U.S. House of Representatives
Committee on the Judiciary
Washington, DC 20515–6216
One Hundred Tenth Congress

January 10, 2007

The Honorable Thomas O. Barnett
Assistant Attorney General, Antitrust Division
U.S. Department of Justice
950 Pennsylvania Avenue, NW
Washington, DC 20530-0001

The Honorable Deborah Platt Majoras
Chairman
Federal Trade Commission
600 Pennsylvania Ave, NW
Washington, DC 20580

Dear Assistant Attorney General Barnett and Chairman Majoras:

I am writing to request the Department's and Commission's views on an important issue before the Supreme Court involving vertical minimum price fixing. The Supreme Court has accepted certiorari in *Leegin Creative Leather Products v. PSKS, Inc.*, 127 S. Ct. 28 (2006), a case that requires the Court to examine whether to overturn a venerable line of cases that treat such price fixing as per se unlawful.

As you know, vertical minimum price fixing, often called resale price maintenance (RPM), is an issue of vital importance to consumers and retailers, as well as many manufacturers. Congress has legislated on this issue on at least four occasions over the past 70 years: in 1937 to pass the Miller Tydings Act, in 1952 to pass the McGuire Act, in 1975 to pass the Consumer Goods Pricing Act, and in 1983 to prohibit the expenditure of appropriated funds to urge the Supreme Court to overturn the per se rule.

As many members of Congress remain vitally interested in this topic, please provide answers to the following questions:

1) Will the Department of Justice and/or the Federal Trade Commission file a brief in the *Leegin* case? If so, please advise of the date and nature of such filing.

2) Given Congress' active involvement in the RPM issue–on the last two occasions (in 1975 and in 1983) in unequivocal support of the *Dr. Miles* line of cases– would you agree that the Supreme Court should defer to Congress on this issue?

3) If the Department and/or Commission plan to file a brief in this case, would you agree to consult with the relevant committees of the Congress in advance of any filing?

4) The Department of Justice and the Federal Trade Commission testified in favor of the 1975 Consumer Goods Pricing Act. Both agencies testified that the per se rule prohibiting RPM protects competition and consumers. Please provide your comments on that testimony, indicating areas of agreement or disagreement.

5) In a relatively recent enforcement initiative, the Federal Trade Commission acted against the sound recording industry's use of minimum advertised prices for the sale of CDs. In that case, the FTC estimated that the restricted resale prices cost consumers $480 million over a three year period. *See* Record Companies Settle FTC Charges of Restraining Competition in CD Music Market, FTC Press Release, *available at* <www.ftc.gov/opa/2000/05/cdpres.htm>. Would you agree that RPM or minimum advertised pricing can be particularly harmful to consumers in cases such as this where there is little interbrand competition?

6) One of the issues before the Supreme Court is whether there are meaningful distinctions between RPM (currently subject to the per se rule) and non-price vertical restraints (subject to the rule of reason). Commenting on this topic, Professor Warren Grimes, in a briefing paper supplied to the Committee, has written:

> Most non-price vertical restraints are used to restrict distribution. RPM, in contrast, can be and often is used with unrestricted distribution. Because of this distinction, RPM is potentially far more threatening to efficient retailing and consumer prices. A manufacturer limiting distribution through location clauses or exclusive distribution practices does not seek a restraint on all retailers. Although the impact of a non-price vertical restraint on intrabrand retail competition can be severe, the restraint itself is self-limiting because the manufacturer, once achieving brand prominence, will want to open its distribution system to maximize sales. RPM is the only widely practiced vertical restraint that threatens the broad cross-section of multi-brand retailers that sell a variety of brands. Thus, among widely employed vertical restraints, RPM is the most threatening to innovative and efficient retailing and to the consumer interest in shopping for the lowest price.

Would you agree or disagree with this explanation? Please explain.

Thank you for your consideration. Please provide responses by January 22, 2007. If you need assistance, feel free to contact Stacey Dansky, counsel to the House Judiciary Committee, at 202-225-3951.

Sincerely,

John Conyers, Jr.

cc: James Clinger
Acting Assistant Attorney General
Office of Legislative Affairs
US Department of Justice

Jeanne Bumpus, Director
Office of Congressional Relations
Federal Trade Office

Draft: January 8, 2007

A Primer On Vertical Minimum Price Fixing (RPM)

Prepared by Prof. Warren Grimes*

Vertical Minimum Price Fixing, often referred to as resale price maintenance (RPM), occurs when a manufacturer sets the minimum resale price at which a retailer may sell the manufacturer's brand. This form of price fixing eliminates discounting and tends to raise the retail price paid by the consumer. An efficient retailer can lower the resale price to attract business and pass along cost savings to the consumer. RPM ends this competition beneficial to consumers and efficient retailers.

RPM should be distinguished from vertical ***maximum*** price fixing, in which the manufacturer limits or lowers the price that the retailer may charge. Vertical maximum price fixing is an exercise of the manufacturer's upstream power over retailers and is assessed under the rule of reason. In contrast, the ***minimum*** price set under RPM is often a reflection of the manufacturer's lack of upstream power over retailers and represents an attempt to gain favor with full-price retailers.

RPM is per se unlawful under a venerable line of cases that begins with Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911). The question of whether this line of cases should be overruled is before the Supreme Court in Leegin Creative Leather Products v. PSKS Inc., 1276 S. Ct. 28 (2006).

RPM is an important issue to consumers, retailers, and many manufacturers. Congress has legislated on this issue on at least four occasions: in 1937 to pass the Miller Tydings Act that allowed States to legislate exceptions to the antitrust prohibition on RPM; in 1952 to pass the McGuire Act that expanded state power to create exceptions; in 1975 to pass the Consumer Goods Pricing Act that repealed the earlier legislation and restored the per se rule governing RPM; and in 1983 to pass a rider to appropriations legislation that prohibited the Department of Justice from expending appropriated funds to urge the Supreme Court to overturn the per se rule.

Why do some manufacturers impose RPM? Manufacturers that sell a strongly branded product attractive to consumers generally shun RPM. Retailers must carry such strong brands that bring customers into the store. A manufacturer of a strong brand welcomes the intrabrand competition among retailers that pushes down the retail profit margin and results in more sales of the manufacturer's product to consumers. Less secure brand sellers, however, may impose RPM to create a financial incentive for retailers to stock and promote the manufacturer's brand. By setting the resale price at a high level, the manufacturer ensures that retailers will earn a high profit margin, thereby creating an incentive for the retailer to stock and promote the manufacturer's brand.

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Does an insecure brand seller have lawful ways of promoting its product? A manufacturer of a product that lacks strong brand appeal can lower its price and attract retailers in this manner. The insecure brand seller that chooses not to lower its price could mount an advertising campaign to increase brand recognition and appeal. The manufacturer may also contract to compensate retailers for promotion (promotion allowances) or offer other incentives to the retailer (such as an agreement to buy back unsold inventory). Finally, the manufacturer may limit distribution to retailers who will become partners in the promotion of the manufacturer's product. Limited distribution may require the imposition of non-price vertical restraints, such as location clauses, that are generally lawful under the antitrust laws.

The Harmful Effects of RPM - If RPM is permitted, it will stymie retail intrabrand competition in the selling of many branded items, limit discounting by efficient retail firms, and force consumers to pay higher prices. Not all manufacturers will impose RPM, but insecure brand sellers can be expected to employ this device widely because they do not wish to cede market share to rivals that do impose it. When Congress enacted the Consumer Goods Pricing Act, it acted on the advice of the federal antitrust agencies, which advised the Congress that consumer prices tended to be higher in states that permitted RPM.

A second harmful effect of RPM is that it creates incentives for a retailer or its sales staff to promote a brand through informal and difficult-to-monitor promotion that may at times be deceptive or misleading to consumers. Promotion activity that is controlled by the manufacturer, such as advertising or promotion allowances, is more easily monitored by law enforcement agencies to prevent unfair or deceptive promotion practices. In the absence of RPM, retail intrabrand competition tends to reduce the retailer's incentive to promote one brand over another because that competition tends to equalize the retailer's profit margins across brand lines.

Finally, retailers that are terminated for discounting often suffer substantial losses when resources allocated to the selling of the manufacturer's brand are lost. Efficient entry into retailing may also become more difficult if RPM becomes pervasive. Retail intrabrand price competition is a primary tool for a new retailer entrant to gain market share.

Who are the most prominent advocates for RPM? Historically, small retailers, who may have difficulty competing against larger or more efficient retailers, have been the strongest advocates of RPM. Manufacturers that may have difficulty maintaining the loyalty of full price retailers have also sought license to impose RPM. A small retailer that is a discounter, however, can be victimized by RPM if a larger full price retailer prevails upon the manufacturer to terminate the small retailer. Consumer groups, discount retailers, and, at least in the past, the antitrust enforcement agencies, have been strong advocates for maintaining the per se rule.

What does the scholarship tell us about RPM? The views presented here are consistent with a prominent thread of scholarship that includes the economists Ward Bowman, William Comanor, Basil Yamey, and former businessman and now economist Robert Steiner. Legal scholars that generally embrace this view include Robert Pitofsky, Lawrence Sullivan, and Warren Grimes. There is, however, another view that has gained prominence in Supreme Court opinions and agency policy.

Justice Brandeis advocated tolerance toward RPM as a tool to protect the small retailer. Working off this view, commentators such as Robert Bork, Richard Posner, and Frank Easterbrook have written prominently in support of a more tolerant policy toward RPM. Some economists, including Howard Marvel and Benjamin Klein, argue that a manufacturer will impose RPM only when it serves both the manufacturer and consumer interest. RPM can and often does increase a manufacturer's sales, and this higher output, it is argued, is a procompetitive result. These scholars must explain why higher prices to consumers benefit competition. They attempt to do this by arguing that higher prices pay for promotion services that inform consumers about valued goods that, absent the promotion, they would not purchase. They also offer a variety of other explanations as to why RPM benefits manufacturers and consumers, including prevention of free-riding by some retailers who shirk promotional responsibilities, supporting image or high-end marketing, and creating incentives for maintaining inventory.

A brief bibliography at the end of this document lists some of the writings of scholars on both sides of the RPM issue.

Is higher output of a product subject to RPM a positive competitive result? If the promotion services paid for by RPM result in matching a consumer with a desired product, the result can be better allocation of goods to consumers. But it can always be argued that higher prices are a way to pay for promotion services that lead to higher sales; this argument could be used to justify horizontal price fixing as well. RPM ends intrabrand retailer competition, potentially across a broad spectrum of brands, and hampers entry and market penetration by efficient retailers. The procompetitive promotional effects of RPM can be obtained in other ways that have no comparable anticompetitive effects, such as manufacturer advertising and manufacturer sponsored promotion allowances.

In addition, RPM has been shown to increase sales of products regardless of their competitive merit. Not only meritorious products, but also shoddy or over-priced products, can be promoted through the use of RPM. Because RPM focuses promotion at the retailer level where monitoring of unfair or deceptive practices is more difficult, there is an additional reason to discourage use of RPM. Manufacturer advertising or manufacturer-sponsored promotion allowances are more easily monitored and do not have the anticompetitive effects that RPM has.

Does RPM end free-ridng? Some retailers do not promote a manufacturer's brand and, instead, may "free-ride" on the promotion efforts of other retailers. The imposition of RPM creates an incentive for retailers to promote the manufacturer's product, but RPM does not guarantee that this will occur. Under RPM, some retailers will pocket the higher margin from consumers without providing any significant promotion. There is a lawful way of addressing free-riding that is far more effective than RPM and will do no harm to intrabrand competition. The manufacturer may contract with retailers to provide promotion services, paying only those retailers who actually perform the promotion. Another less harmful and more effective way to address free-riding is to restrict distribution through lawful location clauses, ensuring that a local dealer's promotion activity will benefit primarily itself.

Can RPM be meaningfully distinguished from non-price vertical restraints? Scholars on all sides of the RPM debate have occasionally argued that one cannot meaningfully distinguish RPM (subject to the per se rule) from non-price vertical restraints (subject to the rule of reason and often considered lawful).

Most non-price vertical restraints are used to restrict distribution. RPM, in contrast, can be and often is used with unrestricted distribution. Because of this distinction, RPM is potentially far more threatening to efficient retailing and consumer prices. A manufacturer limiting distribution through location clauses or exclusive distribution practices does not seek a restraint on all retailers. Although the impact of a non-price vertical restraint on intrabrand retail competition can be severe, the restraint itself is self-limiting because the manufacturer, once achieving brand prominence, will want to open its distribution system to maximize sales. RPM is the only widely practiced vertical restraint that threatens the broad cross-section of multi-brand retailers that sell a variety of brands. Thus, among widely employed vertical restraints, RPM is the most threatening to innovative and efficient retailing and to the consumer interest in shopping for the lowest price.

Does RPM promote interbrand competition? In Continental TV, Inc. v. GTE Sylvania, 433 U.S. 36, 54 (1977), the Supreme Court said that vertical restraints, although squelching intrabrand competition, promote interbrand competition.

The Supreme Court's statement is simplistic and misleading. By promoting brand selling, RPM and other vertical restraints increase market segmentation and in this sense reduce interbrand competition. The imposition of RPM on a lesser-known brand can increase sales of that brand, but these increased sales may or may not be an indicator of more competitive outcomes. The local dealer promotion enhanced by RPM is more subject to abuse and cannot be rotely equated with meritorious interbrand competition. Manufacturer sponsored advertising, in far less problematic fashion, enhances both interbrand and intrabrand competition.

Is Intrabrand competition less important than interbrand competition? In a footnote in *GTE Sylvania*, 433 U.S. at 52, n 19, the Supreme Court stated, without support, that protection of interbrand competition is the "primary concern" of antitrust law. In fact, intrabrand competition, depending on the context, may be the only competition that protects consumers and disciplines the retail system to perform competitively. For example, in a case brought by the FTC in the late 1990s, the recording industry was accused of setting minimum advertised prices on sound CDs. Because these recordings were protected by copyright law, there was little or no interbrand competition among manufacturers. Consumers could shop for lower prices on a desired recording only if intrabrand retail competition provided a choice in prices. In a May 2000 press release, the FTC estimated that the resale price restrictions had cost consumers $480 million in excess prices over a three year period.

More broadly, intrabrand retail competition is important in any industry involving the sale of branded products. Brand selling, by definition, involves efforts by manufacturers to create a brand preference that insulates a product from a rival's offerings. Intrabrand retail competition is vital in curbing the excesses of brand selling that, if left unchecked, could make it far more difficult for innovative and efficient retailers to succeed.

What does the Leegin *case tell us about the competitive merits of RPM?* The Supreme Court will be revisiting the per se rule governing RPM in the case of Leegin Creative Leather Products, Inc. v. PSKS, Inc., 2001 CCH Trade Cas. ¶75,166 (5^{th} Cir. 2006), cert. granted, 127 S. Ct. 28 (2006). Leegin markets its leather goods as high image products sold in stores that maintained high retail prices. PSKS had carried and promoted Leegin leather products for many years. After PSKS conducted a sale at which Leegin products were offered at prices below the manufacturer's suggested retail prices, Leegin terminated PSKS. This litigation ensued.

The jury found a conspiracy and per se violation of Section 1 of the Sherman Act and the district court approved a treble damage verdict in favor of PSKS. The Fifth Circuit affirmed, relying on the *Dr. Miles* line of cases.

Leegin used RPM in support of a high image marketing strategy. Other RPM cases, including some brought by the Government enforcers, have involved high image marketing campaigns. See the cases cited in Sullivan & Grimes, The Law of Antitrust, An Integrated Handbook, §7.4b2 (2d ed. 2006).

For some critics, high image marketing raises troublesome competition issues. Manufacturers tend to earn high profit margins on high image products and have an incentive to market products in this manner, regardless of their inherent quality. The antitrust and marketing literature demonstrates that some high image products, when tested by independent experts, are inferior in quality to products that are sold at much lower prices.

The incentives for high image marketing will remain, and this type of marketing will continue, regardless of whether the per se rule governs RPM. The narrower question posed by the *Leegin* case, however, is whether a manufacturer should be permitted to enhance its high-image marketing efforts through the use of RPM. Because of the substantial anticompetitive effects linked to RPM, the answer is no.

High image marketers can use a number of lawful techniques to implement their marketing strategy. For example, a manufacturer may agree to restrictive distribution (such as location clauses) that make selected retailers partners in the manufacturer's high image marketing campaign. Using selective distribution, the manufacturer can avoid discount stores or other retailers that would not fit the high image marketing strategy. In addition, if one of the outlets offers the goods at a sale price, it will have minimal effects on other retailers because the manufacturer has limited distribution and overlap among retailers. If the manufacturer chooses to broaden distribution to reach a large and overlapping group of retailers, it must work to maintain brand image through national advertising or other means short of eliminating intrabrand retail price competition.

SHORT BIBLIOGRAPHY

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