

ANTICOMPETITIVE PRICING PRACTICES

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I. CONCERTED PRICING BEHAVIOR

For antitrust purposes, concerted activity among market participants is often treated differently than unilateral activity. A single firm acting unilaterally lacks the capacity to distort competition unless the firm possesses market power in a relevant market. Firms that individually lack market power can, however, distort markets (restrain competition) by acting in concert with other similarly situated market participants. Section One of the Sherman Antitrust Act deals with such concerted action by proscribing any contract, combination or conspiracy in restraint of Trade.

While any trade-restraining conspiracy is subject to scrutiny under Sherman One, agreements between competitors (horizontal agreements) are generally understood to threaten competition more than agreements between individuals or firms at different levels of the production/distribution chain (vertical agreements). Horizontal agreements to fix or stabilize prices, or to control levels of output, are believed to have the greatest potential for restraining competition. Under Supreme Court precedent going back to 1911, *vertical* agreements effecting price were treated as though they were equivalent to horizontal price fixing. That changed dramatically in 2007 when the Court directed that vertical price fixing be treated like other vertical non-price restraints.

A. HORIZONTAL PRICE RESTRAINTS (Price Fixing)

There is no question that a straightforward agreement between competitors to fix or stabilize the prices they charge for goods or services (or to reduce the level of their output of those goods or services) is *per se* illegal under Sherman One. However, issues can arise as to whether there is an express vs. tacit agreement among parties having distinct economic interests, and whether that agreement is “naked” or ancillary to some broader pro-competitive collaboration.

1. There Must be a Plurality of Participants

A plurality of actors is required to form a forbidden “contract, combination or conspiracy.” Section 1 “does not reach conduct that is ‘wholly unilateral,’” rather, it prohibits concerted action involving “separate entities.” *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 768 (1984). Concerted activity is “judged more sternly” under Sherman One because of the inherent anticompetitive risk that arises whenever concerted activity “deprives the marketplace of the independent centers of decision making that competition assumes and demands.” *Id.* at 768-769.

Intra-Corporate Decision Making: The “intra-corporate conspiracy doctrine” holds that acts of corporate agents are attributed to the corporation itself, thereby negating the multiplicity of actors necessary for the formation of an agreement. See, e.g. *Joseph E. Seagram & Sons, Inc. v. Hawaiian Oke & Liquor, Ltd.*, 416 F2d 71, 80-84 (9th Cir. 1969), cert. denied 396 U.S. 1062 (1972). However, a corporation that is controlled by a group of competitors may be treated as a conspiracy among the controlling competitors. *United States v. Sealy, Inc.* 388 U.S. 350, 353 (1967); (holding that a corporation formed by Sealy mattress licensees “was a joint venture of, by and for its stockholder-licensees, and the stockholder-licensees are themselves directly,

without even the semblance of insulation, in charge of Sealy's operations." See also *North Texas Specialty Physicians v. FTC*, 528 F.3d 346, 356 (5th Cir. 2008), (holding that a "memberless" non-profit corporation formed under state law to act as bargaining intermediary for physicians "does not foreclose a finding of concerted action by the physicians who constitute, use and control" the non-profit.)

Corporate Families: In some older antitrust cases the Supreme Court adopted an "intra-enterprise conspiracy" doctrine that treated the members of integrated corporate families as independent "conspirators," e.g. *United States v. Yellow Cab Co.*, 332 U.S. 218 (1947); *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons*, 340 U.S. 211 (1951). These cases turn on the legalities of separate incorporation rather than economic reality. In 1984 the Supreme Court finally held that a parent and its wholly owned subsidiary could not be "conspiring entities" under Sherman One. *Copperweld Corp. v. Independence Tube Corp.*, *supra*, 467 U.S. at 776-777. The Court instructed that: "A parent and its wholly owned subsidiary have a complete unity of interest. Their objectives are common, not disparate; their general corporate actions are guided or determined not by two separate corporate consciousnesses, but one." *Id.* at 771. But the Court also warned: "[W]e do not consider under what circumstances, if any, a parent may be liable for conspiring with an affiliated corporation it does not completely own." 467 U.S. at 767. Subsequent lower court decisions have held that two wholly owned subsidiaries lacked conspiratorial capacity *inter se*. E.g. *Advanced Health-Care Services, Inc. v. Radford Community Hosp.*, 910 F. 2d 139 (4th Cir. 1990). The capacity of a corporate parent and its affiliated subsidiaries to conspire with one another is less clear when the parent corporation has less than 100% ownership and control of the subsidiaries. See, e.g. *Aspen Title & Escrow Inc. v. Jeld Wen, Inc.*, 677 F.Supp. 1477 (D.Or. 1987) (parent capable of conspiring with any subsidiary that is less than wholly owned); *Direct Media v. Camden Tel & Te. Co.*, 989 F.Supp.1211) (S.D. Ga. 1997) (parent incapable of conspiring with 51% owned subsidiary). Similar questions arise in situations where common ownership or control resides in an individual rather than a corporate parent, e.g. *Fishman v. Estate of Wirtz*, 807 F.2d 520 (7th Cir. 1986) (*Copperweld* did not extend to non-controlled companies with some common investors); *Blankenship v. Herzfeld*, 721 F.2d 306 (10th Cir. 1983), (pre-*Copperweld* case holding that corporations that were separately incorporated and separately owned by members of same family using common family name to operate similar businesses in different cities did not have capacity to conspire for Sherman One purposes).

Partnerships and Joint Ventures: The Supreme Court has held that *at least in some cases* the members of a bona fide partnership or joint venture will lack conspiratorial capacity for purposes of Sherman One. *Arizona v. Maricopa County Medical Soc.*, 457 U. S. 332, 356 (1982) ("Partnerships or other joint arrangements in which persons who would otherwise be competitors pool their capital and share the risks of loss as well as the opportunities for profit" are "regarded as a single firm competing with other sellers in the market"). The issue is whether the competitor collaboration entails real economic integration sufficient to eliminate meaningful competition between the partners/joint venturers with respect to the specific activity being restrained. See, e.g. *City of Mt. Pleasant Iowa v. Associated Elec. Co-op., Inc.*, 838 F2d 268 (8th Cir. 1988) (*Copperweld* principles applied to members of rural electrical cooperative even though separately incorporated); *American Needle Inc. v. Nat'l Football League*, 538 F.3d. 736, 743 (7th Cir. 2008) *Cert. granted* ___ U.S. ___ (6/29/09) (NFL teams incapable of conspiring with one another respecting sales made through a joint marketing venture of material bearing

member teams' logos); *but see*, *National Hockey League Players Ass'n v. Plymouth Whalers Hockey club*, 419 F.3d 462, 469 (6th Cir. 2005) (Canadian hockey league and member teams were separate entities capable of conspiring to adopt anticompetitive player rules); compare *Fraser v. Major League Soccer, LLC*, 284 F.3d 47, 57-58 (1st Cir. 2002) (finding that "distinct entrepreneurial entities" operating professional soccer teams under an umbrella corporate entity had more conspiratorial capacity than the vertically integrated corporations involved in *Copperweld*, *supra*; but declining to decide whether the teams had conspiratorial capacity because the "real economic integration" among team operators meant that the challenged restraint [the Teams' unified player hiring policy] should be judged by [and would pass muster under] the more relaxed rule-of-reason).¹

Physicians and Hospitals: Physicians who act as managing staff at hospitals often have independent practices. Question about the conspiratorial capacity of hospitals and affiliated physicians arise when the physicians sit in review of applications by competing physicians for hospital staff privileges. The results of court cases have been inconsistent. Compare, *Bolt v. Halifax Hospital Medical Center*, 891 F.2d 810, 819 (11th Cir. 1990) (holding that both the hospital and the staff physicians have conspiratorial capacity), with *American Chiropractic v. Trigon Healthcare*, 367 F.3d 212, 223 (4th Cir., 2004) and *Oksanen v. Page Memorial Hospital*, 945 F.2d 696, 710 (4th Cir. 1991), *cert. denied*, 502 U.S. 1074 (1992) (holding that the physicians can be held to be conspirators with one another, but not the hospital or health plan). See also, Health Care Quality Improvement Act of 1986, 42 U.S.C. § 1101 et. seq. (barring claims alleging a conspiracy between a hospital and its peer review committee).

2. There Must be an "Agreement"

Section one of the Sherman Act proscribes "contracts," combinations" or "conspiracies" in restraint of trade. These terms denote concerted action -- i.e. there must be evidence of an agreement, or at least "a conscious commitment to a common scheme designed to achieve an unlawful purpose." *Monsanto v. Spray-Right Service Corp.*, 465 U.S. 752, 764 (1984). This can be established by direct evidence (i.e. testimony from witness-participants or documents that

¹ The question of whether the competitors who participate in a JV retain their conspiratorial capacity with respect to the JV's pricing decisions (an inquiry that focuses on whether the participants retain their status as distinct economic entities) is often raised in tandem with the question of whether the JV's challenged price restraint should be evaluated under the rule of reason or the *per se* rule (an inquiry that focuses on the whether the price restraint is needed to achieve the JV's supposed efficiencies). See *discussion at I-A (3), infra*. In *Texaco v. Dagher*, 547 U.S. 1 (2006), the Supreme Court seemed to hold that two major oil companies that had formed an FTC-approved refining/marketing JV were incapable of conspiring to fix the prices of the JV's products. *Id.* at 7. But because product pricing was a "core function" of the JV the Court refused to subject its unified pricing practice to *per se* condemnation. (see note 4, *infra*). And because plaintiffs hadn't challenged the pricing practice under the rule of reason the Court found it unnecessary to decide whether the joint venturers had conspiratorial capacity. *Id.* at 7 n.2. Two years later in *American Needle*, *supra*, the Seventh Circuit refused to evaluate the reasonableness of the NFL's exclusive distribution arrangement with Reebok because the NFL's member teams were deemed to act as a "single entity" when marketing merchandise bearing their team logos. Unsatisfied with this result the NFL has asked the Supreme Court to recognize the NFL's "single entity" status with respect to all "core venture functions". Having granted certiorari the Supreme Court will have an opportunity to provide further guidance as to when a JV's status as a "single entity" obviates the need to evaluate the reasonableness of trade restraints implemented by or through the joint venture.

record the agreement) -- but such evidence is rarely available. A price fixing agreement can also be proved with circumstantial evidence, but such evidence is often ambiguous -- i.e. it is consistent with concerted action or conspiracy but not necessarily inconsistent with independent (ergo permissible) conduct. In a 1986 case, *Matsushita Electric Industries Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986), the Supreme Court raised the bar for plaintiffs relying on circumstantial evidence to prove conspiracy -- by requiring evidence that “tends to exclude the possibility” that the defendants were acting independently.

Parallel Conduct: Parallel conduct (including parallel pricing) does not, by itself, exclude the possibility of independent action even if the parallel conduct is intentional. *Brooke Groupe Ltd. v Brown & Williamson Tobacco Co.*, 509 U.S. 209, 227 (1993) (“conscious parallelism” can occur when firms in concentrated markets, “recognize their shared economic interests and their interdependence with respect to price and output decisions” -- and pricing conduct based on this recognition does not, by itself, indicate concerted action). In addition to parallel conduct there must be some “plus factor” tending to show express collusion. *Flat Glass Antitrust Litigation*, 385 F.3d. 350, 360 (3d Cir. 2004) (“Existence of these “plus factors” tends to ensure that courts punish “concerted action” -- an actual agreement -- instead of ‘unilateral independent conduct of competitors’.”). Summary judgments have routinely been granted in the absence of such plus factors. See, e.g. *Williamson Oil Co. v. Philip Morris USA*, 346 F.3d 1287 (11th Cir. 2003); *Blomkast Fertilizer v. Potash Corp.*, 203 F.3d. 1028 (8th Cir. 2000) (granting summary judgment even though there was some evidence of an explicit agreement).

The Supreme Court recently moved the point of potential dismissal forward from the summary judgment stage to the pleading stage. *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 127 S.Ct. 1955, 1966 (2007) (“When allegations of parallel conduct are set out in order to make out a § 1 claim, they must be placed in a *context that raises a suggestion* of a preceding agreement, not merely parallel conduct that could just as well be independent action”). The *Twombly* plaintiffs were telephone subscribers who accused the defendants (incumbent local exchange carriers or “ILECs”) of conspiring to refrain from entering one another’s service areas, and to make it difficult for competing local exchange carriers (“CLECs”) to enter their service areas and compete for plaintiffs’ business. The Court held that the parallel conduct that plaintiffs attributed to the ILECs (e.g. forbearing from competition, overcharging for wholesale service, disrupting CLEC customer billing) did not “suggest” the existence of an “agreement” because it was in the ILECs independent self interest to engage in the parallel conduct. The Court denied that it was imposing a new “probability requirement” at the pleading stage and declared that existing pleading rules require plaintiffs to plead “enough facts to raise a reasonable expectation that discovery will reveal evidence of illegal agreement.” In the Court’s view: “The need at the pleading stage for allegations plausibly suggesting (not merely consistent with) agreement reflects the threshold requirement of Rule 8(a)(2) that the ‘plain statement’ [of plaintiffs claim] possess enough heft to show that the pleader is entitled to relief.” *Id.* at 1965-1966. Despite the Supreme Court’s disclaimer, some lower courts appear to read *Twombly* as requiring more specific factual pleading of the conspiracy element of price fixing claims. See, e.g. *Kendall v. Visa U.S.A. Inc.*, 518 F.3d 1942, 1048 (8th Cir. 2008) (dismissing complaint where allegations of conspiracy were “nothing more than a conclusory statement” without specifics to “answer the basic questions: who did what, to whom [or with whom], where and when.”); *In re Elevator Antitrust Litigation*, 502 F.3d 47, 50 (2d Cir. 2007) (dismissing complaint where allegations of

price fixing conspiracy were only in “general terms without any specification of any particular activities by any particular defendant.”)

Competitor Exchanges of Price Related Information: The exchange of price information by competitors is sometimes relied on as a plus factor, or as independent circumstantial evidence of a conspiracy to fix prices. While such exchanges can facilitate the formation and enforcement of anti-competitive conspiracies, they can also enable competitors and other market participants to operate efficiently. An early Supreme Court case suggested that a pattern of exchanging sensitive price information among competitors might, by itself, be enough to demonstrate a Sherman One conspiracy. See, *American Column & Lumber Co., v. United States*, 257 U.S. 377, 411-412 (1921) (condemning exchange of detailed reports of current production and price data that had or necessarily would result in a concerted effort [i.e agreement] to curtail production). But in *Maple Flooring Mfr’s Assoc’n. v. United States*, 286 U.S. 563 (1925), the Court refused to condemn an exchange between competitors of price information regarding past transactions with un-named customers because such information was deemed unlikely to enable any anticompetitive conspiracy among the information recipients. More recently, in *United States v. Container Corporation of Amer.*, 393 U.S. 333, 334-335 (1969), the Court limited its condemnation of defendants’ detailed exchange of price information to the facts in that case -- which involved a highly concentrated market and proof the prices had, in fact, been stabilized.² In general, the exchange of current or prospective pricing information that is transaction-specific is more objectionable (and more probative of collusion on price) than information that is historical and/or aggregated.

Conduct Against Economic Self-Interests: Evidence of collusion can be found when the alleged conspirators act jointly in a manner that would, absent the expectation of competitor collaboration, be contrary to their individual economic self-interest. In *Interstate Circuit, Inc. v. United States*, 306 U.S. 208 (1939), the Supreme Court found an agreement among eight motion picture distributors each of whom responded affirmatively to a large exhibitor’s detailed invitation to fix admission prices. The Court found that a price fixing agreement had been reached by the eight distributors because (a) each distributor knew that all of the other distributors had been invited to engage in the illegal arrangement, and (2) an affirmative response by any one of them would have been irrational unless the distributor had reason to believe that the others would do the same thing. Since then it has become “firmly established that actions that are contrary to an actor’s economic interest constitute a plus factor that is sufficient to satisfy a price fixing plaintiff’s burden in opposing a summary judgment.” *Williams Oil Co. v. Phillip Morris USA*, 346 F.3d 1287, 1310 (11th Cir. 2000).

Industry-Wide Use of Facilitating Practices: Firms may use standardized marketing practices (e.g., resale price maintenance policies, delivered pricing, “most- favored-nation” pricing) to facilitate their implementation of a price fixing agreement. These “facilitating

² Under the facts found in *Container Crop.*, the Court held that the container manufacturers’ agreement to exchange of price-related information, by itself, resulted in an unreasonable restraint of trade -- without proof of an agreement to fix prices. See also, *United States v. United States Gypsum Co.*, 438 U.S. 422, 457-459 & n.16 (1978) (“Exchanges of current price information []have the greatest potential for generating anticompetitive effects and although not *per se* unlawful have consistently been held to violate the Sherman Act.”).

practices” are sometimes cited as “plus factors” because their widespread use can stabilize prices or reduce/control price competition. See, e.g., *Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643 (1980) (condemning agreement among beer wholesalers to eliminate short term credit and require payment on delivery); *National Macaroni Mfg. v. FTC*, 65 F.T.C. 583 (1964), *aff’d* 345 F.2d 421 (7th Cir. 1965) (condemning an agreement to standardize macaroni content). Courts have consistently found wide-spread basing point pricing to be indicative of price fixing. See, *FTC v. Cement Institute*, 333 U.S. 683, 716 n.17 (1948); *Triangle Conduit and Cable Co. v. F.T.C.*, 168 F.2d 174 (7th Cir. 1948); but see, *Boise Cascade Corp v. F.T.C.*, 637 F.2d 573, 581 (9th Cir. 1980) (concluding that basing point pricing is not *per se* illegal if it is unilateral - even if it entails industry wide use of the same practice).³

Market Conditions Suggestive of, or Conducive to, Collusion: The Supreme Court came close to permitting the inference of a price fixing conspiracy from cost and price data alone in *American Tobacco v. U.S.*, 328 U.S. 781 (1946) (agreement found where all major tobacco companies raised their prices while both demand and costs were falling). Courts look to a number of other market conditions considered to be conducive to or symptomatic of collusion (e.g. market concentration, price leadership, standardized products, high fixed costs, stable/supra-competitive prices). But a certain level of concentration may be required if firms are to reach the size needed to maximize economies of scale. In highly concentrated markets, conditions that might otherwise signal collusion (price leadership, supra-competitive prices, price stability) may actually be consistent with independent decision making. The question is whether such market conditions provide “plus factors” that are probative of actual “collusion”, or whether such conditions are symptomatic of the “interdependence” that is a normal economic feature of such markets. See, *Flat Glass Antitrust Litigation, supra* at 360-362 (relying on market conditions conducive to collusion to show “motive” to collude as a plus factor).

3. The Restraint Must Fail the appropriate “Reasonableness” Test

Sherman One has been construed to outlaw only “unreasonable” restraints of trade. The judicially fashioned “rule-of-reason” is the “accepted standard” for testing whether a practice violates Sherman One. *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 127 S.Ct. 2705, 2712 (2007). Under the rule-of-reason, courts determine the reasonableness of a restraint by identifying a “relevant market” and evaluating the competitive effects of the restraint within that relevant market. Courts have, however, identified certain concerted activities by competitors that have anticompetitive effects that are always or almost always unreasonable. Conspiracies to engage in these activities are *illegal per se* -- i.e. they are condemned without an elaborate investigation into the existence of market power or the potential for efficiencies or

³ In 1984 the FTC tried to attack facilitating practices by using its authority under Section 5 of the Federal Trade Commission Act -- which does not require proof of an agreement. The case involved the market for antiknock compounds for gasoline which was highly concentrated and showed high profits, price leadership and rigid price uniformity. There was no evidence of an agreement but the FTC sought to enjoin several industry-wide facilitating practices (advance price notices, delivered pricing, most-favored-nation price protection). The Second Circuit held that such relief could not be obtained in a Section 5 enforcement action absent a showing that (1) the practices were animated by an anticompetitive purpose and intent, and (2) there is no competitive justification for the practices. *E.I. DuPont De Nemours & Co. v. FTC*, 729 F.2d 128 (2d Cir. 1984).

other benefits. *Copperweld Corp. v. Independent Tube Corp.*, 467 U.S. 752, 768 (1984) (“certain agreements, such as horizontal price fixing and market allocation, are thought so inherently anticompetitive that each is illegal *per se* [under Sherman One] without inquiry into the harm it has actually caused.”) The *per se* rule is a rule of administrative convenience. *GTE Sylvania, supra* at 50, n.16 (noting that “*per se* rules tend to provide guidance to the business community and to minimize the burdens on litigants and the judicial system”); *Leegin Creative Leather Products, supra*. 127 S.Ct. at 2718 (clarifying that administrative convenience can only be used to justify *per se* treatment of restraints that are “manifestly anticompetitive”). When applicable, the *per se* rule renders irrelevant any attempt to justify the condemned practice with proof of potential efficiencies or other business or social benefits. *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 221 (1940). As a result, the plaintiff who asserts a *per se* antitrust claim is relieved of an onerous burden of proof; but just as importantly, the defendants are barred from offering proof that would tend to justify their actions. E.g. *National Society of Professional Engineers v. United States*, 435 U.S. 679 (1978) (condemning a professional association rule against competitive bidding and rejecting attempts to prove social benefits).

“Naked” Horizontal Price Fixing -- Per Se Illegal: A “naked” price fixing agreement is one that is *not* part of or ancillary to a business arrangement that has a legitimate purpose unrelated to the suppression of competition. If such an agreement among competitors *explicitly* affects price (or output) it is virtually assured of *per se* treatment. Such an agreement does nothing more than bind the participants to a common pricing practice. In *U.S. v. Socony-Vacuum Oil Co.*, *supra*, the Supreme Court applied the *per se* rule to an arrangement among major oil producers to “allocate” gasoline demand. The Court held that any “combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity . . . is illegal *per se*.” The agreement need not fix a specific price, but to warrant *per se* treatment it must have a fairly direct impact on price. E.g. *Catalano v. Target Sales, Inc.*, 446 U.S. 643,647 (1980) (agreement to refrain from offering competitive credit terms); *National Society of Professional Engineers v. United States*, 435 U.S. 679, 692-693 (1978), (agreement to refrain from discussing prices with potential customers until after negotiations have resulted in the initial selection of an engineer); *FTC v. Cement Institute*, 333 U.S. 683, 690-693 (1948) (agreement to use a specific method of quoting prices -- i.e. base point pricing); *Sugar Institute v. United States*, 297 U.S. 553, 601-602, 56 S.Ct. 629, 643, 80 L.Ed. 859 (1936), (agreement to adhere to previously announced prices and terms of sale, even though advance price announcements are perfectly lawful and even though the particular prices and terms were not themselves fixed by private agreement). The *per se* rule is most often applied to naked agreements among competitors to fix **minimum** prices, but the Supreme Court has also applied the *per se* rule to an arrangement in which insurers and doctors agreed to fix the **maximum** prices that the doctors would charge. *Arizona v. Maricopa County Medical Society*, 457 U.S. 332 (1982). The arrangement served the legitimate purpose of permitting the participating insurers to guarantee full payment of the participating doctors’ charges, but the Court condemned it as *per se* illegal because it thought maximum price fixing could easily be used to mask minimum price fixing. *Id.* at 34.

“Nearly Naked” Horizontal Price Fixing -- Quick Look: If a competitor agreement affects price but is a *not* a naked restraint its competitive effects will normally be judged under the rule-of-reason. In *Broadcast Music, Inc. v. CBS*, 441 U.S. 1, 24 (1979), the Supreme Court held that blanket licenses of copyrighted music by different composers should be judged under

the rule-of-reason because, although the blanket licenses involved a kind of price fixing, they also made it possible for the composers to mass market their compositions. See, also, *NCAA v. Board of Regents* 468 U.S. 85, 117-120 (1984) (rule-of-reason rather than the *per se* rule applied to the NCAA's restrictions on member institutions' ability to compete by entering into separate contracts to televise their games).⁴ In most rule-of-reason cases the plaintiff must (1) identify and define a market in which adverse competitive effects can occur, then (2) show that competition within the relevant market has been or is likely to be adversely effected by the challenged agreement, and (3) show that the adverse competitive effects are "unreasonable" in light of any efficiencies or other business justification defendants are able to claim and prove. Because this proof burden can be overwhelming, the Supreme Court has sanctioned a truncated rule-of-reason analysis (called a "Quick Look") for price-related agreements which, while not *per se* illegal, are nevertheless "inherently suspect." This Quick Look analysis is a burden shifting paradigm that borrows from both the *per se* rule and the rule-of-reason. Upon proof of an "inherently suspect" restraint there is a presumption that its effect on competition is unreasonable. The defendants must overcome that presumption by showing either (a) that they lack the market power needed to achieve the anticompetitive results that were presumptively attributed to the restraint, or (b) that the arrangement has a plausible competitive justification. Defendant's failure to do so results in *per se* treatment of the challenged agreement.

The Supreme Court has cautioned that a truncated or "Quick Look" analysis is only warranted where experience has established that the principal tendency of the challenged restriction is anticompetitive. *FTC v. Indiana Federation of Dentists*, 476 U.S. 447 (1986) (condemning without "detailed market analysis" an agreement to limit competition by withholding X-rays from patients' insurers after finding no competitive justification). Any agreement that limits or controls price competition is a likely candidate for such truncated analysis. *Polygram Holding, Inc. v. FTC*, 416 F.3d 29, 37 (D.C. Cir. 2005) (joint venturers' agreement to restrict their discounting and advertising of products outside the joint venture deemed suspiciously akin to "another practice that already stands convicted in the court of consumer welfare," - i.e. a naked horizontal price restraint); *North Texas Specialty Physicians v. FTC*, 528 F.3d 346 (5th Cir. 2008) (upholding FTC's "somewhat abbreviated" *PolyGram* analysis of physician membership organizations negotiating and price setting on behalf of members). But see *California Dental Association v. FTC*, 526 U.S. 756 (1999) (divided Court rejected either *per se* or other truncated analysis of a dental association's prohibition on deceptive advertising that effectively eliminated all ads based on price or quality -- something dangerously close to a "naked" price fixing agreement -- apparently because of a perceived lack of judicial experience with such restraints, at least in a professional services setting); *Major*

⁴ Courts have used the "ancillary restraint" doctrine to evaluate the competitive effects of restraints that are "collateral" to Joint ventures formed by competitors. If a price fixing agreement between the joint venturers is collateral to the JV but reasonably necessary to achieve its pro-competitive purposes the resulting restraint will be assessed along with the formation of the joint venture -- the whole package being evaluated under the rule of reason. The possibility of *per se* condemnation might still arise if the collateral pricing restraint is *not* ancillary to the joint venture (i.e. not needed to achieve its legitimate business purpose) -- in which case the competitive effects of the restraint will be assessed separately as if there was no joint venture. However, in *Texaco v. Dagher*, 547 U.S. 1 (2006), the Supreme Court held that a decision made by a legitimate joint venture about the pricing of its *own* products could not be subject to *per se* condemnation because such product pricing decisions are an integral part of, rather than collateral to the normal operation of a JV. *Id.* at 7-8.

League Baseball Properties, Inc. v. Salvino, Inc., 542 F.3d 290, 334, No. 06-1867 (2d Cir. 2008) (rule-of-reason and not the *per se* rule or “quick look” analysis applied to coordinated licensing and pricing of MLB member teams’ logos because the “arrangement might plausibly be thought to have a net pro-competitive effect, or possibly no effect at all on competition”).

In April 2000, the two federal antitrust enforcement agencies (i.e. the Department of Justice and Federal Trade Commission) issued a set of guidelines dealing with “efficiency enhancing integrations.” “*Antitrust Guidelines For Collaborations Among Competitors*” (hereinafter “*Guidelines.*”) A competitor collaboration (most often a joint venture) will be considered “efficiency enhancing” if it achieves a cost savings or other benefit to consumers by expanding output, reducing prices, or enhancing quality, service or innovation. To achieve economic “integration” the participating competitors must contribute significant capital, technology, or other complimentary assets to the venture. If a restraint that would otherwise be considered *per se* illegal is causally related to, and reasonably necessary to achieve pro-competitive benefits from” an efficiency enhancing integration, the reasonableness of the restraint will be evaluated under the rule-of-reason. *Guidelines*, § 3.2. However, in the case of “suspect” agreements (including those that entail price fixing) the Guidelines envision a process of shifting presumptions that resembles a “Quick Look” analysis. *Guidelines*, at § 1.2 and 3.3. (Citing, *FTC. v. Indiana Federation of Dentists*, and *California Dental Ass’n v. FTC*, *supra*). The *Guidelines* recognize a 20 percent market share “safety zone” for collaborations that involve non-price restraints, but not for those involving horizontal price fixing. *Guidelines*, § 4.2. The same is true for the 3-player innovation market safety zone. *Guidelines*, § 4.3.

4. Private Enforcement, Standing and “Antitrust Injury”

A private plaintiff’s ability to take advantage of the *per se* rule is limited by applicable standing requirements. Under section 4 of the Clayton Act, “any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws” has a private treble damages cause of action. 15 U.S.C. § 15(a). Under section 16 of the Clayton Act, any person who is “threatened [with] loss or damage by a violation of the antitrust law,” can sue for injunctive relief and attorney fees. 15 U.S.C. § 26. To meet these standing requirements, a private plaintiff must plead and prove actual or threatened “antitrust injury” -- which is “injury of the type the antitrust laws were intended to prevent and that flows from that which makes defendants’ acts unlawful.” *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489 (1977) (denying standing to plaintiff whose injury resulted from an *increase* in competition flowing from defendant’s conduct). Even if a price fixing claim is *per se* illegal (so that injury to competition is presumed to occur), plaintiff must plead and prove that plaintiff suffered “antitrust injury.” *Atlantic Richfield v. USA Petroleum Co.*, 495 U.S. 328, 334-335 (1990), (denying standing to plaintiff claiming injury due to a conspiracy to lower prices through maximum resale price fixing -- which was *per se* illegal at the time). While injury to competition (as distinguished from injury to an individual competitor) must be pled and proved as an element of any Sherman One claim, “[t]he antitrust injury requirement cannot be met by broad allegations of harm to the market as an abstract entity.” *Id.* at 339 n.8. For standing purposes, antitrust injury “must be viewed from the perspective of the plaintiff’s position in the marketplace, not from the merits-related perspective of the impact of defendant’s conduct on overall competition; See also, *Angelico v. Lehigh Valley Hospital, Inc.*, 184 F.3d 268. The same principle applies to claims for injunctive relief under § 16 of the Clayton Act: *Cargill, Inc. v. Monfort of Colo., Inc.*,

479 U.S. 104, 113 (1986) (“[A] private plaintiff must allege *threatened* loss or damage of the type the antitrust laws were designed to prevent and that flows from that which makes defendants’ acts unlawful.”); See generally, II Areeda & Hovenkamp, Antitrust Law, 337a (2d ed. 2000).

Checklist For Horizontal Price Fixing

- ☑ Does the arrangement have the purpose and effect of fixing/stabilizing prices, or limiting/controlling price competition (or does it reduce/control output)? This includes standardized pricing formulas, eliminating or standardizing discounts, uniform freight charges, credit terms or other terms effecting price.
- ☑ Do the participants in the pricing arrangement include two or more competitors -- i.e. persons/entities having distinct economic interests? (important in cases involving corporate families, joint ventures, agency relationships, and other competitor collaborations.)?

Note: If the arrangement involves non- competitors who are vertically related, the arrangement may be challenged as “vertical” price fixing (discussed below)
- ☑ Is there any direct evidence of an express agreement (witness-participants, recordings, documents); and assuming no direct evidence, is there something other than parallel conduct (including “conscious parallelism”) to support an inference of concerted action (or exclude the possibility of independent action)?
 - What are the “plus factors” and are they sufficient to support an inference of concerted (rather than independent) action?
 - Does the structure of the relevant market (e.g. oligopoly) limit the persuasiveness of otherwise probative economic “plus factors?”
- ☑ Does the arrangement impose a “naked” restraint on price competition (or output) -- i.e. is price (output) coordination the sole purpose/effect of the arrangement (making it *per se* illegal), or
- ☑ Is the coordinated pricing arrangement part of a larger collaborative undertaking that has a legitimate business purpose unrelated to suppression of price competition (e.g. greater efficiency, increased output, new market entry, greater consumer choice), and if so,
 - does the collaborative arrangement involve a meaningful economic “integration” to which the competitors contribute significant technology, or other complimentary assets, and
 - -- is it really necessary to coordinate pricing in order to achieve the legitimate business purpose of the arrangement (e.g. a joint venture that can only work if firms agree on price)
- ☑ If the price fixing arrangement is a necessary part of a larger, efficiency-enhancing competitor collaboration (i.e. not a “naked” restraint) who must first prove the competitive impact (pro or con) and when must that proof burden be met (Quick Look vs. rule-of-reason)?

B. VERTICAL PRICE RESTRAINTS (Resale Price Maintenance)

The antitrust law is concerned with at least one type of price fixing agreement that involves parties who are not competitors, namely: resale price maintenance (RPM) agreements -- sometimes called vertical price fixing. An RPM agreement is a contract between vertically related firms in which the supplier controls the price at which the covered merchandise is resold. The treatment of RPM under the antitrust laws has been controversial and subject to change over time. As of this moment RPM agreements, like agreements that entail non-price vertical restraints, are analyzed under the rule-of-reason.

1. *Per se* Rule and the “Colgate Exception”

In one of its earliest antitrust decisions, the Supreme court held that an RPM agreement is *per se* illegal under Sherman One.⁵ *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911). However, eight years later, the Court held that an RPM indictment failed to set forth a Sherman One offense because it did not mention the existence of an “agreement” between Colgate and its reseller customers. *United States v. Colgate & Co.*, 250 U.S. 300 (1919). The Court held that Colgate had the right to refuse to do business with anyone, and that was all that it was charged with doing -- i.e. the indictment merely alleged that Colgate posted its suggested retail prices and, when it learned that a retailer undercut the posted price, refused to make further sales to that retailer. Colgate’s exercise of its right to “unilaterally” refuse to deal with discounting retailers did not satisfy Sherman One’s requirement of an “agreement” between market participants. In *United States v. Parke, Davis & Co.* 362 U.S. 29 (1960), the Court articulated a number of limits on the ability of a supplier to implement an effective RPM program without appearing to enter into a forbidden agreement. To qualify, a supplier can announce a minimum resale price and declare its intent to refuse to deal with price cutters; but it must not threaten, intimidate, warn or take any enforcement action other than unilaterally refusing to deal. See, e.g. *Isaksen v. Vermont Castings Inc.*, 825 F.2d 1158 (7th Cir. 1987) (holding that actual manufacturer efforts to get dealers to adhere to RPM policy, plus a showing of actual dealer compliance, is sufficient to demonstrate an “agreement”). The “Colgate exception” to the *per se* rule has been the subject of much litigation and a source of angst among lawyers who must advise clients on how to fashion a *Colgate*-compliant RPM policies.

2. Fair Trade Laws

From 1937 until 1975, the Miller-Tydings Fair Trade Act and related federal legislation authorized individual states to enact laws that would permit resale price maintenance within their

⁵ Dr. Miles’ *per se* rule does not apply to minimum *advertised price* or “MAP” agreements because they normally do not purport to fix the actual *resale price*. See, *In re. Nissan Antitrust Litigation*, 577 F.2d 910 (5th Cir. 1978). As a result suppliers have been free to institute cooperative advertising programs that (1) suggest the prices that can be advertised by participating resellers, and (2) provides that if a retailer advertises below the stated prices, the supplier will not reimburse the retailer for the ad. Such arrangements are, however, subject to scrutiny under the rule of reason. To avoid rule of reason condemnation the FTC has recommended that a MAP policy include notice to retailers that they are free to sell below suggested minimum advertised prices, and that they remain free to use their own funds to advertise below those prices. See, FTC Policy Statement re Cooperative Advertising Programs-Rescission, 6 Trade Reg. Rep. (CCH) ¶ 39,057 (April 17, 1997).

respective borders. During this period 46 different states enacted so called “fair trade” laws which, at one time or other, legalized RPM agreements. Under these statutes an RPM agreement was *per se* legal (not subject to challenge under either *per se* rule or the rule-of-reason). It is generally recognized that widespread adaptation of RPM agreements among retailers in fair trade states resulted in price increases for consumers. In 1975 Congress enacted the Consumer Goods Pricing Act (CGPA) which had the effect of undoing Congress’ prior fair trade enabling legislation and preempting any existing fair trade laws on the books. At the time, the CGPA was viewed by the Supreme Court as a Congressional mandate to preserve the rule of *per se* illegality for RPM agreements. See, e.g. *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 51 n.18 (1977) (opining that by repealing the fair trade enabling legislation Congress, “expressed its approval of the *per se* analysis of vertical price restrictions.”). In its recent decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.* 551 U.S. 817, 127 S.Ct.2705 (2007), the Court explained that, while Congress’ enactment of the CGPA rejection of *per se* legality under state fair trade laws, Congress did not intend to legislatively impose a rule of *per se* illegality. Instead, the Court found in the CGPA’s enactment an expression of Congress’ intent that courts return to the well established “common law” mode of interpreting the antitrust laws -- including questions of RPM. legality.

3. Demise of *Per Se* Rule

In a 1977 case involving a *non-price* vertical restraint (territorial market allocation) the Supreme Court recognized the distinction between “intra-brand” competition (between retailers selling the same branded products) and “inter-brand” competition (between manufacturers and retailers selling competing branded products) -- and declared that the principal concern of the antitrust law is the protection of inter-brand competition. *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S.36, 52 (1977). The court recognized that vertical non-price constraints reduce intra-brand competition, but they often have a greater and more beneficial effect on inter-brand competition. From that point all vertical non-price restraints were subject to the rule-of-reason -- and courts began to apply the same reasoning to vertical *price* restraints (i.e. RPM).

Maximum RPM Agreements: In *Albrecht v. Herald Co.*, 390 U.S. 145 (1968), the Supreme Court had held that it was *per se* illegal for a supplier of daily newspapers to establish the *maximum* price that newspaper delivery firms could charge their subscriber-customers. However, in *State Oil Co. v. Khan*, 522 U.S. 118 (1997), the Court declared that maximum RPM agreements as a class would thereafter be judged under the rule-of-reason. The Court acknowledged that vertical *maximum* price controls could actually help promote inter-brand competition. *Id.* at 11-12.

Minimum RPM Agreements: As recently as 1984, the Supreme Court reaffirmed *Dr. Miles’* rule of *per se* illegality for *minimum* RPM agreements. See, *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 761 (1984). However, when it decided *Leegin, supra*, in 2007, the Court held that rule-of-reason analysis was appropriate for RPM agreements because: “The vertical agreements establishing minimum resale prices can have either pro-competitive or anti-competitive effects, depending upon the circumstances in which they are formed.” 127 S.Ct. at 2717. After stressing the importance of protecting *inter-brand* competition, the Court went on to find that RPM agreements can and often do promote inter-brand competition by *reducing* intra-brand price competition.

Absent vertical restraints [on resale prices], the retail services that enhance *interbrand* competition might be underprovided. This is because discounting retailers can free ride on retailers who furnish services and then capture some of the increased demand those services generate. *GTE Sylvania* [433 U.S. 36, at 55] . . . [T]he high service retailer will lose sales to the discounter, forcing it to cut back its services to a level *lower than consumers would otherwise prefer*. Minimum resale price maintenance alleviates the problem because it prevents the discounter from undercutting the service provider. With price competition decreased, the manufacturer's retailers compete among themselves over services. (emphasis added).

127 S.Ct. at 2715-16. The court found that minimum RPM agreements could facilitate the entry of new products -- by providing retailers with the assured margin they would need to justify the marketing-related investments needed to introduce the new brand, *Id.* at 2716. Ultimately the Court concluded that unlike horizontal price fixing agreements, minimum RPM agreements cannot be said to always or nearly always impose unreasonable restraints on trade.

4. Continuing Requirement of an “Agreement”

The *Leegin* decision doesn't pronounce minimum RPM agreements *per se legal* -- it only removes the threat of *per se illegality*. RPM agreements are still subject to scrutiny under the rule-of-reason -- and the existence of an agreement remains a necessary predicate to liability under that rule. Although it has been criticized as a lawyer's contrivance, the *Colgate* doctrine continues to provide the legal basis for a “no-agreement” defense in minimum RPM cases. A manufacturer can still avoid entering an RPM “agreement” by acting “unilaterally” in setting and enforcing an RPM policy. In *Monsanto Co. v. Spray-Rite Services Corp.*, 465 U.S. 752 (1984) the Supreme Court held that an RPM agreement could not be inferred despite evidence that (1) a dealer continually sold below the supplier's minimum price, (2) competing re-seller customers complained to the supplier about the discounter, (3) the supplier terminated the discounter.

Firms that have existing *Colgate*-compliant RPM programs should give careful consideration to maintaining that program in order to preserve their “no-agreement” defense. As a general rule, firms should enter into formal RPM agreements only if they are needed to effectively implement an RPM program, or if there is some other compelling business reason for forgoing the *Colgate* defense.

5. Future Rule-of-Reason Analysis

The *Leegin* Court recognized that it will take time for lower courts to develop a “litigation structure” with presumptions, standards of proof, and guidelines to facilitate application of the rule-of-reason to RPM agreements. *Leegin*, 127 S.Ct. at 2720. The *Leegin* decision suggests market share screens or safe harbors that would remove numerous instances of RPM agreements from serious challenge. The Court also suggests several circumstances in which RPM agreements might be found “unreasonable,” namely: (1) where most manufacturers in a given product category or market use RPM agreements with most re-seller customers in the market in order to facilitate a horizontal price fixing or market allocation agreement among manufacturers; (2) where a dominant manufacturer uses RPM agreements with its dealers to persuade them to refrain from handling the products of a competitor (provided that the

manufacturer has sufficient market power to have such an impact on the market for dealer services); (3) where a group of retailers uses RPM agreements with their suppliers to implement a horizontal agreement among themselves to protect their margins (a fact that might be shown by evidence of the “source” of the agreement), and (4) where a dominant *retailer* uses an RPM agreement to forestall or prevent competition from newer low-cost market entrants or new channels of trade (provided the dominant retailer has the market power needed to foreclose competition in this way). *Id.* at 2716-2717.

Market Power Screen: The *Leegin* decision emphasizes protection of *interbrand* over intrabrand competition. Two of the potential RPM abuses identified in *Leegin* involve situations in which a *single firm* (seller or buyer) possesses market power in the relevant interbrand market. The *Leegin* decision also notes the potential for RPM abuse by a *seller or buyer cartel*, but questions whether the potential abuse would be effective if the cartel lacks the market power needed to effect interbrand competition. To raise these issues an RPM plaintiff may be required to plead and prove that a single buyer or seller (or cartel of buyers or sellers) has a threshold of market power (market share) in a relevant interbrand market. Interbrand market power has been instrumental in decisions condemning *non-price* vertical restraints under the rule-of-reason. See, e.g. *Toledo Mack Sales & Serv. v. Mack Trucks*, 539 F.3d 204, 210 (3rd. Cir. 2008), finding non-price vertical restraint to be unreasonable -- based on evidence that the manufacturer had sufficient power in certain truck engine markets to control prices in those markets).

The *Leegin* decision only expresses concern about *intrabrand* competition when the RPM agreement is brought about by the demands of a “dominant” retailer - one that has market power in the retail sales market and upon whom each manufacturer in this market depends for a large portion of its sales. *Leegin*, at 2719-2718. In one post-*Leegin* decision, *BabyAge.com Inc. v Toys ‘R Us Inc.*, 558 F.Supp. 2d 575 (E.D. Pa. 2008), the court refused to dismiss a complaint in which the plaintiff claimed that a buyer having market power in a relevant market had imposed RPM agreements on multiple manufacturers, as a means of avoiding price competition with the plaintiff retailers. The court held that it was sufficient for plaintiff to allege that each manufacturers RPM agreements had caused the prices of that manufacturer’s goods to increase beyond competitive levels, and that at least some sales by that manufacturer had been blocked. *Id.* at 583 (citing *Leegin, supra*); See also, *McConough v. Toys “R” Us, Inc.*, ___ F.Supp.2d ___ (E.D.Pa. No. 06-0242, 7/15/09) (certifying class of consumer purchasers who claimed that dominant retailer Babies “R” Us threatened to discontinue carrying products of manufacturers unless they agreed to prevent discounting by *internet* retailers)

Presumptions and Burdens: The *Leegin* decision suggests that courts consider the use of presumptions, and proof burdens to produce a workable “litigation structure” for efficiently applying rule-of-reason analysis in future RPM cases. *Id.* at 2705, 2720. In comments filed in a recent F.T.C. proceeding, twenty-eight State attorneys general (including Minnesota’s) suggested that a “quick look” or “inherently suspect” analysis be applied to *all* RPM agreements because they have been shown to raise consumer prices. *In re Nine West Group, Inc.*, Docket No. C-3937. The FTC refused to presume that the restraints that would be imposed by Nine West’s proposed RPM agreements would be unreasonable; but the Commission suggested that a truncated analysis (requiring the defendant to prove pro-competitive effects) would be appropriate if plaintiff can show that the RPM proponent is a manufacturer that has market power sufficient to raise prices, or that a group of retailers is the source of the RPM agreement.

Others have suggested that the RPM agreements be presumed to impose unreasonable restraints in “open distribution” systems (where there are *no* other vertical restraints on dealers), because RPM agreements in such systems have little chance of curbing “free riding” and their potential for anticompetitive effects on dealer competition is enhanced.

Vertical vs. Horizontal Analysis: The *Leegin* Court notes that horizontal price fixing cartels at either the manufacturer or dealer level will result in competitive restraints that are presumptively unreasonable under the *per se* rule. But the Court goes on to say: “To the extent a vertical agreement setting minimum resale prices is entered upon to facilitate either type of [horizontal] cartel, it, too, would need to be held unlawful under the rule-of-reason.” *Id.* at 2717. It is unclear whether this statement means that because the RPM agreement is vertical it needs a full rule-of-reason analysis (perhaps requiring an impact on interbrand competition) even if it is entered upon to facilitate a horizontal conspiracy (which would be *per se* illegal); or that courts should judge such RPM agreements under a special rule (perhaps “quick look”) as part of the new “litigation structure” that is needed for efficient application of the rule or reason to RPM agreements. The Third Circuit recently read this language to require full rule-of-reason analysis. *Toledo Mack Sales & Service, Inc. v. Mack Trucks, Inc.*, 530 F.3d 204, 221, 225 (3rd Cir. 2008) (“The rule-of-reason analysis applies even when, as in this case, the plaintiff alleges that the purpose of the vertical agreement between a manufacturer and its dealers is to support illegal horizontal agreements between multiple dealers.”).

There will also be occasions when a seller who has entered into an RPM agreement with independent retailers also sells directly to the retail trade through its own outlets. This will require courts to revisit the question of whether a seller’s competitive presence in the retail market can convert the seller’s otherwise vertical RPM agreements into a horizontal price fixing conspiracy between the seller-as-retailer and its RPM counter-parties. Several pre-*Leegin* decisions have held that when a seller and its retail customers enter into agreements that impose vertical non-price restraints on the retailers, these arrangements are not transformed into a horizontal conspiracy by the mere fact that the seller performs a dual distribution role. See e.g. *International Logistics Group, Ltd. v. Chrysler Corp.*, 884 F.2d 904, 908 (6th Cir. 1989); *Ryko Mfg. Co. v. Eden Services*, 823 F.2d 1215, 1230-1231 (8th Cir.1987), cert. denied, 108 S.Ct. 751, 98 L.Ed.2d 763 (1988), see also, *Spahr v. Leegin Creative Leather Products, Inc.*, 2008 WL 3914461 (E.D. Tenn. 2008) (separate class action in which the trial court found that, notwithstanding *Leegin*’s alleged dual distribution role, its RPM agreements would be judged under the rule-of-reason -- because a *per se* analysis is appropriate only when the conspiring dealers are the source of the RPM agreements).

6. State Law/Federal Legislation

Bills introduced in both the House (H. 657) and Senate (S. 239) would, if enacted, overrule the Supreme Court’s decision in *Leegin* and restore the rule of *per se* illegality for RPM agreements under federal law. No attempt will be made to handicap those bills, but it is worth noting that Wisconsin Senator Herb Kohl of the Kohl department store family is chairman of the Senate Judiciary Committee. Senator Kohl has been an outspoken critic of the *Leegin* decision.

Leegin's impact on state antitrust law may vary from state to state.⁶ Minnesota's antitrust law (like Sherman One), does not specifically prohibit RPM agreements; but it has been construed (pre-*Leegin*) to make RPM agreements *per se* illegal. *State v. Alpine Air Products*, 490 N.W.2d 888, 894 (Minn. Ct. App. 1992) aff'd, 500 N.W. 2d 788 (Minn. 1993). Minnesota courts generally interpret our state's antitrust law to conform with interpretations of federal antitrust law -- even when the Supreme Court changes its interpretation. When the federal law was construed to preclude indirect purchaser claims, the Minnesota Court of Appeals held that indirect purchaser claims are similarly precluded under Minnesota's antitrust law. *Keating v. Phillip Morris, Inc.* 417 N.W.2d. 132, 136 (1987). The *Leegin* decision may produce a similar judicial re-interpretation of state law applicable to RPM agreements; and if it does, the Minnesota legislature may intervene⁷ -- as it did when it enacted indirect purchaser legislation to override the *Keating* decision. See, Minn. Stat. § 325D.57. On the other hand, Minnesota's courts might balk at automatically accepting the significant *substantive* change that *Leegin* has made to a long standing principal of antitrust law. In that case, the Minnesota courts might either (a) retain the state's current *per se* illegality rule, or (b) drop *per se* illegality but substitute the presumption suggested by Minnesota Attorney General in the *Nine West* case, *supra*, or some other truncated analysis. In any case, the law regarding resale price maintenance in Minnesota and other states remains fluid.

⁶ In today's global economy firms must also consider the possibility that an RPM agreement will still be considered illegal *per se* under the competition law of foreign jurisdictions. For example, the European Commission's Block Exemption Regulation and Guidelines for Vertical Restraints continue to treat RPM agreements as a "hardcore restriction" that is presumptively illegal. See, Block Exemption Regulation, Article 4(a).

⁷ In *California v. ARC America Corp.*, 490 U.S. 93, 101, 102 (1989) the Supreme Court held that state indirect purchaser laws were not preempted by federal antitrust law because the state laws, "are consistent with the broad purposes of the federal antitrust laws: deterring anticompetitive conduct and ensuring the compensation of victims of that conduct." A state law that condemns RPM agreements as *per-se* illegal would (according to *Leegin*) have the effect of restraining potentially pro-competitive business practices -- a result that arguably conflicts with the pro-competitive purpose of federal antitrust law. However, the chance of a "conflict" preemption is diminished by the fact that *Leegin* does not declare that RPM agreements are *per se* legal.

Checklist For Resale Price Maintenance Agreements

I. Is a formal RPM agreement worth the potential liability exposure given uncertainty concerning (i) a new and evolving rule-of-reason approach to RPM under federal antitrust law, and (ii) possible *per se* or other truncated treatment under various state laws?

- Does the product in question compete in a “commoditized” market with little prospect of achieving product differentiation? If that’s the case
 - an “open distribution” system with full dealer competition (no vertical restraints) may be the best business model for the manufacturer, and
 - RPM agreements will be perceived as deriving from (and designed to serve the anticompetitive purposes of) the participating dealers.

- If product differentiation is a feasible/desirable objective, will that objective be served by point of sale service, training, facilities or other dealer-dependent inputs, and if so
 - will the RPM agreement really enable/motivate the dealers to provide the necessary inputs (by reducing “free riding” or otherwise), and if so
 - are there other equally effective means of generating the desired dealer inputs without imposing direct price restraints on the dealers (e.g., marketing incentives, performance criteria or vertical non-price restraints such as exclusive territorial/customer arrangements)?

- If RPM is the preferred dealer management tool, is there an existing and effective *Colgate*-compliant RPM policy in place (or could one be implemented)?
 - Are there special administrative problems (dealer communications)?
 - Are there special contractual problems (e.g. long term supply contracts terminable only for cause)?
 - Franchise agreements and other special cases?

II. If your client (seller or buyer) has entered or intends to enter into an RPM agreement how would the arrangement fare under *Leegin’s* new rule-of-reason analysis?

- Is the manufacturer/seller the proponent of the RPM agreement, and if so:
 - Are RPM agreements being used to gain entry into an established market?
 - Is the proponent a single firm having a market share sufficient to enable its use of RPM agreements to induce dealers to favor its products (or disfavor or refuse to handle the products of rival manufacturer/sellers), or
 - Is the use of RPM sufficiently widespread across a given product market to enable their use by a cartel of manufacturers/sellers to facilitate horizontal price fixing?

- Is a dealer or other re-seller the proponent of the RPM agreement, and if so:
 - Is the proponent a single firm having a market share sufficient to enable its use of RPM agreements to prevent competition from newer low-cost market entrants or new channels of trade?
 - Is the proponent a group of dealers whose combined market share is sufficient to enable use RPM agreements to protect their resale margins?

II. UNILATERRAL PRICING BEHAVIOR

Unilateral pricing behavior can be challenged under section two of the Sherman Act if it involves “price predation,” or under section two of the Clayton Act (also known as the Robinson Patman Act) if it involves “price discrimination.” Courts are understandably reticent about predatory pricing claims because they entail aggressive price competition by the alleged predator -- and the antitrust laws are generally supposed to *promote* vigorous price competition. For the same reason, courts are skeptical of price discrimination claims where the discriminatory pricing conduct is alleged to have an adverse impact on competition between the firm charging the discriminatory price and a firm that produces a competing product. The situation is different when the price discrimination is alleged to have an adverse impact on competition at the customer level. Liability for such “secondary line” injury is controversial but for a different reason - i.e., it tends to protect individual competitors, whereas the antitrust laws are designed to protect competition.

Predatory pricing and price discrimination are not the only unilateral pricing practices that can be challenged under Sherman Two. Additional pricing practices such as bundling, tying, are covered elsewhere in the program materials.

A. PREDATORY PRICING

Predatory pricing occurs when a seller attempts to drive one or more competing sellers out of business by temporarily charging very low prices under circumstances in which the predatory seller can expect to charge supra-competitive prices later. Predatory bidding is essentially the reverse situation -- i.e. a predatory buyer attempts to drive one or more competing buyers out of business by paying a very high price for a given product, under circumstances in which the predatory buyer can expect either to pay a less than competitive price for the product later; or to charge a supra-competitive price for an output that is made with the product. Only very large firms are capable of “predatory pricing” or “predatory bidding” in an antitrust sense -- i.e. pricing and/or bidding practices of an alleged predator will not run afoul Sherman One’s anti-monopolization provisions unless the alleged predator either possess, or presents a dangerous probability of acquiring monopoly power.

1. Predatory Pricing

The Supreme Court has carefully limited the circumstances under which a person can claim an antitrust violation based on allegations that a defendant’s prices are too low. In *Brooke Group v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), the Supreme court established a two pronged test for determining whether such prices are “predatory” and therefore unlawful under Sherman Two. Plaintiff must show that (1) “the prices complained of are below an appropriate measure of [defendant’s] costs,” and (2) there is a “dangerous probability” that the defendant will be able to recoup its “investment” in below-cost prices. *Id.* at 222-224

Appropriate Measure of Cost: Economic theory posits that in a competitive market the law of supply and demand will drive sellers’ prices to, but not below, their marginal costs (MC). Because it is difficult to calculate MC, average variable cost (AVC) is often substituted for MC. Noted antitrust authorities Areeda and Turner propose that pricing below AVC be presumed to

be predatory. Under the test articulated by the Supreme Court in *Brooke Group* the predator's prices must be below "an appropriate measure" of defendant's cost, but the Court specifically declined to define what the appropriate measure is. 509 U.S. at 222. In at least two other cases, the Supreme Court has declined to define the "appropriate measure of costs" below which defendant's prices must be set in order to support a Sherman Two price predation claim. See, *Cargill v. Montfort of Colorado*, 479 US 104, 117-118 n.12 (1986); *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 584-85 n. 8 (1986).

Potential Recoupment: Rather than conclusively presume that pricing below an "appropriate measure of cost" entails illegal price predation, the Supreme Court has added a requirement that the defendant have a dangerous probability of recouping the losses that are necessarily incurred during the period of below-cost pricing. The potential for such recoupment is a function of the price predator's existing or acquired market power -- which usually makes price predation an unrealistic pricing strategy for firms that do not already have a large market share

Evaluating Market Power: For antitrust purposes, "market power" is the ability to raise prices above competitive levels and sustain them for a significant period of time without loss of profit. A monopoly occurs when a dominant firm acquires a very large amount of market power. A firm's "market share" is often considered a "proxy" for its market power -- because market share is much easier to calculate.⁸ The Supreme Court has suggested in *dicta* that a 21% market share is so low as to make predation unlikely, *Cargill v. Monfort of Colorado* 479 U.S. 104 119 n. 15 (1986), but a much larger share is probably required for the practice to make economic sense. In a case that is based on an *attempt* to monopolize (where the defendant does not yet possess sufficient market power), entry barriers may be required to make recoupment plausible. See, e.g. *American Academic Suppliers v. Beckley-Cardy*, 922 F.2d 1317, 1320 (7th Cir. 1991) (holding that predation simply cannot be proven unless entry barriers are high).

2. Predatory Bidding

A monopsonist might be in a position to engage in buy-side price predation by bidding up the price of an input that is essential to competition -- in the hope of charging supra-competitive prices when competitors deprived of the essential input are driven from the market. In *Weyerhaeuser v. Ross-Simmons Hardwood Lumber*, 127 S.Ct. 1069 (2007), the Supreme Court held that the "price predation" principles articulated in *Brooke Group* apply to such predatory bidding -- because monopoly and monopsony are theoretically similar in terms of their impact on competition, and because there are both theoretical and practical similarities between predatory pricing and predatory bidding. When applied to predatory bidding, *Brooke Group's* two pronged test would require that (1) the predator's bid must cause the cost of the relevant output to rise above the revenues generated from subsequent sales, and (2) the predator must have a dangerous probability of recouping, through the exercise of monopsony power, the losses incurred in bidding up input prices. *Weyerhaeuser, supra*, at 1078.

⁸ The Supreme Court has indicated that market shares above 66% indicate monopoly power without clearly specifying the lower boundary. See *United States v. duPont*, 351 U.S. 377 at 379 (1956).

3. Predatory “Price Squeeze”

A price squeeze occurs when a vertically integrated monopolist attempts to force subnormal returns on vertically related independent companies by charging them a high price for an essential input, and then selling the competitive output through its own or vertically related subsidiaries at a price that the independent companies cannot profitably match. A number of lower courts have held that such unilateral pricing behavior constitutes unlawful monopoly maintenance under Sherman Two. See, e.g. *United States v. Aluminum Corp. of American*, 148 F.2d 416 (2nd Cir. 1945); *Bonjorno v. Kaiser Alum. and Chem. Corp.*, 752 F.2d 802, 808-810 (3rd Cir. 1985); see also *Covad Communications Co. v. Bell South Corp.*, 374 F.3d 1048 (11th Cir. 2004) (holding that a potential price squeeze claim could survive *Trinko*, discussed below). Earlier this year the Supreme Court rejected this lower court precedent and held that a price squeeze claim may not be brought under Sherman Two when the defendant has no antitrust duty to deal with the plaintiff at wholesale. The Court based its decision on two premises, namely: (1) that a vertically integrated monopolist is under no general duty to deal with competitors, and (2) that it makes no economic sense to prohibit the monopolist from engaging in price squeeze behavior in circumstances where the monopolist can lawfully refuse to deal with the competitor altogether.

Duty to Deal at Wholesale: A monopolist’s refusal to deal with competitors will not, by itself, violate the antitrust laws. *United States v. Colgate & Co.* 250 U.S. 300 (1919) A few “exceptions” to this general rule have been recognized in markets where a monopolist controls a facility or component that is essential to competition. E.g., *United States v. Terminal R.R. Ass’n of St. Louis*, 224 U.S. 383 (1912); *Otter Tail Power Co. v. United States* 410 U.S. 366 (1973); *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985) The so called “essential facilities” doctrine requires that at least four factors be present in order to impose on a monopolist a duty to deal with competitors: (1) control of the essential facility by a monopolist; (2) a competitor’s inability practically or reasonably to duplicate the essential facility; (3) the denial of the use of the facility to a competitor; and (4) the feasibility of providing the facility to competitors. The Seventh Circuit relied on the essential facilities doctrine to compel AT&T to make its local loop infrastructure available to a competing long distance carrier in *MCI Communications v. American Tel. & Tel. Co.*, 708 F.2d 1081, 1132-33 (7th Cir. 1983), but the doctrine remains controversial. In *Verizon Communications Inc. v. Law Offices of Curtis v. Trinko, LLP*, 540 U.S. 398 (2004) the Supreme Court refused to impose on firms having monopolies in local telephone markets (the incumbent local exchange carriers or “ILECs”) an antitrust duty to provide competing local exchange carriers (CLECs) with wholesale telephone transport service because, pursuant to the 1996 Telecommunications Act, the ILECS were already under a regulatory duty to deal with the CLECs.⁹ In the absence of an antitrust duty to

⁹ Although it was not necessary to dispose of the claim the majority opinion also states that plaintiff’s claims would not fit the “essential facilities” doctrine as articulated in *Aspen, supra*, even if the ILECs were under no regulatory duty to deal with plaintiffs. The Court distinguished *Aspen* using factors (i.e. whether the defendant ILEC forewent short term profits because it would profit in the long term after competition exited) from which one might infer acceptance of the government’s proposed “but for” standard for exclusionary conduct under Sherman Two. See, Brier for the United States and the Federal Trade Commission as Amicus Curiae Supporting Petitioner, § II.2 (filed

deal, *Trinko* held that the ILECS were under no antitrust obligation to provide the CLECs with a level of service that might be deemed “sufficient”.

The dispute that arose in *LinkLine*, *supra*, involved the ILEC’s control of the same local exchange infrastructure that was at issue in *Trinko*, but the plaintiffs wanted use the ILEC’s infrastructure to transport digital signals (used for internet access) rather than the analogue signals (used for voice communication). The Court assumed that the defendant ILEC had no antitrust duty to provide digital transport service-- i.e. that its *only* duty to deal at wholesale was a regulatory duty imposed by the FCC.¹⁰ That being the case, “[a]ny challenge to [the ILEC’s] wholesale prices is foreclosed by a straightforward application of *Trinko*.” Going further, however, the *Linkline* majority opined that even if the ILEC was subject to an antitrust duty to deal at wholesale there was no compelling reason to recognize a “price squeeze” theory of antitrust liability. A vertically integrated monopolist necessarily has the ability to restrict the margins of competing downstream resellers but the majority deemed existing theories of antitrust liability (including unlawful refusal to deal) adequate to address any potential threat to competition. And if the integrated monopolist’s complete refusal to deal at wholesale would incur no liability under existing theories of antitrust law, the *Linkline* majority could find no economic justification for compelling the monopolist to deal on specific terms (including price) that would permit downstream resellers to compete. *Id.* at ____.

Predatory Pricing at Retail: The *LinkLine* plaintiff’s had originally claimed that, notwithstanding the absence of an antitrust duty to deal at wholesale, the ILECs were under an antitrust duty to provide them with wholesale prices that, when compared to the ILEC’s retail prices, would leave plaintiffs with a fair or adequate margin.¹¹ But the Court refused to question the ILEC’s wholesale pricing because the ILECs were presumed to be under no *antitrust* duty to deal with plaintiffs at any price at the *wholesale* level. And the Court declined to interfere with the ILEC’s *retail* pricing as long as it was not “predatory” under *Brooke Groupe*. In the Court’s view, subjecting defendants to price squeeze claims when their prices remain above an appropriate measure of cost “would invite the precise harm we sought to avoid in *Brooke Group*: Firms might raise retail prices or refrain from aggressive price competition to avoid potential antitrust liability,” (quoting *Brooke Group*, 509 U.S. at 223). Bottom line for *Linkline*: where there is no antitrust duty to deal at the wholesale level and no predatory pricing at the retail level,

5/23/03) (“[C]onduct is not exclusionary or predatory unless it would make no economic sense for the defendant *but for* its tendency to eliminate or lessen competition.”).

¹⁰ The Court of Appeals had assumed that the defendant ILEC was under a *regulatory* duty to provide plaintiffs with broadband internet access over digital subscriber lines (called DSL service), and that under *Trinko* there could be no *antitrust* duty to provide that same service. See, *LinkLine v. SBC California*, 503 F. 3d 876, 878-879, n.6, (9th Cir. 2007). Though it was not necessary to do so, the *Linkline* majority opined that even if *Trinko*’s regulation-based reasoning did not apply the defendant ILEC probably would not be under an *antitrust* duty to provide plaintiffs with DSL transport service because, notwithstanding the ILEC’s supposed monopoly of the local DSL service market, competition from other digital transport technologies (cable, wireless and satellite) would deprive the ILEC of market power in the overall market for broadband internet access. *LinkLine*, *supra* at ____, n.2.

¹¹ Because the plaintiffs abandoned this claim prior to the Court’s grant of certiorari the only advocates for this position before the Supreme Court were various amici including the American Antitrust Institute..

“a firm is not required to price both of these services in a manner that preserves its rival’s profit margins.”¹²

B. PRICE DISCRIMINATION

Since 1936, Section 2 of the Clayton Act, AKA the Robinson-Patman Act (RPA) has made certain differential pricing unlawful. Unlike the rest of federal antitrust law, the RPA amendments were designed, not to protect competition, but to protect small businesses against large economically powerful chain stores. A particular target were the discounts that manufacturers furnished to large chain stores. The RPA’s solution (a broad prohibition against differential pricing) has been the subject of much criticism by economists and antitrust purists who regularly call for its repeal. Other Authorities have called for amendments that would bring it in line with the general purposes of the Antitrust laws.

1. Technical Requirements

The RPA is perhaps the most technical of the U.S. antitrust laws. The following requirements must be satisfied to make out a *prima facie* claim:

- two or more consummated sales,
- one of which satisfies the “commerce” requirement,
- made reasonably close in point of time,
- of commodities,
- of like grade and quality,
- with a difference in price,
- charged by the same seller,
- to two or more different purchasers,
- for use, consumption, or resale within the United States or any territory thereof,

Two or More Consummated Sales: Non-sale transactions (licenses, consignments, agencies, leases and reciprocal swaps) are not covered. The sales must be consummated -- i.e. a sale plus a mere offer to sell or a refusal to sell is insufficient. But see *En Vogue v. UK Optical Ltd.*, 843 F.Supp. 838 (E.D.N.Y. 1994) (motion to dismiss denied; the buyer could be a covered “purchaser” where it had contracted to make a minimum number of purchases, even though no sales had as yet been made).

In some cases two or more dealers who handle the same manufacturer’s products are forced to bid against one another for sales to the same downstream buyer. Sometimes the winning bid can be fulfilled with existing dealer inventory, but sometimes the dealer looks to the manufacturer for a bidding discount (e.g. for special volume orders or customized products).

¹² Article 82 of the EC Treaty is often compared to Sherman Two, but Article 82’s broad condemnation of “abuse of dominance” includes conduct that falls short of maintaining or threatening to obtain a monopoly. As a result, EC Competition Authorities take a dramatically divergent approach to “price squeeze” cases under Article 82. See, e.g., *Deutsche Telecom v. Commission*, Court of First Instances Case T-217/03, (applying an “attribution test” to determine whether a dominant telephone carrier’s retail pricing would allow a reasonably efficient downstream rival to earn a normal profit).

Many courts have held that granting differential discounts in the context of such intra-brand bid contests does not violate the RPA because only one of the competing dealers will win and actually make the discounted purchase. *Reeder-Simco GMC, Inc. v. Volvo GM Heavy Truck Corp.*, 374 F.3d 701,708 (8th Cir. 2004), rev'd on other grounds, 546 U.S. 164 (2006). The Supreme Court recently declined to adopt a broad rule precluding RPA application to competitive intra-brand bidding, choosing instead to focus on the absence of competitive injury. *Reeder-Simco, supra*, 546 U.S. at 178; but see, *Data Capture Solutions Repair & Remarketing, Inc. v. Symbol Technology, Inc.*, 2007-2 Trade Cas. (CCH) ¶ 75,925 (D.Conn. 10/18/07) (relying on *Volvo* for its holding that: "The two purchaser rule . . . excludes claims like this one that complain of price discrimination in intra-brand bidding situations.")

Contemporaneous Sales: The consummated sales must be made contemporaneously or within the same approximate time period. In addition to the time interval between sales courts will consider the seasonal nature of some industries, perishability of goods, and whether sales are made under supply contracts or on the spot market.

Different Prices: The RPA appears to prohibit any price differential that has the requisite adverse effect on competition (discussed below). The test is whether there is a net difference in price taking into account all discounts, allowances, rebates, free goods or services delivery terms or freight allowances. Different "credit" terms may be extended to different customers provided a uniform standard of credit-worthiness is applied. Certain allowances (e.g. early order discounts, cash discounts, or allowances available if the customer picks up the order) need not be included in the net price calculation if the seller makes the allowance "practically available" to all customers. To qualify, the seller must give notice of availability and insure that the allowance is in fact available to all regardless of size.

In Commerce Requirement: It is not enough that sales made at different prices have a "substantial effect" on interstate commerce (as is the case for Sherman One claims). The seller or buyer accused of price discrimination must actually be "engaged in commerce." This has been interpreted to mean that at least one of the sales at issue must be made across a state line. See, *Gulf Oil Corp. v. Copp Paving Co, Inc.*, 419 U.S. 186, 200 (1974). However, shipments of goods will be considered to be "in commerce" until the "flow of commerce" has been broken. *Able Sales Co. v. Compania de Azucar*, 406 F.3d 56, 62–65 (2005), (the in commerce requirement was satisfied where goods shipped across state lines were temporarily stored prior to sale.)

Sales of Commodities: The RPA only applies to sales of "commodities" -- which are generally confined to "tangible goods"(not services or information). The exclusion of sales of services and/or information leaves a large enforcement gap in today's service and information technology oriented economy. In cases where commodities and services or intellectual property are mixed, courts apply a fact-intensive inquiry to determine if the "dominant nature" of the transaction is a sale of commodities. See, e.g. *Innomed Labs, LLC v. ALZA Corp.*, 368 F.3d 148, 156 (2d. Cir. 2004).

Like Grade and Quality: This requirement is not met if the commodity sold at the higher price is *physically different* from the one sold at the lower price. However, products that are merely advertised or branded as different products may be of like grade or quality if they are

physically the same. *FTC v. Borden Co.*, 383 U.S. 637, 646 (1966), (evaporated milk sold to large chain stores under a “house brand” found to be of like grade and quality as same milk sold to smaller stores under Borden’s nationally advertised brand). The treatment of custom ordered goods is less clear. *Compare, Reeder-Simco GMC, Inc. v. Volvo GM Heavy Truck Corp.*, 374 F.3d 701 (8th Cir. 2004) rev’d 546 U.S. 164 (custom ordered heavy duty trucks having options meeting customer specifications found to be of “like grade and quality”), with *Toledo Mack Sales & Service, Inc. v. Mack Truck, Inc.*, 530 F.3d 204 (3rd Cir. 2008), (holding that the RPA does not apply to custom made goods of the type that were at issue in that case). A related provision of RPA § 2(a) provides that, even if goods are of like grade and quality, they can be sold at different prices where the differential fairly reflects, “changing conditions affecting the market for or marketability of the goods concerned, such as [] actual or imminent deterioration of perishable goods, obsolescence of seasonal goods, distress sales under court process, or sales in good faith in discontinuance of business in the goods concerned.”

2. The Competitive Injury Requirement

The RPA proscribes price discrimination only to the extent that it threatens to injure competition. *Volvo Trucks N. Am., Inc. v. Reeder-Simco GMC, Inc.*, 546 U.S. 164, 176 (2006), quoting *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 220 (1993). However, proof of actual competitive injury is not required -- the test under RPA § 2(a) is whether there is a “reasonable possibility” that the price discrimination will harm competition. *Falls City Industries, Inc. v. Vanco Beverage, Inc.*, 460 U.S. 428, 435-435 (198); *Godfrey v. Pulitzer Pub. Co.*, 276 F.3d 405, 410 (8th Cir. 2002). RPA§ 2(a) specifically outlaws price discrimination if its effect may be either (1) to substantially lessen competition or tend to create a monopoly in any line of commerce” or (2) “to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination or with customers of either of them.” Building on this language Courts recognize different kinds of competitive injury depending on where the injury occurs in the product distribution chain.

Primary Line Competitive Injury: “Primary line” competitive injury occurs when discriminatory pricing adversely affects competition between the discriminating seller and its rivals. In *Brooke Group, supra*, the Supreme Court held that an RPA price discrimination claim based on primary line injury is of the same general character as a predatory pricing claim under § 2 of the Sherman Act. That means that the plaintiff in a primary line RPA case must satisfy the two-pronged test for price predation -- i.e. a plaintiff must prove (1) that the discriminatory price charged by a competing seller is below an appropriate measure of the competing seller’s cost and (2) that the competing seller has a reasonable prospect of recouping its investment in below cost prices after plaintiff (or other competing sellers) are driven from the market. *Brooke Group*, 509 U.S. at 222-224. Under this two-pronged test only very large firms are capable of engaging in discriminatory pricing that will cause primary line injury.

Secondary Line Competitive Injury: “Secondary line” competitive injury occurs when discriminatory pricing impacts competition between a recipient of the better price (a “favored purchaser”) and one of its rivals (a “disfavored purchaser”). Injury at this level of the distribution chain can be proved *directly* -- by showing that the disfavored purchaser actually lost sales or profits as a result of the differential pricing, see, *FTC v. Sun Oil Co.*, 371 U.S. 505, 518-519 (1963) (A hallmark of the requisite [secondary line] competitive injury [], is the diversion of

sales or profits from a disfavored purchaser to a favored purchaser). Secondary line injury can also be proved *indirectly* -- based on the inference that, “injury to competition is established *prima facie* by proof of a substantial price discrimination between competing purchasers over time.” *Falls City Indus., Inc.*, *supra*, 460 U.S. at 435, citing *FTC v. Morton Salt Co.*, 334 U.S. 37, 46 & 50-51 (1948). Inferring antitrust injury from the mere fact that a significant price discrimination has occurred (the so-called *Morton Salt* inference) has been criticized because it amplifies the RPA’s tendency to protect competitors rather than competition. See, e.g. *Chroma Lighting v. GTE Prods. Corp.*, 111 F.3d 653, 658 (9th Cir. 1997) (holding that “in a secondary-line Robinson-Patman case, the *Morton Salt* inference that competitive injury to individual buyers harms competition generally may not be overcome by proof of no harm to competition”).

Morton Salt Inference Reconsidered? In its most recent RPA decision the Supreme Court instructed lower courts to construe the RPA “consistently with broader policies of the antitrust laws.” The Court also promised to “resist interpretation geared more to the protection of existing competitors rather than to the stimulation of competition.” *Volvo Trucks North America, Inc. v. Reeder-Simco GMC, inc.* 546 U.S. 164, 180-81 (2006). The Court then repeated its earlier pronouncement that “[i]nterbrand competition . . . is the primary concern of antitrust law,” (quoting *Continental T.V. v. GTE Sylvania, Inc.*, 433 U.S. 36, 51, note 19 [1977]), and pointedly noted that “selective price discounting fosters competition among suppliers of different brands.” *Id.* at 181. Nevertheless, the Court reaffirmed the *Morton Salt* rule that “a permissible inference of [secondary line] competitive injury may arise from evidence that a favored competitor received a significant price reduction over a substantial period of time,” *provided* plaintiff can show that it is in actual competition with the allegedly favored purchaser for the same customer or customers. *Id.* at 177. The *Volvo* plaintiff based its RPA claim on Volvo’s differential discounts to Volvo dealers engaged in intra-brand competitive bid contests. There was no evidence that the favorable discounts were buyer induced (based on the favored dealer’s market power). Under these circumstances the Court held that the only transactions that could support an inference of competitive injury were those that entailed differential discounts in head-to-head competitive bids for sales to the same customers -- which the Court deemed insufficient in number and duration to trigger the usual *Morton Salt* inference. Some lower courts have taken *Volvo* as an reaffirmation, rather than rejection of the *Morton Salt* inference. See, *Feesers, Inc. v. Michael Foods, Inc* 498 F.3d 206, 220 (3rd Cir. 2007) (citing *Volvo* to support its refusal to require that plaintiff disfavored purchasers prove that it had actually lost sales to the favored purchasers); *Danvers Motor Co., Inc. v. Ford Motor Co.*, 2007-1 Trade Cas. (CCH) ¶ 75, 608, 107, 206 -107, 207 (D.N.J. 1/31/07) (relying on *Volvo* to support certification of class claiming class-wide injury based in *Morton Salt* inference).

Private Enforcement, Standing “Antitrust Injury” and Damages: The Supreme Court has held that this “antitrust injury” doctrine applies to private RPA claims. *J. Truett Payne Co. v. Chrysler Motors Corp.*, 451 U.S. 557, 101 S.Ct. 1923 (1981). That means that standing to assert a private RPA claim is only conferred on those who have suffered actual “antitrust injury” -- i.e. injury that (1) is of the type the antitrust laws are intended to prevent, and (2) flows from that which makes the defendant’s acts unlawful. *Brunswick Corp., v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 97 S.Ct. 690 (1977). The *favored* buyer in secondary line injury case always receives a cost advantage in connection with subsequent re-sales, but the *disfavored* buyer (who would be the plaintiff) isn’t automatically entitled to recover the amount of that cost advantage multiplied by the volume of the disfavored buyer’s purchases. *J. Truett Paine Co.*, *supra*, at _____. The

disfavored buyer must also show that the favored buyer's cost advantage "caused" a loss of sales or profits -- which normally requires proof that the cost advantage was actually passed through to the favored buyer's customers, and that the benefit of the pass-through was sufficient to cause a loss or diversion of sales from the disfavored buyer. These additional proof requirements tend to mitigate the impact of the *Morton Salt* inference on defendants in private civil actions to recover damages for price discrimination under the RPA.

Tertiary Line Competitive Injury: "Tertiary line" competitive injury can occur in distribution systems having two or more tiers of resellers (e.g. wholesalers, jobbers, retailers). Firms that participate at different levels of a multi-tier distribution system often perform valuable marketing or distribution-related functions. A seller generally may charge the same net price to all customers regardless of their position in the distribution chain - even if doing so results in *real economic* price discrimination. *Illegal* price discrimination will only occur if the seller charges different prices to purchasers operating at different distribution tiers. The RPA clearly proscribes the charging prices at one level of the distribution chain if it causes or threatens injury to competition at another level of the distribution chain. See, *FTC v. Morton Salt*, 334 U.S. 37, 46-47 (1948) (favorable price that was charged to retailers caused injury to wholesalers); *FTC v. Anheuser-Busch, Inc.*, 363 U.S. 536, 549 (considering and rejecting legislative history suggesting that price differentials do not offend RPA unless effected purchasers are in a competitive relationship with one another). Competitive injury can occur when a wholesaler (having received a first tier discount from its supplier) passes the discount on to some but not all competing retailers, or when a manufacturer and/or its wholesale customers also sell to their own retailers at prices below those charged to their other retailer customers. See, e.g. *Perkins v. Standard Oil Co., of California*, 395 U.S. 642, 644 (1969), (standard sold directly to its own retailers at a price below what it charged to independent retailers (plaintiffs); and standard gave intermediaries a discount that was passed on to retailers that competed with plaintiffs).

Functional Discounts: The discounts granted to wholesalers and jobbers often reflect the marketing and distribution functions they perform. The term "functional discounts" does not appear in the RPA and courts do not recognize a blanket exemption for such discounts. However, the Supreme Court has declared that competitive injury cannot automatically be inferred from the existence of a difference in pricing if the difference "merely accords due recognition and reimbursement for actual marketing functions." *Texaco v. Hasbrouck*, 496 U.S. 543, 562 & 571 (1990). A functional discount defense, "does not demand the rigorous accounting associated with a [statutory] cost justification defense," *Id.* at 561, but it is not clear what cost-related showing must be made. A functional discount might reasonably be related either to the costs incurred by the buyer in performing the pertinent distribution functions, or to the costs that the seller avoids by not performing those functions. In the *Texaco* case, *supra*, the defendant oil company granted special price discounts to two distributors knowing that most of their sales were actually made at the retail level (in competition with plaintiff filling station operators) rather than at the wholesale level. The Court rejected Texaco's claim that the preferred distributors' discounts were "functional" because there was "no substantial evidence indicating that the discounts . . . constituted a reasonable reimbursement for the *value to Texaco* of their actual marketing functions." *Id.* at 562.

3. Buyer Induced Discrimination

The RPA was directed as much against powerful buyers as against sellers. RPA § 2(f) makes it illegal for a buyer “knowingly to induce or receive a discrimination in price which is prohibited” by the Act. However, a buyer cannot violate the Act unless a seller is actually induced to act in violation of the Act-- even if seller avoids liability by meeting competition based on the buyer’s deception. *Great Atlantic & Pacific Tea Co., v. FTC*, 440 U.S. 69 (1979).

4. Indirect Price Discrimination

RPA § 2(a) makes it unlawful “either directly or indirectly, to discriminate in price between purchase of commodities of like grade and quality.” This language prohibits discrimination in the provision of services -- e.g. better delivery, stocking, credit terms (indirect discrimination). Seller must make all allowances or services functionally or proportionally available to competing wholesalers and retailers. “Functionally available” generally means that the offer must be made reasonably available to all buyers regardless of size (e.g. free delivery of over 1000 units not functionally available if only 5% of buyers can order in 1000 unit lots). See, e.g. *Smith Wholesale Co. V. R.J. Reynolds Tobacco Co.*, 477 F.3d 854, 877-880 (6th Cir. 2007) and *Smith Wholesale Co. v. Philip Morris USA Inc.* 219 F. App’x 398 (6th Cir. 2007) (related cases affirming summary judgment for defendants on grounds that tobacco companies’ market share rebates were functionally available to plaintiff wholesalers.). RPA §§ 2(c), 2(d), and 2(e) specifically prohibit sellers and buyers from using brokerage, allowances, and services to accomplish indirectly what sections 2(a) and 2(f) directly prohibit. See generally, *FTC Guides for Advertising Allowances and Other Merchandising Payments and Services*, 16 C.T.R.I., Part 240.

Allowances and Facilities: Sellers can give “allowances” to buyers who perform certain services themselves such as promotion (advertising), handling or hauling -- but such allowances must be made available “on proportionally equal terms.” RPA § 2(d). And the sellers themselves may not furnish one buyer with facilities for processing, handling or resale of a commodity unless the same facilities are made available to all competing buyers on proportionally equal terms. RPA § 2(e). Violations of these RPA provisions are *per se* illegal. However, a private plaintiff seeking damages is not relieved of its burden under Section 4 of the Clayton Act. *Rutman Wine Co. v. E&J Gallo Winery*, 829 F.2d 729, 737 (9th Cir. 1987.)

Brokerage Services: RPA § 2(c) specifically prohibits sellers from granting, and buyers and their agents from receiving anything of value as a commission or brokerage fee (or any allowance in lieu thereof), “except for services rendered in connection with the sale or purchase of goods, wares or merchandise.”

Commercial Bribery: RPA § 2 (c) affords a vehicle for firms to claim an antitrust violation based on conduct that amounts to “commercial bribery.” See, e.g. *FTC v. Henry Braun & Co.*, 363 U.S. 166, 168-169 & n.6 (1960) (Congress “intended to proscribe. . .the ‘bribing’ of a seller broker by the buyer.”); *Environmental Tectonics v. W.S. Kirkpatrick, Inc.*, 847 F.2d 1052,1066 (3rd Cir. 1988) (“this court has concluded that as a general matter commercial bribery is actionable under 2[c]”). Some courts hold that § 2(c) creates *per se* liability for any act of commercial bribery, e.g. *In Town Hotels, L.P. v. Marriott Int’l, Inc.*, 246 F.Supp.2d 469, 480

(S.D.W.Va. 2003) (finding no indication in text or legislative history implying that § 2[c] has only pro-competitive purposes); see also, *Philip Morris, Inc. v. Grinnell Lithographic Co., Inc.*, 67 F.Supp. 2d 126, 137-138 (E.D.N.Y. 1999). Other courts hold that the act of bribery must be shown to have adversely affected plaintiff's ability to compete -- which would normally require evidence of price discrimination. E.g. *Hansel N' Gretel Brand, Inc. v. Stavitsky*, No. 94-Civ - 4027, 1997 WL 543088 *9 (S.D.N.Y. 9/3/97) (commercial bribery . . . has no relation to the inhibition of competition, . . . unless it subjected competitors to discriminatory pricing."); *Federal Paper Board Co. v. Amata*, 693 F.Supp. 1376, 1388-89 (D.Conn. 1988)

5. Statutory Defenses

The RPA contains two very specific affirmative defenses as to which the defendant carries the burden of proof.

Cost Justification Defense: RPA § 2(a) provides: "[N]othing herein contained shall prevent [price] differentials which make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are [] sold or delivered." Despite its apparent application to most volume discounts, the Supreme Court has required sellers to produce highly detailed cost studies that are not practicable for many sellers. *U.S. v. Borden*, 370 U.S. 460 (1962), (limiting customer classifications for cost justification purposes to groups in which there is "a close resemblance of the individual members . . . on the essential point or points which determine the costs considered."). Sellers unable meet the stringent proof requirements of a cost justification defense may be forced to engage in true economic price discrimination (by charging customers the same price even though the cost of serving them is different); or look to the judicially crafted exception for "functional discounts" (discussed, supra).

Good Faith Meeting Competition Defense: RPA § 2(b) provides: "[N]othing herein contained shall prevent a seller rebutting the prima-facie case . . . by showing that his lower price or the furnishing of services or facilities [] was made in good faith to meet an equally low price of a competitor . . .". This statutory "meeting competition" defense permits a seller to meet but not beat competing offers. *Great Atlantic & Pacific Tea Co., v. FTC*, 440 U.S. 69, 82-85 (1979). Earlier cases requiring seller's to verify buyers' claims of lower-priced offers ran afoul of Sherman One's prohibition against the exchange of price information among competitors. see e.g. *FTC v. A.E. Staley Mfg. Co.* 324 U.S. 746 (1945), (buyer's statement that "I can get this cheaper somewhere else," not sufficient to show actual, verifiable knowledge that a competitor had offered a lower bid). More recent decisions permit sellers to rely on buyers' claims provided the buyer's statements are reasonably believable. E.g. *Falls City Indus., Inc. v. Vanco Beverage, Inc.*, 460 U.S. 428,438 (1983), quoting, *U.S. v. United States Gypsum Co.*, 438 U.S. 422, 451 (1978) (meeting competition defense only "requires the seller, who has knowingly discriminated in price, to show the existence of facts which would lead a reasonable and prudent person to believe that the granting of a lower price would in fact meet the equally low price of a competitor."). In addition to meeting a specific offer made by a competitor in connection with a particular sale, a seller can "meet competition" by matching the generally lower price structure found in a different geographic area. *Falls City Industries, Inc., supra*, 460 U.S. at 448.

Suppliers who compete for sales to certain large re-seller customers (e.g. Wal-Mart) are sometimes invited to bid for the supply contract. Price discrimination could occur if (1) the supplier has other re-seller customers who compete with the party soliciting the bids; (2) the competitive bid includes a discount not made available to the other re-seller customers, and (3) the bid is accepted and competing sales are made. Is it feasible (or desirable) for the supplier to discover and meet (but not beat) bids submitted by competitors from whom competing bids are solicited? The FTC has held that the meeting competition defense can apply where the supplier makes a bid calculated in good faith to be approximately equal to the competitor's expected bid. *Beatrice Foods Co.*, 76 FTC 719, 811 (1969), (Beatrice's discounted bid calculated by predicting who the low bidder would be based on known bidding/pricing habits -- and later reduced further in good faith reliance on misleading claims by Kroger). Several courts have adopted FTC's pragmatic approach. See, e.g. *Water Craft Mgmt. LLC v. Mercury Marine*, 361 F.Supp.2d 518, 548-49 (M.D.La. 2004), (competition properly met where bid was based on common though speculative knowledge of competitors' offer): *Reserve Supply Corp. v. Owens Corning Fiberglas Corp.*, 971 F.2d 37, 45-46 (7th Cir. 1992), (buyer's report of competitor's lower offer "[n]ecessarily attendant with [buyer's] . . . message that if the discount is not met, business will shift to the competitor"); *Walker v. Hallmark Cards, Inc.*, 992 F.Supp. 1335, 1340 (M.D. Fla. 1997), (meeting competition defense based on defendant tracking and verifying reports of competitive offers).

Price Discrimination Checklist

- Is there a meaningful price differential considering all elements effecting price (i.e. terms of sale, credit terms & criteria, promotions, allowances, discounts, rebates, free warehousing, free delivery)?
- Are there two or more consummated sale transactions (not leases, consignments, licenses) at least one of which is made at a favorable (lower) price, and at least one at a disfavored (higher) price? To qualify the consummated sales must be
 - made by the same seller
 - to different purchasers
 - reasonably contemporaneously in time (considering seasonal/perishable goods)
 - of a commodity (not service or intangibles such as intellectual property)
 - of like grade and quality (subject to close outs, changed mkt. conditions)
 - “in commerce” (excluding transactions that occurred wholly within one state)
- Does (did) the element that caused the price differential entail
 - A special offer that is “practically available” and properly communicated to all purchasers (including those who paid the disfavored price), or
 - A “functional discount” made available to re-seller customers who perform distribution/marketing functions on behalf of the seller (and if so, is the amount of the discount reasonably related [a] to the cost saved by the seller or [b] to the cost incurred by the re-seller in performing the distribution/marketing function), or
 - A targeted offer made in an effort to meet a competing offer reasonably believed to have been made to the favored purchaser(s) by a competing seller?
- If the differential pricing practice is said to have adversely effected competition between the favored and disfavored purchasers,
 - is there direct evidence that sales were lost by or diverted from disfavored purchasers, or
 - has the seller charged a substantial price differential over a significant period of time (triggering the *Morton Salt* inference), and
 - if the case involves a private civil action to recover damages, can plaintiff prove that the price differential was passed through to the favored purchaser’s customers and that it was significant enough to cause the loss/diversion of plaintiffs’ sales?
- If the differential pricing practice is said to have adversely effected competition between the discriminating seller and its rival sellers,
 - Did the discriminating seller make sales at a price that is (was) lower than its average variable cost (or some other “appropriate measure” of its cost), and if so
 - Does the discriminating seller enjoy a market share or the benefit of entry barriers that provide reasonable assurance that losses incurred during the period of below cost pricing will later be recouped through supra-competitive pricing, and
 - if the case involves a private civil action to recover damages, is the seller’s rival an efficient producer who can show that it has been injured by its inability to profitably meet the discriminating seller’s “predatory” (i.e. below cost) price.