Testimony of Thomas G. Hungar

Before the

Subcommittee on Courts and Competition Policy
Committee on the Judiciary
United States House of Representatives

Hearings on "Bye Bye Bargain? Retail Price Fixing,
the *Leegin* Decision, and Its Impact on Consumer Prices"

April 28, 2009

Room 2141, Rayburn House Office Building

Testimony of Thomas G. Hungar[*]
before the
Subcommittee on Courts and Competition Policy
Committee on the Judiciary
United States House of Representatives
April 28, 2009
Room 2141, Rayburn House Office Building

Mr. Chairman and Members of the Committee, thank you for the opportunity to appear before you to testify about resale price maintenance (RPM). The views stated in my written and oral testimony are my own, and do not necessarily reflect the views of my law firm.

INTRODUCTION.

As you know, an RPM agreement is a contract between a manufacturer and a distributor that guarantees a minimum profit margin to the distributor by setting a retail price floor. From 1911, when the Supreme Court decided *Dr. Miles Medical Co. v. John D. Park & Sons Co.*,[1] until 2007, when the Supreme Court overruled the *Dr. Miles* decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc*,[2] RPM agreements were subject to a *per se* ban that rendered them automatically illegal under the Sherman Act.

In this written testimony, I will first discuss the numerous procompetitive justifications for RPM arrangements. I will then explain why proposals to re-impose the *Dr. Miles* rule, in whole or in part, through legislation are misguided and premature.

---

[*] Partner, Gibson, Dunn & Crutcher LLP, Washington, D.C.; former Deputy Solicitor General of the United States.

[1] 220 U.S. 373 (1911).

[2] 127 S. Ct. 2705 (2007).

I. THERE ARE EXTENSIVE AND WELL-SUPPORTED PROCOMPETITIVE JUSTIFICATIONS FOR RPM.

In *Leegin*, the Supreme Court recognized that economic literature is "replete with procompetitive justifications for a manufacturer's use of resale price maintenance."[3] The Court named several examples: (1) RPM can encourage competition and differentiation between different brands; (2) RPM can eliminate the "free rider" problem that occurs when customers require significant assistance to shop for a product but can then purchase the product elsewhere; (3) RPM can help allow new brands to break into a market by encouraging retailers to advertise and display them; and (4) even absent free-riding, RPM can be the most effective way of ensuring that retailers provide certain services. As explained below, these and other procompetitive justifications for RPM demonstrate that RPM can serve a variety of legitimate, efficiency-enhancing goals that strengthen inter-brand competition and benefit consumers as well as manufacturers. Accordingly there is no plausible basis for condemning RPM across the board.

At the outset, it is important to understand that RPM is only one of several indisputably legal and procompetitive techniques that manufacturers can use to encourage retailers provide their customers with favorable combinations of prices and services. These techniques include territorial arrangements, franchising arrangements, exclusive dealing arrangements, direct payment to retailers for promotional efforts, unilateral price policies, and vertical integration, as well as RPM. Underlying all of these methods is the fact that manufacturers generally want to keep distribution costs and retail mark-ups low, to pass lower costs on to consumers and thereby increase demand and gain market share. Manufacturers are not in the business of increasing retailer profits, and have no interest in doing so; a manufacturer's interest is instead to incentivize

[3] *Id.* at 2714.

its retailers to market its product in the most effective way, thereby maximizing inter-brand competition and increasing the manufacturer's sales. Accordingly, when we see a manufacturer using vertical agreements to influence its retailers through any of these techniques, the most plausible explanation is that the manufacturer is using the technique to compete with other brands and gain market share, not to enrich its retailers.

A. RPM Can Encourage Competition and Differentiation Between or Among Different Brands.

A manufacturer naturally seeks to make additional sales by better serving consumers' interests. Contrary to the apparent belief of some critics of RPM, however, consumers are not interested solely in low prices. Rather, consumers may also be interested in (and willing to pay for) a variety of other factors such as access to product demonstration and service; convenience of store hours and location; flexible and generous return policies; and knowledgeable, pleasant, well-trained, and efficient sales personnel. In order to satisfy those consumer interests, a manufacturer must either be vertically integrated (so that it owns and controls its own retail outlets) or must rely on independent retailers to help it achieve its goals. But it is well established that the interests of retailers and manufacturers do not always coincide. In many circumstances, of course, manufacturers will benefit most from dealer efforts to increase sales by lowering retail prices, and in those circumstances the adoption of RPM would be economically unwise and detrimental to the manufacturer's interests (and as a result, manufacturers that adopt RPM will not succeed in the marketplace). For other manufacturers, however, sales efforts focused on factors other than price may be more effective at serving the interests of consumers and thereby differentiating the manufacturer's product from those of its competitors. In those circumstances, dealers may have no incentive to expend the additional resources necessary to satisfy those customer desires, because those additional expenditures would reduce their own profits.

RPM addresses this mismatch between manufacturer and dealer incentives by guaranteeing the retailer a certain minimum resale margin over the cost of the good to the dealer. This minimum margin encourages retailers to compete aggressively to sell the RPM manufacturer's product because they are assured additional profit per unit sold on the RPM brand. Thus, RPM encourages retailers to promote the RPM brand as against other brands—a procompetitive goal. Indeed, as Justice O'Connor recognized for a unanimous Supreme Court in *State Oil Co. v. Khan*,[4] "the primary purpose of the antitrust laws is to protect interbrand competition." The Antitrust Section of the American Bar Association has explained the practice of RPM this way: "[r]esale price maintenance, like other vertical restraints, is typically a response to a supplier's problem of inducing distributors to provide adequate levels of distribution for its products."[5] In other words, by limiting intra-brand price competition (*i.e.*, competition among retailers with respect to the same manufacturer's product), the manufacturer may induce its distributors to provide promotional services and sales efforts that meet consumer needs or desires and thereby increase the attractiveness of the product. Or, as Professor Marvel of The Ohio State University

---

[4] 522 U.S. 3, 15 (1997).

[5] Section of Antitrust Law, ABA, Antitrust Law and Economics of Product Distribution 58 (2006); *see* Pauline M. Ippolito & Thomas R. Overstreet, Jr., *Resale Price Maintenance: An Economic Assessment of the Federal Trade Commission's Case Against the Corning Glass Works*, 39 J. L. & Econ. 285, 322-325 (1996) (concluding that RPM challenged by the FTC was most likely employed to increase distribution of the products).

Department of Economics put it in his recent presentation before the FTC, a manufacturer can use RPM to "induce [its] dealers to target dealers of rival products, not each other."[6]

B. RPM Can Prevent Free Riding.

As both the majority and dissenting Justices in *Leegin* recognized, RPM can help solve what is referred to as the retailer free-rider problem. The RPM solution to the free-rider problem is widely accepted by economists. Indeed, in *Leegin*, some 23 prominent economists filed a friend-of-the-Court brief stating: "There is a consensus in the economic literature that minimum RPM can, in certain circumstances, remedy a free-riding problem and thereby increase competition and enhance consumer welfare."[7]

As the Court explained in *Leegin*, "discounting retailers can free ride on retailers who furnish services and then capture some of the increased demand those services generate. Consumers might learn, for example, about the benefits of a manufacturer's product from a retailer that invests in fine showrooms, offers product demonstrations, or hires and trains knowledgeable employees."[8] Opportunistic retailers may seek to free-ride on full-service retailers by refusing to offer the high level of services themselves. Not having invested in the necessary services, the opportunistic retailer can offer discounted prices to consumers, and "the high-service retailer will lose sales to the discounter, forcing it to cut back its services to a lower level than consumers

---

[6] Howard P. Marvel, Remarks at the Fed. Trade Comm'n, The Benefits of Resale Price Maintenance 17 (Feb. 17, 2009), *available at* http://www.ftc.gov/opp/workshops/rpm/docs/hmarvelppt0217.pdf.

[7] Brief of *Amici Curiae* Economists in Support of Petitioner at 5, *Leegin*, 127 S. Ct. 2705 (2007) (No. 06-480) (Economists' Br.).

[8] *Leegin*, 127 S. Ct. at 2715 (citing Richard Posner, Antitrust Law 172–73 (2d ed. 2001)); *see id.* at 2729 (Breyer, J., dissenting).

would otherwise prefer."[9] RPM is one solution to that problem "because it prevents the discounter from undercutting the service provider. With price competition decreased, the manufacturer's retailers compete among themselves over services."[10]

The free-riding justification for RPM was vividly explained by Ping, Inc., a relatively small golf club manufacturer, in its *amicus* brief in *Leegin*.[11] According to Ping, "custom fitting has been a key to [its] competitive success" against larger manufacturers.[12] "Over the years Ping has developed, and improved upon, numerous processes and products that assist a retailer in properly fitting a golfer with Ping equipment tailored to that golfer's individual game, regardless of his or her skill level."[13] Ping invested heavily in its custom fitting business model: "Ping has

---

[9] *Id.* at 2716.

[10] *Id.* Similarly, manufacturers may use RPM to make it attractive for "prestige" retailers to carry the manufacturer's product. Prestige retailers have invested money and effort in developing a reputation for stocking only the highest quality or most fashionable goods, and some consumers find it efficient and beneficial to rely on the purchasing decisions made by such retailers to guide their own purchasing decisions. Such quality certification could be frustrated by free riding, however, if discount retailers seek to free ride on the prestige retailers' reputations and purchasing judgment by stocking and selling the same products at a discount. RPM thus provides an incentive for prestige retailers to carry products when free riding might otherwise make it unprofitable for them to do so. Howard P. Marvel, *The Resale Price Maintenance Controversy: Beyond the Conventional Wisdom*, 63 Antitrust L.J. 59, 65–67 (1994); Howard P. Marvel & Stephen McCafferty, *Resale Price Maintenance and Quality Certification*, 15 Rand J. Econ. 346 (1984); Ronald N. Lafferty, *et al.*, *Impact Evaluations of Federal Trade Commission Vertical Restraints Cases* 34–35 (FTC 1984); Thomas R. Overstreet, Jr., *Resale Price Maintenance: Economic Theories and Empirical Evidence* 56–62 (FTC 1983).

[11] Brief of Ping, Inc. as A*micus Curiae* in Support of Petitioner at 9, *Leegin*, 127 S. Ct. 2705 (2007) (No. 06-480) (Ping Br.).

[12] *Id.* at 6.

[13] *Id.*

trained thousands of retailers, bringing them to its Phoenix, Arizona, factory to attend custom-fitting courses. Ping also devotes enormous time and resources to educating retailers about PING products, new technologies, and its custom fitting manufacturing process and quality controls."[14] These investments have succeeded in satisfying customers: "[a]s a result of these efforts, consumer surveys have repeatedly ranked Ping as the leader in custom fitting."[15]

But free riding threatened to undermine Ping's successful business model. "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."[16] Ping's experience reflected the progressive unraveling of customer service discussed above. "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."[17] The natural consequences followed: "Ping recognized that if such activities were allowed to continue unabated, most, if not all, of Ping's retailers would lose any incentive

---

[14] *Id.*

[15] *Id.*

[16] *Id.* at 7.

[17] *Id.*

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."[18]

Economists agree that RPM can be one of the most effective procompetitive ways a company like Ping can address its free-rider problem. "Minimum RPM agreements can ameliorate the free-rider problem by helping ensure that retailers that do not provide service cannot underprice the retailers that do."[19] And curtailing free-riding through RPM "generally increase[s] overall consumer welfare."[20] When RPM is legal, and assuming there are not other anticompetitive factors, a company like Ping can agree on a minimum price with all of its dealers to ensure (1) that all of them have a high enough profit margin to offer the important services, and (2) that they will not lose sales to "discount" dealers that do not provide the services.[21]

---

[18] *Id.*

[19] Economists' Br., *supra* note 7, at 8.

[20] *Id.* (citing G. Franklin Mathewson & Ralph A. Winter, *The Incentives for Resale Price Maintenance Under Imperfect Competition*, 21 Econ. Inquiry 337, 347 (1983) and Kenneth G. Elzinga & David E. Mills, *The Economics of Resale Price Maintenance*, in Issues in Competition Law and Policy 7–9 (ABA Antitrust Section, Wayne Dale Collins, ed., 2007)).

[21] As discussed below (Part II.B, *infra*), Ping in fact adopted a different solution to this problem prior to *Leegin*, by announcing its suggested retail price, policing all of its retailers to determine whether they sold below that price, and then immediately terminating any offending dealers. Ping Br., *supra* note 11, at 8, 10. That practice was legal even under preexisting law, and would continue to be legal even if RPM were legislatively banned. In Ping's case the practice allowed it to achieve the same results as RPM, albeit in an economically inefficient and costly manner, because Ping's only option for enforcing its preferred pricing was to terminate offending dealers without notice, disrupting carefully-established relationships. Any effort to preserve dealer relationships by seeking to persuade dealers to abide by the manufacturer's retail price could have given rise to potential antitrust liability and treble damages under *Dr. Miles*.

C. RPM Can Facilitate Brand Entry.

Another way in which RPM can benefit consumers and advance procompetitive goals is by helping new brands break into markets. The Supreme Court has repeatedly acknowledged that "new manufacturers and manufacturers entering new markets can use [vertical] restrictions in order to induce competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer."[22] Indeed, even the dissenting Justices in *Leegin* agreed that this was a valid, procompetitive reason for imposing RPM. As Justice Breyer wrote, "a newly-entering producer wishing to build a product name might be able to convince dealers to help it do so—if, but only if, the producer can assure those dealers that they will later recoup their investment."[23] RPM provides an additional guaranteed profit margin for the retailer that already-established brands do not provide (generally because their brand recognition gives them added bargaining power vis-à-vis the retailers). As a result, RPM gives retailers an incentive to invest the necessary resources in providing shelf space for the new brand, learning its features and benefits, and informing customers who desire those features and benefits about the new product rather than an established brand that might not meet their needs as well. One important aspect of this justification recognized by the *Leegin* dissent is that it expressly encourages competition by helping new brands break into the marketplace. It is a method of RPM used by up-and-comers, not by established market giants.

---

[22] *Leegin*, 127 S. Ct. at 2716 (quoting *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 55 (1977) and citing Marvel & MCafferty, *Resale Price Maintenance and Quality Certification*, 15 Rand J. Econ. 346, 349 (1984)).

[23] *Leegin*, 127 S. Ct. at 2728 (Breyer, J., dissenting).

Interestingly, the defendant in *Leegin* itself adopted RPM in part for this very purpose. Leegin offered a relatively small line of women's leather clothing accessories that was competing with established national brands, such as Coach. Leegin adopted RPM in part to associate its brand image with "quality, value, and customer service . . . by giving retailers incentives to provide special attention and service to prospective [Leegin] customers."[24] In that case, RPM allowed increased product diversity and more consumer choice, thereby enhancing inter-brand competition and benefiting consumers.

D. RPM Can Ensure That Retailers Provide Beneficial Services.

Separate and apart from the free-riding justification, RPM may be one of the most effective and economically efficient ways for a manufacturer to ensure that its retailers are providing the full range of point-of-sale services sought by consumers. As the Supreme Court explained in *Leegin*, "[i]t may be difficult and inefficient for a manufacturer to make and enforce a contract with a retailer specifying the different services the retailer must perform."[25] Value-enhancing sales efforts are not limited to factors such as product exhibition and demonstration, on which other retailers can free ride. Consumers often value features of the retail experience that can only be provided by the retailer, not the manufacturer, such as attractive and conveniently located retail stores and speedy and efficient completion of customer transactions (factors that do not lend themselves to free riding by other retailers).[26] A familiar example of such customer-

---

[24] Brief for Petitioner at 3, *Leegin*, 127 S. Ct. 2705 (2007) (No. 06-480) (Pet. Br.).

[25] *Id.* at 2716.

[26] *See* Frank Mathewson & Ralph Winter, *The Law and Economics of Resale Price Maintenance*, 13 Rev. Indus. Org. 55, 67–69, 72–73 (1998); Ralph A. Winter, *Vertical Control and Price Versus Nonprice Competition*, 108 Q.J. Econ. 61 (1993).

driven, distributor-provided service was Coors Brewing Company's commitment to keep its beer cold at all stages from brewing through customer purchase. It was likely extremely difficult for Coors to provide the right set of incentives to its distributors and retailers to ensure they complied with the "always cold" promise. Procompetitive practices like the Coors "always cold" service are among the types of distributor-provided services that some manufacturers might use RPM to encourage and to fund. RPM can provide the necessary incentives for retailers to incur the costs of providing such features in the manner best calculated to attract customers. For example, it might be extremely inefficient or impossible for a manufacturer to inspect each of its retailers' stores to ensure that those stores are attractive, whereas it would be much easier to enforce an RPM contract which, if followed, would both encourage each retailer to keep the store attractive and ensure that each retailer has sufficient profit margin to do so.

E. RPM Can Protect Dealers and Manufacturers from Uncertain Demand.

RPM can also enhance competition and benefit consumers by encouraging retailers to stock the manufacturer's product at desirable levels in the face of uncertain consumer demand that might otherwise cause retailers to purchase and stock lower quantities of the product. By preserving retailer margins during times of low demand, RPM may reduce the likelihood of price increases during periods of increased demand. Moreover, the margin protection afforded by RPM may induce retailers to carry larger inventories, thereby benefiting consumers by assuring the continued availability of the product during times of high demand.[27]

---

[27] *See* Raymond Deneckere et al., *Demand Uncertainty and Price Maintenance: Markdowns as Destructive Competition*, 87 Am. Econ. Rev. 619 (1997); Raymond Deneckere et al., *Demand Uncertainty, Inventories, and Resale Price Maintenance*, 111 Q.J. Econ. 885 (1996).

In the absence of RPM, if a manufacturer misjudges the consumer demand for its product, retailers may find themselves carrying excess inventory and may be tempted to take deep losses just to clear inventory, dumping the product on the market and causing serious harm to other retailers and to the brand image. According to Professor Marvel, in his recent oral remarks to the FTC,[28] that is precisely what happened to Atari's videogame console in the early 1980s. Atari anticipated high holiday demand, and retailers stocked high levels of the console. When demand turned out to be lower than expected, retailers were stuck with large inventories, dumped Atari's products, and took deep losses. Atari rapidly developed a low-quality brand image due to the low prices; and retailers, feeling burned by the losses they were forced to take, became reluctant to carry future Atari products. Atari never recovered. If an RPM policy had prevented retailers from dumping Atari's products following the holiday season, Atari, retailers, and consumers might all have been better off in the long run.

F. RPM Can Give Customers Peace of Mind.

Another procompetitive justification for RPM, not mentioned by the Supreme Court, is customer peace-of-mind. The defendant in *Leegin* explained that, in its view, "the typical retail strategy of putting products on and off 'sale' degrades a manufacturer's brand by causing customers to feel cheated when they buy at the wrong moment."[29] Leegin wanted to give its customers peace-of-mind by providing them with an "everyday fair price."[30] General Motors appealed to the same consumer desires through its advertised "no haggle" car pricing policy for

---

[28] *See* Marvel, *supra* note 6 (oral remarks).

[29] Brief of Petitioner at 3, *Leegin Creative Leather Prods. v. PSKS, Inc.*, No. 06-480 (Jan. 22, 2007).

[30] *Id.*

Saturn automobiles. As Kenneth Elzinga, Professor of Economics of the University of Virginia, put it in his expert report in the *Leegin* case, economic reasoning supports this goal: "by maintaining one price for each product, [the manufacturer] relieves customers of the search costs of learning if a particular retailer's offered price is too high. The policy also alleviates any concern that a markdown is imminent and consumers will be left . . . 'holding the bag.'"[31] Stress reduction is a real benefit manufacturers can confer upon consumers: "[o]ne need only think of the stress some shoppers encounter in certain transactions (e.g., buying an automobile) to understand the value to the consumer of such a guarantee."[32]

Two aspects of this justification for RPM are worth emphasizing. First, it is entirely driven by perceived consumer desires and does not necessarily raise average price even for that product; it may merely reduces price volatility. Second, these brands (Leegin's leather clothing accessories and Saturn automobiles) exist in diverse marketplaces in which many other manufacturers have a different view about what customers want and cater to different customer demands. Thus, Saturn's "no haggle" policy did not lead to across-the-board minimum price agreements through the automobile industry, but it did serve to meet the needs and preferences of a particular segment of automobile customers. Nor did Leegin's RPM policies lead to pervasive RPM in women's clothing accessories. RPM policies designed to reduce price volatility and increase customer peace-of-mind *increase* the range of customer choices because customers can choose a potentially less-expensive brand that will require considerable shopping around to find the best

---

[31] Kenneth G. Elzinga, An Economic Analysis of the Antitrust Issues in *PSKS, Inc. d/b/a/ Kay's Kloset, Kay's Shoes;and Toni Cochran, L.L.C., d/b/a/ Toni's v. Leegin Creative Leather Products, Inc.*, (E.D. Tex. Jan 12, 2004) (No. 2-03-CV-107-TJW), Petition for a Writ of Certiorari at 48a, *Leegin*, 127 S. Ct. 2705 (2007) (No. 06-480).

[32] *Id.*

price, or can instead choose a brand that guarantees that it will available for the same price everywhere. More consumer choices means more competition and more consumer benefit, not less.

II. SUGGESTIONS TO REIMPOSE THE *PER SE* BAN ON RPM IN WHOLE OR IN PART ARE MISGUIDED AND PREMATURE.

A. Critics of the *Leegin* Decision Exaggerate Its Impact.

Contrary to the implications of some of *Leegin*'s critics, the overruling of *Dr. Miles* does not mean that RPM is now automatically legal in all circumstances. Instead, *Leegin* means only that courts will scrutinize RPM arrangements on a case-by-case basis, using the same "rule of reason" that (as the Supreme Court has repeatedly emphasized) applies by default to antitrust lawsuits.[33] There is no dispute about this point: FTC Commissioner Harbour, in her opening remarks at the recent FTC workshops, said that the *Leegin* majority "expressly disclaimed any suggestion that rule of reason analysis [for RPM] should become a *de facto* rule of *per se* legality."[34] Lower courts will not hesitate to ferret out anticompetitive uses of RPM under the rule of reason, because the Supreme Court has instructed them "to be diligent in eliminating . . . anticompetitive uses [of RPM] from the market."[35] If RPM's effects in any specific case are as harmful as RPM's critics contend they are likely to be, enforcement agencies and private plaintiffs will easily prove those anticompetitive effects under the rule of reason.

---

[33] *Leegin*, 127 S. Ct. at 2712 ("The rule of reason is the accepted standard for testing whether a practice restrains trade in violation of § 1" of the Sherman Act.).

[34] Pamela Jones Harbour, Comm'r, Fed. Trade Comm'n, Opening Remarks at the Resale Price Maintenance Workshop 5 (Feb. 17, 2009), *available at* http://www.ftc.gov/speeches/harbour/090217rpmwksp.pdf.

[35] *Leegin*, 127 S. Ct. at 2719; *see* Harbour, *supra* note 34, at 5.

Furthermore, even when RPM is not automatically illegal, most manufacturers will not practice it. History and economic learning show that only some participants in any given industry will engage in RPM.[36] It is extremely unlikely to become pervasive in any industry.

B. Even Under *Dr. Miles*, Manufacturers Could Achieve the Same Economic Results as Those Produced by RPM, Only in More Costly and Less Efficient Ways.

Banning RPM would not prohibit manufacturers from achieving many of the same ends through other, less efficient means. In particular, through unilateral action and vertical integration, manufacturers could enforce minimum retail prices even under the *Dr. Miles* rule. The legality of these methods shows that *Leegin*'s impact will not be nearly as significant as its critics predict (because manufacturers have been using these less efficient and more costly alternatives to RPM for years). It also shows that it makes little sense to reimpose the *Dr. Miles* rule when these other methods will indisputably remain legal.

---

[36] During the era in which state "Fair Trade" laws permitted resale price maintenance, economists estimate that "up to 10 percent of all retail products in the United States were subject to resale price floors." Ralph A. Winter, *Vertical Control and Price Versus Nonprice Competition*, 108 Q.J. Econ. 61, 61 (1993); *see also* Thomas R. Overstreet, Jr., Bureau of Econ., Fed. Trade Comm'n, Resale Price Maintenance: Economic Theories and Empirical Evidence 6–7 (1983) (same). Similarly, in a report issued in 1945, the FTC "estimated that price-maintained goods amounted to only 5 percent of all sales" during the 1930s. Thomas K. McCraw, *Competition and "Fair Trade": History and Theory*, 16 Research in Econ. Hist. 185, 210 (1996). Consumers Union "estimated that the peak year [for RPM under the Fair Trade laws] was 1959, when price-maintained goods accounted for 10 percent of sales." *Id.* at 233 n.44. And it is important to remember that the Fair Trade era was more conducive to RPM than the rule-of-reason regime adopted by the Supreme Court in *Leegin*, because RPM was automatically *legal* under the Fair Trade laws, whereas *Leegin* permits consumers to challenge particular RPM policies in those circumstances where they may have anticompetitive effects.

One method, unilateral action, is commonly called the *Colgate* rule.[37] Under that rule, although a manufacturer cannot *agree with* its retailers to adhere to minimum retail prices, the manufacturer can *unilaterally* terminate any retailer it believes is discounting too deeply. As long as there is no agreement and no communication about its reasons, a manufacturer may cut off discounting retailers without violating *Dr. Miles*—and may thus, over time, reduce the prevalence of discounters. But companies with *Colgate* policies must invest huge amounts of administrative time and legal fees to ensure they do not do anything that could later be interpreted by a court as an "agreement" on minimum prices, and must be prepared to terminate retailers and disrupt carefully built-up retail relationships without explanation or further negotiation.

The Ping *amicus* brief explains the elaborate administrative and legal methods Ping had to use in implementing a *Colgate* polity to ensure that its customers received the correct level of service from its retailers without violating *Dr. Miles*. According to its brief, in order to comply with the *Colgate* rule, Ping "drastically restrict[ed] employees' communications with the retailers to whom they sell and, worse, summarily terminate[d] retailers for even the smallest policy violations, without considering whether the violation was intentional or why it occurred. Ping employ[ed] as many as 12 full-time people who work[ed] on the [*Colgate*-compliant] Pricing Policy and related matters and has spent millions of dollars on the administration of the Policy since 2004."[38]

Another method of legally setting minimum retail prices is vertical integration: manufacturers can expand into distributing their own products; or large distributors can purchase small-

---

[37] *See United States v. Colgate & Co.*, 250 U.S. 300 (1919).

[38] Ping Br., *supra* note 11, at 10.

label manufacturers, turning them into private label products. Vertically-integrated manufacturers directly set retail prices for their products because they themselves are the retailer.

Vertical integration is pervasive in many markets, possibly because the *Dr. Miles* rule encouraged it for so long. For example, one cannot buy CharterClub women's clothing from anyone but Macy's. Nor can one buy Abercrombie & Fitch clothes anywhere but from an Abercrombie & Fitch retail store. But vertical integration can add inefficiency to the market (and thereby increase prices) by forcing companies to work outside their expertise: clothes-making requires a different set of skills than real estate management and sales staffing of retail outlets, for example. The *Dr. Miles* rule encouraged manufacturers that wanted to achieve the procompetitive goals of RPM to integrate vertically into retail sales, even when vertical integration was not the most economically efficient means of achieving those goals.

A regime favoring vertical integration also disproportionately benefits larger manufacturers. It is only large, well-established manufacturers that will have the necessary capital and resources to invest in an internal distribution and retail network. Smaller companies, like Leegin itself, have almost no chance of using vertical integration to ensure that their customers receive the appropriate level of care and service.

With so many other options available to manufacturers to meet the same goals and achieve similar results (through *Colgate* policies and vertical integration, as well as exclusive dealing, direct payments, territorial division, and the like), the fact that some manufacturers nevertheless desire to use RPM creates a strong inference that RPM is the most efficient means of achieving those goals in some circumstances. Why would a manufacturer choose to use RPM if it could achieve the same desired retailer behavior through direct payments, for example? It would not. If a manufacturer (such as Leegin) seeks to adopt RPM despite the availability of the

other methods, the logical inference is that RPM is likely to be the most efficient method for that manufacturer's product to compete aggressively against other brands in the same market. Gains in distribution efficiencies achieved through adoption of RPM policies, like other efficiency gains, are likely to be passed on to consumers.[39]

Both *Colgate* policies and vertical integration allow manufacturers legally to approximate the pro-competitive effects of RPM agreements, but at a cost of reduced efficiency that hurts manufacturers and consumers alike. There is no reason to reimpose the *Dr. Miles* rule when manufacturers can evade it by adopting other means to achieve the same ends, nor is there any reason to encourage inefficient and wasteful *Colgate* policies and inefficient vertical integration when the same goals can be achieved more efficiently through RPM. The market itself will generally ensure that manufacturers do not adopt or maintain RPM policies that do not enhance inter-brand competition, because a manufacturer's customers can simply "vote with their feet" by switching to another brand if they do not value the non-price benefits that the manufacturer sought to foster through use of RPM.

---

[39] The nature of RPM agreements does not prevent the pass-through of efficiency gains. RPM seeks to provide a guaranteed *margin* to retailers by setting a minimum markup over wholesale. If wholesale prices fall because of efficiency gains, the retail price can also fall while the margin remains the same. As a simple example, a manufacturer in a *Colgate* regime might sell its product at a wholesale price of $100 per unit and expect retailers to sell at a retail price of $300 (a $200 markup). If the manufacturer drops the inefficient *Colgate* system and adopts RPM, it could use the efficiency gains and overhead reduction to reduce its wholesale price to $90 while maintaining the same markup margin (to ensure the requisite customer services), resulting in a new consumer price of $290. The $10 per unit RPM efficiency gains would have been passed directly to the consumer.

C. Legislatively Banning or Restricting RPM Would Be Bad Antitrust Policy and Would Harm Consumers.

1. *The current judicially-crafted rule of reason procedure is the best method to detect and prevent anticompetitive uses of RPM.*

An overwhelming majority of economists who have studied the uses and effects of RPM agree that RPM can—and often does—have procompetitive justifications that enhance inter-brand competition and benefit consumers. The fact that RPM can have procompetitive uses and can benefit consumers is not open to serious debate in the economic community, as demonstrated by the *amicus* brief signed by 23 leading economists, including 8 economists who formerly held the top economic positions at the FTC or Department of Justice during both Democratic and Republican administrations.[40] Outlawing all uses of a practice that can benefit consumers in many circumstances just because it might harm competition in others is fundamentally inconsistent with the antitrust laws. The thorough "rule of reason" antitrust analysis is the proper method to distinguish "good" RPM from "bad" RPM. "Bad" RPM should be dealt with through detection and enforcement—by the FTC, DOJ, and private litigants—not through a blanket legislative prohibition that would simultaneously cut off "good" RPM as well.

It is possible that as an alternative to outright prohibitions on RPM, some advocates may urge the enactment of a special framework that would mandate greater scrutiny for RPM agreements than that given to other vertical agreements in antitrust suits. But that would be unwise. The genius of the Sherman Act is the flexibility it gives the courts to tailor legal rules to the cir-

---

[40] *See* Economists' Br., *supra* note 7, at 5 ("There is a consensus in the economics literature that minimum RPM can, in certain circumstances, remedy a freeriding problem and thereby increase competition and enhance consumer welfare. There is some dispute in the literature about how commonly and under what circumstances RPM has such effects, but the literature does not suggest that this is a rare or aberrational effect of RPM.").

cumstances of each case, and to reflect changing economic realities and growing economic understanding. Senator Sherman himself expected the courts to "determine in each particular case" the "precise line between lawful and unlawful combinations."[41] Federal courts have decades of experience applying, interpreting, and developing the nation's antitrust laws. As they gain experience with economic arrangements, courts have developed sensible presumptions and burden-shifting procedures tailored to specific situations. For example, in the 1984 *NCAA* decision, the Supreme Court created an exception to the usual doctrine that horizontal output-reducing agreements were *per se* illegal.[42] The Court recognized that some industries, such as sports leagues, require such horizontal agreements to function at all. The Court did not need a statute to create a specific, custom-tailored antitrust review process. Similarly, the D.C. Circuit recognized that a truncated antitrust analysis was appropriate in the *Polygram* case.[43] No legislation was needed to allow the court to condemn the anticompetitive music marketing agreements in that case without a full-blown rule of reason analysis.

These examples support three conclusions about judicially-created antitrust procedures. First, courts are quite capable of creating appropriate procedures and presumptions and already have sufficient flexibility to "get it right." Second, the fact that RPM was *per se* illegal until very recently means that courts have not had time to develop expertise and refine antitrust analy-

---

[41] 21 Cong. Rec. S2460 (daily ed. Mar. 21, 1890) (statement of Sen. Sherman).

[42] *NCAA v. Bd. of Regents*, 468 U.S. 85 (1984).

[43] *Polygram Holding, Inc. v. FTC*, 416 F.3d 29 (D.C. Cir. 2005).

sis in the RPM field—a point made by Commissioner Harbour herself.[44] In the coming years, without legislative involvement imposing rigid procedures on the basis of little or no information, courts may very well develop their own abbreviated analytical methods for certain types of RPM agreements (similar to the *Polygram* analysis) as they develop experience with the real-world effects of RPM. It will take time and careful case-by-case analysis to develop that experience, and courts are on the front lines of gaining that experience as they decide actual cases based on real examples with (or without) real competitive effects.

Third, it is universally accepted that horizontal agreements are far more likely to harm competition than are vertical arrangements. It would be incongruous and inappropriate for Congress to mandate detailed antitrust procedures for a specific *vertical* arrangement while leaving *horizontal* antitrust procedures entirely to the courts. The fact that Congress already trusts courts to police the most dangerous forms of anticompetitive behavior—horizontal agreements—should be a sign that courts can also be trusted to deal with less risky vertical agreements as well. And at the very least, the courts should be given an opportunity to consider these issues before any serious consideration is given to congressional action. To legislate a "solution" now, in the absence of any meaningful real-world data or experience that would provide a basis for informed congressional action, would be a grave mistake. Congress should allow the courts and the enforcement agencies to do their jobs, and develop experience with real RPM agreements in real markets.

---

[44] Harbour, *supra* note 34, at 1.

2. *Banning RPM would harm consumers and competition.*

Banning RPM (in whole or in part) would not be a neutral act. There would undoubtedly be harmful consequences from such action, because it would interfere with manufacturers' desires to reduce free riding, to break into new markets, to protect dealers from uncertain demand, and to accomplish any of the other procompetitive goals of RPM. Even if there is some "bad" RPM mixed with the "good," overdeterring RPM across the board will harm consumers and competition.

A vivid example of overdeterrence, described by Professor Marvel in the recent FTC workshop, is that of Salton Corporation and the Foreman Grill. As Professor Marvel wrote, "Salton did not invent the contact grill, but it promoted and popularized its model as the George Foreman grill and dominated the market."[45] Resale price maintenance was apparently part of Salton's marketing and distribution strategy, and eventually New York and 48 other states sued Salton for its RPM arrangements that were *per se* illegal under the *Dr. Miles* rule. As a result of the suit, Salton agreed to end its RPM arrangements. Consequently, retailers dumped their inventory of Foreman Grills on the market, and consumer demand plummeted as consumers apparently began to view Foreman Grills as inferior products. Customers turned to more expensive and apparently more prestigious brands of grills, such as those offered by Cuisinart. The inferior reputation, based on market dumping, soon bankrupted Salton. Higher-priced contact grills still dominate the market, but there is now one fewer brand to compete with. In this case, the elimination of the RPM agreements reduced brand selection and reduced competition. As Professor Marvel pointed out, in hindsight, Salton's RPM agreements were procompetitive; but New York

---

[45] Marvel, *supra*, note 5, at 37.

and the other States discovered that fact only as a result of Salton's death and autopsy. There is no question that banning RPM would create more examples, like Salton's, of consumer harm.

3. *Price is not the only factor important to consumers.*

Commissioner Harbour has argued that practices that can result in higher consumer prices should be viewed with particular suspicion.[46] But RPM will not always lead to increased consumer prices. As already discussed, RPM can be a more efficient method of ensuring customer service than other legal vertical techniques, and manufacturers using RPM are likely to pass those efficiency gains on to consumers in the form of lower prices.[47]

Furthermore, price is not the only factor that is important to consumers. Some customers desire high levels of service, such as expert and knowledgeable sales staff, well-organized products, quality sales facilities, wide selection, or good post-sale service.[48] Retailers compete for consumers on all of these grounds, not on price alone. RPM arrangements can help cater to these customers who focus on factors other than price, and offer them choices they might not otherwise have. RPM is not inherently suspicious just because it can lead to some brands having higher prices. The market becomes more competitive, not less, when brands are able to compete on dimensions other than price in order to meet consumer desires. Thus, any legislative effort to ban RPM merely because it can lead to higher prices (and ensure enhanced levels of service) would not reflect a true concern for the benefit of consumers, but rather a paternalistic view that

---

[46] Harbour, *supra* note 34, at 9.

[47] *See supra* note 39.

[48] *See* Ralph A. Winter, Remarks at the Fed. Trade Comm'n, Resale Price Maintenance With and Without Free-riding 4 (Feb. 17, 2009), *available at* http://www.ftc.gov/opp/workshops/rpm/docs/rwinter0217.pdf.

consumers cannot be trusted to make their own choices regarding the proper trade-off between price and service.

Moreover, suppliers engage in many other activities that may raise prices to consumers but that no one would consider banning in our open economic society. Product advertising is a means of promoting products that can lead to increased prices. We are not inherently suspicious of advertising, nor would we think of prohibiting it with our antitrust laws, merely because it can increase a manufacturer's overhead and lead to higher consumer prices. Likewise, we would not consider *per se* bans on direct payments by suppliers to retailers for shelf space and enhanced displays, despite the fact that such costs are likely to be passed on to consumers. Nor would we think of banning manufacturer contracts that require retailers to provide minimum levels of service, despite the fact that the costs of administering those contracts will likely be passed on to consumers. Why should we be suspicious of RPM when it is merely another means—one that may or may not affect price—of accomplishing the same goals as these other practices that do not arouse suspicion?

Similarly, many non-price vertical restraints can lead to increased prices in some circumstances. As the Supreme Court has acknowledged, "all vertical restraints, including the exclusive territory agreement[s] [we have] held not to be per se illegal . . ., have the potential to allow dealers to increase 'prices' and can be characterized as intended to achieve just that."[49] Indeed, "vertical nonprice restraints only accomplish the benefits identified" for them "because they reduce intrabrand price competition to the point where the dealer's profit margin permits provision

---

[49] *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 728 (1988).

of the desired services."[50] RPM simply accomplishes directly what non-price vertical restraints accomplish indirectly.[51] Given the potential for non-price vertical restraints—which are judged under the rule of reason—to lead to increased prices in some circumstances, it makes no sense to subject RPM to a *per se* ban merely because it can have the same effects.

Some opponents of RPM attack it because they believe it squelches development of new retailing methods. They argue, for example, that "warehouse" discount retailers or online discounters have been a positive development and that RPM policies would hamper other such developments. But this argument rests on the false assumption that when RPM is legal it will be omnipresent. The fact that RPM arrangements will be evaluated under the rule of reason, like other vertical restraints, does not mean that RPM will be adopted by most or even many manufacturers. We know this from our experience with *Colgate* policies and vertical integration, which are substitutes for RPM. Some manufacturers have *Colgate* policies—but most do not.

---

[50] *Ibid.*; *see*, *e.g.*, *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 54–55 (1977) ("Vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products. . . . Economists have identified a number of ways in which manufacturers can use such restrictions to compete more effectively against other manufacturers. For example, new manufacturers and manufacturers entering new markets can use the restrictions in order to induce competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer. Established manufacturers can use them to induce retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their products. Service and repair are vital for many products, such as automobiles and major household appliances. The availability and quality of such services affect a manufacturer's goodwill and the competitiveness of his product.") (citation and footnote omitted).

[51] *See Monsanto Corp. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 762 (1984) ("the economic effect of all of the conduct described above—unilateral and concerted vertical price-setting, agreements on price and nonprice restrictions—is in many, but not all, cases similar or identical"); Frank H. Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 Antitrust L.J. 135, 156 (1984).

Some manufacturers are vertically integrated—but most are not. It is in our current *Colgate*/vertical integration world that warehouse stores and online retailing have flourished. The fact that consumers cannot buy Tiffany silverware below the price set by Tiffany (because it is vertically integrated) does not prohibit other silver manufacturers from making competing brands of silverware available at Sam's Club. The fact that Ping uses a *Colgate* policy does not mean that other brands of discount golf clubs are not available on eBay. Innovative retail methods can flourish even when some brands set minimum prices, whether by *Colgate* policies, vertical integration, or RPM.

CONCLUSION.

With so many procompetitive justifications for RPM, there is simply no plausible justification for banning the practice, in whole or in part. We continue to operate under a regime in which truly anticompetitive conduct can be detected, enjoined, and sanctioned (by means of punitive treble damages) under the existing antitrust laws. As the Supreme Court has repeatedly stated, practices should not be automatically condemned unless *experience* has shown us that those practices always or almost always harm competition.[52] There is simply no such body of experience for RPM. To the contrary, there are several examples of RPM or RPM-like agreements that have enhanced competition. Neither the courts nor Congress have the experience necessary to "predict with confidence" that RPM agreements will be invalidated under the rule of reason.[53] I therefore urge Congress to allow manufacturers to innovate and create ways of meet-

---

[52] *See Leegin*, 127 S. Ct. at 2713.

[53] *Id.*

ing customers' desires, and to allow courts to develop experience in the field by deciding actual cases under the rule of reason.

Mr. Chairman and Members of the Committee, thank you for the opportunity to address this issue.

THOMAS G. HUNGAR

Thomas G. Hungar is an appellate litigation partner in the Washington, D.C., office of Gibson, Dunn & Crutcher LLP and Co-Chair of the firm's Appellate and Constitutional Law Practice Group. He has presented oral argument before the Supreme Court of the United States in 24 cases, including *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, and he has also appeared before numerous lower federal and state appellate courts.

Mr. Hungar served as U.S. Deputy Solicitor General from 2003 until 2008. In that position, he had responsibility for the federal government's Supreme Court litigation in the antitrust area, as well as intellectual property, securities, environmental, tax, government contracts, communications, and international trade matters. He oversaw more than 50 of the business-related cases considered by the Supreme Court during that time.

Mr. Hungar is a Master in the Edward Coke Appellate American Inn of Court. While at the Department of Justice, he served as Appellate Counsel to the Intellectual Property Task Force Executive Staff, and he was awarded the John Marshall Award for Outstanding Legal Achievement. He previously served as an Assistant to the Solicitor General from 1992-1994, and as a law clerk to Justice Anthony M. Kennedy and Ninth Circuit Judge Alex Kozinski. He received his J.D. from Yale Law School, where he served as a Senior Editor of the Yale Law & Policy Review, and received his B.S. magna cum laude in Mathematics/Computer Science and Economics from Willamette University.