A Primer on Resale Price Maintenance

By Matthew L. Powell

As the name implies, resale price maintenance (RPM) is an express agreement between a supplier and distributor that sets a maximum or minimum price (or both) at which the distributor can sell the supplier's products. This sounds like a practical approach for a supplier wanting to control its products' prices. But § 1 of the Sherman Act states that *every* contract, combination, or conspiracy in restraint of trade is illegal.[1] Read literally, this blanket prohibition would reach all types of restraints on trade, including agreements among entities at different levels of the same distribution chain. It's a good thing, then, that the Supreme Court limited this all-encompassing restriction to apply only to those agreements that *unreasonably* restrict trade.[2]

Nevertheless, for nearly 100 years RPM agreements were classified as per se violations of the antitrust laws, i.e., the type of hard-core anticompetitive conduct that has little or no redeeming competitive value in almost all cases.[3] Competitive harm is assumed from a per se violation, paving the way for a successful lawsuit. Traditionally, RPM agreements were classified as per se illegal because they removed a distributor's freedom to determine resale prices, limited price competition between the supplier's products, limited distributor profits, and were believed to result in higher prices to consumers.

Recognizing the changing tide of economic theory, the Supreme Court eliminated the per se illegal treatment of setting maximum resale prices in 1997, holding in *State Oil Company v Khan*[4] that there was "insufficient economic justification for *per se* invalidation of vertical maximum price fixing."[5] Ten years later in *Leegin Creative Leather Products, Inc v PSKS, Inc*,[6] the Court took the next logical step and also removed minimum RPM agreements from the per se illegal category of conduct. *Leegin* recognized that minimum RPM agreements have many potential procompetitive effects and per se illegal treatment was no longer justified. According to the Court, "[a]bsent vertical price restraints, the retail services that enhance interbrand competition might be underprovided. . . ."[7] The Court recognized that "discounting retailers can free ride on retailers who furnish services and then capture some of the increased demand those services generate."[8] RPM agreements, like other vertical restraints, "can stimulate interbrand competition—the competition among manufacturers selling different brands of the same type of product—by reducing intrabrand competition—the competition among retailers selling the same brand."[9]

Leegin did not, however, exempt RPM agreements completely from antitrust scrutiny under the Sherman Act.[10] Although RPM agreements were no longer per se violations under *Leegin*, they are subject to the nebulous realm of rule of reason analysis along with other vertical restraints.[11] The rule of reason is a nonspecific test that considers the purpose and effect of the particular agreement and determines whether the procompetitive effects outweigh possible anticompetitive restraints. Generally, it requires a fact-intensive inquiry into whether, "under all the circumstances," a restraint on trade results in anticompetitive effects in a properly defined relevant market, and if any are proven, whether procompetitive benefits outweigh the harm.[12] This often requires detailed, expert analysis into the proper geographic market, a manufacturers' market power, and the effects on competition.

Under the rule of reason, then, a plaintiff has a much more difficult and expensive path to successfully proving that a supplier's pricing policies are unreasonable restraints on trade. But the costs and complexity are equally burdensome for the defending supplier, especially in borderline cases. To further muddy the waters, there are few cases analyzing RPM agreements under the rule of reason and little federal enforcement agency guidance in contrast to the recent Federal Trade Commission document setting forth the agency's outlook on agreements among competitors that limit or fix the terms of employment.[13]

And even though RPM agreements are not per se illegal under the federal antitrust laws, a number of states continue to treat vertical price fixing as per se illegal under state laws, which can be stricter because of a lack of federal preemption in the antitrust field.[14] This danger is heightened given certain states' willingness to bring enforcement actions challenging RPM agreements, such as the Maryland Attorney General's recent action against Johnson & Johnson Vision Care, Inc.[15] Accordingly, a manufacturer must be wary when considering whether to implement a minimum resale price maintenance policy and should carefully consider the law in jurisdictions where its distributors are located, the manufacturer's relative market share and ability to influence prices, and other relevant factors.

Additional considerations before implementing a resale price maintenance program

The usual caveats about consulting with a qualified attorney before implementing an RPM agreement apply, but a number of factors can be used to guide that discussion. For example, courts will look to whether multiple manufacturers in the same industry have adopted resale price maintenance agreements with distributors.[16] If so, courts view that as a sign of potential collusion among manufacturers to fix the price of their products to protect margins, especially if one or more of the manufacturers has market dominance.[17] Likewise, if a group of retailers demands that a manufacturer implement an RPM agreement, it may signal potential collusion among the retailers to protect profitability. Again, scrutiny will be greater if the retailers have market power.[18]

Courts will also look at the potential procompetitive effects such as whether (1) the agreement encourages the retailer to increase customer service by providing new or updated showrooms, product demonstrations, and employees dedicated to the specific products; (2) the agreement reduces the number of discounters that do not provide the enhanced customer services that benefit the product's or the manufacturer's image (the "free rider" problem); and (3) the manufacturer is attempting to become a new entrant in the market and seeks to induce retailers to invest in customer services and promotion for the product.[19] Any procompetitive benefit will increase the odds of overcoming a challenge to the policy on antitrust grounds.

Another layer of analysis is needed when the manufacturer directly sells or distributes its products through its own retail outlets in addition to third-party distributors. In such cases, the manufacturer both deals at arm's length in the sale of its products to distributors and competes with the same distributors in the sale of its product to consumers. These arrangements can alter the analysis from a vertical RPM agreement between a supplier and distributors to a horizontal price-fixing agreement among competing distributors. The *Leegin* Court did not address these dual distribution arrangements, so there are still unanswered questions for the courts in this area.[20]

Alternatives to RPM

Although the following is not an exhaustive list of available options for a supplier to control distributor pricing, these alternatives have passed judicial scrutiny under the federal antitrust laws.

Colgate policy

In *United States v Colgate & Co*,[21] the Supreme Court fashioned what was then the only carve-out to the per se illegality of a manufacturer's restricting a distributor's ability to set retail prices before *Khan* and *Leegin*. But even after *Leegin*, the practice permitted under *Colgate* is still a viable option for manufacturers wishing to protect against discounting retailers.

Because the Sherman Act only prohibits contracts, agreements, and conspiracies in restraint of trade, the Court held that unilateral conduct by the manufacturer—e.g., through

fast facts

- Resale price maintenance agreements, whether setting maximum or minimum prices, are no longer per se violations of the Sherman Antitrust Act; however, they are still subject to antitrust scrutiny under the rule of reason, which balances procompetitive effects with anticompetitive restraints.
- Resale price maintenance agreements are still per se illegal under some state laws.
- There are alternatives to resale price maintenance agreements to control distributor behavior that have passed judicial scrutiny under federal antitrust laws, but they also carry risk.

terminating a retailer for not adhering to resale prices—was insufficient to establish a contract, agreement, or conspiracy to set prices. *Colgate* held that manufacturers had no obligation to deal with any particular company and could lawfully refuse to deal with distributors if they wanted. Accordingly, under *Colgate*, a manufacturer can unilaterally announce and enforce a policy of dealing only with distributors who sell at the manufacturer's preferred price.

Actual implementation of the *Colgate* approach is wrought with challenges, however, because of the difficulties with enforcement. Acts such as interfering with the distributor's pricing autonomy, changing credit terms, or threatening the price-cutting distributor with economic punishment will remove any antitrust protection and subject an otherwise lawful policy to rule of reason scrutiny under *Leegin*. Nevertheless, there is still considerable freedom in this area, such as suggested resale prices and published price lists. Generally, these activities are lawful if they are not used in conjunction with coercive acts by a manufacturer to compel a discounting distributor to comply with the suggested retail price.

Minimum advertised price

A subset of resale price maintenance is known as a minimum advertised price (MAP) program. Under a MAP program, manufacturers and retailers agree that resale prices will only be advertised at the manufacturer's preferred price, but retailers will have the ability to charge a different price to customers. This is often seen in Internet sales outlets where the sales price is not given until the customer places the product in the virtual cart. Generally, MAP programs will not violate the Sherman Act if the only recourse for a manufacturer dealing with a noncompliant retailer is the elimination of cooperative advertising allowances to the offending retailers.[22] MAP programs are closely related to *Colgate* policies and have many of the same drawbacks and benefits.

Consignment

Consignment arrangements require the manufacturer to supply the reseller with the product without passing title to the product until sale to the end customer. The per se rule does not apply to consignment arrangements to the extent they involve a legitimate principal-and-agent relationship.[23]

Conclusion

There are many ways for a manufacturer to exercise control over distributors that do not involve direct control of resale prices, such as direct-to-customer discounts, cooperative advertising cost-sharing, and territorial and customer restrictions. But since the Supreme Court removed the remaining per se prohibition against RPM agreements under federal antitrust law in *Leegin*, manufacturers have another potential tool to control product pricing and image. However, legal risks remain when considering an RPM agreement, and there are many factors to consider before a business decides on or alters its distribution model. ■

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ENDNOTES

1. 15 USC 1.
2. See, e.g., *Bd of Trade of Chicago v United States*, 246 US 231, 238; 38 S Ct 242; 62 L Ed 683 (1918); *State Oil Co v Khan*, 522 US 3, 10; 118 S Ct 275; 139 L Ed 2d 199 (1997); *Texaco Inc v Dagher*, 547 US 1, 5; 126 S Ct 1276; 164 L Ed 2d 1 (2006).
3. See, e.g., *Dr Miles Med Co v John D Park & Sons Co*, 220 US 373, 408; 31 S Ct 376; 55 L Ed 502 (1911).
4. *Khan*, 522 US 3.
5. *Id.* at 18.
6. *Leegin Creative Leather Products, Inc v PSKS, Inc*, 551 US 877; 127 S Ct 2705; 168 L Ed 2d 623 (2007) (overruling per se rule for vertical minimum pricing).
7. *Id.* at 878.
8. *Id.*
9. *Id.* at 890.
10. 15 USC 1 *et seq.*
11. *Leegin*, 551 US at 890.
12. See *Arizona v Maricopa Co Med Soc*, 457 US 332, 343; 102 S Ct 2466; 73 L Ed 2d 48 (1982).
13. See Federal Trade Commission, *Antitrust Guidance for Human Resource Professionals* (October 2016) <https://www.justice.gov/atr/file/903511/download> (accessed June 12, 2017).
14. *California v ARC Am Corp*, 490 US 93, 102; 109 S Ct 1661; 104 L Ed 2d 86 (1989) (finding no federal preemption); Cal Bus and Prof Code § 16720(b). In Michigan, it is the intent of the legislature that, in construing all sections of the Michigan Antitrust Reform Act, "the courts shall give due deference to interpretations given by the federal courts to comparable antitrust statutes, including, without limitation, the doctrine of per se violations and the rule of reason." MCL 445.784(2).
15. Complaint, *Maryland v Johnson & Johnson Vision Care, Inc*, No. 03C16002271 (Md Cir Court, February 29, 2016) <http://www.marylandattorneygeneral.gov/News%20Documents/JJVC_COMPLAINT.pdf> (accessed June 12, 2017).
16. See *Leegin*, 551 US at 892.
17. *Id.*
18. *Id.* at 893.
19. *Id.* at 890–891.
20. *Id.* at 907–908.
21. *United States v Colgate & Co*, 250 US 300; 39 S Ct 465; 63 L Ed 992 (1919).
22. See, e.g., *Lake Hill Motors, Inc v Jim Bennett Yacht Sales, Inc*, 246 F3d 752, 757 (CA 5, 2001) (applying the rule of reason to a dealer's challenge to a cooperative advertising program that reimbursed dealers for advertising only if the advertising stated either the manufacturer's suggested resale price or no price).
23. See *Simpson v Union Oil Co of Cal*, 377 US 13, 18; 84 S Ct 1051; 12 L Ed 2d 98 (1964) (consignee may be required to sell at a fixed price, but consignments cannot be "used as a cloak" to avoid antitrust laws).