# 23. Resale Price Maintenance

Antitrust Law

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# Resale Price Maintenance

- Concept
  - *Resale price maintenance* (RPM) is the term commonly used to denote a price-related vertical restraints, that is a vertical restraints on the resale price
  - Types of resale price maintenance
    - *Minimum RPM*: "I will sell you Product X, but only if you agree that you will resell the product at a price no less than $Y." Sets a price floor.
    - *Maximum RPM*: "I will sell you Product X, but only if you agree that you will resell the product at price no more than $Y." Sets a price ceiling.
    - Pure (exact) RPM: "I will sell you Product X, but only if you agree that you will resell the product at price $Y." Sets an exact price.
- Question
  - Under what circumstances, if any, is the imposition of a price vertical restraint a violation of the antitrust laws?

# Resale Price Maintenance

- Statutory coverage
  - Sherman Act § 1
    - Applies whenever the vertical restraint results from an agreement
    - Two examples
      - Supplier S and reseller R1 could agree on the price at which R1 will resell the supplier's product
      - Supplier S and reseller R2 could agree on the resale price R1 must maintain in order for S to continue to supply R1
    - Coercion
      - The fact that a reseller is "coerced" into accepting an RPM restriction that it does not want in order to obtain a supply commitment does not negate the existence of an agreement for Section 1 purposes
  - Sherman Act § 2
    - In principle, in some circumstances RPM could be exclusionary
      - The supplier could set the resale price so high and provide its dealers with a substantial economic incentive to deal only with the supplier's products. If the dealers are an essential distribution channel for competitive products, these products could be foreclosed from the market.
      - The supplier could set the resale price sufficiently low that competitors could find it difficult to compete at the resale level
      - There is a separate question in every case of whether it is *anticompetitively* exclusionary
    - Section 2 is almost never invoked in practice
      - Easier to prove a Section 1 violation

# History of Section 1 Treatment

- *Dr. Miles* (1911)[1]
  - Declared contracts between Dr. Miles, a manufacturer of proprietary medicines, and its retailers that set the retail price for Dr. Miles products to be a per se violations of Section 1
    - Resale price restrictions on good purchased by a retailer for its own account constituted a restraint on alienation and hence a restraint of trade
    - The purpose of the restraints was to maintain prices and prevent competition among dealers
    - Since the retailers could not lawfully combine among themselves to these same ends, Dr. Miles, which was one step removed, a fortiori lacked a sufficient interest to justify the restraint
  - Comments
    - Dr. Miles also had consignment agreements with its wholesalers
      - Under these agreement, Dr. Miles gave its wholesalers possession of its products but did not part with ownership. Since Dr. Miles had retained ownership, it was free to direct its wholesaler-agents as to prices they could charge.
        - NB: A consignment does not involve a sale. When the wholesaler made a sale, it sold as an agent of Dr. Miles and title passed from Dr. Miles to the buyer. There was no resale.
    - Although not addressed in the Supreme Court's opinion, there is some suggestion in the historical record that Dr. Miles set its resale prices as part of a cartel of proprietary medicine manufacturers

[1] Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).

# History of Section 1 Treatment

- *Colgate* (1919)[1]
  - Examined in Unit 18 on unilateral refusals to deal
  - Established that a supplier could announce that it would only continue to sell to resellers that abided by the supplier's resale price policy and could refuse to deal with those reseller's that did not abide by the policy
    - The key to the decision was an absence of an agreement between Colgate and its resellers.
    - As construed by the Supreme Court, the resellers were entirely free—that is, unbound by any agreement—as to the prices at which they could sell resell Colgate's products that they had purchased and held in their inventory
    - On the other hand, Colgate was free not to deal with resellers that violated its resale policy (i.e., there was no duty to deal)
    - The fact that a reseller might have an economic incentive to abide by Colgate's resale policy in order to be able to purchase from Colgate in the future did not create an agreement within the meaning of Section 1 between Colgate and the reseller as to the resale price
  - Practical implication
    - Since *Dr. Miles* made resale price maintenance per se unlawful, any supplier that wanted to control downstream prices had to either—
      - Utilize a consignment or agency system, so that the middlemen acted as agents of the supplier and not as principles for their own account, or
      - Fall within the *Colgate* doctrine, so that there would be no agreement and Section 1 would not apply

[1] United States v. Colgate & Co., 250 U.S. 300 (1919).

# History of Section 1 Treatment

- *Parke, Davis* (1960)[1]
  - Examined in Unit 18 on unilateral refusals to deal
  - Limited *Colgate* to the announcement of a resale policy and a simple refusal to deal going forward with resellers that do not abide with this policy
  - PD went beyond *Colgate* in two ways:
    - Engaged in a secondary boycott with wholesalers against discounting retailers and disseminated names of discounting retailers to wholesalers in furtherance of this boycott
    - Reached agreement with some retailers that they would cease discounting
      - Sometimes a simple agreement
      - Other times, particular retailers required PD to obtain agreement from other retailers that they each would cease discounting before the target discounter would agree to stop discounting (i.e., "I will agree to stop discounting only if you get my competitors A and B to stop discounting")
  - Practical implication
    - Severely restricted *Colgate's* application to RPM
      - Any expression of acquiescence by a reseller to the supplier's resale policy that was given to a supplier was regarded as evidence of an agreement between the supplier and the reseller on the resale price
      - Any involvement of any third party in the monitoring or enforcement of the supplier's suggested resale prices took the conduct out of *Colgate's* protection
        - Even if outside the *Colgate* doctrine, there still must be an agreement with someone in order to be governed by Section 1. The courts, however, frequently ignored this requirement.

[1] United States v. Parke, Davis & Co., 362 U.S. 29 (1960).

# History of Section 1 Treatment

- *Albrecht* (1968)[1]
  - Background
    - Herald Co. published the Globe-Democrat, a morning newspaper distributed in the St. Louis area by independent carriers who buy them at wholesale for their own account and sell them at retail
      - Marks its papers with a suggested retail price
      - Carriers are granted exclusive territories, which are subject to termination if they charge above the suggested retail price
    - Albrecht is an independent carrier that began charging above Herald's suggested price
    - In response, Herald—
      - notified Albrecht that its territory was no long exclusive and that Herald would begin competing in the territory
      - notified subscribers in the area that if they wanted a lower price Herald would deliver it
      - Engaged Milne Circulation Sales to solicit subscribers for Herald in the area, resulting in about 300 of Albrecht's customers switching to Herald
      - Engaged George Kroner as another carrier to do home deliveries in the area
      - Notified Albrecht that if it continued selling above Herald's suggested price Herald would terminate Albrecht altogether—Albrecht refused and Herald terminated it
  - Complaint
    - Herald formed a combination with "plaintiff's customers and/or Milne Circulation Sales, Inc. and/or George Kroner" to fix resale prices in violation of Section 1

[1] Albrecht v. Herald Co., 390 U.S. 145 (1968).

# History of Section 1 Treatment

- *Albrecht* (1968)
  - District Court
    - Jury verdict for Herald
    - Denied motion for a jnov, which asserted that *Parke, Davis* required a finding of a per se illegal combination
  - Eight Circuit affirmed
    - Herald's conduct wholly unilateral
    - No precedent  on a seller establishing maximum prices for a distributor given an exclusive territory

# History of Section 1 Treatment

- *Albrecht* (1968)
  - Supreme Court: Reversed (7-2)
    - White (for seven members)
      - Herald's conduct created a combination under *Parke, Davis* with Milne and Kroner to force Albrecht to conform to suggested retail price
        - The (in)famous footnote 6 on possible other conspiracies:

> Petitioner's original complaint broadly asserted an illegal combination under § 1 of the Sherman Act. Under *Parke, Davis* petitioner could have claimed a combination between respondent and himself, at least as of the day he unwillingly complied with respondent's advertised price. Likewise, he might successfully have claimed that respondent had combined with other carriers because the firmly enforced price policy applied to all carriers, most of whom acquiesced in it. See *United States v. Arnold, Schwinn & Co.,* 388 U.S. 365, 372 (1967). These additional claims, however, appear to have been abandoned by petitioner when he amended his complaint in the trial court.
>
> Petitioner's amended complaint did allege a combination between respondent and petitioner's customers. Because of our disposition of this case it is unnecessary to pass on this claim. It was not, however, a frivolous contention.[1]

        - Remember, members of a combination are jointly and severally liable for all damages caused by the conspiracy
      - Resale price fixing of all types is per se illegal: "[A]greements to fix maximum prices 'no less than those to fix minimum prices, cripple the freedom of traders and thereby restrain their ability to sell in accordance with their own judgment.'"[2]

[1] *Albrecht*, 390 U.S. at 150 n.6 (some citations omitted).
[2] *Id*. at 151 (citing Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, 340 U.S. 211, 213 (1951).

# History of Section 1 Treatment

- *Albrecht* (1968)
  - Supreme Court: Reversed (7-2)
    - White (for seven members)
      - More on the possible anticompetitive effect of maximum resale price maintenance arrangements

> Maximum and minimum price fixing may have different consequences in many situations. But schemes to fix maximum prices, by substituting the perhaps erroneous judgment of a seller for the forces of the competitive market, may severely intrude upon the ability of buyers to compete and survive in that market. Competition, even in a single product, is not cast in a single mold. [1] Maximum prices may be fixed too low for the dealer to furnish services essential to the value which goods have for the consumer or to furnish services and conveniences which consumers desire and for which they are willing to pay. [2] Maximum price fixing may channel distribution through a few large or specifically advantaged dealers who otherwise would be subject to significant nonprice competition. [3] Moreover, if the actual price charged under a maximum price scheme is nearly always the fixed maximum price, which is increasingly likely as the maximum price approaches the actual cost of the dealer, the scheme tends to acquire all the attributes of an arrangement fixing minimum prices. It is our view, therefore, that the combination formed by the respondent in this case to force petitioner to maintain a specified price for the resale of the newspapers which he had purchased from respondent constituted, without more, an illegal restraint of trade under § 1 of the Sherman Act.[1]

      - Query
        - Which, if any of these three possible anticompetitive effects, are consistent the supplier's profit-maximizing interests or otherwise make economic sense?

[1] *Albrecht*, 390 U.S. at 152-53 (footnote omitted).

# History of Section 1 Treatment

- *State Oil* (1997)[1]
  - Unanimously overruled *Albrecht* and made maximum resale price maintenance subject to the rule of reason
  - Background
    - State leased gas stations/convenience stores
    - Lessees were required to purchase gasoline from State Oil
      - State Oil price = State Oil's suggested retail price minus a margin of 3.25 cents per gallon
      - Lessees could sell at any price they wished, but if they sold above the suggested resale price they would have to rebate the margin in excess of 3.25 cents to State Oil
  - Complaint
    - Arrangement constituted per se illegal maximum resale price maintenance, since as a practical matter it compelled lessees to charge no more than the suggested price
  - District court: Summary judgment for State Oil
    - Complaint did not state a per se violation
    - Khan failed to raise a genuine issue of material fact on injury to competition under the rule of reason
  - Seventh Circuit: Reversed (Posner)
    - Agreement did set maximum resale prices, and was per se unlawful under *Albrecht*
      - Called *Albrecht* "unsound" with "increasingly wobbly, moth-eaten foundations," but it is for the Supreme Court to reverse it

[1] State Oil Co. v. Khan, 522 U.S. 3 (1997).

# History of Section 1 Treatment

- *State Oil* (1997)
  - Supreme Court: Reversed (9-0)
    - Section 1 reasonableness standard
      - Most restraints are subject to the rule of reason and so must be proven by the evidence that they are anticompetitive to be unreasonable for the purpose of Section 1
      - Some restraints, however, are conclusively presumed to be unreasonable under the per se rule
        - Must have "predictable and pernicious anticompetitive effect" and "limited potential for procompetitive benefit", and
        - Judicial experience with the restraint must "enable[ ] the Court to predict with confidence that the rule of reason will condemn it"[1]
    - Revisit the *Albrecht* per se rule in light of other recent cases, including
      - *GTE Sylvania*, which overruled the per se rule against nonprice vertical restraints in their of their potential, at least in come situations, to increased interbrand competition to the benefit of consumers, and
      - *Matsushita*, which emphasized caution in condemning arrangements resulting in lower prices to consumers
    - Reject the per se rule against maximum resale price maintenance
      - While in some situations, maximum resale price maintenance may be anticompetitive, in other situations it may be used procompetitively to limit the exercise of local market power of a downstream firm
        - A supplier has an interest in limiting the exercise of a downstream firm, since the exercise of that power will reduce the demand for the supplier's product as well as the supplier's profits
        - Limiting the exercise of this power is also in the interests of consumers, since it reduces their prices

[1] *State Oil* , 522 U.S. at 10.

# History of Section 1 Treatment

- *Leegin* (2007)[1]
  - Overruled *Dr. Miles* in a 5-4 decision and made minimum resale price maintenance subject to the rule of reason
  - Background
    - Leegin
      - Designs, manufactures, and distributes leather goods and accessories
      - Typically sells in independent, small boutiques and specialty stores
    - Leegin resale price policy
      - In 1997, Leegin adopted under which it refused to sell to retailers that discounted Leegin goods below Leegin's suggested retail prices
        - Leegin adopted the policy to give its retailers sufficient margins to provide customers the service central to its distribution strategy
        - Leegin also expressed concern that discounting harmed Leegin's brand image and reputation
      - In 2002, Leegin adopted its "Heart Store Program," under which it offered retailers incentives to become Heart Stores, and, in exchange, retailers pledged, among other things, to sell at Leegin's suggested prices
    - PSKS
      - Operates Kay's Kloset, a women's apparel store in Lewisville, Texas, that sells products from about 75 manufacturers, including Leegin
      - In 2002, when Leegin discovered PSKS was discounting Leegin products 20% below Leegin's suggested retail prices, Leegin stopped selling to the store

[1] Leegin Creative Leather Prods, Inc. v. PSKS, Inc., 551 U.S. 877 (2007).

# History of Section 1 Treatment

- *Leegin* (2007)[1]
  - Complaint
    - Leegin violated Section 1 by entering into agreements with various of its retailers to charge only those retail prices suggested by Leegin
  - District court
    - Court refused to admit economic testimony on the procompetitive effects of Leegin's programs, holding that such evidence was irrelevant since minimum RPM was per se illegal under *Dr. Miles*
    - Court denied Leegin's motion to instruct the jury that minimum resale rice maintenance was subject to the rule of reason
    - Jury returned a verdict for PSKS and awarded $1.2 million in actual damages
  - Fifth Circuit: Affirmed
    - Leegin did not dispute that it had entered into vertical rice-fixing agreements
    - Only argued that it was error for the district court to instruct jury that the agreements were subject to the per se rule and not the rule of reason

[1] Leegin Creative Leather Prods, Inc. v. PSKS, Inc., 551 U.S. 877 (2007).

# History of Section 1 Treatment

- *Leegin* (2007)[1]
  - Supreme Court: Reversed and remanded (5-4)
    - Kennedy (for five members of the Court (with Roberts, Scalia, Thomas, and Alito)
      - Rule of reason is the accepted standard for judging the reasonableness of a restraint
      - Per se rule is an exception to be applied only to restraints
        - that—
          - "would always or almost always tend to restrict competition and decrease output"
          - "have "manifestly anticompetitive" effects, and
          - "lack ... any redeeming virtue," and
        - with which courts—
          - have had considerable experience, and
          - can predict with confidence that the restraint would be invalidated in all or almost all instances under the rule of reason
      - Any departure from the rule of reason "must be based upon demonstrable economic effect rather than . . . upon formalistic line drawing"
      - *Dr. Miles*' rationale does not reflect this modern jurisprudence—the *Dr. Miles*' per se rule was grounded in
        - The common law rule that restraints against alienation were generally invalid, and
        - The idea that minimum RPM would benefit distributors, not suppliers, and that a horizontal combination among distributors to the same end would be per se unlawful

[1] Leegin Creative Leather Prods, Inc. v. PSKS, Inc., 551 U.S. 877 (2007).

# History of Section 1 Treatment

- *Leegin* (2007)[1]
  - Supreme Court: Reversed and remanded (5-4)
    - Kennedy (for five members of the Court (with Roberts, Scalia, Thomas, and Alito)
      - Minimum resale price maintenance should be subject to the rule of reason
        - Economics literature is replete with procompetitive justifications for a manufacturer's use of resale price maintenance
        - Justifications for vertical price restraints are similar to those for other vertical restraints, which *GTE Sylvania* returned to the rule of reason
          - In particular, can stimulate interbrand competition to the benefit of consumers by
            - eliminating "free-riding" by intrabrand competitors, and
            - even in the absence of free-riding, providing extra margin that can be used by the distributor to provide demand-enhancing services
          - Also has the potential to give consumers more options so that they can choose among low-price, low-service brands; high-price, high-service brands; and brands that fall in between
      - Recognize that minimum in some circumstances can be anticompetitive, but these situations can be handled under the rule of reason
        - Even if minimum RPM consistently increases retail prices, this is not a sufficient reason standing alone to subject the restraint to the per se rule since the associated higher margin may have been used to provide greater consumer value
          - Many manufacturers spend money on advertising and other demand-enhancing services that ultimately increase consumer prices, but no one would think that these expenditures are anticompetitive

[1] Leegin Creative Leather Prods, Inc. v. PSKS, Inc., 551 U.S. 877 (2007).

# History of Section 1 Treatment

- *Leegin* (2007)
  - Supreme Court: Reversed and remanded (5-4)
    - Breyer (dissenting, with Stevens, Souter, and Ginsburg)
      - Stare decisis requires the Court to retain the *Dr. Miles* per se rule
        - If such a long-standing rule is to be changed, it should be changed by Congress
        - Congress' repeal in 1975 of the exemption for RPM in states with "Fair Trade Laws" (which allowed RPM), if anything, shows that Congress do not favor permitting RPM
      - Economic evidence suggests that minimum RPM is usually harmful to consumers
        - Clear situations when minimum RPM is anticompetitive (especially when distributors are driving the practice)
        - Empirical studies show that minimum resale price maintenance almost always raises price—which is a gross harm to consumer
          - WDC: This should not be surprising. If minimum RPM did not increase prices, there would be no reason to institute the restraint
        - Supporters cannot cite studies that the price increases are often offset with procompetitive consumer benefits so that overall consumers benefit from the practice
        - Elimination of free-riding is not a persuasive consumer benefit, since the provision of free point-of-sale (POS) services and other consumer benefits to enhance demand is a commonplace occurrence even with *Dr. Miles* in place
        - Therefore, must conclude that consumers are worse off in general with minimum RPM than without it
      - Very difficult for courts in practice to distinguish between procompetitive and anticompetitive occurrences of minimum RPM, and given the empirical evidence the best course is to accept the overinclusiveness errors of the per se rule rather than the likely underinclusiveness errors of the rule of reason

# Modern Practice

- Federal law
  - After *State Oil* and *Leegin*, all forms of RPM are subject to the rule of reason
  - There have been no litigated federal cases challenging—
    - Maximum RPM since *State Oil*
    - Minimum RPM since *Leegin*

- State antitrust law
  - 37 states joined in an amicus brief in *Leegin*, urging the Court to retain the per se rule against minimum RPM
  - After *Leegin*, the attorneys general in some of those states—including New York and California—took the position that their state antitrust laws contained to treat minimum resale price maintenance as per se unlawful
  - The landscape today remains unclear
    - In recent years, the California Attorney General obtained a consent decree against a Colorado company that had RPM agreements with its independent resellers[1]
    - The New York Attorney General sought to enjoin an RPM program and lost a contested trial court proceeding[2]

[1] *See* People v. Bioelements Inc., File No. 10011659 (Cal. Super. Ct. Riverside Cty Jan. 11, 2011) (consent decree).
[2] *See* People *ex rel.* State v. Tempur-Pedic Int'l, Inc., 30 Misc. 3d 986, 916 N.Y.S.2d 900 (N.Y. Sup. Ct. 2011) (case dismissed).

# Modern Practice

- RPM in practice post-*Leegin*
  - Although no doubt concern about the use of the per se rule under state law (especially in California) has dissuaded some companies from adopting a minimum RPM scheme, for the most part there appears to be little interest among companies in minimum RPM
  - The exceptions are probably small companies like Leegin, which seek to establish themselves by
    - encouraging retailers to stock and promote their products due to the higher margins, and
    - maintaining a high quality image not undermined by discounting
  - The elimination of free-riding does not appear to be a major business concern
  - Casual empiricism suggests (at least to me) that in most situations businesses appear to prefer other arrangements, especially exclusive territories and careful selection of distributors, to minimum RPM
  - Also, in part because of state antitrust law considerations, companies considering minimum RPM may continue to employ a *Colgate* approach of announcing a suggested resale price policy and refusing to sell to distributors that have violated the policy (but without some of the paranoia that followed in the wake of *Parke, Davis*)
    - Sometimes this practice is known as a *Unilateral Pricing Policy*[1]