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I. INTRODUCTION

Chairman Kohl and Members of the Subcommittee, I appreciate this opportunity to share with you my personal views on minimum vertical price fixing,[1] sometimes also referred to as resale price maintenance, RPM, or margin maintenance.

The Supreme Court's 2007 *Leegin* decision[2] gave manufacturers the right to set minimum resale prices for consumer goods, which typically thwarts discounting and leads to higher prices for consumers. This conduct used to be *per se* illegal under longstanding Supreme Court precedent.[3] The *Leegin* majority in effect legitimized the conduct, even though the Court was given no reasonable assurances that consumers actually benefit from RPM.

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[1] Several other published sources provide a more complete statement of my views on minimum vertical price fixing. *See especially* Pamela J. Harbour, *A Tale of Two Marks, And Other Antitrust Concerns*, 20 LOYOLA CONSUMER L. REV. 32 (2007); Pamela Jones Harbour, Commissioner, Federal Trade Commission, *Open Letter to the Supreme Court of the United States, Subject: The Illegality of Vertical Minimum Price Fixing* (Feb. 26, 2007), *available at* http://www.ftc.gov/speeches/harbour/070226verticalminimumpricefixing.pdf.

This testimony express my personal views. It does not necessarily reflect the position of the Federal Trade Commission or any other individual Commissioner.

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

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

I believe this outcome is contrary to good economic and legal policy. It gives excessively short shrift to consumer preferences, which are supposed to be the driving force behind healthy, competitive markets. Post-*Leegin*, and absent action by Congress, consumer preferences will be subordinated to the interests of manufacturers and merchants of branded consumer goods.

Lawyers working for a U.S. firm in Brussels recently observed that the debate over the proper treatment of RPM "has been hijacked by the concerns of the luxury goods industry."[4] I could not agree more, especially since the negative effects on consumers stretch far beyond luxury goods. In these tough economic times, it is especially wrong to saddle consumers with higher prices for daily necessities, with no countervailing benefits.

II. LESSONS FROM THE PAST: CONSUMER INTERESTS SHOULD BE PARAMOUNT

When we talk about the overarching purpose of the antitrust laws, I think everyone, on all sides of the debate, would agree that the goal is to do what is best for consumers. There is significant disagreement, however, on how to accomplish this objective.

A. Economic Theory

I turn to Adam Smith, the progenitor of modern economic thought, whose teachings provide a firm foundation for my belief that consumer interests should be paramount in the marketplace. Smith himself made two observations that are particularly relevant to the RPM debate.

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[4] Stephen Kinsella & Hanne Melin, *Who's Afraid of the Internet? Time to Put Consumer Interests at the Heart of Competition*, GCP, THE ONLINE MAGAZINE FOR GLOBAL COMPETITION POLICY 2 (Mar. 12, 2009), *available at* http://www.globalcompetitionpolicy.org/index.php?&id=1607&action=907.

First, Smith noted that consumers are best off when they can purchase the goods they desire at the cheapest price. Indeed, he went so far as to observe that this proposition was so self-evident that it would never have been questioned, "had not the interested sophistry of merchants and manufacturers confounded the common sense of mankind."[5] I would argue that the *Leegin* majority opinion reflects just such sophistry.

Smith's second observation is equally at odds with the *Leegin* decision:

> Consumption is the sole end and purpose of all production; and the interests of the producer ought to be attended to, only so far as it may be necessary for promoting that of the consumer. . . . But in the mercantile system, the interest of the consumer is almost constantly sacrificed to that of the producer; and it seems to consider production, and not consumption, as the ultimate end and object of all industry and commerce.[6]

Adam Smith seems to have anticipated some of the arguments that we now refer to generally as "supply-side economics," where the focus is on maximizing the welfare of producers, with an assumption that consumers ultimately will receive downstream benefits.

B. Legislative History of the Antitrust Laws

With that economic background in mind, I next turn to the legislative history of the federal antitrust laws themselves. This history strongly corroborates my belief that the antitrust laws are intended to promote the interests of consumers over those of manufacturers. There is virtually no

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[5] ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 461 (Edward Cannan ed., The Modern Library 1937) (1776).

[6] *Id*. at 625.

credible support for any assertion that Congress intended to prioritize producer welfare over consumer welfare.[7]

With respect to RPM specifically, it is difficult to reconcile the legislative history with the *Leegin* Court's casual disregard for Congressional intent. Congress has *never* adopted or endorsed a preference for RPM at the federal level. Even when faced with intense lobbying pressure by the National Association of Retail Druggists early in the 20th century, Congress did not step in to overturn the Court's 1911 *Dr. Miles* decision.[8]

During the depths of the Great Depression, Congress did create an antitrust exemption for RPM programs governed by state "fair trade" statutes.[9] However, Congress ultimately looked back on the nation's 37-year natural experiment with RPM, graded it a monumental failure, and, in 1975, repealed that exemption to restore a national rule of *per se* illegality under *Dr. Miles*.[10] This decision was based on express factual findings that "fair trade" was fair only to manufacturers and retailers, not to consumers. The Congressional record painted RPM as a dismal, if not disastrous, detour from

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[7] To the extent that the legislative history expresses a desire for "efficiency," legislators were referring to productive efficiency (*i.e.*, how effectively a factory produces widgets), not some sort of "total welfare" approach that weights producer welfare as heavily as consumer welfare. *See* Robert H. Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 HASTINGS L.J. 65, 83 (1982). Even Judge Bork – whose version of "consumer welfare" primarily means producer welfare – cited legislative history that overwhelmingly supports his conclusion that Congress passed the antitrust laws to make consumers better off. *See, e.g.*, ROBERT H. BORK, THE ANTITRUST PARADOX 20-21 (1978).

[8] JOSEPH C. PALAMOUNTAIN, JR., THE POLITICS OF DISTRIBUTION 94 (1968.

[9] Miller-Tydings Resale Price Maintenance Act (Act of Aug. 17, 1937, Pub. L. 314, ch. 690, Title III, 50 Stat. 693); *see also* McGuire-Keogh Fair Trade Enabling Act (Act of July 14, 1952, Pub. L. 543, ch. 745, 66 Stat. 631).

[10] The Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 801.

sound public policy. Specifically, Congress compared economic data from states that had permitted fair trade with data from states that did not. Congress concluded that RPM:

- ➢ caused consumers to pay as much as 37 percent higher prices;
- ➢ reduced levels of sales per outlet;
- ➢ produced significantly higher rates of business failures;
- ➢ provided fewer entry opportunities for new products or manufacturers;
- ➢ distorted retailer incentives to provide consumers with objective comparisons of the competing products on their shelves; and
- ➢ diminished competition both within a brand (intrabrand competition) and between competing brands (interbrand competition).[11]

In short, Congress's negative opinion of RPM in 1975 could not have been clearer.[12]

Beyond its repeal of the fair trade laws, Congress has affirmatively expressed its distaste for RPM on at least four other occasions. Speaking in the dialect of appropriations, Congress has imposed limits on the budgets of the federal antitrust enforcement agencies, prohibiting them from spending any funds to advocate for the reversal of *per se* illegality for RPM. Language in one appropriations bill expressly criticized the Department of Justice's *Vertical Restraint Guidelines*

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[11] *See* H.R. REP. NO. 94-341 (1975); S. REP. NO. 94-466 (1975).

[12] The Consumer Goods Pricing Act of 1975 did not expressly require that RPM be treated as *per se* unlawful – presumably because it was unnecessary, given that RPM already was *per se* unlawful under *Dr. Miles*. Yet, the *Leegin* Court interpreted the lack of an express declaration of *per se* illegality as a deliberate omission, and concluded that Congress did not intend the *per se* rule to apply. This is particularly puzzling, given that the *Leegin* Court liberally cited the Court's *1977 GTE Sylvania* opinion with approval. *GTE Sylvania* expressly held that Congress *did* intend RPM to be *per se* illegal. Continental TV, Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 51 n.18 (". . . Congress recently has expressed its approval of a per se analysis of vertical price restrictions by" the passage of the Consumer Goods Pricing Act.).

because their lenient approach to vertical restraints did not accurately reflect federal antitrust law or good competition policy.[13]

C. Congress's Justifications for Declaring RPM Illegal in 1975 Are Still Valid Today

I have closely reviewed the factual findings upon which Congress relied in repealing the fair trade exemption in 1975, and I still find those findings extremely persuasive today. How, or why, the *Leegin* majority overlooked this critical part of the legislative record is difficult to understand.

In his *Leegin* dissent, Justice Breyer asked whether any changed circumstances might justify reversal of *Dr. Miles*. He did identify a few things that changed between 1975 and 2007. Retailing became more concentrated. Concentration also increased in manufacturing industries that previously used RPM. Discount marketing expanded tremendously. Justice Breyer concluded – correctly, I believe – that none of these changes supported the Court's decision to reverse course on RPM. Why would the Court believe that a new experiment with RPM would succeed today, where the last one failed?

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[13] Departments of Commerce, Justice, and State, the Judiciary, and Related Appropriations Act, 1984, § 510, Pub. L. No. 98-166, 97 stat. 1102-03 (1983); Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriation Act, 1986, § 605, Pub. L. No. 99-180, 99 stat. 1169-71 (1985). The provisions of the latter act expressly cited *Dr. Miles* with approval, and cited the then-just-released Department of Justice Vertical Restraints Guidelines with disfavor. Finding the Guidelines inconsistent with existing law and not in the interests of the business community, the appropriations statute expressly stated that those Guidelines "shall not be accorded any force of law or be treated by the courts of the United States as binding or persuasive," and called for their recall. *Id*. at 99 stat. 1170; Continuing Appropriations for Fiscal Year 1987, § 605, Pub. L. No. 99-500, 100 Stat. 1783–77 (1986); Continuing Appropriations, Fiscal Year 1988, § 605, 101 Stat. 1329-38 (1987).

III. LOOKING AHEAD: CONSUMERS NEED RELIEF FROM *LEEGIN*

Are we falling into a *Groundhog Day*[14] vortex, where we are doomed to endlessly repeat the same mistakes over and over again? Competition policy can, and should, do a better job of protecting consumers.

I was struck recently by a cartoon in the March 22nd edition of the Sunday *Washington Post*; the punch line equated "insanity" with "doing the same thing over and over but expecting different results." I worry what will happen if Congress fails to take prompt action to reverse the *Leegin* decision. Congress may, someday, be called upon to write another report detailing the disastrous harm inflicted on consumers during the Supreme Court's newest experiment with RPM. And who will pay for this experiment, which seems just as likely to fail as the last one? The American consumer.

Indeed, if you believe what you read in the newspapers, American consumers already are paying that price. The Court's new experiment has led many consumers to incur RPM price premiums – even in these trying economic times. Since the Court decided *Leegin*:

- ➢ the number of companies using some version of RPM has significantly increased;
- ➢ the use of third-party monitoring services by manufacturers to identify and discipline Internet discount pricing has rapidly expanded;
- ➢ some discounters have been terminated by as many as a quarter of their suppliers; and

[14] GROUNDHOG DAY (Sony Pictures 1993).

- ➢ other discounters, like PSKS, Inc. (the plaintiff in the *Leegin* case), have gone out of business, and been unable to get the courts to even consider the merits of their claims under the rule of reason.[15]

Consumers do not realize that they are paying substantial RPM premiums. Not surprisingly, the manufacturers who impose these premiums are unlikely to notify customers that discounts are no longer available. Nor are retailers, who support and collect the RPM premiums, particularly interested in telling their customers that prices were "too low" before.

In fairness to the *Leegin* Court, the majority correctly noted that RPM sometimes has a beneficial impact on competition, which may offset the harm to consumers. The ultimate question is, when does this happen? When manufacturers impose RPM, how often (if ever) will the value of the beneficial impact exceed the cost of the RPM premium that consumers pay?

A. Existing Case Law May Rest On Flawed Foundations

The antitrust laws promise consumers the ability to buy goods and services in competitive markets, at competitive prices. Both interbrand and intrabrand competition contribute to fulfilling that promise.[16] Existing case law, however, obfuscates the importance of intrabrand competition, which is the type of competition that RPM virtually eliminates. In a footnote in the Court's 1977 *GTE Sylvania* opinion, Justice Powell stated that interbrand competition is the primary focus of the

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[15] *See* PSKS, Inc. v. Leegin Creative Leather Products, Inc., 2009 WL 938561 (ED TX 2009).

[16] LAWRENCE A. SULLIVAN & WARREN S. GRIMES, THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK 322-23 ("But economists as far back as Alfred Marshall recognized that competition at all levels of the distribution system is beneficial to the efficient allocation of goods and services.").

antitrust laws.[17] This bald proposition was devoid of any citation of authority, and was not supported by any legislative history. Yet, the Court repeatedly has relied on Justice Powell's phrase (and no more) to justify its holdings in subsequent cases.[18]

Rote recitations of other, supposedly unquestionable aphorisms from *GTE Sylvania* have been included in most of the Court's recent RPM cases, even when they did not actually apply to the pending case.[19] Most notably, virtually every opinion, including *Leegin*, invokes free-riding by discounters who do not provide "necessary" additional services. In reality, however, none of these cases seem to have involved free-riding problems.[20] In *Leegin*, for example, the plaintiff (Kay's Kloset) appeared to be an otherwise acceptable distributor in every way, except for the fact that it discounted.[21]

Ideally, and as I will discuss in further detail later in my remarks, additional scholarship would be devoted to establishing whether the underlying principles articulated in *GTE Sylvania* are correct or not. At the very least, the courts should not rely "on unthinking recitations of tired

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[17] *GTE Sylvania*, 433 U.S. at 52 n.19 ("Interbrand competition is . . . the primary concern of antitrust law.").

[18] *See* Warren S. Grimes, *The Path Forward After* Leegin*: Seeking Consensus Reform of the Antitrust Law of Vertical Restraints*, ANTITRUST L.J. 467, 471-80 (2008).

[19] *Id*. at 504 (". . . *Sylvania* aphorisms . . . are widely used but seldom linked to the facts in the case before the court.").

[20] *See* Warren S. Grimes, *The* Sylvania *Free Rider Justification for Downstream-Power Vertical Restraints: Truth or Invitation for Pretext*?, in HOW THE CHICAGO SCHOOL OVERSHOT THE MARK 192 (Robert Pitofsky ed., Oxford Univ. Press 2008) ("The jury found that Business Electronics was terminated not for free riding but because it was discounting Sharp calculators. Nonetheless, Scalia, writing for the Court, repeatedly referred to *Sylvania* free riding theory as a reason for declining to apply the *per se* rule governing vertical minimum price-fixing.").

[21] *Id*. at 480.

language that may have no relevance to competitive analysis"[22] when analyzing RPM. Otherwise, no matter what legal standard is applied to RPM in the post-*Leegin* era, the courts will never get it right. In *GTE Sylvania*, the Court was rebelling against the Warren Court's alleged formalistic line-drawing to support liability. The current Court appears to have drawn similarly formalistic lines to short-circuit the RPM inquiry in the opposite direction and to suggest a presumption of legality. When line-drawing is devoid of substance, and labels replace rigorous analysis, the law suffers – as do consumers.[23]

B. Rule of Reason Treatment Is Insufficient To Protect Consumers

Technically, the *Leegin* Court did not foreclose the possibility that RPM might be anticompetitive under some circumstances.[24] The *Leegin* Court noted that it intended for the lower courts to be diligent in their application of the rule of reason to weed out competitively harmful uses of RPM.[25] But good intentions will not cure a bad rule of law. Throughout antitrust law, the rule

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[22] *Id.*

[23] *See GTE Sylvania*, 433 U.S. at 47 (quoting Appalachian Coals, Inc. v. United States, 288 U.S. 344, 360, 377 (1933) (". . . realities must dominate the judgment . . . [the] Anti-Trust Act aims at substance.").

[24] *Leegin*, 127 S. Ct. at 2716-18.

[25] *Id*. at 2719-21. The Court, however, provided no guidance to the lower courts regarding how the rule of reason might be used to weed out the harmful uses of RPM. Basic concepts – such as the nature of the market power inquiry for RPM analysis – went unaddressed. *See* Jessica L. Taralson, Note, *What Would Sherman Do? Overturning the* Per Se *Illegality of Minimum Vertical Price Restraints Under the Sherman Act in* Leegin Creative Leather Products, Inc. v. PSKS, Inc. *Was Not As Reasonable As It Seemed*, 31 HAMLINE L. REV. 549, 590 (2008) ("In summation, had the *Leegin* Court given sufficient weight to market power, both as an element of analysis and as a concept, the Court would have recognized that the amount of market power necessary to impose a minimum vertical price restraint should justify holding all such restraints . . . illegal.").

of reason tends to be a euphemism for the absence of liability.[26] So too with respect to RPM, the rule of reason is quickly beginning to prove itself to be incapable of sorting out the good and bad uses of RPM, and consumers will be the poorer for it. Threshold presumptions must be established to draw workable contours for rule-of-reason analysis of RPM.[27]

1. Lack of Empirical Research

The lack of empirical research regarding the effects of RPM is a further complication, especially under a rule of reason standard.[28] There are economic theories praising RPM, and other theories condemning it, but none of these theories (on either side) are supported by any systematic body of empirical evidence. At best, we have strongly held beliefs about the effects of RPM, sometimes bordering almost on the religious. But we are missing facts, which are the building blocks of litigation.

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[26] We already see the beginnings of this problem in the *Leegin* case on remand. Based on the conjunctive use of the Court's *Leegin* decision and the strict antitrust pleading standards articulated by the Court in Bell Atlantic Corp. v. Twombly, 127 U.S. 1955 (2007), PSKS's case against Leegin has been dismissed on the pleadings. Neither the merits of the RPM claim, nor the horizontal price fixing claim raised by PSKS on remand, have ever been reached. PSKS, Inc. v. Leegin Creative Leather Products, Inc., Docket No. 2:03 CV 107 (TJW) (E.D. Tex. Apr. 6, 2009), *citing* Spahr v. Leegin Creative Leather Products, Inc., 2008 WL 3914461 (E.D. Tenn. 2008) (dismissing RPM and dual distribution price fixing claims on a motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6)). *See also* Valuepest.Com of Charlotte, Inc. v. Bayer Corp., 2009 WL 756901 (4th Cir.2009) (court declined to reach merits of RPM claim against defendant manufacturers of termite control chemicals).

[27] Grimes, *supra* note 17, at 492.

[28] Both the majority and dissent in *Leegin* recognized the absence of empirical support for any of the theories that claim RPM harms or benefits competition. *Compare Leegin*, 127 S. Ct. at 2717 ("although the empirical evidence on the topic is limited . . . .") (Kennedy, J.) *with id.* at 2729 ("[h]ow often, for example, will the benefits to which the Court points occur in practice? I can find no economic consensus on this point.") (Breyer, J., dissenting).

The realities of litigation dictate that when the facts are equally probative of guilt or innocence (depending on which theory is adopted to evaluate them), the outcome is heavily determined by the allocation of the ultimate burden of proof. If full-blown rule of reason analysis is applied in RPM cases, the burden of proof will be placed on the victims (or, in some cases, government enforcers working on behalf of the victims), not on the defendants who imposed the RPM policies. In other words, the burden will be borne by the consumer who paid more for the price-fixed goods. The burden will be borne by the terminated discounter who refused to go along with the fixed price. And these plaintiffs likely will lose, because they will be unable to present sufficient factual evidence that RPM has, on balance, harmed competition.

2. The Commission's RPM Workshops

President Truman once asked for a "one-armed economist" because he was frustrated by the tendency of economists to hedge their conclusions with "on the one hand...on the other hand" disclaimers.[29] Likewise, the Commission cannot rely on a mythical one-armed economist to provide us with a definitive answer regarding the proper legal treatment of RPM. Therefore, the Commission is doing its best to further the development of real-world facts about the effects of RPM.

The Commission recently initiated a series of workshop sessions to explore the economic and legal realities of RPM. I have annexed a copy of the Federal Register Notice announcing the workshops, as well as a copy of my opening remarks during the first workshop session. As these

[29] *See* TODD G. BUCHHOLZ, NEW IDEAS FROM DEAD ECONOMISTS 34 (2d ed. 2007).

documents explain, the Commission seeks empirical insight into when consumers are more or less likely to be helped, or harmed, by RPM.[30]

I am quite optimistic that our workshop series will make an important contribution to RPM scholarship. Ideally, these workshops will enable the Commission to identify empirical research projects that might be undertaken to prove or disprove the assumptions underlying the various economic theories regarding RPM. But even if the workshops succeed on this front, it will be years, if not a decade or longer, before this research generates any consensus on the proper economic and legal treatment of RPM. Consumers should not have to wait this long to obtain relief from the flawed *Leegin* decision.

IV. CONCLUSION

When it comes to the RPM debate, one simple fact is indisputable: RPM guarantees that consumers will pay higher prices. Until it is proven otherwise, I will continue to believe that consumers are very unlikely to gain any countervailing benefit in return for these elevated prices. The tremendous growth of discount chains, at the expense of higher-end specialty stores, tends to support my view.

Proponents of RPM say that it benefits consumers more than it harms them. If so, let the champions of RPM prove it. More specifically, if a firm makes a business judgment to use RPM, that firm should bear the burden of proving that consumers will not be harmed. The likely victims of the RPM policy should not shoulder the burden of proving anticompetitive effects.

[30] Both documents are available on the RPM workshops page of the Commission's website, http://www.ftc.gov/opp/workshops/rpm.

Given the state of our economy right now – as we wait anxiously for our financial markets to "self-correct" – a general belief in self-correcting markets likely is frayed, at best. I am extremely skeptical, therefore, that markets will self-correct in ways that curb the mistaken uses of RPM in situations that do not benefit consumers. The promise of self-correction ought to be a hard sell to American consumers.

I began my testimony today by quoting lawyers in Brussels. In closing, let me suggest that the Europeans may have better ideas about RPM than the *Leegin* Court. Under EC law, RPM is presumed unlawful, and thus prohibited, unless the RPM proponent can show that the "restriction is indispensable to the attainment of clearly defined pro-competitive efficiencies *and* that consumers demonstrably receive a fair share of the resulting benefits."[31] American consumers are entitled to the same benefit of the doubt.

Thank you. I would be happy to answer your questions.

[31] Kinsella & Melin, *supra* note 4 (emphasis in original).