"PER SE" OR NOT "PER SE"
AN HISTORICAL "QUICK LOOK" AT MINIMUM RPM UNDER CALIFORNIA LAW

BY DON T. HIBNER, JR.
HEATHER M. COOPER
SHEPPARD MULLIN RICHTER & HAMPTON

GOLDEN STATE ANTITRUST AND UNFAIR COMPETITION LAW INSTITUTE
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1. Introduction.

On June 28, 2007, the Supreme Court, in a 5-4 decision, finally interred *Dr. Miles*.[1] In *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, the United States Supreme Court affirmed the sustaining of a demurrer to a bill in equity, and held that it was illegal under Section 1 of the Sherman Act for a manufacturer and its distributors to agree on a minimum price that the distributor must charge for the manufacturer's goods, upon resale. The decision in *Dr. Miles*, issued in 1911, has had a checkered, but long life. With *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*,[2] the Supreme Court closed the circle that is best exemplified by its seminal sea-change decision in *Continental T.V., Inc. v. GTE Sylvania, Inc.*, issued in 1977.[3] *Continental T.V.* held that in a vertical non-price restraint case, the accepted standard for testing whether a practice unreasonably restrains trade in violation of Section 1 of the Sherman Act, is

* Mr. Hibner is Of Counsel to the law firm of Sheppard Mullin Richter & Hampton, and Ms. Cooper is an associate. They are located in its Los Angeles office.

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

[2] 551 U.S. 877 (2007).

[3] 433 U.S. 36 (1977). See, Don T. Hibner, Jr. and Andrea B. Hasegawa *The Silver Anniversary of an Antitrust Sea-Change: Continental T.V. and Brunswick at Twenty-Five*, 11 COMPETITION 27 (2002-2003). *Continental T.V.* not only transformed vertical non-price restraint doctrine, but also implicitly criticized the approach evident in a number of Supreme Court decisions relating to the use of *per se* tests to condemn behavior whose economic effects are not immediately clear. The Court noted that early decisions, including *Standard Oil Co. of New Jersey v. United States*, 221 U.S. 1 (1911) "established the rule of reason as the prevailing standard of analysis." *Id*. at 60-68. The *Continental T.V.* Court described the rule of reason analysis as a "demanding standard", and emphasized that any "departure from the rule of reason standard must be based upon demonstrable economic effect rather than … upon formulistic line drawing." 433 U.S. at 59.

the rule of reason. This standard requires the fact finder to "weigh all of the circumstances of a case." This includes specific information about the relevant business and the restraint's history, nature and effect.[4] The rule of reason distinguishes between restraints with anticompetitive effects that are harmful to consumers, and those with procompetitive effects that are in the consumer's best interest.

Leegin followed a series of Supreme Court decisions that had whittled away the use of *per se* rules in antitrust cases. Building upon its decision in *Business Electronics Corp. v. Sharp Electronics Corp.*[5], the Court held that resort to *per se* rules is confined to restraints "that would always or almost always tend to restrict competition and decrease output.[6] As held in *Business Electronics*, a *per se* rule is only appropriate after courts have developed considerable experience with the type of restraint at issue. It is only where the court can predict with confidence that the restraint would be invalidated in "all or almost all" instances under the rule of reason, that a *per se* rule would be appropriate. This will tend to preserve scarce judicial resources.

Beginning with *Continental T.V.* in 1977, the Court turned to a presumption in favor of the rule of reason, and eliminated the application of *per se* rules in all non-price vertical restraint cases.

Recognizing that there has been considerable insight into the economic analysis relevant to inquiries into resale price maintenance, the Court in *Leegin* stated that currently, "all or almost all" economists and commentators would agree that there are at least some instances where resale price maintenance, while degrading intrabrand competition, will have a salutary effect on

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[4] 433 U.S. at 49.

[5] 485 U.S. 717 (1988).

[6] 485 U.S. at 726.

interbrand competition, and will thus be, on balance, more pro-competitive than anti-competitive.[7]

In the wake of *Leegin*, there has been a substantial and growing body of literature on the reach and significance of *Leegin* particularly as it may apply to state antitrust law.[8] In addition, beginning almost immediately after the Court decided *Leegin*, legislation has been introduced in Congress to overrule *Leegin*, and return to the world of *Dr. Miles*.[9] At last count, 41 state attorneys general, including California, have written to Congress to express support for the "Discount Pricing and Consumer Protection Act", S. 148, which is currently before the 111th Congress. It would amend the antitrust laws to restore the rule of *Dr. Miles* that minimum RPM agreements violate the Sherman Act. Various states, including California, New York and Florida are supportive. California has taken a further step, and has taken the position that *Leegin* notwithstanding, the California Cartwright Act "explicitly defines" a resale price maintenance agreement as a "trust", and is thus *per se* unlawful by the terms of the statute itself.[10]

This paper will examine the pros and cons of that position, and concludes that the better rule is exemplified by a venerable maxim of jurisprudence, that predated *Dr. Miles* by 39 years. Codified in the California Civil Code, as Section 3510 it is instructive. It provides:

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[7] *Leegin Creation Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 900-902 (2007).

[8] Thomas Brom, *The Price is Right*, CALIFORNIA LAWYER (September 1, 2009); Steven G. Mason, *The Price is Right*, LOS ANGELES LAWYER 29 (April, 2009); M. Russell Wolford, Jr. and Kristen C. Limarzi, *The Reach of Leegin: Will the States Resuscitate Dr. Miles?* THE ANTITRUST SOURCE (October 2007); Richard A. Dunkin and Allison K. Guernsey, *Waiting for the Other Shoe to Drop: Will State Courts Follow Leegin?* FRANCHISE LAW JOURNAL 173 (Winter 2008); Paul Gift *Price Fixing and Minimum Resale Price Restrictions Are Two Different Animals*, 12 GRAZIADIO BUSINESS REPORT Issue 2 (2009); Michael A. Lindsay, *Overview of State RPM*, ANTITRUST MAGAZINE (Fall 2007); Frank M. Hinman and Sujal J. Shah, *Counseling Clients on Vertical Price Restraints*, 23 ANTITRUST MAGAZINE 60 (Summer 2009); Benjamin Klein, *Competitive Resale Price Maintenance in the Absence of Free Riding*, (to be published in ANTITRUST LAW JOURNAL, Fall 2009).

[9] See, Discount Pricing Consumer Protection Act, S. 148, introduced January 6, 2009 by Senator Herb Kohl (D-WI). A substantially similar bill was introduced previously on October 30, 2007, the "Discount Pricing Consumer Protection Act," S. 2261.

[10] Thomas Brom, *The Price is Right*, *supra*.

"When the reason of a rule ceases, so should the rule itself."[11]

This article will demonstrate that while the California courts have spoken with many voices through time, the current consensus, if one there be, is that, as stated by Justice Traynor in *Speegle v. Board of Fire Underwriters*,[12]

> The Cartwright Act merely articulates in greater detail a public policy against restraint of trade that has long been recognized at common law. Thus, under the common law of this state combinations entered into for the purpose of restraining competition and fixing prices are unlawful.[13]

However, Justice Traynor also recognized the following:

> Congress did not intend 'to freeze the proscription of the Sherman Act within the mold of the then current judicial decisions defining the commerce power,' but intended on the contrary to go to the utmost extent of its power. The Cartwright Act is couched in similarly comprehensive language; it forbids combinations of the kind described with respect to every type of business.[14]

The question that suggests itself as being illuminating, if not dispositive, is: What was the state of the common law at the time that the Cartwright Act was enacted in 1907? What was the state of the law at the time of *Dr. Miles*, in 1911? As we will see, the common law in place in California in 1907 recognized the doctrine of "partial" as opposed to "general" restraints as being subject to a rule of reason. In fact, when confronted with the then recent decision in *Dr. Miles*, in 1912, the California Supreme Court distinguished, or rejected the Supreme Court's decision in *Dr. Miles*, on the ground, among others, that the "good" subject to the resale price maintenance agreement had widely available substitutes, and thus the agreement was reasonable as an aid to the development of brand value, and the communication of the manufacturer's

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[11] Cal. Civ. Code § 3510 (enacted 1872).

[12] *Speegle v. Board of Fire Underwriters of the Pac.*, 29 Cal. 2d 34 (1946).

[13] 29 Cal. 2d at 44.

[14] *Id*.

representations as to the quality of its products to consumers, vis à vis reasonably close substitutes.[15]

As we will see, this line of cases developed and remained the law in California from 1912 until 1931, when the rule upholding partial restraints was codified by the passage, in 1931, of the first state "fair trade act", codified as Section 16,900 to 16,905 of the Business and Professions Code.[16] It remained the law until its repeal in 1975.[17]

As we will see, the California Supreme Court did not adopt the rule in *Dr. Miles* until 1978, in *Mainland v. Burckle*.[18] In *Mainland*, the Court stated: "The federal law in this regard [per se illegality] is too well established to require extensive discussion" (citing *Dr. Miles*).[19] The Court followed *Dr. Miles* uncritically. It recognized that, at least as of that time, that:

> Since the Cartwright Act is patterned after the Sherman Act, federal cases interpreting the Sherman Act are applicable in construing our state laws.[20]

We submit, that with the demise of *Dr. Miles*, "the reason for the rule has ceased", and that California law should be construed in accordance with its common law roots, but in a modern economic context. As "all or almost all" economists and commentators agree that not "all or almost all" uses of minimum resale price maintenance are pernicious and anticompetitive, we should avoid a wooden, formalistic rule, that will punish aggressive but legitimate

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[15] *See*, e.g., *D. Ghirardelli Co. v. Hunsicker*, 164 Cal. 355 (1912); *Grogan v. Chaffee*, 156 Cal. 611 (1909). *See*, also, *People v. Building Maint. Contractors' Ass'n*, 41 Cal. 2d 719, 727 (1953) ("Moreover, it may be assumed that the broad prohibitions of the Cartwright Act are subject to an implied exception similar to the one that validates reasonable restraints of trade under the Federal Sherman Antitrust Act").

[16] 1931 Cal. Stat. 278. For a discussion of the impetus for a "fair trade" law, see, Ewald T. Grether, *Experience in California Fair Trade Legislation Restricting Price-Cutting*, 24 CAL. L. REV. 640 (1936).

[17] Stats. 1975, c. 402, Section 1; Stats. 1975, c. 429, Section 1. *See*, Warren S. Grimes, *The Seven Myths of Vertical Price Fixing: The Politics and Economics of a Century-Long Debate*, 21 SOUTHWESTERN U.L. REV. 1285, 1289 (1992).

[18] 20 Cal. 3d 367 (1978).

[19] 20 Cal. 3d at 376.

[20] 20 Cal. 3d at 377.

competition on the merits. How to separate "good" RPM from "bad" RPM? As suggested by Justice Kennedy in *Leegin*,[21] we should wait and encourage the crafting of "a litigation structure" to ensure that a rule of reason analysis operates to eliminate anticompetitive restraints, while providing more guidance to businesses. This would entail the establishment of presumptions and burdens going forward, that would suggest a vehicle already familiar to the California courts: namely, a quick look rule of reason. In the number of factual situations where Justice Kennedy stated RPM could be problematic, this quick look could employ a "market power screen" analysis.[22]

Now, let's take a closer look at *Dr. Miles* as well as the California law relating to rule of reason analysis in "partial restraint" cases, a doctrine that was well established at the time of *Dr. Miles*, and served as the basis for the California Supreme Court's distinguishing *Ghirardelli*[23] from *Dr. Miles*.

2. <u>The Saga of Dr. Miles.</u>

Our centerpiece is one of the earlier vertical restraint antitrust cases decided under the Sherman Act. It supports the proposition that where one ends up is a function of where one begins the journey. From the passage of the Sherman Act in 1890 until at least the Supreme Court's decision in *Continental T.V.*[24] there has been a continuing controversy over the purposes to be served by antitrust laws. In its legislative history, the Sherman Act reveals considerable

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[21] *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 898-899 (2007). ("As courts gain experience considering the effects of these restraints by applying the rule of reason over the course of decisions, they can establish the litigation structure to ensure the rule operates to eliminate anticompetitive restraints from the market and to provide more guidance to businesses. *Courts can, for example, devise rules over time for offering proof, or even presumptions where justified, to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints and to promote competitive ones*." (emphasis added).

[22] Examples of uses of a market power screen analysis under California law are, e.g., *Roth v. Rhodes*, 25 Cal. App. 4th 530 (1994), and *Exxon Corp. v. Superior Court*, 51 Cal. App. 4th 1672 (1997).

[23] *D. Ghiradelli Co. v. Hunsicker*, 164 Cal. 355, 359-362 (1912).

[24] *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977).

confusion concerning its purposes and effects. As noted by a leading commentator, the legislative history has supplied a veritable "wishing well into which one may peer to glimpse evidence that supports preferred policies".[25]

But there is early authority that the Sherman Act was, in large part, a codification of the common law. What is unclear, however, is which common law, and when? As we will see, it makes a great deal of difference whether one turns the clock back to the period of the Henry V, Queen Anne, or George V. The content of the common law of England changed greatly as society mutated from a system of craft guilds regulating relations between master, journeyman and apprentice, and the transition towards a market economy in the 18th Century. In *Dyer's* case[26] the Court of Common Pleas denied an attempted collection on a bond for John Dyer's breach of his agreement not to "use his art of a dyer's craft within the town. . . for half a year". The court held that the condition restraining Dyer was void as against the common law. In contrast, by the early 18th century, in *Mitchel v. Reynolds*[27] the law had developed a distinction between "general" and "partial" restraints. While "general" restraints were void as against public policy, "partial" restraints would be lawful if found to be reasonably "ancillary" to a legitimate innovative commercial purpose. At the time *Dr. Miles* was decided, in 1911, the British House of Lords had gone so far as to uphold a worldwide covenant not to compete for a period of twenty-five years in the development of rapid fire guns. In *Nordenfelt v. Maxim Nordenfelt Guns & Ammunition Co.*,[28] the court enforced an ancillary restraint that barred the seller of an

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[25] Ernest Gellhorn and William E. Kovacic, ANTITRUST LAW AND ECONOMICS 21 (4th Ed. 1994).

[26] 2 Hen. V, 5, Pl. 26 (C.P. 1414) (reign of Henry V).

[27] 24 Eng. Rep. 347, (K.B. 1711) (reign of Queen Anne).

[28] A.C. 535 (H.L. 1894). (There may be a sub-silencio national security rational, as the development of machine guns and automatic cannon during this period, had spurred an arms race. These guns had had a devastating adverse impact during the Anglo-Boer war of 1902 and of course changed land warfare for evermore, in World War I.) See, John Ellis, THE SOCIAL HISTORY OF THE MACHINE GUN (1976).

arms-manufacturing business from competing with the purchaser anywhere in the world for a period of twenty-five years.

However, the "common law" then generally followed in the United States was a mixed bag.[29] American courts were somewhat less receptive than British courts to the reasonableness of "partial" restraints. One line of American decisions banned price-fixing agreements and other anti-competitive arrangements when the challenged restraint affected "necessities."[30]

As we will see, the selection of the "common law" base period is of primary importance and was perhaps determinative of the outcome in *Dr. Miles*. At the time of *Dr. Miles*, there was a relatively well-developed body of common law precedents that upheld minimum resale price agreements, where the item in question was in open competition with an array of substitutable items to which consumers could turn. These included California authorities. In fact, it was the common law precedents that were determinative of California law at the time of the Cartwright Act that guided its development, and resulted in the California Supreme Court distinguishing and refusing to follow *Dr. Miles* itself.[31]

Dr. Miles Medical Co. ("Dr. Miles") was a manufacturer of trademarked non-prescription medicines made pursuant to secret formulas. Dr. Miles had contracts with more than 400 wholesalers and 25,000 retailers, specifying the "minimum prices" at which sales were to be made by its vendees." Dr. Miles brought a bill in equity against a wholesale druggist who not only refused to enter into such contracts, but had induced the breach of existing contracts between Dr. Miles and other wholesalers and retailers, in order to procure the medicines for sale

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[29] For example, in 1901, Justice Holmes, writing for the Massachusetts Supreme Court, upheld a patent medicine manufacturer's contact binding retailers to a resale price. *See*, *Garst v. Harris*, 58 N.E. 174 (Mass. 1900). *See also*, *Commonwealth v. Grinstead*, 63 S.W. 427 (Ky. 1901); *Walsh v. Dwight*, 58 N.Y.S. 91 (1899). *Nordenfelt* was in the reign of Queen Victoria, and *Dr. Miles* in the reign of George V.

[30] *See*, *Richardson v. Buhl*, 77 Mich. 632 (1889).

[31] *See*, *Grogan v. Chaffe*, *supra*, and *D. Ghiradelli v. Hunsicker*, *supra*.

at "cut prices". Thus, the defendant was, in modern parlance, a "breach inducer".[32] The United States Supreme Court affirmed a demurrer to the bill in equity, and held that a manufacturer who sells goods to a wholesaler may not restrict their resale by constraining the buyer's pricing decisions. Relying on the common law's sometimes hostile approach towards equitable servitudes on chattels, the Court noted that "a general restraint upon the alienation is ordinarily invalid" and where its purpose is to destroy competition by fixing prices, the restraint is "injurious to the public interest and void."[33] In so doing, the Court turned back the clock to the common law as it was reported to have existed in 1628. Had the Court skipped forward to 1711, to the time of *Mitchel v. Reynolds*,[34] however, the analysis might have been different, as "partial restraints" were generally analyzed as to their reasonableness and if appropriately limited as to time and location, would have been upheld.

It is interesting to note, however, that *Dr. Miles* itself did *not* announce that its ruling was "per se". This was a determination courts made later.[35] Suffice it to say, however, that because

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[32] As described by Justice Holmes in his dissent, the role of equity was to restrain the defendant "from inducing, by corruption and fraud, agents of the plaintiff and purchasers from it to break their contracts not to sell its goods below a certain price." 220 U.S. at 409. Justice Holmes continues "I cannot believe that in the long run the public will profit by this Court permitting knaves to cut reasonable prices for some ulterior purpose of their own and thus to impair, if not to destroy, the production and sale of articles which is assumed to be desirable that the public should be able to get." 220 U.S. at 412.

[33] 220 U.S. at 404, citing Coke on Littleton, Section 360: "If a man, be possessed of a horse or any other chattel, real or personal, and give his whole interest or property therein, upon condition that the donee or vendee shall not alien the same, the same is void, because his whole interest and property is out of him, so as he hath no possibility of reverter; and it is against trade and traffic and bargaining and contracting between man and man."

[34] *Mitchel v. Reynolds*, 24 Eng. Rep. 347 (K.B. 1711).

[35] *See*, *e.g.*, *FTC v. Beech-Nut Packing Co.*, 257 U.S. 441, 454-55 (1922) (policing and blacklisting of violators *per se* pursuant to *Dr. Miles*.) Interestingly, however, in *Chavez v. Whirlpool Corp.*, 93 Cal. App. 4th 363 (2001), the Court of Appeal, Second District, not only affirmed the 1919 "*Colgate*" exception to *Dr. Miles*, which limited its reach to "agreements", but went further and endorsed self-monitoring and the use of "mystery shoppers" to measure policy compliance. The court noted "just as the announcement of a resale price policy and refusal to deal with dealers who do not comply is permissible, measures to monitor compliance that do not interfere with the dealers' freedom of choice are permissible. To hold otherwise would render the manufacturer's announced policy ineffective and undermine rights protected by the *Colgate* doctrine."… *Id.* at 373. *Chavez* also endorsed the rule in *Monsanto Co. v. Spray-Rite Service*

the opinion affirmed a judgment entered on the sustaining of a demurrer to a bill in equity, it did, in fact, amount to an absolute rule.[36]

As has been suggested by several commentators, the decision in *Dr. Miles* may have nevertheless been correct on its facts, but for the wrong reasons. The Court made at least two fundamental errors. First, it assumed that the economic results of vertical and horizontal restrictions were the same.[37] Subsequent economic analysis through the years has determined that they are similar in some, but certainly not all, respects.[38] Second, as discussed above, it erroneously held that vertically imposed resale price restraints would be a "total restraint upon alienation".[39] This was a function of the base point for determining what common law body of law to interrogate. As this was hundreds of years after the period when the guild system was flourishing in England, there was no sustaining rationale for determining that the restraint Dr. Miles imposed on its wholesale and retail druggists was other than a "partial restraint", and thus subject to the analysis under a standard of reasonableness.

But, the outcome of *Dr. Miles* may well have been guided by a concern that the RPM was dealer-inspired, and facilitated horizontal collision among competing druggists. As reported by Areeda & Hovenkamp, it was generally known at the time that trade associations such as the National Association of Retail Druggists, were engaging in a course of conduct to actively "persuade" manufacturers to adopt resale price maintenance programs. In fact, as early as 1906,

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Corp., 465 U.S. 752 (1984), which limited the circumstances from which a "tacit" agreement may be inferred, where the proffered evidence is ambiguous.

[36] Justice Hughes recognized that "with respect to contracts and restraint of trade, the earlier doctrine of the common law has been substantially modified in adaptation to modern conditions. He describes the "rule laid down is not regarded as inflexible, and has been considerably modified." He then proceeds to affirm the sustaining of the demurrer to the bill in equity, and the resulting judgment of dismissal. *Id*. at 406.

[37] *Id*. at 408.

[38] *See*, *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977); Ernest Gellhorn, William E. Kovacic and Steven Calkins, ANTITRUST LAW AND ECONOMICS 340 et seq. (5th Ed. 2004).

[39] *Id*. at 404-405.

the Justice Department had brought actions against retail and wholesale druggist associations, as well as manufacturers, including Dr. Miles, for collective resale price activities.[40]

In his dissent, Justice Holmes started out by observing that the Court had no experience in determining whether the public was better or worse off in favoring downstream purchasers over upstream suppliers. He suggested that the Court, in fact, had no experience, or precedent and no logic in reaching the public policy conclusion that it did.[41]

Now, let's take a further trip in the time machine back to California in the early 1900's.

3. A "Quick Look" At Resale Price Maintenance Under California Law - A Reason for Pause.

Much of what we understand about the Cartwright Act is unclear, inconclusive, or both. For years, California courts informed us that the Cartwright Act was "patterned" on the Sherman Act.[42] We have also been told that the Cartwright Act "merely articulates in greater detail the

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[40] VIII Areeda & Hovenkamp, ANTITRUST LAW, Section 1620, p. 215, n. 43. See also, Gellhorn, *supra*, at 293; Andrew N. Kleit, *Efficiencies Without Economists: The Early Years of Resale Price Maintenance*, 59 SOUTHERN ECON. J. 597 (1993) (documenting early 20th century awareness of efficiency rationales for resale price maintenance activities.

[41] 220 U.S. at 411 ("On such matters, we are in perilous county. I think that, at least, it is safe to say that the most enlightened judicial policy is to let people manage their own business in their own way, unless the ground for interference is very clear").

[42] *Speegle*, *supra*, at 12. *See*, *also*, *Oakland – Alameda County Builders v. F.P. Lathrop Construction Co.*, 4 Cal. 3d 354, 363 (1971); *Corwin Co. v. Los Angeles Newspaper Service Bureau, Inc.*, 4 Cal. 3d 842, 852 (1971); *Marin County Board of Realtors, Inc. v. Palsson*, 16 Cal. 3d 920, 932 (1976); *Mailand v. Burckle*, 20 Cal. 3d 367, 378 (1978); *Blank v. Kirwan*, 39 Cal. 3d 311, 320 (1985). However, in *State ex rel Van de Kamp v. Texaco*, 46 Cal. 3d 1147 (1988), the Court disapproved the "patterned after" attribution language of prior cases, and adapted the suggestion contained in an article by Moses Lasky. See, Moses Lasky, *Folklore and Myth In Judicial Opinions – Some Reflections Inspired by Texaco – Getty*, 20 U.C. DAVIS L. REV. 591, 592 (1987). The Court stated that rather than being "patterned" after the Sherman Act, it was "patterned" after the Reagan bills of 1888 and 1890, and other state laws that predated the passage of the Sherman Act. *Id.* at 1154. However, in *Roth v. Rhodes*, 14 Cal. App. 4th 1224, 1234 (1993), the Court of Appeal reverted to the "patterned after" language and noted that both statutes have their "roots in the common law", and that consequently federal cases interpreting the Sherman Act are applicable to problems arising out of the Cartwright Act. *Id.* As suggested by Hibner and Cooper, "the salutary benefits derived from the Cartwright Act are not a function of whether the Act was "patterned" on the Sherman Act, or on antitrust laws enacted by various states, including Texas, Michigan and/or Ohio. It is rather the evolution of our understanding of the Act's basic objectives. We conclude that since at least 1960, with the general understanding that the Cartwright Act is currently believed to be "not only harmonious" with the Sherman

public policy against restraintive trade that has long been recognized as common law."[43] This authority, the seminal case of *Speegle v. Board of Fire Underwriters of the Pacific*, also informs us that:

> … [C]ongress did not intend to freeze the proscription of the Sherman Act within the mold of the then current judicial decisions defining the commerce power", but intended on the contrary to go to the utmost extent of its power. The Cartwright Act is couched in similarly comprehensive language; it forbids combinations of the kind described with respect to every type of business.[44]

Still later, we were advised that there is no direct source of the legislative history of the Cartwright Act. In *Cianci v. Superior Court*,[45] the California Supreme Court, through Justice Mosk, advised:

> While no direct sources of the legislative history of the Cartwright Act exist, we may reasonably assume that the Legislature's intent was substantially similar to that of United States Senator John Reagan.[46]

He noted that the Cartwright Act is a "near carbon copy" of the Reagan bill.[47] He then concluded that all we would have to do to understand the legislative history of the Cartwright Act is to figure out what Senator Reagan may have meant in an isolated reference in the Congressional record, when describing his companion bill. Justice Mosk concluded that, with reference to Senator Reagan's remarks, that the Cartwright Act reaches beyond the Sherman Act to threats to competition in their incipiency – much like section 7 of the Clayton Act. He also

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Act, but shares it's "identical objectives, we may expect the two laws to move forward in the foreseeable future in a complimentary fashion, each supporting and augmenting the goals of the other." Don T. Hibner, Jr. & Heather M. Cooper, *The Cartwright Act at 100 – A History of Complementary Antitrust Enforcement – A Celebration*, 17 COMPETITION 81, 83 (Fall 2008).

[43] *Speegle*, *supra* note 12 at 43-44.

[44] 29 Cal. 2d at 43.

[45] 40 Cal. 3d 903 (1980).

[46] 40 Cal. 3d at 919 (citing *Marin County Bd. Of Realtors v. Palsson*, 16 Ca. 3d 920, 926 (1976)).

[47] *Id*.

concluded, however, that the Cartwright Act "speaks solely in terms of economic effects". He then adopted a consumer welfare model as the "principle is not the sole goal of the antitrust laws".[48] He cited for this proposition Areeda & Turner, and also Professor Bork. But he did not attempt to articulate how the Cartwright Act can be "broader", if it is based upon a developing common law, that itself is based upon the goals of allocative efficiency and consumer welfare rent seeking activities.

A scant three years later, the California Supreme Court expressly repudiated the notion that the Cartwright Act was "broader," in *State ex rel Van de Kamp v. Texaco, Inc.*[49] In that instance, in disapproving the "patterned after" language of prior cases, Justice Lucas, writing for the Court, reviewed the then existing case law under Texas and Michigan law, upon which Justice Mosk claimed that the Reagan bills of 1888 and 1890 were "patterned", and concluded that the Cartwright Act was not intended to address mergers, much less, mergers in their incipiency.[50]

To add to the mix of confusion, and imperfect and incomplete scholarship, it has also been noted by commentators, that at least according to newspaper articles contemporary with the enactment of the Cartwright Act, in 1907, Senator Cartwright copied his bill from Ohio law.[51] An article in the Los Angeles Daily Times, May 16, 1907, reports:

> The fact that the Cartwright Act is practically an exact duplicate of the Ohio law, which has been declared constitutional, and which has been brought many trusts to book probably has had its salutary influence.[52]

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[48] *Id*. at 918-919.

[49] 46 Cal. 3d 1147 (1988).

[50] 46 Cal. 3d 1147, 1154.

[51] Antitrust & Unfair Competition Law Section, State Bar of California, CALIFORNIA ANTITRUST AND UNFAIR COMPETITION LAW Section 1.08, notes 97-98 (3d Ed., 2003).

[52] L.A. Daily Times, May 16, 1897, at p. 1. See, Hibner and Cooper, *supra*, at 92 n. 63.

If we cannot tell what the Cartwright Act was intended to mean, because of the sparcity of legislative intent evidenced under California law, where does this leave us? Can it be successfully argued that because of the detail of Section 16720, the Cartwright Act "sort of means what it says?" Not according to the seminal article by Julian O. Von Kalinowski and John J. Hanson, published in the U.C.L.A. Law Review in 1959.[53] In attempting to ascertain the meaning of the Cartwright Act from the words of the statute itself, they conclude that it is not an improvement on the general language used in the Sherman Act. They wrote:

> Although 16720 appears to be detailed, it seems clear that the language used therein (e.g. "create or carry out restrictions") is as general as that used in the federal antitrust statutes. *Accordingly, the problem of generality which existed with respect to the federal antitrust law also exists with respect to the Cartwright Act.*[54]

There is another source of possible uncertainty, if not confusion. The Cartwright Act, enacted in 1907, was amended in 1909 to add two provisions. The first, which was codified as Section 16723, exempted agreements the object of which was to conduct operations at a "reasonable profit." The "reasonable profit" exemption of the 1909 amendment was subsequently held unconstitutional, but severable, thus not impairing the Cartwright Act as a whole.[55] In *People v. Building Maint. Contractors' Ass'n.*[56] the California Supreme Court reaffirmed its decision in *Speegle*, and in addition, held that section 16723 was unconstitutional.

However, a second amendment was also added in 1909, that remains with us until the present. This amendment, codified in section 16725, in 1941, which provides:

> It is not unlawful to enter into agreements or form associations or combinations, the purpose and effect of which is to promote,

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[53] Julian O. Von Kalinowski and John J. Hanson, *The California Antitrust Laws*: *A Comparison With the Federal Antitrust Laws*, 6 U.C.L.A. L. REV. 533 (1959).

[54] *Id*. at 535 (emphasis supplied).

[55] *Speegle, supra* at 12.

[56] 41 Cal. 2d 719 (1953).

> encourage or increase competition in any trade or industry, or which are in furtherance of trade.[57]

What does this mean? We suggest that not even Senator Reagan would have a ready answer for this, much less Senator Cartwright. However, an argument can be made that it is the California counterpart to the 1911 *Standard Oil* decision under the Sherman Act.[58] It mandates a "rule of reason", by allowing a defendant to proffer an affirmative defense that the purpose and effect of an agreement is to "encourage or increase competition in any trade or industry".

This is discussed in *People v. Building Maint. Contractors Ass'n*, decided by the California Supreme Court in 1953.[59] There, Justice Traynor, writing for the Court in affirming the entry of an injunction against a horizontal price fixing agreement by stevedores, formed into the "Building Maintenance Contractors Association", struck down the "reasonable profit" amendment of 1909.[60] The defendants also argued, however, that on the basis of Section 16725,[61] that the injunction should be vacated, and the ruling of the trial court reversed. In affirming, Justice Traynor returned us to the common law. He noted that Section 16725 was the "converse" of Section 16720(a), which defines a "trust as one created to carry out restrictions in trade or commerce". Justice Traynor opined:

> Since the Cartwright Act articulates in greater detail a public policy that has long been recognized in common law [citing *Speegle*], these provisions must be considered in light of common-law precedents. *Moreover, it may be assumed that the broad prohibitions of the Cartwright Act are subject to an implied*

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[57] Stats. 1909, c. 362, p. 594 Section 1, added as Section 1672 to the Business and Professions Code Section by Stats. 1941, c. 526, Section 1.

[58] *Standard Oil Co. of New Jersey v. United States*, 221 U.S. 1 (1911).

[59] 41 Cal. 2d 719 (1953).

[60] Stats. 1909, c. 362, p. 593, codified as Business and Professions Code 16723, by stats., 1941, c. 526, p. 1836; declared unconstitutional in *People v. Building Maintenance Contractor's Association, supra*, and repealed by stats. 1961, c. 796, p. 2058 Section 1.

[61] California Bus. & Prof. Code Section 16725, was added by stats. 1909, c. 362, p. 594 Section 1, and codified pursuant to stats. 1941, c. 526, Section 1.

> *exception similar to the one that validates reasonable restraints of trade under the federal Sherman Antitrust Act* [citing *Standard Oil*].[62]

Justice Traynor went on to note, however, that "agreements fixing pricing are illegal *per se*".

He then made it clear, that his characterization of a *per se* rule against the fixing of prices relates solely to horizontal, and not vertical agreements. Justice Traynor wrote:

> "An exception was recognized permitting a manufacturer to enter valid contracts with retailers fixing the pricing at which his product might be sold."[63]

He then analyzed *D. Ghiarardelli Co. v. Hunsicker*,[64] and *Grogan v. Chaffee*.[65] Citing *Herriman v. Menzies*[66] as well, he explained that in *Herriman*,

> [I]t was held that an agreement between stevedoring firms with respect to prices was not invalid when it appeared that the firms in question constituted only an insignificant part of those engaged in the business and had no power to control prices generally.[67]

While recognizing the exception for vertical price restraints, Justice Traynor opined that the ruling of *Herriman*, as it was in a horizontal context, is "no longer controlling".[68] In the alternative, he stated "in any event, defendants do not constitute an insignificant part of the building maintenance industry in San Francisco."[69]

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[62] 41 Cal. 2d at 727 (emphasis added).

[63] *Id*.

[64] 164 Cal. 355 (1912).

[65] 156 Cal. 611 (1909).

[66] 115 Cal. 16 (1896).

[67] 41 Cal. 2d at 727.

[68] *Id*.

[69] 41 Cal. 2d at 727-728.

Now, let's take a last "quick look" at *Grogan, D. Ghirardelli*, and *Herriman*. Regarding *Herriman*, of interest to our analysis is the citation of *Skrainka v. Scharringhausen*[70] an 1880 case from Missouri, cited with approval. The *Skrainka* court stated:

> The old doctrine of the common law that contracts in restraint of trade are void is no longer to be rigorously insisted upon, precisely as it was insisted upon in the earlier cases in which it was announced. It has been modified by the more recent decisions as the laws of trade have become better understood during the development of our commercial system, and the changes which have been introduced in the social system.[71]

Here, *Herriman*, relying upon *Skrainka*, states the truism most recently seen in *Leegin*,[72] namely that our understanding of what a "restraint" may be, is a moving target and a work in process. It is not a function of *Dyer's* case, the guild system, or the reign of Queen Anne.

Grogan v. Chaffee,[73] was a case that involved vertical resale price maintenance agreements. The Court held that such agreements were not illegal under Civil Code Section 1673, where substitutable goods were widely available. In *Grogan*, the plaintiff produced olive oil through a proprietary process. It affixed a resale price maintenance notice to each bottle of olive oil, or the package in which the bottle was contained, that it sold. The notice stated that the article was sold only on the condition that the purchaser, if it retailed the goods, shall maintain a fixed resale selling price. Defendant, a retail grocer, purchased the olive oil from Grogan pursuant to the pre-announced terms but resold at prices that were in violation of the resale price notice.

The California Supreme Court held that the resale price maintenance agreement at issue was not unlawful as a "restraint of trade", as olive oil was a fungible product in wide supply, and

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[70] 8. Mo. App. 522 (1880).

[71] 115 Cal. At 22, citing 8 Mo. App. 522 (1880).

[72] *Leegin Creative Leather Products, Inc. v. PSKS, Inc.,* 551 U.S. 877 (2007).

[73] 156 Cal. 611 (1909).

that Grogan held no monopoly power in a market for fungible olive oil. *Grogan*, however, was decided under the Civil Code codification of the common law, as expressed in Civil Code Section 1673. Thus, the case did not specifically arise under the Cartwright Act.

D. Ghirardelli Co. v. Hunsicker,[74] was a case on "all fours" with *Dr. Miles*. It was decided both under the common law and under the Cartwright Act, and upheld RPM as lawful, on its facts.

More particularly, the California Supreme Court specifically noted the then recent United States Supreme Court decision in *Dr. Miles*, and held it to be distinguishable. This was on the ground, as also set forth in *Grogan*, that there were many competing substitutes available to consumers and thus no restraint of trade. The *Ghirardelli* Court reasoned that in *Dr. Miles*, the products concerned were "patent medicines", that there were no readily available substitutes for these products, and that *Dr. Miles* thus held a "monopoly" in the commodity in question.[75] On the other hand, the *Ghirardelli* Court found, in a relevant market where "chocolate is chocolate," there is no restraint of trade, and the restraint would be considered at common law to be only "partial", and not "general".

Finally, the *Ghirardelli* Court cited *Dr. Miles* for the proposition that whether the contract is a restraint of trade is a function of "adaptation to modern conditions". In effect, the *Ghirardelli* Court gave *Dr. Miles* the benefit of the doubt as a structured rule of reason case and not a *per se* condemnation of a practice, in the light of modern conditions.

However, the *Ghirardelli* Court placed its own decision in a state of flux in what may be an alternative holding. The Court noted that even if conceded for purposes of argument that the

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[74] 164 Cal. 355 (1912).

[75] 164 Cal. At 361-62. A good argument can be made that *Ghirardelli*, as well as *Grogan*, involved a vestigial "quick look" rule of reason analysis.

resale price maintenance agreement in *Ghirardelli* would have violated the Cartwright Act, as it stood unamended in 1907, any such defect would have been cured by the 1909 amendment to Section 1 of the Act.[76] This was because, the Court noted, the complaint in *Ghirardelli* sufficiently showed that the only object of the plaintiff was to conduct its operations at "reasonable profit".[77] There was no discussion of the companion amendment of 1909 to Section 16725, which would seem to suggest a rule and reason analysis, where a defendant alleged and offered proof, that the purpose and effect of the agreement was to promote, encourage or increase competition. This could arguably be so, whether the agreement was for "reasonable profit" or otherwise.[78] Commentators Van Kalinowski and Hanson concurred: "Thus, the legality of resale price maintenance agreements under the Cartwright Act in the absence of the exemption discussed below, is not clear."[79]

4. <u>Other Cases Following Grogan and Ghirardelli</u>

Grogan and *Ghirardelli* continued to be cited with approval by California Courts from the *Ghirardelli* decision in 1912, through the enactment of the first state fair trade act, enacted in California in 1931. The effects of the Great Depression on the retailing industry, and perhaps the rapid advent of chain stores and mass selling by catalogues, prompted California in 1931 to enact

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[76] Stats. 1909, c. 362, p. 593, Section 1, added by stats. 1941, c. 526, Section 1 as California Business & Professions Code 16723, in 1941.

[77] *Id*.

[78] Stats 1907, c. 530, p. 984, Section 2.5, added by Stats 1909, c. 362, p. 594. Section 1, Codified stats. 1941, c. 526, Section 1.

[79] Von Kalinowski & Hanson at 544. In a harbinger of things to come, Von Kalinowski & Hanson also concluded "The California courts, however have not developed the doctrine that certain acts are per se illegal under the Cartwright Act. *It would seem wise to avoid the acceptance of per se rules of conduct. Once a practice has been declared illegal per se this has meant, under the Federal anti-trust laws, that no further inquiry is necessary – the process, if engaged in, is illegal … The adoption of "per se" rules may defeat the true objectives of the antitrust laws, the promoting of competition. Id. at 541-42 (emphasis added).*

a bill to authorize vertical price fixing where branded goods were involved, and were in "fair and open competition" with substitutes.[80]

The California Fair Trade Act was codified as California Business and Professions Code Section 16900 to 16905. In order to comply with the California Fair Trade Act, the product involved or the label or container of the product, was required to bear the trademark, brand or name of the producer or owner of the product. In addition, the product must have been in "fair and open competition" with products of the same general class.[81] Agreements "between producers or between wholesalers or between retailers as to sale or resale prices" was not covered.[82]

A number of California decisions continued to cite *Grogan* and *Ghirardelli* with approval, in the era of the California Fair Trade Act.[83] Thus, resale price maintenance agreements under the Cartwright Act remained lawful, or at least not *per se* unlawful, from 1912 in *Ghirardelli*, through 1975, when the California Fair Trade Act was repealed.[84]

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[80] *See*, 1931 Cal. Stat. 278; *see also*, Warren S. Grimes, *The Seven Myths of Vertical Price Fixing: The Politics and Economics of a Century-Long Debate*, 21 SOUTHWESTERN U.L. REV. 1285-1289 (1992).

[81] *See* Cal. Bus. and Prof. Code 16902.

[82] *See* Von Kalinowski & Hansen at 544. It is interesting to note that the requirement that the fair-traded product be in "fair and open competition" with products of the same general class would seem to be quite descriptive of the rule in *Grogan*, and *Ghirardelli*. In fact, it would make a pretty good "quick look" rule of reason standard, as a "market power screen".

[83] One illustrative decision in the wake of *Ghirardelli* is the 1915 decision in *Munter v. Eastman Kodak, Co.*, 28 Cal. App. 660 (1915). *Munter* upheld an RPM agreement substantially identical to that of *Ghirardelli* and, for that matter, *Dr. Miles*. It held that it was only where the practice was designed to "establish and foster a monopoly which affects or injures the public welfare", that it could be unlawful RPM. In essence, in order to state a claim for RPM as a violation of the Cartwright Act, it was required that there be sufficient allegations of a combination formed and maintained to "maintain a monopoly of the trade" citing *Grogan* and *Ghirardelli* with approval. Needless to say, a good argument is that the 1909 "reasonable profit" amendment may also have been dispositive, even though not discussed.

[84] *See* Stats. 1975 C.402, section 1; Stat. 1975, c.429, § 1. *See also*, Consumer Goods Pricing Act of 1975, Pub. L. #94-145, 89 Stat. 801, amending 15 U.S.C. section 1, 4510(a), and repealing "the fair trade" exemption established under the 1937 Miller-Tydings amendment to the Sherman Act, and the 1952 McGuire amendment to the FTC Act. See, Miller-Tydings Resale Price Maintenance Act, Ch. 690, Stat. 693 (1937); McGuire Act of 1952, 15 U.S.C. § 45a.

A series of California cases upholding fair trade under the amendments to the Business and Professions Code, include *Associated Oil Co. v. Myers*,[85] *Max Factor & Co. v. Kunsman*,[86] *Dr. Miles California Company v. Sontag Chain Stores Co., Ltd.*,[87] *Great Western Distillery Products, Inc. v. John A. Wathen Distillery Company*,[88] and *Downs v. Benatar's Cut Rate Drug Stores*.[89] The *Downs* opinion suggests a workable "quick look" test which is to determine whether the product subject to a resale price provision "is in fair and open competition with commodities of the same general class produced by others." The court in *Downs* noted, in citing *Ghirardelli* and *Grogan*, that RPM was lawful in California "many years prior to the adoption of the fair trade act". The court stated "the cases dealing with anti-trust laws hold that it is a question of fact in view of all the circumstances where the contracts are entered into when notice of minimum retail prices are given."[90]

Years later, in 1978, Justice Mosk confronted *Dr. Miles*. In the curious case of *Mainland v. Burckle*,[91] the parties entered into a franchise agreement wherein the defendants leased a drive-thru dairy/gasoline station to plaintiffs. The franchise agreement required plaintiffs to purchase gasoline from Powerine Oil Company, and guaranteed plaintiffs a 7% profit on the sale of all gasoline. In exchange for the profit guarantee, the defendants retained the right to set the price of the gasoline sold.

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[85] 217 Cal. 297 (1933)

[86] 5 Cal. 2d 446 (1936)

[87] 8 Cal. 2d 178 (1937)

[88] 10 Cal. 2d 442 (1937)

[89] 75 Cal. App. 2d 61 (1946)

[90] *Id*. at 66.

[91] 20 Cal. 3d 367 (1978).

After two years of operating under the franchise agreement, the plaintiffs refused to allow defendants to set gasoline prices in exchange for the guarantee, and purchased gasoline from another supplier. Plaintiffs filed an action against the defendants and Powerine Oil Company, alleging that the agreement and arrangement violated the Cartwright Act.[92]

Writing for the majority, Justice Mosk stated "[s]ince the Cartwright Act is patterned after the Sherman Act, federal cases interpreting the Sherman Act are applicable in construing our state laws.[93] He then cited a series of federal antitrust cases, including *Socony-Vacuum*,[94] *Trenton Potteries*,[95] and *Dr. Miles*.[96] Without any citation to the prior judicial history of "partial restraints" under the California common law, or *Grogan*[97] or *Ghirardelli*,[98] Justice Mosk stated:

> The federal law in this regard is too well-established to require extensive discussion. … [citations omitted]. Indeed, at its last term, the Supreme Court reaffirmed this principle. Though reverting to the rule of reason in a case involving vertical geographic restrictions (*Continental TV, Inc. v. GTE Sylvania, Inc.* (1977) 433 U.S. 36) the Court pointedly observed that it was concerned there only with nonprice vertical restrictions and that the *per se* illegality of price restrictions has been established firmly for many years.[99]

Thus, the *Mainland* court failed to recognize the sea-change of *Continental T.V.*, or appreciate the gradual erosion of *per se* rules brought about by the recent recognition of

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[92] In footnote 15 of the opinion, Justice Mosk noted "Thus, the fact that defendants set the price at which plaintiffs sold gasoline at approximately the level of plaintiffs' competitors is not important. Under the franchise agreement, they had absolute power to fix the price and they could, if they wished, have pegged it higher or lower than market price." Query, whether today, there would have been "antitrust injury" sufficient to sustain a finding of injury to "business or property". *See, e.g., Atlantic Richfield Co. v. U.S.A. Petroleum Co.*, 495 US 328 (1990).

[93] 20 Cal. 3d 367, 376.

[94] *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940).

[95] *United States v. Trenton Potteries*, 273 U.S. 392 (1927).

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

[97] *Grogan v. Chaffee*, 156 Cal. 611 (1909).

[98] *D. Ghirardelli Co. v. Hunsicker*, 164 Cal. 355 (1912).

[99] 20 Cal. 3d at 377.

advancements in economic analysis, that rendered written or formalistic *per se* rules inapplicable.[100] Justice Mosk did note, however,

> Admittedly, the arrangements between the parties did not amount to the usual vertical arrangement whereby different levels of business entities, completely independent of one another insofar as profits and losses are concerned, agree to maintain a price at which goods will be resold. … [I]t might be theorized that plaintiffs were conducting some type of joint enterprise with defendants for the sale of gasoline and that the prohibition against price-fixing in section 16720 was not intended to apply in such a situation.[101]

Justice Clark dissented. He began his opinion by noting:

> "Anomalously, the majority uses the anti-price fixing provisions of the Cartwright Act - designed to reduce prices and to eliminate restraint of trade – to invalidate contractual provisions designed to reduce prices and to foster competition with other retailers."[102]

He noted that the undisputed evidence established that the purpose of the joint venture was to sell gasoline at prices below the competition, and that only when the plaintiffs breached the agreement, were prices raised above some competitors.[103]

Justice Clark recognized, as did the trial court, that both the right to profit and the risk of loss of retail sales were shared by non-competing parties, operating at different levels in the distributive chain. Thus, the agreement between them could not be regarded as constituting a *per se* violation of a price fixing regulation, as it was intended to promote competition. Justice Clark

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[100] *Continental T.V.* suggested that the Supreme Court would simply wait for a proper case, that would allow for the demise of *Dr. Miles*, in an appropriately narrow decision. The Court noted that in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 374, the government had abandoned its *per se* theories, and had proceeded on a rule of reason basis. 433 U.S. at 44.

[101] *Id.* at 378. Was Justice Mosk alluding to California Business and Professions Code Section 16725, which states that "it is not unlawful to enter into agreements to form associations or combinations, the purpose and effect of which is to promote, encourage or increase competition in any trade or industry, of which we are in furtherance of trade"? A good argument can be made that this was exactly the purpose and effect of the pricing formula agreed upon by the parties to the franchise agreement, which was to curb dealer "opportunism". *See*, *State Oil Co. v. Kahn*, 522 U.S. 3 (1997).

[102] *Id*. at 385.

[103] *Id*.

would have found that the parties were, in effect, engaged in a joint enterprise. Nevertheless, rightly or wrongly, this is how *Dr. Miles* became the law in California in 1978.

5. <u>Along Comes Leegin</u>.

The sea-change of *Continental T.V.* has not abated. It has continued, as has erudite commentary from antitrust practitioners and economists, on the efficacy of business practices once misunderstood, misapplied, or summarily condemned. In the wake of the increased economic understanding referenced in *Continental T.V.*, we have seen the rollback of *per se* rules with *Fortner II,*[104] *Jefferson Parish*,[105] *Monsanto*,[106] *Business Electronics*,[107] *Khan*,[108] and now *Leegin.*[109]

As these decisions have been familiar to antitrust practitioners in the years since 1977, our exposition here will be brief. Suffice it to say, economic learning advancements have made the talisman of *per se* rule entitlement subject to recurring and continuing scrutiny, not on an historic basis, but on a contemporary one. In *Broadcast Music, Inc.*,[110] the Supreme Court stated that when a "practice facially appears to be one that would always or almost always tend to restrict competition and decrease output […] or instead one designed to 'increase economic

[104] *United States Steel Corp. v. Fortner Enterprises, Inc.*, 429 U.S. 610 (1977).

[105] *Jefferson Parish Hosp. Dist. 2 v. Hyde*, 466 U.S. 2 (1984).

[106] *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984).

[107] *Business Elec. Corp. v. Sharp Elec. Corp.*, 485 U.S. 717 (1988).

[108] *State Oil Co. v. Khan*, 522 U.S. 3 (1997).

[109] *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007).

[110] *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1 (1979).

efficiency and render markets more, rather than less, competitive," it is considered per se illegal and may be condemned without further analysis.[111]

Thus, under the *per se* rule, a restraint is conclusively presumed as unreasonable "without elaborate inquiry as to the precise harm [it has] caused or the business excuse for [its] use".[112]

Because the application of a *per se* rule would foreclose any in-depth analysis of the purpose of the restraint, and the nature of any market effects that it may or may not cause, the Supreme Court has limited its application to categories of restraints for which no elaborate study is required to demonstrate that the nature and effect of the rule, to be declared "per se" is "plainly" or "manifestly" anticompetitive.[113] In the words of *Northern Pac. Ry Co.*, the question is: does the restraint have a "pernicious effect on competition and lack . . . any redeeming virtue"?[114]

A developing analytical tool between the "*per se*" conclusive presumption that will exclude mitigating evidence, and a full blown "rule of reason" inquiry of the *Chicago Board of Trade*[115] variety, is the "quick look", "truncated", or "structured" variety of the rule of reason. Thus, where there are commercial intricacies that are beyond the usual factual pattern that would warrant the application of a *per se* rule, it may be necessary to make an initial characterization of the "always or almost always" element. Do we really know enough about what we think we are seeing to be confident that there could hardly ever be any other result? Should we allow the

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[111] *Id*. at 19-20. (citing *National Society of Professional Engineers v. United States*, 435 U.S. 679 at 688; *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, at 50, and *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1, 4.

[112] *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1, 5 (1958). *See also*, *NCAA v. Board of Regents*, 468 U.S. 85, 103-04 (1984) (*per se* rules are evoked when surrounding circumstances make the likelihood of anticompetitive conduct so great as to render unjustified further examination of the challenged conduct").

[113] *See*, *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 723 (1988).

[114] *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1, 5 (1958).

[115] *Chicago Board of Trade v. United States*, 246 U.S. 231 (1918).

defendant to proffer evidence of purpose for effect? The more we learn about a practice, the more the traditional *per se* inclusiveness of the rule should be tempered, to take account of recent developments in factual and economic analysis.[116] This is nothing more than what the courts have been doing since the evolution from the *Dyers*[117] case to *Mitchel v. Reynolds*,[118] through *Addyston Pipe & Steel Co.*,[119] *Chicago Board of Trade*,[120] and the line of cases leading to *Continental T.V.,*[121] *Khan*,[122] and now *Leegin*.[123] It is a journey of inquiry that by definition, will always be a "work in process". And so it should be, as our objective should be to "get it right". A "*per se*" rule that no longer fits the profile should no longer conclusively exclude evidence of procompetitive purpose or effect.

Thus, a "quick look" analysis reflects traditional attempts to strike the appropriate balance between accurately determining competitive effects in particular factual situations, and the substantial administrative costs of a full blown rule of reason analysis. Thus, where "an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anticompetitive effect on customers and markets, the courts do not expend the not insubstantial judicial effort and resource allocation to require the plaintiff to

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[116] *See*, Christine A. Varney, ANTITRUST FEDERALISM: ENHANCING FEDERAL/STATE COOPERATION at 9 (Oct. 7. 2009)

[117] Y.D. Pasch. 2 Hen. V., f. 5, Pl. 26 (C.P. 1414).

[118] 24 Eng. Rep. 347 (K.B. 1711).

[119] *United States v. Addyston Pipe & Steel Co.*, 175 U.S. 211 (1899).

[120] *Chicago Board of Trade v. United States*, 246 U.S. 231 (1918).

[121] *Continental T.V., Inc. v. GTE Sylvannia, Inc.*, 433 U.S. 36 (1977).

[122] *State Oil Co. v. Kahn*, 522 U.S. 3 (1997).

[123] *Leegin Creative Leather Products v. PSKS, Inc.*, 551 U.S. 877 (2007).

establish every aspect of the anticompetitive effect before the burden shifts to the defendant to prove the restraint's offsetting procompetitive effects.[124]

While the courts do not always agree on whether a truncated rule of reason analysis is a separate, stand-alone analytical characterization or is merely an analytical observation post on the continuum of outcomes, a truncated rule of reason analysis is no stranger to the analytical application of antitrust principles.[125]

Similarly, the "quick-look" is no stranger to California antitrust law. Key "quick-look" cases may be categorized as including *Roth v. Rhodes*,[126] as well as *Exxon Corp. v. Superior Court.*[127] Both *Roth v. Rhodes* and *Exxon* utilize forms of "market power screens". So do a myriad of tying cases, since *Jefferson Parish* [128] that tell us that a "*per se*" tying case can only be characterized as "*per se*" where a rule of reason analysis has determined that there is "sufficient economic power" in a properly defined relevant market to enable the person selling the tying product to distort downstream competitive effects in the market for the tied product. Go figure!

Needless to say, this is exactly the approach that *Leegin* invites the practitioner to follow.

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[124] *California Dental Ass'n. v. FTC*, 526 U.S. 756, 770 (1999).

[125] The phrase "quick look" was first used by the Seventh Circuit to describe an analysis that found a restraint to be *per se* illegal when, on a "quick look", its anticompetitive effects were apparent, obviating a need for an elaborate inquiry under the rule of reason. *See*, *General Leaseways, Inc. v. National Truck Leasing Ass'n.*, 744 F.2d 588, 595 (7th Cir. 1984). *See also*, *FTC v. Indiana Federation of Dentists*, 476 U.S. 447 (1986); *NCAA v. Board of Regents*, 468 U.S. 85 (1984). However, in *California Dental Association Ass'n. v. FTC*, *supra*, the FTC rejected a "quick look", and condemned the association's rules limiting advertisements of price, particularly involving discounts, and quality claims. The Supreme Court reversed, and held that the FTC's "quick look", should have been a "longer look", but still short of the "fullest market analysis". The court should instead adopt a flexible inquiry appropriate to the needs of a given case, and "look into the circumstances, details, and logic of a restraint. 526 U.S. at 781. *See*, Stephen Calkins, *California Dental Association: Not A Quick Look But Not the Full Monty*, 67 ANTITRUST L.J. 495 (2000).

[126] 25 Cal. App. 4th 530 (1994).

[127] 51 Cal. App. 4th 1672 (1997).

[128] *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984). See discussion of *Jefferson Parish* as a structured rule of reason case, in *Gellhorn*, *supra* at pp. 388-90.

The facts with *Leegin* suggests itself as being highly comparable to those of *Ghirardelli*.[129] Petitioner, Leegin Creative Leather Products Inc. ("Leegin") designed, manufactured and distributed leather goods and accessories. In 1991, it began to sell leather belts under the "Brighton" brand. The Brighton brand was an attempt by Leegin to expand its business into the women's fashion accessory market. As such, it was a new product introduction into a heterogeneous market, where fashion acceptance by consumers is essential to brand success. In attempting to sell its new Brighton belt line to a market consisting mostly of independent, small boutiques and specialty stores, it utilized RPM as a vehicle to enhance proper brand facings and service, to achieve maximum outlet penetration.

To induce small boutique operators to add its product line to their existing line, Leegin wished to incentivize them into acceptable product promotion and service, that would augment the appeal of its new line to consumers. The record in *Leegin* contains the testimony of one of its key executives, Mr. Kohl, who explains:

> [W]e want the consumers to get a different experience than they get in Sam's Club or in Wal-Mart. And you can't get that kind of experience or support or customer service from a store like Wal-Mart.[130]

Accordingly, it wanted to insure that the small retailers who would accept its new product introduction into their line would be induced to do so by an enhanced profit margin, as a result of a minimum price schedule applicable to the Brighton line of belts. This was the origin of the "Brighton retail pricing and promotion policy". In accordance with the terms of the policy, Leegin refused to sell to retailers that discounted the line below Leegin's suggested prices. While this could have been accomplished through a *Colgate* pre-announced term and conditions

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[129] 164 Cal. 355 (1912).

[130] 551 U.S. at 882.

program, it lapsed into an "agreement", and was thus subject to analysis as a price restraint. The issue was whether its dealer-encouragement policy would be subject to the application of *Dr. Miles*, to the exclusion of any mitigating evidence of its procompetitive purpose and intended effects.

It subsequently discovered that Kay's Kloset, an outlet of PSKS, was discounting Leegin's entire Brighton brand line by 20%. Kay's Kloset contended that it was, in effect, "meeting competition". Leegin nevertheless requested that it cease discounting. When it refused to do so, Leegin stopped selling to Kay's Kloset stores. Thus the issue was framed.

PSKS sued Leegin in the Eastern District of Texas, alleging a *per se* violation of Section 1 of the Sherman Act, citing *Dr. Miles*.[131] Leegin responded that it had established a unilateral pricing policy under *Colgate*.[132] The jury disagreed, and found an "agreement". It awarded damages after having been instructed as to the *per se* rule of *Dr. Miles*. The Fifth Circuit affirmed. The Supreme Court granted certiorari.

A good argument can be made that this was exactly the sort of case that had been prophesized in *Continental T.V.*[133] and *Khan*,[134] but was not before either of those courts. Both the *Continental T.V.* and *Khan* Courts were careful to narrowly limit the scope of its ruling to the facts and issues before it, and not to broaden its inquiry. Nevertheless, a review of the literature developed in the wake of *United States v. Arnold Schwinn & Co.*, in 1967,[135] and *Albrecht v. Herald Co.*[136] foretold what was sure to come to fruition. Our understanding of economic and

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

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

[133] *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977).

[134] *State Oil Co. v. Khan*, 522 U.S. 3 (1997).

[135] 388 U.S. 365 (1967).

[136] 390 U.S. 145 (1968).

commercial reality had moved substantially forward since 1911, and it was readily apparent that the days of *Dr. Miles* were drifting away, as sand through the glass. *Leegin* was just such a case. In reversing, the Supreme Court, with Justice Kennedy writing for the majority, recognized that the days of *Dr. Miles* were now ended. As Justice Kennedy wrote:

> The reasoning of the Court's more recent jurisprudence has rejected the rationales on which *Dr. Miles* was based. By relying on a common-law rule against restraints on alienation … the Court justified its decision based upon "formalistic" legal doctrine rather than "demonstrable economic effect." … The Court in *Dr. Miles* relied upon a treatise published in 1628, but failed to discuss in detail the business reasons that would motivate a manufacturer situated in 1911 to make use of vertical price restraints.[137]

The Court continued:

> Usually associated with land, not chattels, the rule arose from restrictions removing real property from the stream of commerce for generations. The Court should be cautious about putting dispositive weight on doctrines from antiquity but of slight relevance. We affirm that the state of the common law 400 or even 100 years ago is irrelevant to the issue before us: the effect of the antitrust laws upon vertical distributional restraints in the American economy today.[138]

In addition, Justice Kennedy pointed to another analytical flaw implicit in *Dr. Miles*.

> *Dr. Miles*, furthermore, treated vertical agreements a manufacturer makes with his distributors as analogous to a horizontal combination among competing distributors. . . . In later cases, however, the Court rejected the approach of reliance on rules governing horizontal restraints when defining rules applicable to vertical ones. [citing *Business Electronics* at 374]… *Our recent cases formulate antitrust principles in accordance with the appreciated differences in economic effect between vertical and horizontal agreements, differences that the Dr. Miles Court failed to consider*.[139]

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[137] 551 U.S. at 887.

[138] *Id.* at 888 (quoting from *Continental T.V.*, 433 U.S. at 53, n. 21).

[139] *Id*. (emphasis supplied).

The Court then reiterated the principal reason for the change in the rule. This was because the "economics literature is replete with procompetitive justifications for a manufacturer's use of resale price maintenance."[140] In addition to the Brief for Economists as *Amici curiae*, the Court cited to the ABA Section of Antitrust Law, Antitrust Law and Economics of Product Distribution,[141] and works by Professors Hovenkamp, Bork, Comanor, and Scherer.[142]

While there may not be total unanimity of opinion on the issue, it can "always or almost always" be said that "all or almost all economists" support the proposition that there is *some* pro-competitive form of vertical RPM, and that it can no longer be condemned by a *per se* rule of conclusive illegality. This assumes, of course, that we are only concerned with summarily condemning conduct that is "always or almost always" anticompetitive.

The opinion by Justice Kennedy also recognizes, however, that not all vertical RPM *will* be procompetitive. A great deal of it might be anticompetitive, and could "flunk" either a "quick look" or "full blown" rule of reason. Justice Kennedy notes several varieties that may be in this category. These may include the use of resale price maintenance by a dominant manufacturer or retailer, who can abuse resale price maintenance for anticompetitive purposes, where a firm lacking market power cannot. Thus, the test might be to determine whether the manufacturer or

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[140] *Id.* at 889, citing Brief for Economists as *Amici Curiae* 16, cited for the proposition "In the theoretical literature, it is essentially undisputed that minimum [resale price maintenance] can have procompetitive effects and that under a variety of market conditions is unlikely to have anticompetitive effects").

[141] ABA Section of Antitrust Law, ANTITRUST LAW AND ECONOMICS OF PRODUCT DISTRIBUTION 76 (2006) ("[t]he bulk of the economic literature on [resale price maintenance] suggest that [it] is more likely to be used to enhance efficiency than for anticompetitive purposes").

[142] *See*, H. Hovenkamp, THE ANTITRUST ENTERPRISE: PRINCIPLE AND EXECUTION 184-191 (2005); R. Bork, THE ANTITRUST PARADOX 288-291 (1978); Brief of William S. Comanor, et al. as *Amici Curiae*. 3 ("[g]iven [the] diversity of effects [of resale price maintenance] one could reasonably take the position that a *rule of reason* rather than a *per se* approach of warranted."); F.M. Scherer & D. Ross, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 558 (3d ed. 1990) ("The overall balance between benefits and costs [of resale price maintenance] is probably close.")

retailer utilizing the RPM restraint in fact can exercise market power to the detriment of overall competitive effects.[143]

Justice Kennedy also notes that RPM may, in appropriate circumstances, facilitate a manufacturer cartel. The use of RPM by a manufacturer's cartel could assist the cartel managers in identifying price-cutting manufacturers who benefit from the lower prices they offer, when they "cheat". In addition, vertical price restraints may also be used to organize cartels at the retailer level.[144] This phenomenon has been reported by many to be not uncommon, and is certainly not unknown in Supreme Court cases, such as, *e.g.*, *United States v. General Motors, Corp.*[145]

Then, why one might ask, would 35 states attorneys general file *amicus* briefs in support of retaining the rule in *Dr. Miles*?

We're not the people to ask. We could speculate that the *per se* rule is comforting in its ease of application and the message of certainty that it sends to the business community. But, as Justice Kennedy points out, the use of the *per se* rule where not warranted would be a tax on procompetitive business practices and innovation.[146] It is not a costless exercise. The use of a market power screen, plus appropriate discovery at the retail level should solve "all as almost all" concerns, with a minimum expenditure of judicial resources.

As the Sherman Act and the Cartwright Act have similar aims, and both are grounded in the common law, they should reflect the present currency value of accumulated experience, and move forward.[147]

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[143] See, 551 U.S. 892-895.

[144] *Id*.

[145] 384 U.S. 127 (1966).

[146] 551 U.S. at 894-896.

[147] Hibner & Cooper at 83-84, 130-131.

As *Dr. Miles* is no longer good law in federal courts, and as it was the sole surviving rationale for a *per se* rule under the Cartwright Act, the maxim of Section 3510 of the California Civil Code (1872) remains apt: "When the reason of a rule ceases, so should the rule."