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ANTITRUST CONSTRAINTS ON VERTICAL PRICE AGREEMENTS AND UNILATERAL PRICING CONDUCT

Alicia L. Downey

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I. VERTICAL RESALE PRICE MAINTENANCE (RPM) AGREEMENTS

Horizontal price-fixing conspiracies—in which direct competitors collude so as to eliminate interbrand price competition—are unequivocally illegal and a priority target of law enforcement in the U.S. and abroad. With basic antitrust compliance counseling, most clients understand the importance of avoiding even the appearance of participating in a horizontal price-fixing agreement. Vertical resale price maintenance, in contrast, is more the concern of private parties and civil enforcers. A supplier's exposure to legal risk from RPM depends on a host of factors and, ultimately, on the level of the supplier's commitment to its resale pricing business objectives.

Vertical resale price maintenance is one of those areas in which antitrust counseling is as much art as science. Clients must be taught, when communicating with resellers and others, how to match their communications with their intent, correct misunderstandings, and speak about the company's resale pricing and advertising policies with "one voice."

Sources of legal constraints on vertical resale price agreements include:

1. Section 1 of the Sherman Act, which prohibits agreements that unreasonably restrain trade in interstate or foreign commerce. 15 U.S.C. § 1.

2. Section 2 of the Sherman Act, which makes it unlawful to monopolize, attempt to monopolize, or conspire to monopolize any part of trade in interstate or foreign commerce. 15 U.S.C. § 2.

3. Section 5 of the FTC Act, which authorizes the Federal Trade Commission to bring actions to prevent "unfair methods of competition" in interstate or foreign commerce. 15 U.S.C. § 45.

4. State analogs to the Sherman Act and FTC Act, many of which are, by statutory mandate, construed in a manner consistent with the federal courts' and the FTC's interpretation of the federal antitrust laws.

5. State price-fixing statutes that diverge from federal law by making RPM illegal per se, e.g., Cartwright Act, Cal. Bus. & Prof. Code § 16720 (defining "trust", elsewhere declared to be unlawful, with specific reference to vertical price-fixing agreements); Kansas Restraint on Trade Act, Kan. Stat. Ann. § 50-101, § 50-102, § 50-112 (as interpreted in *O'Brien v. Leegin Creative Leather Prods., Inc.*, 277 P.3d 1062 (Kan. 2012)); Md. Comm. Code § 11-204 (expressly declaring vertical minimum price-fixing agreements to be per se unlawful).

6. State industry-specific statutes prohibiting suppliers from directing or influencing resale pricing by their dealers. E.g., Conn. Gen. Stat. § 42-133v(f) "No [new motor vehicle] manufacturer or distributor shall terminate, cancel or fail to renew a dealer's franchise for the failure or refusal of the dealer to do any of the following: . . . (2) refusal to sell any product at a price suggested by the manufacturer or distributor"); N.Y. Veh. & Traf. Law § 463(2)(r) (making it

unlawful for a manufacturer or distributor "[t]o establish or attempt to establish the actual resale price for any new motor vehicle, part or accessory charged by a franchised motor vehicle dealer in the state, provided, however, nothing contained herein shall prohibit publication of recommended resale prices or historical information by a franchisor"); Or. Rev. Stat. § 650.130(7) (making it unlawful for a manufacturer or distributor to "[e]stablish a maximum price a dealer may charge for motor vehicles with a gross vehicle weight rating of less than 8,500 pounds").

7. Although a detailed survey of non-U.S. law is beyond the scope of this article, the competition laws of many foreign jurisdictions prohibit vertical price-fixing altogether or strictly limit the circumstances in which it may be permissible. No company should ever assume that a U.S. law-compliant program designed to control or influence resale pricing may lawfully be implemented in other countries.

A. Under Federal Law, the Rule of Reason Standard Determines Whether RPM Agreements Are Unlawful Restraints on Trade.

Under a vertical resale price maintenance (RPM) agreement, the supplier of a product and its downstream dealer or distributor agree on the price at which the dealer or distributor may resell the product to its customers. Under federal law, in dual distribution situations, in which the supplier may be in competition with its own dealers for retail sales of the supplier's product, a resale price agreement would ordinarily viewed as a vertical price restraint, not as a horizontal price-fixing conspiracy, as long as the supplier, and not a combination of competing resellers, was the source of the restraint. *See Spahr v. Leegin Creative Leather Prods., Inc.*, 2008 WL 3914461, **6-7 (E.D. Tenn. 2008) (rejecting claim that accessories manufacturer's dual distribution system transformed its resale price agreements into per se unlawful horizontal price-fixing agreements) (citing *International Logistics Group, Ltd. v. Chrysler Corp.*, 884 F.2d 904, 906 (6th Cir. 1989), *cert. denied*, 494 U.S. 1066, (1990)).

Maximum RPM agreements ensure that resale prices remain at or below a certain level. Such agreements were deemed per se violations of the Sherman Act until 1997, when the Supreme Court held that maximum RPM should be subject to evaluation under the rule of reason, as such agreements were less likely to harm than to benefit consumers. *State Oil Co. v. Khan*, 522 U.S. 3 (1997) (overruling *Albrecht v. Herald Co.*, 390 U.S. 145 (1968)). Generally speaking, maximum resale price restrictions are perceived to be in the interest of consumers. As such, in the absence of more problematic supplier conduct, they are less likely to be the subject of legal challenges or regulatory action.

A minimum RPM agreement prohibits a reseller from pricing a product below a certain price. Some minimum RPM agreements may mandate selling at a fixed price, while others may require the reseller to ensure that any discounting does not exceed a certain percentage off the supplier's resale price list. Like maximum RPM, minimum resale price-fixing was, for decades, deemed per se illegal. *See Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911). During that time, the counseling challenge was to devise methods and policies by which suppliers might legitimately achieve resale price objectives without forming agreements to set minimum resale prices.

The treatment of minimum RPM under U.S. antitrust law has drawn considerable attention in recent years, since the Supreme Court's majority decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.* 551 U.S. 877, 127 S. Ct. 2705 (2007) ("*Leegin*"), overruled *Dr. Miles* and held that minimum RPM agreements should henceforth be assessed under the rule of reason. Thus, in addition to focusing on whether conduct reflects a price-fixing agreement (or, e.g., merely a pricing suggestion), where such an agreement arguably can be found to exist, practitioners must now engage in a fact-intensive consideration of relevant market definition and market power, and a balancing of the agreement's procompetitive and anticompetitive effects.

In the years since *Leegin* was decided, both houses of Congress have repeatedly introduced legislation to "repeal" the decision by declaring vertical minimum price-fixing per se unlawful, with no success to date and none anticipated in the near future.

The majority in *Leegin* supported its decision by identifying three situations where minimum RPM could be procompetitive:

- First, minimum RPM may be deployed by a supplier to eliminate intrabrand price competition and thereby encourage retailers to invest in consumer services or promotional efforts that help the supplier compete against its rivals. *Id*. at 2715-16. Without RPM, retailers might be reluctant to make such investments because of the risk that they will lose sales to discounting "free riders" that offer little or no such services. *Id*. at 2716.

- Second, to the extent minimum RPM facilitates market entry for new brands by ensuring that retailers will earn high margins to invest in promoting an unknown product, it may promote interbrand competition. *Id.*

- Third, even absent free-riding, RPM may induce retailers to perform services or promotions that they otherwise would not perform. *Id.*

The majority identified three situations in which minimum RPM may harm competition; these are likely to be the focus of any rule of reason analysis in future cases:

- First, the Court said that "the number of manufacturers that make use of the practice in a given industry can provide important instruction." *Id.* at 2719. Thus, if a market is controlled by only a few manufacturers and they all implement RPM, there is a greater potential for an adverse impact on overall competition, as well as a greater prospect of collusion among them.

- 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. *Id.* If retailers (or even a single large retailer) are pressuring for the imposition of minimum resale prices and the supplier has little or no procompetitive rationale or desire to independently adopt that strategy, there is an enhanced prospect that the agreements will be viewed as serving only to avoid price competition.

- 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." *Id.* at 2720. This third factor, looking at the supplier's market power, requires an analysis of the relevant market, including barriers to entry.

*B. Post-*Leegin *Cases Illustrate the Rule of Reason Approach to Minimum RPM.*

Jacobs v. Tempur-Pedic Int'l, Inc., No. 4:07-CV-02, 2007 WL 4373980 (N.D. Ga. Dec. 11, 2007) (rejecting claim that relevant market could be limited to "visco-elastic foam mattresses"; absent a cognizable market definition, plaintiffs could not challenge alleged minimum RPM agreement), *aff'd*, 626 F.3d 1327 (11th Cir. 2010).

PSKS, Inc. v. Leegin Creative Leather Products, Inc., No. 2:03 CV 107. 2009 WL 938561 (E.D. Tex. Apr. 06, 2009) (on remand, dismissing the complaint for failure to state a claim on the grounds that plaintiff's market definition of "wholesale sale of brand-name women's accessories to independent retailers" was deficient and rejecting theory that "artificially" high prices established the requisite anticompetitive effects), *aff'd,* 615 F.3d 412 (5th Cir. 2010), *cert. denied*, U.S., No. 10-635 (Feb. 22, 2011).

Spahr v. Leegin Creative Leather Products, Inc., No. 2:07-CV-187, 2008 WL 3914461 (E.D. Tenn. 2008) (dismissing retailer's complaint for failure to adequately define the relevant market and anticompetitive effects and ruling that under Tennessee antitrust statute, alleged RPM agreement would be assessed under rule of reason), *appeal dismissed*, No. 08-6165 (6th Cir. Nov. 20, 2008).

Toledo Mack Sales & Service, Inc. v. Mack Trucks, Inc., 530 F.3d 204, 225 (3d Cir. 2008) (vacating order granting judgment as a matter of law where at trial, "Toledo presented direct evidence that Mack agreed with its dealers to support their anticompetitive [price-fixing] agreements and that it did so by, among other things, refusing to offer sales assistance to dealers who sought to sell outside their [areas of responsibility]", and where there was also evidence that the agreement had anticompetitive effects in the relevant product and geographic markets).

In re Nine West Group, Inc., No. C-3937, Order Granting in Part Petition to Reopen and Modify Order Issued April 11, 2000 (May 6, 2008) (following *Leegin*, consent order based on enforcement action against alleged per se illegal minimum RPM agreements was modified to permit such agreements, conditioned on respondent's periodic self-reporting on subsequent effects in pricing and output).

Babyage.com, Inc. v. Toys "R" Us, Inc., 558 F. Supp. 2d 575 (E.D. Pa. 2008) (denying motion to dismiss class action complaints brought by Internet retailers and consumers alleging that defendant, in order to eliminate competition from Internet discounters, abused its dominance as a retailer to coerce suppliers of various baby care products into adopting RPM policies and terminating non-complying retailers in violation of the Sherman Act, Sections 1 and 2 and Pennsylvania common law), *consumer class certified in McDonough v. Toys "R" Us, Inc.*, 638 F. Supp. 2d 46 (E.D. Pa. 2009). In March 2011, Toys "R" Us agreed to pay $17 million to settle the consumers' action, $5 million to settle the retailers' action, and a $1.3 million civil penalty to settle a related FTC investigation.

C. Unilateral Conduct **a***nd the* **Colgate** *Doctrine*

A large body of case law, starting with *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919), addresses when a decision to terminate or a refusal to deal with price discounters is protected as unilateral conduct, and when such conduct crosses the line and becomes a resale price agreement. In *Colgate*, the Supreme Court upheld a supplier's right to "exercise his own independent discretion as to parties with whom he will deal." Thus, it is not unlawful to refuse to deal with (or, in the absence of some other legal constraint) to terminate relationships with discounters, as long as the refusal to deal or termination is the result of supplier's own unilateral decisionmaking.

This principle was reaffirmed and expanded upon in *Monsanto Co. v. Spray-Rite Serv. Co.*, 465 U.S. 752 (1984):

> [T]he 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. Independent acts to set minimum resale prices—when the supplier has not sought or accepted an agreement from its retailers—do not amount to a RPM contract:

> The concept of "a meeting of the minds" or "a common scheme" in a distributor-termination case includes more than a showing that the distributor conformed to the suggested price. It means as well that evidence must be presented both that the distributor communicated its

> acquiescence or agreement, and that this was sought by the manufacturer. [*Id.* at 764 n.9.]

Some cases in which courts have distinguished between unilateral conduct and RPM agreements include, 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 agreement where wholesalers were directed by Parke Davis "to stop the flow of Parke Davis products to the retailers, thereby inducing the retailers' adherence to its suggested retail prices").

Australian Gold, Inc. v. Hatfield, 436 F.3d 1228 (10th Cir, 2008) (no RPM agreement established where distributor agreement reserved the supplier's right to terminate distributor for failure to comply with the supplier's unilateral minimum RPM policy; further, "[t]he agreements specifically state that 'ETS does not request and will not accept Distributor's agreement to comply with any such suggested price . . . .").

Acquaire v. Canada Dry Bottling Co., 24 F.3d 401 (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"; no RPM agreement established by supplier's conditioning participation in a promotional discount program on distributors' adherence to suggested retail prices and use of supplier's invoicing form disclosing to retail customers both the suggested resale price and wholesale price).

Jeanery, Inc. v. James Jeans, Inc., 849 F.2d 1148 (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*").

Isaksen v. Vermont Castings, Inc., 825 F.2d 1158 (7th Cir. 1987) (no RPM agreement is established merely by providing suggested price list to distributors, but evidence of threats to "mix up" retailer's orders if it did not raise prices, followed by compliance, could support finding the requisite agreement).

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").

See also State of New York v. Tempur-Pedic Int'l, 2011 WL 198019 **5-6 (N.Y.Sup. Jan. 14. 2011) (ruling that proof of an RPM contract was lacking, where supplier communicated its unilateral minimum price policy to retailers, but evidence failed to show "that interactions between Tempur-Pedic and its retailers amounted to a meeting of the minds or consisted of harassment, threats to harm business, or concerted acts between Tempur-Pedic and its retailers to harass other noncompliant retailers"), *aff'd*, 944 N.Y.S.2d 518 (1st Dept. 2012).

D. Conflicting Treatment of RPM Under Federal and State Law

Notwithstanding the change in federal law wrought by *Leegin*, per se treatment of minimum RPM under state law remains a high priority for the attorneys general in some states, as exemplified by the following post-*Leegin* legal actions and legislation:

> *O'Brien v. Leegin Creative Leather Prods., Inc.*, 277 P.3d 1062 (Kan. 2012). In May 2012, the Kansas Supreme Court held that provisions of

the Kansas Restraint on Trade Act ("KRTA"), Kan. Stat. Ann. § 50-101, § 50-102, § 50-112, expressly declared vertical price-fixing agreements to be per se illegal. The Court declined to read the provisions in question as applicable only to "unreasonable" agreements, an interpretation that would have aligned the KRTA with the Sherman Act.

California v. DermaQuest Inc., No. RG10497526 (Cal. Sup. Ct., Feb. 23, 2010). In February 2010, the California Attorney General filed an action under alleging that a beauty products manufacturer violated the Cartwright Act by entering into minimum RPM agreements with resellers, which the complaint alleged were per se illegal under the relevant state law. 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).

California v. Bioelements, Inc., No. 10011659 (Cal. Sup. Ct. Jan. 11, 2011). In another California enforcement action, the attorney general's complaint alleged that Colorado-based cosmetics manufacturer Bioelements entered into *per se* illegal RPM contracts with Internet resellers. The stipulated judgment required 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.

MD. COMM. CODE § 11-204. In a direct response to the *Leegin* decision, a 2009 amendment to the

> Maryland state antitrust statute declared minimum RPM *per se* illegal, expressly providing 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." The statute authorizes civil damages and injunctive relief 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 2012, a New York appeals court affirmed a lower court decision holding that Section 369-a of the New York General Business Law did not declare vertical price agreements to be illegal, merely "unenforceable." *New York v. Tempur-Pedic International, Inc*., 944 N.Y.S.2d 518 (1st Dep't 2012). The New York Attorney General's action against Tempur-Pedic alleged that its unilateral suggested retail pricing policy and MAP agreements amounted to per se illegal RPM in violation of the state law. Under the suggested retail price 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 statute at issue, Section 369-a, the state Fair Trade Act repealer, provides that "contracts" between manufacturers and retailers fixing resale prices are "unenforceable." The trial court denied the Attorney General's petition on the grounds that the evidence failed to establish the existence of a price-fixing "contract" between Tempur-Pedic and any retailer, and furthermore, that Section 369-a only made such contracts "unenforceable"; it did not make them "illegal." *New York v. Tempur-Pedic*

International, Inc., 30 Misc. 3d 986 (N.Y. Sup. Ct. 2011); *see also WorldHomeCenter.com, Inc. v Franke Consumer Prods., Inc.*, 2011 WL 2565284, 2011 US Dist LEXIS 67798 (S.D.N.Y. 2011); *Worldhomecenter.com, Inc. v KWC Am., Inc.*, 2011 WL 4352390, 2011 US Dist LEXIS 104496 (S.D.N.Y. 2011).

E. Compliance Implications of the Federal-State Divergence in the Treatment of RPM

The divergent approach to RPM under state price-fixing statutes complicates antitrust counseling in this area. As a practical matter, suppliers may have more limited options for influencing resale prices than *Leegin* might suggest. The reality for compliance counseling—both before and after *Leegin*—is that poorly-worded written and oral communications between a supplier and its resellers will make it easier to infer that the supplier sought and the reseller communicated—whether willingly or under economic duress—its acquiescence, i.e., the meeting of the minds required to find and agreement, on minimum resale pricing. Federal constraints on such agreements have loosened significantly but, in some states (e.g., California, Kansas, Maryland), in some industries (e.g., mass-marketed consumer goods), and in some circumstances (e.g., where disgruntled retailers lodge complaints), the establishment of a price agreement may expose the supplier to a host of expensive and disruptive private claims and public enforcement efforts.

For these reasons, many practitioners advise that the most prudent approach for companies with legitimate reasons to control downstream discounting is to adopt and administer a unilateral *Colgate* policy consistent with the checklist below:

A *COLGATE* POLICY 10-POINT CHECKLIST

1. Is the policy set forth in a one-sided, standardized written communication addressed to all resellers?

2. Does the policy recite credible, procompetitive reasons for minimum pricing, such as maintaining a premium brand image and consumer goodwill, encouraging dealer investments in promotion and services, discouraging free riding, and promoting interbrand competition?

3. Does the policy state that it is the supplier's unilateral policy, subject to unilateral amendment or withdrawal at the supplier's sole discretion?

4. Does the policy reiterate that resellers may set their own resale prices? ("This Policy is not a restriction against selling at any particular price. You are free to establish the prices at which you sell our Products and we will neither seek nor accept any agreement with respect to such resale prices.")

5. Does the policy disclose that the consequences for non-compliance will be discontinuance of sales to the noncompliant reseller for an indefinite period of time?

6. Is the policy enforced in good faith, and are all related communications truthful and reviewed by counsel?

7. Is the policy reviewed and circulated to resellers on at least an annual basis?

8. Does the policy state that no employee of the supplier is authorized to negotiate or vary the terms of the policy?

9. If there are written reseller agreements, do the termination provisions of those agreements allow unilateral termination or non-renewal by the supplier without cause upon short, but commercially reasonable, written notice to the reseller?

10. Does the policy designate an appropriate company contact to whom questions or concerns regarding the policy should be directed in writing?

F. Minimum Advertised Price (MAP) Agreements

Minimum advertised price (MAP) agreements govern the advertising or display of price information by resellers, but do not control the actual resale price. For this reason, MAP agreements are treated under the antitrust laws as non-price vertical restraints, which are subject to the rule of reason. *See Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 54-55 (1977) ("Vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products. These "redeeming virtues" are implicit in every decision sustaining vertical restrictions under the rule of reason.").

There have been cases and agency actions in which MAP programs have been challenged on the grounds that they effectively eliminate the retailer's practical ability to set its own price or otherwise impede or eliminate competition. *See, e.g., Worldhomecenter, Inc. v. L.D. Kichler Co.*, 2007 U.S. Dist. LEXIS 22496 (E.D.N.Y. March 28, 2007) (denying motion to dismiss complaint that alleged that supplier's Internet MAP policy effectively bound internet retailers to sell at prices dictated by supplier); *In re Time Warner*, Commissioners' Statement at http://www.ftc.gov/os/2000/05/cdstatement.htm (explaining that music distributors' MAP policies, while not amounting to RPM agreements, were nonetheless unlawful under a rule of reason analysis, where the five distributors together accounted for over 85% of the market, and each had market power in that no music retailer could realistically choose not to carry the music of any of the five major distributors; MAP policies were adopted by each of the distributors for the purpose, and in fact had the effect, of stabilizing retail prices with consequential effects on wholesale prices, ending price competition that had previously existed, compliance with the MAP policies effectively eliminated the retailers' ability to communicate discounts to consumers and financial incentives ensured that retailers had little incentive to actually sell product at a discount).

Where a supplier's MAP restrictions expressly permit the retailer to sell at prices set by the retailer, and where in fact discounted sales actually do take place, the risk that a MAP program will be deemed to be RPM in disguise is low. *See U.S. Pioneer Elecs. Corp.* 115 F.T.C. 446 (FTC 1992) ("Unilaterally terminating a dealer for advertising below suggested prices is less competitively threatening to interbrand competition than unilaterally terminating a dealer for failing to follow a suggested resale price.").

MAP programs under which retailers must adhere to price advertising restrictions (i.e., advertising resale prices at or above a fixed minimum or no prices at all) in order to receive cooperative advertising funds from the supplier have long been upheld by courts and the FTC. *E.g., In re Nissan Antitrust Litigation*, 577 F.2d 910 (5th Cir. 1978), *cert. denied*, 439 U.S. 1072 (1979); *Clinique Lab., Inc.*, 116 F.T.C. 126 (1993); FTC Statement of Policy Regarding Price Restrictions in Cooperative Advertising Programs, 6 Trade Reg. Rep. (CCH) ¶ 39,057 (FTC, May 21, 1987).

II. PRICE DISCRIMINATION

The Robinson-Patman Act of 1936, 15 U.S.C. § 13, constrains sellers from treating competing customers differently with regard to pricing, terms of sale, and marketing support. It also prohibits buyers from knowingly inducing a seller to engage in unlawful price discrimination. The full text of the Act is set forth below in Appendix A.

The Robinson-Patman Act was intended to address concerns "that small businesses, particularly small retailers, were rapidly losing market share to large 'chain stores' that were able to underbuy and thus to undersell the small operators." HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE § 14.6a1 (3d ed. 2005). Because of the specific protections it affords to "disfavored" purchasers, the Act is often criticized for being at odds with the fundamental purpose of the Sherman Act and other antitrust laws to protect competition, as opposed to competitors.

The Supreme Court repeatedly has instructed the lower courts that interpretations of the Robinson-Patman Act should not extend beyond its express prohibitions, and that the Act should be interpreted in a manner consistent with the policies of the Sherman Act. *Volvo Trucks North America v. Reeder-Simco GMC, Inc.*, 546 U.S. 164, 181 (2006) ("Even if the Act's text could be construed in the manner urged by Reeder and embraced by the Court of Appeals, we would resist interpretation geared more to the protection of existing *competitors* than to the stimulation of *competition.*") (emphasis in original); *Great Atl. & Pac. Co. v. FTC*, 440 U.S. 69, 80 (1979) (interpretations should not "extend beyond the prohibitions of the Act and, in so doing, help give rise to a price uniformity and rigidity in open conflict with the purposes of other anti-trust legislation"); *Automatic Canteen Co. v. FTC*, 346 U.S. 61, 74 (1953) (The Act should be construed so as to ensure its coherence with the "broader antitrust policies that have been laid down by Congress.").

There has been virtually no significant federal agency enforcement of the Act in recent decades. As a practical matter, the biggest risk of noncompliance is private litigation.

Recent cases illustrate how suits brought under the Act can impose significant discovery burdens and defense costs, even when defendants ultimately prevail. *See, e.g.*, *Williams v. Duke Energy Int'l, Inc.*, 681 F.3d 788 (6th Cir. 2012) (remanding for further proceedings after reversing judgment dismissing RPA cause of action and holding that plaintiffs, who purchased electricity from defendant, had sufficiently alleged they suffered a competitive disadvantage as a result of the rebates provided to favored purchasers); *Feesers, Inc. v. Michael Foods*, 591 F.3d 191 (3d Cir. 2010) (summary judgment granted by district court was reversed on first appeal to Third Circuit; after plaintiff prevailed in a bench trial, the Third Circuit vacated the judgment, holding that in a secondary line price discrimination case, parties competing in a bid market cannot be competing purchasers where the competition for sales to prospective customers occurs *before* the sale of the product for which the RPA violation is alleged), *cert. denied*, __ U.S.__, 131 S. Ct. 160 (Oct. 4, 2010)*; Volvo Trucks North America v. Reeder-Simco GMC, Inc.*, 546 U.S. 164 (2006) (reversing Eighth Circuit's judgment affirming jury verdict and award of $1.3 million in damages, trebled, in favor of the plaintiff, and holding that a manufacturer may not be held liable for secondary-line price discrimination absent a showing that the manufacturer discriminated between dealers competing to resell its product to the same retail customer).

Given the complexity of modern marketing practices, proving damages under the Robinson-Patman Act can be difficult. In such cases, however, there is still the possibility that injunctive relief may constrain the future actions of a violating seller. *See, e.g.*, *American Booksellers Ass'n, Inc. v. Barnes & Noble, Inc.*, 135 F. Supp. 2d 1031 (N.D. Cal. 2001); *National Ass'n of College Bookstores v. Cambridge Univ. Press*, 990 F. Supp. 245 (S.D.N.Y. 1997).

Because of the expense, disruption, and the potential damages exposure and loss of goodwill resulting from

Robinson-Patman Act lawsuits, many companies make it a priority to focus their compliance training efforts on ensuring that the people involved in the sale and purchase of commodities and the design of promotional and incentive programs fully understand and comply with the requirements of Act.

A. Key Elements of Actionable Price Discrimination

Price discrimination is usually alleged to have occurred at either of two levels of competition: (1) primary line—i.e., competition between a discriminating seller and its competitors; or (2) secondary line—i.e., competition between favored and disfavored buyers of the discriminating seller. There are reported cases in which tertiary line claims alleging injury to competition between the customers of favored and disfavored buyers, and even fourth-line injury have been recognized. *See Texaco, Inc. v. Hasbrouck*, 496 U.S. 543 (1990) (tertiary-line claim); *Perkins v. Standard Oil Co.*, 395 U.S. 642 (1969) (fourth-line claim).

A prima facie claim of unlawful price discrimination under Section 2(a) of the Act, 15 U.S.C. § 13(a), requires proof of multiple distinct elements, including:

(1) at least two contemporaneous sales of

(2) commodities

(3) of like grade and quality

(4) to competing buyers

(5) at different prices

(6) in interstate commerce

(7) that may injure competition.

Each of these elements is briefly addressed in turn below.

1. Two Contemporaneous Sales

To establish discrimination by comparing different selling prices, there must have been at least two sales, to different purchasers, at different prices. Because prices inevitably change over time, the subject sales must have been reasonably contemporaneous, measured at the time of contracting, not the date of delivery. *Capital Ford Truck Sales, Inc. v. Ford Motor Co.*, 819 F. Supp. 1555, 1572 (N.D. Ga. 1992) ("[c]ontracts which contemplate contemporaneous delivery, but which are entered into at different times, are not 'reasonably contemporaneous' for purposes of the Act and are not the proper subject of a price discrimination claim").

Whether the subject sales are reasonably contemporaneous depends on such factors as industry-specific sales patterns and practices and the contractual relationships between the seller and the favored and disfavored buyers. *See, e.g., B-S Steel of Kansas, Inc. v. Texas Indus., Inc.* 439 F.3d 653 (10th Cir. 2006) (steel purchases eight months apart were not reasonably contemporaneous); *Coastal Fuels of Puerto Rico, Inc. v. Caribbean Petroleum Corp.*, 990 F.2d 25 (1st Cir. 1993) (the Act does not "prohibit price differences between spot sales and long-term contract sales that reflect different market conditions"); *Motive Parts Warehouse v. Facet Enters.*, 774 F.2d 380 (10th Cir. 1985) (terminated dealer could not base price discrimination claim on sales to new dealer at better prices).

Actual *sales* are required for purposes of comparing prices; prospective customers, terminated customers, lessees, licensees, parties to swap agreements, or consignees may not bring claims under the Act. *Airweld, Inc. v. Airco, Inc.*, 742 F.2d 1184 (9th Cir. 1984), *cert. denied*, 469 U.S. 1213 (1985) (exchange agreement for same product was not a sale under the Act); *Black Gold, Ltd. v. Rockwool Indus, Inc.*, 729 F.2d 676 (10th Cir.), *cert. denied*, 469 U.S. 854 (1984) (refusal to deal is not price discrimination); *Export Liquor Sales, Inc. v. Ammex Warehouse Co.*, 426 F.2d 251 (6th Cir. 1970) (lease is not a sale under the Act); *Microsoft Corp. v. BEC Computer Co.*, 818 F. Supp. 1313 (C.D. Cal. 1992) (license is not a sale under the Act).

2. Commodities

The Act governs *only* sales of tangible commodities or goods, not services, real estate, securities, intellectual property licenses, or other intangibles. *Williams v. Duke Energy Int'l, Inc.*, 681 F.3d 788 (6th Cir. 2012) (reiterating that electricity is a commodity for RPA purposes, because it is "produced, sold, stored in small quantities, transmitted, and distributed in discrete quantities," in contrast to cellular telephone service, which is not a commodity because it "cannot be produced, felt, or stored, even in small quantities. The plaintiffs do not buy a quantity of it, store it, and resell it their customers."); *First Comics, Inc. v. World Color Press, Inc.*, 884 F.2d 1033 (7th Cir. 1989) (comic books were incidental to printing services purchased by publisher), *cert. denied*, 493 U.S. 1075 (1990); *Union City Barge Line, Inc. v. Union Carbide Corp.*, 823 F.2d 129 (5th Cir. 1987) (transportation and delivery services were not within the scope of the Act). If a sale involves a mixture of goods and services, the court determines the "dominant nature" of the subject of the transaction based on the facts of each case.

3. Like Grade and Quality

The sold commodities must have been of "like grade and quality," which pertains to the physical characteristics of the products in question. If the products are physically identical, then mere differences in labeling, packaging, branding or warranties will not defeat this element. *FTC v. Borden Co.*, 383 U.S. 637, 645-46 (1966) (economic factors inherent in brand names and national advertising are not relevant to "like grade and quality" test); *DeLong Equip. Co. v. Washington*

Mills Abrasive Co., 887 F.2d 1499 (11th Cir. 1989) (where there was evidence that "special" product and "stock" product were physically identical, the products could be found to be of like grade and quality and district erred in granting summary judgment dismissing Robinson-Patman Act claim), *cert. denied*, 494 U.S. 1081 (1990).

4. Competing Purchasers

Different—i.e., discriminatory, prices—must have been obtained from two different purchasers unrelated to the seller.

Sales from a parent to a wholly owned or controlled subsidiary will ordinarily not fall within the scope of Act. *See, e.g., Caribe BMW, Inc.*, 19 F.3d at 748-51; *Russ' Kwik Car Wash, Inc. v. Marathon Petroleum Co.*, 772 F.2d 214, 220-21 (6th Cir. 1985). That interpretation comports with the Supreme Court's holding in *Copperweld Corp. v. Independence Tube Corp.*, that a parent and its subsidiary are a "single entity" that cannot conspire with itself in violation of the Sherman Act. 467 U.S. 752 (1984).

The two purchasers must have been in competition for sales to the same customer. In the absence of head-to-head competition, this element is not satisfied. *Feesers, Inc. v. Michael Foods*, 591 F.3d 191 (3d Cir. 2010) (holding that parties competing in a bid market were not competing purchasers where the competition for sales to prospective customers occurred *before* the sale of the product for which the RPA violation was alleged), *cert. denied*, __ U.S.__, 131 S. Ct. 160 (Oct. 4, 2010)*; see also Volvo Trucks North America v. Reeder-Simco GMC, Inc.*, 546 U.S. 164 (2006) (liability for secondary-line price discrimination under the Robinson-Patman Act requires a showing that the manufacturer discriminated between dealers competing to resell its product to the same retail customer); *George Haug Co. v. Rolls Royce Motor Cars Inc.*, 148 F.3d 136, 141-42

(2d Cir. 1998) (question is whether purchasers were directly competing for resales among same group of customers).

5. Different Prices

The existence of different prices is established by comparing the net prices, after all discounts and rebates, for which the subject goods were actually sold.

Benefits such as preferential credit terms, freight allowances, and "sham" promotional allowances in excess of the value of promotional services rendered by the buyer may be viewed as facilitating indirect price discrimination. *See, e.g., Craig v. Sun Oil Co.*, 515 F.2d 221 (10th Cir. 1975), *cert. denied*, 429 U.S. 829 (1976); *American Booksellers Ass'n, Inc. v. Barnes & Noble, Inc.*, 135 F. Supp. 2d 1031, 1066-68 (N.D. Cal. 2001) ("A promotional allowance provided by a seller to a buyer that bears little relationship to the buyer's actual advertising costs provides a cash windfall to the favored buyer and, thus, can only be viewed as a reduction in the buyer's cost of goods. This is easily construed as indirect price discrimination.") (citing *Fred Meyer, Inc. v. FTC*, 359 F.2d 351, 362 (9th Cir. 1966), *rev. on other grounds*, 390 U.S. 341 (1968)).

6. Interstate Commerce

The interstate commerce element is easily satisfied in most cases. Although both sales must occur within the United States or its territories, *In re Japanese Elecs. Prods. Antitrust Litig.*, 723 F.2d 238, 317 (3d Cir. 1983), only one of the requisite two contemporaneous sales needs to involve transporting the subject commodity across a state line. *Gulf Oil Corp. v. Copp Paving Co.*, 419 U.S. 186, 200 (1974). *See also Coastal Fuels of Puerto Rico, Inc. v. Caribbean Petroleum Corp.*, 79 F.3d 182 (1st Cir. 1993) (product at issue must physically cross state line in at least one of the subject sales).

In more complicated cases, in which goods originate from out of state, but are stored, perhaps processed, sold, and delivered in-state, courts use a fact-intensive "stream of commerce" analysis, which considers whether the subject goods were stored for a short period of time before being sold to specific local customers known to the seller, or whether, in contrast, the goods were finished products produced locally from raw materials originating out of state. The latter fact pattern is less likely to satisfy the interstate commerce element. *Compare Standard Oil v. FTC*, 340 U.S. 231 (1951); *L&L Oil Co. v. Murphy Oil Co.*, 674 F.2d 1113, 1116 (5th Cir. 1982); *Dean Milk Co. v. FTC*, 395 F.2d 696, 714-15 (7th Cir. 1968) *with McCallum v. City of Athens, Ga.*, 976 F2d 649, 656-57 (11th Cir. 1992); *Bacon v. Texaco, Inc.*, 503 F.2d 946, 948 (5th Cir. 1974) (per curiam), *cert. denied*, 420 U.S. 1005 (1975); *Belliston v. Texaco, Inc.*, 455 F.2d 175, 178-79 (10th Cir.), *cert. denied*, 408 U.S. 928 (1972).

7. Injury to Competition

Unlike a claim brought under the Sherman Act, proof of actual harm to competition is not required as an element of liability, only "a reasonable possibility that a price difference may harm competition." *See Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 220 (1993); *Falls City Indus., Inc. v. Vanco Beverage, Inc.*, 460 U.S. 428, 436 (1983).

"A hallmark of the requisite competitive injury" is the diversion of sales or profits from a disfavored purchaser to a favored purchaser. *Volvo*, 546 U.S. at 177 (citing *FTC* v. *Sun Oil Co.*, 371 U.S. 505, 518-19 (1963); *Falls City Indus.*, 460 U.S. at 437-38 & n.8). In cases where the price discrimination is substantial and persists over time, the disfavored buyer may rely on a rebuttable inference that competition has been injured. *FTC v. Morton Salt Co.*, 334 U.S. 37, 50 (1948). "[T]his inference may be overcome by evidence breaking the causal connection between a price differential and lost sales or profits." *See Falls City Indus.*, 460 U.S. at 435. It may also be overcome when the price difference is a legitimate functional discount, i.e., "reasonable reimbursement for the purchasers' actual marketing functions." *Texaco, Inc. v. Hasbrouck*, 496 U.S. 543, 571 (1990).

G. Statutory and Judicial Defenses to Liability for Price Discrimination

1. Meeting Competition

Section 2(b) of the Act expressly permits price differences when a seller is acting "in good faith to meet an equally low price of a competitor." 15 U.S.C. § 13(b). The Supreme Court has defined good faith as "a flexible and pragmatic . . . concept. The standard is simply the standard of the prudent businessman responding fairly to what he reasonably believes is a situation of competitive necessity." *Falls City Indus.*, 460 U.S. at 441.

The defense is not limited to customer-specific responses, but rather is "intended to allow reasonable pricing responses on an area-specific basis where competitive circumstances warrant them," only for as long as the competitive circumstances justifying it, as reasonably known by the seller, persist. *Id.* at 448, 450. General competition in the market will not suffice. *Hoover Color Corp. v. Bayer Corp.*, 199 F.3d 160, 165 (4th Cir. 1999). Sellers are further constrained from inquiring directly of competitors about their offers, even for the purpose of verifying the lower offer. *United States v. U.S. Gypsum Co.*, 438 U.S. 422 (1978).

Section 2(b) "requires more than a showing of facts that would have led a reasonable person to believe that a lower price was available to the favored buyer from a competitor." *Falls City Indus.*, 460 U.S. at 439. The party asserting the meeting competition defense must show that under the particular circumstances, it reasonably believed that the quoted price or a lower one was available to the favored buyers from the seller's competitors, and that offering the lower price would in fact meet the competitor's equally low price. *Id.* at 438-39; *Hoover Color Corp.*, 199 F.3d 160 (despite availability of competitor's lower price, defendant's offer was not good faith response).

There are several factors that courts may view as relevant in determining the seller's "good faith," including whether the seller: (1) received reports of similar discounts from customers; (2) was threatened with termination of purchases if the discount was not met; (3) made efforts to corroborate the reported discount by seeking documentary evidence or by appraising its reasonableness in terms of available market data; and (4) had past experience with the buyer. *See, e.g., Reserve Supply Corp. v. Owens Corning Fiberglass Corp.*, 971 F.2d 37 (7th Cir. 1992); *Callaway Mills Co. v. FTC*, 362 F.2d 435, 441-43 (5th Cir 1966).

It is not necessary that the seller be certain that its price concession will meet the lower price. A seller can therefore assert the defense even if, unknowingly but in good faith, it offered a price that not only met but also beat the competition. *Great Atlantic*, 440 U.S. at 82-83; *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 668 F.2d 1014, 1045 (9th Cir. 1981), *cert. denied*, 459 U.S. 825 (1982). *But see Falls City Indus.*, 460 U.S. at 445 (emphasizing that seller's goal must not be to beat competition).

2. Cost Justification

Section 2(a) of the Act allows price "differentials which make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered." 15 U.S.C. § 13(a). In order for the "cost justification" defense to be successful, the seller must show that there are actual cost differences arising from differing methods or quantities in which the commodities in question are sold or delivered. The seller may not simply rely on the theory that delivering commodities in larger quantities is cheaper than delivering the same commodities in smaller quantities. *Texaco, Inc. v. Hasbrouck*, 496 U.S. 543, 561 n.18 (1990); */FTC v. Morton Salt Co.*, 334 U.S. 37, 48 (1948); *Acadia Motors, Inc. v. Ford Motor Co.*, 44 F.3d 1050 (1st Cir. 1995); *Hanson v. Pittsburgh Plate Glass Indus., Inc.*, 482 F.2d 220, 225 (5th Cir. 1973), *cert. denied*, 414 U.S. 1136 (1974).

3. Changing Market Conditions

Section 2(a) allows different prices in response to "changing conditions affecting the market for or the marketability of the goods concerned, such as, but not limited to actual or imminent deterioration of perishable goods, obsolescence of seasonal goods, distress sales under court process, or sales in good faith in discontinuance of business in the goods concerned." 15 U.S.C. § 13(a). Qualifying market condition changes must fall within any of the enumerated conditions identified in the statute or be sufficiently similar as to fall within its scope. *See Comcoa, Inc. v. NEC Tels., Inc.*, 931 F.2d 655, 661 (10th Cir. 1991) (permitting discounts when certain telephone systems became obsolete and difficult to sell); *A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc.*, 683 F. Supp. 680 (S.D. Ind. 1988) (recognizing perishability defense where eggs were perishable commodity with short shelf life), *aff'd on other grounds*, 881 F.2d 1936 (7th Cir. 1989), *cert. denied,* 494 U.S. 1019 (1990).

4. Functional Availability

There are numerous cases in which courts have recognized that price discrimination claims may be rejected on the grounds that the more favorable price was practically, or "functionally," available to the allegedly disfavored purchaser. *See FTC v. Morton Salt*, 334 U.S. 37 (1948); *Metro Ford Truck Sales, Inc. v. Ford Motor Co.*, 145 F.3d 320 (5th Cir. 1998), *cert. denied*, 525 U.S. 1068 (1999); *DeLong Equip. Co. v. Washington Mills Abrasive Co.*, 887 F.2d 1499, 1517 (11th Cir. 1989); *Boise Cascade Corp. v. FTC*, 837 F.2d 1127 (D.C. Cir. 1988); *Shreve Equipment, Inc. v. Clay Equipment Corp.*, 650 F.2d 101 (6th Cir.), *cert. denied*, 454 U.S. 897 (1981); *Precision Printing Co., Inc. v. Unisource Worldwide, Inc.*, 993 F. Supp. 338 (W.D. Pa. 1998); *Capital Ford Truck Sales, Inc. v. Ford Motor Co.*, 819 F. Supp. 1555 (N.D. Ga. 1992); *FLM Collision Parts, Inc. v. Ford Motor Co.*, 543 F.2d 1019 (2d Cir. 1976), *cert. denied*, 429 U.S. 1097 (1977).

> "Where a purchaser does not take advantage of a lower price or discount which is functionally available on an equal basis, it has been held that either no price discrimination has occurred, or the discrimination is not the proximate cause of the injury." [*Shreve Equipment*, 650 F.2d at 105.]

To avail itself of the practical availability defense, the seller must show that buyers were informed how to obtain the lower price and that they had a realistic opportunity to purchase at the lower price. *Caribe BMW, Inc. v. Bayerische Motoren Werke A.G.*, 19 F.3d 745 (1st Cir. 1994); *Capital Ford Truck Sales, Inc. v. Ford Motor Co.*, 819 F. Supp. 1555 (N.D. Ga. 1992) (triable issue on availability on some sales, because plaintiff had no feasible way of learning about lower prices); *Morton Salt*, 334 U.S. at 42 (quantity discounts not functionally available when only largest customers could feasibly qualify).

H. Illegal Brokerage

Section 2(c) of the Act was enacted to address payments to fictitious or "dummy" brokers accepting commissions, i.e., *de facto* discounts, for the benefit of the buyer. *FTC v. Henry Broch & Co.*, 363 U.S. 166, 169 (1960) ("One of the favorite means of obtaining an indirect price concession was by setting up 'dummy' brokers who were employed by the buyer and who, in many cases, rendered no services. The large buyers demanded that the seller pay 'brokerage' to these fictitious brokers who then turned it over to their employer. This practice was one of the chief targets of § 2(c) of the Act.").

Unlike traditional price discrimination claims, neither the statutory defenses (e.g., cost justification, meeting competition), nor the requirement of harm to competition at large, are applicable to a Section 2(c) claim. *Metrix Warehouse, Inc. v. Daimler-Benz A.G.*, 716 F.2d 245 (4th Cir. 1983); *Biddle Purchasing Co. v. FTC*, 96 F.2d 687 (2d Cir. 1938). From a compliance standpoint, therefore, if a broker is appointed, the brokerage contract should generally prohibit the broker from passing on any part of its commission to the buyer.

An exception in Section 2(c) permits payments "for services rendered," which a few courts have applied in particular factual circumstances. *E.g., Burge v. Bryant Public Sch. Dist.*, 658 F.2d 611 (8th Cir. 1981) (school district could receive commissions for providing space and assisting with scheduling of student photographs); *Stephen Jay Photography, Ltd. v. Olan Mills, Inc.*, 713 F. Supp. 937, 942-43 (E.D. Va. 1989) (same), *aff'd*, 903 F.2d 988 (4th Cir. 1990).

I. Discriminatory Provision of Promotional Allowances and Services

Sections 2(d) and 2(e) of the Act prohibit a seller from paying allowances or furnishing services to a buyer for the buyer's assistance in promoting the resale of the seller's product, unless the allowances or services are offered to all competing buyers on "proportionally equal" terms. *See generally* FTC Guides for Advertising Allowances and Other Merchandising Payments and Services ("*Fred Meyer Guides*"), 16 C.F.R. §§ 240 *et seq.*, available at http://www.ftc.gov/bc/docs/16cfr240.shtm.

Courts and the FTC have stated that "sections 2(d) and 2(e) are limited to allowances and services intended principally to promote resale." *See id.* Claims based on allegedly discriminatory allocation or failure to deliver product, therefore, do not fall within Section 2(e). *Ed Houser Enters., Inc. v. Gen. Motors Corp.*, 76-1 Trade Cas. ¶ 60,845 (S.D. Ill. 1976), *aff'd*, 595 F.2d 366 (7th Cir. 1978); *David R. McGeorge Car Co. v. Layland Motor Sales, Inc.*, 504 F.2d 52 (4th Cir. 1974), *cert. denied*, 420 U.S. 992 (1975).

Unlike price discrimination, discriminatory promotional practices under Section 2(d) and 2(e) do not require any showing of actual or potential harm to competition. The *Fred Meyer Guides* list the different elements of Section 2(d) and Section 2(e) violations as follows, and they are addressed in more detail below:

Section 2(d) applies only to:

(1) A seller of products

(2) Engaged in interstate commerce

(3) That either directly or through an intermediary

(4) Pays a customer for promotional services or facilities provided by the customer

> (5) In connection with the resale (not the initial sale between the seller and the customer) of the seller's products
>
> (6) Where the customer is in competition with one or more of the seller's other customers also engaged in the resale of the seller's products of like grade and quality.
>
> (b) Section 2(e) applies only to:
>
> (1) A seller of products
>
> (2) Engaged in interstate commerce
>
> (3) That either directly or through an intermediary
>
> (4) Furnishes promotional services or facilities to a customer
>
> (5) In connection with the resale (not the initial sale between the seller and the customer) of the seller's products
>
> (6) Where the customer is in competition with one or more of the seller's other customers also engaged in the resale of the seller's products of like grade and quality.

16 C.F.R. § 240.2. The two provisions are complementary, as Section 2(d) applies to *payments* for promotional services or facilities provided by the customer, while Section 2(e) prohibits discriminatory provision by the seller of *promotional services or facilities*.

Sections 2(d) and 2(e) are both intended to prohibit hidden price discrimination in the form of payments, allowances, or services in compensation for resale merchandising services, when they are offered or provided on a discriminatory basis. The *Fred Meyer Guides* offer examples of promotional services and facilities covered by Sections 2(d) and (e), including: "cooperative advertising; handbills; demonstrators and demonstrations; catalogues; cabinets; displays; prizes or merchandise for conducting promotional contests; [and] special packaging, or package sizes." 16 C.F.R. § 204.7. The most important criteria for determining if payments, services and facilities fall within the scope of Sections 2(d) and 2(e) is whether the they are conferred in connection with the customer's resale of the product.

1. Competing Customers

The *Fred Meyer Guides* define "competing customers" as follows:

> . . . all businesses that compete in the resale of the seller's products of like grade and quality at the same functional level of distribution regardless of whether they purchase directly from the seller or through some intermediary.

This definition requires a showing that favored and disfavored customers compete with each other in the same geographic area and at the same functional level, i.e., for the same resale customers. *Eastern Auto Distrib. v. Peugeot Motors of Am., Inc.*, 795 F.2d 329 (4th Cir. 1986); *FTC v. Simplicity Pattern Co.*, 360 U.S. 55 (1959) (fabric stores competed with variety stores in sales of dress patterns).

2. Proportionally Equal Terms

Proportional equality is "the crux of Sections 2(d) and 2(e)." FTC, *Reasons for Changes in Guides*, 55 Fed. Reg. 33,651 (1990). Courts and the FTC have encouraged flexible approaches to determining whether payments, services or facilities are being offered on proportionally equal terms. 16 C.F.R. § 240.9 (2003); *Simplicity Pattern*, 360 U.S. at 61 n.6. The *Fred Meyer Guides* suggest that compliance "can be done most easily by basing the payments made or the services furnished on the dollar volume or on the quantity of the product purchased during a specified period." 16 C.F.R. § 240.9(a).

3. Defenses

Ensuring the functional availability of a promotional program to all competing customers on "proportionally equal" terms will defeat claims based on Sections 2(d) and 2(e). 16 C.F.R. § 240.10. To meet competition, a seller may offer promotional payments, services, or facilities in a good faith effort to match payments, services, or facilities offered by competitors. 16 C.F.R. § 240.14. Cost justification, however, is not available as a defense under Section 2(d) or 2(e). 16 C.F.R. § 240.15.

J. Buyer Liability for Inducing Unlawful Price Discrimination

Section 2(f) of the Act prohibits buyers of goods from knowingly inducing or receiving discriminatory prices prohibited under Section 2(a) of the Act. *See, e.g., Great Atl. & Pac. Tea Co., Inc. v. FTC*, 440 U.S. 61, 76 (1979); *Automatic Canteen Co. v. FTC*, 346 U.S. 61, 62 (1953); *Alhambra Motor Parts et al. v. FTC*, 309 F.2d 213, 215 (9th Cir. 1962).

To establish a prima facie case under Section 2(f), the evidence must first establish a Section 2(a) violation by the seller. *Boise Cascade Corp. v. FTC*, 837 F.2d 1127, 1147 (D.C. Cir. 1988) ("For there to be a guilty buyer, there must be a guilty seller."); *Harbor Banana Distrib., Inc. v. FTC*, 499 F.2d 395, 399 (5th Cir. 1974) ("A prohibited discrimination is a condition precedent to a finding of unlawful conduct under § 2(f)"); *Retail Service Assoc. v. ConAgra Pet Prod. Co.*, 759 F. Supp. 976, 980 (D. Conn. 1991) ("A section 2(f) violation is derivative in nature and must be accompanied by a section 2(a) violation").

Thus, a buyer is not liable for receiving or even inducing discriminatory prices if the price differential is justified by any defense available to the seller under the Act, even if the defense was unknown to the buyer at the time of sale. [/] *Great Atl. & Pac. Tea*, 440 U.S. at 78 ("Congress did not provide in § 2(f) that a buyer can be liable even if the seller has a valid defense"); *Automatic Canteen*, 346 U.S. at 71.

The claim requires a further showing that the buyer knew or should have known that the discriminatory prices it received were prohibited under the Act. *Automatic Canteen*, 346 U.S. at 74; *Delta Marina, Inc. v. Plaquemine Oil Sales, Inc.*, 644 F.2d 455, 458 (5th Cir. 1981). And like Section 2(a), Section 2(f) requires proof of potential harm to competition at large. *Boise Cascade*, 837 F.2d at 1145-46 ("The competitive injury requirement . . . is satisfied by showing of a 'reasonable possibility that a price difference may harm competition.'"), *quoting Falls City Indus., Inc. v. Vanco Beverage, Inc.*, 460 U.S. 428, 435-36 (1983)).

K. Exemption for Non-Profit Institutions

A statutory exemption to the Robinson-Patman Act, enacted in 1938 as the Non-Profit Institutions Act, provides that the Act shall not "apply to purchases of their supplies for their own use by schools, colleges, universities, public libraries, churches, hospitals, and charitable institutions not operated for profit." 15 U.S.C. § 13c. Qualifying for this exemption requires a showing of 1) a purchase of supplies for its own use by 2) a non-profit institution (or a part of an institution). The exemption is strictly construed. A purchase by a commercial distributor for purposes of resale to charitable institutions, for example, even with the intent to resell at cost, would not fulfill either part of the test.

The focus of most antitrust litigation and agency opinions concerning Section 13c has been on interpreting the requirement that the purchase by the non-profit institution be "for its own use." The leading case of *Abbott Laboratories v. Portland Retail Druggists Association*, 425 U.S. 1 (1976), set forth the following functional test:

> "[T]heir own use" is what reasonably may be regarded as use *by the hospital* in the sense that such use is part of and promotes the hospital's intended institutional operation in the care of persons who are its patients. This implies the limitation and it turns the measure naturally from the purchase to the use, as Section 13c requires.

Id. at 14 (emphasis in original).

The Court's focus on use, rather than on the fact of purchase alone, however, does not eliminate the requirement that the purchase be made by a non-profit institution. In one case, the purchase of college books for resale at a profit by a self-sustaining campus bookstore was ruled not exempt. *Students Books Co. v. Washington Law Book Co.*, 232 F.2d 49 (D.D.C. 1955), *cert. denied*, 350 U.S. 988 (1956). A gerontological research institute's purchase at no cost or below wholesale of goods for proposed resale to the elderly also failed the test. *Foundation for Later Life*, [1979 Transfer Binder] Trade Reg. Rep. (CCH) ¶ 21,457 (FTC 1978). In contrast, the resale of drugs at cost by a non-profit hospital to a non-profit affiliate for the affiliate's own use was viewed by the FTC as qualifying for the exemption. *St. Peter's Hosp. of the City of Albany*, [1977 Transfer Binder] Trade Reg. Rep. (CCH) ¶ 21,316 (FTC 1977).

III. PREDATORY PRICING, PREDATORY PURCHASING, BUNDLING, AND LOYALTY DISCOUNTS

A. Predatory Pricing

In addressing claims under Section 2 of the Sherman Act that, in furtherance of a monopolistic scheme, a firm set prices so low as to be "predatory," the basic operating principle of the antitrust laws is that "[l]ow prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition." *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 340 (1990). Thus, the Supreme Court has "carefully limited the circumstances under which plaintiffs can state a Sherman Act claim by alleging that prices are too low." *Pacific Bell Tel. Co. v. linkLine Communications, Inc.*, 555 U.S. 438, 129 S. Ct. 1109, 1120 (2009).

A predatory-pricing scheme is one in which "the predator reduces the sale price of its product (its output) to below cost, hoping to drive competitors out of business. Then, with competition vanquished, the predator raises output prices to a supracompetitive level." *See Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 549 U.S. 312, 318 (2007) (citing *Matsushita Elec. Industrial Co.* v. *Zenith Radio Corp.*, 475 U.S. 574, 584-85, n.8 (1986)). "For the scheme to make economic sense, the losses suffered from pricing goods below cost must be recouped (with interest) during the supracompetitive-pricing stage of the scheme." *Id.* (citing *Matsushita,* 475 U.S. at 588-89; *Cargill, Inc.* v. *Monfort of Colo., Inc.,* 479 U.S. 104, 121-22, n.17 (1986)).

Thus, two distinct elements are required to establish predatory pricing. First, the plaintiff must show that "the prices complained of are below an appropriate measure of its rival's costs." *Brooke Group Ltd. v. Brown & Williamson*

Tobacco Corp., 509 U.S. 209, 222-24 (1993)). Courts vary in their determination of the "appropriate measure" of costs for purposes of determining whether the element of below-cost pricing has been satisfied. *E.g., United States v. AMR Corp.*, 335 F.3d 1109 (10th Cir. 2003) (affirming use of average variable cost, but stating, "Because there may be times when courts need the flexibility to examine both AVC as well as other proxies for marginal cost in order to evaluate an alleged predatory pricing scheme, we again decline to dictate a definitive cost measure for all cases."); *Taylor Publ'g Co. v. Jostens, Inc.*, 216 F.3d 465, 478 (5th Cir. 2000) (average variable cost); *Rebel Oil Co., Inc. v. Atlantic Richfield Co.*, 146 F.3d 1088, 1092-93 (9th Cir.) (discussing various standards), *cert. denied*, 525 U.S. 1017 (1998).

"The second prerequisite to holding a competitor liable under the antitrust laws for charging low prices is a demonstration that the competitor had a reasonable prospect, or, under § 2 of the Sherman Act, a dangerous probability, of recouping its investment in below-cost prices." *Brooke Group*, 509 U.S. at 224. Without recoupment, "predatory pricing produces lower aggregate prices in the market, and consumer welfare is enhanced. Although unsuccessful predatory pricing may encourage some inefficient substitution toward the product being sold at less than its cost, unsuccessful predation is in general a boon to consumers." *Id.*

B. Predatory Purchasing

In *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 549 U.S. 312, 127 S. Ct. 1069 (2007), the Supreme Court addressed the antitrust treatment of predatory purchasing—i.e., bidding at above-market prices in order to deprive other buyers of access to a necessary input—under Section 2 of the Sherman Act. The Court held that the predatory pricing test announced in *Brooke Group* applies to predatory bidding, too, as the claims essentially mirror each other in significant ways:

> A predatory-pricing plaintiff alleges that a predator cut prices to drive the plaintiff out of business and, thereby, to reap monopoly profits from the output market. In parallel fashion, a predatory-bidding plaintiff alleges that a predator raised prices for a key input to drive the plaintiff out of business and, thereby, to reap monopsony profits in the input market. Both claims involve the deliberate use of unilateral pricing measures for anticompetitive purposes. And both claims logically require firms to incur shortterm losses on the chance that they might reap supracompetitive profits in the future.

549 U.S. at 322.

Thus, to establish a claim for predatory bidding, a plaintiff must show that the alleged predatory bidding led to below-cost pricing of the defendant's outputs, i.e., that the defendant's bidding caused the cost of the relevant outputs to rise above the revenues generated by sales of those outputs. *Id.* at 325. In addition to showing the defendant's below-cost output pricing,

> [a] predatory-bidding plaintiff also must prove that the defendant has a dangerous probability of recouping the losses incurred in bidding up input prices through the exercise of monopsony power. . . . As with predatory pricing, making a showing on the recoupment prong will require "a close analysis of both the scheme alleged by the plaintiff and the structure and conditions of the relevant market."

Id. (quoting *Brooke Group*, 509 U.S. at 226).

C. Use of Bundling and Loyalty Discounts to Enhance Market Power

Bundled discounts apply to a package of products and services sold for a price that is less than the total would be if the buyer bought each individual product or service separately. Under federal antitrust law, bundling can be the basis of claim that a bundled pricing agreement is an unreasonable restraint on trade in violation of Section 1 of the Sherman Act, or, when unilateral pricing conduct is involved, a claim of monopolization or attempted monopolization under Section 2 of the Sherman Act. Bundled discounts on commodities that effectively amount to anti-competitive exclusive dealing may also support a claim under Section 3 of the Clayton Act.

The Supreme Court has not defined the standard under which to assess whether particular bundling discount practices violate the antitrust laws. At present, only two circuit courts—the Third and Ninth Circuits—have addressed the issue, and they diverge in their approach.

In *LePage's Inc. v. 3M*, 324 F.3d 141 (3d Cir. 2003) (*en banc*), the Third Circuit declined to adopt a bright line test and held that a showing of exclusionary effects was sufficient to establish a Section 2 claim based on the plaintiffs' use of bundled discounts, loyalty rebates, and other incentives to drive its nearest competitor in one particular product line out of business. Under the Third Circuit's test, it does not matter whether a discount results in below-cost pricing of one or more of the competitive products being bundled.

In *LePage's*, the plaintiff, a manufacturer of private label transparent tape, asserted that 3M used its monopoly over its Scotch branded products to gain a competitive advantage in the private label tape segment of the transparent tape market in the United States. 3M did so through a multi-tiered bundled rebate structure, which offered higher rebates when customers purchased products in a number of 3M's different product lines, in addition to large lump-sum cash payments to customers, promotional allowances and other cash incentives to encourage customers to enter into exclusive dealing arrangements with 3M. LePage's could not offer competitive discounts because it did not offer as diverse an array of products. The jury found that 3M's conduct violated Section 2, and 3M appealed.

Citing *Brooke Group*, 3M argued that its bundled rebate structure was legal because it never priced below cost. The Third Circuit rejected that argument, instead focusing on the evidence of 3M's intent to drive competitors out of the market and the harm to LePage's done by 3M's conduct. *LePage's*, 324 F.3d at 161-62. The Supreme Court subsequently denied certiorari, 542 U.S. 953 (2004), and *LePage's* therefore stands as the governing law in the Third Circuit.

In contrast, the Ninth Circuit adopted a more objective approach and held that a bundled discount may be unlawfully exclusionary only if, after allocating the full amount of the discount to the competitive product or service, the resulting price is below the defendant's average variable cost of producing that product or service. *Cascade Health f/k/a McKenzie Willamette v. PeaceHealth*, 502 F.3d 895, 913-14 (9th Cir. 2007), *amended*, 515 F.3d 883 (9th Cir. 2008); *see also Masimo Corp. v. Tyco Healthcare Group L.P.*, 2009 WL 3451725 (9th Cir. Oct. 28, 2009) (bundled discount was not anticompetitive where plaintiff did not show bundled prices were below incremental cost).

In the *PeaceHealth* case, the defendant operated three hospitals in Lane County, Oregon, with 465 beds in the aggregate. The defendant's hospitals offered primary and secondary hospital services as well as more complex services known as tertiary care. The plaintiff was the only other provider of hospital services in Lane County, with a 114-bed hospital offering only primary and secondary services. The jury found, and on appeal the parties did not dispute, that the relevant market was the market for primary and secondary services in Lane County, of which PeaceHealth held a 75% percent share.

The plaintiff alleged that PeaceHealth froze McKenzie out of the market for primary and secondary services by offering significant discounts on tertiary services to insurance companies that agreed to purchase *all* hospital services—i.e., primary, secondary and tertiary services—exclusively from PeaceHealth. The plaintiff could provide primary and secondary services at a lower cost than PeaceHealth, but because it did not provide tertiary services it could not match the bundled discounts offered by PeaceHealth.

At trial in the district court, the jury instructions were based on *LePage's*, which did not require the jury to consider whether PeaceHealth had priced below cost. On appeal, the Ninth Circuit rejected the reasoning of *LePage's* and instead, adopted a discount allocation standard that required a showing of pricing below cost. On the basis of deficient jury instructions, the Ninth Circuit vacated the judgment and remanded the case for further proceedings.

The Ninth Circuit's approach to bundling has been followed by lower courts in other circuits. *E.g., Valassis Communications, Inc. v. News Am., Inc.*, 2011 WL 2413471 (E.D. Mich. June 15, 2011); *Peoria Day Surgery Ctr. v. OSF Healthcare Sys.*, 2010-1 Trade Cas. (CCH) ¶ 76,870 (C.D. Ill. Dec. 30, 2009). To date, the Third Circuit's *LePage's* decision has been less influential, although it remains controlling law in that circuit.

Loyalty discounts differ from bundling in that they are designed to incentivize buyers to buy more from the supplier and, typically as a result, to buy less from the supplier's competitors. A common form of loyalty discount is the market share discount contingent on the buyer's agreement to purchase a higher percentage of its requirements from the supplier. As a reward, the buyer receives a discount on the incremental purchases that exceed the minimum. Another type of loyalty discount rewards the buyer with lower pricing on all of its purchases, so long as the buyer agrees to purchase at least a certain percentage of its requirements from the supplier.

Loyalty discounts often do not easily lend themselves to being analyzed with respect to whether they entail below-cost pricing. For that reason, they are best analyzed as de facto exclusive dealing arrangements, subject to the rule of reason.

Taken to an extreme by a supplier with significant market power, loyalty discounts can be the basis of antitrust liability and regulatory actions, as they did in *LePage's*, 324 F.3d at 159-63, in *Masimo Corp. v. Tyco Healthcare Group L.P.*, 2009 WL 3451725 (9th Cir. Oct. 28, 2009) (upholding liability verdict as supported by evidence that "substantial" market foreclosure was due to defendant's 90% market share requirement for loyalty discounts), the FTC's action against Intel Corporation (FTC Docket No. 9341, Final Decision and Order (Nov. 2, 2010)), available at http://ftc.gov/os/adjpro/d9341/index.shtm), and the Antitrust Division's action against United Regional Health Care System (Case No. 7:11-cv-00030-O, Final Judgment (Sept. 29, 2011 N.D. Tex.)), available at http://www.justice.gov/atr/cases/unitedregional.html.

In all three cases, the discounts were significant, available over a prolonged period of time, offered in conjunction with other strategies designed to deter or even coerce buyers from dealing with the defendant's competitors, and could not feasibly be matched or beaten by equally efficient competitors. In every case, the loyalty discounts were shown or alleged to have led to substantial harm to competition in the form of higher prices, reduced output, or more limited consumer choices.

Where one or more of these factors is absent, loyalty discounts by themselves are far less likely to pose significant risk. *See, e.g., Allied Orthopedic Appliances v. Tyco Health Care Group*, 592 F.3d 991 (9th Cir. 2010) (affirming lower court's ruling that defendant's market-share discount agreements and sole-source agreements did not create an unreasonable restraint on trade because hospitals' commitments under the agreements were "voluntary and [could] be ended at any time, and hospitals [were] thus free to switch to more competitively priced generics"); *Virgin Atlantic Airways v. British Airways*, 257 F.3d 256 (2d Cir. 2001) (affirming summary judgment dismissing claims that defendant airline's incentive agreements that rewarded travel agents and corporate customers with discounts for certain air travel purchases, where purchasers were not locked into buying from defendant or otherwise restricted from buying from other airlines); *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039 (8th Cir. 2000) (reversing judgment entered on jury verdict where evidence showed that customers to whom defendant offered loyalty discounts were willing and able to, and in fact did, switch to other suppliers and plaintiffs failed to establish high barriers to entry in the relevant market).

IV. MOST FAVORED NATION (MFN) PRICE AGREEMENTS

Under a "most favored nation" (MFN) price agreement, the seller agrees that the buyer will receive at least the lowest price the seller offers to its other customers. As a general matter, MFN agreements are not per se unlawful. To the extent that buyers with significant market share demand such agreements from their suppliers and harm to competition results, they may be subject to challenge. *See, e.g., In re Ethyl Corp.* 101 F.T.C. 425 (1983) (challenging MFN clauses in fuel additive sales contracts as a practice facilitating reduction in or elimination of price competition).

Depending on the circumstances, where sales of commodity goods to competing customers are involved, an MFN agreement that guarantees that the buyer's competitors will always pay higher prices than the buyer (i.e., "MFN-plus") may, even in the absence of the buyer's or seller's market power, expose the parties to claims under the Robinson-Patman Act.

MFN agreements in the health care context have been the subject of several private and public enforcement actions. *E.g., Blue Cross & Blue Shield United of Wis. v. Marshfield Clinic*, 65 F.3d 1406 (7th Cir. 1995); *Ocean State Physicians Health Plan v. Blue Cross and Blue Shield of R.I.*, 883 F.2d 1101 (1st Cir. 1989), *cert. denied*, 494 U.S. 1027 (1990); *United States v. Delta Dental of R.I.*, 943 F. Supp. 172 (D.R.I. 1996); *cf. Willamette Dental Group, PC v. Oregon Dental Serv. Corp.*, 130 Or. App. 487, 882 P.2d 637 (1994) (challenging MFN clause under Oregon's analogue to Section 2 of the Sherman Act).

In October 2010, the Antitrust Division and the State of Michigan sued Blue Cross Blue Shield of Michigan (BCBS-MI), alleging that MFN clauses in its agreements with more than 70 Michigan hospitals raised competitors' hospital costs, excluded competitors from several markets and reduced their ability to compete in many markets, and increased costs to self-insured employers and health insurance prices to consumers, without lowering BCBS-MI's own hospital costs. A copy of the Complaint is available at http://www.justice.gov/atr/cases/bcbsmfn.html.

The agreements at issue allegedly require hospitals to charge BCBS-MI's competitors more than what the hospitals charge BCBS-MI or mandate that the hospitals charge BCBS-MI's competitors at least as much as they charge BCBS-MI. In exchange for agreeing to these MFN clauses, the hospitals allegedly received higher compensation from BCBS-MI.

In June 2011, the federal district court denied BCBS-MI's motion to dismiss the complaint. A number of follow-on class actions against BCBS-MI are pending and the DOJ's and state enforcers' investigations into the use of MFN clauses in the health care industry are reportedly ongoing in several states and the District of Columbia.

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Alicia L. Downey is the managing partner of Downey Law LLC, of Boston, Massachusetts. Copies of this and other articles authored by Alicia are available on her firm website, at www.downeylawllc.com.