such a rule would not be excessive. Part III sets forth a structured rule of reason that is both easy to administer and unlikely to generate false positives or create a chilling effect.

Posner's second premise improperly assumes that collusion involving RPM can be policed under the rules governing horizontal conspiracies. To establish a violation of those rules, a plaintiff or prosecutor must establish an agreement among the purportedly conspiring parties.[113] Doing so can be difficult. While precedents permit a fact-finder to infer such an agreement from evidence of conscious parallelism and so-called "plus factors" indicating that the parallel conduct is the result of some commitment to a common scheme,[114] it can be quite challenging to establish those plus factors.[115] The result is that much tacit collusion goes unpunished.[116]

111. *Id.*
112. *Id.* at 23-26.
113. *See* 15 U.S.C. § 1 (2008) (forbidding only contracts, combinations, and conspiracies in restraint of trade).
114. *See, e.g.*, Interstate Circuit, Inc. v. United States, 306 U.S. 208, 226-27 (1939).
115. *See, e.g.*, Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 588 (1986)

Indeed, Posner himself has argued that the law should address such tacit collusion by finding antitrust violations when market conditions would support collusive pricing and parties appear to be using "facilitators" that aid in promoting a common output reduction/price increase.[117] That is precisely what would be accomplished by regulating RPM under a structured rule of reason. The fact-finder would determine whether the market at issue is ripe for collusion and, if so, the use of RPM—a collusion facilitator—would violate the antitrust laws. It is ironic that Posner would maintain that the existing rules governing horizontal conspiracies preclude the need to police RPM when he has so vigorously maintained that the horizontal conspiracy rules are hamstrung by an overly stringent agreement requirement and should be expanded so that they regulate the use of facilitators in collusion prone markets.

Of course, the policy dispute over the desirability of a rule of per se legality is ultimately moot, because the *Leegin* Court made clear that courts are to police minimum RPM under some version of the rule of reason.[118] Thus, a rule of per se legality, like an unstructured rule of reason, is a nonstarter. We turn, then, to proposals for structured rules of reason.

B. The States' Proposed Approach: Higher Price Places Burden on Defendant To Prove Procompetitive Effect that Could Not Have Been Achieved Less Restrictively

One proposed rule of reason approach would automatically place the burden on the defendant to establish that the RPM at issue had a procompetitive effect that could not have been achieved less restrictively. That is the approach espoused by twenty-seven states

(holding that in order to survive motion for summary judgment or directed verdict, plaintiff seeking to establish agreement on basis of circumstantial evidence "must produce evidence that tends to exclude the possibility that the alleged conspirators acted independently" (internal quotation omitted)).

116. *See, e.g.*, HOVENKAMP, *supra* note 18, at 126-36 (asserting that a "lawyerly" approach to finding an agreement leaves most tacit collusion unpunished and arguing instead for an "economic" approach).

117. *See* POSNER, *supra* note 27, at 51-93; Richard A. Posner, *Oligopoly and the Antitrust Laws: A Suggested Approach*, 21 STAN. L. REV. 1562, 1582 (1969).

118. Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705, 2719-20 (2007) (rejecting per se legality for RPM and calling for evaluation under rule of reason).

in a recent dispute involving women's footwear manufacturer, Nine West Group, Inc. (Nine West).[119] In written comments urging the FTC not to modify a 2000 consent order precluding Nine West from any activity that might constitute minimum RPM, the attorneys general of the twenty-seven states set forth a general proposal for evaluating minimum RPM agreements under the rule of reason.[120]

The states began by exhorting the Commission to follow the analytical approach endorsed by the D.C. Circuit in *Polygram Holding, Inc. v. FTC*.[121] Under that approach, which builds on the "quick look" or truncated rule of reason the Supreme Court began to apply in 1978 in *Professional Engineers*,[122] an antitrust tribunal

119. Based on Nine West's designation of "off limits" or "non-promote" shoes that its retailers were not to promote except during designated sale periods, the Federal Trade Commission (FTC) claimed that Nine West had violated the per se rule against minimum RPM. *See* Complaint, *In re* Nine West Group, Inc., F.T.C. Docket No. C-3937 (Apr. 11, 2000), *available at* http://www.ftc.gov/os/2000/04/ninewestcmp.htm. In April 2000, Nine West agreed to a broadly worded consent order requiring it to refrain from (among other things): fixing prices at which its retailers may sell, advertise, or promote its products; "otherwise pressuring" its dealers to adhere to resale prices; and "[s]ecuring or attempting to secure any commitment or assurance from any dealer concerning the resale price at which the dealer may advertise, promote, offer for sale or sell any Nine West Products." *See* Decision and Order, *In re* Nine West Group, Inc., F.T.C. Docket No. C-3937 (Apr. 11, 2000), *available at* http://www.ftc.gov/os/2000/04/ninewest.do.htm. After the Supreme Court abrogated the per se rule against minimum RPM, Nine West petitioned the FTC for a modification of this consent order. *See* Petition to Reopen and Modify Order, *In re* Nine West Group, Inc., F.T.C. Docket No. C-3937 (Apr. 11, 2000), *available at* http://www.ftc.gov/os/caselist/9810386/071106petition.pdf.

120. *See* Amended States' Comments Urging Denial of Nine West's Petition *In re* Nine West Group, Inc., F.T.C. Docket No. C-3937, (Apr. 11, 2000) *available at* http://www.oag.state.ny.us/bureaus/antitrust/pdfs/Amended_State_comments_011708-9west.pdf [hereinafter *Amended States' Comments*].

121. *Id.* at 5 (asserting that governing rule of reason should be based on approach of *In re* Polygram Holding, Inc., F.T.C. Docket No. 9298, *available at* 2003 WL 21770765, *aff'd*, 416 F.3d 29 (D.C. Cir. 2005)).

122. Nat'l Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679 (1978). Since *Professional Engineers*, which applied a truncated ("quick look") rule of reason analysis, *see id.* at 688, the Supreme Court has emphasized that the level of analysis required for judging the reasonableness of a restraint of trade falls along a spectrum and depends upon the depth of analysis required for determining the likely competitive effect of any particular trade restraint. As the Court explained in *California Dental Ass'n v. FTC*:

> The truth is that our categories of analysis of anticompetitive effect are less fixed than terms like "*per se*," "quick look," and "rule of reason" tend to make them appear. We have recognized, for example, that "there is often no bright line separating *per se* from Rule of Reason analysis," since "considerable inquiry into market conditions" may be required before the application of any so-called "*per*

considering a practice that is "inherently suspect," though not per se illegal, may presume the practice unreasonable unless the defendant "either identif[ies] some reason the restraint is unlikely to harm consumers or identif[ies] some competitive benefit that plausibly offsets the apparent or anticipated harm."[123] A practice is "inherently suspect" if there is a "close family resemblance between the suspect practice and another practice that already stands convicted in the court of consumer welfare."[124]

Minimum RPM is inherently suspect, the states maintained, because it inevitably raises consumer prices and thus bears a "close family resemblance" to per se illegal horizontal price fixing.[125] Accordingly, the states argued, RPM should be presumptively illegal unless the defendant establishes a procompetitive benefit that offsets the anticompetitive harm.[126] To do so, the defendant must show that RPM increased its total sales.[127] Such proof would indicate that the RPM resulted in retail services that were of greater value to consumers than the incremental price increase occasioned by the practice.

> *se*" condemnation is justified .... [T]here is generally no categorical line to be drawn between restraints that give rise to an intuitively obvious inference of anticompetitive effect and those that call for more detailed treatment. What is required, rather, is an enquiry meet for the case, looking to the circumstances, details, and logic of a restraint. The object is to see whether the experience of the market has been so clear, or necessarily will be, that a confident conclusion about the principal tendency of a restriction will follow from a quick (or at least quicker) look, in place of a more sedulous one.

Cal. Dental Ass'n v. FTC, 526 U.S. 756, 779-81 (1999).

123. Polygram Holding, Inc. v. FTC, 416 F.3d 29, 36 (D.C. Cir. 2005).

124. *Id.* at 37.

125. *Amended States' Comments*, *supra* note 120, at 8 ("If consumers pay more because of vertical price-fixing, the restraint should be 'inherently suspect.'").

126. *Id.* ("Under *PolyGram*, Nine West then has the burden of proving a plausible and cognizable justification."). *Cf.* Veronica Kayne, *Resale Price Maintenance and the Rule of Reason: The Liability Risk Increases*, SESOURCE: THE MONTHLY ELECTRONIC NEWSLETTER OF THE ABA SECTION ON BUSINESS LAW, July 2007, at 5 (noting that under post-*Leegin* rule of reason, "[i]f the plaintiff [complaining of RPM] starts off with evidence of a price increase, then the defendant will have to demonstrate that it is not an anticompetitive price increase or show countervailing procompetitive benefits").

127. *Amended States' Comments*, *supra* note 120, at 8 (arguing that Nine West should be required to prove that "(1) its vertical price fixing caused retailers to provide actual enhanced value or services; (2) the enhanced value or services increased demand for its shoes; and (3) the increased demand from that value or those services was greater than the decreased demand caused by the higher price that consumers paid").

But even if the defendant made this required showing, the RPM at issue would not stand acquitted under the states' approach. The showing of procompetitive effect would merely shift the burden to the party challenging the RPM to show that the procompetitive benefit could have been achieved less restrictively by, for example, mandating the retail services provided or paying retailers to provide such services.[128] If the challenger showed the possibility of a less restrictive means of inducing the demand enhancing services, the defendant would then have to show that the purportedly less restrictive alternative was actually a less efficient means of achieving the retail services at issue.[129]

While the states' proposed approach appears on first glance to embody a fairly balanced burden shifting regime, in actual practice it would automatically place a heavy burden on the defendant and would likely lead to the condemnation of many—perhaps most—instances of RPM. First, the threshold determination of an "inherently suspect" practice would be automatically satisfied, for practically every instance of minimum RPM results in an increase in consumer prices.[130] The defendant would thus always bear the burden of proving that the RPM at issue increased total sales, and any failure of proof on that point would result in a verdict for the challenger. Next, even if the defendant could prove that the RPM increased total sales, it would inevitably have to make the additional showing that the services generating the additional sales could not have been induced in a less restrictive fashion, for the party challenging the RPM will always be able to assert that such services could have been explicitly required by the manufacturer.[131]

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128. *Id.* ("Even if that showing were made, the Commission would need to consider whether the enhanced value or services could be achieved in a less restrictive way than by vertical price-fixing.").

129. *Id.* at 8-9 & n.14.

130. *See* THOMAS R. OVERSTREET, JR., RESALE PRICE MAINTENANCE: ECONOMIC THEORIES AND EMPIRICAL EVIDENCE 116-17, 160 (1983).

131. For example, the states shifted the burden back to Nine West to show the nonexistence of a less restrictive alternative by simply asserting:

> Vertical pricefixing is not invariably the most efficient way to achieve procompetitive effects. The manufacturer could require its distributors to provide services as a matter of contract and even pay separately for those services. In that circumstance, the manufacturer could terminate or threaten to terminate the relationship if the retailer did not live up to those obligations. That alternative way of fostering services for consumers is more effective and

The upshot is that any instance of minimum RPM will be condemned unless the defendant can prove (1) that the RPM induced retail services that enhanced total sales and (2) that the manufacturer could not have induced those services as efficiently by expressly contracting for them.

Both prongs would be difficult to prove. The first would require the defendant to show that sales figures following the imposition of RPM were more favorable than they would have been absent the RPM. To make that showing, the defendant would have to employ sophisticated statistical methods to separate out conflating influences and thereby isolate the effects of RPM.[132] The second prong would require the defendant to prove the high costs of ex ante contracting for the provision of desired services. Looking at things in hindsight, fact-finders (especially jurors with little business experience) often have a hard time recognizing the practical difficulties associated with drafting and enforcing completely specified performance contracts.

Because both showings that would be required of defendants under the states' proposed approach are difficult to make, most challenges to instances of minimum RPM will have a substantial chance of succeeding—this generates an adverse treble damages verdict[133] that largely deters RPM. That would be an undesirable outcome because, as explained below, it is likely that most instances of RPM are procompetitive.[134]

> efficient than threatening to terminate the relationship because the retailer is not charging consumers a higher price.

Amended States' Comments, *supra* note 120, at 9. Any party challenging RPM could simply parrot these precise words in order to shift the burden to the defendant to prove that the output enhancement could not have been achieved as efficiently using a less restrictive means.

132. *See* Posner, *supra* note 80, at 21 (noting that proving output enhancement following use of RPM "requires controlling for the effects on the firm's output of exogenous factors, that is, those unrelated to the challenged practice itself. There are statistical methods for doing this, but they are not fool-proof in application, nor are they easy for judges and juries to understand").

133. *See supra* note 90.

134. *See* discussion *infra* Part III.A.

*C. The FTC Approach: Defendant Can Avoid Burden of Proving Procompetitive Effect of RPM Only if it Proves Absence of "*Leegin *Factors"*

In ruling on Nine West's petition for modification of the 2000 consent order, the FTC declined to follow the states' proposed evaluative approach but adopted a similar, though less stringent, approach.[135] The Commission agreed with the states that minimum RPM should be evaluated using some version of the truncated rule of reason analysis approved in *Polygram Holdings*.[136] It did not agree, though, that every instance of RPM that raises consumer prices is "inherently suspect."[137] Instead, the Commission reasoned that a defendant should be able to avoid the conclusion that its RPM is inherently suspect, and thus avoid the need to prove procompetitive effect, by proving the absence of the factors the *Leegin* Court identified "for identifying when RPM might be subjected to closer analytical scrutiny."[138] Those factors were: (1) that the RPM is used by manufacturers collectively comprising a significant portion of the product market;[139] (2) that dealers, rather than the manufacturer, were the impetus for the RPM;[140] and (3)

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135. *See* Order Granting in Part Petition to Reopen and Modify Order Issued April 11, 2000, *In re* Nine West Group Inc., F.T.C. Docket No. C-3937 (May 6, 2008), 11-14, *available at* http://www.ftc.gov/os/caselist/9810386/080506order.pdf [hereinafter Nine West Order].

136. *Id.* at 12 ("The *Leegin* decision may be read to suggest a truncated analysis, such as the one applied in *Polygram Holdings*, might be suitable for analyzing minimum resale price maintenance agreements, at least under some circumstances.").

137. *Id.* at 13.

> The [*Leegin*] Court also explicitly noted that evidence of price effects would only be the beginning point for further analysis of competitive harm. This seems to indicate the Court's view that the price setting associated with an RPM agreement ordinarily is less intrinsically dangerous than agreements among direct rivals to set prices or other terms of trade.

138. *Id.* at 14.

139. Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705, 2719 (2007) ("When only a few manufacturers lacking market power adopt the practice, there is little likelihood it is facilitating a manufacturer cartel .... Resale price maintenance should be subject to more careful scrutiny, by contrast, if many competing manufacturers adopt the practice.")

140. *Id.*

> If there is evidence retailers were the impetus for a vertical price restraint, there is a greater likelihood that the restraint facilitates a retailer cartel or supports a dominant, inefficient retailer .... If, by contrast, a manufacturer adopted the policy independent of retailer pressure, the restraint is less likely to promote

that there is a dominant manufacturer or dealer that possesses market power.[141] Because Nine West proved the absence of all these factors, it was not required to make the further showing that its use of RPM was procompetitive.[142] Had it failed to establish an absence of the "*Leegin* factors," it would have been required to prove that its use of RPM had actually enhanced its output (i.e., had led to increased total sales despite higher prices).[143] Notably, the Commission required Nine West to file regular reports showing that its use of RPM benefits consumers and that the *Leegin* factors remain absent.[144]

The FTC's resolution of Nine West's petition for modification thus suggests that the legality of RPM agreements should be determined as follows: once a minimum RPM agreement is established, the defendant bears the burden of proving: (1) that RPM is not used by manufacturers collectively comprising a significant share of the relevant product market; (2) that it, not its dealers, initiated the RPM; and (3) that there is no dominant manufacturer or dealer with market power. If it makes these showings, its RPM is presumed legal for the time being. (Subsequent challenges to the RPM may burden the defendant to establish continued absence of the *Leegin* factors.) If the defendant cannot prove that the *Leegin* factors are absent, then its RPM constitutes an unreasonable restraint and is illegal unless the defendant proves that the RPM enhanced its total sales relative to what they would have been absent the pricing policy.[145]

The FTC's proposed approach is likely to condemn fewer instances of RPM than the states' approach, for a defendant can avoid the difficult showing of enhanced sales if it establishes the absence of the *Leegin* factors. Still, though, the defendant would bear a

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anticompetitive conduct.

141. *Id.* at 2720 ("[T]hat a dominant manufacturer or retailer can abuse resale price maintenance for anticompetitive purposes may not be a serious concern unless the relevant entity has market power.").

142. Nine West Order, *supra* note 135, at 15.

143. *Id.* at 15-16 ("If we were to conclude that Nine West runs afoul of the *Leegin* factors and raises competitive concern, Nine West could also meet its burden by demonstrating that its use of resale price maintenance is procompetitive.").

144. *Id.* at 17-18.

145. The FTC did not state whether the defendant would bear the additional burden of proving that the enhanced output could not have been achieved as efficiently using less restrictive means.

substantial burden. First and most notably, it would have to establish the relevant market, always a difficult task.[146] In its consideration of Nine West's petition for modification, for example, the FTC required Nine West to expend significant effort demonstrating the contours of the market in which it participates.[147] Having established the market, the defendant would then have to produce data on the use of RPM by other manufacturers in that market and on the market shares of those manufacturers. It would then have to prove that it, not its dealers, initiated the RPM. That showing could be difficult to make if there was any evidence that high service dealers had complained about their low service, presumably cheaper, rivals. Those dealer complaints, which may simply have alerted the defendant to the need to control dealer quality by reducing price competition,[148] might be taken to suggest that dealers were the impetus for the restraint. Finally, the defendant would have to establish its own lack of market power and the absence of market power on the part of each of its dealers. The latter showing would presumably require it to establish a second market (the dealer market). If the defendant failed to make any of

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146. *See, e.g.*, MILTON HANDLER ET AL., TRADE REGULATION: CASES AND MATERIALS 210 (4th ed. 1997) ("In theory and practice, relevant market definition is as difficult an undertaking as any in antitrust.").

147. For example, the FTC required Nine West to provide answers to the following questions about market contours and entry barriers in order to establish the market in which it participates:

> Please break out, if possible, Nine West's approximate market shares in identifiable segments of the overall market, e.g., dress shoes, casual shoes, walking/light exercise shoes, sandals, etc. Also, state any arguments or evidence about why these lines are or are not antitrust markets.
>
> ....
>
> How difficult is it for a new manufacturer/distributor of women's shoes to develop a brand, i.e., how long does it take, how costly is it to get shelf space in retail locations, does it matter if the distributor has other shoes or is a new entrant, how much cost is involved in brand development, e.g., market studies, advertising, etc., do brand entry conditions vary by type of shoe, e.g., easier to enter with a sandal than a dress shoe?

Letter from Ronald S. Rolfe, Esq., Cravath, Swaine & Moore, LLP to Eric D. Rohlck, Federal Trade Commission, In the Matter of Nine West Group, Inc., Docket No. C-3937 (Mar. 26, 2008), *available at* http://www.ftc.gov/os/caselist/9810386/080326ninewestadditionalinfoltr.pdf.

148. *See* Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 762-63 (1984) (observing that manufacturers who respond to dealer complaints about price cutting dealers may be motivated by a concern to preserve or enhance dealer services, not by a desire to assist the complaining dealers).

these showings, then it would have to satisfy the difficult proof burden set forth under the states' proposed approach.

While the FTC approach would not be as restrictive as the states' proposed approach, it is likely that the difficulty of making the showings necessary to avoid treble damages liability would similarly deter many procompetitive instances of RPM.

D. The Comanor/Scherer Approach: RPM is Unreasonable if Retailer-Initiated; Otherwise, Focus on Quantitative Foreclosure

A third proposal for a structured rule of reason is that set forth by economists William S. Comanor and Frederic M. Scherer in their *Leegin* amicus brief.[149] Comanor and Scherer, who have separately questioned the purported procompetitive benefits of RPM,[150] submitted their amicus brief "supporting neither party."[151] One purpose of their brief was "to suggest a tractable approach for implementing antitrust standards on RPM."[152] In particular, they wrote "to suggest ... guidelines" for implementation of a rule of reason by the lower courts.[153]

The structured rule of reason proposed by Comanor and Scherer would begin with a "quick look" to determine whether the restraint was instigated by the manufacturer or its distributors.[154] Evidence that distributors were the impetus for the restraint would result in its condemnation, unless the manufacturer defendant could show "credible contradictory evidence" undermining that finding.[155]

If the initial inquiry revealed that the restraint was instigated by the manufacturer, then the legality of the RPM would turn on "a test of quantitative substantiality."[156] A party challenging RPM

149. Brief for William S. Comanor and Frederic M. Scherer as *Amici Curiae* Supporting Neither Party, Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705 (2007) (No. 06-480), *available at* 2007 WL 173679 [hereinafter Comanor/Scherer Brief].

150. *See, e.g.*, SCHERER & ROSS, *supra* note 7, at 541-48; Comanor, *supra* note 7, at 984; Scherer, *supra* note 7, at 697.

151. Comanor/Scherer Brief, *supra* note 149.

152. *Id.* at 1.

153. *Id.* at 3.

154. *Id.* at 8-9.

155. *Id.* at 9 ("Evidence from a quick look that the restraint was induced by distributors should lead to the presumption of a *per se* violation, rebuttable on the presentation of credible contradictory evidence.").

156. *Id.* ("[P]reliminary evidence that the restraint was instigated by the manufacturer

would have two options for establishing a prima facie case for liability under the quantitative substantiality test. First, the challenger could show (1) that at least 50 percent of sales in the relevant product market were subject to RPM (presumably including sales by manufacturers that have vertically integrated forward into retailing); and (2) that the challenged RPM extended the practice's coverage by at least 10 percent of relevant sales.[157] Alternatively, the challenger could show (1) that the product market at issue is oligopolistic, with a Herfindahl-Hirschman Index (HHI) exceeding 1800;[158] and (2) that the challenged RPM was being implemented by a manufacturer with at least a 10 percent share of the relevant market.[159] If the challenger made either of those two-pronged showings, then the RPM would be deemed illegal unless the defendant could prove either "that the relevant market [was] improperly defined, that consumers' choices have not in fact been significantly limited, ... or that the restraints were necessary to sustain the provision of services valuable to consumers."[160] The second and third of these options would presumably require some sort of proof that the RPM enhanced total sales relative to what they would have been absent the restraint and that the RPM was more efficient than less restrictive means at inducing the dealer services that generated those enhanced sales—the same showing required of defendants under the states' proposed approach.[161]

Like the proposed approaches of the states and the FTC, the rule of reason approach proposed by Comanor and Scherer would over-deter RPM. First, the initial "quick look" is overly broad in its condemnation. A rule that automatically indicts any instance of dealer instigated RPM ignores the fact that such RPM may well be output-enhancing and thus procompetitive. To determine whether

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should trigger a *rule of reason* adjudication. Where a *rule of reason* approach is appropriate, a test of quantitative substantiality should be applied.").

157. *Id.*

158. A market's HHI is determined by summing the squares of the market share percentages of all participants in the market. Thus, a market consisting of six firms with market shares of 20 percent, 20 percent, 20 percent, 20 percent, 10 percent, and 10 percent would have an HHI of 1800 (400 + 400 + 400 + 400 + 100 + 100). *See* POSNER, *supra* note 27, at 70.

159. Comanor/Scherer Brief, *supra* note 149, at 10.

160. *Id.*

161. *See supra* notes 123-26 and accompanying text.

an instance of RPM is procompetitive or anticompetitive, a fact-finder should decide whether *the dominant rationale* for the practice is the manufacturer's interest in enhancing the attractiveness of its products (in which case the RPM is procompetitive) or the dealers' or manufacturer's interest in facilitating collusion or erecting entry barriers (in which case the RPM is anticompetitive). The identity of the party instigating an instance of RPM does not reveal the dominant rationale for the practice.[162] As the Supreme Court has long recognized, dealer complaints about price cutting, low service rivals may induce a manufacturer to impose RPM as a means of encouraging the dealer efforts that will enhance demand for its products.[163] Thus, it is quite possible that an instance of RPM could be *instigated* by a group of dealers but yet *motivated* by the manufacturer's desire to induce dealer promotion and quality enhancement efforts. Such RPM would be procompetitive and should not be automatically condemned.[164]

In addition, the rule of reason Comanor and Scherer would apply to manufacturer initiated instances of RPM is overly prohibitive. Because the initial quick look would have weeded out instances in

162. An analogy may help explain why the identity of the instigating party does not reveal the dominant motivation for the practice. Suppose a homeowner has a large, old tree on the edge of her property. The tree's large branches extend over both the owner's house and her neighbor's fence. When the neighbor discovers that the tree is rotting, he asks the owner to cut it down to protect his fence. While the owner loves the old tree and would rather pay to replace her neighbor's fence than to chop down the tree, she realizes that her failure to remove the tree endangers her own house. She therefore chops down the tree. While her neighbor's complaint/request *instigated* her decision to chop down the tree, it was not the *motivation* for her action. Similarly, although a retailer's (or retailer group's) request for RPM may *induce* a manufacturer to impose such a policy, the request may not be the *motivation* for the policy if the manufacturer adopts it to encourage product promotion efforts.

163. *See* Bus. Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 727-28 (1988) (observing that "price cutting and some measure of service cutting usually go hand in hand"); Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 762 (1984) ("[I]t is precisely in cases in which the manufacturer attempts to further a particular marketing strategy by means of agreements on often costly nonprice restrictions that it will have the most interest in the distributors' resale prices.").

164. As noted, the Comanor/Scherer approach would allow a defendant to avoid condemnation of its RPM following a showing that the restraint was induced by distributors if the defendant presented "credible contradictory evidence." Comanor/Scherer Brief, *supra* note 149, at 9. If the defendant were permitted to discharge this burden by showing that the policy was ultimately *motivated* by manufacturer concerns about dealer efforts, then this initial quick look is less troubling. The approach's narrow focus on the identity of the RPM instigator suggests, however, that evidence concerning ultimate motivation would not save a dealer-initiated instance of RPM from condemnation. *See id.*

which dealer collusion could be afoot,[165] the focus of the rule of reason analysis would be to identify instances of RPM that could be facilitating manufacturer collusion.[166] As explained in greater detail in Part III.B.1, RPM can aid such collusion only when the use of RPM is widespread among the manufacturers competing in a market that is susceptible to collusion because it is concentrated, the product at issue is relatively fungible, and there are substantial barriers to entry.[167]

Both liability tests under the latter part of the Comanor/Scherer approach would presumptively condemn instances of RPM even when the prerequisites for anticompetitive harm—widespread use, concentrated market, fungible product, entry barriers—are not fully satisfied. The first test (RPM covers at least 50 percent of sales and challenged instance would expand coverage by 10 percent)[168] requires widespread use of the practice but does not require that the market at issue be structurally capable of being cartelized. Because one would expect widespread use of RPM precisely when it provides the greatest efficiency benefits, such use should not suffice to establish a prima facie case of illegality. The second test (market is highly concentrated and defendant using RPM has at least 10 percent market share)[169] requires one of the structural factors necessary for cartelization (high concentration) but does not require the other structural prerequisites (entry barriers, fungible product) or that the use of RPM be widespread. Thus, both tests for establishing the presumptive illegality of RPM under the Comanor/Scherer approach would condemn too many instances of the practice. While defendants would have an opportunity to rebut the presumption of illegality, doing so would be difficult for reasons

165. *See supra* notes 151-52 and accompanying text.

166. The post-quick look part of the Comanor/Scherer approach is focused on detecting manufacturer collusion. Comanor/Scherer Brief, *supra* note 149, at 9. It is unsuitable for detecting the potential noncollusion anticompetitive harm created by RPM: the erection of entry barriers by a dominant manufacturer. As explained below, anticompetitive foreclosure from such a use of RPM could occur only if the RPM at issue was likely to induce discrimination against other brands, and the retailers subject to RPM on the defendant's brand constituted a substantial percentage of the available marketing outlets for the product at issue. *See infra* notes 216, 264-65 and accompanying text.

167. *See infra* Part III.B.1.

168. *See supra* text accompanying note 154.

169. *See supra* notes 155-56 and accompanying text.

explained above.[170] The Comanor/Scherer approach would therefore over-deter RPM.

E. The Antitrust Law *Approach*

A fourth structured rule of reason approach for evaluating the legality of minimum RPM is that set forth in the influential *Antitrust Law* treatise.[171] Well before the overruling of *Dr. Miles*, the treatise authors proposed an alternative rule of reason approach that could replace the per se rule.[172]

Under the treatise's approach, a plaintiff could set forth its prima facie case by showing *one* of the following factors:[173]

1. the manufacturer's market is concentrated (HHI > 1200), and RPM arrangements or their equivalent[174] cover a substantial portion of total sales (at least 15 percent);[175]
2. the dealer market is concentrated (HHI > 1200);[176]
3. RPM arrangements or their equivalent are widespread throughout the product market, covering at least 50 percent of sales;[177]
4. the RPM arrangement was dealer initiated, meaning that it was adopted after "demand by dealers acting collectively" (defined as two or more dealers acting in concert or an association of dealers) or a "request by a 'dominant' dealer" (defined as one that accounts for 30 percent of the manufacturer's local or total sales of a

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170. *See supra* notes 123-26, 156-57 and accompanying text.

171. The *Antitrust Law* treatise is so extensively "relied on ... by [antitrust] lawyers and judges that U.S. Supreme Court Justice Stephen Breyer once remarked ... that most lawyers would prefer to have on their side 'two paragraphs of Areeda on antitrust than four Courts of Appeals and three Supreme Court Justices.'" *Langdell's West Wing Renamed in Honor of Areeda*, HARV. GAZETTE, Apr. 25, 1996, *available at* http://www.news.harvard.edu/gazette/1996/04.25/LangdellsWestWi.html.

172. *See* 8 AREEDA & HOVENKAMP, *supra* note 10, ¶ 1633a, at 328-39.

173. *Id.* ¶ 1633e1, at 337.

174. This would include sales by manufacturers that had vertically integrated forward into the retail market.

175. 8 AREEDA & HOVENKAMP, *supra* note 10, ¶ 1633c1(A), at 330.

176. *Id.* ¶ 1633c1(B), at 331. The treatise deems a retailer market concentrated if the HHI exceeds 1200. *See id.* ¶ 1633c1(A), at 330.

177. *Id.* ¶ 1633c1(C), at 331.

brand—local when restraint is employed only in that dealer's locality);[178]

5. the RPM arrangement covers a powerful brand, meaning that the manufacturer's brand comprises at least 30 percent of total sales in the product market;[179]
6. there is a dominant dealer responsible for at least 30 percent of the manufacturer's sales within the area covered by the restraint;[180]
7. the manufacturer imposes the RPM arrangement selectively (in only one or a few geographic markets);[181] or
8. the covered product is homogeneous so that there is an "obvious absence" of any need for special promotional efforts by retailers because the product is not that different than competing brands.[182]

If the plaintiff established that the product at issue is homogeneous so that special promotional efforts are not required (the eighth factor above), then the presumption of illegality would be irrebuttable and the plaintiff would prevail.[183] If the plaintiff instead established its prima facie case by showing any of the other factors, the defendant would have a rebuttal opportunity. The defendant could rebut the presumption of illegality by showing that: (1) it has a legitimate business problem; (2) the problem "is significant in the sense of being nontrivial"; (3) the RPM "is reasonably connected to [the problem's] solution"; and (4) "any less restrictive alternative suggested by the challenger is significantly less effective or significantly more costly."[184]

The defendant's proof burden on these four required showings would differ depending on which anticompetitive concern was implicated by the plaintiff's prima facie case.[185] If the plaintiff's showing suggested an anticompetitive concern other than dealer

178. *Id.* ¶ 1633c1(D), at 331.
179. *Id.* ¶ 1633c1(E), at 331.
180. *Id.* ¶ 1633c1(F), at 331.
181. *Id.* ¶ 1633c1(G), at 331.
182. *Id.* ¶ 1633c1(H), at 331-32.
183. *Id.* ¶ 1633e3(A), at 338.
184. *Id.* ¶ 1633e3(B), at 338.
185. *Id.* ¶ 1633e3(C), at 338.

power, then the defendant would have to prove each of the above elements by a preponderance of the evidence.[186] If the plaintiff's showing instead suggested that excessive dealer power was the sole anticompetitive concern, then the defendant's burden could be lighter.[187] The reason for this discrepancy is that anticompetitive dealer interests, unlike anticompetitive manufacturer interests, "cannot be served by a restraint that is no more restrictive than necessary to serve a legitimate manufacturer interest."[188] Accordingly, if the plaintiff's prima facie case suggested only dealer power as the anticompetitive concern but did not involve a showing of either high dealer concentration (HHI substantially exceeding 1200)[189] or very widespread market coverage (coverage substantially greater than 50 percent)[190], then the defendant would not bear the full burden of *persuasion* on all prongs of its rebuttal.[191]

The authors of the *Antitrust Law* treatise deserve a great deal of credit for proposing a structured rule of reason approach at a time when *Dr. Miles*'s per se rule presided.[192] The treatise's thoughtful proposal for separating procompetitive from anticompetitive instances of RPM likely helped persuade many—including perhaps some current Supreme Court justices—that courts could craft a principled means of policing vertical price restraints under the rule of reason. The specific proposal the treatise sets forth, however, is

186. *Id.* ¶¶ 1633e3(B)-(C), at 338.

187. *Id.* ¶ 1633e3(C), at 338-39.

188. *Id.* ¶ 1633d1, at 334.

189. *See supra* notes 175-76 and accompanying text.

190. *See supra* text accompanying note 177.

191. *Id.* ¶ 1633e3(C), at 338-39. Specifically, if the plaintiff established its prima facie case by showing either (1) dealer concentration or RPM coverage "not much above the threshold of concern" (HHI > 1200; market coverage > 50 percent), *see supra* notes 176-77 and accompanying text, or (2) dealer requests or demands for RPM, *see supra* note 178 and accompanying text, then the plaintiff would bear the burden of persuasion on the first three elements of the defendant's prima facie case. 8 AREEDA & HOVENKAMP, *supra* note 10, ¶ 1633e3(C), at 338-39. The defendant would retain the burden of persuasion on the last element—in other words, it would have to show that any less restrictive alternative proposed by the challenger would be significantly less effective or significantly more costly than RPM. *Id.* If the plaintiff established its prima facie case by showing such weak factors as a large manufacturer or dealer market share or the selective imposition of RPM, *see supra* text accompanying notes 176-77, then the plaintiff would bear the burden of persuasion on all four elements of the defendant's rebuttal case. 8 AREEDA & HOVENKAMP, *supra* note 10, ¶ 1633e3(C), at 339.

192. Volume Eight of the second edition of the treatise, which proposed the aforementioned approach, was published in 2004. *See supra* note 10.

troubling. Besides being remarkably complex,[193] so that courts cannot easily apply it and antitrust counselors cannot confidently predict the judgments it will produce, the approach, like the other proposals considered so far, is overly prohibitive.

Most notably, the approach would automatically condemn minimum RPM on all products a fact-finder determined to be homogeneous.[194] The treatise takes this position because it concludes that product homogeneity "is inconsistent with known legitimate uses of RPM."[195] But that is simply not true. While RPM might be used *to combat free riding* only when the products at issue are so "distinctive" that point of sale consumer services (such as customer education about the product) could enhance demand,[196] the practice could create other procompetitive benefits even if the price restrained products were relatively homogeneous. For example, even a manufacturer of a commoditized product may impose RPM to encourage dealers to take actions that preserve or enhance the product's quality but are not readily observable by consumers.[197] Indeed, evidence suggests that RPM has been used to motivate these sorts of dealer actions (for example, product rotation) on such homogeneous products as nonpremium (Coors brand) beer.[198] The approach advocated in the *Antitrust Law* treatise would thwart this procompetitive use of RPM on any product that a fact-finder might deem to be homogeneous.

With regard to RPM on heterogeneous products, the *Antitrust Law* approach is deficient in that it would too quickly burden the defendant to establish the procompetitiveness of an instance of RPM. In an actual dispute over the legality of RPM, the party

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193. *See, e.g.*, *supra* note 191 (discussing the approach's complicated scheme for allocating proof burdens).

194. 8 HOVENKAMP & AREEDA, *supra* note 10, ¶¶ 1633c3, 1633c3(D), at 333-34.

195. *Id.* ¶ 1633c3(D), at 334.

196. *See supra* notes 49-63 and accompanying text (discussing how RPM may be used to combat free riding on point of sale services).

197. *See supra* notes 64-74 and accompanying text (discussing RPM's use as a device for enforcing unspecified quality control agreements).

198. *See* OVERSTREET, *supra* note 130, at 126 (describing dissertation (Andrew McLaughlin, An Economic Analysis of Resale Price Maintenance (1979) (unpublished Ph.D. dissertation, University of California, Los Angeles) (on file with the University of California, Los Angeles, library)) as concluding that "RPM was an efficient and socially beneficial method of promoting dealer services of refrigeration, and product rotation which enhanced the quality of Coors' unpasteurized beer"); Klein & Murphy, *supra* note 8, at 280-82.

bearing the burden of establishing the presence or absence of procompetitive effect stemming from the instance at issue will likely lose, particularly when the proof requirement includes consideration of less restrictive alternatives (the fourth required prong of the defendant's rebuttal). As the *Antitrust Law* treatise itself recognizes:

> [A less restrictive] alternative can be suggested in virtually every case—for example, that free-riding dealers can be required by contract to render the same services as the full-service dealers. In response, virtually every manufacturer could plausibly say that monitoring price is cheaper and more effective than monitoring the number of each dealer's well-trained demonstrators and the thoroughness and competence of their demonstrations. Experts can be found to assert either side of the cost-effectiveness questions. Only in rare cases will the tribunal be able to reach a confident conclusion. To put the burden of persuasion on the restraint's defenders is to limit greatly the practical availability of any defense—which is increasingly appropriate as the basis for the inference of dangers to competition becomes stronger. To put the burden on the challenger is to make a justification relatively easy to establish.[199]

Although it recognizes that allocation of the burden of proof on procompetitive effect will generally be outcome-determinative, the *Antitrust Law* approach would place the burden on the defendant—thereby effectively sealing its fate—even absent a showing that an instance of RPM could give rise to anticompetitive effects. For example, the mere facts that the manufacturer's market is relatively concentrated (HHI > 1200) and that use of RPM covers greater than 15 percent of total sales (collectively, the first factor that could establish a plaintiff's prima facie case)[200] are far from sufficient to enable RPM to be used as a facilitator of collusion. Yet, a plaintiff's showing of those facts would strap the defendant with a proof burden it likely could not successfully discharge. Similarly, by itself, dealer concentration (the second factor that could establish a plaintiff's prima facie case)[201] could not render RPM a useful

199. 8 AREEDA & HOVENKAMP, *supra* note 10, ¶ 1633d, at 337 (footnote omitted).
200. *See supra* notes 174-75 and accompanying text.
201. *See supra* note 176 and accompanying text.

device for facilitating dealer collusion; either brand dominance or widespread use among manufacturers would also be required.[202] Nonetheless, high concentration in the dealer market would saddle the defendant with the difficult to discharge burden to prove procompetitive effect.[203] Indeed, none of the factors that would individually suffice to make out the plaintiff's prima facie case could, standing alone, permit an anticompetitive use of RPM. Yet, a showing of any single factor (except for the fifth, sixth, and seventh)[204] would shift the proof burden in a way that would make it difficult for a defendant to prevail. Like the aforementioned proposals, this approach would be overly prohibitive and thus overly deterrent.

III. AN ALTERNATIVE APPROACH

While the structured rules of reason that have been considered thus far generally call for consideration of the appropriate factors for evaluating instances of RPM, they are not structured to generate an optimal separation of procompetitive wheat from anticompetitive chaff, for each is overly deterrent. This Part seeks to remedy that deficiency by proposing a rule of reason approach that will both consider the correct factors in evaluating RPM and allocate proof burdens in a manner that will maximize the net benefits of RPM regulation. Subpart A sets forth the general principles that should determine the contours of the rule of reason applicable to minimum RPM. Subpart B then proposes a structured rule of reason that honors those principles.

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202. *See* HOVENKAMP, *supra* note 39, § 11.2b, at 449 ("RPM ... can be evidence of retailer collusion only if 1) the manufacturer imposing the restriction is a monopolist in the retailer's area; or 2) the restriction is used by a very high percentage of the manufacturers in the market.").

203. *See supra* notes 183-86 and accompanying text.

204. If the plaintiff's prima facie case were based on a weak showing (that is, a showing of one of these factors), the plaintiff would bear the burden of persuading the fact-finder of the *absence* of any procompetitive rationale proffered by the defendant. *See supra* note 191.

A. Principles Governing Rule Selection

Socially optimal antitrust rules are those that minimize the sum of decision costs and error costs.[205] In the context at hand, decision costs are the costs that must be incurred to reach a decision on the legality of a challenged instance of RPM. They are a function of a rule's informational requirements and the ease with which it can be applied. Error costs consist of the allocative inefficiencies resulting from wrongly permitting instances of anticompetitive RPM (the costs of false acquittals) and the efficiency losses resulting from improperly deterring procompetitive instances of RPM (the costs of false convictions).[206] They are a function of (1) the probability that the proffered rule will reach an incorrect judgment and (2) the magnitude of loss that will result from that error. In crafting a structured rule of reason for RPM, then, courts should take account of the likelihood of incorrect judgments, the magnitude of losses from various errors, and the difficulty of administering the rule.

1. Likelihood of Incorrect Judgments

To gauge an evaluative approach's chances of reaching incorrect judgments, courts should begin by considering whether RPM is more often procompetitive or anticompetitive. Economic theory, empirical evidence, and retailing trends suggest that procompetitive uses of the practice will dominate. All else being equal, then, the governing rule should acquit more often than it convicts.

a. Economic Theory

The preconditions for procompetitive uses of RPM, unlike those for anticompetitive strategies, are frequently satisfied. RPM may be used to ensure point of sale services that might be the subject of free riding whenever dealer provided services enhance demand for a manufacturer's product and the services at issue are susceptible to free riding (because, for example, dealers are located within close

205. *See* Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 16 (1984).

206. *See id.*; *see also* Keith N. Hylton & Michael Salinger, *Tying Law and Policy: A Decision-Theoretic Approach*, 69 ANTITRUST L.J. 469, 498-501 (2001) (explaining error cost framework).

proximity of each other).[207] RPM may provide an optimal means of ensuring dealer performance of unspecified agreements whenever dealer activities would enhance the attractiveness of a manufacturer's offerings and the quality enhancing activities are difficult to delineate in advance or to monitor.[208] RPM may facilitate entry whenever a new producer seeks to gain access to or promotion by retail outlets that already stock and provide favorable shelf space to well-established brands.[209] And RPM may used to stem the potential price volatility that inhibits retailers from carrying untested goods whenever consumer demand for a new product is unknown.[210] Because these various conditions quite often exist, procompetitive rationales for instances of RPM are frequently plausible.

The preconditions for anticompetitive uses of RPM, by contrast, are rarely satisfied. For RPM to facilitate a dealer cartel, dealers must seek the policy and the manufacturer must be willing to impose it.[211] Dealers will not seek the policy if a supracompetitive price for the manufacturer's product would induce a significant number of customers to switch to another brand.[212] Such demand substitution would presumably occur unless switching was difficult because either (1) the manufacturer has market power in the market for the product subject to RPM, or (2) most of the manufacturer's competitors similarly impose RPM. Thus, one of those criteria must be satisfied for dealers to seek RPM.[213] A manufacturer is likely to comply with such a request (which would likely increase retail margins, thus reducing the manufacturer's total sales without increasing its per unit profits) only if the manufacturer lacks alternative means of distributing its products. That will be the case only if (1) there is not a sufficient number of other

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207. *See supra* Part I.B.1.a.

208. *See supra* Part I.B.1.b.

209. *See supra* Part I.B.2.

210. *See supra* Part I.B.3.

211. *See generally* HOVENKAMP, *supra* note 39, § 11.2b, at 449-51 (explaining that dealers must seek, and manufacturers must consent to, RPM if it is to be used to facilitate dealer collusion).

212. *See id.* § 11.2b, at 449 ("If the manufacturers in the market have no market power, then the retailers of any single manufacturer could not raise the price of the manufacturer's product to monopoly levels. Customers would switch to a different brand.").

213. *Id.* (observing that precondition for dealers' seeking RPM is that either "1) the manufacturer imposing the restriction is a monopolist in the retailer's area; or 2) the restriction is used by a very high percentage of the manufacturers in the market").

retailers to distribute the manufacturer's product, or the cost of switching to those retailers is high, and (2) forward integration into product distribution is not feasible.[214]

For RPM to facilitate a manufacturer cartel, the market in which the manufacturer participates must be susceptible to cartelization, and the use of RPM must be widespread enough to assist with the collusion. Anticompetitive harm from the facilitation of a manufacturer cartel therefore is unlikely unless: (1) the manufacturer market is concentrated,[215] (2) the product at issue is fairly fungible,[216] (3) there are entry barriers into the manufacturer market,[217] and (4) RPM is used by manufacturers comprising a substantial portion of the market.[218]

For RPM to create an entry barrier that effectively forecloses the manufacturer's rivals from the market, the margin guaranteed to dealers must be large enough to induce them to drop, or to refrain from promoting, competing brands. Moreover, the RPM must be imposed so broadly that it generates significant foreclosure of rivals (in other words, the rivals cannot have access to other acceptable channels of distribution).[219] Given the ubiquity of discount retailers, who compete with each other primarily on price and would be unlikely to forego carrying a lower priced product in exchange for a higher margin,[220] these conditions will rarely be satisfied.

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214. *Id.* § 11.2b, at 451 (discussing situations in which manufacturers may have difficulty rejecting retailer demands for RPM).

215. *See* POSNER, *supra* note 27, at 66 ("Some degree of concentration thus appears to be a necessary condition of successful collusion in markets subject to the Sherman Act.").

216. *See id.* at 75 ("The less standardized (more customized) a product is, ... the more difficult it will be for the sellers of the product to collude effectively. The heterogeneity of the orders will make it impossible for the sellers to agree upon a single price for all orders.").

217. *See id.* at 72-75.

218. *See* HOVENKAMP, *supra* note 39, § 11.2b2, at 453 ("The manufacturers' cartel will work, however, only if its members collectively control enough of the market to wield monopoly power.").

219. *See* Elzinga & Mills, *supra* note 26, at 7 (observing that the RPM-augmented foreclosure theory "cannot apply where manufacturing competitors and entrants retain access to the market via competing retailers or alternative channels of distribution. Nor can it apply where the manufacturer using RPM does not control a large share of the relevant market in spite of using this practice.").

220. *See infra* notes 237-48 and accompanying text.

b. Empirical Evidence

Consistent with economic theory, the somewhat sparse empirical evidence on RPM's competitive effects suggests that most instances of RPM are procompetitive. In a 1983 Bureau of Economics Staff Report to the FTC, report author Thomas R. Overstreet examined RPM's competitive effect by analyzing all FTC RPM cases from mid-1965 to the end of 1982[221] and cataloguing the then-existing empirical studies of RPM.[222] Overstreet's report suggests that most instances of RPM are not anticompetitive. With respect to the RPM in the FTC cases, which he took to be representative of instances of RPM generally,[223] Overstreet concluded that most occurred in markets that could support neither manufacturer nor dealer collusion.[224] While Overstreet provided a more equivocal summary of his findings from the survey of empirical studies,[225] close examination of those findings suggests that they cannot support the view that RPM is, more often than not, anticompetitive.[226]

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221. OVERSTREET, *supra* note 130, at 63-82.

222. *Id.* at 106-63.

223. *Id.* at 81 ("[T]he structural 'snapshot' of the 1950's, comparing fair-trade markets to all manufacturing markets, combined with our finding that recent FTC RPM cases have involved markets which structurally are distributed in about the same way as are all manufacturing markets, suggests that the FTC case sample may provide a fairly reasonable basis for drawing some limited general conclusions.").

224. *Id.* at 71-76 (discussing lack of manufacturer concentration in markets in which RPM was challenged); *id.* at 80 ("[O]f the 47 cases with data on the number of distributors, over 80 percent involved in excess of 200 dealers. Widespread dealer collusion involving more than 100 (or 200) decision makers seems unlikely to be effective or persistent in the absence of restrictions on entry ... or some mechanism for overt coordination ...."); *id.* at 81 (concluding that "[i]t is unlikely that there is effective manufacturer coordination featuring RPM in all or even most of these markets" and that "available information also suggests that the use of RPM is unrelated to widespread dealer collusion in most instances"); *see also* Stanley I. Ornstein, *Resale Price Maintenance and Cartels*, 30 ANTITRUST BULL. 401, 431 (1985) (analyzing Justice Department and FTC cases and concluding that vertical restraints may have been used to support manufacturer cartels in only 36 percent of the cases). *But see* 8 AREEDA & HOVENKAMP, *supra* note 10, ¶ 1606f, at 91 (criticizing Ornstein's study).

225. OVERSTREET, *supra* note 130, at 163 ("Theory suggests that RPM can have diverse effects, and the empirical evidence suggests that, in fact, RPM has been used in the U.S. and elsewhere in both socially desirable and undesirable ways.").

226. In surveying the empirical studies of RPM, Overstreet examined price surveys (that is, studies examining the effect of RPM on consumer prices), *id.* at 106-19, a number of case studies, *id.* at 119-29, two prior FTC studies of RPM, *id.* at 129-48, and several accounts of the use of RPM in foreign countries, *id.* at 149-60. As Overstreet explained, price surveys are inapposite to the question of whether RPM has procompetitive or anticompetitive effects,

Examination of litigated RPM cases suggests that most instances of RPM are, in fact, procompetitive. In a 1991 study, Pauline Ippolito examined all 203 reported cases of RPM from 1975 through

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because higher prices are consistent with both. *Id.* at 106, 116-17, 160.

With respect to the case studies, Overstreet concluded that "[t]he probable effects indicated from the case studies are that RPM sometimes reduces and sometimes enhances social welfare." *Id.* at 129. It seems, however, that the reduction of social welfare to which Overstreet refers generally was not occasioned by facilitation of collusion but instead by the provision of "excessive" retailer services. *See supra* notes 87-89 and accompanying text (explaining how output enhancing services might be deemed "excessive"). Only two of the eleven case studies Overstreet examined suggested a collusive explanation for RPM. OVERSTREET, *supra* note 130, at 130-40 (summarizing case studies of RPM on light bulbs (two studies), china, televisions, jeans (two studies), shoes, stereo components, beer, bread, and various products sold in Rhode Island—finding evidence of collusion in only one of the light bulb studies and the bread study). By contrast, six suggested that use of the practice may have been procompetitive. *Id.* (finding some evidence of procompetitive effect from use of RPM on china, jeans, shoes, stereo components, beer, and various products in Rhode Island).

The two prior FTC studies Overstreet examined did not conclude that RPM is anticompetitive more often than not. In the first, submitted to Congress in two parts in 1929 and 1931, the Commission surveyed manufacturers, wholesalers, retailers, consumers, and economists as to their perceptions of the advantages and disadvantages of RPM. OVERSTREET, *supra* note 130, at 129-34 & nn.1-2. The results were mixed. *Id.* at 134 ("The conclusion which it now seems warranted to draw from this inquiry is that some advocates of RPM were motivated by efficiency considerations, and others were not."). The second study, submitted to Congress in 1945, considered price and volume effects following the imposition of RPM in regions where it was permitted. *Id.* at 135-48. Price effects and effects on volume per retail outlet are irrelevant to the competitive analysis because price increases and reductions in per-retailer volume can be consistent with procompetitive effects. *Id.* at 140. Effect on manufacturer sales volume is relevant, but the data on that point were inconclusive. *Id.* The 1945 study also included a detailed account of the involvement of various trade groups in advocating for "Fair Trade" laws (that is, state laws insulating RPM from liability and federal statutes authorized such state laws from 1937 to 1975, *see* Miller-Tydings Act 50 Stat. 693, 15 U.S.C. § 1 (1937); McGuire Act, 66 Stat. 631, 15 U.S.C. § 45 (1952); Consumer Goods Pricing Act of 1975, Pub. L. 94-145, 89 Stat. 801 (1975)) and seeking imposition of RPM. OVERSTREET, *supra* note 130, at 140-44. The study found that some, but not all, retailer associations were successful at persuading manufacturers to impose RPM. *Id.* Given the degree to which some retailers had taken the lead in seeking RPM under Fair Trade, the 1945 study concluded that the Fair Trade statutes and RPM were contrary to the public interest. *Id.* at 144-48. It highlighted particular aspects of state fair trade statutes that made them particularly useful as devices for facilitating retailer collusion. *Id.* at 146-47. Notably, those specific statutory defects do not exist under the post-*Leegin* regime, which simply brings RPM under the rule of reason. *Id.* at 148.

Finally, Overstreet considered evidence that retailer groups in foreign countries had attempted to utilize RPM to achieve collusive ends. *Id.* at 149-57. Because he did not consider possible procompetitive effects from the use of RPM in those foreign countries, this portion of his report is not probative of the degree to which RPM is generally procompetitive or anticompetitive.

1982.[227] Ippolito reasoned that the prohibition against RPM was most strict during those years,[228] so one would expect firms to attempt RPM only when they expected it to be especially profitable.[229] By looking at the theories asserted in the 203 litigated cases, Ippolito sought to determine *why* RPM was perceived by manufacturers to be so profitable (that is, in how many cases might the profitability of the practice have stemmed from its facilitation of collusion?).[230] Because price fixing is per se illegal, Ippolito hypothesized that "if the plaintiff had any evidence that the practice at issue in the litigation was used to support collusion, we would expect to see horizontal price-fixing allegations in these cases, in addition to the RPM allegation."[231]

As it turned out, allegations of horizontal collusion were rare, as "[o]nly 9.8 percent of the private cases and 13.1 percent of the entire sample of cases included allegations of dealer or [manufacturer] collusion."[232] By contrast, a number of the cases featured characteristics that were more consistent with procompetitive uses of RPM than with anticompetitive collusion. For example, up to 65 percent of the private cases and up to 68 percent of the government cases involved products for which consumer demand would likely be significantly affected by the provision of "special services" susceptible to free riding.[233] Approximately 43 percent of the private cases and 28 percent of the government cases involved products for which the dealer's role in product quality determination is important.[234] And in twenty-four of the twenty-eight "simple good[s]" cases (in which special services are not as likely to be demand enhancing),

227. Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & ECON. 263, 266-67 (1991).

228. *Id.* at 266. This was the period after Fair Trade laws were revoked (so all RPM was per se illegal) and before the Supreme Court decided *Monsanto Co. v. Spray-Rite Corp.*, 465 U.S. 752 (1984), which increased the difficulty of establishing the agreement element of a Section One violation premised on RPM. See Ippolito, *supra* note 227, at 266 n.12 (discussing *Monsanto*).

229. *Id.* at 264.

230. *Id.* at 265.

231. *Id.* at 281.

232. *Id.*

233. *Id.* at 282-85.

234. *Id.* at 285-89.

the facts were consistent with the use of RPM to enhance dealers' sales efforts.[235] Based on these findings, Ippolito concluded:

> While clearly limited by the information available in the case opinions, this analysis does not indicate that collusion is the primary explanation for the RPM-type practices at issue in either the private-case sample or in the combined private- and government-case sample .... Based on an analysis of the products and the types of dealers in the cases, service- and sales-enhancing theories, taken together, appear to have greater potential to explain the practices.[236]

c. Retailing Trends

Trends in American retailing suggest that anticompetitive uses of RPM are even less likely now than they were during the periods analyzed by Overstreet and Ippolito. In the last couple of decades, large discount retailers have proliferated throughout the United States. Consider, for example, the nation's largest retailer (and the world's largest company by revenue), Wal-Mart Stores, Inc.[237] Wal-Mart's domestic retail stores, branded as Wal-Mart Discount Stores, Wal-Mart Supercenters, Sam's Clubs, and Neighborhood Markets,[238] are notoriously focused on offering consumers the lowest possible prices, albeit with few retail amenities. In 1970, there were only thirty-eight Wal-Mart outlets in the United States.[239] By 1975, that total had grown to 125, and by 1985, it stood at 882.[240] As of 1995, Wal-Mart operated a total of 2667 domestic units,[241] and by the end of August 2008, the number of domestic units had grown to 4227.[242] And, of course, Wal-Mart faces competition from numerous other

235. *Id.* at 289-91.
236. *Id.* at 291-92.
237. *See* Global 500, FORTUNE, June 21, 2008, *available at* http://money.cnn.com/magazines/fortune/global500/2008/full_list.
238. *See* History Timeline, http://walmartstores.com/AboutUs/7603.aspx (last visited Jan. 23, 2009).
239. *Id.*
240. *Id.*
241. Those 2667 domestic units consisted of 1995 discount stores, 239 Supercenters, and 433 Sam's Clubs. *Id.*
242. *See* Unit Count and Square Footage, http://walmartstores.com/Investors/ 7610.aspx (last visited Jan. 23, 2009).

discount retailers that also attempt to woo customers by offering low prices.[243]

Not only have the large discount retailers increased their presence throughout the United States, they also have expanded their product offerings. Beginning in the late 1980s, the major national discounters, along with a number of other discounters, began operating so-called "hypermarkets," enormous retail stores carrying a vast range of products under one roof, including full lines of groceries and general merchandise. Thus, large discount retailers, which compete primarily on price and would be unlikely to alienate their core customers by demanding that manufacturers set minimum retail prices, have become both more ubiquitous and more expansive in their product offerings since the studies by Overstreet and Ippolito. Given these retailers' prominence and breadth of offerings, most manufacturers confronted with a demand for RPM from a dominant dealer or group of dealers would have the option of refusing that demand and distributing their products through the major discounters' well-established networks.

Thus, Justice Breyer likely erred in his *Leegin* dissent when he pointed to retailing trends to suggest that anticompetitive harms from RPM are becoming *more* likely. Justice Breyer reasoned that "[c]oncentration in retailing has increased .... That change, other things being equal, may enable (and motivate) more retailers, accounting for a greater percentage of total retail sales volume, to seek resale price maintenance, thereby making it more difficult for price-cutting competitors (perhaps internet retailers) to obtain market share."[244]

As a purely logical matter, increased retailer concentration *may* do many things.[245] Justice Breyer's decision to focus on the potential

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243. Among the largest of Wal-Mart's competitors are Target Corp., which operates 1591 discount stores (including 231 SuperTarget locations) in the United States, *see* Target, Corporate Overview, http://investors.target.com/phoenix.zhtml?c=65828&p=irol-homeprofile (last visited Jan. 23, 2009), and Sears Holdings Corp., which operates approximately 1400 Kmart discount stores in the United States, *see* Kmart At A Glance, http://www.kmartcorp.com/corp/story/general/kmart_glance.stm (last visited Jan. 23, 2009).

244. Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705, 2733 (2007) (Breyer, J., dissenting).

245. It may, for instance, reduce retailer margins as retailers attain productive efficiencies that accompany increased scale. *Cf.* MICHAEL BERGDAHL, WHAT I LEARNED FROM SAM WALTON: HOW TO COMPETE AND THRIVE IN A WAL-MART WORLD 113-30 (2004) (discussing Wal-Mart's extensive "expense control strategies and tactics," many of which are facilitated by its

downside—increased retailer efforts to attain RPM—may be a vestige of the largely discredited structure-conduct-performance ("S-C-P") paradigm, which held that a market's structure determines the participants' conduct, which in turn determines market performance.[246] Justice Breyer seemed to assume that a more concentrated retailer market would inevitably involve greater efforts to collude. Absent from Justice Breyer's analysis, though, was any consideration of the *composition* of the more concentrated retailer market. Justice Breyer referred to evidence that "the combined sales of the 10 largest retailers worldwide has grown to nearly 30% of total retail sales of top 250 retailers,"[247] but he failed to mention that the six American retailers in the global top ten are Wal-Mart, Home Depot, Kroger, Target, Costco, and Sears Holdings (the operator of Kmart stores).[248] All of those retailers are vigorous price competitors, and four of them—Wal-Mart, Target, Costco, and Sears (operating as Kmart)—have positioned themselves as low-price discounters. It is highly unlikely that they have the motivation, much less the ability, to pressure manufacturers to impose RPM, and their growth and expansion of product offerings reduces the chance that any manufacturer will find itself without access to efficient retailers that are willing to compete on consumer prices. Thus, the use of RPM to facilitate retailer-level collusion is increasingly unlikely.

Moreover, as discount retailers consolidate and gain a larger proportion of retail distribution, manufacturer-level collusion becomes less likely. Given the breadth of their store networks, large discount retailers offer manufacturers especially attractive distribution outlets. The prospect of tremendous sales through a massive discount retailer chain would create a constant temptation for any participant in a manufacturer-level cartel to secure placement in the chain by cheating on the fixed price. That temptation grows (and, conversely, the chance of successful manufacturer collusion shrinks)

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scale).

246. *See generally* HOVENKAMP, *supra* note 39, § 1.7 at 42-47 (describing "the troubled life of the structure-conduct-performance paradigm").

247. *Leegin*, 127 S. Ct. at 2733 (Breyer, J., dissenting) (citing DELOITTE & TOUCHE LLP, 2007 GLOBAL POWERS OF RETAILING (2006), *available at* http://www.deloitte.com/dtt/cda/doc/content/2007_Global_Powers_of_Retailing(3).pdf [hereinafter DELOITTE STUDY]).

248. *See* DELOITTE STUDY, *supra* note 247, at 7 (listing global top ten retail leaders). Sears Holdings operates Kmart discount stores. *See* Kmart, *supra* note 243.

as discount retailers comprise a larger proportion of total retail sales. Justice Breyer thus erred by focusing only on the concentration in retailing without accounting for the low price focus of the more concentrated retailers.

It seems, then, that economic theory, empirical evidence, and retailing trends all suggest that more instances of RPM will be procompetitive than anticompetitive. The governing rule of reason should take care not to condemn too many instances of a practice that one would expect, more often than not, to be procompetitive.

2. Magnitude of Losses from Errors

When the liability rule governing a business practice misfires, social cost results. If an application of the rule wrongly acquits a practice that is harmful on balance, the social cost consists of the net harm from that instance of the behavior plus the future harm that will be sanctioned by the legal precedent approving of the harmful conduct at issue. Conversely, when a rule wrongly convicts a practice that is beneficial on balance, the social cost consists of the net benefit foregone by stopping the challenged instance of the behavior plus the future benefits that are thwarted because of the precedent condemning that type of beneficial conduct.

In antitrust, where the harm from a wrongful *acquittal* is an increase in market power, and the harm from a wrongful *conviction* is the widespread thwarting of beneficial business practices, these harms are likely to be incommensurate.[249] The harm from wrongful conviction will generally outweigh the harm from wrongful acquittal. This is true because the harm from false acquittal—market power—is generally self-correcting by entry or, in the case of collusion, cheating. By contrast, the harm from false conviction—economy-wide thwarting of a beneficial practice—may be undone only by a court decision (or legislative or regulatory development) that corrects the bad precedent.[250]

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249. Easterbrook, *supra* note 205, at 2 ("A fundamental difficulty facing the [antitrust] court is the incommensurability of the stakes.").

250. As Judge Easterbrook explained:

> If the [antitrust] court errs by condemning a beneficial practice, the benefits may be lost for good. Any other firm that uses the condemned practice faces sanctions in the name of stare decisis, no matter the benefits. If the court errs by

This analysis argues in favor of a rule of reason that, if it errs, does so more often in the direction of false acquittals than false convictions. The harm from a false acquittal—approving RPM that could either support collusion or help to maintain a product monopoly subject to the perpetual threat of entry—would probably be less severe than the harm from an economy-wide condemnation of a practice that encourages output-enhancing conduct by dealers.

3. Difficulty of Administering the Rule

In order to minimize the costs of administration, the governing rule of reason should focus the liability test so that the parties and the court know precisely what facts are outcome determinative.[251] In addition, the rule should clearly allocate proof burdens so that the appropriate outcome is clear upon a failure of proof. The rule should also provide clear guidance to business planners so that they can easily assess the liability risk associated with various courses of action. If possible, it should provide safe harbors for conduct that presents a very low risk of anticompetitive harm.[252] Finally, to the extent that it can do so without significantly increasing error costs, the rule should put the burden of production on the party to whom the information is most easily accessible.[253]

> permitting a deleterious practice, though, the welfare loss decreases over time. Monopoly is self-destructive. Monopoly prices eventually attract entry. True, this long run may be a long time coming, with loss to society in the interim. The central purpose of antitrust is to speed up the arrival of the long run. But this should not obscure the point: judicial errors that tolerate baleful practices are self-correcting, while erroneous condemnations are not.

Id. at 2-3.

251. Such focusing will reduce administrative costs by preventing parties from gathering, and courts from examining, irrelevant facts.

252. *Cf.* Thomas A. Lambert, *Evaluating Bundled Discounts*, 89 MINN. L. REV. 1688, 1741-42 (2005) (discussing the value of clear guidance to business planners and reliable safe harbors).

253. Tension may arise between the need to place the burden of production on the party to whom the information is most accessible and the need to allocate proof burdens in a manner that will minimize error costs. For example, if (as with minimum RPM) procompetitive uses of a practice are more common than anticompetitive uses and the costs of false conviction exceed those of false acquittal, the burden of proving facts suggesting anticompetitive potential generally should be on the plaintiff. If, however, some of the information relevant to determining anticompetitive potential is more accessible to the defendant, administrative cost concerns would call for placing the burden of production on that party. To determine which concern should govern, the court should assess whether the

B. The Proposed Rule

In light of the foregoing analysis, a burden shifting regime tilted somewhat in favor of the defendant would likely minimize the sum of error costs from false acquittals and false convictions while keeping administrative costs in check. Under this regime, the party challenging an instance of RPM would bear the initial burden: (1) to produce direct evidence of competitive harm by showing that the challenged instance of RPM had caused a reduction in output, or (2) to produce circumstantial evidence of competitive harm by showing that the prerequisites to such harm were satisfied. Once the challenger had made such a showing, the defendant manufacturer could avoid liability only by showing that the challenger failed to discharge its initial proof burden or by offering an affirmative defense. Such a defense would consist of a showing that the challenged practice was, in fact, procompetitive. If the defendant made such an affirmative defense, the challenger could prevail only if it established that the procompetitive benefits claimed by the defendant were likely illusory. The following discussion fleshes out the details of the plaintiff's prima facie case, the defendant's rebuttal opportunity, and the responses available to the plaintiff.

1. Plaintiff's Prima Facie Case

Because most instances of minimum RPM are procompetitive[254] and the harms from a false conviction are likely to exceed those from a false acquittal,[255] the party challenging an instance of RPM should bear the initial burden to produce evidence that the challenged practice is, or is likely to be, output-reducing. The challenger could take either a "direct" or a "circumstantial" approach to discharging that burden. Under the direct approach, the challenger would produce evidence that the RPM at issue had, in fact, reduced the manufacturer's output of the relevant product relative to what

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enhanced error costs from placing the proof burden on the defendant are likely to exceed the administrative cost savings. The burden should be allocated so as to minimize the likely sum of error and decision costs.

254. *See supra* Part III.A.

255. *See supra* notes 249-50 and accompanying text.

it would have been absent the price restraint.[256] For example, the challenger could show (1) that the manufacturer's output declined following imposition of RPM, and (2) that the decline cannot be explained by other factors (such as an economy-wide recession or the introduction of a competing product). Given the difficulty of the latter showing, which would be an indispensable part of a challenger's direct prima facie case,[257] most challengers would likely opt to discharge their initial proof burden circumstantially.

Under the circumstantial approach, the challenger would bear the burden of establishing a significant possibility that anticompetitive harm could stem from the challenged RPM. To do so, the plaintiff would need to show that the factual prerequisites were satisfied for at least one of the three types of anticompetitive harm that may result from RPM (dealer collusion, manufacturer collusion, or market foreclosure).[258]

a. Circumstantial Dealer Collusion Theory

RPM can be used to enhance dealer collusion only if dealers seek RPM as a cartel facilitator and the manufacturer, who generally benefits from the lowest possible dealer margins, complies with their demand.[259] Thus, in order to establish a circumstantial prima facie case on a dealer collusion theory, the plaintiff would have to prove that dealers would be likely to seek RPM for collusive purposes and that the manufacturer would be inclined to honor

256. Judge Posner has advocated this direct approach to determining whether a vertical restraint is anticompetitive. *See* Posner, *supra* note 80, at 21; Richard A. Posner, *The Rule of Reason and the Economic Approach: Reflections on the* Sylvania *Decision*, 45 U. CHI. L. REV. 1, 18-19 (1977).

257. *See* Posner, *supra* note 80, at 21 (noting that this method "requires controlling for the effects on the firm's output of exogenous factors, that is, those unrelated to the challenged practice itself," and observing that the statistical methods involved "are not foolproof in application, nor are they easy for judges and juries to understand").

258. Herbert Hovenkamp, co-author of the *Antitrust Law* treatise, *see supra* notes 171-204 and accompanying text, has elsewhere suggested the sort of circumstantial approach proposed here. *See* HOVENKAMP, *supra* note 39, § 11.7d, at 493-95. Hovenkamp's latter approach involves a more stringent prima facie case than that set forth in the *Antitrust Law* treatise. *Compare* 8 AREEDA & HOVENKAMP, *supra* note 10, ¶ 1633, at 328-39, *with* HOVENKAMP, *supra* note 39, § 11.7d, at 493-95.

259. *See generally* HOVENKAMP, *supra* note 39, § 11.2, at 448-51 (explaining that dealers must seek, and manufacturers must consent to, RPM if it is to be used to facilitate dealer collusion).

their request. To establish dealer interest in RPM as a cartel facilitator, the challenger would need to prove that:

1. the dealer market is susceptible to cartelization because (a) it is relatively concentrated, *and* (b) there are substantial entry barriers;[260] and
2. either (a) the manufacturer has market power in the market for the price-restrained product, *or* (b) RPM is common among manufacturers of that product.[261]

To establish manufacturer willingness to comply with a dealer demand for RPM, the plaintiff would need to prove that it would be difficult for the manufacturer to resist that demand. Accordingly, the challenger would need to show that:

1. the dealer or group of dealers seeking RPM comprises a substantial proportion of reasonably available marketing outlets;[262] and
2. forward integration into the dealer market would be impracticable for the manufacturer.[263]

Absent all four showings, a plaintiff could not establish a substantial possibility that the challenged RPM could facilitate dealer collusion.

b. Circumstantial Manufacturer Collusion Theory

Manufacturers are unlikely to impose RPM to facilitate a manufacturer cartel unless the market in which they participate is

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260. This first two-pronged showing is required because dealers presumably would not seek RPM to facilitate collusion in a market that is insusceptible to cartelization.

261. One of these two showings is required because dealers will not seek to raise consumer prices through the imposition of RPM if such higher prices are likely to drive consumers to competing brands of the product at issue.

262. If the dealers demanding imposition of RPM do not collectively comprise a substantial proportion of reasonably available marketing outlets, the manufacturer asked to impose RPM (and thereby raise dealer margins) would likely resist that demand. If the requesting dealers dropped the manufacturer's products, the manufacturer would be able to make up for those dealers' lost sales by increasing its sales through other dealers. The demanding dealers thus would have little leverage to demand imposition of RPM.

263. A manufacturer that could easily integrate forward into retailing could not be coerced easily by dealer demands to impose RPM. One situation in which forward integration into retailing is likely to be impracticable is when the manufacturer's product is not amenable to single-product distribution and is more likely to be purchased from a multi-product retailer. *See* HOVENKAMP, *supra* note 39, § 11.2b, at 451.

capable of being cartelized. Moreover, RPM cannot serve as an effective facilitator of manufacturer collusion unless it is utilized by the bulk of the manufacturers in the market. Accordingly, a challenger seeking to state a circumstantial prima facie case based on a manufacturer collusion theory should have to show that:

1. the manufacturer market is concentrated;[264]
2. the product upon which RPM is imposed is relatively fungible;[265]
3. there are substantial entry barriers into the manufacturer's market;[266] and
4. the use of RPM is widespread among manufacturers of the product.[267]

c. Foreclosure Theory

The theory that RPM may cause anticompetitive foreclosure assumes that the manufacturer imposes RPM, thereby guaranteeing a minimum retail markup on its brand, as a "carrot" aimed at inducing retailers not to carry or promote rival brands of the product at issue. In order to make out a prima facie case for liability on a foreclosure theory, a party challenging an instance of RPM should have to prove that:

1. the RPM at issue was likely to induce such discrimination against other brands; and

264. Markets containing numerous nonfringe sellers are difficult to cartelize. *See* POSNER, *supra* note 27, at 66 ("Some degree of concentration thus appears to be a necessary condition of successful collusion in markets subject to the Sherman Act.").

265. Because of the need to adjust consumer prices to account for differences in features, quality, etc., it is difficult to fix prices on nonfungible products. *See id.* at 75 ("The less standardized (more customized) a product is, ... the more difficult it will be for the sellers of the product to collude effectively. The heterogeneity of the orders will make it impossible for the sellers to agree upon a single price for all orders.").

266. Because supracompetitive prices attract entry that can render a price fixing scheme unprofitable, price fixing is difficult in markets with low entry barriers. *See id.* at 72-75.

267. In order for RPM to substantially facilitate a manufacturer cartel, by either dissuading cartel participants from cheating or making their cheating more visible, it must be in widespread use among the colluders. *See* HOVENKAMP, *supra* note 39, § 11.2b2, at 453 ("The manufacturers' cartel will work, however, only if its members collectively control enough of the market to wield monopoly power.").

2. the retailers subject to RPM on the defendant's brand constitute a substantial percentage of the available marketing outlets for the product at issue.[268]

The plaintiff could establish the first prong by showing either that the manufacturer required exclusive dealing in exchange for the RPM or that dealers carrying the defendant's price restrained brand generally do not carry other brands. With respect to the second prong, "substantial" foreclosure of marketing opportunities should resemble the level of foreclosure required to establish liability for exclusive dealing, which threatens a similar sort of anticompetitive effect.[269]

2. Defendant's Rebuttal Opportunity

Once the plaintiff produced evidence that the challenged RPM resulted in reduced output (the direct approach) or that the prerequisites to one of the aforementioned theories of anticompetitive harm were satisfied (the circumstantial approach), the defendant would have two arrows in its quiver. First, the defendant could attempt to show that the evidence produced did not establish the challenger's prima facie case. If the challenger had taken the direct approach of showing an actual output reduction, the defendant could attack the challenger's evidence attributing reduced output to the imposition of RPM.[270] If the challenger had instead pursued the circumstantial approach, the defendant could show that one of the prerequisites to anticompetitive harm had not been proven. Because the challenger should bear the full burden of proof on its prima facie case, the defendant would prevail if it convinced the fact-finder that there was a deficiency in the challenger's evidence.

268. *See* Elzinga & Mills, *supra* note 26, at 7 (observing that the RPM-augmented foreclosure theory "cannot apply where manufacturing competitors and entrants retain access to the market via competing retailers or alternative channels of distribution. Nor can it apply where the manufacturer using RPM does not control a large share of the relevant market in spite of using this practice.").

269. *See* HOVENKAMP, *supra* note 39, § 10.9a, at 436-37 (discussing anticompetitive foreclosure effect of exclusive dealing); *id.* § 10.9e, at 441-45 (discussing foreclosure levels required to establish liability based on exclusive dealing).

270. For example, the defendant could show that the challenger failed to account for the effects of exogenous factors on output. *See* Posner, *supra* note 80, at 21.

In addition, the defendant could mount an affirmative defense. The type of defense would vary based on the nature of the plaintiff's prima facie case (direct or circumstantial). To counter a challenger's direct showing of an actual output reduction, the defendant would have to produce its own evidence (that is, an alternative study) showing that its output was enhanced, not reduced, by the imposition of RPM. To counter a circumstantial prima facie case, the defendant could show that the RPM at issue had a procompetitive effect. It could make that showing by demonstrating (1) that it faced a significant business problem (for example, free riding on the provision of dealer services, difficulty in contracting over dealer performance, unpredictable demand, a need to gain new entry); and (2) that the RPM at issue was used to remedy that problem.[271]

3. Responses Available to Challenger

If the challenger took the direct route in establishing its prima facie case, and the defendant affirmatively defended by producing its own study showing an output enhancement, the task would fall on the finder of fact to determine which of the parties offered the more persuasive account. If the fact-finder concluded that the evidence weighed in favor of the challenger's claim that RPM caused a reduction in the defendant's total output, then the challenger should prevail; if not, the defendant should.[272]

If the challenger instead set forth a circumstantial prima facie case and the defendant made the affirmative defense set forth above, then the challenger would be entitled to one more bite at the apple. The challenger could prevail if, and only if, it persuaded the fact-finder that either (1) the claimed procompetitive benefit was pretextual or (2) the benefit could have been achieved as efficiently

271. This is similar to the affirmative defense set forth in the *Antitrust Law* treatise. *See* 8 AREEDA & HOVENKAMP, *supra* note 10, ¶ 1633e3(B), at 338; *see supra* note 184 and accompanying text.

272. If the fact-finder were to conclude that the parties' accounts concerning output effects were equally persuasive, the defendant should prevail. The challenger should bear the burden of proving anticompetitive effect.

using less restrictive means.[273] If the challenger failed to do so, the verdict should be in favor of the defendant.

C. Evaluation of the Proposed Rule

Few challenges to instances of minimum RPM will succeed under the proposed rule. A challenger must either (1) produce convincing evidence that RPM resulted in an output reduction that cannot be attributed to another cause or (2) first demonstrate the existence of all the prerequisites to one of RPM's potential anticompetitive harms and then rebut any claim that the RPM was imposed as the most efficient means of securing a procompetitive end. These proof burdens are difficult to satisfy. Still, the proposed rule should deter blatantly anticompetitive instances of RPM, particularly since successful challenges will result in treble damages,[274] which are not justified by the clandestine nature of the offense and thus result in some measure of overdeterrence.[275]

Given that most instances of RPM are procompetitive,[276] that the costs of false convictions generally exceed those of false acquittals,[277] and that damages trebling for RPM violations already creates a measure of overdeterrence,[278] the somewhat pro-defendant proposed rule would seem to strike the proper balance for minimizing error costs. In addition, the proposed rule would keep administrative costs

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273. Unlike the approach set forth in the *Antitrust Law* treatise, the approach advocated here would require the challenger to actually prove the existence of an equally efficient, less restrictive alternative mean of producing the procompetitive benefit at issue. *Cf.* 8 AREEDA & HOVENKAMP, *supra* note 10, ¶ 1633e3(C), at 338-39; *see also supra* note 191 and accompanying text. This is appropriate because, as the *Antitrust Law* treatise recognizes, the proof burden allocation on this issue will likely be outcome determinative, *see supra* note 199 and accompanying text, and most instances of RPM should be acquitted, not condemned. *See supra* Part III.A.1-2.

274. 15 U.S.C. § 15 (2006).

275. Damages for antitrust violations are trebled in order to account for the fact that many antitrust violations (for example, horizontal price fixing conspiracies) are hidden and thus likely to escape successful prosecution. For blatant antitrust violations—those not conducted in secret—damage trebling results in some degree of overdeterrence. Because RPM is not a "secret" business practice, a measure of overdeterrence is already built into the prohibition on anticompetitive uses of the practice. *See* HOVENKAMP, *supra* note 18, at 66-68; POSNER, *supra* note 27, at 272.

276. *See supra* Part III.A.1.

277. *See supra* notes 249-50 and accompanying text.

278. *See supra* note 272.

in check. Because the rule calls for a focused inquiry and clearly allocates proof burdens, it would be relatively easy for courts to apply, and the substantial burden the rule places on plaintiffs would deter frivolous lawsuits. By laying out essential elements of a plaintiff's prima facie case, the rule creates de facto safe harbors (for example, no liability on a manufacturer or dealer collusion theory if the defendant lacks market power and RPM is not widespread among manufacturers) and thereby lowers the cost of providing guidance to business planners. The only potential difficulty, in terms of administrative costs, is that the proposed rule would require the RPM challenger to produce evidence that may be more accessible to the defendant manufacturer.[279] In the end, though, the administrative cost savings from reallocating proof burdens from the challenger to the defendant probably would not outweigh the increased error costs resulting from enhancing the risk of costly false positives by making the plaintiff's prima facie case easier to establish.[280] The proposed evaluative approach thus would minimize the sum of error and decision costs, thereby maximizing the net social benefits of RPM regulation.

CONCLUSION

The *Leegin* Court's holding that minimum RPM is not per se illegal constituted a major step toward an economically rational and theoretically coherent approach to vertical restraints; however, the Court realized that the task of crafting a rational evaluative approach for minimum RPM is far from complete. For that reason, it exhorted the lower courts to "establish the litigation structure to ensure the rule [of reason] operates to eliminate anticompetitive restraints from the market and to provide more guidance to businesses."[281] It also encouraged them to "devise rules over time for

279. For example, a plaintiff pursuing a "direct" prima facie case would have to produce data on the defendant's total output, data that would be more accessible to the defendant. If the plaintiff pursued a "circumstantial" prima facie case, it may (depending on the theory of anticompetitive harm it pursued) have to establish the defendant's market power, and the defendant may be in a better position to produce relevant evidence concerning the contours of the relevant market, its share of that market, entry barriers into the market, etc.

280. *See supra* note 253 (discussing tradeoff between allocating proof burdens to parties with most accessible information and creating liability test that will minimize error costs).

281. Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705, 2720 (2007).

offering proof, or even presumptions where justified, to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints and to promote procompetitive ones."[282] Courts and commentators are currently working on this task, and this Article aims to assist them in their efforts.

Unfortunately, the approaches that have thus far been proposed for evaluating the legality of instances of minimum RPM are deficient. Both the open-ended, unstructured rule of reason and Judge Posner's proposed rule of per se legality are nonstarters—the former because it is both difficult to administer and almost entirely indeterminate, and the latter because it is precluded by the *Leegin* Court's holding that some sort of rule of reason inquiry is required and because it would sanction even blatantly anticompetitive instances of RPM. The "structured" rules of reason that have been proposed are all, to various degrees, overly deterrent. If courts were to adopt those evaluative approaches, the victory achieved in *Leegin* could turn out to be largely pyrrhic.

This Article thus has proposed an evaluative approach that would maximize the net benefits of RPM regulation. Harnessing economic learning on the potential competitive effects of RPM and the prerequisites for those effects, the approach focuses courts on the appropriate factors for identifying anticompetitive potential and embraces a burden shifting regime that is aimed at minimizing the sum of error and decision costs.

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282. *Id.*