Seattle University School of Law Digital Commons

Faculty Articles

Faculty Scholarship

2010

Rethinking Antitrust Policy Toward RPM

John B. Kirkwood

Follow this and additional works at: <https://digitalcommons.law.seattleu.edu/faculty>

Part of the [Antitrust and Trade Regulation Commons](#)

Recommended Citation

John B. Kirkwood, *Rethinking Antitrust Policy Toward RPM*, 55 ANTITRUST BULL. 423 (2010).

This Article is brought to you for free and open access by the Faculty Scholarship at Seattle University School of Law Digital Commons. It has been accepted for inclusion in Faculty Articles by an authorized administrator of Seattle University School of Law Digital Commons.

Rethinking antitrust policy toward RPM

BY JOHN B. KIRKWOOD*

Resale price maintenance is a particularly dangerous vertical intra-brand restraint. Because of its direct impact on price competition, it is likely to harm consumers in a substantial number of cases. At the same time, RPM is likely to benefit consumers in a significant number of other cases. Given these mixed effects, the ideal legal standard would distinguish between those instances in which RPM is anticompetitive and those in which it is procompetitive. While *Leegin* thought that the full rule of reason could play this role, it did not acknowledge what every scholar who has looked at the issue has found—that the full rule of reason has operated in practice as a standard of virtual per se legality, absolving almost every restraint examined. This article proposes an alternative approach—a presumption of illegality combined with safe harbors—and explains why it is likely to produce better results at lower cost.

* Associate Professor and Associate Dean for Faculty Development, Seattle University School of Law; Editor, *Research in Law and Economics*; Senior Fellow, American Antitrust Institute; former Assistant Director for Planning and Assistant Director for Evaluation, Bureau of Competition, Federal Trade Commission.

AUTHOR'S NOTE: Numerous people, at AAI and elsewhere, have helped make this a better article, including Rick Brunell, Bert Foer, Warren Grimes, Greg Gundlach, Lily Kahng, Thom Lambert, Gregory Silverman, Bob Steiner, an anonymous reviewer, and participants in a workshop at Seattle University School of Law.

© 2010 by Federal Legal Publications, Inc.

I. INTRODUCTION

Over the last three decades, the Supreme Court has methodically dismantled the controls that antitrust law once imposed on vertical intrabrand restraints. More than thirty years ago, in *Sylvania*,¹ the Court overruled *Schwinn*² and held that vertical customer and territorial restrictions could not be condemned automatically but had to be judged under the rule of reason. Almost twenty years later, the Court jettisoned another per se rule in *Kahn*,³ holding that maximum vertical price fixing must also be evaluated under the rule of reason. Finally, in *Leegin*,⁴ the Court took its most monumental step, overruling a ninety-six-year-old precedent⁵ and declaring that resale price maintenance (RPM)—vertical *minimum* price fixing—had to be assessed under the full rule of reason.

The Court's last step is the most disturbing because RPM is the most competitively dangerous vertical intrabrand restraint. It is the only one that directly prevents dealers from reducing the price of a manufacturer's product, and both theory and evidence suggest that it is likely to be anticompetitive in a substantial number of cases. While RPM may not be anticompetitive in the overwhelmingly majority of cases, or perhaps even in most, there are too many documented cases of consumer harm, and too many ways in which it could harm consumers, to conclude that anticompetitive instances are rare or trivial. In consequence, the ideal legal standard for RPM would make it possible for plaintiffs to challenge and courts to condemn its anticompetitive manifestations. The ideal legal standard would not immunize virtually every case. Yet that is exactly what the full rule of reason—the legal standard the Court mandated in *Sylvania*, *Kahn*, and *Leegin*—is likely to do. Every scholar who has looked at the issue has concluded that the full rule of reason operates in practice as a standard of de facto legality. Under it, defendants almost always win.

¹ Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977).

² United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967).

³ State Oil Co. v. Kahn, 522 U.S. 3 (1997), *overruling* Albrecht v. Herald Co., 390 U.S. 145 (1968).

⁴ Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877 (2007).

⁵ Dr. Miles Med. Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).

Antitrust needs a more discriminating standard, one that would in practice and at reasonable cost distinguish between instances of RPM that are likely to harm consumers and instances that are likely to benefit them. This article suggests that a presumption of illegality combined with safe harbors would achieve these goals. This standard would make it much easier for plaintiffs to challenge plainly anticompetitive RPM. At the same time, it would allow defendants to quickly dispose of cases attacking plainly innocuous RPM. And in mixed cases, where both procompetitive and anticompetitive effects are present, this standard would do at least as well as the full rule of reason in differentiating between beneficial and harmful RPM.

The European Commission (EC) has already adopted a presumption of illegality. For years, it has treated RPM as a "hardcore restriction" that presumptively violates article 81(1) of the Treaty of Rome.⁶ In recent comments, the American Antitrust Institute (AAI) endorsed the EC's approach and argued that it could be a model for U.S. courts.⁷ In two respects, however, the EC's standard appears to be too restrictive. First, it does not provide any safe harbors for RPM, even in circumstances, such as new entry, where the restraint is highly unlikely to be anticompetitive. Second, according to the American Bar Association, the EC has never actually accepted a justification for RPM: its rebuttable presumption of illegality is in fact irrebuttable.⁸ If that is true, it is

⁶ See Comm. Reg. 2790/1999, Art. IV, 1999 O.J. (L336) 21, 23; see also Luc Peepkorn, *Resale Price Maintenance and Its Alleged Efficiencies*, 4 EUR. COMPETITION J. 201, 202-03 (2008) (describing the Commission's presumption of illegality).

⁷ See Comments of the American Antitrust Institute on the European Commission's Proposed Block Exemption Regulation and Guidelines on Vertical Restraints, Sept. 27, 2009, at 4-5, available at http://www.antitrustinstitute.org/archives/files/AAI%20Comments%20on%20EC%20Vertical%20Guides_092820090810.pdf.

⁸ See Joint Comments of the American Bar Association Section of Antitrust Law and Section of International Law on the Proposal of the European Commission for a Revised Block Exemption Regulation and Guidelines on Supply and Distribution Agreements, Sept. 2009, at 24, available at <http://www.abanet.org/Antitrust/at-comments/2009/09-09/comments-proposal-ec.pdf> ("the Sections are not aware of an instance in the last 50 years in which a firm has successfully made efficiency arguments to defend an RPM clause under EC competition law").

too harsh. Since RPM is likely to be procompetitive in a substantial number of cases, the aim should not be to recreate the per se ban under a different guise, but to develop a standard that reliably and cost-effectively distinguishes the anticompetitive instances from the procompetitive. A truly rebuttable presumption with safe harbors would do that.

The *Leegin* Court recognized this overall objective, observing that the lower courts should structure the rule of reason over time so that it becomes “a fair and efficient way to prohibit anticompetitive restraints and to promote procompetitive ones.”⁹ The Court was also sensitive to the anticompetitive effects of RPM, noting that under the full rule of reason the lower “courts would have to be diligent in eliminating [RPM’s] anticompetitive uses from the market,”¹⁰ for “the potential anticompetitive consequences of vertical price restraints must not be ignored or underestimated.”¹¹ Indeed, the Court even suggested that as the “courts gain experience . . . applying the rule of reason,”¹² they can establish “presumptions where justified.”¹³ But despite AAI’s urging,¹⁴ the Court did not adopt any presumptions that would make RPM easier to challenge, leaving the lower courts with the impression that they could “structure” the full rule of reason by clarifying the plaintiff’s burdens under it, but they could not, for the time being at least, ease those burdens.

Reinforcing that impression, in her first article on the issue, Christine Varney, the Assistant Attorney General in charge of the Antitrust Division, did not mention, much less evaluate, any presumptions of illegality. Instead, noting that the Supreme Court has never “engaged

⁹ *Leegin*, 551 U.S. at 897.

¹⁰ *Id.*

¹¹ *Id.* at 894.

¹² *Id.* at 898.

¹³ *Id.* at 898–99.

¹⁴ See Brief of the American Antitrust Institute as Amicus Curiae in Support of Respondent at 28–29, *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007) (No. 06-480) (recommending, if the Court overrules *Dr. Miles*, a rebuttable presumption of illegality, stating: “If businesses wish to raise prices to consumers by agreement, it is hardly unreasonable to place the burden on them to justify the practice in a particular case”).

in an abbreviated analysis of vertical restraints,”¹⁵ she simply proposed a “structured” version of the full rule of reason, under which a plaintiff would have to demonstrate certain elements in order to make out a *prima facie* case that the challenged “RPM is apt to be anticompetitive.”¹⁶ In his article in *The Antitrust Bulletin’s* Special Issue: Antitrust Analysis of Resale Price Maintenance after *Leegin* (Volume I), Lambert recommends a similar approach.¹⁷

In its *Nine West* decision,¹⁸ the Federal Trade Commission (FTC) was somewhat more intrepid. While allowing *Nine West* to adopt

¹⁵ Christine A. Varney, *A Post-Leegin Approach to Resale Price Maintenance Using a Structured Rule of Reason*, ANTITRUST, Fall 2009, at 22.

¹⁶ *Id.* Thus, if the plaintiff contended that the RPM was anticompetitive because it facilitated manufacturer collusion, the plaintiff would have to prove that “(1) RPM is used pervasively in the relevant market; (2) market structure conditions are conducive to price coordination; and (3) RPM plausibly helps significantly to identify cheating.” *Id.* at 24.

¹⁷ Thomas A. Lambert, *A Decision-Theoretic Rule of Reason for Minimum Resale Price Maintenance*, 55 ANTITRUST BULL. 167 (2010). The burdens that a plaintiff would have to carry under Lambert’s approach make sense as a matter of pure economic theory, for they all relate to the likelihood that an instance of RPM is anticompetitive. But like the existing full rule of reason, Lambert’s approach would impose heavy burdens on a plaintiff, even when RPM was harmful, as Lambert recognizes. He states: “Few challenges to instances of minimum RPM will succeed under the proposed rule.” *Id.* at 222. He justifies this restrictive rule on two grounds: (1) “more instances of RPM will be procompetitive than anticompetitive” and (2) “the harm from wrongly acquitting an anticompetitive instance of RPM is likely to be less significant than the harm from wrongly convicting a procompetitive instance of the practice.” *Id.* at 191–92.

Neither basis, in my view, warrants such a pro-defendant tilt. While it may be true that RPM is more likely to be beneficial than harmful, this conclusion is not compelled by either theory or evidence, as I explain below. More important, even if it were true, the legal standard that would follow from this conclusion is one that would protect more RPM than it condemns, not one that would allow almost all RPM. Finally, Lambert’s comparison of false positives and false negatives is skewed because he assumes that only false positives would create erroneous precedent. *See id.* In fact, court decisions that mistakenly exonerate anticompetitive instances of RPM would also create precedent, increasing the likelihood of false negatives in the future.

¹⁸ *In re Nine West Group Inc.*, No. C-3937, 2008 WL 2061410 (FTC May 6, 2008).

RPM, it ventured that *Leegin* “might” permit RPM to be condemned under a truncated or “quick look” rule of reason if the plaintiff established one or more of the factors that *Leegin* identified as relevant to determining whether RPM is anticompetitive.¹⁹ Although *Leegin* itself never indicated that these factors would trigger a truncated inquiry, the FTC’s approach, if adopted by the courts, would be a step forward. It would make it easier for plaintiffs to challenge harmful instances of RPM. The FTC’s approach would not be ideal, however, for these factors would still impose heavy burdens on many plaintiffs, leading, most likely, to a significant number of cases in which RPM is incorrectly permitted.

The remainder of this article explains why a standard of presumptive illegality coupled with safe harbors would be superior to the principal alternatives—the full rule of reason and a truncated rule of reason based on the *Leegin* factors. Part II shows that RPM is the most competitively dangerous restraint and is likely, absent any legal constraints, to cause anticompetitive effects in a substantial number of cases. Part III strengthens this conclusion by demonstrating that the principal asserted justifications for RPM are often questionable, either because the claimed efficiency does not apply, because it is not significant, or because it can be achieved through other means. Parts II and III also recognize, however, that RPM is likely to be procompetitive in

¹⁹ *Id.* at 6. The *Leegin* factors are the prevalence of RPM in the relevant market, the source of the restraint, and the existence of market power at the manufacturer or dealer level. See *Leegin*, 551 U.S. at 897–98. Thus, if RPM is widely used in the market and it was imposed on the manufacturers by dealers with market power, the practice is likely to be anticompetitive.

Because *Nine West* sought to modify an existing order, the FTC placed the burden on it of showing that its use of RPM would not harm competition. *Id.* at 3. *Nine West* carried this burden, according to the FTC, because it established that all the *Leegin* factors were *absent* in its case. *Id.* at 6–7. In an ordinary private suit for damages, the FTC’s approach would presumably require the plaintiff to show that one or more *Leegin* factors were *present* in order to trigger a truncated rule of reason.

The FTC did not specify how many factors a plaintiff would have to establish. The more factors required, the more the FTC’s approach would approximate the structured rule of reason Varney proposed.

a substantial number of cases. Not only are there several valid and empirically supported efficiency explanations for RPM, but the preconditions for anticompetitive impact will frequently not be met. Part IV demonstrates, however, that despite RPM's mixed effects, the full rule of reason is not an appropriate method for controlling it, since the requirements of the full rule of reason are difficult to satisfy, even when the challenged conduct is anticompetitive. As a result, this standard is likely to amount to a regime of de facto legality. Part V points out that the same criticism applies, although with less force, to the FTC's standard in *Nine West*, a truncated rule of reason that would require the plaintiff to prove one or more of the *Leegin* factors.²⁰ Part VI describes the approach I recommend—presumptive illegality combined with safe harbors—and summarizes its advantages.

II. COMPETITIVE HARMS

RPM is the only vertical intrabrand restraint that prevents dealers in a manufacturer's product from reducing the price of that product.²¹

²⁰ In the remainder of the article, I do not return to the "structured" rule of reason proposals that Varney and Lambert have offered because they appear roughly comparable in the burdens they would impose to the existing full rule of reason. What Varney and Lambert are trying to do, after all, is to make the full rule of reason less amorphous and more rigorous by laying out exactly what a plaintiff should have to show in order to make out an economically sound *prima facie* case that the challenged RPM is anticompetitive. They are not trying to lighten the plaintiff's load.

Thus, Lambert proposes that "a plaintiff 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; 2. the product upon which RPM is imposed is relatively fungible; 3. there are substantial entry barriers into the manufacturer's market; and 4. the use of RPM is widespread among manufacturers of the product." Lambert, *supra* note 17, at 218 (footnotes omitted). This would require the plaintiff to cover essentially the same bases it would have to cover under the full rule of reason (market definition, market power inferred from market share, entry barriers, and likely anticompetitive effects). See *infra* part IV.

²¹ To simplify the discussion, I refer to "manufacturers" and "dealers" as the upstream and downstream firms in a production and distribution system. My analysis is not limited, of course, to markets for manufactured goods or to distribution systems in which the resellers are called dealers rather than wholesalers, retailers, or franchisees.

Thus, if a manufacturer of one brand adopts RPM, dealers in that brand cannot engage in direct price competition with other dealers carrying the same brand. They also cannot use that brand to engage in direct price competition with other dealers carrying different brands. In short, unlike vertical nonprice restraints, RPM directly interferes with both intrabrand and interbrand price competition, making it the most dangerous vertical intrabrand restraint.²² Leading scholars concur. Areeda and Hovenkamp declare: “[T]here is a strong consensus that RPM poses greater threats to competition than do most nonprice restraints, perhaps significantly greater.”²³ Klein and Murphy state: “[I]ndustrywide price restraints may serve as an enforcement device for cartel arrangements and represent more of a potential antitrust problem than nonprice restraints.”²⁴

²² While nonprice restraints tend to reduce the intensity of both price and nonprice competition among dealers of the same brand, they do not prevent a dealer in one brand from engaging in price competition with a dealer carrying another brand. RPM, in contrast, poses a direct obstacle to interbrand price competition.

To be sure, RPM does not completely forestall price competition. As noted below, dealers subject to RPM may be able to offer free shipping, bundled discounts, or reduced prices on other brands. See *infra* part III.A. But on the brand in question, they cannot practice the most direct and important form of price competition—reducing the price of the product.

²³ PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1620.1 (Supp. 2008) [hereinafter AREEDA & HOVENKAMP SUPP.]; see also 8 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1630b (2d ed. 2004) [hereinafter 8 AREEDA & HOVENKAMP] (“It is . . . entirely reasonable to regard resale price maintenance as a more pervasive threat to competition than nonprice restraints.”).

²⁴ Benjamin Klein & Kevin Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J.L. & ECON. 265, 280 n.20 (1988). See also Warren S. Grimes, *A Dynamic Analysis of Resale Price Maintenance: Inefficient Brand Promotion, Higher Margins, Distorted Choices, and Retarded Retailer Innovation*, 55 ANTITRUST BULL. 101 (2010) (“There are a number of features that suggest [RPM] poses greater competitive risks and offers fewer potential procompetitive benefits than vertical restraints that restrict distribution.”); Richard M. Brunell, *Overruling Dr. Miles: The Supreme Trade Commission in Action*, 52 ANTITRUST BULL. 475, 521 (2007) (“Besides doing less harm, nonprice vertical restraints are more likely to have procompetitive benefits than vertical price restraints might have.”).

Because of RPM's direct impact on resale prices, it is likely to cause prices to consumers to increase. In addition, those higher prices may be anticompetitive—and reduce the welfare of consumers—when RPM produces or facilitates collusion at the manufacturer level, collusion at the dealer level, suppression of more efficient or innovative dealers, excessive resale services, or misleading promotion.²⁵

A. Higher prices

The purpose of RPM is to raise resale prices. All of the asserted justifications for RPM depend on its ability to raise resale prices, and as Brunell's review of the evidence indicates, RPM has generally had this effect.²⁶ For example, studies of the fair trade era in the U.S. (a period in which states could allow RPM within their borders) show that prices of items subjected to fair trade were significantly higher in states where fair trade was permitted than in states where RPM remained illegal and that fair trade cost consumers several billion dollars a year.²⁷ Other studies have found that when sellers ended RPM in major industries like light bulbs, retail drugs, and blue jeans, consumers realized substantial savings.²⁸ The FTC estimated that record companies' efforts to

²⁵ These are the most commonly discussed but not the only ways in which RPM may harm competition. For other scenarios, see Greg Shaffer, *Theories of Harm from Resale Price Maintenance* (FTC Hearings on Resale Price Maintenance Feb. 19, 2009), available at <http://www.ftc.gov/opp/workshops/rpm/.Docs/gschafferppt0219.pdf>. For instance, Shaffer describes the following case: "Suppose an upstream firm with market power sells to competing downstream firms who also have market power. . . . With RPM, the upstream firm with market power can increase its profit by requiring that retailers set a higher retail price on its product even though at the same time it lowers the wholesale price it charges to retailers. Both actions serve to guarantee retailers a larger markup on the upstream firm's product, and the retailers respond by raising the retail prices of the competing products in their product line." *Id.*

²⁶ See Brunell, *supra* note 24, at 496–97; see also 8 AREEDA & HOVENKAMP, *supra* note 23, ¶ 1604b (RPM "tends to produce higher consumer prices than would otherwise be the case. The evidence is persuasive on this point").

²⁷ See H.R. REP. NO. 94-341, at 3 (1975).

²⁸ See F.M. Scherer, *Comment on Cooper et al.'s "Vertical Restrictions and Antitrust Policy,"* 1 COMPETITION POL'Y INT'L 65, 72–74 (2005).

restrain resale prices of CDs caused consumers to pay as much as \$480 million more than they would have without RPM.²⁹

The higher prices produced by RPM would not harm consumers, of course, if the practice generated services or information that consumers judged to be worth the extra money. In such a case, RPM would benefit both the manufacturer that adopted the practice and its ultimate customers. In most of the following settings, however, all of which have anticompetitive effects, RPM would increase the profits of manufacturers or dealers but reduce the welfare of consumers.

B. Collusion at the manufacturer level

Because of RPM's adverse impact on interbrand price competition, it can facilitate price collusion at either the manufacturing level or the dealer level. At the manufacturer level, RPM can enhance the effectiveness of collusion, tacit or explicit, in several ways. First, RPM makes resale prices more stable and more visible, increasing the ability of manufacturers to coordinate their pricing strategies. In addition, RPM reduces the incentive for any manufacturer to cheat on the collusive price, since the manufacturer's price cut cannot be passed directly on to consumers. Moreover, RPM greatly reduces the propensity of dealers to engage in price wars among themselves, which helps manufacturers collude because if price wars break out among dealers, they will tend to seek relief by asking for price cuts from their suppliers, undermining price stability at the manufacturing level.³⁰ Thus, one of Wal-Mart's top executives stated: "I don't have any question but that competitive pricing at the retail level creates more pressure on manufacturers' factory prices than is present when they're able to set retail prices as well."³¹ Moreover, the FTC recently alleged that record companies had taken steps to raise the retail prices of their products in

²⁹ See Press Release, Fed. Trade Comm'n, Record Companies Settle FTC Charges of Restraining Competition in CD Music Market (May 10, 2000), available at <http://www.ftc.gov/opa/2000/05/cdpres.htm>.

³⁰ 8 AREEDA & HOVENKAMP, *supra* note 23, ¶ 1606c (noting "instances in which intense price competition at the dealer level has led to price cuts at the manufacturing level").

³¹ S. Robson Walton, *Antitrust, RPM, and the Big Brands: Discounting in Small-Town America (II)*, 15 ANTITRUST L. & ECON. REV. 11, 16 (1983).

order to end a price war among retailers, a conflict that had caused several retailers to seek lower prices from one of the companies.³²

RPM is unlikely to facilitate collusion, tacit or express, at the manufacturer level unless the structure of the market is conducive to it. As a general rule, that means that the market must be concentrated, entry barriers must be significant, the manufacturers using RPM must make up a substantial portion of the market, and differentiation of the various manufacturers' brands must not be so great that coordinated pricing is infeasible. While these conditions imply that RPM is unlikely to be a collusion-facilitating device in many instances, in other cases the restraint is likely to reinforce manufacturer collusion. In *C-O-Two Fire Equipment*, for example, a group of producers imposed RPM on their dealers as part of a horizontal price fixing arrangement.³³

C. Collusion at the dealer level

RPM is an even more effective tool for cementing collusion at the dealer level, since it eliminates the most direct form of price competition among dealers, price competition on product prices. Here, too, market conditions must be conducive to such collusion,³⁴ but there are

³² See Complaint, *In re Universal Music & Video Distrib. Corp.*, No C-3974 (FTC 2000), available at <http://www.ftc.gov/os/2000/09/unicomp.htm>; see also Maurice E. Stucke, *Does the Rule of Reason Violate the Rule of Law?*, 42 U.C. DAVIS L. REV. 1375 (2009) (summarizing complaint).

³³ See *C-O-Two Fire Equip. Co. v. United States*, 197 F.2d 489 (9th Cir. 1952).

³⁴ The dealers as a group must have sufficient market power to impose RPM on one or more manufacturers, and the manufacturer(s) involved must have enough market power, singly or collectively, that a retail price increase on the product(s) in question would not cause the dealers to lose an unacceptable quantity of sales. As Hovenkamp notes, dealers are more likely to be able to inflict RPM on a manufacturer when "economies of scope at the retail level make single-brand distribution impractical," for in this case, a manufacturer "cannot easily integrate into retailing on its own." HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY* 451 (3d ed. 2005). When retailing is dominated by "large multi-brand, multiproduct" dealers, moreover, entry may be quite difficult and these dealers may be able to "exert substantial power over [their] suppliers." *Id.* at 452.

As this discussion indicates, dealer collusion can harm consumers even if the colluding dealers carry only a single manufacturer's brand. As long as that brand is differentiated from other brands, RPM imposed on the manufacturer

a significant number of actual examples, as Hovenkamp emphasizes: "A wealth of history shows that dealers have attempted to use RPM imposed by suppliers to facilitate horizontal dealer collusion."³⁵ Indeed, some of the best-documented instances of RPM have involved dealer cartels, including the well-known, Depression-era, drug store cartel.³⁶ Just last year, the Third Circuit concluded that a cartel of Mack Truck dealers had, among other things, induced Mack Truck to impose RPM on a price-cutting dealer.³⁷ In contrast, nonprice restraints, which by definition do not fix product prices, are less effective in facilitating explicit or tacit price collusion at the dealer level.³⁸

D. Suppression of more efficient or innovative dealers

RPM inhibits the development of more efficient forms of distribution because it prohibits a more productive or innovative distributor from passing on the benefits of its superior efficiency in lower product prices.³⁹ This obstacle to economic progress has frequently

by colluding (or otherwise powerful) dealers can force up the price of its brand and reduce the welfare of consumers. In short, a restraint directed primarily at intrabrand competition can still injure the competitive process. See Warren S. Grimes, *The Path Forward After Leegin: Seeking Consensus Reform of the Antitrust Law of Vertical Restraints*, 75 ANTITRUST L.J. 467, 472–73 (2008).

³⁵ HOVENKAMP, *supra* note 34, at 451 (noting, for example, that "the *Dr. Miles* decision . . . was the byproduct of one of the biggest cartels in American history—an agreement by members of national associations of wholesale and retail druggists to fix the price of proprietary medical drugs" and that, in addition, "in many of the early RPM decisions, there was strong evidence of horizontal as well as vertical collusion").

³⁶ See Thomas R. Overstreet Jr. & Alan A. Fisher, *Resale Price Maintenance and Distributional Efficiency: Some Lessons from the Past*, 3 CONTEMP. POL'Y ISSUES 43, 49–50 (1985) (during the 1930s, a cartel organized by the National Association of Retail Druggists "achieved virtually universal compliance with a price-fixing policy—despite very large numbers and an extremely unconcentrated market").

³⁷ See *Toledo Mack Sales & Serv., Inc. v. Mack Trucks, Inc.*, 530 F.3d 204 (3d Cir. 2008).

³⁸ 8 AREEDA & HOVENKAMP, *supra* note 23, ¶ 1630b ("Historically . . . price rather than nonprice restraints have been the vehicle chosen by dealer organizations to limit competition among their members.").

³⁹ Brunell, *supra* note 24, at 501–02.

been noted. Steiner observed that “growth of . . . more efficient new retailing forms often has been seriously retarded by their inability to obtain well-known manufacturers’ brands, free of RPM.”⁴⁰ Areeda and Hovenkamp point out that in the absence of RPM, “price competition among dealers favors the expansion of those with efficient scale and methods, thus lowering the cost of distribution.”⁴¹ Sullivan and Grimes agree: “Preserving entry opportunities for new retailers and new retailing approaches is a critical component to the dynamic growth of our economy. Intrabrand competition serves this goal by preserving one of the new entrant’s more competitive tools: the ability to discount popular branded items that draw customers.”⁴² The Office of Fair Trading recently studied the elimination of RPM on books in the United Kingdom and concluded that it contributed to the entry and rapid growth of innovative forms of book retailing—Internet sellers and supermarkets.⁴³ In addition, Scherer and Ross conclude, there is evidence that in Europe, “the appearance of supermarkets was significantly retarded until laws discouraging resale price maintenance were passed.”⁴⁴

⁴⁰ Robert L. Steiner, *How Manufacturers Deal With the Price-Cutting Retailer: When Are Vertical Restraints Efficient?*, 65 ANTITRUST L.J. 407, 424 & n.47 (1997).

⁴¹ 8 AREEDA & HOVENKAMP, *supra* note 23, ¶ 1632c4.

⁴² LAWRENCE A. SULLIVAN & WARREN S. GRIMES, *THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK* 335 (2d ed. 2006). *See also* Grimes, *supra* note 24, at 128 n.56 (“Many of the most efficient retailing methods involve a marketing strategy that relies on minimum service and rapid turnover of inventory. The warehouse store or the Internet outlet, for example, generally offers few amenities. Under these business models, there are fewer opportunities to pass efficiencies on except in the form of lower prices, and it is precisely this avenue that will be denied to them when RPM is imposed.”).

⁴³ *See* OFFICE OF FAIR TRADING, *AN EVALUATION OF THE IMPACT UPON PRODUCTIVITY OF ENDING RESALE PRICE MAINTENANCE ON BOOKS* (2008), *available at* http://oft.gov.uk/shared_oft/economic_research/oft981.pdf.

⁴⁴ F.M. SCHERER & DAVID ROSS, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* 553 (3d ed. 1990). *See also* Overstreet & Fisher, *supra* note 36, at 49 (“The National Association of Retail Druggists (NARD) was astonishingly successful in using RPM and related political influence to delay the development of discount drug store chains”).

Once an innovative form of distribution becomes established, RPM is unlikely to be used to suppress it. By that point, manufacturers have become accustomed to its benefits, and some of the innovative distributors may be large enough to forestall the adoption of RPM.⁴⁵ But when more efficient or innovative dealers are emerging, they are vulnerable to restraints imposed on them by manufacturers acting at the behest of traditional outlets, which have greater leverage than the emerging dealers because they account for a much larger volume of sales.⁴⁶ Thus, for example, toy manufacturers acceded to the

⁴⁵ See Joint Comments of the American Bar Association, *supra* note 8, at 22 (“large multi-brand retailers (e.g., “Big Box” stores) have buying power that can effectively block RPM”); Warren S. Grimes, *Buyer Power and Retail Gatekeeper Power: Protecting Competition and the Atomistic Seller*, 72 ANTITRUST L.J. 563, 579 (2005) (the large multi-brand retailer has “substantial leverage in dealing with even the largest producers of strong brands of consumer products” and can control whether products “will be priced or marketed aggressively”).

Lambert asserts that the growth of large discount retailers has reduced the likelihood that RPM will be used to facilitate collusion among manufacturers or dealers. See Lambert, *supra* note 17. While that is true, it may be misleading, because the growth of large discount retailers does not indicate that RPM, when it does occur, is more likely to be procompetitive than before. Rather, it simply indicates, as Grimes and the ABA recognize, that the presence of a big discounter like Wal-Mart in a market makes it less likely that RPM will be imposed in that market *for any reason*, procompetitive or anti-competitive. When a big retailer does insist on RPM, the restraint may be anticompetitive. See *infra* note 47.

⁴⁶ For a traditional retailer to be able to force a manufacturer to impose RPM on a smaller, more efficient dealer, the traditional retailer must not only account for a substantial volume of the manufacturer’s sales, but the manufacturer must not be able to replace those sales by turning to other traditional retailers, the new dealer, new entrants, or forward integration. The traditional retailer, in short, must have buying power protected by entry barriers. For an analysis of buying power, see John B. Kirkwood, *Buyer Power and Exclusionary Conduct: Should Brooke Group Set the Standards for Buyer-Induced Price Discrimination and Predatory Bidding?*, 72 ANTITRUST L.J. 625 (2005). For an extensive analysis of entry barriers, see John B. Kirkwood & Richard O. Zerbo, Jr., *The Path to Profitability: Reinvigorating the Neglected Phase of Merger Analysis*, 17 GEO. MASON L. REV. 39 (2009). Moreover, the traditional retailer must induce enough manufacturers to adopt RPM that the new dealer cannot grow so rapidly through the sale of non-price-maintained products that it undermines the traditional retailer’s market position.

demands of Toys “R” Us, then the largest toy retailer in many markets, and refused to sell product to a new and especially promising method of distribution, warehouse clubs.⁴⁷

E. Excessive services

RPM may also reduce the welfare of consumers when it causes dealers to provide excessive services. Although RPM is not always a reliable method of stimulating services,⁴⁸ when it is effective it can sometimes generate an excessive quantity, which can harm consumers in two principal ways.

1. HARM TO INFRAMARGINAL CONSUMERS Consumers who do not value the services induced by RPM, but do care enough about the product to purchase it even if they have to pay more, are hurt by RPM. They pay higher prices and receive nothing in return. More-

⁴⁷ See *Toys “R” Us, Inc. v. Fed. Trade Comm’n*, 221 F.3d 928 (7th Cir. 2000). While *Toys “R” Us* involved a refusal to deal, not RPM, a unit of Toys “R” Us may have been involved in RPM. Two private suits have been brought—and the FTC has opened an investigation—because of allegations that Babies “R” Us, a division of Toys “R” Us, pressured several manufacturers to impose RPM on retailers who were undercutting it. See Joseph Pereira, *Toys “R” Us Faces Federal Antitrust Inquiry—Regulators Probe Whether Retailer Stifled Discounting by Rivals, Violating an 11-Year-Old Order*, WALL ST. J., Oct. 17, 2009, at A3. See also *McDonough v. Toys “R” Us*, 638 F. Supp. 2d 461 (E.D. Pa. 2009) (certifying class and citing evidence that Babies “R” Us coerced suppliers to eliminate Internet discounting).

In both cases, to be sure, the challenged behavior may have enhanced competition, either by curbing free riding or by providing the defendants with the margins they needed to carry and promote the products in question. Absent the restraints, in other words, the low-cost dealers might have been able to free ride on the defendants’ efforts or—simply by constraining their margins—prevent them from stocking and pushing the manufacturers’ brands. In either case, the loss to consumers from the diminished promotion or availability of these products at the defendants’ stores might have outweighed the gains from the growth of more efficient methods of distribution. See *infra* part III (discussing the free rider and margin-increase justifications). See also Lambert, *supra* note 17, at 200–05 (discussing *McDonough*). Neither justification, however, was embraced by the FTC or appellate court in *Toys “R” Us* or the district court in *McDonough*.

⁴⁸ See *infra* part III.A.

over, the harm to these consumers may outweigh the benefits to other purchasers of the product—consumers who do value the services engendered by RPM and are willing to pay the higher prices required. It is this second group of consumers—the *marginal* consumers—that motivates the manufacturer’s decision to impose RPM, for this second group increases its purchases in response to the additional services induced by RPM. But the first group—the *inframarginal* consumers—is injured, and it has repeatedly been shown that in plausible circumstances, the harm to the first group will exceed the gains to the second, reducing overall consumer welfare.⁴⁹ The circumstances are plausible because it is reasonable to believe that there are complex or technical products that a significant number of consumers understand well enough not to want to pay for additional services or more promotional information.⁵⁰

⁴⁹ See William S. Comanor, *Vertical Price Fixing and Market Restrictions and the New Antitrust Policy*, 98 HARV. L. REV. 1990 (1985); William S. Comanor & John B. Kirkwood, *Resale Price Maintenance and Antitrust Policy*, 3 CONTEMP. POL’Y ISSUES 9 (1985); F.M. Scherer, *The Economics of Vertical Restraints*, 52 ANTITRUST L.J. 687 (1983).

⁵⁰ See SCHERER & ROSS, *supra* note 44, at 547–48 (“Consumers with high pre-RPM reservation prices presumably know enough about the product that they are eager to purchase it even without information provided by the dealer The extra information is of greater value to marginal consumers than to the more confirmed inframarginal buyers. In effect, the uniform elevation of prices under RPM makes inframarginal consumers pay a premium for something of little value to them Under plausible conditions, a tendency toward welfare reductions seems more likely than the opposite.”).

The conventional objection to this theory is that it is not limited to RPM, since all advertising and promotional activity may cause some inframarginal consumers to pay for information or promotion they do not want. But that is an overstatement. The anticompetitive effect occurs only when the conduct causes an increase in price, which need not occur with all advertising or promotional activity. Rather, in some cases, a manufacturer of a differentiated product will advertise it simply to sell more units, paying for the advertising out of the existing margin on the product. In such cases, the price will not go up, and may even fall if the increase in sales allows the manufacturer to achieve greater scale economies. In contrast, RPM typically results in a price increase. See *supra* part II.A.

The more serious problem with this theory is the difficulty of applying it to a specific case. See Benjamin Klein, *Competitive Resale Price Maintenance in the*

2. SELF-CANCELLING PROMOTION Consumer harm would also occur when RPM is prevalent in a market and the promotional activities it induces largely cancel each other out, leaving each manufacturer with little increase in output and no significant market share gain and consumers paying higher prices without a substantial increase in useful information. In this situation, no manufacturer is willing to end RPM and switch to a low-service, low-price strategy, because it would then lose sales to its rivals, but collectively both manufacturers and consumers are worse off, and economic efficiency suffers. When promotional activities largely interfere with each other, in short, the net result is negative, as Scherer and Ross explain:

When most of the firms selling a mature product retain RPM, . . . the sales increase advantages each seeks by enforcing high dealer margins and high expenditure on service tend to be cancelled out by the matching outlays on rival products, and until the prisoner's dilemma is broken, a high-service, high-cost equilibrium holds, without appreciable collective output increases. This . . . is almost surely inefficient.⁵¹

F. *Misleading promotion*

Even when RPM is not widely used, it can still reduce consumer welfare if the promotional activities it induces are deceptive. Suppose that only a few manufacturers in a market fix resale prices, causing dealer margins on their brands to be higher than those on other brands. This differential is likely to induce some dealers to promote the price-fixed brands over other brands, even when there is no difference in quality. The result may be to mislead consumers.⁵²

Absence of Free Riding, 72 ANTITRUST L.J. 431, 463 (2009) ("It is highly unlikely that a court could empirically estimate these differential effects between marginal and inframarginal consumers and accurately determine when total consumer welfare was or was not reduced."). Until developed further, therefore, the theory may not be appropriate for litigation, but it does provide additional support for the proposition that RPM is likely to harm consumers in a substantial number of cases.

⁵¹ SCHERER & ROSS, *supra* note 44, at 553; *see also* Grimes, *supra* note 34, at 484 ("if the restraint is widely employed, no supplier may benefit from its use").

⁵² *See* Grimes, *supra* note 34, at 485 (when only some brands in a market are subject to RPM, "there is a heightened risk of . . . deceptive or misleading promotion"). The same kind of deception may also occur when RPM is wide-

G. *Likelihood of anticompetitive effects*

This catalog of anticompetitive effects shows, as numerous commentators have recognized, that RPM is capable of reducing competition and harming consumers in multiple ways. The discussion also provides concrete examples of the best-known mechanisms and indicates that the other anticompetitive effects, even if not demonstrable, are plausible in certain circumstances. Thus, if the result of the full rule of reason is to make RPM *de facto* legal, it seems fair to conclude that consumers are likely to face substantial harm.⁵³

The systematic empirical evidence on RPM is consistent with this conclusion. While it is quite limited in quantity and quality—and thus makes policy formulation in this area difficult—it does indicate, when combined with the preceding discussion, that RPM is likely to be anticompetitive in a significant number of cases. To be sure, like the efficiency evidence discussed in part III, the evidence of anticompetitive effect does not demonstrate that RPM is always or typically harmful,

spread in a market. See 8 AREEDA & HOVENKAMP, *supra* note 23, ¶ 1633 (“Where multibrand dealers are typical, . . . widespread coverage within the manufacturers’ market may also mean that the manufacturers use the restraint to induce dealer recommendations that deceive consumers.”). For a possible example, see Grimes, *supra* note 34, at 501–02 (“As a result of these RPM schemes, a golfer shopping for new clubs at a golf shop may be pressured by sales personnel to buy a boutique club (because the dealer will make a higher margin on this sale) notwithstanding lower price clubs that have only the narrowest difference in performance.”).

There are, of course, other ways to combat deceptive promotion (e.g., tort doctrines, consumer protection laws), but these may not be effective in policing point-of-sale activities by dealers. See, e.g., Grimes, *supra* note 24, at 117–18 (“By creating incentives for dealer promotion, RPM makes deceptive or misleading promotion more difficult to monitor and control . . . [Sales pitches by dealers] are usually oral, untranscribed, and difficult to prove. If a consumer has been misled by an on-site oral pitch, the incentive to bring a court action is seldom sufficient to overcome the substantial burdens of a law suit.”).

⁵³ Of course, a rule of *de facto* legality might still be the best legal standard if other legal rules would impose even greater harm on consumers. See generally Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6 (1981). But as this article indicates, a presumption of illegality combined with safe harbors is likely to promote the welfare of consumers better than a rule of complete immunity.

or even that anticompetitive cases of RPM are more likely than pro-competitive cases, though that may be true. What the evidence does suggest—the systematic empirical data discussed below and the specific cases of abuse noted above—is that consumers are likely to be harmed by RPM in a nontrivial number of cases and that a rule of de facto legality is inappropriate.

Ippolito and Overstreet have conducted the most frequently cited, systematic reviews of RPM cases.⁵⁴ Both investigate the same two anticompetitive possibilities—that RPM was used to facilitate collusion among manufacturers or dealers. While each finds that collusion could have occurred in a significant number of cases, both conclude that it is unlikely that RPM was adopted to support collusion at either the manufacturer level or the dealer level in most of the cases reviewed.⁵⁵ Critics have noted, however, that both studies have significant methodological problems. Ippolito's findings are based on whether the complaints in the cases she examined contained allegations of collusion. As Justice Breyer remarked, this approach "equates the failure of plaintiffs to *allege* collusion with the *absence* of collusion—an equation that overlooks the superfluous nature of allegations of horizontal collusion in a resale price maintenance case and the tacit form that such collusion might take."⁵⁶ Overstreet's findings on collusion at the dealer level are based on the number of dealers involved, but as Brunell pointed out, "large numbers do not necessar-

⁵⁴ See Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & ECON. 263 (1991); THOMAS R. OVERSTREET, *RESALE PRICE MAINTENANCE: ECONOMIC THEORIES AND EMPIRICAL EVIDENCE* (Bureau of Economics Staff Report, Federal Trade Commission 1983).

⁵⁵ See Ippolito, *supra* note 54, at 281 ("Only 9.8 percent of the private cases and 13.1 percent of the entire sample included allegations of dealer or supplier collusion."); OVERSTREET, *supra* note 54, at 78 (manufacturer collusion unlikely in most cases because "a good deal of the RPM reflected in FTC cases has occurred among small firms selling in markets that are structurally competitive"), at 80 (dealer collusion unlikely in most cases because in the cases where the number could be determined, the great majority involved more than 200 dealers).

⁵⁶ *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 920 (2007) (Breyer, J., dissenting). Hovenkamp points out that tacit collusion is the "more serious threat" and is unlikely to have been alleged, since it is not illegal. See HOVENKAMP, *supra* note 34, at 454.

ily indicate low concentration or the absence of a dominant dealer or a small number of dominant dealers, and the study does not consider whether resale price maintenance may have been limited to local markets in which dealer concentration was high."⁵⁷ If a more detailed examination of each case could have corrected these problems, it is likely that both studies would have uncovered more instances in which RPM posed a threat to competition.⁵⁸

In addition, the studies relate only to the likelihood of collusion, not to the other anticompetitive effects described above. If the findings of the studies, adjusted for their shortcomings, were combined with the other ways in which RPM can reduce competition, the most plausible conclusion is that RPM is likely to harm consumers in a substantial number of cases. Justice Breyer's review of theory and evidence led him to a similar conclusion: "[The] studies and analyses . . . suggest (though they cannot prove) that resale price maintenance can cause harms with some regularity—and certainly when dealers are the driving force."⁵⁹ Overstreet himself declared that "the historical experience, or practice of RPM [is] largely a sorry record of abuses."⁶⁰ One reaches a similar conclusion when one looks at the other side of the ledger—the possible procompetitive explanations for RPM.

⁵⁷ *Discount Pricing Consumer Protection Act: Do We Need to Restore the Ban on Vertical Price Fixing?: Hearing on S. 148 before the Subcomm. on Antitrust, Competition Policy and Consumer Rights of the S. Comm. on the Judiciary*, 111th Cong. 28–29 (2009) (statement of Richard M. Brunell) [hereinafter Brunell]. In addition, as Overstreet recognized in a later article, one of the best-known dealer cartels in history, the retail druggists' cartel, "achieved virtually universal compliance with a price-fixing policy—despite very large numbers and an extremely unconcentrated market." Overstreet & Fisher, *supra* note 36, at 49–50.

⁵⁸ This seems equally true of a third study, Stanley I. Ornstein, *Resale Price Maintenance and Cartels*, 30 ANTITRUST BULL. 401 (1985), which reached similar conclusions and is vulnerable to similar criticisms. See 8 AREEDA & HOVENKAMP, *supra* note 23, ¶ 1606f. Even without correcting for its shortcomings, moreover, this study concluded that one-third of the cases "may have involved a cartel" at the manufacturer or dealer level. Ornstein, *supra*, at 431. Areeda and Hovenkamp state that this "seems a very substantial threat." 8 AREEDA & HOVENKAMP, *supra* note 23, ¶ 1606f.

⁵⁹ *Leegin*, 551 U.S. at 915 (Breyer, J., dissenting).

⁶⁰ Overstreet & Fisher, *supra* note 36, at 45.

III. PROCOMPETITIVE JUSTIFICATIONS

The justifications most commonly offered for RPM are likely to be invalid in a significant number of cases, either because the necessary preconditions are not satisfied, the benefits are minor, or they can be achieved in less restrictive ways. This indicates that the net effect of RPM is likely to be anticompetitive, not procompetitive, in a substantial number of cases. At the same time, it seems fair to conclude that RPM is likely to be procompetitive—and benefit consumers—in a considerable number of other cases. This follows from the result of part II—that RPM is likely to be anticompetitive in a significant but not overwhelming number of cases—and from the strength of the theoretical and empirical support for the justifications most frequently advanced for RPM.

This part examines the three most common justifications for RPM—that it induces dealer services by curtailing free riding; that it stimulates dealer services by increasing dealer margins; and that it improves brand image by eliminating discounting or loss-leader pricing. A fourth common justification—promoting new entry—is discussed in part VI, where it forms the basis for a safe harbor.

A. Inducing dealer services by preventing free riding

The most prominent justification in the literature is that RPM induces dealers to furnish presale services by preventing other dealers from free riding on those efforts. The logic is familiar and powerful. Suppose that dealer *A* provides costly services like product demonstrations but dealer *B* does not and, as a result, dealer *B* sells the manufacturer's product at a lower price. And suppose, to take advantage of both the valuable services and the lower price, many consumers watch the demonstrations at dealer *A* but purchase the product from dealer *B*. In this situation, both the consumers in question and dealer *B* are free riding on dealer *A*'s services, and unless such conduct is curtailed, it is likely to lead *A* to reduce its provision of services, harming consumers and the manufacturer alike.

As commentators have recognized, however, this justification, while impressive in theory, is not applicable in many situations. In particular, a manufacturer that attempts to justify RPM on the ground that it prevents free riding must overcome two major hur-

dles.⁶¹ First, the manufacturer must show that the preconditions for the justification are satisfied. That is, the manufacturer must prove that its dealers actually provide presale services or other promotional activities for which they could not charge separately; that absent RPM, some dealers would free ride on those activities; and that this free riding would be so extensive that it would impair the ability of other dealers to profitably provide the desired services. As Lao notes, those conditions are not commonly met, since “very few products require dealer demonstrations, consumer education, operational expertise, special showrooms and the like for effective marketing, and few dealers actually provide any such services.”⁶² Likewise, Areeda and Hovenkamp declare:

[U]nrestrained intrabrand competition does not lead to substantially detrimental free riding when dealers provide no significant services (such as drugstores selling toothpaste), the services they do provide cannot be utilized by customers who patronize other dealers (luxurious ambience), the services are paid for separately (post-sale repair), the services provided are not brand specific and are fully supported by a wide range of products (high-quality department store), the services can be provided efficiently by the manufacturer (advertising), or a sufficient number of consumers patronize the dealers from whom they receive the service.⁶³

Grimes concurs and concludes that the “economic evidence suggests that free-riding on pre-sale services is not all that widespread.”⁶⁴ Klein states that the “free-riding framework has led to clearly pretextual explanations.”⁶⁵

⁶¹ For recent dissections of the free rider justification, see Marina Lao, *Resale Price Maintenance, The Free-Rider Explanation, and United States Antitrust Policy*, in *HOW THE CHICAGO SCHOOL OVERSHOT THE MARK: EFFECT OF CONSERVATIVE ECONOMIC ANALYSIS ON U.S. ANTITRUST* 196 (Robert Pitofsky ed., 2008); Grimes, *supra* note 34; Brunell, *supra* note 24.

⁶² Lao, *supra* note 61, at 201; *see also id.* at 200 (“[T]he classic free rider hypothesis, though theoretically valid, has limited applicability.”).

⁶³ 8 AREEDA & HOVENKAMP, *supra* note 23, ¶ 1601e.

⁶⁴ Grimes, *supra* note 34, at 476; *see also* Brief for William S. Comanor & Frederic M. Scherer as Amicus Curiae Supporting Neither Party at 6, *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007) (No. 06-480) (“There is skepticism in the economic literature about how often” RPM “is needed to prevent free-riding and ensure that desired services are provided.”).

⁶⁵ Klein, *supra* note 50, at 433.

In some cases, of course, free riding is a legitimate and significant problem. According to Lao, that is most likely to be true “in the sale of complex or novel products that require consumer education, or in-store demonstration to display their features, quality, and general appeal.”⁶⁶ Moreover, as access to the Internet has grown, the potential for free riding has increased. It is now easier for many consumers to free ride by purchasing a product online after checking out its features at a brick-and-mortar store.⁶⁷ Given these possibilities, antitrust law should provide manufacturers with the opportunity to show that free riding is a significant concern.

Even if free riding is a legitimate and material problem, however, the manufacturer faces a second issue: Why can’t this problem be solved, or at least substantially mitigated, through some arrangement short of RPM? The most obvious step is simply to require dealers, as a condition of retaining their dealerships, to provide the desired services. Alternatively, a manufacturer could agree to pay its dealers—in the form of promotional allowances or other stipends—if they perform the desired services. Either set of contractual arrangements (or a combination of the two) might induce most dealers to furnish the services the manufacturer wants, even if some dealers are willing to free ride.⁶⁸

With respect to some services, of course, it may be impossible for a manufacturer to specify the quantity and quality it desires.⁶⁹ As a

⁶⁶ Lao, *supra* note 61, at 200.

⁶⁷ Even then, however, such free riding may not undermine the incentives of brick-and-mortar stores to provide services, for there may be even greater free riding in the opposite direction. Research sponsored by AAI has found evidence that more consumers gather information about a product online and then purchase it at a brick-and-mortar store than the reverse. See Gregory T. Gundlach, Kenneth Manning & Joseph Cannon, *Free Riding and Resale Price Maintenance: Insights from Marketing Research and Practice*, in this issue of the *Antitrust Bulletin*. This article, which identifies pertinent findings from the marketing literature, helps fill the pressing need for more empirical evidence on the impact of RPM.

⁶⁸ See *Toys “R” Us, Inc. v. Fed. Trade Comm’n*, 221 F.3d 933, 938 (7th Cir. 2000) (rejecting a free rider defense because the services performed by the retailers, such as advertising, warehousing, and full-line stocking, were compensated by the manufacturers).

⁶⁹ See Klein, *supra* note 50, at 453 (“[C]onsider point-of-sale promotional services that take the form of increased salesperson efforts. What is

result, the manufacturer may be unable to develop enforceable contractual requirements that produce the full range of desired services, and free riding on the unspecified services may discourage its dealers from providing them. But even if that is the case—even if contractual provisions are not an effective way to stimulate all the services the manufacturer wants—RPM may not solve the problem, since dealers subject to RPM can still engage in free riding. While RPM prevents them from lowering the price of the seller's product, it does not require that they perform any services and does not preclude them from diverting business from other distributors by offering free shipping, free samples of other products, bundled discounts, or other benefits. As a result, even with RPM, dealers may resort to a significant amount of free riding.⁷⁰

the measurable unit of service the manufacturer is purchasing that could be the basis of a per service retailer compensation formula?").

⁷⁰ See Peeperkorn, *supra* note 6, at 209:

RPM does not take away the underlying free rider problem. The "dominant strategy," as it is called in game theory, is still for each distributor not to invest in promotion but to free ride on possible investments made by others and pocket the higher margin. Instead of using the extra margin for promotion, a distributor will in practice prefer to invest in other means of attracting customers, means not hindered by free riding, such as offering lower-priced after-sales services or lowered prices achieved through bundling.

RPM will thus not lead to extra promotion outlays, or will do so only to a limited extent; it is not an efficient instrument for obtaining the desired efficiency.

See also Klein & Murphy, *supra* note 24, at 266 ("Even if the manufacturer fixes the retail price and does not permit price competition, retailers still have an incentive to free ride by supplying nonprice services that are not desired by the manufacturer but are of value to consumers . . . say, lower priced tied accessories."); Klein, *supra* note 50, at 439 ("Most statements of the theory assume that the only way retailers can compete, once they cannot reduce price, is by supplying these retailer services desired by the manufacturer. However, free-riding retailers often will be able to compete more effectively in other ways. For example, . . . free installation or liberal return privileges or possibly even more general services, such as convenient free parking, luxurious store furnishing, fast checkout.").

To be sure, the availability of these other means of competing does not mean that RPM cannot play any role in curbing free riding, for lowering the price of

To forestall free riding, a manufacturer needs to address all the ways that a dealer can engage in free riding, a goal it can accomplish in many cases through exclusive territories, exclusive distributorships, or other types of selective distribution. These restraints are more effective in stanching free riding because they reduce the ability of dealers in a manufacturer's brand from competing with each other on any dimension. As Grimes points out, the "vertical restraints that are most likely to limit or prevent free-riding on pre-sale promotion are those that narrow or limit distribution, such as location clauses or exclusive territories."⁷¹ Where these alternatives can be employed, they appear to be at least as potent as RPM in stimulating dealer services, yet unlike RPM, they do not prevent dealers in a manufacturer's brand from lowering the price of that brand to compete with other brands.⁷²

The best method of stimulating dealer services may be to combine some form of selective distribution and with some type of contractual requirement or inducement. By coupling nonprice restraints with contractual carrots or sticks, in other words, a seller may be able to maximize its distributors' incentives to provide the desired services. To be

the product may be the most effective way that a free riding dealer can divert business from a full service dealer.

⁷¹ Grimes, *supra* note 34, at 477; see also Peeperkorn, *supra* note 6, at 209 ("Other vertical restraints, such as providing exclusive territories, are much better equipped to solve the free riding problem."); Klein & Murphy, *supra* note 24, at 280 ("Exclusive territories generally have some advantages over resale price maintenance in terms of a lower dealer shirking potential. The shirking potential is reduced by eliminating the interdealer free-rider problem."). A manufacturer can also reduce free riding by distributing different variations of its products through different dealer classes (e.g., one brand for warehouse stores and a variant for full-service retailers).

⁷² See 8 AREEDA & HOVENKAMP, *supra* note 23, ¶ 1632b ("there are few documented instances of significantly impaired distribution" as a result of the per se ban on RPM). To be sure, selective distribution may have its own drawbacks. If most sellers practice selective distribution, for example, some individual dealers may not carry a full array of competing brands, making it more difficult for customers to engage in comparison shopping. Yet the alternative to selective distribution—unrestricted distribution with RPM—is likely to be less effective in stimulating dealer services and more effective in reducing price competition.

sure, territorial restrictions like exclusive territories are likely to be infeasible in retail markets. But other forms of selective distribution—such as limiting the number of dealers or refusing to deal with known discounters—would still be practical, and contractual provisions would remain an option. Nevertheless, in some cases, no combination of alternatives may be as effective as RPM in preventing free riding. As a result, a manufacturer should have the opportunity to raise and substantiate a free rider justification, forcing the plaintiff to demonstrate that the restraint had even greater anticompetitive effects.

B. Stimulating dealer services by increasing dealer margins

RPM may also induce dealers to provide valuable services, even when free riding is not an issue, where dealer profit margins would otherwise be too small to provide the necessary incentive. Suppose that the manufacturer's product is highly differentiated from rival brands and that, as a result, the manufacturer's profit margin is large, say \$30 on each unit it sells. But suppose that its dealers, who compete intensely with each other, earn margins of only \$10 a unit. In this setting, no dealer would have an incentive to incur \$20 in promotional costs to sell an extra unit, even though that promotional effort would benefit the manufacturer and the purchaser. RPM can correct this problem, by raising dealer margins to a level high enough to cover the cost of the desired promotion.⁷³

RPM can also correct another source of what Klein calls "incentive incompatibility."⁷⁴ Suppose that a dealer's promotion of manufacturer A's product increases the sales of that product, but those extra sales

⁷³ Klein and Murphy are the prime exponents of this theory. In their view, it explains the use of RPM by "brand name clothing manufacturers marketing their products through department and specialty stores," such as London Fog raincoats, Florsheim shoes, and Levi Strauss jeans. Klein & Murphy, *supra* note 24, at 289 & n.36. The "key features of these cases," according to Klein and Murphy, are that "the manufacturers have substantial margins and that retail sales effort and shelf space are key determinants of aggregate demand, but that these services are not generally subject to consumer free riding." *Id.* at 289. Klein elaborates and defends this theory in a recent article. See Klein, *supra* note 50.

⁷⁴ Klein, *supra* note 50, at 444.

come entirely at the expense of the dealer's sales of other manufacturers' products. The dealer's promotion, in other words, causes customers to shift their purchases among the dealer's products but does not increase its total sales.⁷⁵ In this circumstance, unless the dealer's margin on manufacturer A's product is larger than its margin on other products, the dealer will not promote product A, since that would raise its costs without increasing its profits. In short, where a promotion cannibalizes the sales of a dealer's other products, the dealer's incentives are not aligned with those of the manufacturer, and RPM, by enhancing the dealer's margin on the manufacturer's product, can reduce or eliminate the divergence.

In two circumstances, then, RPM can rectify an incentive incompatibility and stimulate dealers to provide valuable services they would not otherwise provide. Like the free rider justification, however, this justification is unlikely to be valid in other circumstances and, even when it does apply, may be overbroad. First, if the goal is simply to enhance dealers' willingness and ability to furnish costly services by raising their margins, that goal can be accomplished, in principle at least, in other ways, such as territorial restrictions, limits on the number of dealers, and refusals to sell to discount outlets.⁷⁶ Second, those nonprice restraints may be more effective than RPM in many cases, since, as noted above, dealers subject to RPM—but no other curbs on intrabrand competition—have a tendency to compete away some or all of their margins through free goods, bundled discounts, or other forms of indirect price competition, as Klein and Murphy recognize.⁷⁷ Third, as these authors note, dealers cannot be

⁷⁵ This necessarily means, as Klein stresses, that the promotion does not create "inter-retailer demand effects." *Id.* That is, it does not induce customers of other dealers to move their business to the dealer in question.

⁷⁶ Klein states that there is a "fundamental economic equivalence" between "exclusive territories and resale price maintenance as alternative ways to compensate retailers for increased promotional efforts. . . ." *Id.* at 456.

⁷⁷ See *supra* note 70; Brunell, *supra* note 57, at 23. See also Klein, *supra* note 50, at 457 ("An exclusive territory in some circumstances may have an advantage over resale price maintenance as a way of compensating retailers because it more effectively reduces inter-retailer free-riding problems and provides retailers with increased pricing flexibility."). As noted, however, exclusive territories may not be practical in many retail markets, and other

trusted to use their higher margins on services and promotional activity that the manufacturer wants. On the contrary, “the manufacturer must always monitor dealer performance and terminate dealers who violate the implicit contractual understanding regarding the supply of promotional services.”⁷⁸ But if the manufacturer must always monitor its dealers’ activities, it would be in a position to reward those dealers who perform the desired services with payments, allowances, or other stipends. It is not clear that it needs to resort to the less precise and more anticompetitive device of vertical price fixing.

Of course, a manufacturer may be able to show in a particular case that no set of alternative arrangements is as cost-effective as RPM. After all, RPM has one advantage over other arrangements: it prevents a dealer who skimps on services from increasing sales by lowering product prices. In contrast, if a manufacturer uses nonprice restraints, promotional payments, or contractual requirements, a dealer who fails to provide the desired services can, until it is detected by the manufacturer, pass on its savings in reduced product prices. Because of this difference, RPM may create a more effective incentive structure, and thus be less costly to administer, than any alternative. On the other hand, a manufacturer that uses RPM must monitor both its dealers’ services and their resale prices, so monitoring costs might actually be higher under RPM.⁷⁹ Because it is not possible to resolve this issue *a priori*, a manufacturer should have the

forms of selective distribution may reduce the availability—and exposure—of the manufacturer’s product. *See id.* (“The major economic advantage of resale price maintenance . . . is that it permits the manufacturer to have a larger number of retailers within an area selling its products.”).

⁷⁸ Klein & Murphy, *supra* note 24, at 285.

⁷⁹ Klein, *supra* note 50, at 459 (“[I]n addition to monitoring minimum retail prices and preventing free riding, the manufacturer also must monitor retailer performance and terminate those retailers who are not supplying all the manufacturer-specific promotional efforts they have been compensated to provide.”); Grimes, *supra* note 24, at 112 (“To get the desired promotion, the producer must monitor both the dealer’s performance of the promotion and the dealer’s adherence to the minimum resale price. As a result, the cost of providing the promotion will be higher when RPM is employed.”).

opportunity to present evidence that RPM was the most efficient way to stimulate dealer services that consumers value.⁸⁰

C. Improving brand image by eliminating discounting and loss-leader pricing

Manufacturers sometimes assert that they need to keep resale prices high because low prices would be interpreted by consumers as a sign of poor quality. “We don’t want consumers to think we’re the cheapest guys in the world,” one producer told *The Wall Street Journal*.⁸¹ This asserted justification rests on the premise that consumers lack adequate information about the manufacturer’s product and have to use its price as a gauge of its quality.⁸² If that is true, then when a dealer discounts a manufacturer’s brand or, worse, when a dealer uses the brand as a loss leader, the image of quality the manufacturer wants to project will be tarnished.

As Areeda and Hovenkamp point out, however, the claim that quality image is inextricably linked to price is not a “powerful one.”⁸³ While consumers may lack information about quality when a product is first introduced, that is unlikely to persist once the product has become successfully established in the marketplace. At that point, consumers have become familiar with the brand and are likely to

⁸⁰ Klein asserts that the increasing-dealer-margin rationale for RPM is “broadly applicable,” and therefore “it is reasonable for antitrust policy to require demonstration of a likely anticompetitive effect before condemning the practice.” Klein, *supra* note 50, at 437. For the reasons just noted, however, this rationale may not be as common as Klein suggests. More important, even if it is the usual explanation for RPM—and most cases of the practice are in fact procompetitive—the full rule of reason, under which the plaintiff cannot proceed unless it first demonstrates likely anticompetitive effects, is not the most appropriate legal standard. It is likely to exonerate virtually all cases of RPM, not just the majority. See *infra* part IV.

⁸¹ Joseph Pereira, *Price-Fixing Makes Comeback After Supreme Court Ruling*, WALL ST. J., Aug. 18, 2008, at A1.

⁸² See SCHERER & ROSS, *supra* note 44, at 552 (a manufacturer’s reputation for quality is impaired when discounting occurs and “consumers allegedly judge quality from price”).

⁸³ 8 AREEDA & HOVENKAMP, *supra* note 23, ¶ 1631a1.

regard discounting by a dealer as an opportunity to purchase a good product at a lower price, not as a sign that its quality has deteriorated. Moreover, if there is a significant link between price and perceived quality, the manufacture can influence the resale price, at any point in the product life cycle, by raising the wholesale price of the product or refusing to sell it to off-price dealers. In some cases, of course, consumers may remain uncertain about the quality of an established product, or they may value certain prestige or status items precisely because they cost a great deal. In these instances, brand image might be a legitimate justification for RPM. But in most cases of known and established products, this justification is likely to be weak.⁸⁴

When a dealer cuts the price of a product below the dealer's own cost—and thus uses the product as a loss leader—there may be an additional justification for RPM. The manufacturer may want to eliminate the loss leading not only to preserve the brand's image of quality, but also to maintain the size and diversity of its dealer network. In particular, it may want to retain smaller or more specialized dealers who cannot afford to sell the product at a loss and would have to drop it if the price cutting continued. The absence of these dealers could make the product less accessible or less desirable to some consumers. It could also permit the remaining dealers to collude, tacitly or expressly, to raise the resale price above the competitive level.

At the same time, however, loss-leader pricing brings immediate benefits to consumers. It sharply lowers the price of the product, and like other forms of promotional pricing, may lead consumers to make beneficial purchases of other products. Moreover, there is no evidence that the potential harms from loss-leader pricing (reduced choice of dealers, higher prices in the long run) occur frequently or, if they do, that they outweigh the benefits of the practice. Areeda and Hovenkamp observe that “no one has yet adduced any empirical evidence that the hypothesized evils of loss-leader selling occur with any frequency. Vague complaints of ‘unfair loss-leader tactics’ are much more common than actual examples of consumer acceptance

⁸⁴ In the case of a new product, when consumers are most likely to have doubts about product quality, the manufacturer would be entitled to a safe harbor under my approach. *See infra* part VI.

being destroyed, rival dealers ruined, or manufacturers prejudiced.”⁸⁵ For these reasons, a court should not accept the loss-leader justification for RPM absent a demonstration by the manufacturer that (1) loss-leader pricing is likely to injure consumers in the long run by reducing their choices, raising the prices they pay, or causing them to misperceive the quality of a manufacturer’s product; and (2) this long-run injury is likely to outweigh the short-run gains from loss-leader pricing.

D. Likelihood of procompetitive effects

This review of the principal justifications for RPM indicates that the practice is unlikely to be procompetitive in all or almost all cases. Each justification is problematic in many circumstances, and a manufacturer attempting to defend vertical price fixing on any of these grounds would face numerous hurdles. As a result, a rule of de facto legality is difficult to defend: there is no solid basis to conclude that RPM is likely to benefit consumers in virtually every case.

At the same time, there are many reasons to believe that RPM is likely to be procompetitive in a substantial number of cases. First, the justifications just described are theoretically valid in some circumstances, and those circumstances do not appear to be rare or highly unusual. Second, the preconditions for an anticompetitive effect, while doubtlessly present in some cases, are unlikely to be true as a general rule, and perhaps not even in the majority of cases. Third, the empirical evidence reviewed in part II suggests that RPM is likely to harm consumers in a substantial number of cases. It does not demonstrate that the restraint is invariably or ordinarily anticompetitive. If this assessment is correct, then RPM is likely to be procompetitive in a large number of cases, perhaps the majority. When RPM was allowed by state fair trade laws, “it was used in a wide variety of retail markets, including many lines of clothing (jeans, shoes, socks, underwear, shirts), jewelry, sports equipment, candy, biscuits, automobiles, gasoline, small and large appliances (stereos, shavers, washing machines).”⁸⁶ This widespread usage indicates that manufacturers often found RPM to be prof-

⁸⁵ 8 AREEDA & HOVENKAMP, *supra* note 23, ¶ 1619; *see also id.* ¶ 1633d (rejecting loss leading as a justification for RPM, at least presumptively).

⁸⁶ Frank Mathewson & Ralph Winter, *The Law and Economics of Resale Price Maintenance*, 13 REV. INDUS. ORG. 57, 59 (1998).

itable. In the absence of evidence that these profits were almost always anticompetitive gains, RPM was frequently procompetitive.

It is difficult to reach a more precise conclusion without more empirical evidence or a consensus of the commentators. Thus, while the *Leegin* majority rejected the view that RPM is invariably anticompetitive, it did not conclude that the restraint is commonly or predominantly beneficial. It merely asserted that efficient uses of RPM are “not . . . infrequent or hypothetical.”⁸⁷ Similarly, in his dissent, Justice Breyer declared: “But what about benefits? How often, for example, will the benefits to which the Court points occur in practice? I can find no economic consensus on this point.”⁸⁸

E. Conclusion

The most reasonable conclusion is that it is unclear how often RPM is anticompetitive and how often it is precompetitive—or even which effect predominates—but it is prudent to assume that it harms consumers in a substantial number of cases and benefits them in a substantial number of other cases. Neither theory nor evidence convincingly supports the view that RPM is almost always anticompetitive, or the opposite view that it is almost always procompetitive. As a result, the ideal legal standard should neither condemn the vast majority of cases nor immunize virtually every instance, but should instead distinguish, effectively and at low cost, between harmful and beneficial RPM. If administered fairly, a presumption of illegality coupled with safe harbors would achieve that goal. Historical experience indicates that the full rule of reason would not.

IV. FULL RULE OF REASON

Posner declared that “in practice, [the rule of reason] is little more than a euphemism for nonliability.”⁸⁹ Blecher made the same point

⁸⁷ *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 894 (2007) (“although the empirical evidence on the topic is limited, it does not suggest efficient uses of the agreements are infrequent or hypothetical”).

⁸⁸ *Id.* at 915 (Breyer, J., dissenting).

⁸⁹ Richard A. Posner, *The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision*, 45 U. CHI. L. REV. 1, 14 (1977).

more colorfully, characterizing the full rule of reason as “a euphemism for an endless economic inquiry resulting in a defense verdict.”⁹⁰ Calkins stated: “Beneath the surface lies a truth that plaintiffs and prosecutors understand all too well: when the full, formal rule of reason is the governing standard, plaintiffs almost never win.”⁹¹

These comments reflect the abysmal track record of plaintiffs under the full rule of reason, whether they are challenging vertical restraints or other allegedly anticompetitive behavior. Ginsburg examined all vertical nonprice restraint cases brought between 1977 and 1991, and found that plaintiffs lost forty-one out of forty-five, more than ninety percent.⁹² He concluded that *Sylvania*’s adoption of the rule of reason had resulted in a regime of “de facto legality.”⁹³ Crane stated that *Kahn* had the same effect: Once vertical maximum price fixing was subject to the full rule of reason, it became “de facto legal.”⁹⁴ In other areas of antitrust law, the full rule of reason has been equally unfriendly to plaintiffs. Looking at the entire range of rule of reason cases in the last decade, Carrier found that of the 222 that reached final judgment, defendants won 221, a towering 99.6%.⁹⁵

⁹⁰ Maxwell M. Blecher, *The Schwinn Case—An Example of a Genuine Commitment to Antitrust Law*, 44 ANTITRUST L.J. 550, 552 (1975).

⁹¹ Stephen Calkins, *California Dental Association: Not a Quick Look But Not the Full Monty*, 67 ANTITRUST L.J. 495, 521 (2000).

⁹² Douglas H. Ginsburg, *Vertical Restraints: De Facto Legality Under the Rule of Reason*, 60 ANTITRUST L.J. 67, 71 (1991).

⁹³ *Id.* Three of the four cases that plaintiffs won were brought against a defendant with a high market share. Without such a high share, the plaintiff’s chances of victory were virtually nil, leading Ginsburg to write: “I conclude that non-monopolists have been effectively freed from antitrust regulation of vertical nonprice restraints.” *Id.* at 67. See also AREEDA & HOVENKAMP SUPP., *supra* note 23, ¶ 1620.1 (“Since the *Sylvania* decision in 1977, very few private plaintiffs have successfully challenged vertical nonprice restraints.”).

⁹⁴ Daniel A. Crane, *Chicago, Post-Chicago, and Neo-Chicago*, 76 U. CHI. L. REV. 1911, 1912 (2009).

⁹⁵ Michael A. Carrier, *The Rule of Reason: An Empirical Update for the 21st Century*, 16 GEO. MASON L. REV. 827, 828 (2009). The only plaintiff’s victory was a government case, *United States v. Visa U.S.A., Inc.*, 344 F.3d 229 (2d Cir. 2003). Carrier, *supra*, at 831. Carrier’s earlier survey, covering 1977–99, did not present a

It is unlikely that these results reflect merely a lack of merit in the plaintiffs' cases. While many of the lawsuits undoubtedly did challenge harmless or procompetitive behavior—and thus should have been rejected—the full rule of reason is such a complicated and costly process that it likely to have prevented a significant number of plaintiffs from pursuing worthwhile claims.⁹⁶ After all, the full rule of reason is one of the most demanding legal standards in all of antitrust. It requires the plaintiff to prove, first of all, that the challenged conduct had actual anticompetitive effects, or that it was likely to have anticompetitive effects because the defendant had (or was likely to obtain) market power and the conduct contributed to that power. Moreover, if the plaintiff establishes a *prima facie* case, and the defendant offers justifications for its behavior, the plaintiff must show that these justifications are inadequate to outweigh the anticompetitive effects of the conduct, either because the conduct had no procompetitive effects, because its procompetitive effects were relatively small, or because they could have been achieved in a less restrictive way.⁹⁷

comparable figure, but did note that plaintiffs lost eighty-four percent of the cases because they failed to show an actual anticompetitive effect or a potential anticompetitive effect based on proof of market power. See Michael A. Carrier, *The Real Rule of Reason: Bridging the Disconnect*, 1999 BYU L. REV. 1265, 1268 (1999). Neither survey examined settlements.

⁹⁶ Ginsburg, *supra* note 92, Crane, *supra* note 94, and Carrier, *The Rule of Reason*, *supra* note 95, do not examine the merits of the cases the plaintiffs lost and thus do not conclude that the plaintiffs *should* have lost such a large proportion of cases. In his earlier article, in contrast, Carrier concluded that the vast majority of courts had correctly found that plaintiffs failed to show actual or potential anticompetitive effects. See Carrier, *The Real Rule of Reason*, *supra* note 95. He acknowledged, however, that he was highly deferential to the courts, treating “decisions as incorrect only where the court flagrantly miscalculates the net effect on competition or on consumer welfare.” Carrier *The Real Rule of Reason*, *supra* note 95, at 1332 n.451. It is entirely possible, therefore, that a significant proportion of these cases should have been won. Notably, none of the cases Carrier examined in 1999 involved RPM, the most competitively dangerous vertical intrabrand restraint.

⁹⁷ See Maurice E. Stucke, *Does the Rule of Reason Violate the Rule of Law?*, 42 U.C. DAVIS L. REV. 1375, 1385–86 (2009) (describing as “an elaborate four-part minuet” the process of litigation under the full rule of reason: first, the plaintiff must establish that the “challenged restraint has had substantial adverse effects on competition” or, in the absence of actual effects, “plaintiffs can

Given the scope and complexity of this inquiry, Hovenkamp states that litigating a rule of reason case is “one of the most costly procedures in antitrust practice.”⁹⁸ Overstreet and Fisher characterize rule of reason cases as “multi-million-dollar litigation monsters” that are “hardly . . . the most desirable legal solution” to the RPM problem except for “private lawyers and economic consultants.”⁹⁹ Areeda and Hovenkamp note that “litigation under the rule of reason generally is extraordinarily expensive in relation to the size of the interest at stake, and it is likely to be even more costly for a practice that is as poorly understood and as complex as RPM.”¹⁰⁰

The biggest hurdle facing a plaintiff under the full rule of reason is the first one it must surmount. In order to establish a *prima facie* case, the plaintiff must demonstrate either that the challenged practice had *actual* anticompetitive effects or that the practice *could* have had anticompetitive effects because the defendant had *market power*.¹⁰¹ Numerous rule of reason cases have failed because plaintiffs could not make either showing. Ginsburg found, for example, that in over half the non-price vertical restraint cases that plaintiffs lost, the defeat was due to an inability to demonstrate either market power or harm to interbrand competition.¹⁰² Carrier’s most recent review revealed that out of the 221 cases that plaintiffs lost, they failed in 215 of them (97%) because they

demonstrate the likely anticompetitive effects of a restraint by showing the defendants’ ‘market power’ ”; second, if “plaintiffs meet their initial burden, . . . the burden of production [shifts] to defendants to provide a procompetitive justification for the challenged restraint”; third, if the “defendants offer procompetitive business justifications, plaintiffs can . . . respond by showing . . . that lesser restrictive alternatives exist for [achieving] the procompetitive objectives”; and finally, “plaintiffs must . . . show that the restraint’s anticompetitive effects outweigh its procompetitive benefits”). *See also* GenevaPharm. Tech Corp. v. Barr Lab., Inc., 386 F.3d 485, 507 (2d Cir. 2004) (under the full rule of reason, the fact finder engages in a “careful weighing of the competitive effects of the agreement—both pro and con—to determine if the effects of the challenged restraint tend to promote or destroy competition”).

⁹⁸ HERBERT HOVENKAMP, *THE ANTITRUST ENTERPRISE* 105 (2005).

⁹⁹ Overstreet & Fisher, *supra* note 36, at 53–54.

¹⁰⁰ AREEDA & HOVENKAMP SUPP., *supra* note 23, ¶ 1620.1.

¹⁰¹ Stucke, *supra* note 97, at 1385, 1433.

¹⁰² Ginsburg, *supra* note 92, at 75.

could not show an actual or probable anticompetitive effect.¹⁰³ Since *Leegin*, several RPM cases have been dismissed on the pleadings because the complaint did not properly allege a relevant market.¹⁰⁴

As these cases suggest, it is not easy to show that a restraint could harm competition because the defendant has (or is likely to attain) market power. Establishing market power is normally a daunting project, since the plaintiff must define a relevant market (in both product and geographic terms), measure the defendant's share of that market, and demonstrate the existence of significant barriers to entry and expansion. Developing evidence on all of these issues normally requires extensive discovery and expensive economic experts,¹⁰⁵ and the issues are often so complex, fact-specific, and contested that there is no assurance of success. For these reasons, Stucke attributes much of the burden of the full rule of reason to the market power hurdle: "Defining a relevant market, by itself, is fact-intensive, time-consuming, costly, and imprecise."¹⁰⁶ Justice Breyer singled out the market power requirement in explaining why he opposed subjecting RPM to the full rule of reason: "The Court's invitation to consider the existence of 'market power' . . . invites lengthy time-consuming argument among competing experts, as they seek to apply abstract, highly technical, criteria to often ill-defined markets."¹⁰⁷ Areeda and Hovenkamp concur: "One of the biggest hurdles for future RPM plaintiffs is likely to be the market power requirement."¹⁰⁸

¹⁰³ Carrier, *The Rule of Reason*, *supra* note 95, at 829. The comparable figure in Carrier's earlier survey was 84%. See Carrier, *The Real Rule of Reason*, *supra* note 95, at 1268.

¹⁰⁴ Brunell, *supra* note 57, at 8.

¹⁰⁵ See Stucke, *supra* note 97, at 1466 ("expert antitrust testimony is often necessary for antitrust plaintiffs to prevail under the rule of reason," since market definition must usually be based on expert opinion, not lay testimony).

¹⁰⁶ *Id.* at 1462.

¹⁰⁷ *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 917 (2007) (Breyer, J., dissenting).

¹⁰⁸ AREEDA & HOVENKAMP SUPP., *supra* note 23, ¶ 1620.1; see also 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.").

Establishing actual anticompetitive effects is unlikely to be much easier, principally because the vast majority of courts now appear to be unwilling to find an anticompetitive effect in the absence of proof of market power. Carrier's review of recent rule of reason decisions found that plaintiffs were unable to show an anticompetitive effect in 215 cases. In 208 of these (97%), the courts expressly noted that plaintiffs had failed to address or demonstrate market power.¹⁰⁹

In view of these hurdles, the full rule of reason is likely to discourage many plaintiffs, especially small dealers, from bringing actions to challenge RPM, even when it is anticompetitive. Indeed, if the record of the last thirty years is a reliable guide, the full rule of reason is likely to operate as a rule of de facto legality, absolving nearly all decisions by manufacturers or dealers to adopt RPM. And even if the future is not so dire, "many instances of anticompetitive RPM may go unchallenged."¹¹⁰ This unwise result is made more likely by the *Leegin* Court's failure to adopt any presumptions helpful to plaintiffs, thereby signaling to the lower courts that RPM should be condemned only when the plaintiff carries its entire set of burdens under the rule of reason. The law should adopt a more discriminating approach.

V. TRIGGERED PRESUMPTIONS

The triggered presumption or "quick look" analysis suggested by the FTC in *Nine West*¹¹¹ does not appear to be the answer. While it would permit more meritorious cases than the full rule of reason, it is still likely to impose large burdens on many plaintiffs and thus is likely to be inferior to the approach recommended in this article—presumptive illegality combined with safe harbors. In *Nine West*, as

¹⁰⁹ See Carrier, *The Rule of Reason*, *supra* note 95, at 830 (in 110 cases, the courts concluded "that the plaintiff does not show an anticompetitive effect without addressing market power"; in 66 cases, the courts simply found "a lack of market power"; in 32 cases, the courts asserted "that there is no anticompetitive effect and no market power").

¹¹⁰ AREEDA & HOVENKAMP SUPP., *supra* note 23, ¶ 1620.1 (under the full rule of reason, without "assistance from the Antitrust Division or the FTC, many instances of anticompetitive RPM may go unchallenged").

¹¹¹ *In re Nine West Group Inc.*, No. C-3937, 2008 WL 2061410 (FTC May 6, 2008).

noted earlier, the FTC stated that *Leegin* might be read to allow the use of a truncated or “quick look” rule of reason analysis if the plaintiff establishes the existence of one or more of the factors mentioned in *Leegin*—market power at the manufacturer or dealer level, widespread use of RPM within the relevant market, or imposition of RPM on the manufacturer by a dealer. Once a plaintiff establishes one or more of these factors, RPM would be deemed “inherently suspect” and presumptively illegal.¹¹²

The FTC’s approach would be an improvement over the full rule of reason because it would enable the plaintiff, in many circumstances, to make out a *prima facie* case—and thus trigger a presumption of illegality—without proving all the preconditions of a theory of anticompetitive effect. For example, if the plaintiff showed that the defendant had market power, the plaintiff would not also have to prove that the RPM facilitated collusion at the manufacturing level, suppressed an innovative dealer, stimulated excessive services, or in some other way fit a recognized theory of anticompetitive harm. The RPM would be presumed to be anticompetitive simply because the defendant had market power.

Because each of the *Leegin* factors is difficult to establish, however, the FTC’s approach would be less desirable than the approach proposed here, under which a plaintiff could create a rebuttable presumption of illegality merely by proving the existence of an agreement to maintain resale prices.¹¹³ Two of the *Leegin* factors would almost

¹¹² For a description of the FTC’s general approach to “inherently suspect” restraints, see *Polygram Holding, Inc. v. Fed. Trade Comm’n*, 416 F.3d 29 (D.C. Cir. 2005), where the D.C. Circuit upheld the approach as an acceptable form of “quick look” rule of reason analysis.

¹¹³ While I have used “merely” to distinguish the burdens of my approach from those of a full or triggered rule of reason, it may not be easy for a plaintiff to establish an agreement to maintain resale prices. Given the Supreme Court’s decisions in *Colgate* and *Monsanto*, a plaintiff cannot prove the necessary agreement without direct evidence of an exchange of commitments between the manufacturer and one or more of its dealers. See *United States v. Colgate & Co.*, 250 U.S. 300 (1919) (no agreement is created when a manufacturer simply announces that it will refuse to sell to dealers who do not adhere to its specified resale prices, even if the dealers thereafter adhere to those prices); *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984)

always impose substantial burdens on plaintiffs. Demonstrating that a manufacturer or dealer, or group of manufacturers or dealers, had market power would entail the same difficult, time-consuming, and uncertain process that the full rule of reason requires of most plaintiffs. If a small dealer had to define a relevant product and geographic market, show that the defendant (or a group of firms including the defendant) had a substantial share of that market, and demonstrate that the market was protected by high entry barriers in order to trigger a presumption of illegality, many meritorious cases would be discouraged.

Establishing another *Leegin* factor—that the source of the restraint was a dealer, not the manufacturer—would be even more difficult. In order to show that RPM was anticompetitive because it served dealer interests rather than those of the manufacturer, it would not be enough to show that the *idea* came from a dealer. The dealer could simply have pointed out to the manufacturer that another dealer was engaging in detrimental free riding and that RPM would halt such behavior. In order to show that RPM was anticompetitive, the plaintiff would have to prove that the *reason* the restraint was adopted was that it was imposed by a dealer (or group of dealers) on the manufacturer against its will. Making such a showing would often be exceptionally challenging because it would require proving both that the dealer (or group of dealers) had market power and that it was the exercise of this power, not the perceived efficiency benefits of RPM, that caused the manufacturer to adopt the restraint. In effect, the plaintiff would have to identify and disprove the most likely procompetitive justifications for the restraint, more than it would have to do under the full rule of reason.¹¹⁴

(an agreement to maintain resale prices cannot be established without showing that the manufacturer sought an assurance from a dealer that the dealer would comply with the manufacturer's specified resale prices, and the dealer gave that assurance). Of course, proof of agreement would not be a problem if a manufacturer, in the wake of *Leegin*, practiced RPM openly. But if the manufacturer maintained resale prices through surreptitious agreements with certain dealers or by exercising its *Colgate* rights, the plaintiff's burden could be difficult or impossible to discharge.

¹¹⁴ See Varney, *supra* note 15, at 25 (in order to show retailer-driven RPM, "the presence of both market power and retailer coercion are critical; manufacturer response to complaints about discounters is insufficient"). Of course,

The third *Leegin* factor—that RPM was widely used in the relevant market—would be easier to establish, but it would still present significant challenges. The plaintiff would have to define a relevant product and geographic market and show that the manufacturers using RPM account for a large share of that market. As noted above, the first element—market definition—is frequently difficult for a small firm, and the second element—pervasiveness—is not easy. If a dealer purchases from a single manufacturer, it may not know whether other manufacturers maintain resale prices. It may know that dealers in other products rarely discount, but it may be unable to say, without extensive discovery, whether that is due to unilateral dealer decisions or agreements with the other producers. Areeda and Hovenkamp concur: “The usual plaintiff is a terminated dealer or, less frequently, a class of consumers challenging a single manufacturer. Apart from a multi-brand dealer or cartel member, the parties to the lawsuit may have no personal knowledge of the practices of other manufacturers.”¹¹⁵ In many cases, in short, the *Leegin* factors are likely to make it quite difficult for a plaintiff, particularly a small dealer, to challenge an anti-competitive instance of RPM.

Grimes has proposed an alternative trigger, one that would be easier for plaintiffs to establish. Grimes would create a presumption of illegality whenever RPM is used in an open distribution system.¹¹⁶ An open distribution system, under his approach, is one in which the manufacturer does not “substantially limit[] distribution in order to encourage dealer commitment and loyalty.”¹¹⁷ Because this approach would make RPM presumptively illegal in any open distribution system, it would be an improvement over both the full rule of reason and

the plaintiff may be able to discharge this burden if it finds e-mails showing that “the manufacturer was never convinced that it would be better off if it adopted RPM or [that it] actually was worse off after imposing RPM” *Id.* at 24 (noting the presence of such e-mails in the Babies “R” Us matter discussed *supra* note 47).

¹¹⁵ 8 AREEDA & HOVENKAMP, *supra* note 23, ¶ 1633.

¹¹⁶ Grimes, *supra* note 34, at 492 (advocating a “presumption . . . that open distribution restraints (such as vertical minimum price fixing or supplier-imposed limits on dealer discount advertising) are unlawful”).

¹¹⁷ *Id.* at 493.

the truncated rule of reason suggested in *Nine West*. It would not, however, be as useful as a broad presumption of illegality combined with safe harbors for two reasons.

First, the courts cannot resolve the easy cases as quickly under the Grimes approach as under mine. When RPM is plainly unjustified because the manufacturer cannot offer any significant justification for it, the plaintiff could not establish a *prima facie* case—and create a presumption of illegality—under Grimes’ approach without showing that the manufacturer’s distribution system was open rather than closed, a showing that may raise significant evidentiary issues. My proposal would not require such a showing. Likewise, when RPM is highly likely to be innocuous because it is employed by a new entrant, my approach would end the litigation by granting a safe harbor to the entrant. Grimes’ approach would require the fact finder to determine whether the entrant had a procompetitive justification, an issue that could not normally be resolved without appraising whether the entrant could have used exclusive territories, slotting payments, or some other alternative. Second, RPM may be less justified in a restrictive distribution system than in an open distribution system. The most common justification offered for RPM is the free riding scenario, but as noted above, free riding is less likely to be a serious problem in a restricted distribution system. When a manufacturer limits the number of its dealers, diminishing competition among them, it reduces their ability and incentive to free ride on each other’s activities. To the extent free riding is a significant problem in the manufacturer’s distribution system, then, there is reason to impose a greater presumption of illegality in a restricted system than an open system. A broad presumption of illegality, applicable to both open and closed distribution systems, would address the anticompetitive potential of RPM in both settings.

VI. PRESUMPTIVE ILLEGALITY WITH SAFE HARBORS

The approach I propose would create a presumption of illegality for RPM and two safe harbors. If administered fairly, and there is good reason to believe it would be, this approach would be superior to all the major alternatives—per se illegality, per se legality, the full rule of reason, and a truncated rule of reason triggered by the *Leegin*

factors. Unlike any of these alternatives, my approach would resolve *both* sets of easy cases (those in which RPM is plainly harmful and those in which it is clearly beneficial) correctly and at low cost. Moreover, my approach would be superior to the two per se rules and at least as good as the two types of rule of reason in resolving the harder, mixed cases, where RPM has both anticompetitive and procompetitive effects.

A. Burdens of proof and production

Under my proposal, the plaintiff would establish a *prima facie* case by proving that the defendant entered into a vertical agreement to maintain resale prices. The plaintiff would not have to show, at this stage of the litigation, that the defendant has market power, that the restraint is likely to have anticompetitive effects, or (in lieu of market power and likely effects) that it had actual anticompetitive effects. If the plaintiff meets this burden, then the RPM agreement would be presumed illegal and the burden would shift to the defendant to rebut the presumption.

The defendant could do so by producing substantial evidence that its conduct is entitled to a safe harbor or that it has a procompetitive business justification. Under either route, the plaintiff would be allowed to dispute the defendant's evidence, but if the defendant proves the existence of a safe harbor, then the presumption would be conclusively rebutted. If the defendant advances a justification, the plaintiff could introduce evidence that the prerequisites for the justification are not satisfied or that its efficiency benefits could be achieved through a less restrictive alternative. If the plaintiff puts forward an alternative, the defendant could respond with evidence that the alternative would have been significantly more costly or less effective than RPM. If so, the ultimate burden of establishing a less restrictive alternative would fall on the plaintiff.

If the plaintiff fails to undermine the defendant's justification—by showing that it is invalid, insignificant, or unnecessarily restrictive—the burden would shift back to the plaintiff to show that the restraint's anticompetitive effects exceeded its procompetitive benefits, reducing the welfare of consumers. To make this showing, the plaintiff would have to set forth a theory of anticompetitive harm—

for example, that the RPM facilitated collusion at the dealer level—and show that the preconditions for this theory existed. In nearly every instance, that would entail proof that a manufacturer or dealer, or a group of manufacturers or dealers, had market power.¹¹⁸ In addition, the plaintiff would have to demonstrate that the anticompetitive effects that flowed from its theory of harm were likely to outweigh the procompetitive effects of the defendant's justification.

B. *Safe harbors*

My approach would create a limited safe harbor for established manufacturers and a broad safe harbor for new entrants.

1. **ESTABLISHED MANUFACTURERS** An established manufacturer that uses RPM would be entitled to a safe harbor if it proves that it does not have significant market power, that none of its dealers has significant market power, and that most other manufacturers in the market (measured by sales volume) do not maintain resale prices. Proof of these three conditions would entirely or almost entirely remove the possibility of significant harm from any of the anticompetitive effects described in part II above. It is highly unlikely, for example, that RPM facilitated collusion at the manufacturing level if the great majority of manufacturers did not engage in RPM or otherwise maintain resale prices.¹¹⁹ Likewise, excessive or misleading dealer promotion is unlikely to have occurred when there was intense competition at both the manufacturing and dealer levels, and a manufacturer that induced excessive or misleading promotion by its dealers was likely to face both price and nonprice competition in response.

To be sure, it will not always be easy for a manufacturer to show that neither it nor its dealers had significant market power and that maintained prices, whether accomplished by agreement or otherwise, were

¹¹⁸ The exception is deceptive promotion, which can cause consumer harm, at least for a time, even though the dealers engaging in it, and the manufacturer who stimulated it, do not have significant market power.

¹¹⁹ A manufacturer can maintain resale prices without RPM by refusing to sell to off-price dealers or by cutting off full-price dealers when they engage in discounting. While these alternatives may not be as effective as RPM, they can have a significant impact on resale prices.

not pervasive in the market. As the earlier discussion made clear, litigation of the issues of market power and pervasiveness can often be a challenging and expensive process, one that may discourage some manufacturers from asserting this safe harbor, even when they would be entitled to it. But there will be clear cases, and the existence of this safe harbor will make it easier to dispose of them. Where the manufacturer is, by widespread agreement, a small factor in the market, where its dealers are numerous and small, and where dealers in rival brands discount them regularly, the safe harbor could be established without difficulty. In *Nine West*, for example, the FTC resolved several of these issues without apparent hesitation, concluding that the company's "use of resale price maintenance is not likely to harm consumers."¹²⁰ In clear cases, in short, my approach would readily eliminate nonmeritorious suits.

This safe harbor is also subject to dynamic conditions beyond a manufacturer's control. If other producers adopt RPM, the first manufacturer in the market to use RPM might no longer be eligible for the safe harbor. Similarly, if one of its dealers becomes dominant in a geographic market, the manufacturer could no longer rely on the safe harbor. This would not mean, of course, that the manufacturer's RPM had become anticompetitive; it would only mean that the manufacturer would have to present evidence of a procompetitive justification in order to rebut the presumption of illegality. Over time, as courts gain experience with this safe harbor, it could be made more precise, e.g., by picking specific market shares and concentration levels below which market power would be conclusively presumed to be absent.¹²¹ The safe harbor could also be enlarged if warranted. What is impor-

¹²⁰ See *In re Nine West Group Inc.*, No. C-3937, 2008 WL 2061410, at 6 (FTC May 6, 2008) ("On the record before us, it appears that Nine West has only a modest market share in any putative relevant products market in which it competes. This suggests *prima facie* that it lacks market power, and there is no reason to believe that there is collective market power in any putative market. There is also no evidence of a dominant, inefficient retailer in this market.").

¹²¹ The task is somewhat complicated because a manufacturer is most likely to use RPM for procompetitive reasons if its products are differentiated from those of its closest rivals. As a result, the manufacturer is likely to have some market power because of this differentiation. Nevertheless, a court might conclusively presume that the manufacturer lacked significant market power if its share of a properly defined relevant market was under 15% and

tant at this stage is establishing the principle that cases of plainly innocuous RPM should escape the presumption of illegality.

2. NEW ENTRANTS For the same reason, a manufacturer that employs RPM to help it enter a new market would be entitled to a safe harbor. In this setting, RPM may be procompetitive because it is the most efficient way to induce dealers to promote the new product, but even if it is not—even if a less restrictive alternative would work as well—RPM is highly unlikely to be anticompetitive.

New entrants often face a free rider problem. When they enter a new market, they frequently need dealers to promote their new brand in order to help it become established, but if those promotions are successful, other dealers will also want to carry the product and those dealers did not incur the promotional costs incurred by the original dealers. As a result, the latter can undercut the former and prevent them from recouping their outlays. RPM can solve this free rider problem by, as Steiner puts it, inhibiting “Johnny-come-lately” stores from siphoning off the rewards that pioneering dealers need for their “missionary work.”¹²²

market concentration was below 1500. The same figures might be applied to dealer markets, though higher ceilings would be appropriate (say 25% and 2500) if the manufacturer proved that its dealers were small, sold only its brands, and were easily replaced.

¹²² Steiner, *supra* note 40, at 430; *see also* Mathewson & Winter, *supra* note 86, at 60 (“In markets where extensive distribution systems are necessary, RPM is often used in the early part of a product’s life cycle to aid in the establishment of the distribution system. In this situation, which holds for markets as diverse as those for stereo components and jeans, RPM lowers the barriers [to] entry into upstream markets.”).

Even when dealers do not need to engage in expensive promotional activity on behalf of a new product, RPM may facilitate new entry by reducing the risks that dealers face in carrying an untried product. If the product is unsuccessful, the dealers may have to mark it down sharply in order to sell off their inventory. If the product is successful, the dealers may be unable to earn high profits on it because other dealers decide they want to carry it too. RPM can reduce both risks by making it more likely that dealers earn significant profits on a new product, whether it is successful or not. *See* Lambert, *supra* note 17. Of course, a manufacturer may be able to alleviate those risks in other ways: it can help dealers unload inventory by accepting returns of unsold units at full price, and it can protect dealer margins on successful products by limiting the number of authorized dealers.

Like all free riders arguments, however, this one is a valid justification for RPM only if the new entrant could not achieve its promotional goals in other, less restrictive ways. Many commentators have observed that free riding on pioneering dealers' promotional efforts can be reduced, if not eliminated, through nonprice restraints such as selective distribution,¹²³ or through up-front payments or other incentives to the pioneering dealers.¹²⁴ In addition, rather than relying on dealers to create demand, manufacturers may create demand for a new product themselves, through advertising or other consumer-directed marketing. If any of these alternatives is as effective and efficient as RPM, a new entrant would not need to employ RPM in order to gain a foothold in a new market.

Despite these objections, a safe harbor for new entrants appears appropriate for two reasons. First, the likelihood of significant, persistent anticompetitive effects is very low. After all, new entry is, by definition, a time limited process: it ends as soon as the firm becomes established in the market.¹²⁵ Moreover, new entrants are easy to identify, they are unlikely to gain market power in the near term, and there will be only one or a few of them at any given time, reducing the danger of collusion. For these reasons, even prominent opponents of RPM, who generally favor a *per se* ban, have been willing to create an exception for new entrants.¹²⁶ Second, in this setting, where the prospects of anticompetitive harm are so low, a firm is more likely to choose the distribution arrangement that is most efficient. If the entrant cannot

¹²³ See, e.g., 8 AREEDA & HOVENKAMP, *supra* note 23, ¶ 1617a3 (while the new entry rationale makes sense as a justification for exclusive territories, it "seems presumptively inapplicable to resale price maintenance").

¹²⁴ See, e.g., Peeperkorn, *supra* note 6, at 212 ("it seems more efficient, both for the manufacturer and for the consumers, if the manufacturer rewards the investments made by the first distributor through a lump sum payment").

¹²⁵ *Id.* at 211 ("this is not a justification to allow RPM for a long period, or . . . for established brands").

¹²⁶ See, e.g., Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a Per Se Rule Against Vertical Price Fixing*, 71 GEO. L.J. 1487, 1495 (1983). See also *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 917–18 (2007) (Breyer, J., dissenting) ("And if 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.'").

reasonably expect to gain significant market power during the entry process, then its margin for error is small. It is unlikely to enjoy any cushion—any supracompetitive margin—that would protect it if its distribution strategy was not the most cost-effective. Although entrants do make mistakes, and most of them perish, there is greater reason to presume in this setting that RPM is the least restrictive alternative.

C. *Justifications*

Under my approach, a defendant could rebut the presumption of illegality by establishing a safe harbor, demonstrating a significant procompetitive justification, or both. In order to demonstrate a significant procompetitive justification, a defendant would have to show that the justification was theoretically valid, that it was significant in magnitude, and that if the plaintiff asserts a less restrictive alternative, there are problems with it. Areeda and Hovenkamp describe these requirements in a particularly thoughtful way:

To define a justification in terms that can realistically be proved, we can reasonably expect at least substantial evidence that the manufacturer has a legitimate business problem, that resolution of that problem would confer a nontrivial benefit, that the restraint can be reasonably effective for the claimed purpose, and that less restrictive alternatives would be significantly more costly or significantly less effective.¹²⁷

This formulation, while sensitive to the practical limits of proof, is nevertheless demanding, and it is likely that many defendants would not be able to satisfy it. But that is appropriate, for RPM is likely to be anticompetitive in a substantial number of cases. As part III indicated, however, both economic theory and empirical evidence suggest that RPM is likely to be procompetitive in a substantial number of cases. It is important, therefore, that the approach I propose be administered in a way that gives manufacturers a reasonable opportunity to overcome the presumption of illegality. This presumption should not become, as it may have become in Europe, a conclusive presumption of illegality, a *per se* ban in disguise.

Fortunately, there is considerable reason to expect that American courts would administer a presumption of illegality in a balanced

¹²⁷ 8 AREEDA & HOVENKAMP, *supra* note 23, ¶ 1633.

way. First, in recent decades American courts have become more cautious about finding antitrust liability and more sympathetic to economic justifications of business practices. Today, approximately fifty-six percent of federal appellate court judges were appointed by Republican presidents,¹²⁸ and judges at all levels recognize that economics plays a crucial role in antitrust analysis.¹²⁹ Both perspectives are likely to cause courts, in their findings of fact and instructions to juries, to take an open-minded—rather than dismissive—approach to economic arguments on behalf of RPM. Second, the Supreme Court has now declared, on three separate occasions, that vertical intra-brand restraints are frequently procompetitive and thus should be evaluated under the rule of reason, not condemned *per se*.¹³⁰ This consistent message, reiterated in *Leegin* itself, is likely to make courts receptive to assertions that RPM is procompetitive and skeptical of claims that it is harmful. Finally, in most cases the defendant is likely to be able to advance a plausible justification for RPM, since, as part III made clear, there are several well-known, theoretically valid, procompetitive explanations for the practice. To be sure, the plaintiff is bound to assert that the manufacturer's procompetitive goals could be achieved in a less restrictive way, but on that issue, the plaintiff has the initial burden of production and the ultimate burden of proof. Moreover, if the plaintiff cannot show that there was an effective and practical alternative to RPM, the plaintiff would be forced to prove that the anticompetitive effects of the restraint outweighed its beneficial effects, a task that would ordinarily require the plaintiff to undertake the daunting project of establishing market power. All these reasons make it unlikely that my approach would simply become a rule of *per se* illegality.

¹²⁸ Alex Kingsbury, *The Long Road to Remaking the Courts*, U.S. NEWS & WORLD REP., June 1, 2009, at 54.

¹²⁹ See John B. Kirkwood, *Consumers, Economics, and Antitrust*, in 21 RES. L. & ECON., ANTITRUST LAW AND ECONOMICS 1 (John B. Kirkwood ed., 2004).

¹³⁰ See *supra* text accompanying notes 1–5.

VII. CONCLUSION

RPM is both the most competitively dangerous vertical intrabrand restraint and a practice that is likely to benefit consumers in a substantial number of cases. As a result, the ideal legal standard for RPM is an approach that distinguishes, effectively and at low cost, between anticompetitive and procompetitive instances of RPM. While the *Leegin* majority asserted that the full rule of reason could play this role, it did not acknowledge what every scholar who has looked at the issue has found—that the full rule of reason has operated in practice as a standard of de facto legality, absolving almost every restraint it has examined. By requiring plaintiffs to prove, as a threshold matter, that the defendant has significant market power or that its behavior caused actual anticompetitive effects, the full rule of reason has made it almost impossible for plaintiffs, particularly the small dealers that typically bring vertical restraint cases, to succeed, even when their actions have merit.

A superior approach would combine a presumption of illegality with safe harbors. Unlike the full rule of reason, or any of the other major alternatives (*per se* illegality, *per se* legality, or a truncated rule of reason triggered by the *Leegin* factors), this approach would allow courts to dispose relatively quickly of both sets of easy cases, those in which RPM is clearly anticompetitive (because the manufacturer cannot offer a significant justification) and those in which it is highly likely to be innocuous (because, say, the manufacturer is a new entrant). This approach would also be no more costly to administer and no less accurate than the full rule of reason in the more difficult cases, those in which RPM has both procompetitive and anticompetitive effects.

Leegin invited the lower courts to structure the full rule of reason, and even develop presumptions, as they gain experience applying the standard over time.¹³¹ This article suggests that the courts should develop presumptions soon, for experience with RPM cases under the full rule of reason is unlikely to be of much help in determining how often the practice is anticompetitive and how often it is procompetitive. If this standard operates as it has in the past, then the vast major-

¹³¹ 551 U.S. at 898–99 (majority opinion).

ity of cases are likely to be dismissed, even when RPM is anticompetitive, because plaintiffs cannot meet its burdensome requirements. In order to obtain better information on the competitive impact of RPM—and reduce the incidence of incorrect results—courts should adopt a broad but fully rebuttable presumption of illegality combined with safe harbors.