Intellectual Property Rights, And Competition Law

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Lecture - 23

Vertical Restraints - Change in Jurisprudence

Dear students we are discussing Dr. Miles. Dr. Miles has served for a long period of time as the jurisprudence of the per se rule from 1911 to 2007. Now the jurisprudence has changed, the entire jurisprudence has changed, in the vertical restrains, in this particular case which we are going to discuss.

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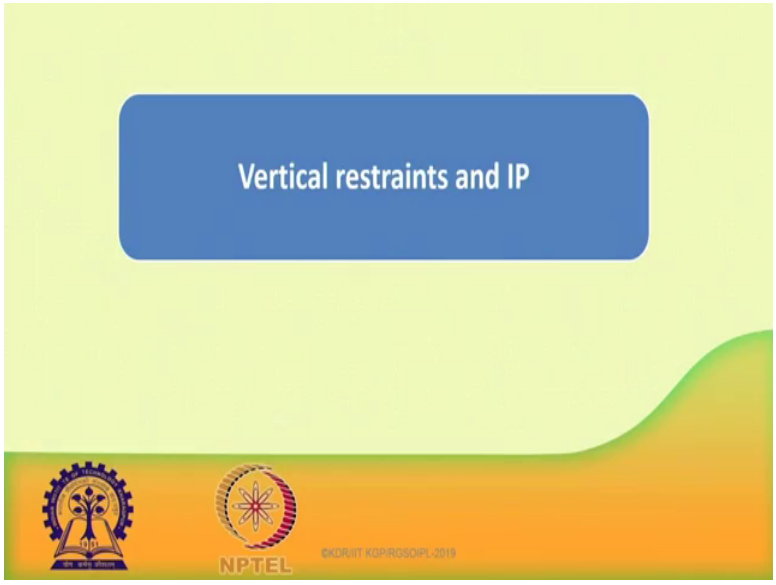

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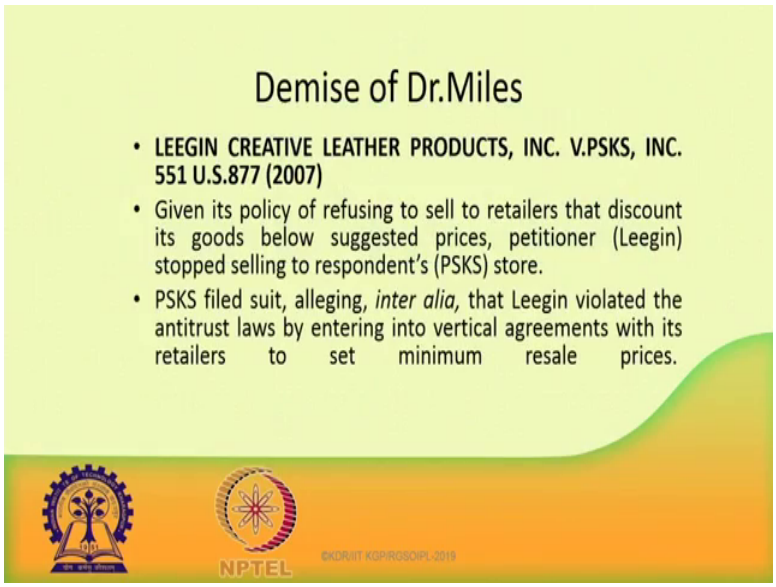

So, we are going to discuss vertical restraints in the *Leegin creative leather products*. In this particular case, the court has reconsidered Dr. Miles case. The result was exactly opposite to the decision in Dr. Miles. Here again the practice was of refusing retailers discounts below suggested prices. The petitioner was Leegin creative leather products and the defendant was PSKS, one store who sold some of the products of Leegin below the prices fixed by Leegin.

Whether this violates contract, whether this violates any intellectual property law, whether this violates any competition law, these are the questions considered and what is the rule to be applicable in this particular case. Here, PSKS filed a suit alleging that Leegin has violated antitrust laws by entering into vertical agreements with its wholesalers, retailers to set minimum resale prices. So, the same scenario arose in Dr. Miles, the entire pricing was done by the manufacturer, entire pricing was controlled by the manufacturer and they entered into agreements with the wholesalers and retailers and also the ultimate price to the consumers was fixed.

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Here Leegin are the manufacturers of women accessories and they entered into vertical agreements with their wholesalers and retailers and these agreements required retailers to charge not less than minimum prices fixed by Leegin. According to Leegin these minimum prices are necessary; necessary to encourage competition among the retailers and to give best customer service and for the product promotion of Leegin creative leather products. These are the arguments of Leegin to fix resale price maintenance.

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Here again the question comes whether the doctrine applied in Dr. Miles was outdated or is based on outdated economics. So, the court reconsidered the decision of Dr. Miles which applied per se rule. They contended that it is better to analysis the rule of reason so as to look into the objectives. Whether the practice adopted by Leegin is anti-competitive or pro-competitive?

So, if it is pro-competitive, then definitely the antitrust rules cannot be applicable. But if it is anti-competitive then definitely the rules will be applicable. That means, there is a leeway in rule of reason for the manufacturers to prove that they are pro-competitive.

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When Leegin product was sold below the minimum prices fixed by Leegin they terminated the agreement with the retailer i.e. the PSKS. So, PSKS sued alleging the violation of antitrust law, Section 1 of the Sherman act that these are anti-competitive practices. By applying Dr. Miles it is per se anti-competitive.

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The district court has given judgment in favour of PSKS and they said that it is per se illegal under Dr. Miles, as well as under Section 1 of the Sherman act. So, if the

manufacturer fixes prices with the wholesale distributor, retail distributors and jobbers, all these are considered to be illegal; per se illegal when you apply the doctrine of Dr. Miles.

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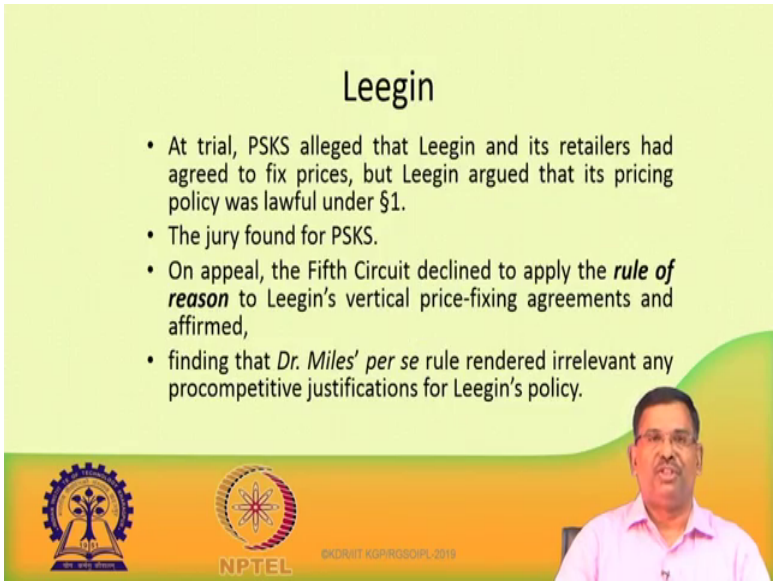

So, the district court gave the judgment in favour of PSKS and in the trial PSKS argued that the pricing policy of Leegin was absolutely violating Section 1 of the Sherman Act and the jury found the case in favour of PSKS, because if you apply Dr. Miles then definitely it is per se illegal. Price fixing is absolutely pernicious to the market and considered to be anti-competitive in nature.

On appeal in the fifth circuit, the court declined to apply the rule of reason because Dr. Miles is considered as the best doctrine for a long period of time, for many years. So, price fixing is considered to be against the Sherman Act and applying Dr. Miles principle they rendered the judgment. So, all the justifications given by Leegin for the rule of reason were refused and it was held in favour of PSKS.

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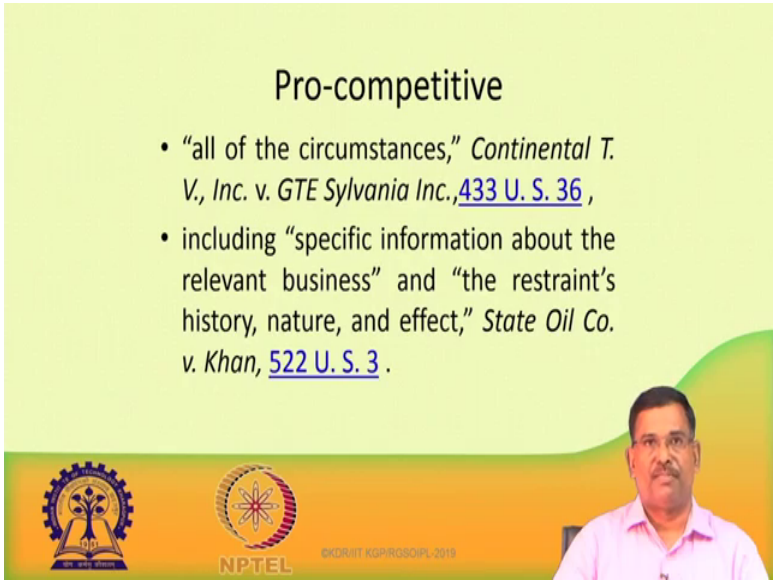

The pro-competitive argument was not at all taken into consideration by the court at that point of time, even at the circuit court. So, the main argument of Leegin was that you have to consider all the circumstances and you cannot simply hold that this is per se illegal, whether the price fixing is pro-competitive or anti-competitive was the argument put forward by Leegin.

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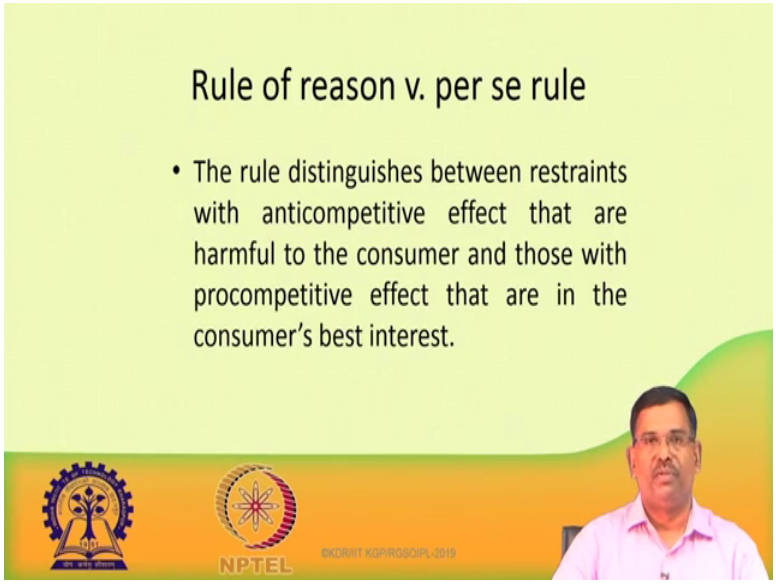

District court as well as the circuit court rejected, refused to apply the rule of reason. So, there is a standoff between the per se rule and rule of reason. District court refused to apply the rule of reason and circuit court also refused to apply the rule of reason, which was raised by Leegin and they stuck on to the per se rule from the Dr. Miles.

Here the role of the court is to very closely look into the competition law. Whatever the methodologies adopted by the manufacturer or distributor or the retailer if there are pro-competitive effect in the market or if it is for the best interest of the consumers then the competition authorities has to hold it valid, no violation of Sherman Act.

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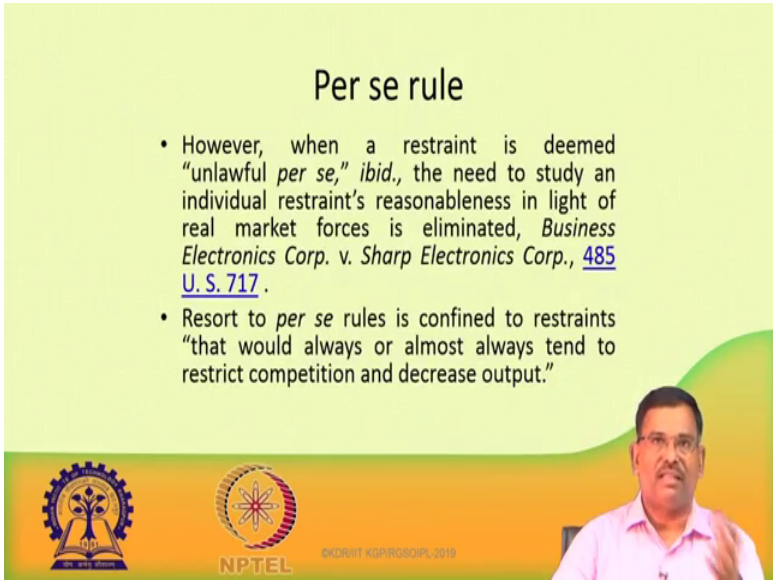

They discussed whether it is unlawful per se. The reasonableness of these individual restraints or reasonableness of this particular business practice. So, I think that the per se rule was very strongly applied by the courts for a long period of time. Outlawing this particular principle is not so easy at any point of time. It is per se illegal and these kind of restraints almost restrict competition and decrease output in the market and no welfare to the consumers.

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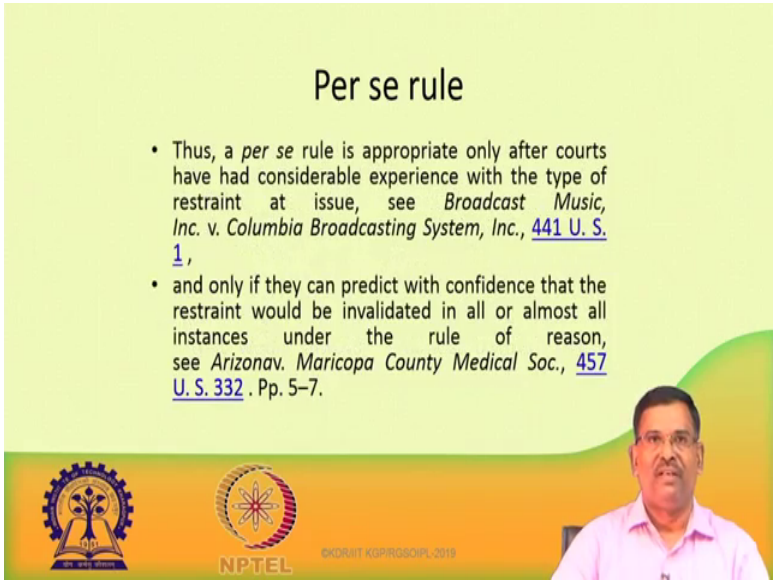

Anybody would think that the per se rule is very strong and in favour of the consumers. But, the question is if I arranged business at the manufacture level, at the wholesale level and retail level and if the product is reaching to the consumer at a fair minimum price and not only to keep discipline but looking into the business policy they are keeping it which will have pro-competitive effects. Any policy, any business policy or any business method either has a pro-competitive effect or it has an anti-competitive effect.

If anybody can prove that it has an anti-competitive effect then, the competition law will come into play and no intellectual property protection can be a justification to violate the competition law.

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So, Leegin has raised the pro-competitive effect justification very strongly. Even if there is a vertical price restraint, it has a pro-competitive effect in the market that means, the minimum resale price maintenance can stimulate interbrand competition, among the manufactures selling different brands of the same type of product. So, if Interbrand competition is there the price will be lowered in the market.

So, among the retailers if there is a strong interbrand competition the retailers can sell it for a lower price which is going to be beneficial to the consumers. So, even if you apply the same circumstances, in certain cases you have to look into the market. What are the prices at which the manufactures are selling it to the wholesaler, selling it to the retailer and then ultimately whether the consumers are getting the particular products, especially medicines at a lower price?

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So, Leegin very strongly argued about interbrand competition. So, interbrand price competition reduces the prices and increases the service. Low prices are always beneficial to the customers. But if there are high prices the brand fails and if there is an interbrand competition it leads to low pricing then, definitely the brand value increases, the service increases and the consumers are benefited by the lower prices.

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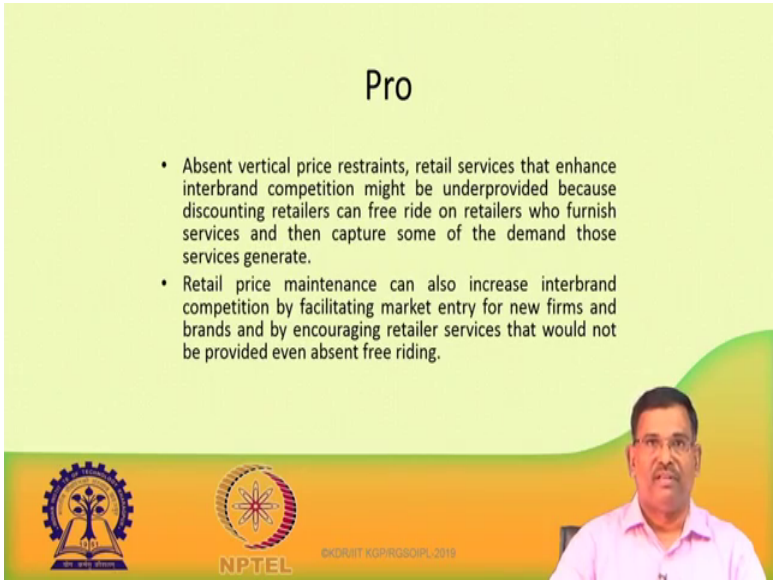

As I told you see in order to overturn a judgment which is there for almost a century, for a long period of time you have to very thoroughly analyse the market and the justifications. There is no doubt that vertical restraints are per se illegal; no doubt, but you have to actually probe into the vertical restraints, the price maintenance, the minimum price maintenance, the minimum sale price. So, if the inter-brand competition argument succeeds, then the argument of pro-competitiveness succeeds.

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The free riding in the market will be completely avoided by inter-brand competition. These two very strong arguments are on one side of the per se rule and the second side is the rule of reason and they strongly clash with each other. The court has to very seriously and very cautiously look into the pro-competitive effect and anti-competitive effect and its consequences on the price restraints.

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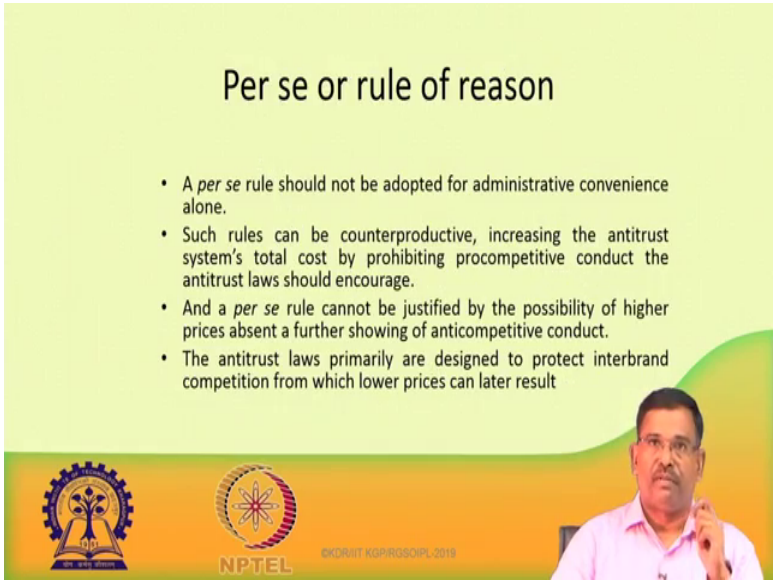

Finally, we can see that the court adopted the rule of reason in this particular case and rejected the per se rule. So, Dr. Miles was overruled in Leegin case. The per se rule is the rule and rule of reason is an exception. It is the duty of the defendants to prove, the duty of the claimant to prove that it is pro-competitive in nature. It is per se anti-competitive, but if you can prove the pro-competitive nature then it is not going to be the violation of the Sherman Act. This was the judgment in Leegin.

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Finally, Dr. Miles was overruled. So, the vertical restraints has to be looked from applying the rule of reason and if you can prove that these vertical restraints are pro-competitive in nature and the competition law is not going to be applicable and it is not going to be violation of the Sherman Act. Definitely the rule of reason is an exception. And the pro-competitive effects have to be proved beyond doubt.

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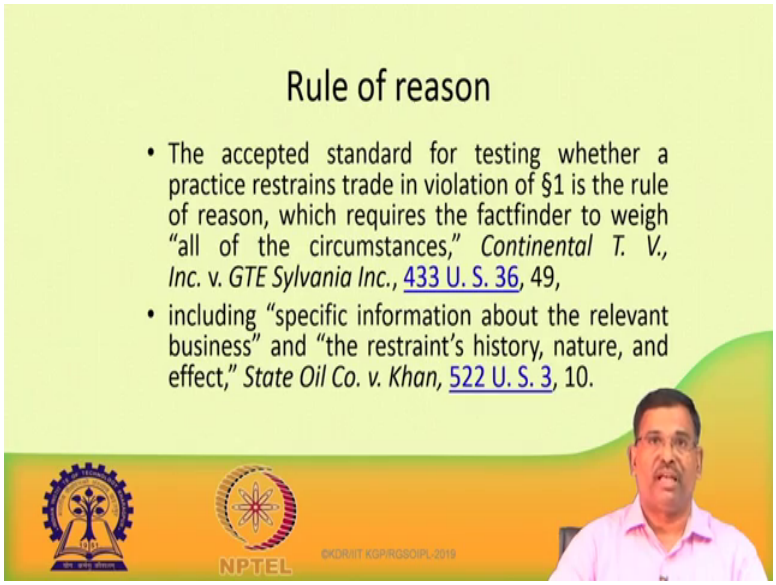

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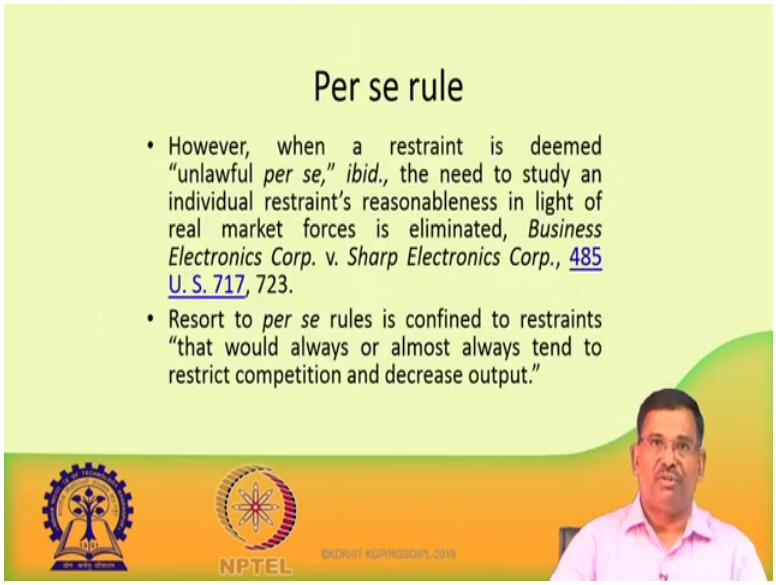

It should be for the best interest of the consumers and all other reasons are rejected. So, if it is a restraint of trade, if it is proved to be a restraint of trade then definitely it is a violation of the Sherman Act. So, the pro-competitive effects should be proved beyond doubt and the consumer welfare should be proved. Resale price maintenance at the vertical level if it is pro-competitive and if it promotes interbrand competition it is not violation of the Sherman Act.

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This was the judgment in Leegin. Definitely this is a shift from the earlier position of per se rule. So, these two cases i.e. Dr. Miles and Leegin are very important for the intellectual property versus competition law, because in the beginning of 1911, the court ruled in favour of per se rule, but in 2007, after long period of time, the court has analysed the pro-competitive effect. They changed their mind and said that it is not always per se rule that will be applicable. So, Section 1 of the Sherman Act need not always be applied.

Appling the rule of reason to find out whether there is any pro-competitive effect on the market as well as whether the consumers are benefitted. If the consumer is benefitted, then definitely the rule of reason will be applicable. Dr. Miles from 1911 was overruled in this particular case.

As I already told in the last class that, in 2017 the department of justice and FTC came out with new guidelines overruling 1995 guidelines. It adopted Leegin principles and included the rule of reason and now the US agencies are not going to presume the per se illegality.

So, this is historical, historical in the sense that the mindset of the manufacturers changed, the mindset of the cartels, the entire combination of cartels changed because if you look from the very beginning, the objective of the Sherman Act, the objective of the Sherman Act was to completely demolish the trust which formed cartels. They were

doing bid rigging, completely controlling the market, resales, bundling, tying. So, the Sherman Act as well as the Clayton Act was successful in controlling these.

With the new realities, the new business realities and new business methods, opening up of markets, opening up of international trade and the enforcement of the intellectual property law through *TRIPS* agreement implemented among 164 WTO member countries. So, if a judgment is taken wrongly then the other WTO members are going to take you to the WTO dispute settlement system for the violation of WTO agreements, restraint of trade.

So, you have to very cautiously apply the competition law. Intellectual property protection is has prime importance in the present day, innovation area. If intellectual property is not protected, it is very difficult, there is no incentive for innovation. So, intellectual property should be protected, but the protection, the limit of intellectual property rights should be within the parameters of the competition law.

So, the rich US jurisprudence clearly proves that consumer welfare is supreme. So, even ruling from Dr. Miles to Leegins, the objective was very clear: consumer welfare, welfare of the market, welfare of the pro-competition in the market, pro-competitiveness should be promoted. So, the objective of competition law is to promote competitiveness in the market, competition in the market, not the competitors.

Thank you.