

## The Supreme Court Goes Beyond “Bong Hits 4 Jesus”

While many in the press were transfixed with the end of term decisions by the new U.S. Supreme Court on school integration and whether high school students had a free speech right to hold up a banner saying “Bong Hits 4 Jesus,” less attention was paid to a case that has the possibility to transform the economic structure of retailing in the U.S. In the case of *Leegin v Kay Klost* the court overturned 96 years of settled anti-trust law regarding whether a manufacturer can set a minimum price of a product at retail without **automatically** violating the anti-trust laws. This article will take a quick look at the possible business implications for the retail industry and also what this means to the evolving digital sign industry.

### What the court held

Without using legal jargon here, the court in a close 5 – 4 decision held that manufacturers can in **many** situations (but not all) engage in setting minimum retail prices without **automatically** running into the substantial penalties of the anti-trust laws. You may have noticed that when you read certain ads they contained the clause, “suggested retail price.” In essence this was the manufacturer, be it Nike or Procter & Gamble, saying what they wanted the product sold for. Before this case they could “suggest” but not “set” what the end user price should be. This case now will allow the manufacturer to set a minimum price at retail and will allow manufacturers to withhold product from resellers that do not toe the line on pricing.



Without exception the manufacturer and retailers have wanted to set “floors” under retail prices and not “ceilings.” This is for obvious reasons. Again, before this case it was **automatically** (“per se”) a violation of anti-trust law to do this. Now the courts will examine each instance on a case by case basis using the “rule of reason” test. Thus assuring more work for...if you guessed the legal profession you would be right. The dissent by Justice Breyer points out that litigation of a “rule of reason” anti-trust case is one of the most expensive procedures in anti-trust law, which is in itself very expensive. Justice Anthony Kennedy, writing for the majority, wrote that one reason to allow these types of arrangements was that discount retailers were in essence getting a free ride. He wrote that the current price setting structure allowed this by having potential customer look, try on and shop the full service retail stores but then buy from the discounters. Justice Kennedy wrote that by not **automatically** prohibit-

ing this type of pricing agreement the law will now produce “more options” for consumers by producing high service/high price retailers, low price/low service retailers and everything in between. According to the court, this in turn will have the effect of creating more, not less, competition.

### The Likely Impact

The business impact of the case is, in a word, unclear. Some argue that it will have no impact at all. But, the majority of people in the retailing community appear to believe it will have both short and long term implications.

### Summary of the “no impact” Arguments

Those that state the case will have no impact at all argue that manufacturers already are able to have their way on the retail price without having to resort to actual retail price “floors.” They argue

that through the use of withholding co-op funds and other incentives to retailers they were able to set the price anyway. Still others who do not see the case as a big deal, point out that while the case allows manufacturers to set the price it does not tell retailers what products they have to carry. Another way to say this is that Wal-Mart will simply not carry any product where the manufacturer has the grand idea to tell the company what to sell it for. That product will be “disappeared.” Still others argue that even if there is an impact it will not be large due to the likes of eBay. This argument is best summarized by the statement that “the internet is turning every product into a commodity.”

### Summary of the “yes it will impact retail” Arguments

There are several arguments that share the assumption that the case will have an impact. The first is that it will give a boost especially to luxury good manufacturers and dilute what someone called “massclusivity” by Target and the like. Some argue that the very reason Apple has been so successful is that it took its brand by the “horns” so to speak and opened the Apple Store. These stores allowed Apple to control everything including the price. These commentators argue that it

is “about time” that manufacturers can use price to position their products. Others argue that it will allow retailers to set themselves apart from the discounters by offering high service at a price, just what Justice Kennedy argued.

On the downside, some are saying that it will just lead to higher prices in general but will have an impact. Consumer product goods (CPG) companies, someone argues, will have the ability to set a retail price when introducing a new product and then adjust it as they see fit. This they say will allow the CPG companies to maximize the return on their investment in R&D and advertising.

### ***ipSigns Analysis***

#### ***The Case Will Have an Impact on Retail***

We agree with those that believe the case will have an impact. For most people the Supreme Court is an abstract and faraway place. It is after all the only branch of government where so powerful a group of people are appointed and not elected. But we think there are likely to be both short and long term effects on the retail industry. Overall we believe that the case will tip the scales in the power relationships between retailers and manufacturers back towards the manufacturers. This will slow the trend in recent years of the retailers having more power in the relationship.

#### ***Look for a Boom for High End Specialty Good Manufacturers***

The first effect is that the case will be a boom to luxury goods manufacturers and retailers. The case will allow specialty good manufactures to place their high end goods into specialty stores without

having to think about what discounters will do. This ***may also*** make it less likely for some companies to open their own retail outlets a la Apple. Nike has been considering for some time an expansion of their direct channel. It will be interesting to see if this case results in that company holding off. On the other hand luxury good manufactures may create their own stores anyway for brand promotion reasons. Due to the case they will not have to worry that across the street a discounter is selling its products for 25% off.

#### ***Watch for New Niche Retailers***

As predicted by the majority, the case will likely help high end specialty retailers as well their manufacturing partners. They will be able to sell products at a high margin so long as they cater to the higher end market and deal in goods that are not mass market.

#### ***Prices at Retail are Likely to Go UP***

The dissent in the case cites several studies that occurred before and after 1975 when retail price maintenance occurred in 36 states before it was made illegal. The Department of Justice found that minimum price maintenance had raised prices by 19% to 27% in the states that allowed it compared to those where it was outlawed. Justice Breyer, again in the dissent, ends by saying, “the only safe prediction to make about today’s decision are that it will likely raise the price of goods sold at retail.....” We agree that this is likely.

#### ***There will be more “private label” goods***

In part to offset higher prices, we believe that there will be an increase in “private label”

goods. These goods will likely come as close as possible to looking like the “real thing” or functioning like them without crossing the line. Of course some will cross the line. This will probably again add to retailers bottom lines in the long haul.

#### ***The Case May Throw A Lifeline to Consumer Electronics Retailers***

Depending on how the manufacturers of consumer electronics goods respond to this case, it could have a very positive effect on the beleaguered CE retailers. It is possible that CE manufacturers will see this as an opportunity to throw themselves and their retail distribution chain a life jacket. If enough of the manufacturers do this it will prop up the prices of these goods. On the other hand, this is just the type of situation where if too many manufactures adopt this ( what the court terms a “producer cartel” ) or if the retailers “were the impetus” for the adoption of resale price maintenance, it will be found to be an anti-trust law violation even under the far less strict “rule of reason” test.

#### ***Likely Effects on Digital Sign Industry***

Last but by no means least, we believe the case will have an impact on the digital sign industry. We are just not sure what the impact will be. On the one hand, the case is likely in the short run to lead to less “trade spending” by manufactures. These are the dollars the manufactures have used in the past at least in part to enforce their retail prices. Why spend trade dollars for that purpose when you can just do it out right? Today the vast majority of the “advertising dollars” spent on digital sign ads in-store come from these dollars. There is some movement of dollars out of true mass media ad budgets

but the “dam has not broken” yet.

On the other hand, retailers are likely to need to differentiate what will likely be their higher margin products that are subject to retail price maintenance on something other than price. This could have the effect of retailers and manufacturers wanting to spend more in the store in order to influence the shopper at the “first moment of decision” more than ever. They will want to position these high end/high margin/high service goods as such to remind customers why they are spending more. But, in the short run it may have a negative effect on ad based systems.

#### ***No One Really Knows for Sure***

The truth is that no one really knows for sure what the impact, if any, there might be. We just believe that on balance the case will have an impact. Let us know what you think the impact will likely be by visiting our website and entering your comments by clicking on the “contact us” button. If you believe it will be “business as usual,” please send us those comments as well. We will collect the comments and write a summary article.