LEEGIN'S UNEXPLORED "CHANGE IN CIRCUMSTANCE": THE INTERNET AND RESALE PRICE MAINTENANCE

For almost a century, agreements between retailers and suppliers fixing a minimum resale price, also known as minimum resale price maintenance (RPM) or vertical minimum price fixing agreements,[1] were considered per se violations of the Sherman Act.[2] For example, Polo could not have entered into a contract with Macy's requiring Macy's to sell a particular shirt for at least sixty dollars. However, over time the Supreme Court slowly relaxed the restrictions on other types of vertical agreements, such as vertical maximum price fixing[3] and nonprice restrictions.[4] In addition, economists posited procompetitive justifications for the use of RPM. It was unsurprising, therefore, when the Court held in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*[5] that RPM agreements should not be prohibited as per se unlawful, but rather should be subject to rule of reason analysis.[6] Reactions to the decision ranged substantially. Some predicted doom for low-priced retailers like Wal-Mart,[7] while many commentators sighed with relief after arguing for years that RPM agreements were often procompetitive.[8] Other commentators questioned the importance of the decision, doubting the usefulness of vertical minimum price fixing under normal market conditions.[9]

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1 This Note will use the term RPM to refer to vertical minimum price fixing agreements, even though in other contexts that term might also apply to agreements that set maximum resale prices.

2 *See* Dr. Miles Med. Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911). Under the per se approach, conduct that is clearly anticompetitive in all or nearly all situations is prohibited. *See* N. Pac. Ry. Co. v. United States, 356 U.S. 1, 5 (1958) (identifying "price fixing," "division of markets," "group boycotts," and "tying arrangements" as per se unreasonable).

3 *See* State Oil Co. v. Khan, 522 U.S. 3, 19, 22 (1997). Vertical maximum price maintenance has been evaluated using rule of reason analysis since *Khan*.

4 Cont'l T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 57–59 (1977).

5 127 S. Ct. 2705 (2007).

6 Rule of reason analysis requires the factfinder to weigh all the factors involved in a case in order to decide whether the challenged practice constitutes an "unreasonable restraint on competition." *Id.* at 2712 (quoting *Cont'l T.V.*, 433 U.S. at 49). It is much more difficult for a plaintiff to successfully challenge a restraint under the rule of reason approach.

7 *See, e.g.*, Tim Craig, Editorial, *MSRP: Suggestion or Mandate?*, RETAILING TODAY, Apr. 9, 2007, at 11 ("With all due respect to the institution of the Supreme Court, did the Justices ever consider the fact that overturning *Dr. Miles* could drive half the retail industry out of business . . . ?").

8 *See, e.g.*, Einer Elhauge, *Harvard, Not Chicago: Which Antitrust School Drives Recent U.S. Supreme Court Decisions?*, COMPETITION POL'Y INT'L, Autumn 2007, at 58, 60 ("If anything was a topic of consensus among the Harvard and Chicago Schools, it was the proposition that the *Dr. Miles* rule of per se illegality was misguided.").

9 *See, e.g.*, Douglas R. Cole & J. Bruce McDonald, Dr. Miles *Receives Its Coup de Grace*, JONES DAY COMMENTARIES, July 2007, *available at* http://www.jonesday.com/files/Publication/00d3f345-311d-4b90-b0b8-8f27a386f77e/Presentation/PublicationAttachment/4fa828b3-0558-42af-

Although the shift to the rule of reason approach in *Leegin* was preferable to maintaining the per se prohibition, the Court's reasoning did not account for changes in modern business practices based on Internet competition. Had the Court considered those changes, it might have crafted a more tailored rule. For something as intimately tied to business strategy and competitiveness as suppliers' relationships with their retailers,[10] legal evaluation of vertical price restraints has failed to consider actual business strategy along with the theoretical and economic arguments for and against RPM. One of the biggest and most vexing challenges for businesses today is how to handle the Internet channel. Competing prices are readily available to consumers, who increasingly take advantage of price information in their purchasing. Businesses' desire to control prices to protect brand image and to protect retailers from Internet competition makes RPM a more valuable tool for manufacturers than it was in the past, a fact largely ignored by the *Leegin* Court, particularly by the dissent.[11] In ignoring the Internet, the Court missed an opportunity to craft a rule that would better balance the competing pro- and anticompetitive justifications for the use of RPM.

Part I discusses the legal developments and the economic debate that preceded the decision in *Leegin*. Part II lays out the Court's decision in *Leegin*. Part III examines the Internet's effect on the competing pro- and anticompetitive rationales offered for RPM. Part IV explores how the Court might have used those developments to craft a more tailored rule. Part V concludes.

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ade5-90a2baa7586a/Dr%20Miles.pdf ("[D]espite the wails of some commentators, *Leegin* should not lead to broad price increases at retail stores."). Commentators argue that under normal market conditions, there would be no need for RPM. Manufacturers would sell to anyone wanting to buy at the market price without restraints. They would want dealers to sell at the lowest retail price to ensure the highest quantity sold possible. *See* Frank Mathewson & Ralph Winter, *The Law and Economics of Resale Price Maintenance*, 13 REV. INDUS. ORG. 57, 64 (1998).

[10] *Cf.* Anthony Greco, *The U.S. Supreme Court's Decision in* Business Electronics v. Sharp*: A Victory for Vertical Price Fixing*, J. LEGAL ECON., July 1991, at 38, 38 ("Perhaps one of the most contentious areas of antitrust policy in this country concerns the vertical relationship between manufacturers and their retailers . . . .").

[11] *See Leegin*, 127 S. Ct. at 2731 (Breyer, J., dissenting) ("I can find no change in circumstances in the past several decades that helps the majority's position."). While this shift was not ignored by the briefs, it was not given as thorough treatment as was warranted. *See, e.g.*, Brief for the United States as Amicus Curiae Supporting Petitioner at 13, *Leegin* (No. 06-480), 2007 WL 173650 (noting only that "[t]he [free rider] problem is exacerbated by catalog retailing and the advent of the Internet, as consumers may visit traditional, brick-and-mortar retailers to examine a product and select its features but then purchase the product at a discounted price from a catalog or on-line retailer").

I. DEVELOPMENTS LEADING TO *LEEGIN*

The debate over RPM raged for years before the Court revisited the issue in *Leegin*. Congress weighed in for a time, passing legislation allowing the practice but later repealing the legislation. The Court also seemed conflicted, overruling cases that had held vertical maximum price and nonprice agreements per se unlawful but consistently not reaching the per se rule as applied to RPM. A considerable economic debate built up around the issue, as many economists argued that RPM could have procompetitive effects in certain situations. These legal developments, coupled with the economic debate, set the stage for the fight in *Leegin*.

A. Congressional and Legal Developments

In *Dr. Miles Medical Co. v. John D. Park & Sons Co.*,[12] the Court held RPM to be a per se violation of section 1 of the Sherman Act[13] as an unlawful restraint on competition.[14] *Dr. Miles* involved a suit by a supplier to enforce an RPM agreement against a wholesaler.[15] The Court focused on the vertical restraint's elimination of any "room for competition between retailers, who supply the public," and concluded that the restraint on trade was "obvious."[16] In addition, the Court was concerned that RPM was simply a form of horizontal price fixing among retailers involving the help of the supplier to ensure compliance.[17]

Soon after the decision in *Dr. Miles*, the Court limited its effect. In *United States v. Colgate & Co.*,[18] the Court held that refusing to deal with a retailer or wholesaler that did not sell the goods at a specified price was not a violation of the Sherman Act.[19] Because such a sale did not put any conditions on the buyer's ability to freely sell the goods, it was not covered by *Dr. Miles*.[20] The fact that the manufacturer might thereafter refuse to sell to retailers reselling below the specified price did not change the analysis.[21]

Congress eventually stepped into the debate in 1937, nearly two decades after the Court had last addressed the issue, and passed the

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[12] 220 U.S. 373 (1911).

[13] 15 U.S.C. § 1 (2000 & Supp. IV 2004) ("Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.").

[14] *See Dr. Miles*, 220 U.S. at 408–09.

[15] *Id.* at 381–82.

[16] *Id.* at 400.

[17] *Id.* at 407–08.

[18] 250 U.S. 300 (1919).

[19] *Id.* at 307–08.

[20] *Id.* at 305–08.

[21] *Id.* at 306–07.

Miller-Tydings Fair Trade Act,[22] which allowed states to legalize RPM. This law was in effect from 1937 to 1975, when it was repealed by the Consumer Goods Pricing Act of 1975.[23] At the time of repeal, thirty-six states had made RPM lawful.[24] The Department of Justice argued to Congress that, during this period, consumers in states allowing the practice had faced 19–27% higher prices than those in states barring the practice.[25]

The mid-1980s proved to be a contentious time for antitrust law, and, in particular, for the appropriate treatment of RPM. The Department of Justice's Antitrust Division was reluctant to enforce the per se rule, believing that RPM could have procompetitive justifications and should be subject to rule of reason analysis.[26] Congress disagreed with this approach, and a bill that would have made RPM agreements a per se violation of the Act (thus codifying *Dr. Miles*) was proposed[27] but never passed. Congress has considered such bills at various times,[28] but has not passed any legislation approving or disapproving the per se rule since 1975.[29]

In the two decades following the passage of the Consumer Goods Pricing Act, the Court relaxed the per se rule on numerous types of non-RPM vertical restraints, although it did not revisit the per se ban on RPM. First, the Court held that nonprice vertical restraints were subject to the rule of reason, not per se illegal.[30] Next, the Court made

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[22] Ch. 690, tit. 8, 50 Stat. 693 (1937).

[23] Pub. L. No. 94-145, 89 Stat. 801.

[24] *Fair Trade Laws: Hearings on S. 408 Before the Subcomm. on Antitrust and Monopoly of the S. Comm. on the Judiciary*, 94th Cong. 1 (1975) [hereinafter *Hearings*] (opening statement of Sen. Philip A. Hart, Chairman, S. Subcomm. on Antitrust and Monopoly).

[25] *Fair Trade: Hearing on H.R. 2384 Before the Subcomm. on Monopolies and Commercial Law of the H. Comm. on the Judiciary*, 94th Cong. 122 (1975) (statement of Keith I. Clearwaters, Deputy Assistant Att'y Gen., Dep't of Justice, Antitrust Div.).

[26] *See, e.g.*, Anthony J. Greco, *The Resale Price Maintenance Struggle: Its Legislative Updating*, 51 AM. J. ECON. & SOC. 173, 173–74 (1992); Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a* Per Se *Rule Against Vertical Price Fixing*, 71 GEO. L.J. 1487, 1488 (1983) ("[T]he Assistant Attorney General of the Antitrust Division . . . and the Chairman of the Federal Trade Commission . . . have asserted on several occasions a reluctance to challenge minimum vertical price fixing on a *per se* theory."). The Division went so far as to file an amicus brief in *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984), urging the application of the rule of reason to RPM agreements. *See* Brief for the United States as Amicus Curiae at 21–27, *Monsanto* (No. 82-914), 1983 U.S. S. Ct. Briefs LEXIS 376.

[27] *Price Fixing Prevention Act of 1989: Hearing on H.R. 1236 Before the Subcomm. on Econ. and Commercial Law of the H. Comm. on the Judiciary*, 101st Cong. 3–6 (1989).

[28] *See, e.g.*, *Consumer Protection Against Price-Fixing: Hearing on S. 429 Before the Subcomm. on Antitrust, Monopolies and Bus. Rights of the S. Comm. on the Judiciary*, 102nd Cong. 163–67 (1991).

[29] It did, however, incorporate a restriction into the Antitrust Division's appropriations bill that prevented the Division from arguing in favor of the rule of reason approach in *Monsanto*. Greco, *supra* note 26, at 174.

[30] Cont'l T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 57–59 (1977).

it more difficult for plaintiffs to prove vertical collusion to fix prices by requiring a showing of more than simply the fact that a manufacturer terminated a price-cutting distributor in response to complaints from other distributors.[31] Instead, the Court required proof of a manufacturer's "conscious commitment to a common scheme designed to achieve an unlawful objective."[32] A few years later, the Court made it more difficult for plaintiffs to succeed in vertical restraint cases by holding that agreeing to terminate a price-cutting retailer at the behest of another retailer does not constitute an "agreement" fixing a retail price.[33] Vertical restraints are not per se illegal unless the retailer and manufacturer agree as to price or price levels.[34] And finally, in 1997, the Court applied rule of reason analysis to agreements to resell goods at or below a set, maximum resale price.[35] However, at that point vertical minimum price fixing remained per se illegal.

B. Economic Perspectives

A significant body of economic literature informed the debate between the Court, Congress, and the Department of Justice. A number of economists doubted RPM was anticompetitive in a large enough proportion of situations to justify its per se treatment. Although compelling arguments were posited on both sides, at the time *Leegin* was decided, the academic consensus tipped in favor of, at a minimum, rule of reason treatment for RPM. Some commentators even suggested per se legality as a more appropriate standard.

1. Anticompetitive Objections to RPM. — As noted above, the Court's decision in *Dr. Miles* turned significantly on the belief that RPM would allow retailers to collude with one another — that is, engage in horizontal price fixing — by using suppliers to police the cartel.[36] This concern was likely well founded in *Dr. Miles*.[37] Evidence of horizontal as well as vertical collusion was present in many of the early RPM cases.[38] The argument is that, in a situation in which a retailer sells many products — for example, a drug store selling shampoo

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[31] *Monsanto*, 465 U.S. at 759, 763–64.

[32] *Id.* at 764 (quoting Edward J. Sweeney & Sons, Inc. v. Texaco, Inc., 637 F.2d 105, 111 (3d Cir. 1980)) (internal quotation mark omitted).

[33] *See* Bus. Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 726–28 (1988).

[34] *Id.* at 726–28, 735–36.

[35] State Oil Co. v. Khan, 522 U.S. 3, 22 (1997).

[36] A cartel is an agreement between firms. Cartels can agree, among other things, to fix prices, control output, allocate customers, and allocate territories.

[37] *See* HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY § 11.2a, at 442 (2d ed. 1999). For an extensive discussion about the environment surrounding the *Dr. Miles* decision, see Rudolph J.R. Peritz, *'Nervine' and Knavery: The Life and Times of* Dr. Miles Medical Company, *in* ANTITRUST STORIES 61 (Eleanor M. Fox & Daniel A. Crane eds., 2007).

[38] *See* HOVENKAMP, *supra* note 37, § 11.2a–.2b, at 442–43.

or toothpaste — it is impractical for a supplier to vertically integrate[39] and thereby avoid a retail cartel. If the retail cartel has sufficient market power, the supplier may be forced to acquiesce to its demands to police pricing.[40] The resulting cartel may be "more stable and durable" than a purely horizontal one because the manufacturer is available to police it.[41]

RPM can also support a manufacturer cartel and stabilize prices at the manufacturer level.[42] Absent RPM, some manufacturers would likely cheat by cutting prices to increase sales volume. However, by maintaining an industry-wide resale price, RPM decreases the incentive to cut manufacturer prices because doing so will not increase sales volume; it will only cut the manufacturer's profits.[43]

Commentators have expressed doubt as to the frequency of collusive, as opposed to non-collusive, uses of RPM.[44] In particular, the retail cartel hypothesis has been strongly criticized as "seriously incomplete and misleading" given that manufacturers support the practice more than retailers do.[45] In addition, commentators have noted that horizontal collusion can be directly prosecuted as per se illegal; it is not necessary to use RPM as a proxy for a horizontal agreement.[46]

Finally, RPM was thought to lead to higher prices. For example, Professor Robert Pitofsky noted that "[t]he one point that emerges clearly in any debate concerning the *per se* rule is that minimum vertical price agreements lead to higher, and usually uniform, resale prices."[47] Evidence supporting this claim has been drawn from the period when the Miller-Tydings Act was in effect: those states that al-

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[39] A supplier can vertically integrate by distributing its product through dedicated retail outlets. For example, Nike's selling its products in Nike stores would be a vertically integrated system; Nike's selling its shoes in Dick's Sporting Goods would not.

[40] *See* HOVENKAMP, *supra* note 37, § 11.2a, at 442; *see also* Pitofsky, *supra* note 26, at 1490 (noting that the effect of RPM "in many respects is the same as that of a horizontal dealer cartel" and that "experience shows that the manufacturer is often induced to act as an organizer of the dealer's cartel by dealer threats or enticements").

[41] Pitofsky, *supra* note 26, at 1490.

[42] *Id.* at 1490–91; Mathewson & Winter, *supra* note 9, at 65.

[43] Pitofsky, *supra* note 26, at 1490–91.

[44] *See, e.g.*, Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & ECON. 263, 281 (1991) ("[T]here is little evidence . . . to support the hypotheses that the RPM law primarily deters collusion or that collusion is the primary reason for the use of RPM.").

[45] Howard P. Marvel & Stephen McCafferty, *The Welfare Effects of Resale Price Maintenance*, 28 J.L. & ECON. 363, 374 (1985); *see also* Mathewson & Winter, *supra* note 9, at 66 (noting that the theory was "less relevant today than historically, since discount stores are well-established in most relevant retail markets").

[46] *See, e.g.*, Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6, 22 (1981).

[47] Pitofsky, *supra* note 26, at 1488*; see also Hearings*, *supra* note 24, at 174 (statement of Thomas E. Kauper, Assistant Att'y Gen., Dep't of Justice, Antitrust Div.).

lowed RPM had higher consumer prices, at least based on some studies.[48] However, during that period, vertical minimum price fixing was per se legal in the states allowing it, so the data do not necessarily prove that prices would be higher if agreements were evaluated under a rule of reason approach.[49] Even if the rule of reason approach did lead to higher prices, however, this is not universally accepted as a negative. Several commentators have argued that uniform prices allow competition to shift from price to services, which consumers may prefer for some goods.[50] In addition, for goods that buyers purchase for their prestige, a compelling argument has been made that consumers actually *prefer* that those goods' prices remain high to preserve the goods' image. The consumer can then retain her status as a purchaser of high-quality goods.[51]

2. Procompetitive Justifications for RPM. — Against these possible anticompetitive effects of RPM, many economists posited procompetitive justifications for the practice. An amicus brief filed by economists in *Leegin* focused on three: preventing free riding on investments in services or quality signals provided by other retailers, ensuring that retailers provide a desired level of customer service, and helping to stabilize demand.[52] This section provides a brief overview of the first two procompetitive justifications, which the Court cited in overruling the per se approach[53]: deterring free riding and ensuring a desired level of customer service.

As to the first justification, retailers and consumers may free ride on high-end retailers' presale services[54] or quality signaling. Often

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[48] *See Hearings*, *supra* note 24, at 174 (statement of Thomas E. Kauper, Assistant Att'y Gen., Dep't of Justice, Antitrust Div.); Ward S. Bowman, Jr., *The Prerequisites and Effects of Resale Price Maintenance*, 22 U. CHI. L. REV. 825, 850–58 (1955) (analyzing results of studies on the effects of fair trade laws on prices).

[49] *See* Elhauge, *supra* note 8, at 61.

[50] *See, e.g.*, Robert H. Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 75 YALE L.J. 373, 454–55 (1966).

[51] *See generally* George R. Ackert, Note, *An Argument for Exempting Prestige Goods from the Per Se Ban on Resale Price Maintenance*, 73 TEX. L. REV. 1185 (1995). Ackert argues that certain types of very high-end products do not have a normal demand curve. Instead, they provide consumers with a status signal that is unavailable if the product is discounted, and consumers will actually demand less of the product if its price is reduced. *See id.* at 1186–87.

[52] Brief of Economists as Amici Curiae Supporting Petitioner at 3, Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705 (2007) (No. 06-480), 2007 WL 173681 [hereinafter Economists' Brief].

[53] *Leegin*, 127 S. Ct. at 2714–15. In addition, the Court noted that resale price maintenance could "increase interbrand competition by facilitating market entry for new firms and brands." *Id.* at 2716.

[54] In an empirical study of litigation, Pauline Ippolito found that this phenomenon, known as the special services theory, potentially "explain[ed] a nontrivial portion of" the private antitrust litigation explored and was possibly "a major explanation for the use of RPM." Ippolito, *supra* note 44, at 283. Professor Lester Telser, one of the earliest authors on the subject, explains the free rider problem as follows:

consumers value service at the retail level and are willing to pay more for it. Although the higher price from the protected retail margin will decrease demand, that decrease may be offset by a demand increase from improved services.[55] When products are "differentiated and therefore are sold on the basis of features and quality as well as price," this may be particularly true.[56] Consumers who value these services will be made better off by them. However, imperfections in the market may lead services to be underprovided without resale price controls. For example, consumers may use the services — such as fitting rooms, tangible displays, and sales help — of a higher-end retailer but then choose to purchase the product from a discounter or over the Internet.[57] Discounters may thereby free ride off the services of higher-end retailers and fail to provide optimal levels of service themselves. In turn, it may become more difficult for a manufacturer to get the higher-end retailer to carry its products since the retailer is unable to capture an acceptable margin, or, alternatively, that retailer may provide a lower level of service than the manufacturer would prefer.

But this theory is not universally accepted. Critics of RPM have doubted the prevalence of free riding,[58] while others have based objections on different consumers' needs for different levels of service. Professor William Comanor, for example, has objected that manufacturers consider only marginal consumers (those consumers who value the product roughly as much as its price) when they set the quality level of their products.[59] Manufacturers ignore inframarginal consumers, who value the product more highly than its price. These inframarginal consumers will still buy the product for the higher, services-adjusted price, but they lose consumer surplus because they are forced to pay more for services that they do not value as highly as the price increase.[60] Therefore, it is at least unclear whether RPM enhances welfare — it depends on how the demand curve shifts with the new ser-

> Sales are diverted from the retailers who do provide the special services at the higher price to the retailers who do not provide the special services and offer to sell the product at the lower price. The mechanism is simple. A customer, because of the special services provided by one retailer, is persuaded to buy the product. But he purchases the product from another paying the latter a lower price. In this way the retailers who do not provide the special services get a free ride at the expense of those who have convinced consumers to buy the product.

Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86, 91 (1960).

[55] *See* Mathewson & Winter, *supra* note 9, at 67.

[56] Economists' Brief, *supra* note 52, at 6.

[57] *See id.* at 6–7.

[58] *See* F.M. SCHERER & DAVID R. ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 551–55 (3d ed. 1990) (collecting authorities).

[59] *See* William S. Comanor, *Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy*, 98 HARV. L. REV. 983, 991 (1985).

[60] *Id.* at 991–92.

vices, and whether that consumer surplus is recaptured by the consumers who do value the services.[61]

Alternatively, consumers may free ride by looking to a higher-end retailer's products as a quality signal. The retailer will employ buyers to select high-quality products, and consumers will rely on those decisions in determining which goods are superior.[62] However, after seeing a given product at a high-end retailer, the consumer may purchase the product elsewhere.[63] Manufacturers may wish to use RPM to encourage high-end retailers to continue to carry their brands.

Even absent free riding, retailers may not be encouraged to invest in an optimal level of retail services unless they are guaranteed a certain margin on the goods.[64] With a guaranteed margin, intrabrand competition shifts to non-price elements, such as service or accessibility.[65] Consumers can thereby find a beneficial package of services, retailers who provide such a package will prosper, and the manufacturer's sales may increase.[66]

These procompetitive justifications led several commentators to recommend that RPM be made per se legal.[67] Professor Robert Bork advocated for per se legality because "the manufacturer who imposes such restraints cannot intend to restrict output and must . . . intend to create efficiency."[68] The most probable efficiencies identified were "inducement or purchase by the manufacturer of extra reseller sales, service, or promotional effort."[69] Then-Professor Richard Posner advocated for a rule of per se legality for a slightly different reason: he found the rule of reason standard to be unworkable and amorphous.[70]

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[61] *Id.*

[62] *See* Howard P. Marvel & Stephen McCafferty, *Resale Price Maintenance and Quality Certification*, 15 RAND J. ECON. 346, 348 (1984).

[63] *Id.* ("By stocking a particular product on its shelves, the retailer attests that the quality and suitability of the item in question are consonant with the retailer's overall reputation. But this sort of dealer recommendation is subject to the same sort of free-riding as more tangible presale services. Consumers who are familiar with the reputation of a retailer as well as with the branded items that retailer offers for sale will find such information useful even if they purchase the goods elsewhere."); *see also* THOMAS R. OVERSTREET, JR., FED. TRADE COMM'N, RESALE PRICE MAINTENANCE: ECONOMIC THEORIES AND EMPIRICAL EVIDENCE 56–61 (1983).

[64] *See* Economists' Brief, *supra* note 52, at 10–11; *see also* Mathewson & Winter, *supra* note 9, at 81 ("[R]esale price maintenance is much more common tha[n] the incidence of free-rider effects in servicing; a sufficient condition for the incentive to impose resale price maintenance is that consumers who are more careful shoppers . . . be on average less influenced by product promotion services.").

[65] *See, e.g.*, Bork, *supra* note 50, at 454–56.

[66] *See id.*

[67] *See, e.g.*, ROBERT H. BORK, THE ANTITRUST PARADOX 297 (1978). *See generally* Posner, *supra* note 46.

[68] BORK, *supra* note 67, at 297.

[69] *Id.*

[70] Posner, *supra* note 46, at 14–15. Professor Posner argued that the traditional formulation of the rule of reason test "invites an unlimited, free-wheeling inquiry," *id.* at 14, and leaves the trier

In addition, any vertical restraints functioning as proxies for horizontal ones could be dealt with through the horizontal rules, even assuming the vertical restraints were legal per se.[71] Given that qualification, Professor Posner doubted that truly vertical restraints would actually reduce competition.[72] It was against this backdrop of conflicting economic analyses that the Court decided to reevaluate its approach to RPM in *Leegin*.

II. THE DECISION IN *LEEGIN*

Leegin Creative Leather Products, Inc. is a designer, manufacturer, and distributor of leather goods and accessories.[73] It argued that for its products, smaller retailers were preferable due to their superior customer service.[74] As part of its plan to maintain that level of service, Leegin wanted to ensure sufficient retailer margins to cover service costs.[75] PSKS (doing business as Kay's Kloset) sold Leegin's products, which at one point accounted for 40–50% of Kay's Kloset's profits.[76] However, in 2002, Leegin discovered that Kay's Kloset stores had been marking down its products by 20% and requested that the discounting cease. Kay's Kloset refused, and Leegin stopped selling to the store.[77] PSKS sued under the Sherman Act and won in the lower courts pursuant to the per se rule against vertical minimum price fixing.[78]

The Supreme Court granted certiorari to decide "whether the Court should overrule the *per se* rule and allow resale price maintenance agreements to be judged by the rule of reason, the usual standard applied to determine if there is a violation of § 1."[79] Answering that question in the affirmative, the Court noted that *Dr. Miles*'s underlying rationale had been discredited, as the decision was based on "'formalistic' legal doctrine rather than 'demonstrable economic effect.'"[80]

of fact "in the dark as to how to decide whether a challenged practice is substantially anticompetitive," *id.* at 15.

[71] *Id.* at 22.

[72] *Id.* at 22–23.

[73] Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705, 2710 (2007).

[74] *Id.* at 2710–11.

[75] *Id.* at 2711. Toward this end, Leegin introduced a "Heart Store Program" offering retailers incentives to become Heart Stores in exchange for, among other things, a pledge to sell at Leegin's suggested prices. Kay's Kloset was once a participant in this program, but was no longer a participant at the time it was terminated as a retailer. *Id.*

[76] *Id.*

[77] *Id.*

[78] *Id.* at 2712.

[79] *Id.* at 2710. On appeal, Leegin did not challenge the finding that it had entered into RPM agreements, instead arguing that the rule of reason should apply to such agreements. *Id.* at 2712.

[80] *Id.* at 2714 (quoting Cont'l T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 58–59 (1977)). The *Leegin* Court noted that *Dr. Miles* had "failed to discuss in detail the business reasons that would motivate a manufacturer situated in 1911 to make use of vertical price restraints." *Id.* In addi-

The Court then cited numerous procompetitive justifications for a manufacturer's decision to use RPM.[81] While noting that anticompetitive reasons for such a decision were also possible, the Court decided the many procompetitive uses were sufficient to warrant rule of reason, as opposed to per se, analysis. Pursuant to the rule of reason analysis, the Court explained, "the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition."[82] Relevant factors include specific information about the business, the restraint's history, nature, and effect, and whether the businesses involved have market power.[83] Finally, the Court took notice of the fact that during the period when the legal environment was most favorable to RPM (from 1937 to 1975, while the Miller-Tydings Act was in effect), few manufacturers used RPM contracts.[84]

Justice Breyer's dissent acknowledged the competing pro- and anticompetitive rationales for RPM, but placed more emphasis on stare decisis than did the majority. The four dissenting Justices were particularly concerned about the reliance upon the per se rule by lawyers, businesspeople, and the public.[85] In addition, the dissent noted that there had been no notable changes in the competing economics literature in half a century,[86] and that there had been "no change in circumstances in the past several decades that helps the majority's position."[87] To the contrary, the only relevant change — Congress's repeal of the Miller-Tydings Act — supported a per se rule.[88]

III. INTERNET COMPETITION: A MAJOR CHANGE IN CIRCUMSTANCE

Although the dissent thought that there had been no change in circumstance and the majority relied largely on articles written in the 1980s, there has been at least one major change in circumstance that has shaped how businesses function: Internet competition. Discussion of how changes in the business environment, particularly the increased consumer information available over the Internet, have made

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tion, the Court in *Dr. Miles* had treated vertical agreements between a manufacturer and distributor as analogous to horizontal combinations, an approach rejected by later precedent. *Id.*

[81] *Id.* at 2715–16.

[82] *Id.* at 2712 (quoting *Cont'l T.V.*, 433 U.S. at 49) (internal quotation mark omitted).

[83] *See id.*

[84] *See id.* at 2725.

[85] *Id.* at 2725 (Breyer, J., dissenting).

[86] *Id.* at 2725–26.

[87] *Id.* at 2731.

[88] *Id.* at 2732 ("Congress fully understood, and consequently intended, that the result of its repeal of . . . Miller-Tydings would be to make minimum resale price maintenance *per se* unlawful.").

the use of RPM more desirable for some types of competitors was more or less an afterthought.[89] While catalog retailers presented similar challenges to traditional retailers, the Internet "greatly lowers the cost of disseminating 'catalogs' to those consumers who are likely to buy particular products," increasing problems for manufacturers and competing retailers.[90]

The *Leegin* majority minimized the potential impact of its decision by relying on several commentators who maintained that few manufacturers employed RPM, even in states where it was legal between 1937 and 1975.[91] But to understand why more manufacturers might want to use RPM today, one has to account for the changes in the business environment. These changes show why retailers may be more tempted to use RPM to control the Internet channel and why the increased use of RPM to control this channel could have both pro- and anticompetitive effects. Taking the changes in the business environment into account also may help courts shape a more practical framework for applying rule of reason analysis to RPM agreements.

Scholars have conceptualized business strategies as falling along three general dimensions: cost, differentiation, and focus.[92] Cost leadership strategy requires reducing costs below competitors' levels, which yields above-average returns because the cost-reducing firm can still earn a profit after rivals have competed away theirs.[93] Differentiation allows a firm to earn above-average returns by doing something unique for which consumers will pay more. Brand image, customer service, and dealer networks are all means by which firms can differentiate products.[94] Finally, a focus strategy aims to appeal to a particular type of buyer or geographic market.[95] By focusing narrowly, sometimes businesses are able to differentiate themselves from broader competitors or lower costs below competitors in niche markets.[96]

Many consumers seek features from sellers beyond low price, opting to pay a bit more for better service or features. This explains, in part, why some manufacturers want to use RPM — because the consumers they target are not solely focused on price.[97] In some situa-

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[89] *See* discussion *supra* note 11.

[90] Judith A. Chevalier, Professor of Economics and Finance, Yale Univ. Sch. of Mgmt., Free Rider Issues and Internet Retailing, Written Statement to the Federal Trade Commission Public Workshop on Possible Anticompetitive Efforts to Restrict Competition on the Internet (Oct. 10, 2002), *available at* http://www.ftc.gov/opp/ecommerce/anticompetitive/panel/chevalier.pdf.

[91] *See Leegin*, 127 S. Ct. at 2725.

[92] *See generally* MICHAEL E. PORTER, COMPETITIVE STRATEGY 34–74 (1998).

[93] *Id.* at 35–36.

[94] *Id.* at 37–38.

[95] *Id.* at 38–40.

[96] *Id.*

[97] *See* Arlo Redwine, *Price Fixing Now an Option*, DEALERNEWS, Oct. 2007, at 18 (noting that "[h]igh-end manufacturers often do see benefits" from RPM). The consumers must be con-

tions, intrabrand price wars might actually hurt the manufacturer's sales. For example, if a manufacturer tries to compete by differentiating its product based on the experience provided by that product (for example, feeling glamorous), price-cutting behavior could damage the brand's image.[98]

Although these traditional strategies remain important, the Internet changes competition in several ways. It tends to make price competition more important. The ease of price comparison on the Internet increases the free rider problem, making RPM a desirable tool for some manufacturers seeking to control their brand image and protect their distribution networks. But the Internet also makes it easier to enforce retail cartels because it makes price-cutting more obvious. Finally, there is a risk of horizontal effects from RPM when a manufacturer vertically integrates online, leading to its setting the price for its competitors.

A. The Internet's Effect on Pricing

Price, for many manufacturers, is not the most desirable avenue on which to compete, but the Internet makes price competition more prevalent.[99] The Internet tends to make prices readily available, and many manufacturers originally feared Internet competition for this reason. The actual effect of Internet competition on price competition is more nuanced. It does not, as some anticipated, lead all competition to be based on price; it does, however, make price competition more salient.

Initially, many thought that the prices on the Internet would converge toward a perfectly competitive level.[100] The Internet was

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cerned about price to some extent, or there would be no need for RPM. However, the argument assumes that some consumers would be concerned enough about quality to want the better product and would be willing to pay the RPM-adjusted price but might free ride if given the opportunity.

[98] *See generally* Ackert, *supra* note 51.

[99] *See* Michael E. Porter, *Strategy and the Internet*, HARV. BUS. REV., Mar. 2001, at 63, 63 ("Some companies . . . have used Internet technology to shift the basis of competition away from quality, features, and service and toward price, making it harder for anyone in their industries to turn a profit."); *id.* at 67 (noting that the Internet lowers variable cost as compared to fixed cost, which increases the incentive to compete on price). *See generally* Michael R. Baye & John Morgan, *Information Gatekeepers on the Internet and the Competitiveness of Homogenous Product Markets*, 91 AM. ECON. REV. 454 (2001) (discussing websites that offer instantaneous price comparisons for relatively homogenous goods). Although customers may benefit from the shorter term focus in the form of lower prices initially, competition on the basis of price "may lead to slower dynamic improvement." Michael E. Porter, *Competition and Antitrust: Toward a Productivity-Based Approach to Evaluating Mergers and Joint Ventures*, 46 ANTITRUST BULL. 919, 940 (2001).

[100] *See, e.g.*, Walter Baker, Mike Marn & Craig Zawada, *Price Smarter on the Net*, HARV. BUS. REV., Feb. 2001, at 122, 123 ("Some observers insist . . . that the Internet will be the great equal-

thought to be a more competitive setting because it reduces search costs and lowers information asymmetries.[101] However, the reality has turned out to be more complex.[102] Several empirical studies have revealed that price dispersion (as opposed to convergence) still exists on the Internet.[103] Consumers have not simply opted for the lowest priced option; trust in the retailer remains important.[104]

While the Internet has not moved all competition to the level of price, few would deny that it makes price comparison easier or that some consumers make selections largely based on price.[105] Consumers identify the Internet as a way to find low prices,[106] and studies have shown that Internet consumers are price sensitive.[107] Prices at purely online retailers tend to be lower than Internet prices available at re-

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izer, driving prices down to the lowest level possible, and that customers will take advantage of the Web's transparency by opting exclusively for the lowest prices.").

[101] *See* Robert J. Kauffman & Charles A. Wood, *Follow the Leader: Price Change Timing in Internet-Based Selling*, 28 MANAGERIAL & DECISION ECON. 679, 681 (2007); *see also* Fiona Scott Morton, Florian Zettelmeyer & Jorge Silva-Risso, *Internet Car Retailing*, 49 J. INDUS. ECON. 501, 502 (2001) ("In addition to being available at close to zero marginal cost, Internet information is of higher quality . . . than information available from offline sources.").

[102] *See* Akshay R. Rao, Mark E. Bergen & Scott Davis, *How To Fight a Price War*, HARV. BUS. REV., Mar.–Apr. 2000, at 107, 110 (noting that evidence that Internet shoppers are very price-sensitive is "mixed").

[103] *See, e.g.*, Xiaolin Xing, *Does Price Converge on the Internet?: Evidence from the Online DVD Market*, 15 APPLIED ECON. LETTERS 11, 14 (2008); *see also* Xing Pan, Brian T. Ratchford & Venkatesh Shankar, *Price Dispersion on the Internet: A Review and Directions for Future Research*, J. INTERACTIVE MARKETING, Autumn 2004, at 116, 117–25 (collecting study results). Professor Xiaolin Xing attributes this price dispersion to differences in brand name. However, by brand he means retailer — as opposed to manufacturer — brand (that is, people trust certain online retailers more than others and are willing to pay a premium). *See* Xing, *supra*, at 14. The concern of this Note is largely with manufacturers' abilities to control their brands' online sales through multiple retail outlets that want to charge divergent prices. Erosion of a manufacturer's brand name can take place even though trust in a retailer becomes more salient.

[104] Erik Brynjolfsson & Michael D. Smith, *Frictionless Commerce? A Comparison of Internet and Conventional Retailers*, 46 MGMT. SCI. 563, 578–79 (2000); Frederick F. Reichheld & Phil Schefter, *E-Loyalty: Your Secret Weapon on the Web*, HARV. BUS. REV., July–Aug. 2000, at 105, 107–08; *see also id.* at 110 ("Contrary to a common perception, the majority of on-line shoppers are not out to score the absolute lowest price.").

[105] *See* Baker, Marn & Zawada, *supra* note 100, at 123 ("[O]n-line consumers regularly say that far and away the most important factor motivating them to buy on-line is lower prices."); Morton, Zettelmeyer & Silva-Risso, *supra* note 101, at 502 (finding that customers who received online referrals to car dealers paid a lower average price than those who did not); Indrajit Sinha, *Cost Transparency: The Net's Real Threat to Prices and Brands*, HARV. BUS. REV., Mar.–Apr. 2000, at 43, 45 ("[C]ost transparency weakens customer loyalty to brands.").

[106] A 2005 survey found that 79% of Internet users thought that the Internet made it "easy for them to find the lowest price for a product," and concluded that "[t]he Internet is seen by many as a resource for finding the lowest price on items." PRINCETON SURV. RES. ASSOC. INT'L, CONSUMER REPORTS WEBWATCH, LEAP OF FAITH: USING THE INTERNET DESPITE THE DANGERS 12 (2005), http://www.consumerwebwatch.org/pdfs/princeton.pdf.

[107] *See, e.g.*, Judith Chevalier & Austan Goolsbee, *Measuring Prices and Price Competition Online: Amazon.com and BarnesandNoble.com*, 1 QUANTITATIVE MARKETING & ECON. 203, 220 (2003).

tailers using a combination of online and brick-and-mortar sales.[108] In large part, lower prices at online retailers may be due to the fact that costs of online services are largely fixed, whereas service costs in the brick-and-mortar setting are variable.[109] In addition to the different nature of the costs, total cost for an online retailer may be lower because there is no need to invest in a physical storefront.

Online shopping and research have not only made price comparison easy, they have also changed the way people shop.[110] Even consumers who do not buy online often look online before going to a storefront to purchase products.[111] As a result, they are better informed about product features and reasonable pricing when going to the store.[112] Consumer knowledge could mean, at least in some industries, that services in a brick-and-mortar setting are less important, rendering the brick-and-mortar retailer less important because the consumer can find out most of the information she would have wanted to know online.[113] This effect is likely to vary depending on the complexity of the product and the manufacturer's business model.

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[108] Pan, Ratchford & Shankar, *supra* note 103, at 122, 125. In addition, Professors Erik Brynjolfsson and Michael Smith find that prices generally are lower on the Internet. Brynjolfsson & Smith, *supra* note 104, at 564–65.

[109] Dennis W. Carlton & Judith A. Chevalier, *Free Riding and Sales Strategies for the Internet*, 49 J. INDUS. ECON. 441, 443 (2001). An additional effect Internet competition can have on price is the erosion of local market power. Because companies can compete on a global level, formerly local monopolies (for example, the only electronics retailer in a small town) now face price competition. This effect can actually lower prices at stores that do not have an Internet presence. *See* Baye & Morgan, *supra* note 99, at 466; *see also* Austan Goolsbee, *Competition in the Computer Industry: Online Versus Retail*, 49 J. INDUS. ECON. 487, 496 (2001) (finding in an empirical study that higher local prices make consumers more likely to buy online).

[110] *See* Sinha, *supra* note 105, at 48 (arguing that the Internet shopping experience "encourages dispassionate comparisons of prices and features" and leads to decisions largely "based on reason rather than emotion").

[111] *See, e.g.*, *Two-Thirds of Consumers Shop Online Before Buying, New Poll Reports*, INTERNET RETAILER, Nov. 7, 2007, http://www.Internetretailer.com/Internet/marketing-conference/73187-two-thirds-consumers-shop-online-before-buying-new-poll-reports.html. Of those shopping online before buying, 75% made online research their first stop in holiday shopping, and 90% said their shopping experience was better when they researched products online before in-store shopping. *Id.*

[112] In this way, consumers may free ride on Internet retailers' services, although the associated cost may be negligible to these retailers, whose costs are largely fixed. Carlton & Chevalier, *supra* note 109, at 443. This scenario might occur if a consumer wants instant gratification from purchasing the product immediately at a brick-and-mortar outlet, but does not want to bother trying to find a salesperson to explain the different features. This highlights a feature of Internet business: good (to some consumers, better) services can be provided at potentially minimal cost, such as full side-by-side comparisons of products.

[113] *Cf.* C.K. PRAHALAD & VENKAT RAMASWAMY, THE FUTURE OF COMPETITION: CO-CREATING UNIQUE VALUE WITH CUSTOMERS 2–5 (2004) (discussing the changing role of the consumer).

B. The Internet's Effect on the Free Rider Problem

What does all of this mean for the possibility of free riding? One of the biggest objections to the free rider theory has been practical, not theoretical. Many have simply doubted that free riding actually happens, or at least that it happens very frequently.[114] Justice Breyer, in his dissent in *Leegin*, acknowledged that it happens "sometimes."[115] The Internet, by making price comparison easy for consumers, makes free riding easier. Empirical research shows that the Internet also makes free riding more prevalent.

On one hand, in many industries, services[116] in-store may become less important as consumers invest time up front to learn about the product. On the other hand, it is easier for consumers to learn about prices available over the Internet before entering stores, even if they continue to rely on retail services. Therefore, those stores that still provide a high level of service for complex products can face greater difficulty in convincing consumers to purchase from them at a higher price. The consumer can simply go to one brick-and-mortar store that provides a high level of service to address any unanswered questions and then head home to make the purchase. This is especially true given the convenience of online purchasing for many products — a consumer does not have to take the time to make trips to multiple venues and try to locate the product she is looking for in a disorganized, difficult to navigate discount warehouse. Instead, she may be able to purchase the product from the comfort of her living room in just a few minutes. It makes sense that free riding would increase as price information becomes more accessible.

Empirical evidence supports this assertion. Although free riding can occur either way (a brick-and-mortar retailer can free ride on an Internet retailer's services and vice versa), the costs of such free riding are different. Internet retailers' costs tend to be fixed, whereas brick-and-mortar retailers' service costs are variable.[117] This means that brick-and-mortar stores must employ salespeople whose time involves an opportunity cost. For each consumer a sales associate helps who ultimately purchases the goods for the lower cost online, that store may lose a sale to a consumer who was willing to buy in the store.[118]

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[114] *See, e.g.*, SCHERER & ROSS, *supra* note 58, at 551–54.

[115] Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705, 2730 (2007) (Breyer, J., dissenting).

[116] By services, this Note means things like providing a knowledgeable sales staff who can explain the features of products and useful or prominent displays. It does not refer to services provided post-purchase (for example, warranties). There should not be any meaningful difference between a consumer's demand for such services from online or retail establishments.

[117] Carlton & Chevalier, *supra* note 109, at 443.

[118] *Id.*

Therefore, free riding will have a more detrimental effect on the brick-and-mortar retailer than on the online retailer. And at least one study has found that free riding across the channels (that is, between brick-and-mortar and the Internet) is significant — of online purchasers, 26.4% visited brick-and-mortar stores before completing their online purchase.[119] And of that 26.4%, only 1.8% purchased online from the brick-and-mortar store they visited.[120] This means that "for every fourth purchase on the Internet, a retailer provided unpaid-for information in its brick-and-mortar store."[121]

This problem is magnified by the fact that it is easier to design a contract to compensate an Internet retailer for providing services, such as detailed product information, online.[122] It is much more difficult to compensate brick-and-mortar retailers directly for services, as it is difficult to determine exactly how much time a salesperson at a brick-and-mortar store spent with a consumer, her level of knowledge of the product, and the numerous other factors that go into making a live sale.[123] Therefore, manufacturers might be more concerned about controlling Internet retailers' free riding off of brick-and-mortar retailers through RPM, since the manufacturers cannot control it by compensating correctly for services.[124] However, the Internet also makes it easier for the manufacturer to provide information to consumers directly, for example, via a manufacturer website providing things like pictures and side-by-side comparisons of products. To the extent that those types of services are reasonable substitutes for sales help, the manufacturer might not care as much about the services available at brick-and-mortar retailers.

Professor Comanor's theory of the inframarginal consumer[125] pushes back against the free rider problem with perhaps greater force than in pre-Internet times. Absent RPM, the Internet could act as an efficient sorting mechanism for inframarginal consumers. Those who are educated about products and do not need special services can simply find the lowest price online, while those who are not educated can

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[119] Sebastian Van Baal & Christian Dach, *Free Riding and Customer Retention Across Retailers' Channels*, J. INTERACTIVE MARKETING, Spring 2005, at 75, 81–82.

[120] *Id.* at 82.

[121] *Id.* It is not clear from the study, however, what motivated the shoppers to purchase online after visiting the retail store. If they visited a brick-and-mortar store but the desired product was out of stock, it would be hard to say that the consumer was "free riding" on the special services of the store, since the consumer could not have purchased the product there. However, the question in the study asked whether the shoppers first "gather[ed] information" in a store before purchase, which indicates that the shopper gained some useful information from visiting the brick-and-mortar store. *Id.* at 80.

[122] Chevalier, *supra* note 90.

[123] *Id.*

[124] *Id.*

[125] *See supra* pp. 1607–08.

go to a store and buy the product for a higher price. Alternatively, those who are not educated about the product but prefer the services provided by an online retailer — which, as noted, often involve a greater proportion of fixed costs than the provision of in-person sales help — can capture some of the per-consumer cost savings of that business model.[126] This analysis assumes that marginal consumers are unlikely to free ride,[127] which is an empirical question beyond the scope of this Note.

C. The Internet's Potential To Increase the Anticompetitive Uses of RPM

Although the Internet exacerbates the free rider problem, it also poses increased risks of certain anticompetitive conduct, most notably retail and manufacturer cartels. And, to the extent one is worried about high prices, the use of RPM for online retailers is likely to lead to greater price differences between pre- and post-RPM prices (due to the lower starting prices of purely online retailers) than during pre-Internet times.

Cartels become easier to enforce when products are sold online because it is easier for other retailers and manufacturers to observe price-cutting behavior. There are several elements that are required for effective collusion, one of which is detection, defined as "some reliable means . . . by which departures from the agreement can be detected."[128] However, cartelization by manufacturers may be less of a concern when their focus is a differentiation strategy because cartels are a bigger concern for homogenous products.[129] Manufacturers pursuing a differentiation strategy could be motivated to adopt RPM simply due to complaints by retailers who are able to readily observe competitive prices online and may perceive a loss in business from that discounting. Manufacturers pursuing a differentiation strategy that relies to some extent on dealer networks will want to keep its retailers satisfied.[130] Manufacturers whose products are heavily discounted

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[126] The fact that purely online retailers have lower variable costs than brick-and-mortar businesses does not necessarily imply that the online retailer will have lower overall costs. However, because costs are fixed, the marginal cost of serving one more consumer on an online retailer is lower than the cost of serving each incremental consumer in a brick-and-mortar store, and the online retailer might (and, evidence suggests, does) pass those cost savings on to consumers.

[127] Or at least are unlikely to free ride in significant enough numbers to cancel the benefits to inframarginal consumers derived from online price competition.

[128] Louis Kaplow & Carl Shapiro, *Antitrust*, *in* 2 HANDBOOK OF LAW AND ECONOMICS 1073, 1103 (A. Mitchell Polinsky & Steven Shavell eds., 2007).

[129] *Id.* at 1117 (noting that "[t]he traditional view in antitrust circles has been that collusion is easier to sustain among firms selling homogeneous products rather than highly differentiated products," and discussing reasons why that might be the case).

[130] Indeed, Professor Michael Porter identifies strong cooperation from channels as an important resource for a differentiation competitor. PORTER, *supra* note 92, at 41.

online may fear repercussions: Higher-end retailers who sell the products perceive that they are losing business on the manufacturer's products, or that they must discount in order to sell the product. Either because their margins on that particular product are lower, or because of anger at the manufacturer's perceived inability to control its channel, the retailers may point walk-in consumers toward other brands. The fact that the specialty retail and higher-end stores no longer recommend the brand diminishes consumers' perception of its quality. Therefore, the consumers most likely to buy the product become those who are interested in price. And because price is often not the most profitable dimension along which manufacturers compete, manufacturers want to avoid this chain of events.

However, the concern about the increased power of retail cartels remains. There is an additional, less frequently observed horizontal element to RPM that the Internet exacerbates. As one commentator has observed, "[m]anufacturers are more likely to vertically integrate . . . using online sales channels than using brick and mortar sales channels."[131] Assume, for example, that a manufacturer wanted to sell its products online through its own website for its suggested retail price. It could do this either by contracting to prevent its retailers from selling online or by requiring them to sell at its suggested price. In either case, the manufacturer ends up setting prices for the retailers competing with its Internet retail front.[132] The extent to which the manufacturer would be motivated by eliminating price competition for its retail fronts depends on the sales it would expect to lose from the increased price as compared to its increased retail margins. If demand is relatively inelastic, one might expect this motivation to be more of a concern.

In addition, Internet price competition can eliminate local monopolies by subjecting them to competition.[133] The extent to which this price competition results in buyers switching to Internet competitors depends on several factors, one of which is the price differential be-

[131] Chevalier, *supra* note 90.

[132] *See* Robert Pitofsky, *Are Retailers Who Offer Discounts Really "Knaves"?: The Coming Challenge to the* Dr. Miles *Rule*, ANTITRUST, Spring 2007, at 61. Professor Pitofsky notes that Leegin was not only a manufacturer and wholesaler, but also a retailer that owned over seventy stores. *Id.* at 62. Its RPM agreements applied to retailers who competed with it directly, leading to a horizontal effect. *Id.* Even assuming PSKS was not a direct competitor, Professor Pitofsky observes that "Leegin executives seem to believe that if Kay's Kloset were allowed to discount, the practice would spread and other retailers who are direct competitors of Leegin would take up the nefarious practice, soon cutting into Leegin's retail profits." *Id.* The Internet, by making vertical integration easier, also makes the likelihood of this horizontal effect more prevalent.

[133] *See* discussion *supra* note 109.

tween buying online and buying at the local store.[134] This effect cautions against RPM that arises at the instigation of local retailers.

IV. INTERNET COMPETITION AND THE RULE OF REASON

The Internet has changed competition on a number of levels. Although it is unclear whether the anticompetitive or procompetitive effects predominate, this Note discusses particular effects that are likely to be of greater concern due to the increasing importance of the Internet channel. Determining whether the Internet contributes more to the pro- or anticompetitive elements of RPM depends on the magnitudes of the various effects. Although this lack of clarity favors rule of reason analysis over a per se approach, the Court should have tailored the rule more than it did in order to provide greater predictability for businesses. This is because businesses are more likely to want to use RPM given the Internet, but will be deterred if they fear antitrust lawsuits. To the extent the traditional rule of reason analysis leads to underenforcement, a more tailored approach would provide plaintiffs with a better chance to succeed in challenging truly anticompetitive RPM agreements. A full discussion of the rule of reason analysis and the debate over tailoring is beyond the scope of this Note, but this Part briefly touches on the debate and how the issues posed by Internet competition discussed above fit into it.

The Court in *Leegin* applied the traditional rule of reason analysis, which requires the factfinder to consider all circumstances.[135] It identified several relevant factors, including specific information about the business; the restraint's history, nature, and effect; and whether the businesses involved have market power.[136] The Court did identify some relevant considerations: the number of manufacturers adopting the practice, the "source of the restraint," and market power.[137] It also suggested that courts could establish a "litigation structure" involving rules for offering proof or presumptions "to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints and to promote procompetitive ones."[138] But until that litigation structure is developed, the rule of reason test asks the factfinder (usually a jury) whether, all things considered, the conduct at issue was anticompetitive.

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[134] *See* Goolsbee, *supra* note 109, at 494–96.

[135] Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705, 2712 (2007); *see also supra* p. 1610.

[136] *See Leegin*, 127 S. Ct. at 2712.

[137] *Id.* at 2719–20.

[138] *Id.* at 2720.

A major criticism of the traditional rule of reason test is that results are unpredictable,[139] especially when juries are the factfinders.[140] This lack of predictability is particularly problematic in the business setting because businesses rely on rules to order their practices.[141] If the outcomes are too unpredictable under the rule of reason analysis, manufacturers may not use the practice even when it would be beneficial to do so[142] — for example, to control free riders, a problem that the Internet exacerbates. Efficiency gains from the use of RPM would be lost. If businesses used RPM despite the risk, the factfinder might not accurately detect inefficient uses, underdeterring anticompetitive conduct.[143]

A second criticism of the rule of reason test in the RPM context, to the extent one is concerned about the anticompetitive effects of RPM, is that rule of reason is close to per se legality in practice.[144] The Department of Justice may not enforce the rule, and because private antitrust suits are costly to bring and difficult to win pursuant to a rule of reason analysis, few plaintiffs will bring suit. Therefore, enforcement levels may be suboptimal, leaving inefficient uses of RPM undisturbed. This is a problem because, as noted, manufacturers may be inclined to use RPM to protect their own online outlet from competition or to respond to the demands of retail cartels. Higher prices with no corresponding gains in consumer welfare could result.

Given these criticisms of the rule of reason, especially viewed in light of the Internet effects discussed in this Note, it would have been beneficial for the Court to have taken a stronger stance in crafting the

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[139] *See, e.g.*, Posner, *supra* note 46, at 14–15.

[140] *See* Daniel A. Crane, *Rules Versus Standards in Antitrust Adjudication*, 64 WASH. & LEE L. REV. 49, 92–94 (2007); *cf.* Patrick J. Kaufmann, *Dealer Termination Agreements and Resale Price Maintenance: Implications of the* Business Electronics *Case and the Proposed Amendment to the Sherman Act*, 64 J. RETAILING 113, 122 (1988) (noting that low cost, low price retailers are naturally allied with consumers, who are concerned with short term price, as opposed to the long term consequences of their actions).

[141] *See* Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 12 (1984) ("The [rule of reason] formulation offers no help to businesses planning their conduct."); Thomas A. Piraino, Jr., *Reconciling the Harvard and Chicago Schools: A New Antitrust Approach for the 21st Century*, 82 IND. L.J. 345, 356 (2007).

[142] Piraino, *supra* note 142, at 356 ("Not only will firms miscalculate and risk anticompetitive conduct that they believe to be lawful; they may also avoid procompetitive behavior under the mistaken assumption that it can be attacked successfully.").

[143] *Id.*

[144] *See, e.g.*, Crane, *supra* note 141, at 64; Frank H. Easterbrook, *Allocating Antitrust Decisionmaking Tasks*, 76 GEO. L.J. 305, 305 (1987) (arguing that litigating under the rule of reason approach "as a practical matter meant that [the challenged practices] were declared lawful per se"); Pitofsky, *supra* note 133, at 64–65 (noting that, during the times when the Justice Department favored the rule of reason approach to RPM agreements, there was "no enforcement at all"); Richard A. Posner, *The Rule of Reason and the Economic Approach: Reflections on the* Sylvania *Decision*, 45 U. CHI. L. REV. 1, 14 (1977) ("[T]he content of the Rule of Reason is largely unknown; in practice, it is little more than a euphemism for nonliability.").

structure of future litigation. For example, as Professors William Comanor and Frederic Scherer recommended, the Court might have adopted an intermediate approach involving the use of presumptions.[145] Instead of merely specifying the nature of the restraint as important, the Court could have adopted a presumption that RPM undertaken at the behest of retailers was illegal, subject to rebuttal by evidence contradicting that conclusion.[146] The Internet's contribution to the effectiveness of retail cartels provides support for this approach, which would give plaintiffs an increased incentive to bring suit in the cases most likely to involve retail cartels. In addition, the Court could have noted the need to carefully examine agreements undertaken when a manufacturer is also a competing retailer, a problem that is more prevalent in the online environment. These steps would have provided more guidance to future litigants and businesses while leaving agreements requested by manufacturers, which have more procompetitive justifications, open for the development of future criteria.

V. CONCLUSION

The Court's application of rule of reason analysis to RPM agreements is a step in the right direction, but the Court overlooked the ways in which business is evolving that make these RPM agreements more useful. The increasing impact of the Internet on business and competition is an overlooked change in circumstance the Court should have considered in more detail. Based on those considerations, the Court should have provided additional guidance for courts and juries to apply the rule of reason test in the future. This guidance would have been helpful both to private antitrust plaintiffs and to businesses wishing to use RPM for legitimate reasons.

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[145] 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), 2007 WL 173679.

[146] *Id.* at 7–8.