

RESALE PRICE MAINTENANCE AND THE RULE OF REASON: THE LIABILITY RISK INCREASES

by Veronica Kayne*

Introduction

It is widely anticipated that the antitrust treatment of resale price maintenance (RPM) agreements is about to change significantly. Instead of being judged under the per se rule, RPM may come, like most competitive conduct, under the rule of reason. The implications of that change are profound. Antitrust defendants believe that the rule of reason is always more advantageous for them than a per se rule and have reflexively fought to have RPM brought under the rule of reason. It is likely, however, to be a Pyrrhic victory, increasing both litigation and liability risks even for the well-counseled defendant-seller, since fewer cases will be dismissed at early stages, many more will go to trial, and plaintiffs will likely win their share.

Under the current analysis, many RPM cases are dismissed at early stages because the challenged conduct is found to be unilateral; unease with the per se rule has led to a very restrictive view of what constitutes an RPM agreement. But if RPM is judged under the rule of reason, courts may no longer be so quick to agree that a manufacturer's so-called "Unilateral Price Policy" is in fact "unilateral," and hence beyond the scope of Section 1 of the Sherman Act. And, of course, application of the rule of reason may encourage more sellers to employ express RPM agreements. Once a case gets past the "agreement" threshold, an allegation of a price increase will be enough to withstand dismissal.

Once a rule of reason case passes the dismissal stage, the case will generally entail full fact discovery and, in most cases, expert economic analysis and testimony before a motion for summary judgment can be made. At that point, evidence of the alleged price increase may be all that's needed to withstand summary judgment and require a trial. At trial, a jury will have to balance a demonstrated price effect against the defendant's proffered justifications. The results could easily run counter to the prevailing wisdom that the rule of reason means that the defendant wins.

Leegin: A Call for Change

For almost a century, resale price maintenance agreements have been per se unlawful; that means that all a plaintiff had to prove to establish liability was that such an agreement existed. But the Supreme Court granted certiorari and heard argument in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.* (S. Ct. No. 06—480, argued March 26). The only question in the case is "whether vertical minimum resale price maintenance agreements should be deemed per se illegal under Section 1 of the Sherman Act, or whether they should instead be evaluated under the rule of reason." Because there is no split in the circuits on this issue (although several courts of appeal have applied the per se rule only after explicitly grumbling about it, *e.g.*, *PSKS, Inc. v. Leegin Creative Leather Products, Inc.*, 171 Fed. Appx. 464, 466 (5th Cir. 2006), *Khan v. State Oil Co.*, 93 F.3d 1358, 1364 (7th Cir. 1996), *rev'd on other grounds*, 522 U.S. 3 (1997)), it is reasonable to conclude that those voting to grant certiorari saw the case as a vehicle for changing the rule. It takes four to grant certiorari, and so if the speculation about the grant is correct,

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only one more vote for change is needed. Prior to argument, many, if not most, antitrust practitioners thought the additional vote was there; afterwards, some are less convinced. But it is likely a change that will come at some point – if not this Supreme Court Term, then in a few years, and it is never too early to start thinking about how to respond, because it's not as simple as it might appear.

A Restrictive Approach to Agreement

The basic approach to RPM has been set for years. Per se treatment for RPM goes all the way back to 1911. *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 US 373 (1911). And 1919 brought us *United States v. Colgate & Co.*, 250 US 300 (1919), which set forth the peculiar rule by which we determine whether there is, in fact, an "agreement" on resale prices. That rule was stated concisely by the Court:

In the absence of any purpose to create or maintain a monopoly, the [Sherman] act does not restrict the long recognized right of a trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal. And, of course, he may announce in advance the circumstances under which he will refuse to sell.

The Court re-affirmed this view in *Monsanto Co. v. Spray-Rite Service Corp.*, 465 US 752 (1984), when it said

Under *Colgate*, the manufacturer can announce its resale prices in advance and refuse to deal with those who fail to comply. And a distributor is free to acquiesce in order to avoid termination.

465 US at 761. It went on to say that before an agreement can be found, there must be evidence "both that the distributor communicated its acquiescence or agreement, and that this was sought by the manufacturer." *Id.* at 764 n.9. Conformity does not create agreement.

The *Colgate* definition of agreement is unusual. *Colgate* describes a situation in which a dealer "goes along to get along," in which a dealer knows the terms of the relationship and purchases the goods with full knowledge – and one, might argue, intent, since the case law never shows us a dealer who wanted one shipment of goods and no more. It can be argued that this is acceptance by performance for purposes of establishing a contract under the Uniform Commercial Code or in a court of equity. As Judge Posner put it,

If a manufacturer distributes a price list, together with an announcement that he will cut off dealers who sell below the list prices, and dealers adhere to those prices because they don't want to be cut off, there is a realistic sense in which the threat of termination has induced the dealers to agree to not cut prices – to agree, in other words to fix prices. That is the argument against *Colgate*. *Monsanto* rejects [that argument].

Antitrust adheres to the fiction that if a dealer merely knows what will cause a seller to cut him off and avoids those activities to ensure supply, there is no agreement. And antitrust develops relatively content-free tests for deciding what conduct goes beyond "an announcement and a refusal" and creates an agreement. These tests include descriptions of what's permissible – "exposition, persuasion, and argument" – and what's not – threats and

coercion, making a “meaningful event depend on compliance or noncompliance with the suggested or stated price.” These content-free tests lack predictive power.

The predictive power, however, comes from the courts’ increasingly negative view of the per se rule. As courts have decided that they do not approve of liability for resale price maintenance, they have relied on these agreement rules, and granted motions to dismiss or motions for summary judgment rather freely on the ground that the plaintiff has not proven an agreement – that defendant’s conduct amounted only to persuasion, and not coercion. One example is *Audio Visual Associates, Inc. v. Sharp Electronics Corp.*, 210 F.3d 254 (4th Cir. 2000). A dealer claimed it raised its price quotation to a potential customer after the manufacturer intervened. The court dismissed the complaint, apparently relying on the fact that the dealer had not “communicated its acquiescence or agreement” to the manufacturer and that the manufacturer had not sought such assurances. *See, e.g., Lattice Semiconductor Corp. v. Interface Elec. Corp.*, 1994-2 Trade Cas. (CCH) P70,779 (9th Cir. 1994) (affirming summary judgment); *Center Video Indus. Co. v. United Media, Inc.*, 995 F.2d 735 (7th Cir. 1993) (affirming summary judgment); *Tidmore Oil Co. v. BP Oil Co.*, 932 F.2d 1384 (11th Cir. 1991) (affirming summary judgment).

Relying on *Colgate* and its progeny, sellers have developed what are known as Unilateral Price Policies (a major variant is the Unilateral Minimum Advertised Price Policy). These vary in their details but generally consist of a letter to dealers stating that the seller wants its products resold at the prices specified in the letter, that dealers who do not resell at those prices will be terminated, that a terminated dealer should not contact the seller to discuss reinstatement (which is wholly in the seller’s discretion), that a particular person at the company is the contact person in the event of questions, and that the seller *does not want the dealer to agree to this, since this is not intended to be an agreement but a statement of unilateral policy*. Some manufacturers go further and establish what are known as “structured terminations” – a suspension of product deliveries for some limited period of time for a first violation of the UPP, a longer suspension for the second, and termination for the third. The validity of these UPPs has rarely been tested. One case that closely examined a UPP and its enforcement is *Chavez v. Whirlpool Corp.*, 93 Cal. App. 4th 363 (2001).

The *Chavez* court applied Sherman Act precedent to a claim under the Cartwright Act, California’s antitrust statute. It affirmed dismissal of the complaint for failure to state a claim upon which relief may be granted. The complaint alleged that Whirlpool had announced a minimum resale price policy and further announced that “it would monitor the retailers’ compliance with the policy by reviewing their advertising, collecting sales receipts, and sending ‘mystery shoppers’ to retail stores, and that it employed other unspecified ‘threats, coercion, intimidation and boycott’ to cause the dealers to comply.” The court ruled that these allegations described behavior permitted under *Colgate*:

“Just as the announcement of a resale price policy and refusal to deal with dealers who do not comply is permissible, measures to monitor compliance that do not interfere with the dealers’ freedom of choice are permissible. . . . By monitoring the dealers’ compliance without forcing compliance or seeking and receiving communication of their compliance, a manufacturer permissibly exercises its right to select with whom to do business and on what terms. In this manner, a manufacturer that announces a resale price policy and enforces the policy by monitoring the dealers’ compliance and refusing to deal with dealers who do not comply does not violate the Cartwright Act.”

93 Cal. App. 4th 363, 373. This case illustrates the inherent difficulty of separating coercion from agreement.

But what if a finding of agreement didn't automatically lead to liability, as it does under the per se rule? If courts believe that the pricing practice can be evaluated on its competitive merits, they might well seek to harmonize the law of agreement in this context with the law of agreement in other contexts. It is easier to prove a horizontal conspiracy than an RPM agreement. Compare *Monsanto* (evidence of acquiescence must be sought and received) with, e.g., *United States v. Foley*, 598 F.2d 1323 (1332 (4th Cir. 1979), cert. denied, 444 U.S. 1043 (1980) (agreement found where defendant announced the price he intended to charge and said that "he did not care what the others did."). Courts would honor *Colgate* itself, but insist on keeping it in its more pristine form – "announcement and termination." They would not condone some of the "persuasive" conduct that manufacturers have employed to "monitor" adherence to their UPPs. They might be more inclined to allow a jury to determine whether acquiescence has been sought and received, as *Monsanto* requires, and set the bar quite low. E.g., *Isaksen v. Vermont Castings, Inc.*, 825 F.2d 1158, 1164 (7th Cir. 1987), cert. denied, 486 U.S. 1005 (1988) (possible to find agreement where a manufacturer tells a dealer "raise your prices or else" and the dealer "merely grunts, but complies."). Thus, manufacturers should expect that policies that today are reasonably considered "unilateral" in light of precedent may not be so considered tomorrow.

Additionally, some manufacturers will enter express RPM agreements with retailers, reasoning that the benefits of clear rules (including the ability to punish a noncomplying dealer without having to terminate it) outweighs any liability risk.

RPM and the Rule of Reason

What does agreement matter, after all, if the practice is to be judged under the rule of reason? The conventional wisdom is that the rule of reason means that the defendant wins. But the conventional wisdom may not apply to resale price maintenance cases. Under the rule of reason, competitive effects will be decisive. There is something of a consensus that RPM causes nominal price – the number of dollars changing hands – to increase at the consumer level. See *Respondent PSKS Brief on the Merits* at 23-25; *Brief of Amicus Curiae New York et al. in Support of Respondent* at 9-16. A plaintiff may start a case with a simple before and after model: the prices were X before RPM and X-plus afterwards. Provided that there is some allegation of a market-wide effect, it is likely enough to withstand a motion to dismiss.

If the plaintiff starts off with evidence of a price increase, then the defendant will have to demonstrate that it is not an anticompetitive price increase or show countervailing procompetitive benefits. In this case, those two showings may amount to the same thing, as the defendant argues that the price reflects the right balance of nominal dollars and all the other information and services that RPM is intended to provide – quality information, innovation, point-of-sale services (such as knowledgeable sales personnel, longer store hours), and so on. The defendant may also take up the interbrand competition issue, contending that its practice does not injure competition in the market, despite a price increase for its product. Interbrand competition may not be a magic bullet, however, since manufacturers accounting for significant collective share may all adopt RPM policies and retailers not subject to them may raise prices under the umbrella of those who are. Given that the plaintiff starts with a nominal price increase, it is in a far more advantageous situation than are most rule of reason plaintiffs.

A manufacturer is thus looking at a situation in which its previously adopted UPP may not be treated as unilateral and a de facto increase in nominal price may prevent early dismissal of the case – not as rosy a scenario as many advocates of rule of reason treatment anticipated. A manufacturer that wants to continue using a UPP or to begin a formal RPM system (by which I mean a practice memorialized in a written agreement) will need to a three step process to minimize its litigation and liability risk. The first step is to have and document a procompetitive goal; the second is to monitor the policy's implementation to ensure that it is achieving that goal; and the third is to understand the relationship between any price effects and those procompetitive benefits – in other words, do the benefits justify or outweigh any price increase?

The first step is to identify the procompetitive purpose the manufacturer hopes to achieve by using RPM. To do this, the manufacturer should collect and review its strategic plans for the last few years and any relevant marketing materials. If these materials suggests a problem at the retail level that might reasonably be mitigated with RPM, the manufacturer may feel more confident going forward. Strategic plans saying “there’s no point in adding consumer-driven features to our product so long as retailers don’t have salesmen who can explain them,” or “there’s no point introducing a product aimed at workaholics if our retailers stores aren’t open after five pm” could support the claim that additional retailer margin will mean that better salesmen will be hired and stores will be open longer. Similarly, marketing memoranda that say, “While our product has changed, consumer surveys indicate that the perception of quality has gone down because of widespread discounting, and we’re losing sales,” could also help justify an RPM program. If there’s nothing in the files, a manufacturer might want to undertake a study of the situation before implementing RPM. At the very least, the manufacturer will want to track the program’s effect: if it’s not accomplishing the goals, but nominal price has gone up, it may be a message that the program – at least in its current form – should be abandoned.

This exercise may also demonstrate that RPM isn’t the answer for a particular product. RPM is not a panacea; it may not be the right tool for the job. An RPM policy won’t improve brand image or draw out point of sale services if authorized dealers are selling the product off the back of a truck along with velvet Elvis paintings. Here, the place to start may not be price; it may be the distribution chain. A manufacturer needs to ask whether its products are sold in the right type of outlets, and whether the treatment it wants for its products are consistent with the treatment offered to other products that the retailer stocks. Some examples may help. If a retailer’s basic mode of operation is “cash and carry” – imagine stacks of boxes of audio equipment as high as a fork lift can reach – a manufacturer can’t fairly expect that store to suddenly have a dedicated sales person to demonstrate the benefits of its audiophile product. Similarly, consider a grocery product that’s been sold for more than twenty years with a pre-marked suggested price; most stores sell at that price. The manufacturer adopts a formal RPM policy, contending that the price sends a signal of quality. It may be hard to argue that such a signal is worth the increase in price, in light of the product’s longevity and the absence of any changes to it.

Documentary evidence that continuing a UPP or adopting an RPM policy is intended to achieve procompetitive results is not sufficient, however. A manufacturer should monitor the implementation of its policy to ensure that it is achieving its goal. If the goal is better-educated salespeople, the manufacturer may want retailers to document the sales personnel’s training; it may want to send “mystery shoppers” to check on this for itself. If the goal is longer store hours, the manufacturer may want stores to certify their hours of operation, and it can easily check the accuracy of the certifications with a phone call or drive-by. Where a plaintiff can prove a nominal price increase, the ability to show that there is more to the UPP or RPM policy than just the price increase is critical.

Finally, the manufacturer may want to develop at least a rough sense of whether the procompetitive benefits the policy creates are balance or outweigh the price increase. Hiring an economist to do a full trial-type study may be overkill in this context, but there are steps short of that which a manufacturer can take. For example, a manufacturer can track whether sales increase after sales personnel are trained or stores increase their hours. If sales do not increase, then the policy should be re-examined.

Conclusion

The twin likelihoods that courts will apply the rules for finding agreement more liberally and that plaintiffs will be able to demonstrate a price increase are only two reasons for predicting an increase in liability risk. A third lies in FTC precedent. *In re Sony* challenged the use of RPM-like minimum advertised price programs by all sellers in a concentrated industry as a violation of Section 5 of the Federal Trade Commission Act. Widespread use of RPM in concentrated industries could lead to another FTC challenge, and widespread use by agreement would be subject to Section 1 as well.

Another factor that must be considered is the effect of other legal regimes. State antitrust laws are often applied in light of federal precedent, but there is no certainty that any given state that currently applies a per se rule to RPM will adopt the rule of reason. *See Amicus Brief for the States of New York, et al.* (37 states argued for retention of the per se rule). Foreign antitrust laws may also come into play. For example, Canada's resale price maintenance regime is very strict; manufacturers cannot even go as far as they can under *Colgate*. Manufacturers will need to pay careful attention to the role of national borders when they adopt UPP and RPM policies.

In conclusion, rule of reason treatment gives manufacturers the ability to legally control resale prices when the circumstances are right. Determining when the circumstances are right, however, is likely to be a more serious and complicated endeavor than it is in the case of other rule of reason practices, such as exclusive distribution agreements. Given the expense of antitrust litigation and the automatic treble damages to a successful plaintiff, it makes sense to begin preparing for a change in the rules well before that change actually happens.