

Intellectual Property Rights, And Competition Law

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Lecture - 23

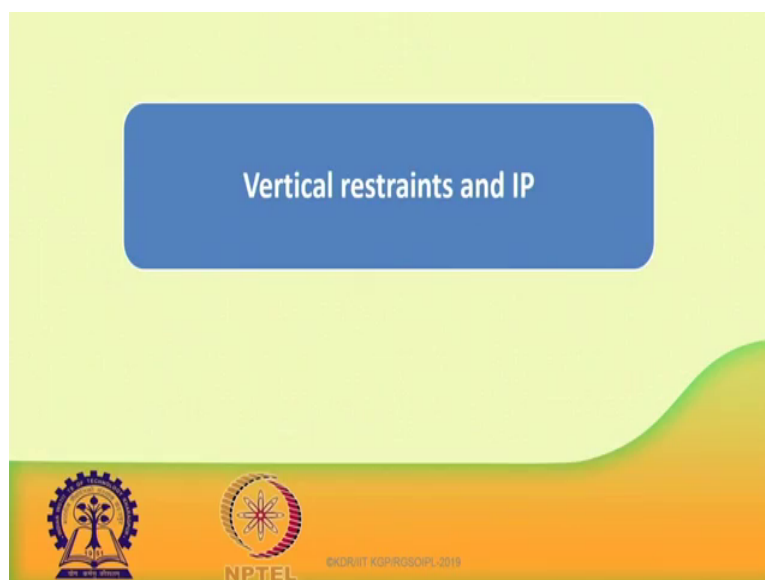
Vertical Restraints - Change in Jurisprudence

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 restraints, in this particular case which we are going to discuss.

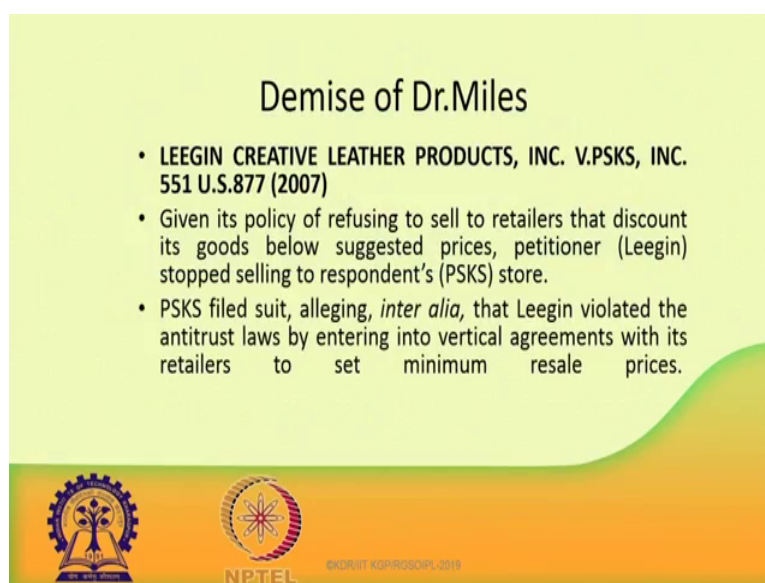
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So, we are going to discuss vertical restraints in the *Leegin creative leather products*. In this particular case, the court has reconsidered Dr. Miles case. The result was exactly opposite to the decision in Dr. Miles. Here again the practice was 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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Leegin

- Leegin Creative Leather Products, a manufacturer of women's accessories, entered into vertical minimum price agreements with its retailers.
- The agreements required the retailers to charge no less than certain minimum prices for Leegin products.
- According to Leegin, the price minimums were intended to encourage competition among retailers in customer service and product promotion.

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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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Leegin

- Leegin argued that this rule was based on outdated economics.
- It contended that a better legal analysis would be the "**rule of reason**," under which price minimums would be held illegal only in cases where they could be shown to be anticompetitive.

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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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Leegin prodcts

- When one retailer, PSKS, discounted Leegin products below the minimum, Leegin dropped the retailer.
- PSKS sued, arguing that Leegin was violating Section 1 of the Sherman Act by engaging in anticompetitive price fixing.







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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Dr.Miles

- The District Court excluded expert testimony about Leegin's pricing policy's procompetitive effects on the ground that *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, [220 U. S. 373](#),
- makes it *per se* illegal under §1 of the Sherman Act for a manufacturer and its distributor to agree on the minimum price the distributor can charge for the manufacturer's goods.



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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The slide is titled "Leegin" and contains a bulleted list of legal points. At the bottom right, there is a small video feed of a man in a pink shirt. The bottom of the slide features the NPTEL logo and the text "ENDRINT KOPINGSDIPL 2019".

Leegin

- At trial, PSKS alleged that Leegin and its retailers had agreed to fix prices, but Leegin argued that its pricing policy was lawful under §1.
- The jury found for PSKS.
- On appeal, the Fifth Circuit declined to apply the **rule of reason** to Leegin's vertical price-fixing agreements and affirmed,
- finding that *Dr. Miles' per se* rule rendered irrelevant any procompetitive justifications for Leegin's policy.

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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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Pro-competitive

- “all of the circumstances,” *Continental T. V., Inc. v. GTE Sylvania Inc.*, [433 U. S. 36](#) ,
- including “specific information about the relevant business” and “the restraint’s history, nature, and effect,” *State Oil Co. v. Khan*, [522 U. S. 3](#) .



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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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Rule of reason v. per se rule

- The rule distinguishes between restraints with anticompetitive effect that are harmful to the consumer and those with procompetitive effect that are in the consumer’s best interest.

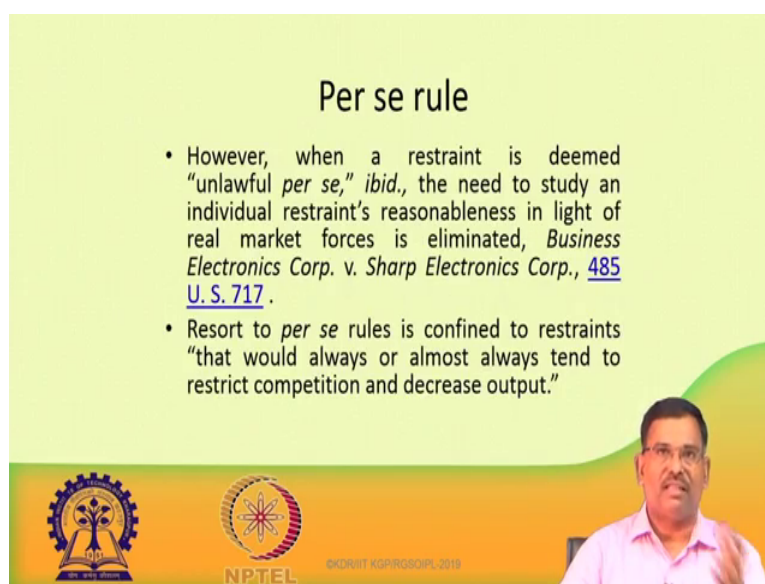


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District court as well as the circuit court rejected, refused to apply the rule of reason. So, there is a standoff between the per se rule and rule of reason. District court refused to apply the rule of reason and circuit court also refused to apply 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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The slide is titled "Per se rule" in a bold, black font. It contains two bullet points. The first bullet point states: "However, when a restraint is deemed 'unlawful *per se*,' *ibid.*, the need to study an individual restraint's reasonableness in light of real market forces is eliminated, *Business Electronics Corp. v. Sharp Electronics Corp.*, [485 U.S. 717](#)." The second bullet point states: "Resort to *per se* rules is confined to restraints 'that would always or almost always tend to restrict competition and decrease output.'" At the bottom of the slide, there are three logos: the Indian National Emblem on the left, the NPTEL logo in the center, and a small portrait of a man on the right. The text "©KJ Somaiya Institute of Management Studies & Research, 2018" is visible at the bottom right.

Per se rule

- However, when a restraint is deemed "unlawful *per se*," *ibid.*, the need to study an individual restraint's reasonableness in light of real market forces is eliminated, *Business Electronics Corp. v. Sharp Electronics Corp.*, [485 U.S. 717](#).
- Resort to *per se* rules is confined to restraints "that would always or almost always tend to restrict competition and decrease output."

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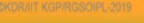


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They discussed whether it is unlawful per se. The reasonableness of these individual restraints or reasonableness of this particular business practice. So, I think that the per se rule was very strongly applied by the courts for a long period of time. 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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Per se rule

- Thus, a *per se* rule is appropriate only after courts have had considerable experience with the type of restraint at issue, see *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, [441 U. S. 1](#),
- and only if they can predict with confidence that the restraint would be invalidated in all or almost all instances under the rule of reason, see *Arizonav. Maricopa County Medical Soc.*, [457 U. S. 332](#) . Pp. 5–7.



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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Pro competitive

- The justifications for vertical price restraints are similar to those for other vertical restraints.
- Minimum resale price maintenance can stimulate interbrand competition among manufacturers selling different brands of the same type of product by reducing intrabrand competition among retailers selling the same brand.

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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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Pro

- A single manufacturer's use of vertical price restraints tends to eliminate intrabrand price competition;
- this in turn encourages retailers to invest in services or promotional efforts that aid the manufacturer's position as against rival manufacturers.
- Resale price maintenance may also give consumers more options to choose among low-price, low-service brands; high-price, high-service brands;
- and brands falling in between.



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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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Pro

- Absent vertical price restraints, retail services that enhance interbrand competition might be underprovided because discounting retailers can free ride on retailers who furnish services and then capture some of the demand those services generate.
- Retail price maintenance can also increase interbrand competition by facilitating market entry for new firms and brands and by encouraging retailer services that would not be provided even absent free riding.



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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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Anti-competitive effects

- Setting minimum resale prices may also have anticompetitive effects; and unlawful price fixing, designed solely to obtain monopoly profits, is an ever present temptation.
- Resale price maintenance may, for example, facilitate a manufacturer cartel or be used to organize retail cartels.
- It can also be abused by a powerful manufacturer or retailer.
- Thus, the potential anticompetitive consequences of vertical price restraints must not be ignored or underestimated.

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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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Per se or rule of reason

- A *per se* rule should not be adopted for administrative convenience alone.
- Such rules can be counterproductive, increasing the antitrust system's total cost by prohibiting procompetitive conduct the antitrust laws should encourage.
- And a *per se* rule cannot be justified by the possibility of higher prices absent a further showing of anticompetitive conduct.
- The antitrust laws primarily are designed to protect interbrand competition from which lower prices can later result



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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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Held

- *Held: Dr. Miles* is overruled and vertical price restraints are to be judged by the rule of reason.
- *Dr. Miles* was based on a common law principle "A general restraint upon alienation is ordinarily invalid."



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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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Rule of reason

- The accepted standard for testing whether a practice restrains trade in violation of §1 is the rule of reason, which requires the factfinder to weigh "all of the circumstances," *Continental T. V., Inc. v. GTE Sylvania Inc.*, [433 U.S. 36](#), 49,
- including "specific information about the relevant business" and "the restraint's history, nature, and effect," *State Oil Co. v. Khan*, [522 U.S. 3](#), 10.



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Pro-competitive effect

- The rule distinguishes between restraints with anticompetitive effect that are harmful to the consumer and those with procompetitive effect that are in the consumer's best interest.







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Per se rule

- However, when a restraint is deemed “unlawful *per se*,” *ibid.*, the need to study an individual restraint’s reasonableness in light of real market forces is eliminated, *Business Electronics Corp. v. Sharp Electronics Corp.*, [485 U.S. 717](#), 723.
- Resort to *per se* rules is confined to restraints “that would always or almost always tend to restrict competition and decrease output.”

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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Re-sale price maintenance

- Minimum resale price maintenance can stimulate interbrand competition among manufacturers selling different brands of the same type of product by reducing intrabrand competition among retailers selling the same brand.
- This is important because the antitrust laws’ “primary purpose ... is to protect interbrand competition,”






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RPM

- Resale price maintenance may also give consumers more options to choose among low-price, low-service brands; high-price, high-service brands; and brands falling in between.
- Absent vertical price restraints, retail services that enhance interbrand competition might be underprovided because discounting retailers can free ride on retailers who furnish services and then capture some of the demand those services generate.



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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.

Applying 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.