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I. INTRODUCTION

The battle over the proper legal treatment of minimum resale price maintenance ("RPM") continues to rage in the United States. Despite the U.S. Supreme Court's 2007 *Leegin* decision abrogating the rule of *per se* illegality for purposes of federal antitrust law,[2] squabbles continue on two fronts.

First, states have split on whether minimum RPM will remain *per se* illegal under state antitrust law. At the time of this writing, nine states have indicated that they will retain the *Dr. Miles* rule of *per se* illegality under their state antitrust statutes, while most of the rest will bring state-level RPM standards in line with federal law.[3]

Second, commentators have divided over what version of the rule of reason should apply to minimum RPM under federal law. Some commentators (including one of the authors here) have called for a full-blown rule of reason analysis under which the plaintiff would bear the burden of proving an actual anticompetitive effect or, at a minimum, the structural prerequisites to such an effect.[4] Others have advocated approaches that would presume the unreasonableness of a challenged instance of RPM if: (i) consumer prices have risen,[5] (ii) the RPM was dealer-initiated,[6] or (iii) the RPM was imposed on homogeneous products that are not sold with "free-rideable" point-of-sale services.[7] These latter approaches are essentially versions of the "quick look" rule of reason, under which an evaluating court effectively presumes that the challenged

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

[3] *See* Michael A. Lindsay, *State Resale Price Maintenance Laws After* Leegin, ANTITRUST SOURCE (Oct. 2009).

[4] *See*, *e.g.*, Thomas A. Lambert, *A Decision-Theoretic Rule of Reason for Minimum Resale Price Maintenance*, 55 ANTITRUST BULL. 167 (2010); Christine A. Varney, *A Post-*Leegin *Approach to Resale Price Maintenance Using a Structured Rule of Reason*, 24 ANTITRUST 22 (Fall 2009).

[5] *See*, *e.g.*, Brief for the American Antitrust Institute as Amici Curiae in Support of Appellant and Reversal, PSKS, Inc. v. Leegin Creative Leather Prods., Inc. (5th Cir. 2009) (No. 09-40506); Amended States' Comments Urging the Denial of Nine West's Petition, *In re* Nine West Group, Inc., No. C-3937 (F.T.C. Jan. 17, 2008) (*available at* http://www.ftc.gov/os/comments/ninewestgrp/080117statesamendedcomments.pdf).

[6] *See*, *e.g.*, Brief for William S. Comanor and Frederic M. Scherer as Amici Curiae Supporting Neither Party, Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705 (2007) (No. 06-480).

[7] *See*, *e.g.*, Marina Lao, *Free-Riding: An Overstated, and Unconvincing, Explanation for Resale Price Maintenance*, in HOW THE CHICAGO SCHOOL OVERSHOT THE MARK: THE EFFECT OF CONSERVATIVE ECONOMIC ANALYSIS ON U.S. ANTITRUST 215-16 (Robert Pitofsky ed. 2008).

restraint is unreasonable but allows the defendant to rebut that presumption by proving an absence of anticompetitive effect or the existence of countervailing efficiencies.

In eschewing both a *per se* rule for states and a quick look approach under federal antitrust law, we proponents of a full-blown rule of reason for minimum RPM have relied on both theory and evidence. With respect to theory, we have emphasized that the prerequisites to potential anticompetitive harm from minimum RPM are rarely satisfied, while those necessary for the practice to achieve a pro-competitive result are often met. With respect to evidence, we have shown that the admittedly sparse empirical data on minimum RPM's actual effects support the view that minimum RPM is more often than not output-enhancing. Accordingly, we maintain that minimum RPM should be presumptively legal, and a challenging plaintiff should bear the burden of proving an actual or likely anticompetitive effect.

In recent months, advocates of more restrictive *per se* or quick look approaches have pointed to new evidence to justify their preferred policies. In particular, they have cited an April 2013 study by Alexander MacKay & David Aron Smith comparing output and price levels in states retaining the *per se* rule with the levels prevailing in states likely to assess minimum RPM under the rule of reason.[8] MacKay & Smith purport to demonstrate that, in the years since *Leegin*, price increases for household consumer goods have been larger, and output growth smaller, in rule of reason states than in states retaining the *per se* rule against minimum RPM. Such findings, the authors contend, support that view that RPM is more often anti- than pro-competitive.

We do not believe the evidence presented by MacKay & Smith undermines the case for a full-blown rule of reason for minimum RPM. In Part II, we briefly summarize the affirmative case for applying such a rule rather than the *per se* rule or some version of a quick look analysis. In Part III, we discuss some limitations of the MacKay & Smith study and explain why it cannot overcome the affirmative case for rule of reason analysis. Part IV concludes.

II. THEORY AND PRE-*LEEGIN* EMPIRICAL EVIDENCE SUPPORT A FULL BLOWN RULE OF REASON

A. Theory

Economists have long recognized, and the Supreme Court has acknowledged, that instances of minimum RPM may create anti- or pro-competitive effects.[9] On the anticompetitive side, minimum RPM may facilitate dealer-level collusion by enlisting the assistance of a manufacturer in establishing and policing a dealer-level price-fixing conspiracy. The practice may also be used by colluding manufacturers to shore up their cartel by reducing the incidence of cheating (which is less tempting if the cheater cannot expand sales to consumers through lower retail prices) and making cheating more detectable (by stabilizing retail prices, which, unlike upstream prices, are easy to monitor). Minimum RPM may also serve as an exclusionary device for either a dominant dealer, which may request a retail price floor in order to avoid price

[8] Alexander MacKay & David Aron Smith, *The Empirical Effects of Minimum Resale Price Maintenance on Prices and Output* (April 29, 2013) (*available at* http://home.uchicago.edu/~davidsmith/research/Leegin_and_MRPM.pdf).

[9] *See* Leegin, 551 U.S. at 890-94 (summarizing pro- and anticompetitive theories of minimum RPM).

competition from more efficient dealer rivals, or a dominant manufacturer, which may employ RPM's guaranteed retail mark-up to "bribe" dealers to disfavor the manufacturer's rivals.

As for pro-competitive benefits, minimum RPM may facilitate dealer provision of point-of-sale services—information provision, the opportunity to test products, attractive showrooms, etc.—by ensuring that low-service dealers cannot "free-ride" upon the efforts of their higher-service rivals and then underprice them. It may facilitate entry by assuring pioneering dealers whose efforts help establish a brand that they will not be undersold by later-adopting dealers once the brand is established. And it may help manufacturers obtain demand-enhancing dealer services that are not susceptible to free-riding but are difficult to secure via express agreement. (By combining a guaranteed retail mark-up with a liberal right of termination, a manufacturer may induce dealers to use their own initiative to expand sales of the manufacturer's brand, and it need not incur the cost of monitoring dealer conduct and enforcing a detailed performance contract.)

While all these effects are theoretically possible, RPM's potential anticompetitive effects are less likely to occur in actual practice because the prerequisites to those effects, unlike the prerequisites to RPM's potential pro-competitive benefits, are rarely satisfied:[10]

1. Use of RPM to facilitate dealer collusion is plausible only if (i) the dealer market is susceptible to collusion (a rare circumstance, given the ease of entering most dealer markets), and (ii) either the manufacturer has substantial market power or RPM is common among competing manufacturers (absent one of those circumstances, any RPM-induced increase in retail price would simply drive consumers to other brands).
2. RPM is unlikely to facilitate manufacturer collusion unless (i) the manufacturer market is susceptible to collusion, and (ii) RPM policies are used so widely within the market that they could actually assist with discouraging and revealing manufacturer cheating.
3. To succeed as an exclusionary device by which a dominant retailer squelches competition from more efficient rivals, RPM policies must be implemented on such a large proportion of the brands carried by the more efficient retailers that they cannot gain an effective foothold in the retailer market.
4. To facilitate manufacturer monopolization by creating an entry barrier that effectively forecloses the manufacturer's rivals from the market, the RPM must (i) guarantee a retail margin large enough to induce dealers to drop or demote brands competing with the manufacturer's, and (ii) apply to so many retailers that it occasions substantial foreclosure from available retail outlets.

Put simply, the "stars must align" in order for any of the theoretical anticompetitive harms of RPM to materialize. And such celestial occurrences are rare indeed.

On the other hand, the pre-requisites to minimum RPM's pro-competitive benefits are frequently satisfied:[11]

[10] *See* Lambert, *supra* note 4, at 181-84 (summarizing prerequisites to anticompetitive effects of minimum RPM).

[11] *Id*. at 184-85.

1. RPM may be used to ensure the provision of output-increasing, "free-rideable" dealer services whenever (i) products are typically sold with point-of-sale services that enhance demand and (ii) free-riding is practicable because, for example, dealers are located within close proximity of each other.
2. RPM may facilitate entry whenever a producer introduces a new brand and sells it through multi-brand retailers.
3. RPM may provide an efficient means for inducing output-enhancing, "non-free-rideable" dealer services whenever such services would increase demand for the producer's offering but are difficult to secure via express agreement (because, for example, they are difficult to delineate *ex ante* or to monitor).

Because the conditions under which RPM may occasion pro-competitive benefit, unlike the prerequisites for anticompetitive harm, are frequently satisfied, theory would suggest that most instances of minimum RPM are pro-competitive.

B. Evidence

The pre-*Leegin* empirical evidence on minimum RPM, sparse though it be, supports the favorable pro-competitive conclusion. In a 1983 report to the FTC, Thomas Overstreet analyzed all FTC RPM cases from mid-1965 through 1982 and catalogued existing empirical studies of RPM.[12] With respect to the RPM in FTC cases, which he took to be representative of instances of RPM generally, Overstreet concluded that most instances were pro-competitive because they occurred in markets that could support neither dealer nor manufacturer collusion. With respect to the empirical studies, he reached the more equivocal conclusion that "RPM has been used in the U.S. and elsewhere in both socially desirable and undesirable ways."[13] But, as one of us has detailed elsewhere, close examination of Overstreet's survey results reveals that they cannot support the view that RPM is, more often than not, anticompetitive.[14]

In a 1991 study, Pauline Ippolito examined all 203 reported RPM cases from 1975 through 1982, the period during which federal antitrust law treated minimum RPM most harshly.[15] Because any RPM-facilitated dealer or manufacturer collusion would be *per se* illegal, Ippolito hypothesized that "if the plaintiff had any evidence that the practice at issue in the litigation was used to support collusion, we would expect to see horizontal price-fixing allegations in these cases, in addition to the RPM allegation."[16] As it turned out, allegations of collusion were rare, appearing in only 9.8 percent of private cases and 13.1 percent of the entire sample. By contrast a majority of the cases involved market facts that were more consistent with pro-competitive than anticompetitive uses of RPM. Ippolito thus concluded that "service and

[12] THOMAS R. OVERSTREET, JR., RESALE PRICE MAINTENANCE: ECONOMIC THEORIES AND EMPIRICAL EVIDENCE (1983).

[13] *Id*. at 163.

[14] Lambert, *supra* note 4, at 187 & n. 71 (discussing Overstreet's findings).

[15] Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J. L. & ECON. 263 (1991).

[16] *Id*. at 281.

sales-enhancing theories, taken together, appear to have greater potential to explain the [RPM] practices" than do collusion-based explanations.[17]

In focusing on potential collusive harms, Overstreet and Ippolito admittedly did not consider RPM's potential to serve as an exclusionary device for a dominant dealer or a dominant manufacturer. (Those two theories of anticompetitive harm had not been developed when Overstreet and Ippolito performed their analyses.) There is little reason to believe, though, that the situation is more dire than Overstreet and Ippolito concluded.

Indeed, retailing trends since the time of the Overstreet and Ippolito studies suggest that anticompetitive harm from RPM has become even more implausible. The last 30 years have witnessed a proliferation of large discount retailers—more than 5,000 Walmart outlets alone. These retailers compete primarily on price and would be unlikely to alienate their core customers by demanding that manufacturers set minimum retail prices or by avoiding brands that are not subject to RPM. Given these retailers' market saturation and depth of product offerings, most manufacturers confronted with a demand for RPM from a dominant dealer would have the option of refusing that demand and distributing their products through the major discounters' well-established store networks.

In addition, it is unlikely that RPM could be used to foreclose new brands from ubiquitous discount retailers, for such retailers—vigorous price competitors—would not agree implicitly to carry only higher-priced brands that are subject to RPM. Thus, the potential for RPM to facilitate retailer collusion or to serve as an exclusionary device for a dominant retailer or manufacturer has diminished since the time of the Overstreet and Ippolito studies.

In sum, both theory and empirical evidence (including evidence of retailing trends) suggest that instances of minimum RPM are more likely to be pro- than anticompetitive. Accordingly, a full-blown rule of reason that places the burden of establishing anticompetitive harm on the plaintiff is the appropriate legal regime for assessing the practice.

III. THE POST-*LEEGIN* EVIDENCE FAILS TO JUSTIFY AN EASIER BURDEN FOR PLAINTIFFS

Proponents of plaintiff-friendlier rules for minimum RPM contend that recent empirical work undermines the case for a full-blown rule of reason.[18] Purporting to conduct "a natural experiment to estimate the effects of *Leegin* on product prices and quantity,"[19] MacKay & Smith recently compared post-*Leegin* changes in price and output levels in states retaining a rule of *per se* illegality with those in states likely to assess RPM under the rule of reason. Utilizing Nielsen consumer product data for 1,083 "product modules" (i.e., narrowly defined product categories such as "vegetables-broccoli-frozen"), the authors assessed price and output changes between the six-month period immediately preceding *Leegin* (January-June 2007) and the last six months of 2009.

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[17] *Id*. at 291-92.

[18] *See, e.g.*, Jonathan B. Baker, *Taking the Error Out of "Error Cost" Analysis: What's Wrong with Antitrust's Right?* (Sept. 30, 2013) (*available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2333736) (citing MacKay & Smith in support of claim that full-blown rule of reason is too pro-defendant).

[19] MacKay & Smith, *supra* note 8, at 3.

With respect to price changes, they found that 15 percent of the product modules exhibited price increases that were higher, by a statistically significant margin, in rule of reason states than in *per se* states. In only 6.9 percent of modules were price increases higher, to a statistically significant degree, in *per se* states than in rule of reason states. With respect to quantity changes, 14.7 percent of modules saw a statistically significant decrease in quantity in rule of reason states versus *per se* states, whereas only 3 percent of modules exhibited a statistically significant quantity increase in rule of reason states over *per se* states.

The authors thus conclude that greater leniency on minimum RPM is associated with higher prices and lower output levels; a conclusion that, they say, supports the view that RPM is more frequently anticompetitive than pro-competitive.

We believe the MacKay & Smith study is flawed and does not justify more restrictive RPM policies. While space limitations cannot accommodate an exhaustive catalogue of the study's methodological and substantive deficiencies, we will briefly describe two flaws that prevent the study from rebutting the case for RPM liberalization.

First, the study provides very little support for the view that RPM has caused anticompetitive harm within the group of product markets examined. As an initial matter (and as the authors admit), the study does not demonstrate that *actual RPM agreements* have caused anticompetitive harm in the post-*Leegin* era. To make such a showing, one would have to demonstrate that: (i) minimum RPM was actually imposed on a product after the *Leegin* decision, (ii) the RPM policy raised the price of that product from what it otherwise would have been, and (iii) the quantity of the product sold fell from what it otherwise would have been. The authors present no evidence that RPM policies were actually implemented on any of the product categories for which they identified statistically significant price increases and quantity decreases. As they concede, their study could show only that *legal environments treating RPM leniently* (not RPM agreements themselves) are conducive to anticompetitive outcomes.[20]

But the authors' data provide little support even for that claim. To prove anticompetitive harm stemming from an "RPM-permissive" legal environment, one would have to show that the transition from *per se* illegality to rule of reason treatment occasioned, for a substantial number of products, both a statistically significant price increase *and* a statistically significant output reduction *on the same product*. An output reduction not accompanied by an increase in price suggests that something besides minimum RPM (or a "permissive attitude" toward RPM) caused output to fall. A price increase without a reduction in output is consistent with the view that RPM induced demand-enhancing dealer activities that mitigated the effect of the price increase.[21] To establish RPM-induced (or even "RPM permissiveness"-induced) anticompetitive harm, one needs to show both effects at once.

[20] *See id*. at 22 ("To be clear, we do not claim these results stem from the execution and enforcement of minimum RPM agreements between manufacturers and retailers but rather from a legal environment where allegations of anticompetitive uses of minimum RPM are examined on a case-by-case basis.").

[21] A price increase without an output decrease could also indicate that demand for the product at issue was inelastic. MacKay & Smith, however, presented no evidence suggesting that demand for any of the product categories exhibiting price increases but not quantity decreases was particularly inelastic.

According to the authors' list of "modules with significant price or quantity changes" (Appendix A), only 17 of the 1,083 product categories examined—a mere 1.6 percent—exhibited both a price increase and quantity decrease. And those effects were for *categories* of products (e.g., barbecue sauces as a whole), not necessarily particular brands of a product (e.g., KC Masterpiece® or Sweet Baby Ray's®). It could well be that within the 1.6 percent of categories exhibiting both an average price increase and an average output decrease, there were no individual brands exhibiting both effects at once.

Indeed, most of the 17 product categories involve dealer and manufacturer markets that are neither cartelizable (so neither the dealer nor manufacturer collusion theory of anticompetitive harm could apply) nor dominated by a powerful manufacturer or dealer (so neither the dominant manufacturer nor dominant dealer theory could apply).[22] To the extent MacKay & Smith's findings provide any evidence that RPM-permissiveness occasions anticompetitive harm in household consumer products markets, that evidence is awfully thin.

Moreover, in limiting their examination to the product categories included in the Nielsen Consumer Panel Data, MacKay & Smith excluded most products for which one of the pro-competitive rationales for minimum RPM—the "avoidance of free-riding" rationale—would apply. As the authors observe, only about "30% of household consumption is accounted for by the categories in the data."[23] That 30 percent is comprised mainly of groceries, other consumable household products, and small, relatively inexpensive appliances. The study thus excludes data related to purchases of large appliances, complicated electronics projects, and other relatively expensive products that are frequently sold along with "free-rideable" amenities such as product demonstrations, consumer education, and set-up or repair services.

Because the MacKay & Smith study systematically disregards information on transactions likely to reflect a pro-competitive use of minimum RPM, it cannot establish the authors' conclusion that "the harm to consumers resulting from rule-of-reason treatment of minimum RPM seems to outweigh its benefits."[24]

IV. CONCLUSION

As states decide how to assess minimum RPM under their antitrust laws, and as the lower federal courts carry out the Supreme Court's directive to "establish the litigation structure to ensure that the rule of reason operates to eliminate anticompetitive [minimum RPM] restraints from the market and to provide more guidance to businesses,"[25] they will—and should—look to the economic evidence on the practice. Proponents of strict RPM rules are sure to point to the MacKay & Smith study as a reason to eschew a full-blown rule of reason.

[22] The 17 modules whose combination of price and quantity changes suggested anticompetitive effect were pregnancy test kits, barbecue sauces, butter-fruit & honey, seafood-anchovies, seafood-sardines-canned, seafood-clams-canned, snacks-corn chips, snacks-puffed cheese, soft drinks-powdered, whipping cream, pasta-refrigerated, pet treatments external, soaps-liquid, wine-domestic-dry table, heater appliances, lamps-remaining (i.e., non-incandescent), and popcorn popper appliances.

[23] MacKay & Smith, *supra* note 8, at 12-13.

[24] *Id*. at 22-23.

[25] *Leegin*, 551 U.S. at 898.

But courts and policymakers should heed the limitations of the study. It shows very little anticompetitive effect in the markets considered, and it ignores altogether the product markets in which RPM is most likely to prove pro-competitive. In our opinion, the study fails to rebut the persuasive theory- and evidence-based argument for applying a full-blown rule of reason to minimum RPM agreements.