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David S. Olson

February 2016

The Federalist Society
1776 I St., N.W., Suite 300
Washington, DC 20006
fedsoc.org

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About the Author

David Olson is an associate professor at Boston College Law School. He teaches patents, intellectual property, and antitrust law. Professor Olson researches and writes primarily in the areas of patent law and copyright. Professor Olson came to Boston College from Stanford Law School's Center for Internet and Society, where he researched in patent law and litigated copyright fair use impact cases.

Before entering academia, Professor Olson practiced as a patent litigator at the law firm of Kirkland & Ellis LLP. Professor Olson clerked for Judge Jerry Smith of the U.S. Court of Appeals for the Fifth Circuit. He received his J.D. from Harvard Law School and his B.A. from the University of Kansas.

Resale Price Maintenance & State Law Holdups

David S. Olson[1]

In the last few decades, the Supreme Court has recognized what had been conventional wisdom among economists for some time—manufacturers have many procompetitive reasons to set the retail prices for their products. Such price setting allows manufacturers to provide incentives for retailers to educate consumers about their products, promote those products, and improve customer service. Consumers can benefit from this education, promotion, and service. In addition, some consumers benefit from knowing that they are being offered the product they want at the best price—without the necessity of spending their limited time price shopping.

Notwithstanding that economists and the Supreme Court have recognized the potential benefits of allowing resale price maintenance, some states continue to outlaw this practice based on the outdated and unsupported view that allowing a manufacturer to set retail prices for its products is always anticompetitive. Since the Supreme Court officially allowed minimum retail price maintenance subject to rule of reason review in 2007, many states have followed the Court's lead, while others have yet to rule on the issue. Several states have rejected the Supreme Court's analysis, however, and therefore continue to prohibit retail price setting as per se illegal. The result of this heterodox view on retail price setting by only a few states is that manufacturers effectively are prohibited from setting national pricing strategies. This in turn harms competition among manufacturers and discourages close collaboration between manufacturers and retailers, even though economists have shown that such collaboration can benefit consumers.

The result is inefficiency in the marketing and selling of products as well as a legal structure that forces manufacturers to engage in a bizarre charade as they inevitably try to assert significant influence over the retail pricing of their products so that they can effectively compete with their rivals. This charade is not only wasteful in terms of manufacturers' efforts, it also wastes valuable enforcement time and resources on the part of state attorneys general who sometimes prosecute inartful resale price maintenance, but are largely powerless to stop nod-and-a-wink setting of retail prices by sophisticated manufacturers. These sophisticated manufacturers—and their lawyers—understand the legal complexities and apply the resources needed to practically achieve retail price setting without violating state or federal antitrust laws. This effort not only results in the inefficient allocation of the manufacturers' resources, it also leads to manufacturers disruptively cancelling distribution agreements with participating retailers who do not understand the nods and winks, or who choose not to follow the manufacturer's "suggested" retail pricing.

If manufacturers could enter contracts with retailers as to the retail pricing of the manufacturers' goods, disruptions and renegade behavior could largely be avoided. In addition, to the extent that prohibitions on retail price setting have some effect, they can harm consumers because they can focus manufacturers on competing on the basis of price, not service. For some kinds of goods, price competition is what consumers want. But for other goods—like complex equipment on which consumers need training—removing incentives to compete on service may make consumers worse off by depriving consumers of services that would allow them to realize the full value of the product. The ultimate price of this waste and lack of competition is borne not just by manufacturers and retailers, but also by taxpayers and consumers.

This article will begin by discussing the history of the treatment by the Supreme Court of manufacturers setting retail prices for their products. It will describe how the Court moved from an initial position of opposition to all retail price setting by manufacturers to the current position of recognizing the competitive benefits of minimum as well as maximum resale price setting.[2] The paper will then examine the reaction of the states to the acceptance of resale price maintenance by the Supreme Court. While many states have historically—

1 I thank David Hackett and Jonathan Hu for able research assistance. I thank Ryan Hynes for logistical and formatting support.

2 The terms "retail price setting," "resale price setting," and "resale price maintenance" are synonymous and used interchangeably throughout this paper.

legislatively or judicially—based their state antitrust law interpretation on U.S. Supreme Court interpretation of federal antitrust law, some states do not harmonize with federal antitrust law. Some of these states continue to outlaw retail price setting by manufacturers based on the erroneous assumption that consumers will get better prices if retailers of the same brand of product compete on the retail price of that product.

The paper will then describe the convoluted process by which—in the face of laws against agreements setting retail prices—manufacturers attempt to unilaterally set minimum retail prices. Manufacturers can do this because even in states in which agreements to set retail prices are illegal, courts allow manufacturers to engage in conduct designed to maintain uniform retail pricing of their products so long as the conduct is unilateral. The paper will explain why this inefficient method of regulating retail prices is wasteful of both manufacturers' and enforcement agencies' resources, to the ultimate detriment of taxpayers and consumers.

I. The Supreme Court's eventual recognition of the procompetitive justifications for resale price maintenance

For many years, the Supreme Court held it to be a per se violation of antitrust law for a manufacturer to dictate to an independent retailer the retail price for the manufacturer's product. The Supreme Court held that it was anticompetitive to prevent retailers from competing as to the price at which they offered the manufacturer's product. The Court's basic intuition was that if competition is good for markets, then more competition must always be better, including competition among retailers to offer the best prices for identical goods.

In support of the Court's intuition, when the Court looked at the marketplace, it could find many examples of retailers competing fiercely on prices, to the benefit of consumers. Grocery stores compete to drive food prices down to razor thin margins, clothing stores compete on pricing the same brands, sellers of electronics compete to offer the same products for lower prices. In short, there is a great deal of competition among retailers to give consumers what they want at the best prices. This competition is good for consumers because it motivates retailers to find ways to cut costs, and to retail their products with the utmost efficiency. When this sort of fierce price competition happens, consumers benefit because they get the products they want at the lowest markups above the wholesale price.

Because retail competition often benefits consumers, the Supreme Court assumed for many decades that allowing manufacturers to set retail prices would necessarily harm consumers. The Court worried that, if manufacturers were allowed to set retail prices, they would set them above competitive levels, or that, even if they set prices at competitive levels initially, the protection from price competition would remove the motivation for retailers to innovate so as to undercut the prices being offered on the same products by their rivals. Thus, because price competition in the market is generally good, and agreements that limit competition are often anticompetitive, the Court decided to prohibit manufacturers from setting retail prices.

What the Supreme Court did not realize in its early decisions on resale price maintenance is that there is a natural market mechanism that discourages inefficient and anticompetitive price setting by manufacturers. Economists pointed out that it is generally in manufacturers' best interests to keep retail markups *as low as possible*.[3] Typically manufacturers sell their goods to wholesalers, who then sell to retailers, who then sell to the public. Sometimes manufacturers sell their goods directly to retailers. In either case, the general practice is for the manufacturer to be paid in full for its products at the time the manufacturer sells its goods into the stream of commerce.[4] From that point on, the manufacturer typically does not get any of the wholesale or retail markups on its goods.[5] Some might

3 *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 889-890 (2007) (collecting procompetitive arguments for resale price maintenance); Mathewson & Winter, *The Law and Economics of Resale Price Maintenance*, 13 Rev. Indus. Org. 57 (1998).

4 There are exceptions to this. Sometimes manufacturers and retailers have arrangements such that the retailer can return a certain amount of unsold stock, or receive discounts on future purchases depending on past sales. But these types of arrangements do not change the analysis.

5 Again, there are certain exceptions to this, given the numerous ways of structuring distribution of goods and related marketing efforts, such as commission systems. But for the

think that this means the manufacturers therefore have no interest in the retail prices of their products. But in fact, manufacturers have a strong interest in keeping retail prices as close to wholesale prices as possible to sell as many products as possible.[6] Because consumers buy less quantity as prices increase, the quantity sold decreases as prices increase. In the manufacturer's ideal world, it would get its products to consumers with no retail markup. But sales and distribution of products involve costs, and retailers must recoup the costs for the service they provide. It is nevertheless always in manufacturers' interests to keep the retail margins as thin as possible. Thus, when a manufacturer sets a minimum retail price, there must be some motivation for it other than simply to give retailers more profits, because increased retailer markups generally come at the cost of decreased quantity of sales of the product, and thus decreased revenue and profits for the manufacturer. Nor is facilitating high retail markups a method for manufacturers directly to get higher profits on sales of their products. If manufacturers have some market power in their products, they can simply charge a higher wholesale price and take their profits at that stage, leaving retailers to compete to keep the retail margins low.

So why do manufacturers sometimes set retail prices? When it comes to setting *maximum* retail prices, the reason is obvious—manufacturers want to limit the retail markup on their products so that they can sell more of their products. Of course, manufacturers must allow a high enough markup to allow retailers to recoup their costs of selling (including normal operating profit), or retailers will not carry their goods. But particularly if retailers do not have enough competition to keep margins down, manufacturers may want to limit the retail markup by contract.

In other cases, manufacturers want to set the exact price of their products at retail, rather than simply a price ceiling. Why would a manufacturer want to set exact retail prices? One reason is to allow manufacturers to more precisely respond to competitors' pricing moves. If a manufacturer can adjust pricing in reaction to its competitors' prices, then it is better able to respond quickly and uniformly to price changes that might cost it market share. Another reason to set exact retail prices is to facilitate regional or nationwide advertising campaigns. If a sector is highly competitive such that prices drive consumer choices, then being able to advertise and guarantee exact pricing throughout a region can allow efficient regional or nationwide advertising.[7] For some consumers, this practice saves them search costs because they know there is no need to spend their limited time searching out a lower price at other retailers offering the same product. A uniform retail price may also help drive more immediate sales of the goods—when the consumer has confidence she is getting the right product features at the best available price, she will feel comfortable buying on the spot rather than price shopping the same good.

These reasons all make sense for why manufacturers might want to set maximum or exact retail prices, but the final question is why manufacturers would want to set *minimum* retail prices, and why they should be allowed to do so. Why allow retailers to mark up goods as much as they want, and also prevent them from competing to reduce the price to below a set level? In 1911, early in the history of antitrust law in the United States, the Supreme Court held in *Dr. Miles Medical Co. v. John K. Park & Sons Co*. that there was no legitimate, procompetitive reason for a manufacturer to do this, and thus held minimum resale price setting to be per se illegal in all circumstances.[8] Only eight years later, however, in 1919, the Supreme Court revisited the *Dr. Miles* decision in *United States v. Colgate*, and ruled that manufacturers may utilize their independent discretion in determining with whom they will deal.[9] The Court noted that this discretion includes the right to announce in advance the circumstances in which a manufacturer

most part, the manufacturer does not share in any retail pricing. And even in the case of commission systems, the manufacturer's motivation remains the same—to keep retail costs as low as possible, for the reasons detailed below.

6 Mathewson & Winter, *supra* note 3 at 74–75.

7 Fast food "value menus" are an example of this, wherein the national franchisor seeks to have uniform prices at its franchise locations to more effectively price compete across a region or the nation. Of course, participation may vary.

8 220 U.S. 373 (1911).

9 250 U.S. 300 (1919)

will refuse to deal—for example refusing to sell to any retailer who elects to charge less than the announced minimum price—as long as there is no "agreement" regarding retail prices. This resulted in the use by some manufacturers of what is often referred to as a "*Colgate* Policy," and the beginning of the aforementioned charade. In the decades after *Colgate*, the Court slowly began to recognize the procompetitive arguments for at least some types of resale price maintenance, and finally, in 2007, the Court expressly accepted the economic realities as to why even minimum resale price setting can be procompetitive.[10]

What are the economic arguments in favor of allowing minimum resale pricing? The first step in understanding how minimum resale pricing can be procompetitive is to broaden the focus from *intra*brand competition to *inter*brand competition. If one looks at the relevant product or service market as a whole, then one sees that, in most markets, consumers have a number of different branded and sometimes unbranded options among which to choose in making purchasing decisions. Competition among various manufacturers of a product is likely to have much more effect on prices and quality of the products than is price competition among retailers of the same brand of products. One can see examples of this everywhere in the market. In the mobile phone product space, phone manufacturers are competing fiercely against each other. This competition drives ever-improving phone quality and functionality, as well as price competition. Likewise, in the wireless phone service market, the wireless service companies compete against each other to offer consumers plans that have more features for lower prices. We have seen how, over time, competition in this field led to calling plans allowing unlimited texting for a low fee, unlimited calling to others using the same company's mobile service, and greater amounts of monthly data for lower prices. These competitive pressures are provided much more by competition among manufacturers and service providers than they are by competition among retail stores selling the same brand of a product or service.

An understanding of the importance of facilitating intense competition among competing manufacturers in turn led to the understanding that minimum resale price setting can be procompetitive. The Supreme Court recognized a number of ways in which minimum resale pricing can be procompetitive in its 2007 *Leegin* opinion.[11] First and foremost, the Court recognized that minimum resale price setting could be used to combat inefficient free riding by some retailers.[12] If a manufacturer makes a product that requires promotion by retailers, consumer education, or service in the sale and maintenance of the product, then setting a minimum resale price can be the most efficient way of, in effect, compensating those retailers for the extra effort required to sell the product. For example, if a manufacturer makes a new product that it believes consumers will want if they can try it, then encouraging retailers to set up demonstration units in their stores can be very important to driving consumer demand for the product. Obviously, demonstrating the unit in store takes up valuable square footage and employee time and effort. This is something that will only be worthwhile to the retailer if the retailer can make up its investment in providing the resources that add consumer value.

Of course, the manufacturer that needs retail support for its products could give retailers other incentives to provide that support. The manufacturer could pay the retailer directly for the costs of demonstrating its products. But this introduces monitoring costs for the manufacturer. Once the retailer has been paid, its incentive is to do as little as possible to satisfy the manufacturer's demands. It will also have no built-in financial incentive to promote the product or demonstrate it more than the minimum required amount—or even less than that, if it can get away with it. Thus, directly paying the retailer may not be the most efficient choice for the manufacturer. Alternatively, the manufacturer could send its own employees out to do demonstrations in retail stores. Indeed, sometimes manufacturers do just this. But the manufacturer will have to send many employees out to perhaps thousands

10 *Leegin*, 551 U.S. 877.

11 *Leegin*, 551 U.S. at 889-91.

12 Klein & Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J. Law & Econ. 265 (1988) (explaining how retail price setting can prevent "free-riding" by low-price retailers who take advantage of competing retailers' product promotion efforts, but then take sales from those promoting retailers by underpricing them).

of stores, which may be very expensive. Additionally, these demonstrations will have to be for limited times, so that the demonstrators can then move on to the next store. This may make the demonstrations both expensive and of limited effectiveness.

Allowing a retailer to charge a higher markup for the product can align retailer and manufacturer incentives and benefit the consumer. If the retailer can make more money per item from selling the manufacturer's product than from selling competing brands, then the retailer will have the incentive to enthusiastically promote the product through demonstrations and consumer education, at least up to that point when the cost of demonstrations and education exceeds the increased margin. As a result of the service (which can include product education or customization) the consumer may realize more value from the product as well. This practice eliminates the wasteful costs to the manufacturer of monitoring the promotion by retailers, and allows promotion and education about products to be done efficiently by the thousands of retailers across the country, instead of at great expense by a manufacturer trying to set up demonstrations of its own.

There is one potential problem with this system. If a retailer invests heavily in promoting a manufacturer's product, but the consumer ultimately buys the product somewhere else, then the retailer will suffer a loss from the promotion. This loss of sales could be systematic if a competing retailer engages in no demonstration or product promotion, but instead simply advertises the good for a lower cost. This low-cost competing retailer can then free ride on the efforts of the promoting retailers and, because the low-cost seller has not incurred promotion costs, it can profitably sell the good for a cheaper price than the full-service retailer who promoted the product. If this becomes widespread enough, then no retailer will have the incentive to incur extra expenses promoting the product, because promoting retailers will lose too many sales to competing low-cost retailers to make it worthwhile. Thus, the manufacturer, which is willing to pay for promotion of its goods through a higher retail markup, will now find very few retailers interested in promoting its goods. This can make it harder for manufacturers to compete as vigorously against each other, and can particularly retard consumer acceptance of new and improved products, to the detriment of consumers and manufacturers alike.[13]

Retail price maintenance efficiently solves the free rider problem. Manufacturers can use a minimum retail price to persuade retailers that they will earn profit from offering more services, and that they can do so with confidence that their promotion and product education efforts will not be undercut. Increased "service" competition will result in consumers receiving enhanced product knowledge, education, and service—in other words an increase in value that generally equals or exceeds any increase in price. In addition, if some retailers want to do extra promotion, perhaps developing expertise in a brand and providing additional educational service to consumers, and charge an even higher price than the minimum, they are able to do so under a minimum retail-pricing plan. This can be helpful to manufacturers and retailers alike as it gives retailers room to explore whether increased promotion and product education results in higher consumer value—which in turn drives increased sales and improves profits.

Of course, setting a minimum retail price but no maximum retail price could allow retailers to charge excessive prices, to the detriment of consumers and of

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13 Manufacturers can compete as to retailer promotion efforts, of course, so a number of manufacturers may allow a higher retailer markup if promotion efforts are needed. Some might think that this will result in a wasteful "arms race" as each manufacturer sets higher resale prices to get a retailer to prefer selling its goods over other manufacturers' goods, but this will not generally be the case. If there is a demand for a good, then a competing manufacturer may fight for market share by cutting prices on the good. Even if the retailer would prefer to sell higher margin versions of the good, and may steer consumers that way, a number of consumers will still be price conscious and buy based on lower price. In cases in which all manufacturers of a certain kind of good are setting minimum resale prices, the likely reason for that is that the sale of such goods needs a certain amount of retail promotion or service. The higher margins may be a way to encourage the retailer to invest in the additional retail space, or to hire more workers to properly sell the good to consumers. For example, automobile sellers give personalized attention and test drives to consumers, but it is rare to find a retailer that is willing to let a consumer test a toaster at the store.

manufacturers, who will sell fewer units at higher prices. Thus, it behooves manufacturers to set minimum prices only in scenarios in which there is adequate competition from other brands to discipline the pricing practices of retailers. Ideally, retailers may charge a bit more for the manufacturers' goods and therefore promote the goods more, but interbrand competition should act to limit the premium retailers can charge even with the heavy promotion.[14] If market conditions change so that there is no longer enough interbrand competition, manufacturers have the best information and incentive to discontinue minimum resale price maintenance, and they will do so in such conditions because it is in their own interest to do so.[15]

Thus, because minimum resale pricing is appropriate in some scenarios, but not in others, we should expect that manufacturers will use it where doing so increases the value the consumer places on the product as a result of the product education and related services received—thus increasing demand for the product. In those instances, this will be the most efficient way to promote these goods and to educate consumers about the qualities or uses of their goods. We should expect retailers to avoid minimum resale pricing in situations in which inadequate competition—either intrabrand or interbrand—will result in retailers charging prices higher than the value of their promotion and service efforts. And indeed, a mix of resale price strategies is exactly what we see in the market. Some manufacturers elect to utilize unilaterally adopted maximum, minimum, or fixed resale pricing plans, while many others do not seek to influence retail prices. Because the manufacturer likely has the best knowledge about its goods and the costs of promoting them, as well as the competitive landscape, we can expect manufacturers to use resale price maintenance plans when they can expect to see more sales due to promotion activities, and thus sell more units at wholesale even at higher retail prices. When a manufacturer sees that it is not driving increased demand from a resale price maintenance plan, or that other ways of promoting its products are more efficient, we should expect the manufacturer not to use a resale price maintenance plan. After all, it is in the manufacturer's interest to keep promotion and retail markups as low as possible to sell more goods. This interest of the manufacturer also corresponds with consumers' interest in low retail markups, and thus the market controls retail markups with no need for government regulation.

Resale price maintenance can be particularly beneficial for new entrants to a market. Retailers and consumers may have little interest in buying from new entrants as opposed to established providers, even if the new entrant's product is less expensive or better quality. Allowing new entrants to pay retailers in the form of minimum retail prices for marketing and promotion efforts can allow a product to be introduced into the market rapidly and efficiently, bringing more competitive pressure to the competing brands. Once the new entrant is established, the manufacturer may choose to discontinue resale price maintenance plans. The increased ability of new entrants to gain market share is a benefit to the new entrants and consumers alike.

The Supreme Court recognized the potential benefits of resale price maintenance in 2007 in its *Leegin* case.[16] In that case, the Court ruled that all resale price maintenance plans—including the minimum resale pricing at issue in the case—would from then on be judged under the general rule of reason analysis that applies to all business activity. Thus, resale price maintenance now only violates antitrust laws in cases in which it is proven that the anticompetitive effects of the particular resale price maintenance plan outweigh

14 In certain rare cases, manufacturers could use uniform minimum resale pricing as an attempt to engage in cartel pricing of the product, or to have a retailer act as a "cartel ringmaster" that coordinates pricing, to consumers' detriment. But this potential for anticompetitive use of minimum resale pricing can be dealt with under the rule of reason standard that the Court announced in *Leegin*. William Comanor and Patrick Rey, *Vertical Restraints and the Power of Large Distributors,* 17 Rev. of Indus. Org., 135-49 (2000).

15 We may also see manufacturers discontinue resale price maintenance once there has been adequate promotion of the product to build demand. On the other hand, if the product is one that needs ongoing service, resale price maintenance may be continued even after demand for the product has been built.

16 *Leegin Creative Leather Prods., Inc.*, 551 U.S. 877 (retail price maintenance agreement subject to rule of reason), *overruling Dr. Miles Med. Co. v. John D. Park & Sons Co.,* 220 U.S. 373 (retail price maintenance per se unlawful).

the procompetitive effects of the plan. Given the strong incentive that manufacturers already have only to use resale price maintenance when it is efficient and does not lead to excessive retail markup, we should expect very few cases in which resale price maintenance alone will be found to be an antitrust violation. If resale price maintenance is part of a larger purpose of anticompetitive behavior, such as facilitating horizontal price fixing, then both per se and rule of reason analysis can be used to condemn the behavior.

II. States' Responses to the Supreme Court's Rule of Reason Treatment of Resale Price Maintenance

One might think that the Supreme Court's recognition that resale price maintenance can be procompetitive would unfetter the practice to the benefit of manufacturers and consumers alike. That has not happened, however, because a few states still treat resale price maintenance as illegal. Because resale price maintenance is often practiced by manufacturers who sell their goods nationwide, and because the internet makes buying from other locales much easier, the fact that some states continue to ban resale price maintenance agreements has resulted in the practice being unavailable, in practical effect, to many nationwide manufacturers. This has limited the ability of these manufacturers to coordinate their pricing in competitive markets and has limited the options for how manufacturers can promote and market their goods. Without the availability of resale price maintenance plans, it can be difficult for manufacturers to convince retailers to engage in significant promotion and servicing of their goods. This also leaves consumers with less product education and fewer choices regarding available levels of service.

In the eight years since the Supreme Court held that resale price maintenance should be judged under the rule of reason rather than be treated as per se illegal, a number of states have followed suit. For twenty-seven of these states, their harmonization with federal antitrust law is automatic in that their antitrust laws mandate that they follow federal antitrust law interpretation.[17] In addition, the state of Kansas amended its antitrust statute to explicitly require that the Kansas antitrust statute be construed in harmony with U.S. Supreme Court decisions interpreting federal antitrust law.[18] Ironically, the catalyst for the amendment to the Kansas antitrust statute was a class action lawsuit sounding in Kansas antitrust law against the very defendant from the case in which the Supreme Court announced the rule of reason for minimum resale pricing: Leegin Creative Leather Products, Inc. The Kansas suit alleged the same acts of minimum retail pricing that were at issue in the federal Supreme Court case. The Kansas Supreme Court held that regardless of the Supreme Court's decision, Kansas antitrust law made minimum resale price maintenance per se illegal.[19] The amended Kansas antitrust statute now mandates that the Kansas Supreme Court interpret Kansas antitrust law in harmony with U.S. Supreme Court decisions on federal antitrust law.[20] In eight more states, the status of resale price maintenance has not yet been reviewed.[21]

In five states there has been an attempt to hold resale price maintenance per se illegal even after *Leegin*, with various measures of success. Attorneys general in three states—New York, Illinois, and Michigan—have argued that resale price maintenance remains per se illegal in their states. These attorneys general have not been successful so far, however, when their positions were challenged in court. Specifically, courts in New York and Illinois have refused to hold resale price maintenance per se illegal. The Michigan attorney general's position has not yet been tested in court. In two other states—Maryland and California—resale price maintenance continues to be treated unambiguously as per se illegal. The treatment of resale price maintenance in each of these states will now be discussed in turn.

The attorneys general in New York, Illinois, and

17 For a summary of each state's law on resale price maintenance, see the Antitrust Source, https://www.americanbar.org/publications/the_antitrust_source.html. This source shows, among other things, that twenty-seven states have statutory language harmonizing their interpretation of antitrust law with federal interpretations. *Id.*

18 Kan. Stat. Ann. § 50-163(b) ("[T]he Kansas restraint of trade act shall be construed in harmony with ruling judicial interpretations of federal antitrust law by the United States supreme court.")

19 *O'Brien v. Leegin Creative Leather Products*, Inc., 294 Kan. 318 (2012).

20 K.S.A. § 50-163.

21 *See* Antitrust Source, *supra* note 17.

Michigan continued to treat resale price maintenance as if it were per se illegal in their states, regardless of the *Leegin* decision. These attorneys general extracted settlements from manufacturers on that basis. But courts in two of the states have not supported the position of the attorneys general, and the statute in the third state is deferential to federal court rulings, thus making the basis for that attorney general's position suspect. In 2008 in *New York v. Herman Miller, Inc.*, the attorneys general in New York, Illinois, and Michigan sued Herman Miller under the laws of their respective states for setting minimum resale prices for its furniture. Rather than test the assertion that resale price maintenance remained per se illegal in those states, Herman Miller settled the case.[22]

When the legality of resale price maintenance was actually litigated in New York and Illinois, however, courts in both states ruled that each state's law required rule of reason analysis rather than per se illegal treatment. In *New York v. Tempur-Pedic International, Inc.*, a New York appellate court rejected the New York attorney general's position and held that the amended New York statute[23] made resale price maintenance agreements unenforceable but not illegal per se.[24] In *House of Brides, Inc. v. Alfred Angelo, Inc.*, a federal district court in Illinois interpreted the Illinois antitrust statute to be in harmony with federal antitrust interpretation, and thus held that resale price maintenance is not per se illegal.[25] The treatment of resale price maintenance under Michigan law has not yet been tested in court, but the statute explicitly calls for harmonization with federal interpretation of antitrust law,[26] and thus it is likely that when a court does address the issue, it will hold that resale price maintenance must be analyzed under the rule of reason in Michigan.

A California state appellate court and a federal district court in California have each held that resale price maintenance is per se illegal under California's antitrust statute, the Cartwright Act. These decisions are open to criticism, however, since they rely on a pre-*Leegin* California Supreme Court case that held resale price maintenance per se illegal in harmonization with federal antitrust interpretation. Now that federal antitrust interpretation has changed, it seems erroneous for California lower courts to blindly follow the *outcome* of a prior California Supreme Court decision that held resale price maintenance per se illegal, rather than the *methodology* of the case, which focused on federal harmonization.

In *Alsheikh v. Superior Court*, a California appellate court ruled that resale price maintenance remains per se illegal under California's Cartwright Act[27] because the California Supreme Court had held resale price maintenance per se illegal in 1978 in *Mailand v. Burkle.*[28] The appellate court stated that, notwithstanding *Leegin*, "[w]e are bound to follow the law set forth by our Supreme Court applying state law."[29] Likewise, in *Darush MD APC v. Revision LP*, a federal district court in California relied on *Mailand* to hold that resale price maintenance remains per se illegal under California antitrust law.[30] Neither the *Alsheikh* court nor the *Darush* court delved deeply into the reasoning of *Mailand,* however, which was

22 *New York v. Herman Miller Inc.*, No.08 CV-02977 (S.D.N.Y. Mar. 25, 2008) (Stipulated Final Judgment and Consent Decree).

23 N.Y. Gen. Bus. Law § 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 manufacturer shall not be enforceable or actionable at law."); *New York v. Tempur-Pedic Intl., Inc.*, 95 A.D.3d 539, 540 (N.Y. App. Div. 1st Dep't 2012) (interpreting N.Y. General Business Law § 369-a to make resale price maintenance agreements unenforceable but not per se illegal).

24 *Tempur-Pedic Intl., Inc.*, 95 A.D.3d 539, 540 (N.Y. App. Div. 1st Dep't 2012) (interpreting N.Y. General Business Law § 369-a to make resale price maintenance agreements unenforceable but not per se illegal).

25 No. 11 C 07834, 2014 WL 64657, at *11 (N.D. Ill. Jan. 08, 2014).

26 Mich. Comp. Laws Ann. § 445.784(2) (West 2012) ("[I]n construing all sections of this 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.").

27 No. B249822, 2013 WL 5530508 (Cal. App. 2 Dist. Oct. 7, 2013).

28 20 Cal.3d 367 (1978).

29 Alsheikh, No. B249822, 2013 WL at 3.

30 No. 12-cv-10296, 2013 WL 1749539 (C.D. Cal. Apr. 10, 2013).

based on harmonizing California antitrust law with the Supreme Court's approach to resale price maintenance. The *Mailand* opinion discussed Supreme Court cases on resale price maintenance much more than it discussed the Cartwright Act.[31] Accordingly, there is a strong argument that the true thrust of *Mailand* is to harmonize California law with federal antitrust interpretation, and that therefore after *Leegin*, resale price maintenance should be subject to rule of reason analysis under the Cartwright Act.

At present, the majority of state antitrust statutes require harmonization with federal judicial interpretation of antitrust law. These states therefore are likely to analyze resale price maintenance under the rule of reason. A number of states have not yet addressed the issue since the *Leegin* decision. Resale price maintenance only appears to be plainly per se illegal in two states. In Maryland, after the *Leegin* decision, the legislature enacted legislation making resale price maintenance explicitly illegal.[32] In California, state and federal courts have held that resale price maintenance is per se illegal under the afore-mentioned controlling California Supreme Court precedent, but the California Supreme Court has not yet ruled on the question. Thus, one might think that manufacturers are in pretty good shape, in that they seem to be free to use resale price maintenance in up to 48 of the 50 states. But this ignores two facts. First, if a manufacturer distributes its products to retailers who sell to consumers located throughout the entire United States (via brick and mortar locations and/or the internet) it can be subject to the laws and jurisdiction of every state. Thus, if a single state holds resale price maintenance illegal, it can be sufficient to stymie resale price maintenance practices in every state. Second, if a manufacturer engages in resale price maintenance outside a state, and does not engage in the practice inside of the states in which it is illegal, evidence of the manufacturer's otherwise widespread use of resale price maintenance agreements may be used against it when allegations of resale price setting agreements are made in one of the states outlawing the practice. Thus we see that, rather than serving to protect the interests only of their own citizens, states that outlaw resale price maintenance in effect veto the practice for the rest of the country, at least when it comes to national manufacturers. This is extremely problematic, and has even led some commentators to argue that federal preemption may be appropriate.[33]

III. The Inefficient Alternative to Manufacturers' Setting of Resale Prices by Agreement: Unilateral "Suggestions" of Retail Pricing and Termination of Noncomplying Retailers

If explicit resale price maintenance agreements are not available to manufacturers, then they must go with second best alternatives in situations in which they need to encourage marketing, promotion, or pre-sale service for their products. One of those alternatives is to simply market, promote, and service the good directly. Manufacturers can do this through advertising, promotional displays, product demonstrations, home trial periods, generous return policies, and direct service and repair. These practices may be significantly more expensive and less effective than having retailers do the work for the manufacturers, however. But without the incentive of resale price maintenance plans to prevent free riding, manufacturers may have difficulty convincing retailers to take on these tasks. Even if manufacturers offer payments directly to retailers to do some or all of these tasks, the costs of monitoring compliance and best efforts may be prohibitive.

Another alternative for manufacturers who need significant promotion, marketing, or service related to their products is vertical integration. In other words, the manufacturer can open its own retail stores and sell its products directly. This is a good option for some

31 Mailand, 20 Cal.3d 367, 375 ("Since the Cartwright Act is patterned after the Sherman Act (15 U.S.C. s 1 et seq.), federal cases interpreting the Sherman Act are applicable in construing our state laws.").

32 Md. Code Ann., Com. Law. § 11-204(a)(1), (b) (2014) ("[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.")

33 *See, e.g.*, Barbara O. Bruckmann, *The Case for a Commerce Clause Challenge to State Antitrust Laws Banning Minimum Resale Price Maintenance*, 39 Hastings Con. L. Qtrly 391 (2012); John R. Foote and Ernest N. Reddick, *Resale Price Maintenance after Leegin: Defense Perspective*, 22 Competition: J. Anti. & Unfair Comp. L. Sec. St. B. Cal. 95 (2013).

products, and so some manufacturers use this method. Apple stores are one example of this in the consumer electronics space. Various clothing brands also have their own retail stores. Recently, the car manufacturer Tesla began to retail directly, although the company has faced challenges to this model where state laws require automobile distribution via auto dealerships. Some restaurant chains own their stores directly, although many use the franchise model. Lego sells its toys directly through corporately owned stores, although most of their sales come from retailers that also sell other brands of toys. Many products do not justify the expense of setting up a retail shop just for that brand. Nor would consumers want to go to separate stores to buy complimentary products, as the popularity of large grocery stores and department stores show. Indeed, even for manufacturers that directly retail, they often also sell their products through general retailers that sell a number of competing products. Because manufacturers have the incentive to directly retail where it is most efficient to do so, and to utilize independent retailers where that is most efferent, curtailing the ability of manufacturers to effectively use unaffiliated retailers will in some cases make retailing goods more expensive for manufacturers, and those higher costs will be passed on to consumers.[34]

Under the Supreme Court's prior jurisprudence, which treated all resale price maintenance agreements as per se illegal, manufacturers nevertheless still sometimes wanted to encourage retailers to promote and offer sales and other related service for the manufacturers' products. The free-riding problem could make it difficult to get retailers to invest in promotion and service related to a good if the consumer was likely to ultimately buy the same product for a cheaper price at a competing no-frills retailer. Thus, in order to encourage investment in product promotion and service, manufacturers sought to maintain retail prices by engaging in a charade.

The charade looked like this: A manufacturer unilaterally determined a retail price that it believed would incentivize valuable promotion, product education, or service efforts by retailers. The manufacturer "suggested" a retail price, telling retailers that they were free to determine their own retail price, but also informing retailers that it will not deal with retailers who elect to sell for less than the "suggested" retail price. The manufacturer then monitored retail prices. Those retailers observed by the manufacturer selling below the minimum "suggested" price were reminded that the manufacturer had determined unilaterally not to deal with retailers that deviate from its suggested retail pricing. If the retailer continued to deviate, the manufacturer followed through on its policy, and stopped selling products to the deviating retailer.

When done right and with careful monitoring of retail pricing, this unilateral method of encouraging retailers to charge a certain retail price had the same effect as resale price maintenance through an agreement with retailers.[35] In *U.S. v. Colgate*, the Supreme Court held that this sort of behavior was acceptable under the antitrust laws because the manufacturer's action was unilateral and therefore there was no resale price maintenance *agreement* that the manufacturer was seeking to enforce.[36] As a result, by adopting unilateral "*Colgate* policies," manufacturers could decide they did not want to do business with price-cutting retailers.[37]

This system was not foolproof, however. Problems could occur for manufacturers when retailers complained to the manufacturer about another retailer selling below the suggested price. If a manufacturer thereafter took action to stop doing business with the low-price retailer, then courts would often infer an agreement to set resale prices between the manufacturer and complaining retailers, and would hold that the actions violated antitrust law. This constant threat of antitrust liability—which carries with it the possibility of treble damages and potential criminal charges for violating per se antitrust law—operated to stop many manufacturers from effectively engaging in resale price maintenance. It also caused interference in positive business relationships between manufacturers and

34 The amount of the higher costs that will be passed on to consumers depends on various factors, including the elasticity of demand for the product.

35 One difference remains, however, in that a unilateral policy cannot be enforced through contract law, the way a resale price maintenance agreement can.

36 *U.S. v. Colgate*, 250 U.S. 300.

37 *Id.*

retailers because manufacturers become reluctant to communicate with retailers regarding certain topics lest a court use those exchanges to infer an "agreement" on retail pricing. Possible antitrust liability also wasted antitrust enforcement resources and judicial resources as lawsuits were brought arguing that a manufacturer's pricing "suggestions" were actually mandatory prices.

Unfortunately, with at least Maryland and California treating resale price maintenance as per se illegal, we can expect this wasteful charade to continue. Indeed, the same federal district court that ruled that resale price maintenance continues to be per se illegal under California law also reaffirmed that *Colgate*-style unilateral pricing policies paired with dismissals of non-complying retailers is not a violation of California antitrust law. In *Darush*, the defendant, Revision LP, utilized a "manufacturer's suggested retail price" (MSRP) policy. Plaintiff retailer, Alan Darush, sold Revision products at prices below the MSRP. Darush alleged that Revision representatives contacted him many times in attempts to get him to raise his prices. When he did not, Revision terminated him as a retailer. Darush sued. The court noted that under federal and California law, making unilateral suggestions as to retail prices is not per se illegal. Indeed, so long as the action is unilateral, the manufacturer can suggest prices and then refuse to work with those who do not sell at those prices.[38] The key is that there is no agreement as to pricing between the parties. As a result, a manufacturer may be able to establish even in California the same retail pricing result allowed in other states after *Leegin*. But to do so it must engage in wasteful and inefficient practices, and bear the constant risk of antitrust prosecution should its actions be viewed as tending toward an agreement rather than as unilateral action.

Were it the case that a mere wink and a nod could facilitate resale price maintenance and avoid any antitrust liability, the categorization of resale price maintenance as per se illegal would not matter much. But courts have not been hands-off in this area. Instead, plaintiffs and government attorneys have pounced when facts exist that could arguably support a claim of a conspiracy to fix prices between the manufacturer and a retailer. For instance, in the *Darush* case, the court held that Darush had alleged sufficient facts to support an allegation of vertical price fixing between the defendant Revision and another one of its retailers, Lovely Skin. The supporting evidence was that various retailers, including Lovely Skin, had complained about Darush's and other internet retailers' pricing below MSRP. Thereafter, Revision terminated Darush as a retailer, and offered to share information with Lovely Skin about Revision's treatment of certain internet retailers. The Court held that this could have been part of a plan between Revision and Lovely Skin to fix prices.

The situation in *Darush* is not unusual. Many manufacturers who wish to use MSRP policies find themselves in sticky situations when some of their retailers complain to the manufacturer about price-cutting by other retailers. Even if the manufacturer had planned to terminate price discounters, once other retailers have complained, the manufacturer terminates the retailer at its own peril, knowing that a court might find a price-fixing scheme when it sees complaints from other retailers followed by the termination of the discount dealer. Thus, retailers face uncertainty, inefficiency, monitoring costs, money damages, treble damages, and possible criminal charges if they utilize and enforce an MSRP policy.

Because of California's large population and economic impact, manufacturers with national distribution networks are particularly stymied by the risk resulting from California's lower courts treating resale price maintenance as per se illegal. For such manufacturers, they may face liability even if they do not employ resale price maintenance agreements in California, but instead simply use "suggested" retail pricing, especially if evidence of their explicit resale price maintenance agreements in other states is used against them in a lawsuit. This, combined with the potential for treble damages if found in violation of a per se rule, continues to have a severe chilling effect on the use of resale price maintenance agreements in the U.S. Indeed, for many manufacturers who market or sell their products via the internet, a single state treating resale price maintenance as per se illegal may be enough to put the practice out of reach.

38 Although the Court might nevertheless find liability if it thinks there is tacit evidence of an agreement in communications between the manufacturer and certain retailers.

IV. Conclusion

Real and significant procompetitive justifications for resale price maintenance agreements exist in certain instances, as the Supreme Court has acknowledged. Manufacturers who believe that such resale price maintenance agreements will help them sell their products may elect to pursue retail pricing agreements with retailers. These manufacturers may use minimum retail pricing agreements as the most efficient and effective way to encourage retailers to educate and service consumers regarding their products. Because manufacturers have a strong profit incentive to keep retailer markup as low as possible, we should generally expect manufactures to use resale price maintenance agreements only in cases in which the agreements have some significant advantages as compared to the typical manufacturer's approach of encouraging retailers to compete to sell the manufacturer's goods for as little markup as possible. Examples of when minimum resale price setting may be advantageous include instances in which manufacturers' products require some element of education or when manufacturers want to encourage retailers to promote and service goods without fear of being undersold by free riding, price-cutting rivals.

Ironically, those few states that continue to treat minimum retail price agreements between manufacturers and retailers as per se illegal are likely increasing costs to consumers—the opposite of the result they intend. If federal law preempted state law—resulting in the nationwide application of the rule of reason in minimum retail price maintenance situations—manufacturers would quickly abandon the inefficient charades they use to attempt to control retail prices. Interbrand competition would result in savings to manufacturers in the form of straightforward minimum pricing agreements, simpler administration, reduced legal costs, and far more efficient monitoring. At least some of this cost saving would then be passed on to consumers. Likewise, taxpayers would save by not having state attorneys general engaged in wasteful enforcement practices against resale price maintenance.

But so long as some states continue to treat resale price maintenance agreements as per se illegal, we can expect that the efficiencies of resale price maintenance agreements to remain unavailable for many national manufacturers, and the consumers who value their products. Meanwhile, the frustrations and inefficiencies of unilaterally "suggesting" retail prices and then cutting off dealings with non-complying retailers will remain, with the concomitant dangers of this approach. The only way to decrease these inefficiencies to the benefit of manufacturers, retailers, taxpayers, and consumers is to have nationwide acceptance that resale price maintenance agreements should be subject to rule of reason analysis. Anything less means that a single state can unintentionally prevent manufacturers from utilizing competitively appropriate resale pricing agreements anywhere in the United States.

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- Robert M. Langer, *State Antitrust Law and the Constitution*, Bloomberg BNA (2015), *available at* http://www.wiggin.com/files/33278_LangerRPMFinal.pdf.
- David W. Kesselman and Trevor V. Stockinger, *Why California's Per Se Rule Against Resale Price Maintenance Is Good For Businesses and Consumers*, 22 Competition 2 (Fall 2013), *available at* http://kbslaw.com/kbs/wp-content/uploads/2014/10/2013_competition.pdf.
- Sally Greenberg, *Resale Price Maintenance should be illegal*, National Consumers League (Sept. 2011), *available at* http://www.nclnet.org/resale_price_maintenance_should_be_illegal.
- Gregory T. Gundlach & Riley T. Krotz, *Resale Price Maintenance After* Leegin*: The Curious Case of Contact Lenses*, American Antitrust Institute-Working Paper (Dec. 1, 2015), *available at* http://www.antitrustinstitute.org/sites/default/files/AAI%20working%20paper%2015-04.pdf.
- Gregory T. Gundlach, *Antitrust Analysis of Resale Price Maintenance After* Leegin, 55 The Antitrust Bulletin 1 (Spring 2010), *available at* http://www.antitrustinstitute.org/sites/default/files/Overview%20and%20Contents%20of%20the%20Special%20Issue.pdf.

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