Resale Price Maintenance and the Emerging Leegin Backlash
Avoiding Anti-Competitive Conduct in an Uncertain Legal Environment

A Live 90-Minute Teleconference/Webinar with Interactive Q&A

Today’s panel features:
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Resale Price Maintenance Post-Leegin
Avoiding Anti-competitive Conduct in an Uncertain Legal Environment

Lynda K. Marshall
October 14, 2009
Resale Price Maintenance Defined

• Resale price maintenance refers to:
  – An agreement on price
    • May involve a specific price, a price floor (minimum resale price maintenance) or a price ceiling (maximum resale price maintenance)
  – Between entities at different levels of the market
    • Characterized as a vertical restraint
    • Generally between a manufacturer and its distributors
  – Regarding the resale price of a product or service

• Until 1997, both minimum resale price maintenance and maximum resale price maintenance were per se illegal
  – In 1997, the Supreme Court in State Oil Co. v. Kahn (1997) overturned the per se rule as it applied to maximum resale price maintenance, holding that such arrangements are subject to rule of reason analysis.
  – In 2007, the Supreme Court overturned the per se rule applicable to minimum resale price maintenance in Leegin Creative Leather Products, Inc. v. PSKS, Inc. (2007).
Leegin Creative Leather Products v. PSKS, Inc.

• The Facts
  – Leegin Creative Leather Products designs, manufacturers and distributes leather goods and accessories under the Brighton brand name.
  – In 1997, Leegin instituted a policy under which it refused to sell to retailers that discounted Brighton goods below suggested prices.
  – PSKS, Inc., a retailer that operated a women’s apparel store in Texas, carried Brighton goods, but refused to adhere to the suggested price.
  – Leegin stopped selling to PSKS’ Texas store as a result of the store’s refusal to adhere to Leegin’s suggested pricing.
  – PSKS sued Leegin alleging that Leegin’s policy was a violation of Section 1 of the Sherman Act.
Leegin Creative Leather Products v. PSKS, Inc.

• The Decision
  – Rule of reason analysis applies to minimum resale price maintenance agreements
  – The following factors play a role in the analysis:
    • The number of manufacturers that make use of the practice
      – When only a few manufacturers adopt the practice, there is little likelihood that the practice is facilitating a manufacturer cartel.
    • The source of the restraint
      – If retailers have pressured the manufacturer to adopt the restraint, it may be indicative of a retailer cartel.
    • The market power of the manufacturer and the distributors
      – The greater the market power of the parties, the greater the chance that the agreement is anticompetitive.
Leegin Creative Leather Products v. PSKS, Inc.

• The Reasoning
  – Per se rules should be limited to practices that always or almost always tend to restrict competition and decrease output – that maxim cannot be applied to minimum resale price maintenance
  – Minimum resale price maintenance agreements can have the following pro-competitive effects:
    • Increasing interbrand competition by reducing intrabrand competition
    • Improving product quality, service and safety by fostering distributor investment
    • Facilitating entry by enabling distributors to recover initial market development costs
    • Increasing consumer options – consumers can choose between low-price and low service, high-price and high service, or something in between
The Dissent - Justice Breyer, writing for the dissent, stated that if he were writing on a blank slate, he may have supported a rule of reason analysis, but this is not a blank slate.

- RPM may have both anticompetitive and procompetitive effects
  - Anticompetitive
    - Eliminate competition between dealers
    - Impede low prices
    - Prevent dealers from adjusting price to meet falling demand
    - Encourage dealers to substitute service competition for price competition
    - Inhibit expansion and new modes of retailing
  - Procompetitive
    - Eliminate free-riding
    - Facilitate new entry
The Dissent

- **Determining whether an RPM arrangements has a good or bad effect is very difficult.**
  - It is not fair to ask judges and juries to apply complex economic criteria
- **Nothing has changed in the American economy that justifies overturning Dr. Miles**
- **In fact, the principle of stare decisis counsels against doing so**
  - *Stare decisis* applies more rigidly to statutory cases such as this (as opposed to constitutional cases)
  - *Stare decisis* is more important when considering older cases; *Dr. Miles* is 100 years old
  - Overturning *Dr. Miles* creates an unworkable legal regime
  - The per se rule for RPM is well-settled law
  - This case relates to contract principles, which implicate reliance, a fact that argues against overturning *Dr. Miles*
  - The per se rule is embedded in the national culture
Federal Caselaw post-Leegin

• There are only a handful of cases out there considering the issue of resale price maintenance post-Leegin
  – The Leegin case itself was remanded after the Supreme Court decision and was dismissed this spring
    • Failure to define a relevant market
  – The class action stemming from Leegin was dismissed in August 2008
    • No allegation of horizontal agreement deserving of per se treatment
    • Failure to define a relevant market
    • No allegation of anticompetitive effect
  – The few remaining cases offer little guidance
    • Toledo Mack Sales & Service, Inc. v. Mack Trucks, Inc.
    • Babyage.com, Inc. v. Toys “R” Us, Inc.
    • State unfair trade/sales act cases
The Scope of *Leegin*

- *Leegin* did not overturn either *Colgate* or *General Electric*
  - *United States v. Colgate* held that a manufacturer does not engage in concerted action under Section 1 of the Sherman Act when it announces a pricing policy unilaterally and refuses to do business with dealers that do not adhere to it.
  - *United States v. General Electric* held that a manufacturer may set minimum prices for its products when there is a genuine principal-agent relationship between the manufacturer and the dealer.

- Adhering to either of these cases requires close attention to business practices
  - *Colgate* – challenge of keeping conduct unilateral
    - Close monitoring of communications with dealers required
  - *General Electric* – requires genuine agency relationship
    - Examine distribution of business risk
Resale Price Maintenance Agreements: What Was Is Again (Or “So Long Rule of Reason”)

Robert A. Lipstein
Crowell & Moring LLP
October 14, 2009
• Federal – RPM is “bad”
  – FTC and DOJ support *Leegin* repeal (S. 148)
  – Agencies exploring how to “structure” rule of reason:
    • *Nine West*
    • *NAMM*
    • Varney Speech
      – *Proof of agreement and scope of operation shifts burden to defendant*
Varney Paradigms

- Manufacturer-Driven RPM
  - RPM covers much of the market
  - Manufacturers can coordinate (market structure is concentrated)
  - RPM helps detect cheating
    - Dominant manufacturer
    - RPM covers most of the market
    - Foreclosure effects on rival manufacturer
Varney Paradigms

• Retailer-Driven RPM
  – One or more retailers with market power
  – Coercion of manufacturers to adopt RPM, and RPM covers much of the market
  – Significant exclusionary effect on actual rival
  
  – RPM is pervasively used (more than 50% of market)
  – Retailer coercion (not merely persuasion)
  – Manufacturers unable to thwart retailer collusion
• 37 State AG’s opposed *Leegin* outcome
• Numerous states are not “obligated” to follow federal law
• Some states have separate RPM statutes
  – E.g., New York General Business Law section 369-a: “Any contract provision that purports to restrain a vendee of a commodity from reselling such commodity at less than the price stipulated by the vendor or producer shall not be enforceable or actionable at law.”
States urged an “inherently suspect” analysis for *Nine West*
  – *Burden shifting argument similar to Varney speech*
State suit (Illinois, New York and Michigan) against Herman Miller settles in 2008 for $750K
Maryland passes *Leegin* repealer, effective date 10-1-09
Maryland’s *Leegin* Repealer

- “For purposes of subsection (A)(1) of this subsection [prohibiting contracts, etc. that unreasonably restrain trade], 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.”
Maryland

- Leaves *Colgate* intact, but

- Last Maryland case on RPM was *Natural Design, Inc. v. The Rouse Company* (302 Md. 47, 485 A.2d 663) (1984)

- Pre-*Sharp, Twombly* and *Trinko*; post-*Monsanto*. The *Monsanto* standard:

  Thus, something more than evidence of complaints is needed. There must be evidence that tends to exclude the possibility that the manufacturer and non-terminated distributors were acting independently.

- *Monsanto*:
  - A price-fixing combination or agreement could be inferred from circumstantial evidence as well as direct evidence as long as the "inference of such an agreement [is not] drawn from highly ambiguous evidence."

  - Evidence necessary to exclude the possibility of independent action is "direct or circumstantial evidence that reasonably tends to prove that the manufacturer and others had a conscious commitment to a common scheme designed to achieve an unlawful objective.”
• **Quality Disc. Tires:**

  "In *Colgate* the Court stated that a seller may announce in advance that he will refuse to deal with any retailers who fail to abide by the seller's announced pricing policies. The Court stated that § 1 of the Sherman Act does not restrict the right of a trader or manufacturer 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 limited scope of the *Colgate* doctrine, however, was emphasized in later cases, such as *Parke Davis*: "When the manufacturer's actions ... go beyond mere announcement of his policy and the simple refusal to deal, and he employs other means which effect adherence to his resale prices ... he has put together a combination in violation of the Sherman Act.”"
• **Quality Disc. Tires v. Firestone Tire:** in a case involving a dealer termination because of pricing practices and complaints from competing dealers, it was not necessary under *Parke Davis* that the plaintiff prove that the seller and other dealers "consciously agreed or conspired to fix prices" as long as the action was not unilateral.

• How will Maryland apply *Colgate* in light of more recent case law?
Maryland “long arm” statute – Courts and Judicial Proceedings § 6-103

- Due process and “purposeful availment”
  - Compare: *Cybersell, Inc. v. Cybersell, Inc.*, 130 F.3d 414, 418 (9th Cir. 1997) (advertising on website, without e-commerce, not sufficient)
• Mackey v. Compass Marketing, Inc. (391 Md. 117, 892 A.2d 479 2006):
  “Under this theory, an out-of-state party involved in a conspiracy who would lack sufficient, personal, “minimum contacts” with the forum state if only the party's individual conduct were considered nevertheless may be subject to suit in the forum jurisdiction based upon a co-conspirator's contacts with the forum state.”

• Analogy to World-Wide Volkswagen: a manufacturer could be subject to jurisdiction in a forum state if it “delivers its products into the stream of commerce with the expectation that they will be purchased by consumers in the forum State.”

• Result: Maryland law can reach manufacturer of RPM agreement that has no nexus with Maryland if its reseller sells to Maryland consumers
Colgate (Nearly) Eviscerated

- Pre-Leegin:
  - Two paths:
    - Suggesting prices (MSRP)
    - Colgate policies
  - Challenge was to keep manufacturer conduct “unilateral”
    - “Coerced” agreements still “agreements”
    - Parke, Davis and Albrecht left little but “pure Colgate”
      “The combination with retailers arose because their acquiescence in the suggested prices was secured by threats of termination; the combination with wholesalers arose because they cooperated in terminating price-cutting retailers.” (Albrecht, describing Parke, Davis)
**Colgate Revitalized**

- *Twombly, Trinko* and *Linkline* revitalize *Colgate*:
  - Wider scope for non-dominant, single firm conduct
  - Higher threshold to show “agreement”

- *Colgate* pros
  - Rule of reason analysis not required (not within Section 1 scope)
  - Disciplines fractured distribution networks
  - Relatively simple to design and articulate (in theory)
Emerging Electronics (“EE”), a spin-off formed by successful Apple engineers, has developed new products to enhance the iPod’s capabilities. EE comes to you with its marketing plan, which includes the following:

1. A survey of brick & mortar retailers, who have expressed interest in possibly carrying EE’s products, but are concerned that (a) tight capital markets mean they cannot invest in inventory unless they are highly confident it will move quickly, and (b) EE will go to market over the Internet, and prices will rapidly erode, leaving no margin for the brick & mortar retailers.

2. A proposal by EE to address the survey results by rolling out the EE products in two stages: (a) very limited Internet distribution, coupled with a strict RPM agreement with a zero tolerance provision (i.e., total termination on first violation); and (b) to be followed by brick & mortar roll-out, also with RPM agreement terms, to make sure that there is adequate stocking of products to meet consumer demand as the initial Internet distribution works to create the appropriate consumer buzz.
Case Study

- EE is based in California, and has no presence in, or links with, Maryland. It does not sell directly to consumers.

Questions:
1. Can EE proceed with the program as designed? What are the legal risks under (a) federal, and (b) state law?
2. Can EE enter into an agreement with an Internet retailer that has a nexus with Maryland?
3. Can EE enter into an agreement with a brick & mortar retailer who sells to Maryland consumers, but is based and maintains its stores outside of Maryland?
4. In terms of enforcement of the Maryland statute, does it matter whether EE enters into an agreement with any retailer that has a nexus with Maryland, or is it sufficient that EE’s Internet retailers can be accessed by Maryland consumers?
5. If EE cannot proceed via the proposed RPM agreement, how would you advise it to modify its marketing plan?
Unauthorized Sellers

- EWholesalers.com is a New York-based website devoted to selling discount electronics. It buys inventory from overstocked dealers, both Internet dealers and bricks and mortar dealers, and then sells that inventory on its website. EWholesalers prices are so good and its inventory so sophisticated that it has become an Internet phenomenon.

- EWholesalers bought a small volume of EE’s new product from one of EE’s bricks & mortar retailers and has placed that product for sale on its website at half of EE’s required price. The product is selling at the speed of light; however, EE and its dealer network is up in arms, threatening all sorts of legal action against EWholesalers.
Unauthorized Sellers

Questions

1. Does EWholesalers face liability for its sales given that it has no agreement with EE? If so, what is the liability risk?

2. What sort of actions can EWholesalers take to protect itself?

3. What sort of risk does the dealer who sold EWholesalers the EE product face? Can EE take action against it and, if so, what type of action? How would it come out?
In light of the fiasco with EWholesalers and the numerous complaints dealers have lodged regarding the proposed pricing structure, including complaints regarding each others’ compliance with that structure, EE has decided to make changes to its distribution network. It proposes to select one authorized Internet dealer and distribute the remainder of its product through a more limited bricks & mortar dealer network.

Questions

How should EE go about restructuring its network? What sort of internal documentation should it put in place, if any? How should it carry out the terminations? Does it face any legal risk from the terminations?
In one last ditch effort to get a handle on distribution, EE develops a new “policy” that contains multiple rebate requirements. Each dealer receives up to a total of 10 percent rebate for complying with all the rebate requirements, however, half of the rebate can be earned only by the dealer reselling EE’s products within a price band specified by EE. Note that under this program, the dealer earns an acceptable margin even if it chooses not to comply with the pricing portion of the rebate program (and thus the case is easily distinguishable from the FTC’s American Cyanamid case). Further, EE is now not setting a single resale price for each product, but offering rebate dollars if the resale price falls within a range of resale prices.
Questions

1. If some dealers participate in the full rebate, and others do not, is there an “agreement” that would bring the program within Section 1 of the Sherman Act, and the Maryland law? Does the analysis change if every retailer chooses to comply with the EE rebate program to earn the full rebate amount?

2. How would you counsel EE to keep the program within the “Colgate” exception?
Avoiding the Antitrust Traps

- Forget *Leegin*
- Understand the limits of *Colgate* – federal and state
- Eliminate risky communications
- Train, Train, Train
Resale Price Maintenance Agreements: What Was Is Again (Or “So Long Rule of Reason”)

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October 14, 2009
Hypothetical for Resale Price Maintenance Update Program

Case 1:

Emerging Electronics ("EE"), a spin-off formed by successful Apple engineers, has developed new products to enhance the iPod’s capabilities. EE comes to you with its marketing plan, which includes the following:

1. A survey of brick & mortar retailers, who have expressed interest in possibly carrying EE’s products, but are concerned that (a) tight capital markets mean they cannot invest in inventory unless they are highly confident it will move quickly, and (b) EE will go to market over the Internet, and prices will rapidly erode, leaving no margin for the brick & mortar retailers.

2. A proposal by EE to address the survey results by rolling out the EE products in two stages: (a) very limited Internet distribution, coupled with a strict RPM agreement with a zero tolerance provision (i.e., total termination on first violation); and (b) to be followed by brick & mortar roll-out, also with RPM agreement terms, to make sure that there is adequate stocking of products to meet consumer demand as the initial Internet distribution works to create the appropriate consumer buzz.

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Case 2
EWholesalers.com is a New York-based website devoted to selling discount electronics. It buys inventory from overstocked dealers, both Internet dealers and bricks and mortar dealers, and then sells that inventory on its website. EWholesalers prices are so good and its inventory so sophisticated that it has become an Internet phenomenon.

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3. What sort of risk does the dealer who sold EWholesalers the EE product face? Can EE take action against it and, if so, what type of action? How would it come out?

Case 3

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Questions

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Case 4

In one last ditch effort to get a handle on distribution, EE develops a new “policy” that contains multiple rebate requirements. Each dealer receives up to a total of 10 percent rebate for complying with all the rebate requirements, however, half of the rebate can be earned only by the dealer reselling EE’s products within a price band specified by EE. Note that under this program, the dealer earns an acceptable
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Questions

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2. How would you counsel EE to keep the program within the “Colgate” exception?
§6–103.

(a) If jurisdiction over a person is based solely upon this section, he may be sued only on a cause of action arising from any act enumerated in this section.

(b) A court may exercise personal jurisdiction over a person, who directly or by an agent:

(1) Transacts any business or performs any character of work or service in the State;

(2) Contracts to supply goods, food, services, or manufactured products in the State;

(3) Causes tortious injury in the State by an act or omission in the State;

(4) Causes tortious injury in the State or outside of the State by an act or omission outside the State if he regularly does or solicits business, engages in any other persistent course of conduct in the State or derives substantial revenue from goods, food, services, or manufactured products used or consumed in the State;

(5) Has an interest in, uses, or possesses real property in the State; or

(6) Contracts to insure or act as surety for, or on, any person, property, risk, contract, obligation, or agreement located, executed, or to be performed within the State at the time the contract is made, unless the parties otherwise provide in writing.

(c) (1) (i) In this subsection the following terms have the meanings indicated.

(ii) “Computer information” has the meaning stated in § 22-102 of the Commercial Law Article.

(iii) “Computer program” has the meaning stated in § 22-102 of the Commercial Law Article.

(2) The provisions of this section apply to computer information and computer programs in the same manner as they apply to goods and services.