Dr. Miles Is Dead. Now What?: Structuring a Rule of Reason for Evaluating Minimum Resale Price Maintenance

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Abstract
In Leegin Creative Leather Prods., Inc. v. PSKS, Inc., decided in 2007, the U.S. Supreme Court overruled its 1911 precedent declaring vertical minimum resale price maintenance (RPM) to be per se illegal. The Leegin Court held that the practice should instead be examined on a case-by-case basis under antitrust’s rule of reason. The Court further exhorted the lower courts to craft a “structured” rule of reason for evaluating RPM. This article critiques six approaches that have been proposed for evaluating minimum RPM and offers an alternative approach. The six approaches critiqued are (1) the Brandeisian, unstructured rule of reason; (2) Judge Posner’s rule of per se legality; (3) the approach advocated by 27 states in the recent Nine West case; (4) the approach adopted by the Federal Trade Commission in that case; (5) the approach advocated by economists William Comanor and F.M. Scherer; and (6) the approach proposed in the Areeda & Hovenkamp Antitrust Law treatise. Finding each of these approaches deficient, the article proposes an alternative evaluative approach that harnesses economic learning and allocates proof burdens in a manner that minimizes the sum of decision and error costs, thereby maximizing the net social benefits of RPM regulation.

Table of Contents

Introduction ........................................................................................ 1

I. RPM and Competition................................................................. 3
A. Potential Anticompetitive Harms .............................................. 4
1. Facilitating Dealer Collusion.................................................. 5
2. Facilitating Manufacturer Collusion.................................... 6
3. RPM-Augmented Foreclosure............................................. 9
B. Potential Procompetitive Benefits ........................................... 10
1. Enhancing Distributional Efficiency ................................. 10
2. Facilitating Entry ............................................................... 17
3. Facilitating the Marketing of Products with Unpredictable Demand ........................................ 18

II. Proposals for Evaluating RPM Under the Rule of Reason ....... 18
A. Two Non-Starters: Per Se Legality and the Unstructured Rule of Reason ........................................ 19
   1. An Unstructured Rule of Reason ................................. 19
   2. Per Se Legality .......................................................... 23
B. The States’ Proposed Approach: Higher Price Places Burden on Defendant to Prove Procompetitive Effect that Could Not Have Been Achieved Less Restrictively ................................................ 26
C. The FTC Approach: Defendant Can Avoid Burden of Proving Procompetitive Effect of RPM Only If It Proves Absence of “Leegin Factors” .................................................. 29
D. The Comanor/Scherer Approach: RPM Is Unreasonable if Retailer-Initiated; Otherwise, Focus on Quantitative Foreclosure .......................................................... 32
E. The Antitrust Law Approach ............................................. 36

III. An Alternative Approach ...................................................... 40
A. Principles Governing Rule Selection .................................. 41
   1. Likelihood of Incorrect Judgments ............................... 41
   2. Magnitude of Losses from Errors ............................... 49
   3. Difficulty of Administering the Rule ............................... 50
B. The Proposed Rule .......................................................... 51
   1. Challenger’s Prima Facie Case ................................. 51
   2. Defendant’s Rebuttal Opportunity ............................... 55
   3. Responses Available to Challenger ............................... 55
C. Evaluation of the Proposed Rule ........................................ 56
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Introduction

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

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1 127 S. Ct. 2705 (2007).

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

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

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

5 See, e.g., Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717, 723 (1988) (noting that resort to per se rules is confined to restraints “that would always or almost always tend to restrict competition and decrease output”).


7 See, e.g., Raymond Deneckere, Howard P. Marvel & James Peck, *Demand Uncertainty and Price Maintenance: Markdowns as Destructive Competition*, 87
literature on RPM: the practice is, at worst, a “mixed bag” in terms of competitive effects. Mixed bags should not be deemed unreasonable per se.8

While the academic literature is replete with accounts of RPM’s competitive effects, there is little commentary addressing how exactly courts should go about judging the “reasonableness” of any particular instance of RPM. This makes sense, of course, for Dr. Miles precluded courts from inquiring into the reasonableness of specific RPM agreements, and such commentary would therefore have been rather pointless.9 But in the post-Leegin era, in the face of a proliferation of RPM arrangements,10 courts must develop means of distinguishing pro- from anticompetitive RPM agreements. Indeed, the Leegin Court expressly contemplated that the lower courts would craft a structured approach for sorting instances of RPM. It explained,

As courts gain experience considering the effect of these [RPM] restraints by applying the rule of reason over the course of decisions, they can establish the litigation structure to ensure the rule operates to eliminate anticompetitive restraints from the market and to provide more guidance to businesses. Courts can, for example, devise rules over time for offering proof, or even presumptions where justified, to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints and to promote procompetitive ones.11

8 See supra note 5 and accompanying text.
9 There is one notable pre-Leegin proposal for a structured rule of reason: that set forth in the Antitrust Law treatise. See 8 PHILIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1633, at 328-39 (2d ed. 2004). The treatise authors likely included this thorough proposal, despite the governing per se rule, to illustrate that rule of reason treatment is workable and would be superior to per se treatment. The treatise’s laudable and visionary analysis is summarized and criticized in Part II.E, infra.
10 See Joseph Pereira, Price-Fixing Makes Comeback After Supreme Court Ruling, WALL ST. JOURNAL A1 (Aug. 18, 2008) (reporting a marked increase in RPM following Leegin).
11 Leegin, 127 S. Ct. at 2720.
This article aims to assist courts with this challenge by proposing a structured rule of reason for evaluating the legality of RPM agreements. Part I lays the foundation by summarizing the economic learning on RPM’s competitive effects. Part II then describes and critiques six evaluative approaches that have been proposed for evaluating the legality of specific instances of RPM. Part III proposes an alternative evaluative approach. Under that approach, a party challenging an instance of RPM could prevail only if it either (1) produced convincing evidence that the RPM resulted in an output reduction that could not be attributed to another cause or (2) both demonstrated the existence of all the prerequisites to one of RPM’s potential anticompetitive harms and rebutted any claim that the RPM was imposed as the most efficient means of securing a procompetitive end. The proposed approach would maximize the net benefits of RPM regulation by minimizing the sum of decision costs and error costs.

I. RPM and Competition

Crafting a rational scheme for separating pro- from anti-competitive instances of RPM requires an understanding of how RPM may enhance or diminish competition. We thus begin with a consideration of RPM’s competitive effects. Possible anti-competitive harms, examined in Part I.A, include the facilitation of collusion by dealers and manufacturers and the erection of barriers to entry by manufacturers. The potential procompetitive benefits, the
focus of Part II.B, include the enhancement of distributional efficiency, the facilitation of entry into the upstream market, and the facilitation of the marketing of products for which consumer demand is uncertain.

**A. Potential Anticompetitive Harms**

RPM’s potential anticompetitive harms result from its ability to facilitate collusion and to foreclose new entrants from available marketing outlets. Collusion, which the Supreme Court has dubbed “the supreme evil of antitrust,”13 is, fortunately enough, difficult to accomplish.14 First, the parties to any collusive arrangement must reach an understanding on how they will limit competition amongst themselves (e.g., if the collusive agreement is price-fixing, what price will be charged?).15 Agreements of this sort among multiple parties are always a challenge to negotiate, and, because collusion is generally illegal,16 the parties to any cartel must do so in a clandestine fashion. In addition, the parties to a cartel must somehow police it—that is, they must monitor their co-conspirators’ compliance with the agreed-upon terms and punish violators. Secretly policing illegal, heavily sanctioned agreements not to compete can be quite difficult.

RPM may disrupt this fortuitous state of affairs by making collusion easier for both dealers and manufacturers. As Part II.B.1 explains, RPM may facilitate collusion at the dealer level by assisting with both the establishment and the enforcement of a price-fixing agreement. Part II.B.2 considers how RPM may facilitate the enforcement of manufacturer-level collusive agreements. Finally, Part II.B.3 considers how manufacturers may employ RPM as an exclusionary device aimed at thwarting competition from new entrants in the manufacturing market.

The argument that RPM improperly restricts dealer freedom also fails. Manufacturers, who typically want their dealers to be as effective as possible, routinely dictate aspects of the dealers’ operations. The law has assumed most of those intrusions on dealer freedom to be valid, see Areeda & Hovenkamp, supra note 9, ¶ 1609 at 114-15, and limiting manufacturers’ freedom to impose such restrictions would simply encourage vertical integration into distribution—an outcome that certainly would not be in the interest of dealers. Thus, a mere infringement on dealer autonomy cannot justify restricting RPM.


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

1. Facilitating Dealer Collusion

Dealers can avoid the difficulty of secretly negotiating a fixed supracompetitive resale price for a product if they can convince the manufacturer of that product to require all dealers to charge such a price. They may, for example, complain to the manufacturer—either individually, as a group, or via some trade association—about discounting dealers that are somehow injuring brand equity. The manufacturer might then respond to their complaints by setting minimum resale prices and thereby essentially establishing the retailer cartel. In addition, the manufacturer, which is in constant contact with its dealers and whose interactions with the competing dealers do not typically raise red flags, may take the lead in enforcing the price-fixing agreement by punishing (e.g., refusing to supply to) dealers that diverge from the fixed price.17 Thus, RPM may permit colluding retailers to overcome the two main hurdles to a price-fixing conspiracy: establishment and enforcement.

Of course, manufacturers must agree to participate in this sort of scheme, and it is not immediately obvious why they would do so. The retail markup—the difference between the price the manufacturer collects from the retailer and the price the retailer charges the end-user consumer—is the cost the manufacturer must incur to distribute its goods via retailers.18 A manufacturer would presumably seek to keep that cost as low as possible and would thus refuse retailer requests to impose minimum RPM (unless the guaranteed retail markup generated retailer services that enhanced consumer demand for the manufacturer’s products, in which case the RPM would be efficiency-enhancing).19 In theory, though, a manufacturer might accede to RPM demands from dealers or groups of dealers that possess market power in the market for retail distribution. If, for example, a trade association representing a majority of available retail outlets in a geographic market demanded on behalf of its members that a manufacturer set minimum resale prices for its goods, and if the manufacturer could not easily integrate forward into retail distribution in the relevant geographic market, the manufacturer might give in to the association’s demands.20

17 For example, evidence suggests that the RPM at issue in Dr. Miles was procured by retail dealers seeking to enlist manufacturer assistance in enforcing their retailer-level cartel. See HERBERT HOVENKAMP, THE ANTITRUST ENTERPRISE: PRINCIPLE AND EXECUTION 186 (2005) (“Retail druggists were fixing prices and using manufacturers as their ‘enforcer.’”).
18 If the manufacturer were to directly distribute its goods to consumers, it could charge the higher consumer price itself, thereby pocketing any retail markup.
19 Part II.C.1 discusses this possibility.
20 8 Areeda & Hovenkamp, supra note 9, ¶ 1604d1, at 46 (discussing exercise of dealer power via trade associations).
Similarly, dealers might exercise their collective power in an unconcerted manner if a number of prominent dealers, representing a substantial percentage of available retail outlets in an area, independently demanded imposition of RPM. Even the pressure of a single dealer could conceivably motivate a manufacturer to impose RPM if the dealer represented a large percentage of available marketing outlets, and switching to other dealers or forward integration into retailing was costly.

2. Facilitating Manufacturer Collusion

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

a) Reducing Incentives to Cheat

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

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

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

23 The manufacturer may reason that it will lose less from granting the discount than from losing the dealer. See See 8 Areeda & Hovenkamp, supra note 9, ¶ 1606c, at 85.

24 Id. ¶ 1606c, at 85-86. As an example of price competition at the dealer level leading to price cuts at the manufacturer level, Areeda & Hovenkamp point to gasoline price wars, where intense dealer-level competition frequently leads to manufacturer discounts in the form of “temporary competitive allowances.” Id. at 86.
In addition, RPM may reduce the benefit a manufacturer gains from acquiescing to demands for discounts. In most cartels, each participant faces a constant temptation to usurp sales from its co-conspirators by lowering its price from the fixed level. Such cheating has caused many a cartel to unravel. When manufacturers that have coordinated on the price they charge dealers also employ RPM, any price break a cheating manufacturer grants its dealers cannot be passed along to consumers in the form of lower retail prices and is thus unlikely to enhance appreciably the cheating manufacturer’s total sales. RPM may therefore reduce the benefit of cheating on a manufacturer-level cartel.

b) Making Cheating More Visible

RPM may also facilitate a manufacturer-level cartel by making cheating more detectable. Manufacturers are more likely to diverge from coordinated prices if they can keep their price cuts a secret. Because the price any manufacturer charges particular dealers is generally private, maintaining such secrecy might not be overly difficult. By employing RPM to set retail prices, which are generally


26 See RICHARD A. POSNER, ANTITRUST LAW 88 (2d ed. 2001) (noting that a manufacturer subject to RPM “will gain no additional sales by granting a secret discount to the dealer except insofar as the discount will operate as a bribe to induce the dealer to push the supplier’s brand over that of competing brands”). Of course, even if retailers cannot pass along price cuts to consumers, manufacturers would still seem to have an incentive to cheat on a conspiracy fixing the prices charged to retailers because doing so could lead retailers to switch purchases from the complying manufacturers to the cheating ones. Still, RPM may reduce, though perhaps not eliminate, the temptation to cheat. While a cheating manufacturer might benefit from more dealer purchases (offset by lower purchases from competing manufacturers), the incremental gain in purchases would not be as great as if total sales were increased by lower prices to end-user consumers. Moreover, cheating leading to higher purchases from the cheater and lower purchases from other manufacturers is likely to be detected. If a dealer cuts back on its purchases from non-cheating suppliers, they are likely to inquire as to the reason for the cutback, so the cheater will likely be detected. In addition, if manufacturers sell through single-brand dealers and the manufacturers have set resale prices the dealers may charge, then there is little incentive for the manufacturers to cheat on the price they charge the dealers. Doing so will not increase total sales to consumers (so retailers will not have any need to buy more in response to a lower price; manufacturers will just give away some of their profits to retailers). Also, it may be difficult for dealers to switch to the manufacturers who have lowered prices to dealers. The price reductions are necessarily secret, so other dealers will not know about them, and there may be high “brand-switching” costs for dealers who handle only one brand of a product.
public, manufacturers can better detect reductions on the prices charged dealers. Dealers who are given price reductions may respond by lowering their retail prices somewhat below the fixed level. Absent RPM, fluctuation in retail prices might result from retailers’ independently varying their margins. With industry-wide RPM, however, a drop in the retail price of one brand gives rise to an inference that the manufacturer of that brand has discounted to its dealers or, at a minimum, has failed to enforce its RPM policy. In either case, some sort of reprimand is in order. In short, RPM may facilitate the policing of manufacturer-level price coordination by increasing the visibility or transparency of wholesale prices.

There are, however, reasons to doubt that manufacturers frequently employ RPM to strengthen coordination by enhancing price transparency. Any RPM that increases dealer margins (as all minimum RPM will do unless it provides for a retail markup that precisely mirrors the incremental cost of retailing) raises the cost manufacturers pay for distribution. Thus, manufacturers will impose RPM to shore up manufacturer coordination only if the incremental collusive gains it can be expected to provide exceed its obvious costs. The incremental gains created by RPM’s “wholesale price-revealing” function are probably not that great. First, for goods sold through multi-brand retailers, coordinating manufacturers could learn of other manufacturers’ price cuts by communicating with the retailers, with whom the non-cheating manufacturers have regular conduct; this implies that many instances of manufacturer cheating could be discovered even without costly RPM. For goods sold through single-brand retailers, it would not be possible to learn of manufacturer price cuts from the retailers. But such goods tend to be highly differentiated, and that differentiation renders price coordination, particularly of the tacit variety, particularly difficult and rather unlikely. Moreover, the sort of cheating that is likely to

27 See id. at 172 (“[C]olluding manufacturers may wish to fix retail rather than just wholesale prices … in order to make it easier to detect cheating, the retail price being more easily ascertained than the wholesale price.”).
28 See generally 8 Areeda & Hovenkamp, supra note 9, ¶ 1606e, at 88-91.
29 Cf. Posner, supra note 26, at 88 (observing that RPM’s enhancement of dealer margins “will be a pure windfall to the dealer”).
30 See 8 Areeda & Hovenkamp, supra note 9, ¶ 1606e2, at 89 (“[U]nless dealers handle only a single brand, each manufacturer can learn rival wholesale prices from the multi-brand dealers who buy from them. Their wholesale prices are thus visible enough for monitoring express or tacit coordination without regard to resale price maintenance.”) For reasons they do not state, Areeda and Hovenkamp conclude that this argument is “not persuasive.” Id.
31 See Elzinga & Mills, supra note 25, at 7 (“Product differentiation engenders all kinds of non-price competition among the cartel members that would be difficult for a cartel to squash, especially in an environment where contracts cannot be enforced in a court of law.”).
disrupt coordinated manufacturer pricing would be relatively widespread discounts to dealers representing a significant share of sales of the relevant product; the occasional discount to one or a few smaller dealers would be far less likely to disturb the coordination. The relatively widespread discounts, though, would likely be detectable by the other price-coordinating manufacturers even without RPM.32 Thus, it is not clear that RPM, which is undoubtedly costly to manufacturers, provides sufficient “collusive benefit” to justify its use as a wholesale price-revealing mechanism.

3. RPM-Augmented Foreclosure

The Leegin Court acknowledged a third anticompetitive harm that may result from instances of RPM: In theory at least, RPM might facilitate the foreclosure of non-dominant brands, particularly those of new entrants, from a dominant manufacturer’s market.33

Imposition of RPM permits a manufacturer to control its dealer’s profit margins. A dominant manufacturer might implicitly bargain with its dealers that it will impose RPM to guarantee them an attractive profit margin on its products in exchange for their refusal to distribute (or promote) the brands of competitors and/or new entrants.34 If dealers choose not to jeopardize their attractive RPM-protected profit margins by handling (or promoting) other brands, competing manufacturers and new entrants may find themselves foreclosed from marketing outlets or, at a minimum, relegated to less desirable channels of distribution. Thus, RPM might be “exclusionary” in that it causes market foreclosure or raises rivals’ costs.35

32 See 8 Areeda & Hovenkamp, supra note 9, ¶ 1606e2, at 89 (“[T]he widespread reduction on a single brand that would trouble [coordinating manufacturers] would presumably be attributed to a cut in the wholesale price.”).
33 Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S.Ct. 2705, 2717 (2007) (“A manufacturer with market power … might use resale price maintenance to give retailers an incentive not to sell the products of smaller rivals or new entrants.”) (citing Marvel & McCafferty, supra note 7, at 366-68).
34 See Elzinga & Mills, supra note 25, at 7 (noting that RPM “might facilitate an implicit contract between the manufacturer and [its] retailers of the following nature[;] The manufacturer assures retailers of an attractive profit margin on sales of its own brand in exchange for their refusing to take on the distribution of competing brands, including brands offered by new entrants”).
35 A number of business practices, such as exclusive dealing and tying, receive antitrust scrutiny because of their ability to foreclose rivals from marketing outlets. See generally Hovenkamp, supra note 17, at 198-206. Foreclosure arguments are particularly strong when cast in terms of “raising rivals’ costs” of distribution. See HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE, § 10.9a2, at 436-37 (3d ed. 2005) (“Many of the foreclosure theories of exclusive dealing become more robust if one views them, not as excluding rivals from a market, but as raising rivals’ costs by relegating them to inferior distribution channels.”).
Of course, for such exclusionary effect to occur, the RPM agreements must cover a sufficiently large portion of available marketing outlets; if competitors have access to sufficiently attractive alternative distribution channels, there can be no competitive harm. RPM by a non-dominant manufacturer, whose market share would not be large enough for the RPM to cause substantial foreclosure, could not have this anticompetitive effect. Moreover, as explained below, RPM may actually facilitate new entry by providing entrants with a means to reward dealers that will carry the entrants’ untested products.

B. Potential Procompetitive Benefits

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

1. Enhancing Distributional Efficiency

To see how RPM may enhance the efficiency of the distributional process, consider how it provides a sort of “middle ground” vertical integration. As Ronald Coase famously observed, the inputs a firm uses in producing its end products may be purchased on a market or produced internally, and a firm will opt for internal production (i.e., will “vertically integrate” into input-production) when the inevitable efficiency loss from allocating productive resources via managerial fiat rather than market forces is less than the transaction costs of acquiring the input on the market. Vertical integration, then, is generally an efficiency-enhancing strategy.

Because the process of getting one’s products to end-users is ultimately an input, manufacturers always confront a “make or buy” decision with respect to distribution services. Each manufacturer

36 See Elzinga & Mills, supra note 25, at 7 (“This [RPM-augmented foreclosure] theory cannot apply where manufacturing competitors and entrants retain access to the market via competing retailers or alternative channels of distribution. Nor can it apply where the manufacturer using RPM does not control a large share of the relevant market in spite of using this practice.”).

37 See infra notes 67 - 68 and accompanying text.

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

may “buy” distribution services by selling at a discount to distribution specialists, who will then resell at a mark-up to consumers.\textsuperscript{40} Alternatively, the manufacturer may “make” distribution services by expanding its operations to include retail sales to end-user consumers. As Coase explained, the manufacturer’s decision of whether to bring distribution services within the firm depends on the relative cost of these two options, costs which change with technological development.\textsuperscript{41}

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

Selling to distributors subject to minimum RPM agreements provides a “middle ground” means by which a manufacturer may secure most of the benefits and avoid many of the costs of both the buy and make options. Because the manufacturer is selling its products to middlemen, it can take advantage of their superior distribution and product-promotion skills. RPM, though, allows the manufacturer to retain \textit{some} control over the distribution process and thus to minimize the downside of buying distribution services. In particular, the use of RPM enables manufacturers to encourage point-of-sale services that could be subject to free-riding and to enforce unspecified “agreements” about how products will be distributed. These benefits explain the odd fact that many manufacturers voluntarily impose minimum RPM, even though doing so effectively raises the retail mark-up, which is ultimately the price the manufacturers are paying for distribution services.\textsuperscript{42}

\textsuperscript{40} The “price” the manufacturer pays for this service is the difference between the price it charges the initial reseller and the higher price ultimately charged to consumers, a price it could collect if it provided distribution services itself.

\textsuperscript{41} Coase, \textit{supra} note 39. \textit{See also} Oliver E. Williamson, \textsc{The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting} (1985); Oliver E. Williamson, \textsc{Markets and Hierarchies, Analysis and Antitrust Implications: A Study in the Economics of Internal Organization} (1975).

\textsuperscript{42} \textit{See supra} note 18 and accompanying text.
a) Encouraging Retail Services by Eliminating Free Riders

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

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

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43 Retailers known for carrying high-quality merchandise provide what has been called a “quality certification” service to manufacturers. See Howard P. Marvel & Stephen McCafferty, Resale Price Maintenance and Quality Certification, 15 RAND J. ECON. 346 (1984).

44 See generally Elzinga & Mills, supra note 25, at 2 (discussing retail services that may enhance demand for a supplier’s products).

45 See Telser, supra note 7; Robert Bork, The Rule of Reason and the Per Se Concept: Price-Fixing and Market Division (Part II), 75 YALE L. J. 373 (1966).

46 See Hovenkamp, supra note 35, § 11.3, at 456 (discussing similar example involving automobile dealers).

47 See Telser, supra note 7, at 91. Golf club manufacturer Ping, Inc. provided a similar example of free-riding in its amicus brief in support of the petitioner in
manufacturer by reducing demand for its products. In addition, consumers will suffer if, in fact, the point-of-sale services originally provided were valued more than they cost to produce.

This free-rider problem could be addressed several different ways. First, retailers might be able to sell separately those aspects of retail service that enhance demand for the manufacturer’s product (e.g., the stereo retailer could charge a small fee for expert consultation and/or admittance to a listening room). While these sorts of fees are not unheard of (e.g., tennis shops often charge a slight fee for use of a “demo” racquet), they are relatively uncommon, presumably because of the high transaction costs they entail. Alternatively, manufacturers could address the free-rider problem by requiring their dealers to adhere to non-price restraints—either geographical restrictions that would separate dealers so that consumers could not easily free-ride or quality standards dictating which retail services must be provided. These sorts of restraints, which are relatively common and have been subject to rule of reason

Leegin. See Brief of Ping, Inc. as Amicus Curiae in Support of Petitioner, Leegin Creative Leather Prods., Inc. v. PSKS, Inc., No. 06-480 (avail. at http://www.abanet.org/antitrust/at-conversation/pdf/Leegin_PING_Amicus.pdf). Ping, long a leader in custom-fitting of golf clubs, has invested substantial resources in training retailers on the complicated custom-fitting process, a process that “requires 30 to 60 minutes to evaluate properly each golfer’s physical characteristics and swing in arriving at the golf club specifications unique to that golfer.” Id. at 6-7, n. 2. Ping explained that free-riding among discounters was injuring its brand (and consumers of the brand):

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

Id. at 7.

48 See Elzinga, supra note 25, at 2-3 (noting that RPM may not be necessary to combat free-riding if retailers can “separate those aspects of retail service that build demand for the manufacturer’s products from other retailer activities and ‘sell’ them to consumers, or the manufacturer, on a stand-alone basis”).

49 Id. at 3 (“In many instances, transaction costs appear to prevent separate service sales from eliminating all free riding.”).

50 Id. at 2 (observing that “allowable non-price vertical restraints” may be used to combat free-riding).
scrutiny since 1977, are somewhat limited in their ability to remedy free-rider problems. Geographic restraints cannot perfectly prevent free-riding in an age in which consumers travel extensively and Internet commerce is pervasive. Moreover, such restraints may be difficult to enforce. Quality standards are difficult both to specify and to enforce, as explained below.

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

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51 See Continental T.V. v. GTE Sylvania, Inc., 433 U.S. 36 (1977) (holding that vertical non-price restraints are to be judged under the rule of reason).
52 For example, a retailer in one region could provide no service and sell lots of cheap goods to a local consumer, who could then resell the products via the Internet. The reselling consumer would have no contractual relationship with the manufacturer and thus could not be subject to territorial restraints.
53 See infra notes 62 - 64 and accompanying text.
54 See generally Telser, supra note 7, at 91 (setting forth the free-rider justification for RPM).
55 For an example of how limits on price competition lead to enhanced service competition, contrast today’s bare-bones service in air travel to the lavish service provided during the era of airline regulation, when air fares were set by the government. Precluded from competing on price, airlines competed vigorously on service, leading to a much more luxurious—albeit more expensive—flying experience. Cf. Keith Lovegrove, AIRLINE: IDENTITY, DESIGN AND CULTURE (2000) (highlighting airline amenities prior to deregulation); CONGRESSIONAL BUDGET OFFICE, POLICIES FOR THE DEREGULATED AIRLINE INDUSTRY 9 (1988) (noting that, following deregulation, service competition decreased as price competition was liberalized). (Of course, the government, unlike a manufacturer that imposes RPM, has no incentive to maximize total sales.)
56 See Elzinga & Mills, supra note 25, at 3 (“Needless to say, a product whose quality is low cannot survive long in the marketplace just because it carries a high retail price and appears in reputable stores. An RPM policy does not enable a manufacturer to make a silk purse out of a sow’s ear.”).
occasioned by RPM, then the RPM strategy will reduce total sales, to the detriment of the manufacturer.

b) **Enforcing Unspecified Agreements**

While the “avoidance of free-riding” rationale for RPM is probably the most commonly articulated procompetitive justification for the practice, it has some important limitations. As an initial matter, RPM is frequently observed in situations in which widespread free-riding on point-of-sale services seems implausible.\(^{57}\) In addition, it is unlikely that RPM actually eliminates the incentive to free-ride on other retailers’ provision of services the manufacturer desires. For example, even if a manufacturer sets a minimum resale price at a level that would provide a margin sufficient to cover desired point-of-sale services, individual retailers could still send customers to other retailers to attain those services and then use the mark-up provided by RPM to provide customers with some other desired amenity, such as a discount on a complementary product.\(^ {58}\) If retailers took that tack, they could win business from the high-service retailers who bore the cost of the point-of-sale services, and those high-service retailers would eventually curtail their efforts. Finally, the free-rider explanation seems particularly implausible when consumers, prior to purchase, cannot detect retailer services that affect product quality, such as the regular rotation of items possessing a limited shelf-life.\(^ {59}\)

Motivated by these limitations of the free-rider rationale for RPM, Benjamin Klein and Kevin Murphy articulated an alternative theory of how RPM may enhance the efficiency of the distributional system. Klein and Murphy conceived of RPM as a means by which manufacturers can secure retailers’ compliance with incomplete performance contracts aimed at inducing retail services that enhance demand for the manufacturers’ products.\(^ {60}\)

Because some of the benefit stemming from a retailer’s product-promotion efforts inures to the manufacturer, retailers are not

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57 Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J. L. & ECON. 265 (1988) (“It is now generally recognized that there are many cases of vertical restraints that do not fit the standard ‘consumer free riding on special services’ theory.”).

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

59 *Id.*

60 *Id.* at 266-67 (setting forth “an alternative theory of how vertical restraints operate to induce desired dealer services,” under which “[m]anufacturers are assumed to induce desired dealer services through a private enforcement mechanism by which active manufacturer monitoring and the threat of manufacturer termination assures dealer performance”).
perfectly motivated to provide an optimal level of retail service (i.e., service to the point at which the incremental cost of the service, borne entirely by the retailer, equals the full incremental benefit, some of which is captured by the manufacturer). Accordingly, manufacturers need some way to encourage the optimal provision of services. One option would be to employ complete, express contracts: the manufacturer could exhaustively specify the precise services the retailer must provide. The problem with this approach is the difficulty of ex ante specification and enforcement. It would be prohibitively costly to specify all the elements of dealer performance in a way that would permit determination of breach and measurement of damages. (Indeed, one of the reasons manufacturers “buy” distribution rather than “make” it is that they do not possess expertise on exactly how their products can best be promoted to end-users.) In addition, monitoring and enforcing a dealer’s performance obligations along multiple service dimensions would require substantial effort. Using explicit contracts to align the incentives of the manufacturer and its retailers is thus difficult.

RPM can provide an alternative means by which a manufacturer may secure services that enhance demand for its products. If the manufacturer generally observes its retailers’ performance, retains the right to terminate underperformers, and provides an attractive retail margin as an incentive to avoid termination, then the manufacturer can motivate its retailers to provide demand-enhancing point of sale services without specifying them exhaustively. As Klein and Murphy explain:

The potential loss of this future quasi-rent stream [i.e., RPM’s margin guarantee] takes the place of a potential court-imposed sanction in assuring dealer performance. If

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61 See Elzinga & Mills, supra note 25, at 4 (“Economic theory indicates that a manufacturer cannot rely on the retailer to provide optimal retail service when the manufacturer captures some of the benefits of that service”).

62 Id. (“The manufacturer, hypothetically, might enter into a contract with the retailer that specifies exhaustively what services the retailer must provide….“).

63 Id.

64 As Klein & Murphy observe:

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

Klein & Murphy, supra note 7, at 294.
the expected present discounted value of the future quasi-rent stream earned by an honest dealer exceeds the expected value of the gain to a dealer who shirks on the supply of desired services, then the capital loss that can be imposed on a dealer by manufacturer termination will be sufficient to assure dealer performance.\(^65\)

Thus, RPM’s role in enhancing distributional efficiency (to the benefit of manufacturers and consumers alike) extends well beyond the context of point-of-sale services that are susceptible to free-riding.\(^66\)

2. Facilitating Entry

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

RPM may provide much-needed assistance to new entrants facing these disadvantages. By giving retailers protection against discounting and thus a guaranteed profit margin, RPM creates an incentive for retailers to carry a new brand, display it prominently, and perhaps even engage in more aggressive promotion efforts.\(^67\)

Thus, RPM may benefit consumers by facilitating entry into markets with strong brands. Because of this benefit, the dissent in *Leegin* conceded that, if it were writing on blank slate, it would create a narrow exception to the per se rule against minimum RPM for use of the practice by new entrants.\(^68\)

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\(^65\) *Id.* at 268.


\(^67\) See Elzinga & Mills, *supra* note 25, at 7 (“To secure entry, a new entrant may seek to gain retail distribution by offering independent retailers protection against discounting, in the hope that margin protection will induce retailers to market and promote the new product.”).

\(^68\) See *Leegin Creative Prods., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705, 2731 (2007) (Breyer, J., dissenting) (“[I]f forced to decide now, at most I might agree that the *per se* rule should be slightly modified to allow an exception for the more easily identifiable and temporary condition of ‘new entry’”) (citing Pitofsky, *supra* note 6, at 1495).
3. Facilitating the Marketing of Products with Unpredictable Demand

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

Given the potential for precipitous price declines, retailers may decline to stock products for which demand is uncertain, choosing instead to wait for products to prove themselves in the marketplace. If enough retailers take that route, untested products will have access to few retail outlets in which to establish their commercial viability. The result may be that high-quality products that could have become commercial successes had they gained access to enough retail outlets never have the opportunity to prove themselves. Consumers will be injured if those products cannot be marketed.

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

II. Proposals for Evaluating RPM Under the Rule of Reason

Given that minimum RPM may create anticompetitive harms of the types identified in Part I.A, the sorts of procompetitive benefits discussed in Part I.B, or some combination of benefit and harm, the Leegin Court wisely ruled that the practice should not be per se illegal. The open issue now is how exactly courts should go about evaluating particular instances of RPM. Given that RPM’s per se illegality rendered that question moot, the issue has received far less attention in the academic literature than has the matter of RPM’s

69 Indeed, this is the strategy utilized by many discount retailers. See 8 Areeda & Hovenkamp, supra note 9, ¶ 1601h, at 15 (observing that “deep discounters offer significantly lower markups on books and CDs, but also a much narrower inventory largely limited to titles whose popularity has already been proven”).

70 See Deneckere, Marvel & Peck, supra note 7; Butz, supra note 7.
general effects on competition. Nonetheless, a few proposals have
been suggested. This Part sets forth and critiques the leading
proposals for evaluating the legality of RPM agreements. Part III,
then, proposes an alternative approach.

A. Two Non-Starters: Per Se Legality and the Unstructured
Rule of Reason

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

1. An Unstructured Rule of Reason

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

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

71 See Hovenkamp, supra note 17, at 105 (observing that because the classic
statement of the rule of reason “never defines what it is that courts are supposed to
look for,” it has led courts to “engage[] in unfocused, wide-ranging expeditions
into practically everything about the business of large firms in order to determine
whether a challenged practice was unlawful”). See also Richard A. Posner, The
Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality, 48
U. Chi. L. Rev. 6, 14 (1981) (observing that the classic statement of the rule of
reason “invites an unlimited, free-wheeling inquiry”).
72 246 U.S. 231 (1918).
73 A Westlaw search reveals 242 federal opinions quoting the bulk of Justice
Brandeis’s version of the rule.
74 Posner, supra note 71, at 15 (referring to “[t]he common practice of including in
jury instructions the passage … from the Chicago Board of Trade opinion, often as
the only guide to the concept of unreasonable restraint that is offered to the jury”).
remedy, the purpose or end sought to be attained, are all relevant facts.\textsuperscript{75}

Applied to minimum RPM, this version of the rule would direct the factfinder to determine, all things considered, whether the total mix of goods and services resulting from RPM is more desirable than the total mix that would result from unfettered price competition among dealers.

Such an inquiry is likely to be entirely indeterminate. Minimum RPM generally results in higher prices for a manufacturer’s product but also enhanced point of sale services. The factfinder would thus have to decide whether the post-RPM outcome of higher prices with more or better services is more or less desirable than the pre-RPM outcome of lower prices with fewer or inferior services. Absent some entirely arbitrary presumption that a low price is better than a high level of service (or vice-versa), there is simply no way to make that decision.\textsuperscript{76} One might think that the overall desirability of one outcome versus the other could be determined by looking at total sales—\textit{i.e.}, if the manufacturer’s total sales increased when dealer price competition was restrained, then the RPM is desirable; if not, it is not.\textsuperscript{77} But even putting aside the difficulties inherent in that inquiry, a focus on total sales cannot answer the question posed by the Brandeisian version of the rule of reason—\textit{i.e.}, whether total social utility is higher with the restraint than without it.

That is because it is theoretically possible for RPM to enhance a manufacturer’s total sales and yet reduce total welfare.\textsuperscript{78} To the extent RPM increases total sales of a manufacturer’s products, it does so by inducing services that make the product at issue more desirable to the consumers who are “on the fence” as to whether to buy the product or not. If the incremental services resulting from RPM increase those marginal consumers’ willingness to pay for the product at issue more than it raises the product’s price, then RPM

\textsuperscript{75} Chicago Board of Trade, 246 U.S. at 238.
\textsuperscript{76} Posner, supra note 71, at 19.
\textsuperscript{77} Judge Posner recommends this approach to determine if any instance of RPM is procompetitive, where competition is defined not as the \textit{process} of rivalry but as the output-maximizing \textit{outcome} that results from vigorous rivalry that involves neither collusion nor predation. \textit{Id.} at 21. Notably, he does not contend that this approach could answer the determinative question posed by the Brandeisian version of the rule of reason—\textit{i.e.}, whether the outcome with an instance of RPM is more desirable than without the RPM.
will result in a greater number of total sales, despite the higher prices. But the additional services that attract new buyers may not be of value to many consumers who value the product more than marginal consumers and would be willing to pay more than the market clearing price, even without the additional services occasioned by RPM. For those “inframarginal” consumers, RPM results in a higher price that is not offset by additional valuable services. This means that their consumer surplus—their wealth gain from buying the product at issue—is reduced by RPM. Thus, even if a factfinder were to focus solely on whether an instance of RPM had increased a manufacturer’s sales (a difficult enough inquiry), it could not answer the Brandeisian question of whether the RPM led to a more desirable state of affairs unless it could determine, for all consumers of the product at issue, whether and to what extent they really valued the incremental services. That task is impossible in practice, and attempts to perform it will result in verdicts that are no more than hunches.

Given its breadth and the lack of any determinative criterion, the unstructured rule of reason is both costly to administer (proof must be taken on so many issues) and unpredictable (the outcome will depend largely on the factfinder’s hunches). Employing such an unpredictable rule would tend to chill even procompetitive uses of RPM, for businesses would not want to risk an adverse treble damages verdict in order to secure RPM’s benefits. Because, as explained below, most instances of RPM are likely procompetitive, evaluating RPM under an unstructured rule of reason would create an unfortunate chilling effect and would thus be undesirable as a matter of policy.

79 See Marvel & McCafferty, supra note 7, at 370 (“Manufacturers, in their desire to maximize profits, focus on the margin, while allocative efficiency incorporates effects on inframarginal customers . . . . The additional customers attracted by the services must be better off as a result of the service provision. But if some of the additional receipts are derived from higher prices charged to inframarginal customers who do not value the services, the benefits to society of the services provided need not justify their cost.”).

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

81 See infra notes 186 - 227 and accompanying text.
Such an approach would also be legally infirm. The *Leegin* Court expressly contemplated a more structured inquiry into the reasonableness of particular instances of RPM. After cataloguing specific factors courts should consider—the pervasiveness of RPM in the manufacturer market, the source of the restraint (whether it was sought by dealers or imposed unilaterally by the manufacturer), and the market power of any dominant manufacturer or dealer—the Court called for the lower courts to develop a structured approach to evaluating RPM. It challenged them to “establish the litigation structure to ensure the rule operates to eliminate anticompetitive restraints from the market and to provide more guidance to businesses,” and it suggested that they do so by “devis[ing] rules over time for offering proof, or even presumptions when justified, to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints and to promote procompetitive ones.” This is a far cry from the open-ended inquiry invited by the unstructured rule of reason set forth by Justice Brandeis.

In addition, the free-wheeling inquiry invited by the unstructured rule of reason is inconsistent with the Court’s more recent teachings on the rule. While many courts—including the Supreme Court—continue to quote Justice Brandeis’s classic statement, the Supreme Court has in recent years narrowed the rule of reason inquiry to focus solely on a restraint’s effects *on competition*, not its effects generally. Thus, it would be improper for courts to consider non-competition matters such as the extent to which the additional

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

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

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

85 *Id.*

86 *Id.*


88 *See, e.g.*, National Soc’y of Prof’l Engineers v. United States, 435 U.S. 679, 688 (1978) (“Contrary to its name, the Rule [of reason] does not open the field of antitrust inquiry to any argument in favor of a challenged restraint that may fall within the realm of reason. Instead, it focuses directly on the challenged restraint’s impact on competitive conditions.”).
services induced by an instance of RPM are really “valuable” to
different groups of consumers (specifically, whether the utility gains
to marginal consumers exceed the losses to inframarginal
consumers). It would also be improper for courts to determine
whether an instance of RPM has increased or decreased competition
by balancing the intra-brand competition loss resulting from the
RPM against the accompanying gain in inter-brand competition.
Such an inquiry, which equates competition with the process of
rivalry, would be completely indeterminate.\(^89\) If competition were
instead defined in terms of marketwide output (i.e., a restraint has
enhanced competition if it has increased overall output), then a court
might properly apply the focused rule of reason by asking whether an
instance of RPM has increased or decreased the manufacturer’s total
sales.\(^90\) Such an output-based inquiry is, however, difficult to
conduct in practice,\(^91\) and courts would benefit from an alternative
legality test that is easier to apply. The structured rule of reason
proposed in Part III suggests a more administrable evaluative
approach that could be used as an alternative to the theoretically
sound but difficult to apply output-based approach.\(^92\)

2. Per Se Legality

A second approach that may be rejected out of hand is a rule of
per se legality for RPM agreements. Judge (then Professor) Richard
Posner set forth this approach in a 1981 law review article entitled
The Next Step in the Antitrust Treatment of Restricted Distribution:
Per Se Legality.\(^93\) Posner’s conclusion that per se legality is the
optimal evaluative approach followed from two premises, both of
which are questionable.

First, Posner argued that the rule of reason is inevitably so
vacuous that determinations under it will be so unpredictable as to
chill the use of RPM, which is usually procompetitive.\(^94\) He
observed that the Brandeis version of the rule “invites an unlimited,
free-wheeling inquiry,”\(^95\) and he asserted that even if the inquiry is
focused solely on the competitive effects of a practice (not all its
effects), “the trier of fact is left in the dark as to how to decide
whether a challenged practice is substantially anticompetitive.”\(^96\)

\(^89\) See Posner, supra note 71, at 19.
\(^90\) See id. at 21.
\(^91\) See id.
\(^92\) See infra notes 233 - 252 and accompanying text.
\(^94\) Id. at 14-18.
\(^95\) Id. at 14.
\(^96\) Id. at 15.
Because most factfinders are ill-equipped to engage in an in-depth inquiry into competitive effect, the risk of mistake—most likely, the risk of false positives—is great. In short, Posner concluded, “[a] standard so poorly articulated and particularized, applied by tribunals so poorly equipped to understand and apply it, places at considerable hazard any restriction that a manufacturer imposes on its dealers and distributors.” Application of the rule of reason, then, is likely to chill procompetitive instances of RPM.

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

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

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

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

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97 Id. Posner further observed that where courts had articulated steps for evaluating non-price restraints, there had been “no rule for deciding such cases,” rather merely “a checklist of factors to which different triers of fact give different weights.” Id. at 18 (emphasis in original).

98 Id. at 22.

99 Id.
administer and unlikely to generate false positives or to create a chilling effect.

Posner’s second premise improperly assumes that collusion involving RPM can be policed under the rules governing horizontal conspiracies. To establish a violation of those rules, a plaintiff or prosecutor must establish an agreement among the purportedly conspiring parties. Doing so can be difficult. While precedents permit a factfinder to infer such an agreement from evidence of conscious parallelism and so-called “plus factors” indicating that the parallel conduct is the result of some commitment to a common scheme, it can be difficult to establish those plus factors. The result is that much tacit collusion goes unpunished. Posner himself has argued that the law should address such tacit collusion by finding antitrust violations when market conditions would support collusive pricing and parties appear to be using “facilitators” that aid in promoting a common output reduction/price increase. Of course, that is precisely what would be accomplished by regulating RPM under a structured rule of reason. The factfinder would determine whether the market at issue is ripe for collusion and, if so, the use of RPM—a collusion facilitator—would violate the antitrust laws. It is ironic that Posner would maintain that the existing rules governing horizontal conspiracies preclude the need to police RPM when he has so vigorously maintained that the horizontal conspiracy rules are hamstrung by an overly stringent agreement requirement and should be expanded so that they regulate the use of facilitators in collusion-prone markets.

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

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101 See, e.g., Matsushita Elec. Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574, 588 (1986) (holding that in order to survive motion for summary judgment or directed verdict, plaintiff seeking to establish agreement on basis of circumstantial evidence “must produce evidence that tends to exclude the possibility that the alleged conspirators acted independently”) (internal quotation omitted).
102 See, e.g., Hovenkamp, supra note 17, at 126-36 (asserting that “lawyerly” approach to finding an agreement leaves must tacit collusion unpunished and arguing instead for an “economic” approach).
104 Leegin Creative Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705, 2719-20 (2007) (rejecting per se legality for RPM and calling for evaluation under rule of reason).
One proposed rule of reason approach would automatically place the burden on the defendant to establish that the RPM at issue had a procompetitive effect that could not have been achieved less restrictively. That is the approach espoused by 27 states in a recent dispute involving women’s footwear manufacturer, Nine West Group, Inc. (“Nine West”).\textsuperscript{105} In written comments urging the FTC not to modify a 2000 consent order precluding Nine West from any activity that might constitute minimum RPM, the attorneys general of the 27 states set forth a general proposal for evaluating minimum RPM agreements under the rule of reason.\textsuperscript{106}

The states began by exhorting the Commission to follow the analytical approach endorsed by the D.C. Circuit in \textit{Polygram Holding Inc. v. FTC}.\textsuperscript{107} Under that approach, which builds on the “quick look” or truncated rule of reason the Supreme Court began to apply in 1978 in the \textit{Professional Engineers} case,\textsuperscript{108} an antitrust

\textsuperscript{105} Based on Nine West’s designation of “off limits” or “non-promote” shoes that its retailers were not to promote except during designated sale periods, the FTC claimed that Nine West had violated the per se rule against minimum RPM. See Complaint, In the Matter of Nine West Group, Inc., Docket No. C-3937 (April 11, 2000) (available at \url{http://www.ftc.gov/os/2000/04/ninewestcmp.htm}). In April 2000, Nine West agreed to a broadly worded Consent Order requiring it to refrain from (among other things) fixing prices at which its retailers may sell, advertise, or promote its products; “otherwise pressuring” its dealers to adhere to resale prices; and “[s]ecuring or attempting to secure any commitment or assurance from any dealer concerning the resale price at which the dealer may advertise, promote, offer for sale or sell any Nine West Products.” See Decision and Order, In the Matter of Nine West Group, Inc., Docket No. C-3937 (April 11, 2000) (available at \url{http://www.ftc.gov/os/2000/04/ninewest.do.htm}). After the Supreme Court abrogated the per se rule against minimum RPM, Nine West petitioned the FTC for a modification of this Consent Order. See Petition to Reopen and Modify Order, In the Matter of Nine West Group, Inc., Docket No. C-3937 (available at \url{http://www.ftc.gov/os/caselist/9810386/071106petition.pdf}).

\textsuperscript{106} See In the matter of Nine West Group, Inc., Fed. Trade Comm’n (Docket No. C-3937), Amended States’ Comments Urging the Denial of Nine West’s Petition (Jan. 17, 2008) (available at \url{http://www.oag.state.ny.us/business/new_antitrust/amicici%20pdf%20docs/Amended_State_comments_011708-9west.pdf}).

\textsuperscript{107} Id. at 5 (asserting that governing rule of reason should be based on approach of \textit{In re Polygram Holding, Inc.}, No. 9298, 2003 WL 21770765 (F.T.C.), aff’d, 416 F.3d 29 (D.C. Cir. 2005)).

\textsuperscript{108} National Soc’y of Prof’l Eng’rs v. FTC, 435 U.S. 679 (1978). Since \textit{Professional Engineers}, which applied a truncated (“quick look”) rule of reason analysis, the Supreme Court has emphasized that the level of analysis required for judging the reasonableness of a restraint of trade falls along a spectrum and depends upon the depth of analysis required for determining the likely competitive
tribunal considering a practice that is “inherently suspect,” though not per se illegal, may presume the practice unreasonable unless the defendant “either identify[ies] some reason the restraint is unlikely to harm consumers, or identif[ies] some competitive benefit that plausibly offsets the apparent or anticipated harm.”

A practice is “inherently suspect” if there is a “close family resemblance between the suspect practice and another practice that already stands convicted in the court of consumer welfare.”

Minimum RPM is inherently suspect, the states maintained, because it inevitably raises consumer prices and thus bears a “close family resemblance” to per se illegal horizontal price fixing. Accordingly, the states argued, RPM should be presumptively illegal unless the defendant establishes a procompetitive benefit that offsets the anticompetitive harm. To do so, the defendant must show that RPM increased its total sales. Such proof would indicate that the

effect of any particular trade restraint. As the Court explained in California Dental Ass’n v. FTC,

The truth is that our categories of analysis of anticompetitive effect are less fixed than terms like “per se,” “quick look,” and “rule of reason” tend to make them appear. We have recognized, for example, that there is often no bright line separating per se from Rule of Reason analysis, since considerable inquiry into market conditions may be required before the application of any so-called “per-se” condemnation is justified. ... [T]here is generally no categorical line to be drawn between restraints that give rise to an intuitively obvious inference of anticompetitive effect and those that call for more detailed treatment. What is required, rather, is an enquiry meet for the case, looking to the circumstances, details, and logic of a restraint. The object is to see whether the experience of the market has been so clear, or necessarily will be, that a confident conclusion about the principal tendency of a restriction will follow from a quick (or at least quicker) look, in place of a more sedulous one.


Id. at 37.

Amended States’ Comments, supra note 106, at 8 (“If consumers pay more because of vertical price-fixing, the restraint should be ‘inherently suspect.’”).

Id. (“Under PolyGram, Nine West then has the burden of proving a plausible and cognizable justification.”). Cf. Veronica Kayne, Resale Price Maintenance and the Rule of Reason: The Liability Risk Increases, eSource: The Monthly Electronic Newsletter of the ABA Section on Business Law (Vol. 5, No. 5, July 2007), at 5 (noting that under post-Leegin rule of reason, “if the plaintiff [complaining of RPM] starts off with evidence of a price increase, the defendant will have to demonstrate that it is not an anticompetitive price increase or show countervailing procompetitive benefits”).

Amended States’ Comments, supra note 106, at 8 (arguing that Nine West should be required to prove that “(1) its vertical price fixing caused retailers to provide actual enhanced value or services; (2) the enhanced value or services increased demand for its shoes; and (3) the increased demand from that value or
RPM resulted in retail services that were of greater value to consumers than the incremental price increase occasioned by the practice.

But even if the defendant made this required showing, the RPM at issue would not stand acquitted under the states’ approach. The showing of procompetitive effect would merely shift the burden to the party challenging the RPM to show that the procompetitive benefit could have been achieved less restrictively by, for example, mandating the retail services provided or paying retailers to provide such services.114 If the challenger showed the possibility of a less restrictive means of inducing the demand-enhancing services, the defendant would then have to show that the purportedly less restrictive alternative was actually a less efficient means of achieving the retail services at issue.115

While the states’ proposed approach appears on first glance to embody a fairly balanced burden-shifting regime, in actual practice it would automatically place a heavy burden on the defendant and would likely lead to the condemnation of many—perhaps most—instances of RPM. First, the threshold determination of an “inherently suspect” practice would be automatically satisfied, for practically every instance of minimum RPM results in an increase in consumer prices.116 The defendant would thus always bear the burden of proving that RPM at issue increased total sales, and any failure of proof on that point would result in a verdict for the challenger. Next, even if the defendant could prove that the RPM increased total sales, it would inevitably have to make the additional showing that the services generating the additional sales could not have been induced in a less restrictive fashion, for the party challenging the RPM will always be able to assert that such services could have been explicitly required by the manufacturer.117 The

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114 Id. (“Even if that showing were made, the Commission would need to consider whether the enhanced value or services could be achieved in a less restrictive way than by vertical price-fixing.”).
115 Id. at 8-9.
117 For example, the states shifted the burden back to Nine West to show the non-existence of a less restrictive alternative by simply asserting:

Vertical price-fixing is not invariably the most efficient way to achieve procompetitive effects. The manufacturer could require its distributors to provide services as a matter of contract and even pay separately for those services. In that circumstance, the manufacturer could terminate or threaten to terminate the relationship if the retailer did not live up to those obligations. That alternative way of fostering services for consumers is more effective and efficient than threatening to terminate
upshot is that any instance of minimum RPM will be condemned unless the defendant can prove (1) that the RPM induced retail services that enhanced total sales and (2) that the manufacturer could not have induced those services as efficiently by expressly contracting for them.

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

Because both showings that would be required of defendants under the states’ proposed approach are difficult to make, most challenges to instances of minimum RPM will have a substantial chance of succeeding and thus generating an adverse treble damages verdict, and RPM will be largely deterred. That would be an undesirable outcome because, as explained below, it is likely that most instances of RPM are procompetitive.

C. The FTC Approach: Defendant Can Avoid Burden of Proving Procompetitive Effect of RPM Only If It Proves Absence of “Leegin Factors”

In ruling on Nine West’s petition for modification of the 2000 consent order, the FTC declined to follow the states’ proposed evaluative approach but adopted a similar, though less stringent, approach because the retailer is not charging consumers a higher price.

Amended States’ Comments, supra note 106, at 9. Any party challenging RPM could simply parrot these precise words in order to shift the burden to the defendant to prove that the output enhancement could not have been achieved as efficiently using a less restrictive means.

118 See Posner, supra note 71, at 21 (noting that proving output enhancement following use of RPM “requires controlling for the effects on the firm’s output of exogenous factors, that is, those unrelated to the challenged practice itself. There are statistical methods for doing this, but they are not fool-proof in application, nor are they easy for judges and juries to understand.”).

119 If a defendant supplier’s RPM is deemed to violate the antitrust laws, the plaintiff is entitled to treble damages. 15 U.S.C. § 15(a) (2008).

120 See infra notes 186 - 227 and accompanying text.
approach. The Commission agreed with the states that minimum RPM should be evaluated using some version of the truncated rule of reason analysis approved in Polygram Holdings. It did not agree, though, that every instance of RPM that raises consumer prices is “inherently suspect.” Instead, the Commission reasoned that a defendant should be able to avoid the conclusion that its RPM is inherently suspect, and thus avoid the need to prove procompetitive effect, by proving the absence of the factors the Leegin Court identified “for identifying when RPM might be subjected to closer analytical scrutiny.” Those factors were (1) that the RPM is used by manufacturers collectively comprising a significant portion of the product market; (2) that dealers, rather than the manufacturer, were the impetus for the RPM; and (3) that there is a dominant manufacturer or dealer that possesses market power. Because Nine West proved the absence of all these factors, it was not required to make the further showing that its use of RPM was procompetitive. Had it failed to establish an absence of the “Leegin factors,” it would have been required to prove that its use of RPM had actually enhanced its output (i.e., had led to increased total

122 Id. at 12 (“The Leegin decision may be read to suggest a truncated analysis, such as the one applied in Polygram Holdings, might be suitable for analyzing minimum resale price maintenance agreements, at least under some circumstances.”).
123 Id. at 13 (“The [Leegin] Court also explicitly noted that evidence of price effects would only be the beginning point for further analysis of competitive harm. This seems to indicate the Court’s view that the price setting associated with an RPM agreement ordinarily is less intrinsically dangerous than agreements among direct rivals to set prices or other terms of trade.”).
124 Id. at 14.
125 Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705, 2719 (2007) (“When only a few manufacturers lacking market power adopt the practice, there is little likelihood it is facilitating a manufacturer cartel …. Resale price maintenance should be subject to more careful scrutiny, by contrast, if many competing manufacturers adopt the practice.”)
126 Id. (“If there is evidence retailers were the impetus for a vertical price restraint, there is a greater likelihood that the restraint facilitates a retailer cartel or supports a dominant, inefficient retailer. … If, by contrast, a manufacturer adopted the policy independent of retailer pressure, the restraint is less likely to promote anticompetitive conduct.”).
127 Id. (“[T]hat a dominant manufacturer or retailer can abuse resale price maintenance for anticompetitive purposes may not be a serious concern unless the relevant entity has market power.”).
128 Nine West Order, supra note 121, at 15.
sales despite higher prices). Notably, the Commission required Nine West to file regular reports showing that its use of RPM benefits consumers and that the Leegin factors remain absent.

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

The FTC’s proposed approach is likely to condemn fewer instances of RPM than the states’ approach, for a defendant can avoid the difficult showing of enhanced sales if it establishes the absence of the Leegin factors. Still, though, the defendant would bear a substantial burden. First and most notably, it would have to establish the relevant market, always a difficult task. In its consideration of Nine West’s petition for modification, for example, the FTC required Nine West to expend significant effort demonstrating the contours of the market in which it participates.

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129 Id. at 15-16 (“If we were to conclude that Nine West runs afoul of the Leegin factors and raises competitive concern, Nine West could also meet its burden by demonstrating that its use of resale price maintenance is procompetitive.”).
130 Id. at 17-18.
131 The FTC did not state whether the defendant would bear the additional burden of proving that the enhanced output could not have been achieved as efficiently using less restrictive means.
132 See, e.g., MILTON HANDLER ET AL., TRADE REGULATION: CASES AND MATERIALS 210 (4th ed. 1997) (“In theory and practice, relevant market definition is as difficult an undertaking as any in antitrust.”).
133 For example, the FTC required Nine West to provide answers to the following questions about market contours and entry barriers in order to establish the market in which it participates:

Please break out, if possible, Nine West’s approximate market shares in identifiable segments of the overall market, e.g., dress shoes, casual shoes, walking/light exercise shoes, sandals, etc. Also, state any arguments or evidence about why these lines are or are not antitrust markets.

How difficult is it for a new manufacturer/distributor of women’s shoes to develop a brand, i.e., how long does it take, how costly is it to get
Having established the market, the defendant would then have to produce data on the use of RPM by other manufacturers in that market and on the market shares of those manufacturers. It would then have to prove that it, not its dealers, initiated the RPM. That showing could be difficult to make if there was any evidence that high-service dealers had complained about their low-service, presumably cheaper, rivals. Those dealer complaints, which may simply have alerted the defendant to the need to control dealer quality by reducing price competition,134 might be taken to suggest that dealers were the impetus for the restraint. Finally, the defendant would have to establish its own lack of market power and the absence of market power on the part of each of its dealers. The latter showing would presumably require it to establish a second market (the dealer market). If the defendant failed to make any of these showings, then it would have to satisfy the difficult proof burden set forth under the states’ proposed approach.

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

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

A third proposal for a structured rule of reason is that set forth by economists William S. Comanor and Frederic M. Scherer in their Leegin amicus brief.135 Comanor and Scherer, who have separately questioned the purported procompetitive benefits of RPM,136

shelf space in retail locations, does it matter if the distributor has other shoes or is a new entrant, how much cost is involved in brand development, e.g., market studies, advertising, etc., do brand entry conditions vary by type of shoe, e.g., easier to enter with a sandal than a dress shoe?


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


submitted their amicus brief “supporting neither party.” One purpose of their brief was “to suggest a tractable approach for implementing antitrust standards on RPM.”\textsuperscript{137} In particular, they wrote “to suggest … guidelines” for implementation of a rule of reason by the lower courts.\textsuperscript{138}

The structured rule of reason proposed by Comanor and Scherer would begin with a “quick look” to determine whether the restraint was instigated by the manufacturer or its distributors.\textsuperscript{139} Evidence that distributors were the impetus for the restraint would result in its condemnation, unless the manufacturer defendant could show “credible contradictory evidence” undermining that finding.\textsuperscript{140}

If the initial inquiry revealed that the restraint was instigated by the manufacturer, then the legality of the RPM would turn on “a test of quantitative substantiality.”\textsuperscript{141} A party challenging RPM would have two options for establishing a prima facie case for liability under the quantitative substantiality test. First, the challenger could show (1) that at least 50 percent of sales in the relevant product market were subject to RPM (presumably including sales by manufacturers that have vertically integrated forward into retailing); and (2) that the challenged RPM extended the practice’s coverage by at least 10 percent of relevant sales.\textsuperscript{142} Alternatively, the challenger could show (1) that the product market at issue is oligopolistic, with a Herfindahl-Hirschman index (“HHI”) exceeding 1,800,\textsuperscript{143} and (2) that the challenged RPM was being implemented by a manufacturer with at least a 10 percent share of the relevant market.\textsuperscript{144} If the challenger made either of those two-pronged showings, then the RPM would be deemed illegal unless the defendant could prove either “that the relevant market [was] improperly defined, that consumers’ choices have not in fact been significantly limited, … or that the restraints were necessary to sustain the provision of services

\textsuperscript{137} Comanor/Scherer Amicus Brief, supra note 135, at 1.
\textsuperscript{138} Id. at 3.
\textsuperscript{139} Id. at 8-9.
\textsuperscript{140} Id. at 9 (“Evidence from a quick look that the restraint was induced by distributors should lead to the presumption of a \textit{per se} violation, rebuttable on the presentation of credible contradictory evidence.”).
\textsuperscript{141} Id. (“[P]reliminary evidence that the restraint was instigated by the manufacturer should trigger a \textit{rule of reason} adjudication. Where a \textit{rule of reason} approach is appropriate, a test of quantitative substantiality should be applied.”).
\textsuperscript{142} Id. at 9.
\textsuperscript{143} A market’s HHI is determined by summing the squares of the market share percentages of all participants in the market. Thus, a market consisting of six firms with market shares of 20\%, 20\%, 20\%, 20\%, 10\%, and 10\% would have an HHI of 1,800 ($400 + 400 + 400 + 400 + 100 + 100$). See Posner, supra note 26, at 70.
\textsuperscript{144} Comanor/Scherer Amicus Brief, supra note 135, at 10.
valuable to consumers. The second and third of these options would presumably require some sort of proof that the RPM enhanced total sales relative to what they would have been absent the restraint and that the RPM was more efficient than less restrictive means at inducing the dealer services that generated those enhanced sales—the same showing required of defendants under the states’ proposed approach.

Like the proposed approaches of the states and the FTC, the rule of reason approach proposed by Comanor and Scherer would overdeter RPM. First, the initial “quick look” is overly broad in its condemnation. A rule that automatically indicts any instance of dealer-instigated RPM ignores the fact that such RPM may well be output-enhancing and thus procompetitive. To determine whether an instance of RPM is pro- or anticompetitive, a factfinder should decide whether the dominant rationale for the practice is the manufacturer’s interest in enhancing the attractiveness of its products (in which case the RPM is procompetitive) or the dealers’ or manufacturer’s interest in facilitating collusion or erecting entry barriers (in which case the RPM is anticompetitive). The identity of the party instigating an instance of RPM does not reveal the dominant rationale for the practice. As the Supreme Court has long recognized, dealer complaints about price-cutting, low-service rivals may induce a manufacturer to impose RPM as a means of encouraging the dealer efforts that will enhance demand for its products. Thus, it is quite possible that an instance of RPM could be instigated by a group of dealers but yet motivated by the manufacturer’s desire to induce dealer promotion and quality-

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145 Id.

146 See supra notes 112 - 115 and accompanying text.

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

148 See Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717, 727-28 (1988) (observing that “price-cutting and some level of service-cutting usually go hand in hand”); Monsanto Co. v. Spray-Rite Serv. Co., 465 U.S. 752, 762-63 (1984) (“[I]t is precisely in cases in which the manufacturer attempts to further a particular marketing strategy by means of agreements on often costly nonprice restrictions that it will have the most interest in the distributors’ resale prices.”).
enhancement efforts. Such RPM would be procompetitive and should not be automatically condemned.\footnote{As noted, the Comanor/Scherer approach would allow a defendant to avoid condemnation of its RPM following a showing that the restraint was induced by distributors if the defendant presented “credible contradictory evidence.” Comanor/Scherer Amicus Brief, supra note 135, at 9. If the defendant were permitted to discharge this burden by showing that the policy was ultimately motivated by manufacturer concerns about dealer efforts, then this initial quick look is less troubling. The approach’s narrow focus of on the identity of the RPM-instigator suggests, however, that evidence concerning ultimate motivation would not save a dealer-initiated instance of RPM from condemnation. See id.}

In addition, the rule of reason Comanor and Scherer would apply to manufacturer-initiated instances of RPM is overly prohibitive. Because the initial quick look would have weeded out instances in which dealer collusion could be afoot,\footnote{See supra notes 139 - 140 and accompanying text.} the focus of the rule of reason analysis would be to identify instances of RPM that could be facilitating manufacturer collusion.\footnote{The post-quick look part of the Comanor/Scherer approach is focused on detecting manufacturer collusion. It is unsuitable for detecting the potential non-collusion anticompetitive harm created by RPM: the erection of entry barriers by a dominant manufacturer. As explained below, anticompetitive foreclosure from such a use of RPM could occur only if the RPM at issue was likely to induce discrimination against other brands, and the retailers subject to RPM on the defendant’s brand constituted a substantial percentage of the available marketing outlets for the product at issue. See infra notes 198, 247 - 248 and accompanying text.} As explained in greater detail in Part III.B.1, RPM can aid such collusion only when the use of RPM is widespread among the manufacturers competing in a market that is susceptible to collusion because it is concentrated, the product at issue is relatively fungible, and there are substantial barriers to entry. Both liability tests under the latter part of the Comanor/Scherer approach would presumptively condemn instances of RPM even when the prerequisites for anticompetitive harm—widespread use, concentrated market, fungible product, entry barriers—are not fully satisfied. The first test (RPM covers at least 50 percent of sales and challenged instance would expand coverage by 10 percent)\footnote{See supra note 142 and accompanying text.} requires widespread use of the practice but does not require that the market at issue be structurally capable of being cartelized. Because one would expect widespread use of RPM precisely when it provides the greatest efficiency benefits, such use should not suffice to establish a prima facie case of illegality. The second test (market is highly concentrated and defendant using RPM has at least 10 percent market share)\footnote{See supra notes 143 - 144 and accompanying text.} requires one of the structural factors necessary for cartelization (high concentration) but does not require the other structural pre-requisites (entry barriers, fungible product, etc.).
product) or that the use of RPM be widespread. Thus, both tests for establishing the presumptive illegality of RPM under the Comanor/Scherer approach would condemn too many instances of the practice. While defendants would have an opportunity to rebut the presumption of illegality, doing so would be difficult for reasons explained above. The Comanor/Scherer approach would therefore over-deter RPM.

E. The Antitrust Law Approach

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

Under the treatise’s approach, a plaintiff could satisfy its prima facie case by showing one of the following factors:

1. the manufacturer’s market is concentrated (HHI > 1200), and RPM arrangements or their equivalent cover a substantial portion of total sales (at least 15 percent);

2. the dealer market is concentrated (HHI > 1200);

3. RPM arrangements or their equivalent are widespread throughout the product market, covering at least 50 percent of sales;

4. the RPM arrangement was dealer-initiated, meaning that it was adopted after “demand by dealers acting collectively” (defined as two or more dealers acting in concert or an association of dealers) or a “request by a ‘dominant dealer’” (defined as one that accounts for 30 percent of the manufacturer’s local or total sales of a brand—local when restraint is employed only in that dealer’s locality);
5. the RPM arrangement covers a powerful brand, meaning that the manufacturer’s brand comprises at least 30 percent of total sales in the product market;\(^{162}\)

6. there is a dominant dealer responsible for at least 30 percent of the manufacturer’s sales within the area covered by the restraint;\(^ {163}\)

7. the manufacturer imposes the RPM arrangement selectively (in only one or a few geographic markets);\(^ {164}\)

or

8. the covered product is homogeneous so that there is an “obvious absence” of any need for special promotional efforts by retailers because the product is not that different than competing brands.\(^ {165}\)

If the plaintiff established that the product at issue is homogeneous so that special promotional efforts are not required (the eighth factor above), then the presumption of illegality would be irrebuttable and the plaintiff would prevail.\(^ {166}\) If the plaintiff instead established its prima facie case by showing any of the other factors, the defendant would have a rebuttal opportunity. The defendant could rebut the presumption of illegality by showing that (1) it has a legitimate business problem; (2) the problem “is significant in the sense of being nontrivial”; (3) the RPM “is reasonably connected to [the problem’s] solution”; and (4) “any less restrictive alternative suggested by the challenger is significantly less effective or significantly more costly.”\(^ {167}\)

The defendant’s proof burden on these four required showings would differ depending on which anticompetitive concern was implicated by the plaintiff’s prima facie case.\(^ {168}\) If the plaintiff’s showing suggested an anticompetitive concern other than dealer power, then the defendant would have to prove each of the above elements by a preponderance of the evidence.\(^ {169}\) If the plaintiff’s showing instead suggested that excessive dealer power was the sole anticompetitive concern, then the defendant’s burden could be lighter.\(^ {170}\) That is because anticompetitive dealer interests, unlike anticompetitive manufacturer interests, “cannot be served by a

\(^{162}\) Id. ¶ 1633c1(E), at 331.

\(^{163}\) Id. ¶ 1633c1(F), at 331.

\(^{164}\) Id. ¶ 1633c1(G), at 331.

\(^{165}\) Id. ¶ 1633c1(H), at 331-32.

\(^{166}\) Id. ¶ 1633e3, at 338.

\(^{167}\) Id. ¶ 1633e3(B), at 338.

\(^{168}\) Id. ¶ 1633e3, at 338.

\(^{169}\) Id. ¶ 1633e3(B), at 338.

\(^{170}\) Id. ¶ 1633e3(C), at 338-39.
restraint that is no more restrictive than necessary to serve a legitimate manufacturer interest.”\footnote{Id. ¶ 1633d1, at 334.} Accordingly, if the plaintiff’s prima facie case suggested only dealer power as the anticompetitive concern but did not involve a showing of either high dealer concentration (HHI substantially exceeding 1200) or very widespread market coverage (coverage substantially greater than 50 percent), then the defendant would not bear the full burden of persuasion on all prongs of its rebuttal.\footnote{Id. ¶ 1633e3(C), at 338-39.}

The authors of the Antitrust Law treatise deserve a great deal of credit for proposing a structured rule of reason approach at a time when Dr. Miles’s per se rule presided.\footnote{Volume VIII of the second edition of the treatise, which proposed the aforementioned approach, was published in 2004.} The treatise’s thoughtful proposal for separating pro- from anticompetitive instances of RPM likely helped persuade many—including perhaps some current Supreme Court justices—that courts could craft a principled means of policing vertical price restraints under the rule of reason. The specific proposal the treatise sets forth, though, is troubling. Besides being remarkably complex,\footnote{See, e.g., supra note 172 (discussing approach’s complicated scheme for allocating proof burdens).} so that courts cannot easily apply it and antitrust counselors cannot confidently provide advice about its application, the approach, like the other proposals considered so far, is overly prohibitive.

Most notably, the approach would automatically condemn minimum RPM on all products a factfinder determined to be homogeneous. The treatise takes this position because it concludes that product homogeneity “is inconsistent with known legitimate uses of RPM.”\footnote{Areeda & Hovenkamp, supra note 9, ¶ 1633c3(D), at 334.} But that is simply not true. While RPM might be used to combat free-riding only when the products at issue are so

\footnote{Specifically, if the plaintiff established its prima facie case by showing either (1) dealer concentration or RPM coverage “not much above the threshold of concern” (HHI > 1200; market coverage > 50 percent), \cite{supra} notes 159 - 160 and accompanying text, or (2) dealer requests or demands for RPM, \cite{supra} note 161 and accompanying text, then the plaintiff would bear the burden of persuasion on the first three elements of the defendant’s prima facie case. 8 Areeda & Hovenkamp, supra note 9, ¶ 1633e3(C), at 337-38. The defendant would retain the burden of persuasion on the last element—i.e., it would have to show that any less restrictive alternative proposed by the challenger would be significantly less effective or significantly more costly than RPM. \cite{Id.} If the plaintiff established its prima facie case by showing such weak factors as a large manufacturer or dealer market share or the selective imposition of RPM, \cite{supra} notes 162 - 164 and accompanying text, then the plaintiff would bear the burden of persuasion on all four elements of the defendant’s rebuttal case. 8 Areeda & Hovenkamp, supra note 9, ¶ 1633e3(c), at 338.}
“distinctive” that point-of-sale consumer services (such as customer education about the product) could enhance demand, the practice could create other procompetitive benefits even if the price-restrained products were relatively homogeneous. For example, even a manufacturer of a commoditized product may impose RPM to encourage dealers to take actions that preserve or enhance the product’s quality but are not readily observable by consumers. Indeed, evidence suggests that RPM has been used to motivate these sorts of dealer actions (e.g., product rotation) on such homogeneous products as non-premium (Coors brand) beer. The approach advocated in the Antitrust Law treatise would thwart this procompetitive use of RPM on any product that a factfinder might deem to be homogeneous.

With regard to RPM on heterogeneous products, the Antitrust Law approach is deficient in that it would too quickly burden the defendant to establish the procompetitiveness of an instance of RPM. In an actual dispute over the legality of RPM, the party bearing the burden of establishing the presence or absence of procompetitive effect stemming from the instance at issue will likely lose, particularly when the proof requirement includes consideration of less restrictive alternatives (the fourth required prong of the defendant’s rebuttal). As the Antitrust Law treatise itself recognizes:

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

176 See supra notes 43 - 56 and accompanying text (discussing how RPM may be used to combat free-riding on point-of-sale services).
177 See supra notes 57 - 66 and accompanying text (discussing RPM’s use as a device for enforcing unspecified quality-control agreements).
178 See Klein & Murphy, supra note 7, at 280-82; Overstreet, supra note 116, at 126 (describing dissertation (Andrew McLaughlin, Economic Analysis of Resale Price Maintenance, Ph.D. Dissertation, UCLA, 1979) as concluding that “RPM was an efficient and socially beneficial method of promoting dealer services of refrigeration and product rotation which enhanced the quality of Coors’ unpasteurized beer”).
competition becomes stronger. To put the burden on the challenger is to make a justification relatively easy to establish.\textsuperscript{179}

Although it recognizes that allocation of the burden of proof on procompetitive effect will generally be outcome-determinative, the Antitrust Law approach would place the burden on the defendant—thereby damning its fate—even absent a showing that an instance of RPM could give rise to anticompetitive effect. For example, the mere facts that the manufacturer’s market is relatively concentrated (HHI > 1200) and that use of RPM covers greater than 15 percent of total sales (collectively, the first factor that could establish a plaintiff’s prima facie case)\textsuperscript{180} are far from sufficient to enable RPM to be used as a facilitator of collusion. Yet, a plaintiff’s showing of those facts would strap the defendant with a proof burden it likely cannot successfully discharge. Similarly, by itself, dealer concentration (the second factor that could establish a plaintiff’s prima facie case)\textsuperscript{181} could not render RPM a useful device for facilitating dealer collusion; either brand dominance or widespread use among manufacturers would also be required.\textsuperscript{182} Nonetheless, high concentration in the dealer market would saddle the defendant with the difficult-to-discharge burden to prove procompetitive effect. Indeed, none of the factors that would individually suffice to make out the plaintiff’s prima facie case could, standing alone, permit an anticompetitive use of RPM. Yet, a showing of any single factor (except for the fifth, sixth, and seventh)\textsuperscript{183} would shift the proof burden in a way that makes it difficult for a defendant to prevail. Like the aforementioned proposals, this approach would be overly prohibitive and thus overly deterrent.

\textbf{III. An Alternative Approach}

While the structured rules of reason that have been considered thus far generally call for consideration of the appropriate factors for evaluating instances of RPM, they are not structured to generate an optimal separation of procompetitive wheat from anticompetitive

\textsuperscript{179} 8 Areeda & Hovenkamp, supra note 9, ¶ 1633d, at 337.
\textsuperscript{180} See supra notes 157 - 158 and accompanying text.
\textsuperscript{181} See supra note 159 and accompanying text.
\textsuperscript{182} See Hovenkamp, supra note 35, at 449 (“RPM … can be evidence of retailer collusion only if 1) the manufacturer imposing the restriction is a monopolist in the retailer’s area; or 2) the restriction is used by a very high percentage of manufacturers in the market.”).
\textsuperscript{183} If the plaintiff’s prima facie case were based on a weak showing (i.e., a showing of one of these factors), the plaintiff would bear the burden of persuading the factfinder of the absence of any procompetitive rationale proffered by the defendant. See supra note 172.
chaff, for each is overly deterrent. This Part seeks to remedy that
deficiency by proposing a rule of reason approach that will both
consider the correct factors in evaluating RPM and allocate proof
burdens in a manner that will maximize the net benefits of RPM
regulation. Subpart A sets forth the general principles that should
determine the contours of the rule of reason applicable to minimum
RPM. Subpart B then proposes a structured rule of reason that is
based upon those principles.

A. Principles Governing Rule Selection

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

1. Likelihood of Incorrect Judgments

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

a) Economic Theory

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

185 Id. See also Keith N. Hylton & Michael Salinger, Tying Law and Policy: A
186 See supra notes 43 - 56 and accompanying text.
free-riding (because, for example, dealers are in located within close proximity of each other). RPM may provide an optimal means of ensuring dealer performance of unspecified agreements whenever dealer activities would enhance the attractiveness of a manufacturer’s offerings and the quality-enhancing activities are difficult to delineate in advance or to monitor. RPM may facilitate entry whenever a new producer seeks to gain access to or promotion by retail outlets that already stock and provide favorable shelf space to well-established brands. And RPM may used to stem the potential price volatility that inhibits retailers from carrying untested goods whenever consumer demand for a new product is unknown. Because these various conditions quite often exist, procompetitive rationales for instances of RPM are frequently plausible.

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

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187 See supra notes 57 - 66 and accompanying text.
188 See supra notes 67 - 68 and accompanying text.
189 See supra notes 69 - 70 and accompanying text.
190 See generally Hovenkamp, supra note 35, at 449-51 (explaining that dealers must seek, and manufacturers must consent to, RPM if it is to be used to facilitate dealer collusion).
191 See id. at 449 (“If the manufacturers in the market have no market power, then the retailers of any single manufacturer could not raise the price of the manufacturer’s product to monopoly levels. Customers would switch to different brands.”).
192 Id. (observing that precondition for dealers’ seeking RPM are either “1) the manufacturer imposing the restriction is a monopolist in the retailer’s area; or 2) the restriction is used by a very high percentage of the manufacturers in the market”).
those retailers is high, and (2) forward integration into product distribution is not feasible.\textsuperscript{193}

For RPM to facilitate a manufacturer cartel, the market in which the manufacturer participates must be susceptible to cartelization, and the use of RPM must be widespread enough to assist with the collusion. Thus, anticompetitive harm from the facilitation of a manufacturer cartel is unlikely unless (1) the manufacturer market is concentrated,\textsuperscript{194} (2) the product at issue is fairly fungible,\textsuperscript{195} (3) there are entry barriers into the manufacturer market,\textsuperscript{196} and (4) RPM is used by manufacturers comprising a substantial portion of the market.\textsuperscript{197}

For RPM to create an entry barrier that effectively forecloses the manufacturer’s rivals from the market, the margin guaranteed to dealers must be large enough to induce them to drop, or to refrain from promoting, competing brands. Moreover, the RPM must be imposed so broadly that it generates significant foreclosure of rivals (i.e., the rivals cannot have access to other acceptable channels of distribution).\textsuperscript{198} Given the ubiquity of discount retailers, who compete with each other primarily on price and would be unlikely to forego carrying a lower priced product in exchange for a higher margin,\textsuperscript{199} these conditions will rarely be satisfied.

\textbf{b) Empirical Evidence}

Consistent with economic theory, the somewhat sparse empirical evidence on RPM’s competitive effects suggests that most instances of RPM are procompetitive. In a 1983 Bureau of Economics Staff Report to the FTC, report author Thomas R. Overstreet examined

\textsuperscript{193} Id. at 451 (discussing situations in which manufacturers may have difficulty rejecting retailer demands for RPM).

\textsuperscript{194} See Posner, supra note 26, at 66 (“Some degree of concentration thus appears to be a necessary condition of successful collusion in markets subject to the Sherman Act.”).

\textsuperscript{195} See id. at 75 (“The less standardized (more customized) a product is, … the more difficult it will be for the sellers of the product to collude effectively. The heterogeneity of the product will make it impossible for the sellers to agree upon a single price for all orders.”).

\textsuperscript{196} See id. at 72-75.

\textsuperscript{197} See Hovenkamp, supra note 35, at 453 (“The manufacturers’ cartel will work, however, only if its members collectively control enough of the market to wield monopoly power.”).

\textsuperscript{198} See Elzinga & Mills, supra note 25, at 7 (observing that RPM-augmented foreclosure theory “cannot apply where manufacturing competitors and entrants retain access to the market via competing retailers or alternative channels of distribution. Nor can it apply where the manufacturer using RPM does not control a large share of the relevant market in spite of using this practice.”).

\textsuperscript{199} See infra notes 216 - 227 and accompanying text.
RPM’s competitive effect by analyzing all FTC RPM cases from mid-1965 to the end of 1982 and cataloguing the then-existing empirical studies of RPM. Overstreet’s report suggests that most instances of RPM are not anticompetitive. With respect to the RPM in the FTC cases, which he took to be representative of instances of RPM generally, Overstreet concluded that most occurred in markets that could support neither manufacturer nor dealer collusion. While Overstreet provided a more equivocal summary of his findings from the survey of empirical studies, close examination of those findings suggests that they cannot support the view that RPM is, more often than not, anticompetitive.

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200 Overstreet, supra note 116, at 63-82.
201 Id. at 106-63.
202 Id. at 81 (“[T]he structural snapshot of the 1950s, comparing fair trade markets to all manufacturing markets, combined with our finding that recent FTC RPM cases have involved markets which structurally are distributed in about the same way as all manufacturing markets, suggests that the FTC case sample may provide a fairly reasonable basis for drawing some limited general conclusions.”).
203 Id. at 71-76 (discussing lack of manufacturer concentration in markets in which RPM was challenged); id. at 80 (“[O]f the 47 cases with data on the number of distributors, over 80 percent involved in excess of 200 dealers. Widespread dealer collusion involving more than 100 (or 200) decision makers seems unlikely to be effective or persistent in the absence of restrictions on entry … or some mechanism for overt coordination …..”); id. at 81 (concluding that “[i]t is unlikely that there is effective manufacturer coordination featuring RPM in all or even most of these markets” and that “available information also suggests that the use of RPM is unrelated to widespread dealer collusion in most instances”). See also S. Ornstein, Resale Price Maintenance and Cartels, 30 ANTITRUST BULL. 401, 430-31 (1985) (analyzing Justice Department and FTC cases and concluding that vertical restraints may have been used to support manufacturer cartels in only 4% to 33% of the cases); but see 8 Areeda & Hovenkamp, supra note 9, ¶ 1606f, at 91 (criticizing Ornstein study).
204 Id. at 163 (“Theory suggests that RPM can have diverse effects, and the empirical evidence suggests that, in fact, RPM has been used in the U.S. and elsewhere in both socially desirable and undesirable ways.”).
205 In surveying the empirical studies of RPM, Overstreet examined price surveys (i.e., studies examining the effect of RPM on consumer prices), id. at 106-19, a number of case studies, id. at 119-29, two prior FTC studies of RPM, id. at 129-48, and several accounts of the use of RPM in foreign countries, id. at 148-60. As Overstreet explained, price surveys are inapposite to the question of whether RPM’s has pro- or anticompetitive effects, for higher prices are consistent with both sorts of effects. Id. at 106, 116-17, 160.

With respect to the case studies, Overstreet concluded that “[t]he probable effects indicated from the case studies are that RPM sometimes reduces and sometimes enhances social welfare.” Id. at 129. It seems, though, that the reduction of social welfare to which Overstreet refers was generally not occasioned by facilitation of collusion but instead by the provision of “excessive” retailer services. (See supra notes 78 - 80 and accompanying text for an explanation of how output-enhancing services might be deemed “excessive.”) Only two of the eleven case studies Overstreet examined suggested a collusive explanation for RPM. Overstreet, supra note 116, at 119-29 (summarizing case studies of RPM on
Examination of litigated RPM cases suggests that most instances of RPM are, in fact, procompetitive. In a 1991 study, Pauline Ippolito examined all 203 reported cases of RPM from 1975 through 1982. Ippolito reasoned that the prohibition against RPM was most strict during those years, so one would expect firms to

light bulbs (two studies), china, televisions, jeans (two studies), shoes, stereo components, beer, bread, and various products sold in Rhode Island; finding evidence of collusion in only one of the light bulb studies and the bread study). By contrast, six suggested that use of the practice may have been procompetitive. Id. (finding some evidence of procompetitive effect from use of RPM on china, jeans, shoes, stereo components, beer, various products in Rhode Island).

The two prior FTC studies Overstreet examined did not conclude that RPM is anticompetitive more often than not. In the first, submitted to Congress in two parts in 1929 and 1931, FEDERAL TRADE COMM’N, REPORT ON RESALE PRICE MAINTENANCE (Part I submitted Jan. 30, 1929; Part II submitted June 22, 1931), the Commission surveyed manufacturers, wholesalers, retailers, consumers, and economists as to their perceptions of the advantages and disadvantages of RPM. Overstreet, supra note 116, at 129-34. The results were mixed. Id. at 134 (“The conclusion which it now seems warranted to draw from this inquiry is that some advocates of RPM were motivated by efficiency considerations, and others were not.”). The second study, submitted to Congress in 1945, FEDERAL TRADE COMM’N, REPORT OF THE FEDERAL TRADE COMMISSION ON RESALE PRICE MAINTENANCE (submitted Dec. 13, 1945), considered price and volume effects following the imposition of RPM in regions where it was permitted pursuant to the Fair Trade laws. Overstreet, supra note 116, at 135-48. Price effects and effects on volume per retail outlet are irrelevant to the competitive analysis because price increases and reductions in per-retailer volume can be consistent with procompetitive effects. Id. at 140. Effect on manufacturer sales volume is relevant, but the data on that point were inconclusive. Id. The 1945 study also included a detailed account of the involvement of various trade groups in advocating for “Fair Trade” laws (i.e., state laws insulating RPM from liability; federal statutes authorized such state laws from 1937 to 1975, see Miller-Tydings Act 50 Stat. 693, 15 U.S.C. § 1 (1937); McGuire Act, 66 Stat. 631, 15 U.S.C. § 45 (1952); Consumer Goods Pricing Act of 1975, Pub. L. 94-145, 89 Stat. 801 (1975)) and seeking imposition of RPM. Id. at 140-44. The study found that a some, but not all, retailer associations were successful at persuading manufacturers to impose RPM. Id. Given the degree to which some retailers had taken the lead in seeking RPM under Fair Trade, the 1945 study concluded that the Fair Trade statutes and RPM were contrary to the public interest. Id. at 144-48. It highlighted particular aspects of state fair trade statutes that made them particularly useful as devices for facilitating retailer collusion. Id. at 146-47. Notably, those specific statutory defects do not exist under the post-Leegin regime, which simply brings RPM under the rule of reason. Id. at 148.

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


207 Id. at 266. This was the period after Fair Trade laws were revoked (so all RPM was per se illegal) and before the Supreme Court decided Monsanto Co. v. Spray-
attempt RPM only when they expected it to be especially profitable.\textsuperscript{208} By looking at the theories asserted in the 203 litigated cases, Ippolito sought to determine \textit{why} RPM was perceived by manufacturers to be so profitable (i.e., in how many cases might the profitability of the practice have stemmed from its facilitation of collusion?).\textsuperscript{209} Because price-fixing is per se illegal, Ippolito hypothesized that “if the plaintiff had any evidence that the practice at issue in the litigation was used to support collusion, we would expect to see horizontal price-fixing allegations in these cases, in addition to the RPM allegation.”\textsuperscript{210}

As it turned out, allegations of horizontal collusion were rare. Only 9.8 percent of the private cases and 13.1 percent of the entire sample of cases included allegations of dealer or manufacturer collusion.\textsuperscript{211} By contrast, a number of the cases featured characteristics that were more consistent with procompetitive uses of RPM than with anticompetitive collusion. For example, up to 65 percent of the private cases and up to 68 percent of the government cases involved products for which consumer demand would likely be significantly affected by the provision of “special services” susceptible to free-riding.\textsuperscript{212} Approximately 43 percent of the private cases and 28 percent of the government cases involved products for which the dealer’s role in product quality determination is important.\textsuperscript{213} And in 24 of the 28 “simple goods” cases (in which special services are not as likely to be demand-enhancing), the facts were consistent with the use of RPM to enhance dealers’ sales efforts.\textsuperscript{214} Based on these findings, Ippolito concluded:

While clearly limited by the information available in the case opinions, this analysis does not indicate that collusion is the primary explanation for the RPM-type practices at issue in either the private-case sample or in the combined private- and government-case sample. … Based on an analysis of the products and the types of dealers in the cases, service and sales-enhancing theories, taken together, appear to have greater potential to explain the practices.\textsuperscript{215}

\textbf{Rite Corp.}, 465 U.S. 752 (1984), which increased the difficulty of establishing the agreement element of a Section One violation premised on RPM.\textsuperscript{208} Ippolito, \textit{supra} note 206, at 264.

\textsuperscript{209} \textit{Id.} at 265.

\textsuperscript{210} \textit{Id.} at 281.

\textsuperscript{211} \textit{Id.}

\textsuperscript{212} \textit{Id.} at 282-85.

\textsuperscript{213} \textit{Id.} at 285-29.

\textsuperscript{214} \textit{Id.} at 289-91.

\textsuperscript{215} \textit{Id.} at 291-92.
c) Retailing Trends

Trends in American retailing suggest that anticompetitive uses of RPM are even less likely now than they were during the periods analyzed by Overstreet and Ippolito. In the last couple of decades, large discount retailers have proliferated throughout the United States. Consider, for example, the nation’s largest retailer (and the world’s largest company by revenue), Wal-Mart Stores, Inc. Wal-Mart’s domestic retail stores, branded as Walmart Discount Stores, Walmart Supercenters, Sam’s Clubs, and Neighborhood Markets, are notoriously focused on offering consumers’ the lowest possible prices, albeit with few retail amenities. In 1970, there were only 38 Walmart outlets in the United States. By 1975, that total had grown to 125, and by 1985, it stood at 882. As of 1995, Walmart operated a total of 2,667 domestic units, and by the end of July 2008, the number of domestic units had grown to 4,224. And, of course, Walmart faces competition from numerous other discount retailers that also attempt to woo customers by offering low prices.

Not only have the large discount retailers increased their presence throughout the United States, they have also expanded their product offerings. Beginning in the late 1980s, the major national discounters, along with a number of other discounters, began operating so-called “hypermarkets,” enormous retail stores carrying a vast range of products under one roof, including full lines of groceries and general merchandise. Thus, large discount retailers, which compete primarily on price and would be unlikely to alienate their core customers by demanding that manufacturers set minimum retail prices, have become both more ubiquitous and more expansive in their product offerings since the studies by Overstreet and Ippolito.

216 See World’s Largest Companies, FORTUNE 165 (June 21, 2008) (available in Westlaw at 2008 WLNR 12725088).
218 Id.
219 Id.
220 Those 2,667 domestic units were comprised of 1,995 discount stores, 239 Supercenters, and 433 Sam’s Clubs. Id.
222 Among the largest of Wal-Mart’s competitors are Target Corp., which operates 1,591 discount stores (including 231 SuperTarget locations) in the United States, see Company Overview (available at http://investors.target.com/phoenix.zhtml?c=65828&p=irol-homeprofile); and Sears Holdings Corp., which operates approximately 1,400 Kmart discount stores in the United States. See About Kmart (available at http://www.kmartcorp.com/corp/story/general/kmart_glance.htm).
Ippolito. Given these retailers’ prominence and breadth of offerings, most manufacturers confronted with a demand for RPM from a dominant dealer or group of dealers would have the option of refusing that demand and distributing their products through the major discounter’s well-established networks.

Thus, Justice Breyer likely erred in his Leegin dissent when he pointed to retailing trends to suggest that anticompetitive harms from RPM are becoming more likely. Justice Breyer reasoned:

Concentration in retailing has increased. That change, other things being equal, may enable (and motivate) more retailers, accounting for a greater percentage of total retail sales volume, to seek resale price maintenance, thereby making it more difficult for price-cutting competitors (perhaps internet retailers) to obtain market share.223

As a purely logical matter, increased retailer concentration may do many things.224 Justice Breyer’s decision to focus on the potential downside—increased retailer efforts to attain RPM—may be a vestige of the largely discredited structure-conduct-performance (“S-C-P”) paradigm, which held that a market’s structure determines the participants’ conduct, which in turn determines market performance.225 Justice Breyer seemed to assume that a more concentrated retailer market would inevitably involve greater efforts to collude. Absent from Justice Breyer’s analysis, though, was any consideration of the composition of the more concentrated retailer market. Justice Breyer referred to evidence that “the combined sales of the 10 largest retailers worldwide has grown to nearly 30% of total retail sales of top 250 retailers,”226 but he failed to mention that the six American retailers in the global top ten are Walmart, Home Depot, Kroger, Target, Costco, and Sears Holdings (the operator of Kmart stores).227 All of those retailers are vigorous price competitors, and four of them—Walmart, Target, Costco, and Sears (operating as Kmart)—have positioned themselves as low-price discounters. It is highly unlikely that they have the motivation, much

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224 It may, for instance, reduce retailer margins as retailers attain productive efficiencies that accompany increased scale. Cf. Michael Bergdahl, What I Learned from Sam Walton: How to Compete and Thrive in a Wal-Mart World 113-30 (2004) (discussing Wal-mart’s extensive “expense control strategies and tactics,” many of which are facilitated by its scale).
227 See Deloitte Study, supra note 226, at 7 (listing global top ten retail leaders). Sears Holdings operates Kmart discount stores. See About Kmart, supra note 222.
less the ability, to pressure manufacturers to impose RPM, and their
growth and expansion of product offerings reduces the chance that
any manufacturer will find itself without access to efficient retailers
that are willing to compete on consumer prices. Thus, the use of
RPM to facilitate retailer-level collusion is increasingly unlikely.

Moreover, as discount retailers consolidate and gain a larger
proportion of retail distribution, manufacturer-level collusion
becomes less likely. Given the breadth of their store networks, large
discount retailers offer manufacturers especially attractive
distribution outlets. The prospect of tremendous sales through a
massive discount retailer chain would create a constant temptation
for any participant in a manufacturer-level cartel to secure placement
in the chain by cheating on the fixed price. That temptation grows
(and, conversely, the chance of successful manufacturer collusion
shrinks) as discount retailers comprise a larger proportion of total
retail sales. Justice Breyer thus erred by focusing only on the
concentration in retailing without accounting for the low-price focus
of the more concentrated retailers.

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

2. Magnitude of Losses from Errors

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

In antitrust, where the harm from a wrongful acquittal is an
increase in market power and the harm from a wrongful conviction is
the widespread thwarting of beneficial business practices, these
harms are likely to be incommensurate. The harm from wrongful
conviction will generally outweigh the harm from wrongful acquittal.
That is because the harm from false acquittal—market power—is
generally self-correcting by entry or (in the case of collusion)

228 Frank H. Easterbrook, The Limits of Antitrust, 63 TEX. L. REV. 1, 2 (1984) (“A
fundamental difficulty facing the [antitrust] court is the incommensurability of the
stakes.”).
cheating. By contrast, the harm from false conviction—economy-wide thwarting of a beneficial practice—may be undone only by a court decision (or legislative or regulatory development) that corrects the bad precedent.\(^{229}\)

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

### 3. Difficulty of Administering the Rule

In order to minimize the costs of administration, the governing rule of reason should focus the liability test so that the parties and the court know precisely what facts are outcome determinative.\(^{230}\) In addition, it should clearly allocate proof burdens so that the appropriate outcome is clear upon a failure of proof. The rule should also provide clear guidance to business planners so that they can easily assess the liability risk associated with various courses of action. If possible, it should provide safe harbors for conduct that presents a very low risk of anticompetitive harm.\(^{231}\) Finally, to the extent that it can do so without significantly increasing error costs, the rule should put the burden of producing information on the party to whom that information is most easily accessible.\(^{232}\)

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\(^{229}\) As Judge Easterbrook explained:

If the [antitrust] court errs by condemning a beneficial practice, the benefits may be lost for good. Any other firm that uses the condemned practice faces sanctions in the name of stare decisis, no matter the benefits. If the court errs by permitting a deleterious practice, though, the welfare loss decreases over time. Monopoly is self-destructive. Monopoly prices eventually attract entry. True, this long run may be a long time coming, with loss to society in the interim. The central purpose of antitrust is to speed up the arrival of the long run. But this should not obscure the point: judicial errors that tolerate baleful practices are self-correcting while erroneous condemnations are not.

*Id.* at 2-3.

\(^{230}\) Such focusing will reduce administrative costs by preventing parties from gathering, and courts from examining, irrelevant facts.


\(^{232}\) There may be some tension between the need to place the burden to produce information on the party to whom it is most accessible and the need to allocate proof burdens in a manner that will minimize error costs. For example, if (as with minimum RPM) procompetitive uses of a practice are more common than
In light of the foregoing analysis, a burden-shifting regime tilted slightly in favor of the defendant would likely minimize the sum of error costs from false acquittals and false convictions, while keeping administrative costs in check. Under that regime, the party challenging an instance of RPM would bear the initial burden either (1) to produce direct evidence of competitive harm by showing that the challenged instance of RPM had caused a reduction in output, or (2) to produce circumstantial evidence of competitive harm by showing that the pre-requisites to such harm are satisfied. Once the challenger made such a showing, the defendant manufacturer could avoid liability only by showing that the challenger had failed to discharge its initial proof burden or by offering an affirmative defense consisting of a showing that the challenged practice is, in fact, procompetitive. If the defendant made such an affirmative defense, the challenger could prevail only if it established that the procompetitive benefits claimed by the defendant were likely illusory. The following discussion fleshes out the details of the challenger’s prima facie case, the defendant’s rebuttal opportunity, and the responses available to the challenger.

1. Challenger’s Prima Facie Case

Because most instances of minimum RPM are procompetitive and the harms from a false conviction are likely to exceed those from a false acquittal, the party challenging an instance of RPM should bear the initial burden to produce evidence that the challenged practice is, or is likely to be, output-reducing. The challenger could take either a “direct” or a “circumstantial” approach to discharging that burden. Under the direct approach, the challenger would produce evidence that the RPM at issue had, in fact, reduced the manufacturer’s output of the relevant product relative to what it would have been absent the price restraint. For example, the

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233 See supra notes 186 - 227 and accompanying text.
234 See supra notes 228 - 229 and accompanying text.
235 Judge Posner has advocated this direct approach to determining whether a vertical restraint is anticompetitive. See Posner, supra note 71, at 21; Richard
challenger could show (1) that the manufacturer’s output declined following imposition of RPM, and (2) that the decline cannot be explained by other factors (such as an economy-wide recession or the introduction of a competing product). Given the difficulty of the latter showing, which would be an indispensable part of a challenger’s direct prima facie case, most challengers would likely opt to discharge their initial proof burden circumstantially.

Under the circumstantial approach, the challenger would bear the burden of establishing a significant possibility that anticompetitive harm could stem from the challenged RPM. This means that the plaintiff must show that the factual pre-requisites are satisfied for at least one of the three types of anticompetitive harm that may result from RPM (i.e., dealer collusion, manufacturer collusion, or market foreclosure).

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

1. the dealer market is susceptible to cartelization because (a) it is relatively concentrated and (b) there are substantial entry barriers; and

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236 See Posner, supra note 71, at 21 (noting that this method “requires controlling for effects on the firm’s output of exogenous factors, that is, those unrelated to the challenged practice itself,” and observing that the statistical methods involved “are not foolproof in application, nor are they easy for judges and juries to understand”).

237 Herbert Hovenkamp, co-author of the Antitrust Law treatise whose proposed evaluative approach is analyzed above, see supra notes 154 - 183 and accompanying text, has elsewhere suggested the sort of circumstantial approach proposed here. See Hovenkamp, supra note 35, § 11.7d at 493-95. The latter approach involves a more stringent prima facie case than that set forth in the Antitrust Law treatise. Compare 8 Areeda & Hovenkamp, supra note 9, ¶ 1633 at 328-39 with Hovenkamp, supra note 35, § 11.7d at 493-95.

238 See generally Hovenkamp, supra note 35, § 11.2 at 449-51 (explaining that dealers must seek, and manufacturers must consent to, RPM if it is to be used to facilitate dealer collusion).

239 This showing is required because dealers presumably would not seek RPM to facilitate collusion in a market that is insusceptible to cartelization.
2. either (a) the manufacturer has market power in the market for the price-restrained product, or (b) RPM is common among manufacturers of that product.\textsuperscript{240}

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

1. the dealer or group of dealers seeking RPM comprises a substantial proportion of reasonably available marketing outlets;\textsuperscript{241} and

2. forward integration into the dealer market would be impracticable for the manufacturer.\textsuperscript{242}

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

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

1. the manufacturer market is concentrated;\textsuperscript{243}

2. the product upon which RPM is imposed is relatively fungible;\textsuperscript{244}

\textsuperscript{240} This showing is required because dealers will not seek to raise consumer prices through the imposition of RPM if such higher prices are likely to drive consumers to competing brands of the product at issue.

\textsuperscript{241} If the dealers demanding imposition of RPM do not collectively comprise a substantial proportion of reasonably available marketing outlets, the manufacturer asked to impose RPM (and thereby raise dealer margins) would likely resist that demand. If the requesting dealers dropped the manufacturer’s products, the manufacturer would be able to make up for those dealers’ lost sales by increasing its sales through other dealers. Thus, the demanding dealers would have little leverage to demand imposition of RPM.

\textsuperscript{242} A manufacturer that could easily integrate forward into retailing would not be easily coerced by dealer demands to impose RPM. One situation in which forward integration into retailing is likely to be impracticable is when the manufacturer’s product is not amenable to single-product distribution and is more likely to be purchased from a multi-product retailer. See Hovenkamp, \textit{supra} note 35, § 11.2b at 451.

\textsuperscript{243} Markets containing numerous non-fringe sellers are difficult to cartelize. See Posner, \textit{supra} note 26, at 66 (“Some degree of concentration thus appears to be a necessary condition of successful collusion in markets subject to the Sherman Act.”).
3. there are substantial entry barriers into the manufacturer’s market,\textsuperscript{245} and

4. the use of RPM is widespread among manufacturers of the product.\textsuperscript{246}

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

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

2. the retailers subject to RPM on the defendant’s brand constitute a substantial percentage of the available marketing outlets for the product at issue.\textsuperscript{247}

The challenger could establish the first prong by showing that the manufacturer required exclusive dealing in exchange for the RPM. Alternatively, it could do so by showing that dealers carrying the defendant’s price-restrained brand generally do not carry other brands. With respect to the second prong, “substantial” foreclosure of marketing opportunities should resemble the level of foreclosure required to establish liability for exclusive dealing, which threatens a similar sort of anticompetitive effect.\textsuperscript{248}

\textsuperscript{244} Because of the need to adjust consumer prices to account for differences in features, quality, etc., it is difficult to fix prices on non-fungible products. See id. at 75 (“The less standardized (more customized) a product is, … the more difficult it will be for the sellers of the product to collude effectively. The heterogeneity of the product will make it impossible for the sellers to agree upon a single price for all orders.”).

\textsuperscript{245} Because supracompetitive prices attract entry that can render a price-fixing scheme unprofitable, price-fixing is difficult in markets with low entry barriers. See id. at 72-75.

\textsuperscript{246} In order for RPM to facilitate substantially a manufacturer cartel by either dissuading cartel participants from cheating or making their cheating more visible, it must be in widespread use among the colluders. See Hovenkamp, supra note 35, § 11.2b2 at 453 (“The manufacturers’ cartel will work, however, only if its members collectively control enough of the market to wield monopoly power.”).

\textsuperscript{247} See Elzinga & Mills, supra note 25, at 7 (observing that RPM-augmented foreclosure theory “cannot apply where manufacturing competitors and entrants retain access to the market via competing retailers or alternative channels of distribution. Nor can it apply where the manufacturer using RPM does not control a large share of the relevant market in spite of using this practice.”).

\textsuperscript{248} See Hovenkamp, supra note 35, § 10.9a, at 436-37 (discussing anticompetitive foreclosure effect of exclusive dealing); id. § 10.9e, at 441-45 (discussing foreclosure levels required to establish liability based on exclusive dealing).
2. Defendant’s Rebuttal Opportunity

Once the challenger produces evidence that the challenged RPM resulted in reduced output (the direct approach) or that the prerequisites of one of the aforementioned theories of anticompetitive harm are satisfied (the circumstantial approach), the defendant would have two arrows in its quiver. First, it may attempt to show that the evidence produced does not establish the challenger’s prima facie case. If the challenger attempts the direct approach of showing an actual output reduction, the defendant may attack the challenger’s evidence attributing reduced output to the imposition of RPM. If the challenger instead pursues the circumstantial approach, the defendant may show that one of the prerequisites to anticompetitive harm has not been proven. Because the challenger bears the full burden of proof on its prima facie case, the defendant will prevail if it convinces the fact-finder that there is a deficiency in the challenger’s evidence.

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

3. Responses Available to Challenger

If the challenger takes the direct route in establishing its prima facie case and the defendant makes an affirmative defense by producing its own study showing an output enhancement, the task falls on the finder of fact to determine which of the parties offers the more persuasive account. If the factfinder concludes that the evidence weighs in favor of the challenger’s claim that RPM has

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249 For example, the defendant may show that the challenger failed to account for the effect on output of exogenous factors. See Posner, supra note 71, at 21.

250 This is similar to the affirmative defense set forth in the Antitrust Law treatise. See 8 Areeda & Hovenkamp, supra note 9, ¶ 1633e3(B), at 338, discussed supra at note 167 and accompanying text.
caused a reduction in the defendant’s total output, then the challenger should prevail. Otherwise, the defendant should.\textsuperscript{251}

If the challenger instead sets forth a circumstantial prima facie case and the defendant makes the affirmative defense set forth above, then the plaintiff is entitled to one more bite at the apple. It can prevail if, but only if, it persuades the factfinder that either (1) the claimed procompetitive benefit is pretextual or (2) the benefit could have been achieved as efficiently using a less restrictive means.\textsuperscript{252} If it does so, it should prevail; otherwise, the verdict should be in favor of the defendant.

\textbf{C. Evaluation of the Proposed Rule}

Few challenges to instances of minimum RPM will succeed under the proposed rule. A challenger must either (1) produce convincing evidence that RPM resulted in an output reduction that cannot be attributed to another cause or (2) first demonstrate the existence of all the prerequisites to one of RPM’s potential anticompetitive harms and then rebut any claim that the RPM was imposed as the most efficient means of securing a procompetitive end. These proof burdens are difficult to satisfy. Still, the proposed rule should deter blatantly anticompetitive instances of RPM, particularly since successful challenges will result in treble damages,\textsuperscript{253} which are not justified by the clandestine nature of the offense and thus result in some measure of overdeterrence.\textsuperscript{254} Given that most instances of RPM are procompetitive,\textsuperscript{255} that the costs of

\begin{footnotesize}
\begin{enumerate}
\item If the factfinder concludes that the parties’ accounts concerning output effects are equally persuasive, the defendant should prevail. The challenger bears the burden of proving anticompetitive effect.
\item Unlike the approach set forth in the \textit{Antitrust Law} treatise, the approach advocated here would require the challenger actually to prove the existence of an equally efficient, less restrictive alternative means of producing the procompetitive benefit at issue. \textit{Compare} 8 Areeda & Hovenkamp, \textit{supra} note 9, ¶ 1633e3(C), at 338-39, discussed \textit{supra} at note 172 and accompanying text. This is appropriate because, as the \textit{Antitrust Law} treatise recognizes, the allocation of proof burden on this issue will likely be outcome determinative, \textit{see id.} ¶ 1633d, at 337, discussed \textit{supra} at note 179 and accompanying text, and most instances of RPM should be acquitted, not condemned. \textit{See supra} notes 184 - 229 and accompanying text.
\item Damages for antitrust violations are trebled in order to account for the fact that many antitrust violations (e.g., horizontal price-fixing conspiracies) are hidden and thus likely to escape successful prosecution. For blatant antitrust violations—those not conducted in secret—damages trebling results in some degree of overdeterrence. Because RPM is not a “secret” business practice, a measure of overdeterrence is already built into the prohibition on anticompetitive uses of the practice. \textit{See Hovenkamp, supra} note 17, at 66-68; Posner, \textit{supra} note 26, at 272.
\item \textit{See supra} notes 186 - 227 and accompanying text.
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false convictions generally exceed those of false acquittals, and that damages-trebling for RPM violations already creates a measure of overdeterrence, the slightly pro-defendant proposed rule would seem to strike the proper balance for minimizing error costs.

In addition, the proposed rule would keep administrative costs in check. Because the rule calls for a focused inquiry and clearly allocates proof burdens, it would be relatively easy for courts to apply. The substantial burden the rule places on plaintiffs would deter frivolous lawsuits. By laying out essential elements of a plaintiff’s prima facie case, the rule creates de facto safe harbors (e.g., no liability on a manufacturer or dealer collusion theory if the defendant lacks market power and RPM is not widespread among manufacturers) and thereby lowers the cost of providing guidance to business planners. The only potential difficulty in terms of administrative costs is that the proposed rule would burden the RPM challenger to produce evidence that may be more accessible to the defendant manufacturer. For example, a plaintiff pursuing a “direct” prima facie case would have to produce data on the defendant’s total output, data that would be more accessible to the defendant. If the plaintiff pursued a “circumstantial” prima facie case, it may (depending on the theory of anticompetitive harm it pursued) have to establish the defendant’s market power; the defendant may be in a better position to produce relevant evidence concerning the contours of the relevant market, its share of that market, entry barriers into the market, etc. In the end, though, the administrative cost-savings from reallocating proof burdens from the challenger to the defendant probably would not outweigh the increased error costs resulting from enhancing the risk of costly false positives by making the plaintiff’s prima facie case easier to establish.

Thus, the proposed evaluative approach would minimize the sum of error and decision costs, thereby maximizing the net social benefits of RPM regulation.

Conclusion

The Leegin Court’s holding that minimum RPM is not per se illegal constituted a major step toward an economically rational and theoretically coherent approach to vertical restraints. The Court realized, though, that the task of crafting a rational evaluative approach for minimum RPM is far from complete. For that reason, it

256 See supra notes 228 - 229 and accompanying text.
257 See supra note 254.
258 See supra note 232 (discussing tradeoff between allocating proof burdens to parties with most accessible information and creating liability test that will minimize error costs).
exhorted the lower courts to “establish the litigation structure to ensure the rule [of reason] operates to eliminate anticompetitive restraints from the market and to provide more guidance to businesses.” It also encouraged them to “devise rules over time for offering proof, or even presumptions where justified, to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints and to promote procompetitive ones.” Courts and commentators are currently working on this task. This article aims to assist them in their efforts.

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

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

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260 *Id.*