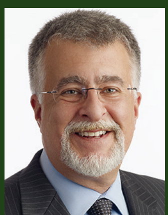
Controlling Retail Prices

The Resale Price Maintenance Two-Step

By Pat Pascarella, Anne Swoboda Cruz, and Stephanie Rzepka

Until anti-*Leegin* states permit companies simply to enter into pro-competitive resale price agreements, properly implemented and monitored policies can provide a fair amount of price discipline, and pose marginal risk.

In 2007, the U.S. Supreme Court abolished the per se rule against minimum resale price agreements and held that they were to be judged instead under the more lenient rule of reason standard. *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 877 (2007). But 10 years later, the combined effect of a disconnect between *Leegin* and certain states' laws and a lack of dispositive court decisions providing substantive guidance has placed manufacturers competing in nationwide markets in the unenviable position of weighing the benefits of rationalizing their retail distribution channels against unpredictable litigation risks.



■ Pat Pascarella is the chair the Tucker Ellis' Antitrust Group. Before joining Tucker Ellis, he served with the U.S. Department of Justice, Antitrust Division in Washington D.C. and as chief in-house antitrust counsel to a Fortune-10 company. Anne Swoboda Cruz, a partner in Tucker Ellis' Los Angeles office, is a trial attorney specializing in commercial litigation and antitrust. Ms. Cruz also is an active member of DRI, including the DRI Women in the Law Committee. Stephanie Rzepka is an associate in Tucker Ellis' Houston office. She represents businesses in antitrust, class action, and complex commercial litigation before state and federal courts and antitrust enforcement agencies.

The Problem

There are many pro-competitive reasons why a manufacturer might want to have some control over the retail pricing of its products. One commonly espoused rationale comes from manufacturers that believe that to compete effectively in the marketplace, their retailers must offer certain customer services. This could come in the form of a showroom, where customers can view or try out the product, or some other form of customer support. Because these services come at a cost, the manufacturer must assure that retailers can collect a sufficient margin on their products despite providing these additional services. That margin, however, can be eroded if some retailers opt not to offer the requisite services and instead attract customers via discount prices. The end result is that customers will tend to use the full-service retailers to view or evaluate a product, then purchase the same product from the dis-

A Word of Warning on *Anti-Leegin* Laws

With many antitrust violations, the prohibited conduct is obvious even to non-lawyers (*e.g.*, do not agree on prices with competitors, do not allocate bids). This is because most antitrust rules are founded in rational economic reasoning. An anti-*Leegin* law banning RPM agreements outright does not fall under this umbrella. Rather, a law that bans RPM agreements in *any* situation is economically irrational. Per the *Leegin* court, the prior per se treatment of minimum resale pricing agreements was based on "formalistic legal doctrine" rather than "demonstrable economic effect." *Leegin*, 551 U.S. at 887. In most cases, if a manufacturer is not a monopolist, imposing a minimum resale price cannot possibly have an adverse effect on consumers since they can simply switch to another supplier. And even if the manufacturer is a monopolist, a minimum resale price will not harm consumers because, in short, there is only one monopoly rent (*i.e.*, the amount a monopolist can charge for its products over and above what might be considered a competitive margin). But the monopolist has that with or without a minimum price restraint. It cannot increase that monopoly rent by imposing a minimum resale price on its retailers.

The point here is that because a ban on RPM agreements is irrational, conduct that could support a finding that the ban has been violated likewise is not intuitively obvious. To an executive or director, such conduct may simply seem to be sound pro-competitive business practices. Accordingly, when implementing an RPM policy or MAPP, a manufacturer must take care to establish somewhat rigid guidelines and procedures to avoid these abstruse pitfalls.

counter. Simply lowering wholesale prices is insufficient because it does not prevent these discount retailers from proportionally cutting their prices to attract price-sensitive consumers.

Manufacturers in this or similar positions will find it desirable to engage in some form of resale price maintenance (RPM). The goal is to maintain resale (or retail) prices at or above a level that permits retailers to earn a living wage, while at the same time investing in the customer services that a manufacturer requires. Ten years ago the Supreme Court recognized that vertical agreements between a manufacturer and its retailers to maintain minimum resale prices were often pro-competitive because the sacrifices to intrabrand competition were more than offset by enhancements to interbrand competition. *Leegin,* 551 U.S. at 877–78. Accordingly, the Court mandated that vertical RPM agreements should be judged under the rule of reason test. *Id*. Thus, if a manufacturer has a pro-competitive business rationale for controlling retail prices, it should be free to enter into enforceable agreements about the appropriate retail price with its distributors and retailers without running afoul of the federal antitrust laws.

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Unfortunately, the key word here is "federal." Forty-nine states have their own antitrust statutes. And while most have federal harmonizing clauses (*i.e.*, the laws are interpreted consistently with their federal counterparts), at least two remain out of sync. After *Leegin*, Maryland passed anti-*Leegin* legislation, maintaining per se treatment of resale price maintenance agreements. And California courts have continued to hold that such agreements are per se violations of the Cartwright Act (California's antitrust statute).

A few other states also have been labeled anti-*Leegin* by some commentators as a result of actions brought, or consent decrees entered, by their attorneys general. However, closer scrutiny of those actions reveals that these states may, in fact, not be anti-*Leegin,* as the matters challenged tended to focus on evidence of horizontal agreements between manufacturers or retailers rather than the presence of a vertical RPM agreement. (Even *Leegin* does not give quarter to horizontal agreements between competitors affecting price.) Adding to this uncertainty, many post-*Leegin* opinions provide limited general guidance because they are either highly fact specific or were resolved too prematurely to rule dispositively on the antitrust issues.

Finally, there are at least two cases involving the computer applications marketplace that contain some unfortunate language regarding the applicability of *Leegin*. In *United States v. Apple Inc*., 791 F.3d 290, 321 (2d Cir. 2015), the Second Circuit found that *Leegin* did not apply to the vertical agreements between Apple and certain book publishers, in part because the agreements would not have been in the publisher's own interest if acting independently. And in *Meyer v Kalanick*, 174 F. Supp. 3d 817 (S.D.N.Y. 2016), the court refused to apply *Leegin* to Uber's agreements with its drivers that they would adhere to its pricing algorithm because "Uber is not selling anything to the drivers that is then resold." *Id*. at 826. While one cannot ignore these cases, neither is likely to alter materially how courts treat RPM policies. In *Apple*, there was significant evidence alleged of a broader, more complex conspiracy as well as Apple's role in orchestrating the conspiracy. And with regard to *Meyer*, while the district court never explains why Uber ride-sharing is not "Uber's product," the case is readily distinguishable from most RPM cases where there is no question that the RPM policy applies to the manufacturer's product.

The Two-Step Solution

In light of all of the above, a manufacturer competing in a national market cannot rely on the fact that an RPM agreement with its retailers is pro-competitive (*i.e.,* that it could pass the rule-of-reason test) to protect it from challenge. Instead, it must do the RPM two-step. This dance consists of implementing two mechanisms to discourage discounting while avoiding any "agreement" on the resale price of the product with the retailers.

- **Step 1:** Announce a suggested resale price policy (sometimes referred to as a unilateral pricing policy (UPP)), under which the manufacturer sets a suggested minimum resale price and ceases doing business with distributors or retailers that discount below that price.
- **Step 2:** Limit retailers' ability to advertise a discounted price via a minimum, advertised pricing policy (MAPP).

Step One: Implementing a Suggested Retail or Uniform Pricing Policy

A suggested retail price policy is a bit of a misnomer. While the lowest acceptable retail price may be "suggested," failure to follow that policy will ultimately result in the termination of the seller. Typically, a retail pricing policy sets out the products covered and the "suggested" minimum prices, and advises that the company will not do business with resellers that price below its suggested price. A well-drafted policy also will make it quite clear that the manufacturer simply is announcing the policy and is not seeking agreement or affirmation regarding its policy from the retailers. This is because the goal of a resale pricing policy is to avoid any "agreement" with the retailers since it is this "agreement" that renders a resale price policy illegal under the anti-*Leegin* laws.

Unilateral Means Unilateral: Avoiding a Vertical Agreement

A manufacturer should begin by announcing its policy in writing to its resellers. That statement should explain the following:

- its products must be sold at or above certain prices;
- resellers who do not comply will be subject to structured or outright termination;
- questions regarding the policy should be directed to a particular contact person;
- terminated parties cannot request reinstatement; and
- the manufacturer is not seeking to have the recipient agree to these provisions because they form a unilateral policy, not an agreement.

The announcement also may explain how the manufacturer will observe resellers to ensure that they are in compliance (*e.g.*, reviewing advertising, sending mystery shoppers, and analyzing receipts). This last item—explaining the compliance observation elements—can be useful for rebutting an argument that the manufacturer intended to rely on other retailers reporting discounters. Plaintiffs' counsel sometimes cite such reporting communications (incorrectly) as evidence of an agreement between a manufacturer and the reporting retailer or retailers.

The fact is that most of the above points are designed to avoid any form of communication between the manufacturer and a reseller that might later be cast by a plaintiff's counsel as evidence of an "agreement" between the manufacturer and the reseller. For example, by directing resellers to a single point of contact within the company, the company can insure that the designated person understands what are and are not permissible discussion topics.

Although some manufacturers set forth a "one strike and you're out" termination policy, courts tend not to require such a stringent approach, and a manufacturer may come to regret drawing that line in the sand if its top reseller runs inadvertently afoul of the policy. A manufacturer's business interests are often better served by enforcing its policy with a "structured termination" process (*e.g.*, warning first-time offenders, suspending product deliveries for a certain period of time after the second violation, and termination after the third infraction). Similarly, the antitrust laws are not blind to the fact that manufacturers and resellers are in constant communication and that this communication is key to maintaining business relationships. Manufacturers may keep these lines of communication open to field questions and complaints regarding the policy along with general inquiries without fear of running afoul of the law.

Staying on the correct side of the unilateral versus bilateral divide in an anti-*Leegin* jurisdiction is relatively straightforward when the resellers comply with the manufacturer's unilateral policy. Where things get murky is the all-too-common scenario in which a reseller violates the policy and puts termination on the table.

Case law on this issue is limited and at times inconsistent. While some courts have found that persuasion accompanied by the ultimate acquiescence of the retailer could support the finding of a vertical agreement, most post-*Monsanto* decisions have been relatively forgiving when it comes to *manufacturers' efforts* to persuade or pressure retailers to adhere to the pricing policy. *E.g., Jeanery, Inc. v. James Jeans, Inc.* 849 F.2d 1148, 1158 (9th Cir.1988). Of note, it also appears that it is more often the response or communication from the retailer to the manufacturer, than any communications from the manufacturer, that provides the basis for finding an agreement. For example, in a recent case in the Central District of California, the court excused a manufacturer's multiple threats made in an attempt to persuade a reseller to raise its prices, but then the court found that an unsolicited offer by a different reseller to the manufacturer to report breaches by other resellers amounted to evidence of an agreement. *Alan Darush MD APC v. Revision LP*, No. CV 12-10296 GAF AGRX, 2013 WL 1749539, at *1 (C.D. Cal. Apr. 10, 2013). This is one reason why reinstatement poses so much risk. It is difficult to imagine a reinstatement scenario that does not involve a communication from the terminated reseller in which the reseller agrees to comply with the policy—a communication that undoubtedly will be characterized in a lawsuit as evidence of an agreement on resale prices. Accordingly, the safest bet for a manufacturer's general counsel is to restrict communications regarding its policy to explaining (not debating) the policy, and notices of violation or termination. Of course, the utility of this approach will inevitably be weighed against the manufacturer's business interests as the certain loss of a principal reseller may eclipse the costs of possible litigation.

Evidence of a Horizontal Conspiracy

A manufacturer implementing a unilateral RPM policy or UPP must avoid creating evidence that could support the inference of an agreement (or conspiracy) between itself and its vertically situated retailers.

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However, vertical conspiracies are not the only conspiracies that can cause problems. While a minimum resale pricing policy may have pro-competitive business justifications, it also can be an effective facilitating mechanism for a horizontal agreement to fix prices among competing retailers or manufacturers. Even post-*Leegin*, horizontal agreements affecting price still tend to run afoul of federal and state antitrust laws. And while *Twombly* raised the bar for allegations of conspiracy, it does not require a confession.

The fact is that many "RPM cases" are really more about horizontal agreements between competitors—with the minimum pricing policy serving as a facilitating mechanism. Some cases involve retailers that agree to limit price competition among themselves only to find their conspiracy undermined by other discounting competitors not party to the illegal agreement. To stop these discounters, the conspiring retailers seek assistance from the manufacturer or supplier in the form of a resale pricing policy that is imposed on all retailers. The unfortunate fact of such a "hub and spoke" conspiracy is that the manufacturer may not even realize that it is facilitating a price-fixing agreement among its retailers.

For the states that still hold that resale price maintenance agreements are per se illegal, market power is irrelevant because there is no analysis of competitive effects.

In other cases, manufacturers may agree among themselves to maintain prices but find that they are unable to verify their co-conspirators' compliance because the downstream retailers remain free to price the competing products however they please. Hence the conspiring manufacturers cannot tell whether another manufacturer is breaking the price-fixing agreement, or a retailer is simply using the manufacturer's product as a loss leader to attract customers. However, if all of the co-conspirators also agree to issue RPM policies, this both facilitates the upstream price-fixing agreement and diminishes any one conspirator's incentive to cheat.

In counseling a client seeking to implement a resale pricing policy, an attorney should look for signs of an illegal horizontal conspiracy. While some of these signs are arguably ambiguous and equally consistent with unilateral, self-interested conduct, it is best to be aware of the evidence that might be offered against the client from the outset.

- **Is there a pro-competitive business rationale behind its need for a resale price maintenance policy?** The lack of a legitimate business rationale could lead a finder of fact to conclude that an RPM policy was imposed for another reason. If possible, a manufacturer should be prepared to demonstrate that the diminution in intrabrand price competition occasioned by the resale pricing policy results in a commensurate increase in the manufacturer's ability to compete in the more important interbrand market.
- **Would a minimum resale price policy make business sense absent the adoption of similar policies by the manufacturer's rivals?** If resale price maintenance does not make business sense absent the adoption of similar polices by the manufacturer's rivals, this could be viewed as evidence of a horizontal conspiracy between the manufacturers. Relatedly, at least one recent case viewed the implementation of RPM policies by a number of rivals in a compressed period of time as evidence of a conspiracy among the manufacturers. Finally, resale price policies that make it difficult for the manufacturer to react quickly to a competitor's pricing strategy could also be viewed as a policing mechanism and evidence of a horizontal conspiracy.
- **Is the minimum resale price policy being considered or implemented at the request of downstream retailers?** As discussed above, a manufacturer can be liable for facilitating a horizontal price-fixing agreement among its downstream retailers. The most common factual setting for this occurrence is brick-and-mortar retailers enlisting the manufacturer's aide in disciplining online-only discounters. This possibility must be explored. Depending of course on the facts, a legitimate business rationale should, but may not always, defeat an inference of conspiracy in this case.
- **Is adopting a minimum resale price policy a major departure from a prior business model in the industry?** This was one of the factors that persuaded the court in a class action filed against major contact lens manufacturers to deny a motion to dismiss. Other evidence of a horizontal conspiracy cited by the court included the short time period in which all of the companies implemented RPM policies, the significant increase in price, and the fact that no single lens manufacturer could have successfully imposed such a significant price increase absent the support of the other manufacturers. *In re Disposable Contact Lens Antitrust*, 215 F. Supp. 3d 1272 (M.D. Fla 2016).

Does Market Power Matter?

For the states that still hold that resale price maintenance agreements are per se illegal, market power is irrelevant because there is no analysis of competitive effects. In other states, or a federal court applying federal law, it does not seem to make a great deal of difference where the sole issue is the competitive impact of an RPM policy.

The Supreme Court's decision in *Leegin* did warn against the danger of allowing dominant manufacturers to implement RPM policies. 551 U.S. at 893–94 ("resale price maintenance… can be abused by a powerful manufacturer" and "give retailers an incentive not to sell the products of smaller rivals or new entrants"). And on remand and subsequent appeal in the same matter, the Fifth Circuit held that "[t]o allege a vertical restraint claim sufficiently, a plaintiff must plausibly allege the defendant's market power." *PSKS, Inc. v. Leegin Creative Leather Prod., Inc.*, 615 F.3d 412, 419 (5th Cir. 2010). However, the presence or absence of market power has played a small and rare role in judicial and administrative decisions evaluating RPM policies, serving more as a safe harbor where market power does not exist, than an affirmative restraint on companies with market power. *In the Matter of Nine W. Grp. Inc.*, No. C-3937, 2008 WL 2061410, at *9 (F.T.C. May 6, 2008) (setting aside an order prohibiting Nine West from entering into RPM policies because Nine West only had "modest market share" and was the source of the RPM); A*T&T Mobility LLC v. Phone Card Warehouse, Inc.*, No. 6:08-cv-1909-Orl-18GJK, 2009 WL 10671271, at *6 (M.D. Fla. Dec. 14, 2009) (identifying market power as only one of the "[f]actors to consider in examining a resale price maintenance agreement"). This should come as no surprise because as detailed previously, an RPM policy does not increase the monopoly rent, and a rational monopolist should be able to collect that rent regardless of whether it is using an RPM policy. Therefore, a manufacturer considering adopting an RPM policy should not shy away from doing so simply because it may be found to possess market power.

Step Two: Implementing a Minimum Advertised Price Policy

While a resale price maintenance policy seeks to avoid potential liability solely through its unilateral nature, minimum advertised price policies (MAPPs) seek two layers of protection. Like an RPM policy, most MAPPs are set and enforced unilaterally. Unlike an RPM policy, MAPPs restrict only certain discount advertising, not the price actually charged by the retailer.

The first question is what sorts of advertising can be prohibited by a MAPP (*i.e.*, when does an advertised price become the retail price being charged the consumer). Generally, an advertised price evolves into a retail price at the point where the price becomes part of the negotiation or transaction between the seller and a specific buyer. In the brick-and-mortar context, this is a simple delineation. Advertised prices are those used in off-site advertising (*e.g.*, mailers, flyers, billboards); therefore, a lawful MAPP should not restrict in-store signage, price tags, or negotiations with store employees.

The extent to which MAPP policies can limit the prices that appear on websites has not been fleshed out completely, and likely will be the subject of future litigation. Most courts and enforcers seem to agree that once an online buyer places the product in a "shopping cart" or proceeds to "checkout," where a final purchase election is made, the price shifts from an advertised price—which may be restricted by a MAPP—to the retail price between the seller and the buyer—which may not. Relatedly, one district court found that MAPPs may restrict prices that appear on websites as long as "internet retailers [have] more than one way to communicate lower prices to clients, either by allowing customers to call or email for a price quote or by offering a coupon to be applied at checkout." *WorldHomeCenter.com, Inc. v. Franke Consumer Products, Inc.*, No. 10 civ. 3205(BSJ), 2011 WL 2565284, at *5 (S.D.N.Y. June 22, 2011).

For now, a MAPP for online advertising should not restrict (1) the retailer's ability to engage in negotiations with the customer outside of the online platform, or (2) the appearance of the actual price at checkout or in the online shopping cart. A MAPP may, however, apply to auction sites on which the minimum bid is set by the retailer.

In theory, MAPPs should present far less risk of an inadvertent violation of the antitrust laws than RPM policies because they do not actually restrict the retailer's ability to set any retail price. But theory and reality often diverge. In the real world, retailers complain to manufacturers and among themselves about price discounters as well as their own costs. Competitors observe and follow the pricing practices of rivals. Manufacturers may be slow or reluctant to enforce their MAPPs and instead engage in dialogue with the discounting retailers. Manufacturers may look to downstream distributors to police their MAPPs, losing oversight and control of the interactions between the distributors and retailers. The list goes on.

What all of these things have in common is that as with the case of RPM policies, they may be viewed as evidence of a horizontal or vertical *price* agreement—the very thing the MAPP was intended to avoid. As a result, a company considering a MAPP must understand that simply publishing a properly drafted MAPP is not enough to protect the company from an inadvertent violation of the antitrust laws. As in the case of an RPM policy, specific guidelines and procedures must be set up and followed. While these are essentially the same as those implemented to prevent an appearance of an agreement in the RPM context, there is one additional item unique to MAPPs: the MAPP should make clear that it is not intended to set or limit the prices the retailer may charge.

The Fly in the Ointment: Unauthorized Resellers

Even with an RPM policy and/or MAPP in place, a manufacturer seeking to control resale pricing may still face the problem of the unauthorized reseller. Because the reseller is not receiving the product from the manufacturer, immediate termination becomes difficult. The first step typically is to trace the product to the "authorized" original distributor, and as allowable by any terms of any agreement between the manufacturer and the authorized distributor, terminate the distributor that is improperly passing the products to the unauthorized reseller. To facilitate this approach, manufacturers should consider implementing some mechanism that permits them to track the source of their products.

A company also may consider a cease-and-desist letter or lawsuit based on numerous potential intellectual property or unfair business theories. Some commentators have suggested that conditioning a manufacturer's warranty on the product being purchased from authorized resellers may assist in this regard, particularly if the product requires certain quality controls in shipment and storage.

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While dealing with unauthorized resellers is outside the scope of this article, the fact of potential unauthorized resellers and the manufacturer's ability to police them should be part of the decision process when contemplating an RPM policy or MAPP.

Conclusion

Perhaps in the not-too-distant future, the anti-*Leegin* states will realize the error of their ways and companies will be able simply to enter into pro-competitive resale price agreements. In the meantime, RPM policies and MAPPs can provide a fair amount of price discipline, and with the proper implementation and monitoring, they pose marginal risk. Of course, even better price controls can be imposed via agency or consignment agreements, but that's a topic for another day. FTD