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A LEGAL ROADMAP TO COMPLIANCE: SETTING AND SUGGESTING RESALE PRICES WITHIN THE BOUNDS OF U.S. ANTITRUST LAW

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Introduction

A full century after Congress enacted the Sherman Act, the U.S. antitrust rules governing when and how a supplier of goods can influence or perhaps even dictate its customers' resale prices are complicated, murky, and surprisingly unsettled. The difficulties that arise in counseling clients in this area can be summed up as follows:

- As a result of the 2007 landmark Supreme Court decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.* __U.S. __, 127 S. Ct. 2705 (2007) (hereinafter, "*Leegin*"), which made minimum resale price maintenance (RPM)—i.e., contracts under which suppliers obligated resellers to sell the supplier's products at no less than the price dictated by the supplier—subject to the rule of reason, there are no longer any bright lines separating legal from illegal conduct under federal law. Assessing RPM under the rule of reason in the same manner as other vertical restraints entails a fact-intensive consideration of relevant market definition and market power, and a balancing of procompetitive and anticompetitive effects.

- The spectrum of potentially challengeable conduct runs from merely suggesting resale prices at the least risky end, to enforcement of RPM with threats and retaliation at the other end. In many cases, the supplier's manner of communicating about resale prices makes it hard to distinguish generally permissible unilateral expressions of pricing and marketing objectives from hardball demands for a bilateral RPM contract.

- Further complicating matters, some state enforcers have expressed the view that regardless of how federal law treats minimum RPM, such contracts remain *per se* illegal under state law. Recent cases in California and New York illustrate the continuing risk of government challenges to conduct that would otherwise be presumptively legal under federal law.

- All of the above difficulties are heightened in situations in which the suppliers resellers must compete for online sales in a global environment driven by increasingly sophisticated Internet technologies, mobile apps, and the like, in which multiple resellers

of the same or similar products can be instantaneously ranked solely on the basis of resale price. Suppliers that hope to influence the resale price of their products—whether through unilateral minimum advertised price (MAP) policies or through actual RPM contracts—need to balance their commitment to that objective with the prospect of more limited distribution outlets and possibly lower sales.

This short paper offers a legal roadmap to assist non-antitrust expert practitioners with legal issue-spotting in the U.S. law of RPM.[1] Of course, it is far less expensive to prevent antitrust problems that it is to fix them. Accordingly, the time to retain an advisor with specific expertise in this area is before the client begins communicating with its customers about its resale price or price advertising objectives—not after unfortunately-worded, discoverable documents have been created or when customers or government regulators publicly accuse the client of illegal price-fixing.

I. Vertical Price-Fixing and Federal Law

Section 1 of the Sherman Act provides the legal framework applicable to vertical resale price and price-related agreements. Section 1 prohibits "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations . . . ."[2] Section 1 applies only to concerted or coordinated action between or among multiple entities (i.e., not to unilateral conduct by a single entity[3]), and only to "unreasonable" restraints of trade (i.e., restraints that "may suppress or even destroy competition"[4]). By its terms, the statute governs conduct affecting interstate commerce—a requirement that would likely be met in most situations confronted by practitioners today.

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[1] Outside the U.S., maximum and minimum RPM may entail more or less legal risk, depending on the industry and the size and market shares of the parties involved. Because the rules and enforcement policies can vary widely from jurisdiction to jurisdiction, a detailed overview is beyond the scope of this paper. These varying rules, however, pose enormously complex challenges to global companies that wish to ensure that resale prices in one jurisdiction do not undermine resellers in another jurisdiction.

[2] 15 U.S.C. § 1.

[3] *See, e.g., United States v. Parke, Davis & Co.*, 362 U.S. 29, 45 (1960) (rejecting defendant's claim that it acted unilaterally and holding that there was sufficient evidence of an unlawful agreement in violation of § 1 where Parke Davis invoked its wholesalers "to stop the flow of Parke Davis products to the retailers, thereby inducing the retailers' adherence to its suggested retail prices").

[4] *See Bus. Elecs. Corp. v. Sharp Elecs. Corp*., 485 U.S. 717, 723 (1988) ("Since the earliest decisions of this Court . . . , we have recognized that [§ 1] was intended to prohibit only unreasonable restraints of trade."); *see also, e.g., Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918).

A. Maximum and Minimum RPM Under Federal Law

From the enactment of the Sherman Act in 1911 until 1997, RPM was *per se* illegal. In 1997, the Supreme Court held that *maximum* RPM agreements, i.e., ceilings for resale pricing, were to be judged under the rule of reason rather than the *per se* rule. *State Oil Co. v. Khan*, 522 U.S. 3 (1997). Ten years later, in *Leegin*, the Supreme Court rejected continued application of the *per se* rule to *minimum* RPM, declaring that *per se* illegality should be reserved for restraints that have "manifestly anticompetitive effects" and "lack any redeeming virtue."[5]

The Supreme Court's analysis in *Leegin* suggests various factors be examined in assessing potential anticompetitive effects. Those challenging RPM programs complain that they result in higher retail prices for the manufacturer's products. But, as the Supreme Court stated, "Many decisions a manufacturer makes and carries out through concerted action can lead to higher prices . . . [y]et no one would think these actions violate the Sherman Act because they lead to higher prices. . . . The manufacturer strives . . . to promote its brand because it believes this conduct will lead to increased demand despite higher prices. The same can hold true for resale price maintenance."[6]

The Supreme Court identified three (non-exclusive) examples of how RPM may harm competition; these are likely to be the focus for lower courts in such cases in the future. First, the Court said that "the number of manufacturers that make use of the practice in a given industry can provide important instruction."[7] Obviously if the market is controlled by a few manufacturers and they implement RPM, the opportunity for collusion among them increases. Second, the Court stated, "The source of the restraint may be an important consideration," particularly if the restraint was adopted as a result of pressure from retailer collectives.[8] Finally, "that a dominant manufacturer or retailer can abuse resale price maintenance for anticompetitive purposes may not be a serious concern unless the relevant entity has market power."[9]

At least one lower court applied these factors in subsequent rule-of-reason analysis. In *Toledo Mack Sales & Service, Inc. v. Mack Trucks, Inc*., 530 F.3d 204 (3d Cir. 2008), the Third Circuit noted:

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[5] 127 S. Ct. at 2713. Since *Leegin* issued, efforts have been undertaken to introduce federal and state legislation repealing the decision and declaring minimum RPM per se illegal. To date these efforts have been unsuccessful, except in Maryland, as discussed *infra*.

[6] *Id*. at 2719.

[7] *Id.*

[8] *Id.*

[9] *Id.* at 2720.

> In *Leegin*, the Supreme Court also identified additional issues relevant to the rule of reason inquiry. Two of those are particularly relevant to Toledo's appeal. First, "[t]he source of the restraint may be an important consideration. If there is evidence retailers were the impetus for a vertical price restraint, there is a greater likelihood that the restraint facilitates a retailer cartel...." 127 S. Ct. at 2719. Second, "that a dominant manufacturer or retailer can abuse resale price maintenance for anti-competitive purposes may not be a serious concern unless the relevant entity has market power." Id. at 2720.

The Court found statements by Mack executives sufficient to allow a jury to decide whether an agreement between Mack and its dealers continued into the limitations period. The Court further found, consistent with *Leegin*, that Toledo produced evidence that the agreement was the result of dealer pressure. The Court stated that Toledo also presented sufficient evidence to allow a jury to conclude that the agreement between Mack and its dealers produced anticompetitive effects in the relevant product and geographic markets.[10]

Since *Leegin*, courts have also focused on the extent to which plaintiffs have defined relevant markets sufficient to permit a rule-of-reason analysis.[11] They have likewise considered the presence of market power and the extent to which the restraint was, in fact, a horizontal conspiracy among dealers foisted upon the manufacturer.[12]

B. Distinguishing Bilateral Resale Price Agreements From Unilateral "*Colgate*" Policies

It is not a violation of Section 1 for a supplier to provide its resellers with suggested resale prices.[13] In such a case there is no agreement or meeting of the minds on the pricing as long as

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[10] *See also McDonough v. Toys R Us, Inc.*, 2009 WL 2055168 (E.D. Pa. 2009).

[11] *See, e.g., PSKS, Inc. v. Leegin Creative Leather Products, Inc.*, 2009 WL 938561 (E.D. Tex. Apr 06, 2009) (rejecting plaintiff's market definition of "wholesale sale of brand-name women's accessories to independent retailers"), *aff'd,* 615 F.3d 412 (5th Cir. 2010), *cert. denied,* U.S., No. 10-635 (Feb. 22, 2011); *Jacobs v. Tempur-Pedic International, Inc.*, 2007 WL 4373980 (N.D. Ga. Dec. 11, 2007) (rejecting claim that relevant market could be limited to "visco-elastic foam mattresses"), *aff'd*, 626 F.3d 1327 (11th Cir. 2010).

[12] See *Toledo Mack, supra*: *McDonough, supra*; *Spahr v. Leegin Creative Leather Products, Inc.*, 2008 WL 3914461 (E.D. Tenn. 2008).

[13] *See, e.g., Monsanto Co. v. Spray-Rite Serv. Co*., 465 U.S. 752, 761 (1984) ("the manufacturer can announce its resale prices in advance and refuse to deal with those who fail to comply"); *Isaksen v. Vermont Castings, Inc*., 825 F.2d 1158, 1162 (7th Cir. 1987) (no violation in providing suggested price list to distributors).

the reseller remains free to deviate from the suggested price.[14] The supplier, however, is free to inform the reseller's customers of suggested retail prices through direct advertising, even though this may pose a dilemma for a reseller that would prefer to set its own prices.[15]

Under the so-called *Colgate* doctrine, a supplier may unilaterally terminate a reseller that refuses to conform to previously-announced suggested resale prices.[16] However, if the termination or refusal to deal is accompanied by warnings, cajoling, threats or conditional grants of second chances, an RPM agreement may be inferred if the reseller gives some indication of acquiescence in such threats or coercion, even if it "merely grunts, but complies."[17]

The concept of a "meeting of the minds" with regard to price-fixing allegations was heavily discussed in the Supreme Court case of *Monsanto Co. v. Spray-Rite Serv. Corp.,* 465 U.S. 752 (1984). In *Monsanto,* the Court stated that a manufacturer's independent acts to set minimum resale prices, without seeking agreement from its retailers, did not amount to a contract. *Id.* at 761; *see also United States v. Colgate & Co.,* 250 U.S. 300, 307 (1919) (reaffirming longstanding right of a private manufacturer to decide with whom he wants to do business and "announce in advance the circumstances under which he will refuse to sell.").

The *Monsanto* Court further explained:

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[14] *See, e.g., Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 735-36 (1988) ("a vertical restraint is not illegal *per se* unless it includes some agreement on price or price levels"(italics in original)); *Monsanto Co.,* 465 U.S. at 764 n.9 (proof of a meeting of the minds by a distributor and manufacturer sufficient to establish a resale price maintenance agreement requires "more than a showing that the distributor conformed to the suggested price").

[15] *See, e.g., Jack Walters & Sons Corp. v. Morton Bldg., Inc.,* 737 F.2d 698, 707 (7th Cir. 1984) (direct advertising of suggested resale prices by manufacturer engaged in dual distribution was "perfectly lawful").

[16] *E.g., United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919) (reaffirming longstanding right of private manufacturers to decide with whom they want to do business and "announce in advance the circumstances under which [they] will refuse to sell.").

[17] *Isaksen v. Vermont Castings, Inc.,* 825 F.2d 1158, 1163 (7th Cir. 1987), *cert. denied,* 486 U.S. 1005 (1988), discussed *infra*. *Compare, e.g., Acquaire v. Canada Dry Bottling Co.*, 24 F.3d 401, 410 (2d Cir. 1994) ("[e]vidence of pricing suggestions, persuasion, conversations, arguments, exposition, or pressure is not sufficient to establish the coercion necessary to transgress § 1 of the Sherman Act"); *Jeanery, Inc. v. James Jeans, Inc.*, 849 F.2d 1148, 1158-59 (9th Cir. 1988) ("putting pressure on a retailer", including a threat not to deliver goods, is "consistent with the privilege of independent action permitted a manufacturer under *Colgate*"), *with United States v. Parke, Davis & Co.*, 362 U.S. 29, 47 (1960) (RPM agreement may be inferred from evidence that manufacturer took "affirmative action to achieve uniform adherence" to prices); *See generally* Brian R. Henry & Eugene F. Zelek, Jr., *Establishing and Maintaining an Effective Minimum Resale Price Policy: A* Colgate *How-To,* 17 ANTITRUST 8 (2003).

> the fact that a manufacturer and its distributors are in constant communication about prices and marketing strategy does not alone show that the distributors are not making independent pricing decisions. A manufacturer and its distributors have legitimate reasons to exchange information about the prices and the reception of their products in the market. Moreover, it is precisely in cases in which the manufacturer attempts to further a particular marketing strategy by means of agreements on often costly nonprice restrictions that it will have the most interest in the distributors' resale prices. The manufacturer often will want to ensure that its distributors earn sufficient profit to pay for programs such as hiring and training additional salesmen or demonstrating the technical features of the product, and will want to see that "freeriders" do not interfere. Thus, the manufacturer's strongly felt concern about resale prices does not necessarily mean that it has done more than the *Colgate* doctrine allows.

465 U.S. at 762-63 (internal citations omitted).

Complaints from retailers about other retailers who cut prices, alone, does not demonstrate that an agreement exists between a manufacturer and its retailers to fix prices. *Id.* at 763, n.8. "[S]omething more than evidence of complaints is needed." *Id.* at 764. A party seeking to prove an agreement to fix prices must present evidence that tends to exclude the possibility that the manufacturer and retailers were acting independently, *i.e.,* evidence that the manufacturer and retailers "had a conscious commitment to a common scheme designed to achieve an unlawful objective.'" *Id.* (citations omitted). To show a "meeting of the minds" or a "common scheme", it must be shown that the retailer "communicated its acquiescence or agreement, and that this was sought by the manufacturer." *Id.* at n.9.

Another instructive case is *Isaksen v. Vermont Castings, Inc.*, 825 F.2d 1158 (7th Cir. 1987), *cert. denied,* 486 U.S. 1005 (1988). In *Isaksen,* the manufacturer provided retailers with a suggested retail price list and informed them that they could sell at any price they wanted. *Id.* at 1162. The plaintiff retailer sold the product at prices below the suggested retail prices. Competing retailers complained to the manufacturer. When the manufacturer found out about the plaintiff's discounting, it began to threaten and harass him in a variety of ways. The plaintiff raised his prices in response to threats from the manufacturer that his orders would be mixed up unless he raised his prices. However, he did not raise his prices until one year after the threats started, and in that year, the manufacturer never carried out its threats to harm the plaintiff's business. The court posited that merely adhering to suggested retail prices does not establish an agreement to adhere; but, if the manufacturer employs coercive tactics or threats to achieve compliance, a contract may be implicitly formed by "conduct in lieu of promissory language." *Id.* at 1164.

II. Vertical Price-Fixing and State Law

With respect to RPM, state antitrust and trade regulation statutes cannot be ignored or forgotten. Just as the Sherman Act codified the federal common law prohibitions against monopolies and anticompetitive restraints on interstate trade, state antitrust statutes were enacted to codify similar state common law restrictions.[18] In most states, federal precedent provides guidance in the interpretation of the analogous state law.[19] In some states, however, there may be critical differences between the relevant federal statute and its state analog, heightening the importance of careful research.

A distinctive feature of public enforcement of state antitrust laws is the existence of the National Association of Attorneys General (NAAG) Multistate Antitrust Task Force, which coordinates multistate efforts to investigate and litigate antitrust violations. Historically the Task Force has identified challenges to minimum vertical price-fixing as an enforcement priority.[20]

Notwithstanding the change in federal law wrought by *Leegin*, minimum RPM continues to be a high priority in some states.

- In 2008, Illinois, Michigan, and New York brought a complaint alleging that an office furniture manufacturer's RPM policy was *per se* unlawful price-fixing under their respective state antitrust statutes. *New York v. Herman Miller Inc.*, No.08 CV-02977, 2008-2 Trade Cases (CCH) ¶ 76,454 (S.D.N.Y., filed Mar. 21, 2008). That action settled within days under a consent decree in which Herman Miller agreed to pay $750,000. *See New York v. Herman Miller Inc.*, No.08 CV-02977 (S.D.N.Y. Mar. 25, 2008) (Stipulated Final Judgment and Consent Decree).

- An amendments to the Maryland state antitrust statute which took effect on October 1, 2009, expressly provides that "a contract, combination, or conspiracy that establishes a minimum price below which a retailer, wholesaler, or distributor may not sell a commodity or service is an unreasonable restraint of trade or commerce." Md. Comm.

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[18] *See, e.g., Apex Hosiery Co. v. Leader*, 310 U.S. 469, 500 (1940); *McGahee v. Northern Propane Gas Co.*, 858 F.2d 1487, 1500 (11th Cir. 1988), *cert. denied*, 490 U.S. 1084 (1989); *United States v. Greater Kansas City Chapter Nat'l Elec. Contractors Ass'n*, 82 F. Supp. 147, 149 (W.D. Mo. 1949) ("the Sherman Anti-Trust Law was and is but an exposition of the common law and common law doctrines in restraint of trade"); *Commonwealth v. McHugh*, 326 Mass. 249, 261, 93 N.E.2d 751, 759 (1950) (Massachusetts Antitrust Act, M.G.L. Chapter 93, is "simply declaratory of the common law"); 1 JULIAN O. VON KALINOWSKI, ANTITRUST LAWS & TRADE REGULATION § 8.01[2] (2d ed. 2005), at 8-2 ("The federal antitrust statutes, and many state antitrust laws, are a codification of the common law . . .").

[19] *Id.* at 1-22 to 1-23.

[20] *See, e.g., New York v. Salton, Inc.*, No. 02-CIV-7096 (S.D.N.Y. filed Oct. 2, 2002); *Maryland v. Mitsubishi Elecs. of Am., Inc.*, 1992-1 Trade Cas. (CCH) ¶ 69,743 (D. Md. 1992); *New York v. Nintendo of Am., Inc.*, 775 F. Supp. 676 (S.D.N.Y. 1991).

Code § 11-204. The statute authorizes civil damage and injunctive actions by the state Attorney General as well as any person or business injured (or threatened with an injury) as a result of a violation. Willful violations of the law are punishable with criminal fines of up to $500,000 and up to six months imprisonment.

- In February 2010, the California Attorney General filed brought an action alleging that a beauty products manufacturer violated the California antitrust laws by entering into agreements with resellers prohibiting them from reselling the manufacturer's products below its suggested retail price. *California v. DermaQuest Inc.*, No. RG10497526 (Superior Court, Alameda County, filed Feb. 23, 2010). DermaQuest entered into a Consent Decree less than a month later, in which it repudiated the agreements at issue, agreed not to enter into future RPM agreements, and paid $120,000 in civil penalties and legal costs. *See* 98 Antitrust & Trade Reg. Rep. (BNA) 316 (Mar. 12, 2010).

- In late March 2010, the New York Attorney General filed a petition in New York state court under Section 369-a of the New York General Business Law seeking an injunction barring mattress manufacturer Tempur-Pedic International from enforcing its unilateral suggested retail pricing policy. Under that policy, Tempur-Pedic had announced that retailers were free to charge whatever price they wish for Tempur-Pedic products, but that Tempur-Pedic would not sell its products to retailers who chose to depart from the manufacturer's suggested retail prices. The case was notable for the Attorney General's decision not to pursue the case under the Donnelly Act, the state antitrust statute, but rather under the Section 369-a, the state Fair Trade Act repealer, which simply provides that "contracts" between manufacturers and retailers fixing resale prices are "unenforceable." Ultimately, the trial court granted Tempur-Pedic's motion to dismiss and denied the Attorney General's petition on the grounds that the state's petition failed to establish the existence of a "contract" between Tempur-Pedic and any retailer, and furthermore, that Section 369-a only made such contracts "unenforceable"; it did not make them "illegal." *People of New York v. Tempur-Pedic International, Inc.*, --- N.Y.S.2d ----, 2011 WL 198019 (N.Y. Supr. Ct. Jan. 14, 2011). The Attorney General has appealed that decision.

- In another recent California case, *People of the State of California v. Bioelements, Inc*., No. 10011659 (Cal. Sup. Ct. Jan. 11, 2011), the complaint alleged that Colorado-based cosmetics manufacturer Bioelements entered into *per se* illegal contracts with resellers that prohibited them from selling products online for less than the manufacturer's suggested retail price. The stipulated judgment requires Bioelements to permanently refrain from fixing resale prices, to notify resellers that it will not enforce existing RPM contracts, and to pay $51,000 in civil penalties and costs.

What these post-*Leegin* cases demonstrate is that, as a practical matter, suppliers whose products are resold in Maryland, New York, California, and an unknown number of other states may have little choice but to behave as if *Leegin* had never been decided.

III. Conclusion

There are several practical implications of the tension between federal and state RPM law. It remains the case that purely unilateral price-influencing conduct is generally immune to challenge. But ensuring that the client understands what "purely unilateral" action entails and communicates its unilateral preferences, policies, and decisions appropriately is sometimes easier said than done.

In the absence of a contract stating otherwise, suppliers generally have a right to refuse to deal with or even terminate discounters, but in all such cases, a "clean break" is advisable. Clients that string resellers along, terminate resellers based on untruthful pretexts, or negotiate reinstatement terms (e.g., "You may buy from us again on the condition you raise your prices.") expose themselves not only to RPM liability but also to claims based on state unfair and deceptive trade practices statutes.

If a client wants to enter bilateral RPM agreements with its resellers, then even under the more lenient federal law, there should be meaningful, bona fide precompetitive reasons for such requirements. The client also needs to be aware of the clear legal risk such conduct brings in states such as Maryland and California, which have statutes that specifically prohibit minimum RPM and, at least in California, attorneys general dedicated to enforcing them.

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