DEVELOPMENTS IN THE LAW OF VERTICAL RESTRAINTS: 2012

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DEVELOPMENTS IN THE LAW OF VERTICAL RESTRAINTS: 2012

I. Standards

A. Are Vertical Resale Price Restraints Still Illegal?

As a result of two U.S. Supreme Court decisions handed down only during the last 15 years, the legality of vertical restraints on maximum and minimum levels of resale prices—known otherwise as resale price maintenance (RPM)[1]—under Section 1 of the Sherman Act[2] is now analyzed under the rule of reason. Specifically, in *State Oil Co. v. Khan*[3] and

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[1] For a judicial definition of resale price maintenance (RPM), *see* Sun Oil Co. v. FTC, 350 F.2d 624, 633 n.15 (7th Cir. 1965) (defining RPM as "'pricing through agreements or conspiracies between two or more persons operating at different levels of the same production–distribution–consumption process.'" (quoting HEINRICH D. KRONSTEIN, MODERN AMERICAN ANTITRUST LAW 145 n.1 (1958))).

[2] 15 U.S.C. § 1 (2010) ("Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal."). Dating back to its 1911 decision in *Standard Oil Co. v. United States*, the Supreme Court has construed Section 1 as outlawing only unreasonable restraints of trade. 221 U.S. 1, 59–60 (1911).

[3] 522 U.S. 3, 22 (1997) ("[V]ertical maximum price fixing, like the majority of commercial arrangements subject to the antitrust laws, should be evaluated under the rule of reason. In our view, rule-of-reason analysis will effectively identify those situations in which vertical maximum price fixing amounts to anticompetitive conduct.") (overruling Albrecht v. Herald Co., 390 U.S. 145 (1968)).

Leegin Creative Leather Products, Inc. v. PSKS, Inc.,[4] the Court held that both vertical maximum RPM and vertical minimum RPM, respectively, are to be given rule-of-reason treatment. Thus, instead of being summarily condemned as per se illegal, business methods and practices involving the use of vertical maximum or minimum RPM are subjected to an individualized factual inquiry into the nature, purpose and history of those restraints, and their actual or likely effect on competition, in accordance with Justice Brandeis's classic and enduring formulation in *Chicago Board of Trade v. United States*.[5] *Khan* and *Leegin* have thus brought the antitrust analysis of vertical price restraints in line with that of vertical non-price restraints such as restrictions on the locations where a franchisee may sell its franchisor's branded products,[6] and designations of

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[4] 551 U.S. 877, 907 (2007) ("Vertical price restraints are to be judged according to the rule of reason.") (overruling Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911)).

[5] 246 U.S. 231, 238 (1918) ("The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts.").

[6] Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 59 (1977) ("In sum, we conclude that the appropriate decision is to return to the rule of reason that governed vertical restrictions prior to *Schwinn*. When anticompetitive effects are shown to result from particular vertical restrictions, they can be

wholesalers as authorized importers of a manufacturer's branded distilled spirits.[7]

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adequately policed under the rule of reason, the standard traditionally applied for the majority of anticompetitive practices challenged under § 1 of the Act.") (overruling United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967)).

GTE Sylvania, *Khan* and *Leegin* are each instances in which the Court concluded that the doctrine of stare decisis did not compel it to adhere to prior precedent applying the per se rule to vertical restraints. In *GTE Sylvania*, however, Justice White expressed discomfort with the Court's willingness to overrule *Schwinn* and took the view that *Schwinn* could instead be distinguished on its facts. *Id.* at 59 (White, J., concurring in judgment). Justice White cautioned his colleagues on the Court that "[t]o reach out to overrule one of this Court's recent interpretations of the Sherman Act, after such a cursory examination of the necessity for doing so, is surely an affront to the principle that considerations of *stare decisis* are to be given particularly strong weight in the area of statutory construction." *Id.* at 60.

Decades later, in *Khan* and *Leegin*, the Court would lay Justice White's stare decisis concerns to rest by characterizing the Sherman Act as a "common-law statute" that gives less force to "the general presumption that legislative changes should be left to Congress" and more credence to the primary role of the courts in "'giv[ing] shape to the statute's broad mandate by drawing on common-law tradition.'" *Khan*, 522 U.S. at 20 (quoting Nat'l Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679, 688 (1978)). *Accord Leegin*, 551 U.S. at 899 ("*Stare decisis* is not as significant in this case, however, because the issue before us is the scope of the Sherman Act.… From the beginning the Court has treated the Sherman Act as a common-law statute.").

[7] Rice v. Norman Williams Co., 458 U.S. 654, 662 (1982) ("The manner in which a distiller utilizes the designation statute and the arrangements a distiller makes with its wholesalers will be subject to Sherman Act analysis under the rule of reason.").

Long before *Khan*, which was decided in 1997, however, the Court had expressed skepticism about the harm caused by vertical price restraints. Specifically, in its 1990 decision in *Atlantic Richfield Co. v. USA Petroleum Co. (ARCO)*,[8] the Court considered the complaint of USA Petroleum (USA), an independent, discount, retail marketer of gasoline that competed directly with Atlantic Richfield (ARCO), a vertically integrated oil company that marketed gasoline through its own gas stations and through ARCO-branded dealers. USA claimed that it had been harmed by ARCO's alleged vertical maximum RPM scheme with ARCO dealers because this scheme had the effect of eliminating "competition that would otherwise exist among ARCO-branded dealers," and fixing, stabilizing, and maintaining the retail price of ARCO-branded gasoline "at artificially low and uncompetitive levels."[9]

The *ARCO* Court held that USA had failed to show antitrust injury required for a private action under Section 4 of the Clayton Act, and that an allegation that the challenged practice is subject to a rule of per se illegality did not obviate the

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[8] 495 U.S. 328 (1990).

[9] *Id.* at 332. USA originally asserted that the alleged vertical maximum RPM scheme constituted both an unlawful restraint of trade in violation of Section 1 of the Sherman Act and an act of attempted monopolization through predatory pricing in violation of Section 2 of the Sherman Act, but it subsequently withdrew the Section 2 claim with prejudice. *Id.* at 332–33. Given USA's withdrawal of its predatory pricing claim, it was assumed on appeal that ARCO's alleged, vertical, maximum-price-fixing scheme was *not* predatory in nature. *Id.* at 333 n.3.

requirement to show antitrust injury.[10] "Although a vertical, maximum-price-fixing agreement is unlawful under § 1 of the Sherman Act, it does not cause a competitor antitrust injury unless it results in predatory pricing.... [I]n the context of pricing practices, only predatory pricing has the requisite anticompetitive effect."[11]

But *ARCO* was more than just a recitation of the antitrust injury requirement previously articulated in *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*,[12] or the distinction between vigorous price cutting and predatory pricing previously observed in *Cargill, Inc.*

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[10] *Id.* at 346.

[11] *Id.* at 339. The Court assumed for the sake of argument "that *Albrecht* correctly held that vertical, maximum price fixing is subject to the per se rule." *Id.* at 335. After *ARCO*, lower courts applied the same analysis of antitrust injury in evaluating claims by complaining dealers as well. *See* Caribe BMW, Inc. v. Bayerische Motoren Werke AG, 19 F.3d 745, 753–54 (1st Cir. 1994) (Breyer, C.J.) (recognizing, at least "in theory," that a complaining dealer may suffer antitrust injury if the vertical maximum-price-fixing agreement "inhibited [the dealer] from selling to those potential BMW customers who would have preferred higher quality service, even if that meant somewhat higher [retail] prices."); Slowiak v. Hudson Foods, Inc., No. 91-C-737-S, 1992 U.S. Dist. LEXIS 9387, at *28–29; 1992-1 Trade Cas. (CCH) ¶ 69,821 (W.D. Wis. Apr. 8, 1992) (holding that a complaining dealer had not been injured by vertical maximum price-fixing because he "was capable of providing all necessary services in connection with the products and was allowed sufficient profits that the maximum price was not a minimum price," and his exclusive territory protected him from being driven out by larger dealers), *aff'd*, 987 F.2d 1293 (7th Cir. 1993).

[12] 429 U.S. 477, 489 (1977).

v. Monfort of Colorado, Inc.[13] Equally importantly, the decision was also an implicit recognition by the Court, based on the record before it, that even a vertical price restraint can have procompetitive effects on interbrand competition—thereby calling into question the wisdom of a rule of per se illegality: "Indeed, the gravamen of [USA's] complaint—that the price-fixing scheme between [ARCO] and its dealers enabled those dealers to increase their sales—amounts to an assertion that the dangers with which we were concerned in *Albrecht* have not materialized in the instant case."[14]

Like the Supreme Court, the U.S. antitrust enforcement agencies have embraced the view that the rule of reason should be applied to business methods and practices involving the use of vertical maximum or minimum RPM. Indeed, the Department of Justice's Antitrust Division (DOJ) and the Federal Trade Commission (FTC) both filed amicus briefs in *Khan* and *Leegin* urging the Court to abandon the per se rule for vertical price restraints.[15] But the

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[13] 479 U.S. 104, 117–18 (1986).

[14] *ARCO*, 495 U.S. at 337.

[15] *See* Brief for the United States as Amicus Curiae Supporting Petitioner at 20 & n.3 (noting that the agencies' enforcement experience does not support a per se condemnation of vertical maximum or minimum RPM based on the possibility that it may facilitate manufacturer or retailer cartelization), Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877 (2007) (No. 06-480); Brief for the United States and the Federal Trade Commission [as] Amici Curiae Supporting Reversal at 25 ("[W]e are aware of no case in which either the Commission or the United States has committed enforcement resources to proceeding against a party on the ground of purely vertical

road to the rule of reason for the agencies can hardly be described as a straight path.

In what can now be regarded as a historical footnote, the DOJ brought its only felony prosecution of vertical price-fixing in the 1980 case of *United States v. Cuisinarts, Inc.*,[16] and then turned around—with the change in administration—to suggest to the Supreme Court in its 1983 amicus brief in *Monsanto Co. v. Spray-Rite Service Corp.*,[17] that "resale price maintenance should not be deemed per se unlawful."[18] The DOJ's abrupt change of position prompted Congress to insert a clause in the agency's appropriation legislation that forbade the

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maximum price fixing."), State Oil Co. v. Khan, 522 U.S. 3 (1997) (No. 96-871).

[16] *See In re* Grand Jury Investigation of Cuisinarts, Inc., 516 F. Supp. 1008, 1010–11 (D. Conn.) (recounting the proceedings in the criminal case, which resulted in a *nolo contendere* plea and a $250,000 fine), *aff'd*, 665 F.2d 24 (2d Cir. 1981). The DOJ also brought a companion civil case that was resolved by consent decree. *See* United States v. Cuisinarts, Inc., Civ. No. H80-559, 1981-1 Trade Cas. (CCH) ¶ 63,979 (D. Conn. Mar. 27, 1981).

[17] 465 U.S. 752 (1984).

[18] Brief for the United States as Amicus Curiae in Support of Petitioner 19, Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752 (1984) (No. 82-914; filed in May 1983). This change of position by the DOJ introduced an element of uncertainty into the follow-on, treble damages class actions spawned by the DOJ's indictment of Cuisinart, which were premised on a rule of per se illegality like the government's case. *See In re* Cuisinart Food Processor Antitrust Litig., No. MDL 447, 1983 U.S. Dist. LEXIS 12412, at *16–17 (D. Conn. Oct. 24, 1983) ("If it were necessary to apply a 'rule of reason' analysis, discovery and trial would necessarily become even more complex, given the large number of commercial relationships involved.").

DOJ from advocating this position to the Court during oral argument.[19] In the end, the issue was moot anyway; the Court declined to address this issue because the case had been tried below with jury instructions on the per se rule, and neither party had ever argued in the district court or on appeal that the rule of reason should apply instead.[20]

After *Monsanto*, the DOJ publicly stuck to the longstanding position that vertical price restraints were per se illegal. For example, in a 1993 speech announcing the rescindment of the agency's 1985 vertical restraint guidelines (which dealt with the treatment of non-price restraints), Anne Bingaman, then the Assistant Attorney General for Antitrust, stated: "Henceforth, the Antitrust Division will treat vertical price fixing as *per se* illegal under the Supreme Court's decisions in *Monsanto* and *Sharp*, and non-price fixing restraints as subject to a *meaningful* rule of reason analysis."[21] This remained

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[19] *See* Dep'ts of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriation Act, 1984, Pub. L. No. 98-166, § 510, 97 Stat. 1071, 1102 (1983); Transcript of Oral Argument at –, 1983 U.S. Trans. LEXIS 18, at *21, Monsanto Co. v. Spray-Rite Serv. Corp., 456 U.S. 752 (1984) (No. 82-914) (*Justice O'Connor:* Mr. Baxter, had Congress not adopted the proviso in its appropriation act, would you have made possibly a different argument to us today? *Mr. Baxter:* We have not withdrawn part 2(b) of our brief, Justice O'Connor. Beyond that I would prefer not to deal with that question.").

[20] *Monsanto*, 465 U.S. at 761 n.7.

[21] Anne K. Bingaman, Asst. Att'y Gen. for Antitrust, U.S. Dep't of Justice, Antitrust Enforcement, Some Initial Thoughts and Actions, Address Before the ABA Section of Antitrust Law, at 6 (Aug. 10, 1993), http://www.justice.gov/atr/public/speeches/0867.pdf. *Accord* Willard K. Tom, Counselor to the Asst. Att'y

the official agency position (as far as the author can tell) until the amicus brief filed in *Khan*.

The FTC took a somewhat less controversial path to rule-of-reason treatment for vertical price restraints. In its 1997 consent decree in *American Cyanamid Co.*,[22] which banned the use of RPM in the sale of American Cyanamid's agricultural herbicides and insecticides, the Commission majority (which included then-Chairman Robert Pitofsky) acknowledged "the Supreme Court's view that resale price maintenance continues to be illegal per se" and "reject[ed] the idea that the Supreme Court can be overruled by scholarly contributions to economic journals."[23] The majority therefore took issue with

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Gen. for Antitrust, U.S. Dep't of Justice, Vertical Price Restraints, Address Before the ABA Section of Antitrust Law, at 2 (Apr. 7, 1994), http://www.justice.gov/atr/public/speeches/0105.pdf ("So that is my starting point: vertical price restraints are per se unlawful.").

[22] Dkt. No. C-3739, 1997 FTC LEXIS 107 (May 16, 1997), *available at* http://www.ftc.gov/os/1997/05/c3739.do.pdf. At the time of the final *American Cyanamid* consent decree, a petition for writ of certiorari had already been granted by the Supreme Court in *Khan*. *See* Khan v. State Oil Co., 93 F.3d 1358 (7th Cir. 1996), *cert. granted in part*, 519 U.S. 1107 (1997).

[23] Stmt. of Chairman Robert Pitofsky & Comm'rs Janet D. Steiger & Christine A. Varney, Fed. Trade Comm'n, Am. Cyanamid Co., Dkt. No. C-3739, 1997 FTC LEXIS 107, at *14–15 (May 16, 1997), *available at* http://www.ftc.gov/os/1997/05/pitovsky.htm. The latter statement—rejecting the notion that Supreme Court precedent can be "overruled by scholarly contributions to economic journals"—would take on a patina of irony after the *Leegin* majority wrote that "*[s]tare decisis*, we conclude, does not compel our continued adherence to the *per se* rule against vertical price restraints. As discussed earlier, respected authorities in the economics literature suggest the *per se* rule is inappropriate, and there is now widespread

Commissioner Roscoe Starek's assertion in dissent that per se treatment should be predicated on evidence of a manufacturer or dealer cartel, or market power.[24]

In its 2000 consent decree in *Nine West Group Inc.*,[25] the FTC enforced a similar ban against the use of RPM, this time with respect to the sale of Nine West's branded women's footwear. Commissioners Orson Swindle and Thomas Leary issued a statement, however, in which they openly questioned whether their conclusions and votes would have been different were vertical minimum RPM analyzed under the rule of reason—consistently with the treatment of vertical maximum RPM after the Supreme Court's 1997 decision in *Khan*.[26]

Years later, in 2008, the FTC would get the opportunity to reexamine its decision in *Nine West*

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agreement that resale price maintenance can have procompetitive effects." Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 900 (2007).

[24] *Compare* Stmt. of Chairman Robert Pitofsky et al., 1997 FTC LEXIS 107, at *14, *with* Dissenting Stmt. of Comm'r Roscoe B. Starek, III, Fed. Trade Comm'n, Am. Cyanamid Co., Dkt. No. C-3739, 1997 FTC LEXIS 107, at *35–42 (May 16, 1997), *available at* http://www.ftc.gov/os/1997/05/starek.htm.

[25] Dkt. No. C-3937, 2000 FTC LEXIS 48 (Apr. 11, 2000), *available at* http://www.ftc.gov/os/2000/04/ninewest.do.htm.

[26] Stmt. of Comm'rs Orson Swindle & Thomas B. Leary, Fed. Trade Comm'n, Nine West Grp. Inc., Dkt. No. C-3937, 2000 FTC LEXIS 48, at *6 (Apr. 11, 2000) ("We do not know what conclusion we might have reached had Nine West's behavior been analyzed under the rule of reason, because that question did not arise."), *available at* http://www.ftc.gov/os/2000/04/ninewestswindleleary.htm.

Group Inc.,[27] following the Supreme Court's 2007 decision in *Leegin*. Specifically, the FTC granted Nine West's petition to reopen and modify the consent order based on changed conditions of law with respect to RPM agreements after *Leegin*.[28] The agency concluded that Nine West should be permitted to engage in RPM agreements because Nine West had shown that it lacks market power and is itself the impetus behind the use of RPM.[29]

The FTC also took from the Supreme Court's discussion of RPM in *Leegin*, however, the view that circumstances can arise in which RPM "can be considered … as 'inherently suspect,' and thus a worthy object for the scrutiny under the presumptions and phased inquiries that the D.C. Circuit approved in *Polygram Holding* for certain horizontal restraints."[30] Because circumstances in the relevant

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[27] Dkt. No. C-3937, 2008 FTC LEXIS 53 (May 6, 2008), *available at* http://www.ftc.gov/os/caselist/9810386/080506order.pdf.

[28] *Id.*, 2008 FTC LEXIS 53, at *3. The FTC granted similar relief to Sharp Electronics after the per se ban on vertical non-price restraints in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), was overruled by the Supreme Court in *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977). *See* Sharp Elecs. Corp., Dkt. No. C-2574, 84 F.T.C. 743 (1974), *reopened and modified*, 112 F.T.C. 303 (1989).

[29] *Nine West*, 2008 FTC LEXIS 53, at *25–26 & *29. Nine West asserted that it wanted to use RPM agreements "to increase the services offered by retailers that sell Nine West products." *Id.* at *26.

[30] *Id.* at *21–22 (referring to the "inherently suspect" formulation of a truncated rule-of-reason analysis approved by the D.C. Circuit in *Polygram Holding, Inc. v. FTC*, 416 F.3d 29 (D.C. Cir. 2005)).

market can change, the agency concluded that it would be necessary and proper to monitor the effects of Nine West's use of RPM on prices and output, and to impose certain reporting obligations on Nine West to facilitate that monitoring.[31]

B. When, If Ever, Might a Vertical Resale Price Restraint Violate the Rule of Reason?

In placing vertical price restraints under the rule of reason, the Supreme Court made clear that this does not mean that those restraints are per se legal.[32] Rather, *Khan* and *Leegin* reflect the Court's judgment that the anticompetitive concerns that have historically been cited against the use of vertical price restraints can be adequately dealt with on a case-by-case basis under the rule of reason.[33]

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[31] *Id.* at *28–29.

[32] Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 905 (2007) ("The rule of reason … does not treat vertical price restraints as *per se* legal."); State Oil Co. v. Khan, 522 U.S. 3, 22 (1997) ("In overruling *Albrecht*, we of course do not hold that all vertical maximum price fixing is *per se* lawful.").

[33] *Leegin*, 551 U.S. at 897 ("If the rule of reason were to apply to vertical price restraints, courts would have to be diligent in eliminating their anticompetitive uses from the market. This is a realistic objective, and certain factors are relevant to the inquiry."); *Khan*, 522 U.S. at 17 ("[W]e believe that such conduct—as with the other concerns articulated in *Albrecht*—can be appropriately recognized and punished under the rule of reason.") & 22 ("In our view, rule-of-reason analysis will effectively identify those situations in which vertical maximum price fixing amounts to anticompetitive conduct.").

The Court in *Khan* thus did not do away with the scenarios articulated in *Albrecht* that might create—at least in theory—a cause for concern regarding the use of vertical maximum RPM. Specifically, there remains the possibility—factually unlikely though it may be—that such restraints could be used to: (1) interfere with dealer freedom;[34] (2) set too low a price for dealers "to offer consumers essential or desired services";[35] (3) preferentially favor distribution by large or specially advantaged dealers;[36] or (4) disguise an arrangement to fix minimum prices (itself not necessarily unlawful after *Leegin*).[37] Under each of these scenarios, a trial court would be expected to weigh the perceived harm flowing from the use of vertical maximum RPM against the potential consequence for competition and consumers should such use be forbidden.[38]

Similarly, the Court in *Leegin* articulated several scenarios under which the use of vertical minimum RPM may have anticompetitive consequences. Specifically, such restraints may be used to: (1) facilitate a manufacturer cartel;[39] (2) facilitate a retailer cartel;[40] or (3) advance the anticompetitive interests of a

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[34] *Khan*, 522 U.S. at 16.

[35] *Id.* at 17.

[36] *Id.*

[37] *Id.*

[38] *Id.* at 18.

[39] Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 892 (2007).

[40] *Id.* at 893. The working premise here is that since a horizontal cartel among competing manufacturers or competing

dominant or powerful manufacturer or retailer.[41] To identify such scenarios, the Court suggested some factors: namely, (1) the number of manufacturers within a given industry that make use of vertical minimum RPM;[42] (2) the source of or impetus for using vertical minimum RPM;[43] and (3) whether the relevant entity possesses market power.[44]

In addition to identifying the scenarios and factors that may point to an anticompetitive use of vertical price restraints, the Court in *Leegin* also suggested

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retailers is per se unlawful, a vertical RPM agreement that facilitates such conduct would need to be held unlawful as well under the rule of reason. *Id.*

[41] *Id.* at 893–94 ("A dominant retailer, for example, might request resale price maintenance to forestall innovation in distribution that decreases costs.... A manufacturer with market power, by comparison, might use resale price maintenance to give retailers an incentive not to sell the products of smaller rivals or new entrants.").

[42] *Id.* at 897 ("When only a few manufacturers lacking market power adopt the practice, there is little likelihood it is facilitating a manufacturer cartel, for a cartel then can be undercut by rival manufacturers.... Likewise, a retailer cartel is unlikely when only a single manufacturer in a competitive market uses resale price maintenance.").

[43] *Id.* at 897–98 ("If there is evidence retailers were the impetus for a vertical price restraint, there is a greater likelihood that the restraint facilitates a retailer cartel or supports a dominant, inefficient retailer.... If, by contrast, a manufacturer adopted the policy independent of retailer pressure, the restraint is less likely to promote anticompetitive conduct.").

[44] *Id.* at 898 ("As a final matter, that a dominant manufacturer or retailer can abuse resale price maintenance for anticompetitive purposes may not be a serious concern unless the relevant entity has market power.").

that the rule-of-reason analysis need not always be an elaborate, comprehensive inquiry of the sort described in *Chicago Board of Trade*.[45] Instead:

> As courts gain experience considering the effects of these restraints by applying the rule of reason over the course of decisions, they can establish the litigation structure to ensure the rule operates to eliminate anticompetitive restraints from the market and to provide more guidance to businessmen. Courts can, for example, devise rules over time for offering proof, or even presumptions where justified, to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints and to promote procompetitive ones.[46]

In *Nine West Group*, discussed in Section I.A *supra*, the FTC interpreted the above quoted passage to mean that a truncated or "quick look" rule-of-reason analysis, such as the "inherently suspect" formulation adopted in *Polygram Holding*,[47] may be

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[45] *See supra* note 5 and accompanying text.

[46] *Leegin*, 551 U.S. at 898–99.

[47] Polygram Holding, Inc. v. FTC, 416 F.3d 29, 36 (D.C. Cir. 2005) ("If, based upon economic learning and the experience of the market, it is obvious that a restraint of trade likely impairs competition, then the restraint is presumed unlawful and, in order to avoid liability, the defendant must either identify some reason the restraint is unlikely to harm consumers or identify some competitive benefit that plausibly offsets the apparent or anticipated harm."). For example, an antitrust defendant might show that notwithstanding its impact on price, a vertical minimum RPM agreement will increase output, thereby demonstrating that the practice enhances product variety and consumer choice. If there is such evidence, then the burden of persuasion will shift back to the

appropriate under some circumstances.[48] In *Leegin*, however, the Fifth Circuit, in a second appeal after remand from the Supreme Court, saw no need to decide whether Leegin's RPM arrangements should be deemed "presumptively illegal" or "inherently suspect" because PSKS's vertical price restraint claim failed anyway as a matter of market definition.[49]

In *Toledo Mack Sales & Service, Inc. v. Mack Trucks, Inc.*,[50] decided after *Leegin*, the Third Circuit concluded on summary judgment that Toledo Mack Sales & Service, an authorized dealer of Mack trucks, had presented sufficient evidence of an illegal RPM agreement between the manufacturer, Mack Trucks, and its dealers.[51] The court of appeals based its conclusion on, among other determinations, the presence of one or more of the *Leegin* "plus" factors—namely, evidence showing that Mack Trucks

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antitrust plaintiff to show that the practice, on balance, is pernicious to competition.

[48] Nine West Grp., Inc., Dkt. No. C-3937, 2008 FTC LEXIS 53, at *19 (May 6, 2008) ("The *Leegin* decision may be read to suggest a truncated analysis, such as the one applied in *Polygram Holdings,* might be suitable for analyzing minimum resale price maintenance agreements, at least under some circumstances."), *available at* http://www.ftc.gov/os/caselist/9810386/080506order.pdf.

[49] PSKS, Inc. v. Leegin Creative Leather Prods., Inc., 615 F.3d 412, 417 (5th Cir. 2010), *cert. denied*, 131 S. Ct. 1476 (2011).

[50] 530 F.3d 204 (3d Cir. 2008).

[51] *Id.* at 226. One effect of the alleged agreement "was a *de facto* ban on out-of-AOR sales by dealers like Toledo that sought to compete with other dealers on price." *Id.* at 221.

possessed market power in two different product markets; and that the vertical agreement between Mack Trucks and its dealers was being used to support an illegal horizontal agreement among Mack dealers to control prices.[52] The Third Circuit therefore vacated and remanded the district court's decision dismissing Toledo's vertical price restraint claim.[53]

An example of a recent agency enforcement action that prohibited—consistently with *Leegin*—the use of RPM as a facilitating practice for a horizontal manufacturer or dealer cartel is the FTC's consent decree in *National Association of Music Merchants, Inc.*[54] In that case, the National Association of Music Merchants, a trade association that counted among its members most U.S. manufacturers, distributors, and dealers of musical instruments, agreed to provisions that prohibit its encouragement of or involvement in information exchanges or conspiracies between or among manufacturers or dealers of musical instruments, and relating to prices for musical instruments or price terms or conditions like RPM policies.[55]

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[52] *Id.* at 226.

[53] *Id.*

[54] Decision & Order, Nat'l Ass'n of Music Merchants, Inc., Dkt. No. C-4255, 2009 FTC LEXIS 75, at *7–8 (Apr. 8, 2009), *available at* http://www.ftc.gov/os/caselist/0010203/090410nammdo.pdf.

[55] *Id.* § II.A.

II. Elements

A. What Constitutes a Vertical Restraint? The Problem of the Coerced Dealer

Vertical restraints, like any other business conduct or practice proscribed by Section 1 of the Sherman Act, must meet the statutory requirement of a "contract, combination …, or conspiracy, in restraint of trade or commerce[.]"[56] Thus, purely unilateral conduct will not suffice, such as when a manufacturer terminates or refuses to supply a dealer pursuant to a pre-announced policy that dealers who fail to adhere to its prescribed prices will risk termination, loss of business, or other adverse consequences. This is, of course, the famous *Colgate* doctrine,[57] and it is based on the longstanding view that a manufacturer or supplier has an unfettered right to decide with whom it will do business.[58]

But the *Colgate* doctrine, despite its simplicity in the abstract, has proven to be difficult and complex

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[56] 15 U.S.C. § 1 (2010).

[57] United States v. Colgate & Co., 250 U.S. 300, 307 (1919) ("In the absence of any purpose to create or maintain a monopoly, the [Sherman Act] does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal. And, of course, he may announce in advance the circumstances under which he will refuse to sell.").

[58] *See, e.g.,* Eastern States Retail Lumber Dealers' Ass'n v. United States, 234 U.S. 600, 614 (1914) ("A retail dealer has the unquestioned right to stop dealing with a wholesaler for reasons sufficient to himself, and may do so because he thinks such dealer is acting unfairly in trying to undermine his trade.").

in real-life application. It has thus spawned a number of Supreme Court (and lower court) decisions that have attempted to clarify its contours and limit its scope. Notably, in *United States v. Parke, Davis & Co.*,[59] the Court traced the evolution of the *Colgate* doctrine through a series of subsequent Court decisions[60] and purportedly clarified the doctrine as follows:

> Thus, whatever uncertainty previously existed as to the scope of the *Colgate* doctrine, *Bausch & Lomb* and *Beech-Nut* plainly fashioned its dimensions as meaning no more than that a simple refusal to sell to customers who will not resell at prices suggested by the seller is permissible under the Sherman Act. In other words, an unlawful combination is not just such as arises from a price maintenance *agreement*, express or implied; such a combination is also organized if the producer secures adherence to his suggested prices by means which go beyond his mere declination to sell to a customer who will not observe his announced policy.[61]

The *Parke, Davis* majority added that "[w]hen the manufacturer's actions, as here, go beyond mere announcement of his policy and the simple refusal to deal, *and he employs other means which effect adherence to his resale prices*, this countervailing consideration is not present and therefore he has put

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[59] 362 U.S. 29 (1960).

[60] *Id.* at 36–43.

[61] *Id.* at 43 (citing United States v. Bausch & Lomb Optical Co., 321 U.S. 707 (1944), and FTC v. Beech-Nut Packing Co., 257 U.S. 441 (1922)).

together a combination in violation of the Sherman Act."[62]

Three Justices dissented from the *Parke, Davis* majority's purported clarification and narrowing of the *Colgate* doctrine, however. In their view, the majority's restatement failed to clarify the doctrine because it remained unclear whether and how "other means" beyond a "simple refusal to deal," taken by a manufacturer to "effect adherence" to its pre-announced policy, would necessarily push the relevant facts within the proscription of a contract, combination, or conspiracy under Section 1.[63] Moreover, in the dissent's view, the majority's approach would transform the basis of the *Colgate* doctrine from one of statutory construction (i.e., the absence of concerted action required by Section 1) to one of social and economic policy (i.e., the point at which a manufacturer should be seen as overstepping the bounds of its prerogative to deal with whom it chooses).[64]

Along these lines, one question that has come up repeatedly in both the Supreme Court and the lower

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[62] *Id.* at 44 (emphasis added).

[63] *Id.* at 53 (Harlan, J., dissenting) ("But we are left wholly in the dark as to what the purported new standard is for establishing a 'contract, combination … or conspiracy.'"). Stated differently, even if a manufacturer takes additional steps beyond a pre-announced policy and simple refusal to deal, those steps arguably might still constitute unilateral action.

[64] *Id.* at 57 (Harlan, J., dissenting) ("But contrary to the long understanding of bench and bar, the Court treats *Colgate* as turning not on the absence of the concerted action explicitly required by §§ 1 and 3 of the Sherman Act, but upon the Court's notion of 'countervailing' social policies.").

courts after *Colgate* is whether manufacturer coercion of dealer adherence would take the relevant facts outside the doctrine's shelter and within the realm of concerted action. For example, *FTC v. Beech-Nut Packing Co.*[65] has been characterized as a coercion case in subsequent Supreme Court cases.[66] *Parke, Davis*,[67] too, has been read to mean "that a

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[65] 257 U.S. 441, 454 (1922) (observing that a trader that failed to adhere to Beech-Nut's "suggested" prices "is subject to be reported to the company either by special agents, … or by dealers[,]" and furthermore, "is enrolled upon a list known as 'Undesirable—Price Cutters,' to whom goods are not to be sold").

[66] United States v. Bausch & Lomb Optical Co., 321 U.S. 707, 722 (1944) ("The Beech-Nut Company, without agreements, was found to suppress the freedom of competition by coercion of its customers through special agents of the company, by reports of competitors about customers who violated resale prices, and by boycotts of price cutters."). *Accord Parke, Davis*, 362 U.S. at 42. It should be noted, however, that *Beech-Nut* involved a standalone claim under Section 5 of the FTC Act, and the Sherman Act was relevant only "in so far as it shows a declaration of public policy to be considered in determining what are unfair methods of competition, which the Federal Trade Commission is empowered to condemn and suppress." 257 U.S. at 453.

[67] In *Parke, Davis*, the majority held:

> But if a manufacturer is unwilling to rely on individual self-interest to bring about general voluntary acquiescence which has the collateral effect of eliminating price competition, and takes affirmative action to achieve uniform adherence by inducing each customer to adhere to avoid such price competition, the customers' acquiescence is not then a matter of individual free choice prompted alone by the desirability of the product. The product then comes packaged in a competition-free wrapping—a valuable feature in

supplier may not use coercion on its retail outlets to achieve resale price maintenance."[68] Moreover, in *Albrecht v. Herald Co.*,[69] the Court suggested in dictum that an illegal combination under Section 1 can be created in situations where a manufacturer coerces dealer adherence to resale prices.[70]

Notwithstanding these pronouncements from the Supreme Court, there has been a considerable amount of confusion among the lower courts over what exactly constitutes "coercion." This confusion can be seen in the following two examples from the case law.

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itself—by virtue of concerted action induced by the manufacturer.

362 U.S. at 46–47.

[68] Simpson v. Union Oil Co., 377 U.S. 13, 17 (1964) ("We made clear in *United States v. Parke, Davis & Co.,* 362 U.S. 29, that a supplier may not use coercion on its retail outlets to achieve resale price maintenance. We reiterate that view, adding that it matters not what the coercive device is.").

[69] 390 U.S. 145 (1968), *overruled on other grounds by* State Oil Co. v. Khan, 522 U.S. 3 (1997).

[70] *Id.* at 150 n.6 ("Under *Parke, Davis* petitioner could have claimed a combination between respondent and himself, at least as of the day he unwillingly complied with respondent's advertised price.… These additional claims, however, appear to have been abandoned by petitioner when he amended his complaint in the trial court."). *Accord* Perma Life Mufflers, Inc. v. Int'l Parts Corp., 392 U.S. 134, 142 (1968) (observing that the franchisee plaintiff may charge a conspiracy based on its unwilling compliance with a restrictive franchise agreement), *overruled on other grounds by* Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984).

In *The Jeanery, Inc. v. James Jeans, Inc.*,[71] the Ninth Circuit reiterated its view that "overt coercion attempting to ensure compliance through threats or demands" must be distinguished—by the context in which such threats or demands are made—from "mere exposition, persuasion, argument, or pressure."[72] Applying this distinction, the court of appeals held that a manufacturer's advice to a dealer that its policy is to terminate dealers that do not sell at the suggested resale price was "legitimate pressure … consistent with the privilege of independent action permitted a manufacturer under *Colgate*."[73] The court added that even if there is evidence of coercive threats, under Section 1 of the Sherman Act "it takes two to tango," and therefore, in accordance with *Monsanto Co. v. Spray-Rite Service Corp.*,[74] there must be evidence that the dealers who allegedly have been coerced communicated their acquiescence to the manufacturer's preannounced RPM policy.[75]

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[71] 849 F.2d 1148 (9th Cir. 1988).

[72] *Id.* at 1158–59 (quoting Filco v. Amana Refrigeration, Inc., 709 F.2d 1257, 1263 (9th Cir.), *cert. dismissed*, 464 U.S. 956 (1983)) (internal quotations omitted).

[73] *Id.* at 1159.

[74] 465 U.S. 752, 764 n.9 (1984) ("The concept of 'a meeting of the minds' … means as well that evidence must be presented both that the distributor communicated its acquiescence or agreement, and that this was sought by the manufacturer.").

[75] *Jeanery*, 849 F.2d at 1160 (quoting *Monsanto*, 465 U.S. at 764 n.9). *See also* Parkway Gallery Furniture, Inc. v. Kittinger/Pennsylvania House Grp., Inc., 878 F.2d 801, 806 n.5 (4th Cir. 1989) (holding that "participation as unwilling co-conspirators" requires "'acquiescence in … firmly enforced

By contrast, in *Isaksen v. Vermont Castings, Inc.*,[76] Judge Posner of the Seventh Circuit held that cases like *Parke, Davis* and *Albrecht* involving some evidence of coercion simply mean "that a plaintiff who is an involuntary participant must prove that the defendant induced his participation by conduct that went beyond merely announcing a policy of terminating dealers who sell below suggested retail prices[.]"[77] In his view, *Monsanto* did not "go so far as to rule that if a supplier telephones a dealer and tells him 'Raise your price by next Thursday, or I'll ship you defective goods,' and the dealer merely grunts, but complies, this is not actionable as an agreement to fix dealer's resale price."[78]

In summary, the lower courts seem to be in agreement that "coercion" requires additional conduct on the part of a manufacturer beyond announcing a policy of terminating dealers who fail to adhere to a suggested resale price and securing "unwilling compliance" by virtue of the latent threat

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restraints … induced by the communicated danger of termination.'" (quoting Perma Life Mufflers, Inc. v. Int'l Parts Corp., 392 U.S. 134, 142 (1968))). *But see Jeanery*, 849 F.2d at 1165 (Reinhardt, J., dissenting) ("The majority gives no authority—and certainly none can be found in *Colgate* or *Monsanto*—for the position that a manufacturer may not only unilaterally terminate a dealer, but it may also use a variety of intermediate coercive tactics designed to disrupt the dealer's business operations, without fear of running afoul of the antitrust laws.").

[76] 825 F.2d 1158 (7th Cir. 1987).

[77] *Id.* at 1163.

[78] *Id.* at 1164.

contained in that announced policy.[79] They remain divided in their views, however, as to what additional conduct will suffice to show "coercion," and whether there must also be some "communicated acquiescence" on the part of dealers beyond their begrudging compliance with the policy.

B. What Constitutes a Vertical Restraint? The Problem of the Complaining Dealer

As mentioned above, the *Colgate* doctrine permits a manufacturer to terminate any dealer who fails to adhere to its pre-announced RPM policy. Both the announced policy on resale prices and the termination (or refusal to deal) are unilateral actions taken by the manufacturer, which by definition do not fall within the proscription of Section 1 of the Sherman Act. Does this analysis change, however, where there is arguably a causal relationship between the termination of a noncomplying dealer pursuant to the announced policy and a complaint

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[79] *See, e.g.,* Russell Stover Candies, Inc. v. FTC, 718 F.2d 256, 259 & n.6 (8th Cir. 1983) (holding that if the *Colgate* doctrine is to have any vitality, there instead must be a showing of "plus factors" that take the case outside the doctrine, such as evidence of coercive tactics); Yentsch v. Texaco, Inc., 630 F.2d 46, 52 (2d Cir. 1980) ("Taken together, then, *Parke, Davis* and *Albrecht* stand for the basic proposition that use of coercion that achieves actual price-fixing is illegal."); Aladdin Oil Co. v. Texaco, Inc., 603 F.2d 1107, 1117–18 (5th Cir. 1979) ("Taken together, these cases suggest that a case of illegal resale price maintenance is made out when a price is announced and some course of action is undertaken or threatened contingent on the willingness or unwillingness of the retailer to adopt the price." (quoting Butera v. Sun Oil Co., 496 F.2d 434, 436–37 (1st Cir. 1974))).

made about the terminated dealer by another dealer to the manufacturer? In other words, could the causal relationship between the dealer's complaint and the manufacturer's termination support a finding of concerted action under Section 1 with respect to vertical price-fixing?

To answer this question, one must remember that a violation of Section 1 of the Sherman Act requires two elements: (1) an agreement (i.e., contract, combination, or conspiracy), and (2) an unlawful objective or scheme (i.e., an unreasonable restraint of trade or commerce—in this case, vertical price-fixing).

With respect to the first element, the Supreme Court held in *Monsanto Co. v. Spray-Rite Service Corp.*[80] that dealer complaints about "price cutters" alone are not enough to establish an agreement.[81] There are at least two reasons why that should be so. First, complaints about the activities of rival dealers are a normal byproduct of a competitive distribution system.[82] Second, such complaints are an important source of information for the manufacturer, who

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[80] 465 U.S. 752 (1984).

[81] *Id.* at 763 ("Permitting an agreement to be inferred merely from the existence of complaints, or even from the fact that termination came about 'in response to' complaints, could deter or penalize perfectly legitimate conduct.").

[82] *Id.* ("As Monsanto points out, complaints about price cutters 'are natural—and from the manufacturer's perspective, unavoidable—reactions by distributors to the activities of their rivals.' Such complaints, particularly where the manufacturer has imposed a costly set of nonprice restrictions, 'arise in the normal course of business and do not indicate illegal concerted action.'") (citation omitted).

must coordinate with all of its dealers to ensure an efficient distribution system.[83]

Based on these reasons, the *Monsanto* Court held that "something more than evidence of complaints is needed[;] [t]here must be evidence that tends to exclude the possibility that the manufacturer and nonterminated distributors were acting independently."[84] More specifically, what is expected from an antitrust plaintiff is "direct or circumstantial evidence that reasonably tends to prove that the manufacturer and others 'had a conscious commitment to a common scheme designed to achieve an unlawful objective.'"[85]

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[83] *Id.* at 763–64 ("Moreover, distributors are an important source of information for manufacturers. In order to assure an efficient distribution system, manufacturers and distributors constantly must coordinate their activities to assure that their product will reach the consumer persuasively and efficiently.") (citations omitted).

[84] *Id.* at 764. The Court clarified, however, that it did not mean to say that evidence of complaints had no probative value. Rather, the burden remained on an antitrust plaintiff to come forward with additional evidence of the existence of a contract, combination, or conspiracy. *Id.* at 764 n.8.

[85] *Id.* at 764 (quoting Edward J. Sweeney & Sons, Inc. v. Texaco, Inc., 637 F.2d 105, 111 n.2 (3d Cir. 1980), *cert. denied*, 451 U.S. 911 (1981)). *Accord* Bailey's, Inc. v. Windsor Am., Inc., 948 F.2d 1018, 1030 (6th Cir. 1991) (holding that there was no evidence that Windsor, the manufacturer, entered into any vertical price-fixing agreement because the reasonable inference was that Windsor "terminated direct sales to one customer in order to retain or increase the volume of business it did with other customers," which in of itself is not illegal); Garment Dist., Inc. v. Belk Stores Servs., Inc., 799 F.2d 905, 908–09 (4th Cir. 1986) (holding that there was no "conscious commitment to a common scheme designed to achieve an unlawful objective" because Belk, the complaining retailer, and

Four years later, in *Business Electronics Corp. v. Sharp Electronics Corp.*,[86] the Supreme Court addressed the question of dealer complaints from the standpoint of the second element of a Section 1 violation. At issue was the district court's instruction to the jury that an agreement or understanding between a manufacturer and a dealer that a rival dealer is to be terminated for its price-cutting was per se unlawful under Section 1: "A combination, agreement or understanding to terminate a dealer because of his price cutting unreasonably restrains trade and cannot be justified for any reason.... If a dealer demands that a manufacturer terminate a price cutting dealer, and the manufacturer agrees to do so, the agreement is illegal if the manufacturer's purpose is to eliminate the price cutting."[87]

The *Business Electronics* Court rejected the district court's "per se rule" against price-cutting because "[t]here has been no showing here that an agreement between a manufacturer and a dealer to terminate a 'price cutter,' without a further agreement on the price or price levels to be charged by the remaining dealer, almost always tends to

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Jantzen, the manufacturer, pursued different goals: "Belk brought pressure against Jantzen in order to eliminate a discount competitor. Jantzen, weighing the advantages of selling to 200 Belk stores against selling to the Garment District, opted to drop the Garment District. Although Jantzen responded favorably to Belk's complaints about the Garment District, it did not enter into any agreement with Belk to fix or maintain retail prices.").

[86] 485 U.S. 717 (1988).

[87] *Id.* at 722.

restrict competition and reduce output."[88] The Court resisted the invitation to indulge in formalism under which "only those agreements imposing vertical restraints that contain the word 'price,' or that affect the 'prices' charged by dealers" would be invalidated as per se illegal.[89] Instead, the Court observed that all vertical, non-price restraints will have some effect on the prices charged by dealers to the extent they are intended to ensure that dealers will find it sufficiently profitable to offer additional, desirable services to consumers.[90]

In summary, although *Business Electronics* and *Monsanto* reaffirmed the per se rule against vertical price-fixing,[91] the Supreme Court took great care to ensure that the rule's application—and the attendant exposure to treble damages liability—would not chill a manufacturer's exercise of its independent business judgment or its use of potentially procompetitive, vertical, non-price restraints.[92] The

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[88] *Id.* at 726–27.

[89] *Id.* at 728.

[90] *Id.* at 727–28.

[91] *Id.* at 724; Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 761 (1984).

[92] *Business Electronics*, 485 U.S. at 728 ("Manufacturers would be likely to forgo legitimate and competitively useful conduct rather than risk treble damages and perhaps even criminal penalties."); *Monsanto*, 465 U.S. at 763 ("Nevertheless, it is of considerable importance that independent action by the manufacturer, and concerted action on nonprice restrictions, be distinguished from price-fixing agreements, since under present law the latter are subject to per se treatment and treble damages.").

two decisions also underscored the Court's abiding concern with "highly ambiguous evidence" being used to infer a price-fixing conspiracy, which could have the effect of "seriously eroding" the doctrines set forth in *Colgate* (i.e., freedom of manufacturers to take independent, unilateral actions) and *GTE Sylvania* (evaluation of the legality of vertical, non-price restraints based on their market impact).[93]

An example of a lower court that has applied the reasoning and analysis from both *Monsanto* and *Business Electronics* is the Ninth Circuit in *The Jeanery, Inc. v. James Jeans, Inc.*,[94] discussed in Section II.A *supra*. In that case, the court of appeals concluded, consistent with *Monsanto*, that multiple

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[93] *Monsanto*, 465 U.S. at 763 ("If an inference of such an agreement may be drawn from highly ambiguous evidence, there is a considerable danger that the doctrines enunciated in *Sylvania* and *Colgate* will be seriously eroded."). *Accord Business Electronics*, 485 U.S. at 726 ("We have been solicitous to assure that the market-freeing effect of our decision in *GTE Sylvania* is not frustrated by related legal rules." (quoting *Monsanto*)). *See also* H.L. Hayden Co., Inc. v. Siemens Med. Sys., Inc., 879 F.2d 1005, 1016 (2d Cir. 1989) (affirming summary judgment where the plaintiffs' evidence was "at best ambiguous"; "the mere fact that a business reason advanced by a defendant for its cut-off of a customer is undermined does not, by itself, justify the inference that the conduct was therefore the result of a conspiracy"); McCabe's Furniture, Inc. v. La-Z-Boy Chair Co., 798 F.2d 323, 330 (8th Cir. 1986) ("The evidence demonstrates that La-Z-Boy and Opferman were motivated by a variety of factors, price among them…. The evidence which the jury could have relied upon to discard La-Z-Boy's nonprice justifications as pretextual is precisely the kind of 'highly ambiguous evidence' … that *Monsanto* warns must not be considered by the jury."), *cert. denied*, 486 U.S. 1005 (1988).

[94] 849 F.2d 1148 (9th Cir. 1988).

complaints by competing retailers about The Jeanery's "persistent price-cutting," and the fact that The Jeanery was terminated in response to these complaints—standing alone—did not support an inference of a conspiracy.[95] The court further held that even if James Jeans's response to a major customer that it would "take care of things" could be construed to create an agreement to terminate The Jeanery, that response nevertheless failed to establish an agreement on "price or price levels," as required by *Business Electronics*.[96]

C. What Constitutes a Vertical Restraint? The Problem of Conspiring Dealers

The preceding section dealt with the scenario of a dealer that complains to a manufacturer about a price-cutting rival. What about the scenario of two or more dealers that conspire to eliminate a price-cutting rival? On this question the Supreme Court has consistently held that a conspiracy between or among dealers within a distribution system should be treated as a horizontal restraint of trade that is subject to the per se rule, and not as a vertical restraint.

The seminal case on this question is arguably *United States v. General Motors Corp.*,[97] decided by the Court in 1966. That case concerned an alleged effort by associations of franchised Chevrolet dealers, with GM's cooperation, to prevent some dealers from

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[95] *Id.* at 1157–58.

[96] *Id.* at 1158.

[97] 384 U.S. 127 (1966).

supplying independent "discount houses" with Chevrolet cars. The DOJ prosecuted the case criminally but the defendants were found not guilty after trial. The DOJ also brought a parallel civil action, which similarly resulted in a judgment for the defendants and led to the appeal to the Supreme Court.

The Court labeled as a red herring questions raised by the parties concerning the meaning, effect, or validity of the "location clause" in the Chevrolet dealer franchise agreements, which arguably might have allowed GM to treat the supply of cars by its dealers to discount houses for sale as an unauthorized change of business location or unauthorized establishment of a new business location.[98] In the Court's view, it did not matter whether GM could have unilaterally and lawfully enforced this clause against the dealers who were doing business with the discount houses.[99] Rather, what "[w]e have here a classic conspiracy in restraint of trade: joint, collaborative action by dealers, the appellee associations, and General Motors to eliminate a class of competitors by terminating business dealings between them and a minority of Chevrolet dealers and to deprive franchised dealers

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[98] *Id.* at 139–40.

[99] *Id.* at 140 ("Against this fact of unlawful combination, the 'location clause' is of no avail. Whatever General Motors might or might not lawfully have done to enforce individual Dealer Selling Agreements by action within the borders of those agreements and the relationship which each defines, is beside the point.").

of their freedom to deal through discounters if they so choose."[100]

Because a conspiracy in restraint of trade is traditionally subject to a per se analysis,[101] the *General Motors* Court concluded that it was "not necessary to consider what might be the legitimate interest of a dealer in securing compliance by others with the 'location clause,' or the lawfulness of action a dealer might individually take to vindicate this interest."[102] Eleven years later, however, in *Continental T.V., Inc. v. GTE Sylvania, Inc.*,[103] the Court would have the occasion to "[give] plenary consideration to the question of the proper antitrust analysis of location restrictions."[104] Although the Court would announce in that case a rule-of-reason

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[100] *Id.* *See also id.* at 144 ("What resulted was a fabric interwoven by many strands of joint action to eliminate the discounters from participation in the market, to inhibit the free choice of franchised dealers to select their own methods of trade and to provide multilateral surveillance and enforcement.").

[101] *Id.* at 145 ("There can be no doubt that the effect of the combination or conspiracy here was to restrain trade and commerce within the meaning of the Sherman Act. Elimination, by joint collaborative action, of discounters from access to the market is a *per se* violation of the Act.").

[102] *Id.* at 140. In other words, the Court held that "[i]t is of no consequence, for purposes of determining whether there has been a combination or conspiracy under § 1 of the Sherman Act, that each party acted in its own lawful interest. Nor is it of consequence for this purpose whether the 'location clause' and franchise system are lawful or economically desirable." *Id.* at 142.

[103] 433 U.S. 36 (1977).

[104] *Id.* at 42 n.11.

approach to vertical nonprice restraints such as location restrictions,[105] it left intact the application of the per se rule to "horizontal restrictions originating in agreements among the retailers."[106] In addition to *GTE Sylvania*, the Court has reaffirmed the vitality of *General Motors'* per se treatment of dealer conspiracies in *Business Electronics Corp. v. Sharp Electronics Corp.*[107] and *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*[108] as well.

The National Association of Attorneys General (NAAG) has had in place a set of guidelines on vertical restraints since 1985.[109] The guidelines adopt the view of *General Motors* that horizontal agreements are per se unlawful regardless of "whether the conspirators are competitors selling

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[105] *Id.* at 58–59.

[106] *Id.* at 58 n.28 ("There may be occasional problems in differentiating vertical restrictions from horizontal restrictions originating in agreements among the retailers. There is no doubt that restrictions in the latter category would be illegal per se, *see, e.g., United States v. General Motors Corp.,* 384 U.S. 127 (1966); *United States v. Topco Associates, Inc., supra*, but we do not regard the problems of proof as sufficiently great to justify a per se rule.").

[107] 485 U.S. 717, 734 (1985) (distinguishing *General Motors'* per se treatment based on the fact that that case involved a horizontal combination at the dealer level).

[108] 551 U.S. 877, 893 (2007) ("A horizontal cartel among competing manufacturers or competing retailers that decreases output or reduces competition in order to increase price is, and ought to be, *per se* unlawful.").

[109] NAT'L ASS'N OF ATT'YS GEN., VERTICAL RESTRAINT GUIDELINES (1995), *available at* http://www.naag.org/assets/files/pdf/at-vrest_guidelines.pdf.

different brands or the same brand."[110] This is because both intrabrand and interbrand competition are deserving of protection under the antitrust laws.[111] Thus, according to the NAAG Vertical Restraint Guidelines (NAAG Guidelines), competing dealers of the same branded goods that conspire to restrain trade in those branded goods would be viewed as having committed a per se violation of Section 1 of the Sherman Act, as well as analogous state law provisions.[112]

It should be noted that the particular type of dealer conspiracy condemned in *General Motors*—namely, a group boycott—may not always warrant per se treatment. In *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*,[113] the Court in essence limited *General Motors* to its facts, classifying it as a case involving "joint efforts by a firm or firms to disadvantage competitors by 'either directly denying or persuading or coercing suppliers or customers to deny relationships the competitors need in the competitive struggle.'"[114] Such group boycotts frequently have one or more of the following

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[110] *Id.* § 2.2 & n.20.

[111] *Id.* § 2.2 & n.19 (citing *GTE Sylvania*, 433 U.S. at 51).

[112] *Id.* § 2.2.

[113] 472 U.S. 284 (1985).

[114] *Id.* at 294 (quoting LAWRENCE A. SULLIVAN, LAW OF ANTITRUST 261–62 (1977)). *See also id.* at 290 ("This Court has long held that certain concerted refusals to deal or group boycotts are so likely to restrict competition without any offsetting efficiency gains that they should be condemned as *per se* violations of § 1 of the Sherman Act." (citing, *inter alia*, United States v. General Motors Corp., 384 U.S. 127 (1966))).

unredeeming attributes: (1) cutting off access to a supply, facility, or market needed by the boycotted firms to compete; (2) a dominant position in the relevant market held by the boycotting firms; and (3) the absence of any plausible justifications such as enhancing overall efficiency or making markets more competitive.[115]

Absent those unredeeming attributes, however, the *Northwest Wholesale Stationers* Court cautioned that "'[there] is more confusion about the scope and operation of the *per se* rule against group boycotts than in reference to any other aspect of the *per se* doctrine.'"[116] "Some care is therefore necessary in defining the category of concerted refusals to deal that mandate *per se* condemnation."[117]

The Court would reinforce its message the following Term in *FTC v. Indiana Federation of Dentists*.[118] In that case, the Court declined to resolve the legality of the Indiana Federation of Dentists' policy of refusal to submit x-rays to dental insurers for use in benefits determinations "by forcing [it] into the 'boycott' pigeonhole and invoking the *per se* rule."[119] Instead, it adopted the FTC's approach of evaluating the policy under the rule of reason,[120] observing in passing that:

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[115] *Id.* at 294.

[116] *Id.* (quoting SULLIVAN, at 229–30).

[117] *Id.*

[118] 476 U.S. 447 (1986).

[119] *Id.* at 458.

[120] *Id.* at 459.

> … [T]he category of restraints classed as group boycotts is not to be expanded indiscriminately, and the *per se* approach has generally been limited to cases in which firms with market power boycott suppliers or customers in order to discourage them from doing business with a competitor—a situation obviously not present here.[121]

In summary, although dealer conspiracies are properly analyzed as horizontal restraints under *General Motors*, those that take the form of a concerted refusal to deal or a group boycott are to be carefully evaluated before being subjected to per se treatment.[122]

D. What Constitutes a Vertical Restraint? The Problem of the Dual Distributor

As *General Motors* illustrated with the case of conspiring Chevrolet dealers, concerted action by competitors at the same level of market structure is generally termed a horizontal restraint, "in contradistinction to combinations of persons at different levels of the market structure, e.g., manufacturers and distributors, which are termed

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[121] *Id.* at 458.

[122] *See, e.g.,* Rossi v. Standard Roofing, Inc., 156 F.3d 452, 462–64 (3d Cir. 1998) (allegations that "Standard and Arzee (and perhaps other horizontal competitors like Allied) conspired with manufacturers like GAF and suppliers like Servistar to deny Rossi access to GAF product as well as to coerce other suppliers not to sell any products to him"—apparently the result of "Standard's and Arzee's dissatisfaction with Rossi's price-cutting proclivities"—made the case suitable for per se analysis).

'vertical' restraints."[123] How is a restraint to be classified, however, where the manufacturer itself is also a distributor—known as a "dual distribution" arrangement?

Federal appellate courts have generally analyzed restraints that arise in the context of dual distribution agreements as vertical restraints.[124] A

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[123] United States v. Topco Assocs., Inc., 405 U.S. 596, 608 (1972). *See also* Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 730 (1988) ("Restraints imposed by agreement between competitors have traditionally been denominated as horizontal restraints, and those imposed by agreement between firms at different levels of distribution as vertical restraints.").

[124] *See, e.g.,* Smalley & Co. v. Emerson & Cuming, Inc., 13 F.3d 366, 368 (10th Cir. 1993) ("The district court also correctly applied the law of this circuit to the 1 allegation of horizontal market allocation, concluding that dual distribution systems like that utilized by E&C are in fact vertical, not horizontal restraints on competition."); Int'l Logistics Grp., Ltd. v. Chrysler Corp., 884 F.2d 904, 906 (6th Cir. 1989) ("The record disclosed that the implemented marketing policies were 'vertical' nonprice restraints imposed by Chrysler upon its distributors' marketing policies that were directed to competitors at different levels of competition. Although some minimal horizontal competitive effects may have resulted, the marketing policies concerning the Power Master engine were not directed toward or designed to impose restraints upon parties at the same competitive level even though Chrysler, the manufacturer, was also a distributor.").

But see Jacobs v. Tempur-Pedic Int'l, Inc., 626 F.3d 1327, 1340 n.15 (11th Cir. 2010) ("This court has not adopted a per se rule for [vertical] classification; instead, we examine the circumstances of each dual distribution arrangement to see whether it more closely resembles a horizontal or vertical agreement. Some cases have classified dual distribution relationships as horizontal in character." (citing cases)). Also, in the second *Leegin* appeal after remand from the Supreme Court, the Fifth Circuit saw no need to take up the question

well-known case is *Krehl v. Baskin-Robbins Ice Cream Co.*,[125] which concerned Baskin Robbins' dual distribution system where the company acted both as (1) the licensor of its trademarks and product formulae to independent ice cream manufacturers that operated as area franchisors with exclusive territories, and (2) an area franchisor for territories that it reserved to itself. The plaintiff franchisees claimed that constituted this system constituted a per se unlawful, horizontal market allocation.[126]

The Ninth Circuit disagreed, however, agreeing with the district court's finding that Baskin Robbins unilaterally dictated the allocation of exclusive territories, without any control or input from the area franchisors.[127] The restraint was therefore vertical in nature. The court of appeals further determined that the application of the per se rule to Baskin Robbins' dual distribution system would be "both inappropriate and anticompetitive" because it did not believe that Baskin Robbins' decision to act as an area franchisor in certain territories had any significant impact on interbrand or intrabrand competition.[128]

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whether dual distribution systems should be presumptively illegal because PSKS's vertical price restraint claim failed anyway as a matter of market definition. PSKS, Inc. v. Leegin Creative Leather Prods., Inc., 615 F.3d 412, 417 (5th Cir. 2010), *cert. denied*, 131 S. Ct. 1476 (2011).

[125] 664 F.2d 1348 (9th Cir. 1982).

[126] *Id.* at 1354.

[127] *Id.* at 1355.

[128] *Id.* at 1356.

The Ninth Circuit discussed and analyzed a slightly more complicated, distribution arrangement in *Dimidowich v. Bell & Howell*.[129] In that case, Bell & Howell, a manufacturer of microfilm products, also maintained an extensive service organization to repair and replace the equipment it manufactured. For the only region of the country where it did not maintain a service organization, Bell & Howell appointed a single, authorized dealer-representative, Comgraphix, to provide the repair and replacement services. Comgraphix also served as Bell & Howell's distributor of microfilm products for the same region.

A plaintiff customer alleged that Bell & Howell and Comgraphix had engaged in a per se unlawful conspiracy to restrain trade. The Ninth Circuit characterized the defendants' business relationship as a dual distributorship with respect to the distribution of Bell & Howell products, and as a horizontal relationship with respect to the defendants' provision of repair and replacement services.[130] The court referred to this as a "hybrid arrangement,"[131] and concluded that under the Sherman Act, a rule-of-reason analysis would be appropriate for this relatively unusual arrangement: "Because of the vertical element of the alleged 'hybrid' agreement, the restriction in the service

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[129] 803 F.2d 1473 (9th Cir. 1986), *modified by* 810 F.2d 1517 (9th Cir. 1987).

[130] *Id.* at 1480. Bell & Howell and Comgraphix were viewed as horizontal competitors with respect to the provision of repair and replacement services because their agreement did not prevent Comgraphix from selling and servicing Bell & Howell equipment outside its defined territory. *Id.* at 1479.

[131] *Id.* at 1480.

market may well result in the same type of significant procompetitive effects in the product market as do restrictions in the context of a dual distributorship."[132] Moreover, under a rule-of-reason analysis, "[i]f, as seems likely from B&H's 10-15% market share, the micrographic equipment market is significantly larger than the service market for B&H equipment, then a non-trivial procompetitive effect in the product market will outweigh the anti-competitive effect in the service market."[133]

Dimidowich is also noteworthy because the Ninth Circuit dismissed *Guild Wineries & Distilleries v. J. Sosnick & Son*,[134] a California intermediate court of appeal decision, as the authoritative interpretation on whether dual distribution arrangements should be subject to a per se analysis under California's Cartwright Act.[135] The Ninth Circuit suggested that the per se analysis in *Guild Wineries* was flawed,[136] and predicted that the California Supreme Court

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[132] *Id.* at 1481.

[133] *Id.* at 1484.

[134] 102 Cal. App. 3d 627, 162 Cal. Rptr. 87 (Cal. Ct. App. 1980).

[135] *Dimidowich*, 803 F.2d at 1482. The Cartwright Act is California's state-law counterpart to the Sherman Act.

[136] *Id.* ("Although a manufacturer's relationship with its distributors has a horizontal aspect when it acts as a distributor itself, it remains primarily a vertical relationship. A manufacturer retains some right to place restraints on its distributors to improve its ability to compete in the product market.").

would follow *Krehl* instead and decide the question differently.[137]

The NAAG Guidelines indicate that dual distribution arrangements will be treated as horizontal in nature and effect "[i]f the intent or predominant effect of the restraint is to prevent competition for the firm in its dealer capacity[.]"[138] In addition to intent evidence, the Guidelines also consider the following factors in deciding whether to treat a vertical restraint imposed by a dual distributor as horizontal in nature and effect: (1) whether a high percentage of the brand's sales at the dealer level are made by company-owned outlets; (2) whether the nonprice restriction in question diminishes interbrand competition because it restrains competing dealers who sell both the supplier's brand and competing brands; and (3) whether the competing independent dealers are also interbrand competitors of the firm at the supplier level.[139]

E. What Constitutes a Vertical Restraint? The Problem of the Hub and Spokes Conspiracy

Another variant in the spectrum of alleged conspiracies involving distribution systems is the

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[137] *Id.* at 1483 ("We are convinced the California Supreme Court would follow our decision in *Krehl* and would analyze both restrictions in the context of dual distributorships and the alleged hybrid conspiracy at issue under the rule of reason.").

[138] NAT'L ASS'N OF ATT'YS GEN., VERTICAL RESTRAINT GUIDELINES § 2.3 (1995), *available at* http://www.naag.org/assets/files/pdf/at-vrest_guidelines.pdf.

[139] *Id.*

"hub and spokes" conspiracy. The following two cases illustrate how such an arrangement has been analyzed by the courts and what facts are important to the analysis.

Toys "R" Us, Inc. v. FTC[140] was an appeal from the FTC's finding "that [Toys "R" Us (TRU)] had acted as the coordinator of a horizontal agreement among a number of toy manufacturers. The agreements took the form of a network of vertical agreements between TRU and the individual manufacturers, in each of which the manufacturer promised to restrict the distribution of its products to low-priced warehouse club stores, on the condition that other manufacturers would do the same."[141] The FTC concluded that this TRU-led boycott was per se illegal under *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*,[142] and alternatively, illegal under a full rule-of-reason analysis.[143] TRU argued on appeal, among other grounds, that the FTC's finding of a horizontal conspiracy was "contrary to the facts and impermissibly confuses the law of vertical restraints with the law of horizontal restraints."[144]

The Seventh Circuit affirmed the FTC, however, holding that there was substantial evidence in the administrative record to support the FTC's finding of a horizontal conspiracy among the competing toy

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[140] 221 F.3d 928 (7th Cir. 2000).

[141] *Id.* at 930.

[142] 472 U.S. 284 (1985).

[143] *Toys "R" Us*, 221 F.3d at 933.

[144] *Id.* at 934.

manufacturers, with TRU acting as the "ringmaster," to boycott the low-priced warehouse clubs.[145] Significantly, the evidence indicated that the manufacturers' decision to stop dealing with the warehouse clubs was "an abrupt shift from the past," and a suspicious one at that, since the manufacturers would be depriving themselves of a profitable sales outlet. Moreover, there was direct evidence of communications between the manufacturers to ensure unanimity of commitment to the alleged boycott.[146]

PepsiCo, Inc. v. Coca-Cola Co.[147] involved, among other things, a claim by PepsiCo that Coca-Cola's insertion of a "loyalty" provision into its agreements with independent food service distributors (IFDs), which prohibited those distributors from delivering PepsiCo products, was a per se illegal, horizontal conspiracy among Coca-Cola (the alleged hub) and its IFDs (the alleged spokes) to boycott PepsiCo.[148] The Second Circuit affirmed the district court's rejection of this claim for lack of evidence of an agreement among the competing IFDs.[149] The court distinguished the *Toys "R" Us* case on its record; in that case there was at least some evidence of an

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[145] *Id.*

[146] *Id.* at 935–36.

[147] 315 F.3d 101 (2d Cir. 2002).

[148] *Id.* at 109.

[149] *Id.* at 110 ("PepsiCo offered no evidence of direct communications among the IFDs; its 'offer of proof' of an agreement was simply that Coca-Cola assured the IFDs that the loyalty policy would be uniformly enforced and encouraged them to report violations.").

agreement among the "spokes," and not just an agreement or understanding between the "hub" and each "spoke."[150] Moreover, *Toys "R" Us* was the product of a highly deferential standard of review as to the FTC's findings of fact; by contrast, this case was an appeal of a summary judgment decision.[151]

The take-away from *Toys "R" Us* and *PepsiCo* is that in the context of a distribution system, an alleged "hub and spokes" conspiracy should have some evidence of an agreement or understanding among the putative horizontal participants themselves, i.e., the "spokes." One should not expect the alleged conspiracy to hang together, as a matter of proof, based only on evidence of coordination between each alleged horizontal participant and the manufacturer or supplier, i.e., the "hub," because that coordination occurs vertically and therefore cannot furnish the required element of horizontality.

F. What Constitutes a Vertical Restraint? The Problem of a Restraint That Indirectly Affects Resale Prices

As pointed out in Section II.B *supra*, the Supreme Court in *Business Electronics Corp. v. Sharp*

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[150] *Id.* ("In addition, the court's bases for holding that a horizontal agreement had been established were that: the manufacturers abruptly shifted their practice of selling to the warehouse clubs; there was direct evidence of communication among the manufacturers; and there was evidence that they only agreed to the demand on the condition that their competitors also agree to go along with it.… Such strong evidence of a horizontal agreement is lacking here.").

[151] *Id.* at 110–11.

Electronics Corp.[152] affirmed the Fifth Circuit's decision that it was not enough for the jury find an agreement between a manufacturer and a dealer to terminate a price-cutter, because there must also be "some agreement on the price or price levels."[153] Absent proof of the latter, what are the consequences of a vertical nonprice restraint that indirectly affects resale prices? For example, how have courts analyzed the legality of a manufacturer's suggested resale prices?

In general, long before *Leegin* and *Khan*, the federal courts have analyzed the legality of vertical restraints that indirectly affect resale prices under the rule of reason.[154] The FTC has as well.[155] In contrast, the NAAG Guidelines treat an agreement

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[152] 485 U.S. 717 (1988).

[153] *Id.* at 726–27. *See, e.g.,* Ben Elfman & Son, Inc. v. Criterion Mills, Inc., 774 F. Supp. 683, 686 (D. Mass. 1991) (holding that a manufacturer's termination of a purported price-cutter in response to a complaint from a competing distributor permits, at most, an inference that the manufacturer preferred the complaining distributor's prices (and business) over the prices charged by the terminated distributor; there was no evidence of a conspiracy, however, to fix resale prices to be charged by distributors).

[154] *See, e.g.,* Dunn v. Phoenix Newspapers, Inc., 735 F.2d 1184, 1187 (9th Cir. 1984) (the practice of advertising suggested resale prices is tested by the rule of reason); *In re* Nissan Antitrust Litig., 577 F.2d 910, 917 (5th Cir. 1978) (co-operative advertising program requiring suggested retail price or no price at all must be tested by the rule of reason).

[155] Fed. Trade Comm'n, Proposed Changes to Guides on Advertising Allowances and Other Merchandising Payments and Services, 555 Antitrust & Trade Reg. Report (BNA) 775, 776 (Oct. 27, 1988).

on minimum advertised prices or price levels as a form of vertical price-fixing.[156]

The numerous examples in the case law are—consistent with a common-law, rule-of-reason approach—both fact-specific and case-specific. For instance, courts have held that a ban on price advertising altogether is viewed as a form of RPM agreement[157] but questioned whether this restraint justifies application of the per se rule because "[a]ny form of vertical restraint affects prices," and the real question is whether "this effect is associated with potential benefits to consumers that are worth the price."[158] As another example, restrictions on "transshipping" branded products from one distributor's exclusive territory to another's territory for resale were not shown to have been solely price-related so as to warrant the per se antitrust treatment then given to RPM agreements.[159] As a third example, a restraint that conditions a manufacturer's discount to a distributor or wholesaler on it being passed along to retailers has been held not to be an RPM agreement because such

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[156] NAT'L ASS'N OF ATT'YS GEN., VERTICAL RESTRAINT GUIDELINES § 2.1 cmt. (regarding the Guidelines' treatment of the *Business Electronics* decision) (1995), *available at* http://www.naag.org/assets/files/pdf/at-vrest_guidelines.pdf.

[157] Ill. Corporate Travel, Inc. v. Am. Airlines, Inc., 806 F.2d 722, 728 (7th Cir. 1986) (Easterbrook, J.) (treating a no-advertising rule as a "price rule").

[158] *Id.* at 727–28.

[159] Trans Sport, Inc. v. Starter Sportswear, Inc., 964 F.2d 186, 190 (2d Cir. 1992); Beach v. Viking Sewing Mach. Co., 784 F.2d 746, 750 (6th Cir. 1986).

discounts are designed to enable retailers to meet local competition, and there is no requirement that retailers sell the products at a set resale price.[160]

III. Safe Harbors

A. Are There Any Per Se Legal Vertical Restraints?

As observed in Section I.B *supra*, the Supreme Court made clear in *Khan* and *Leegin* that rule-of-reason treatment does not mean that vertical price restraints are per se legal.[161] Nor did *GTE Sylvania* declare any vertical nonprice restraints to be per se legal.[162] On the contrary, the Court went out of its way in that case to make clear that it was not "foreclos[ing] the possibility that particular applications of vertical restrictions might justify per se prohibition under [*Northern Pacific*]."[163]

That said, there is one "safe harbor" recognized in the case law (if it may be called that), and it stems from the Sherman Act's requirement of a contract, combination, or conspiracy between two or more, legally distinct persons or entities.

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[160] Lewis Serv. Ctr., Inc. v. Mack Trucks, Inc., 714 F.2d 842, 846 (8th Cir. 1983); AAA Liquors, Inc. v. Joseph E. Seagram & Sons, Inc., 705 F.2d 1203, 1206 (10th Cir. 1982).

[161] *See supra* notes 32 & 33 and accompanying text.

[162] *See* Eiberger v. Sony Corp., 622 F.2d 1068, 1076 (2d Cir. 1980) ("That a practice is not per se unlawful does not mean it is per se lawful.") (rejecting Sony's argument that *GTE Sylvania* blessed its warranty fee system as a vertical practice).

[163] Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 58 (1977) (citing Northern Pac. R. Co. v. United States, 356 U.S. 1 (1958)).

In *United States v. General Electric Co.*,[164] the DOJ brought a civil case alleging that General Electric's (GE) distribution system for selling its incandescent light bulbs was really a disguised, per se unlawful, RPM scheme because GE's distributors were in fact wholesale and retail merchants.[165] GE responded to this charge by maintaining that its distributors were in fact bona fide agents selling on consignment and not independent entities.[166]

The DOJ's charge and GE's response thus framed one of the questions before the Supreme Court:

> … The question is whether, in view of the arrangements, made by the company with those who ordinarily and usually would be merchants buying from the manufacturer and selling to the public,—such persons are to be treated as agents, or as owners of the lamps consigned to them under such contracts. If they are to be regarded really as purchasers, then the restriction as to the prices at which the sales are to be made is a restraint of trade and a violation of the Anti-Trust law.[167]

Based on its review of the record, the Court sided with GE on this question.[168] In addition to con-

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[164] 272 U.S. 476 (1926).

[165] *Id.* at 478–79.

[166] *Id.* at 479.

[167] *Id.* at 483–84.

[168] *Id.* at 484 ("We find nothing in the form of the contracts and the practice under them which makes the so-called B and A agents anything more than genuine agents of the company, or the delivery of the stock to each agent anything more than a consignment to the agent for his custody and sale as such.").

cluding that the distribution system did in fact set up a bona fide agency relationship, the Court gave no concern to the fact that GE's agents used to be wholesale or retail merchants that had bought the bulbs from GE for resale; GE was free to change the nature of its business relationship with its distributors.[169]

Although *General Electric* thus recognized an "agency or consignment relationship" defense to an RPM claim, the Court made clear that such a relationship must be genuine. In *Simpson v. Union Oil Co.*,[170] the Court determined that Union Oil's retail dealer "consignment" agreement with the dealers leasing its retail outlets was a sham because the dealers were in fact independent businessmen—"small struggling competitors seeking retail gas customers" but unable to get customers through the use of competitive pricing because of the challenged price restraint.[171] The Court thus distinguished *General Electric* on its facts.[172]

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[169] *Id.* at 484–85 ("The circumstance that the agents were in their regular business wholesale or retail merchants, and under a prior arrangement had bought the lamps, and sold them as their owners, did not prevent a change in their relation to the company. We find no reason in this record to hold that the change in this case was not in good faith and actually maintained.").

[170] 377 U.S. 13 (1964).

[171] *Id.* at 20–21. The Court concluded: "To allow Union Oil to achieve price fixing in this vast distribution system through this 'consignment' device would be to make legality for antitrust purposes turn on clever draftsmanship. We refuse to let a matter so vital to a competitive system rest on such easy manipulation." *Id.* at 24.

[172] *Id.* at 23 n.10.

The courts of appeals have consistently applied the "agency or consignment relationship" defense recognized in *General Electric*[173] and declined to declare that the defense "died an unnatural death at the hands of [*Simpson*]."[174] More recently, the Fourth Circuit in *Valuepest.com, Inc. v. Bayer Corp.*[175] concluded that the defense remains alive and well, even after *Leegin*,[176] but maintained that

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[173] *See, e.g.,* Ill. Corporate Travel, Inc. v. Am. Airlines, Inc., 806 F.2d 722, 725–26 (7th Cir. 1986) (Easterbrook, J.) ("'The agency relationship has a function other than to circumvent the rule against price fixing' … when, objectively viewed, the arrangement serves one of the economic functions of agencies in general, such as apportioning risk to the firm best able to bear risks, or lodging pricing decisions in the firm best able to gauge market conditions" (quoting *Morrison*, *post*, 797 F.2d at 1436); Morrison v. Murray Biscuit Co., 797 F.2d 1430, 1438 (7th Cir. 1986) (Posner, J.) ("Consignment selling, like selling through brokers, is a long-established, widespread, and clearly legitimate business practice—not just a device for circumventing the per se rule against price fixing.").

The NAAG Guidelines would appear to recognize an agency relationship defense as well. *See* NAT'L ASS'N OF ATT'YS GEN., VERTICAL RESTRAINT GUIDELINES § 2.1 (1995) ("An RPM agreement is reached when *two or more independent firms* at different levels in the distribution system agree to fix, raise, lower, maintain or stabilize the price at which goods or services will be resold.") (emphasis added), *available at* http://www.naag.org/assets/files/pdf/at-vrest_guidelines.pdf.

[174] *Illinois Corporate Travel*, 806 F.2d at 724. *See also* Ryko Mfg. Co. v. Eden Servs., 823 F.2d 1215, 1223 (8th Cir. 1987) ("*Simpson* does not mean that legitimate agency or consignment arrangements can give rise to antitrust liability.").

[175] 561 F.3d 282 (4th Cir. 2009).

[176] *Id.* at 288 ("Quite simply, *Leegin* has no bearing on the continued vitality of *General Electric*, and plaintiffs' argument

purported agency relationships still have to be scrutinized as possible shams designed to evade the antitrust laws, as instructed by *Simpson*.[177]

B. Are There Any Vertical Restraint "Safe Harbors" Based on Market Conditions?

Another "safe harbor" (of sorts) for vertical restraints has to do with market power and related conditions in the relevant antitrust market. In *Continental T.V., Inc. v. GTE Sylvania, Inc.*,[178] the Supreme Court observed in a footnote that the potential competitive harm posed by a vertical nonprice restraint can be checked by the existence of interbrand competition:

> … [W]hen interbrand competition exists, as it does among television manufacturers, it provides a significant check on the exploitation of intrabrand market power because of the ability of consumers

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to the contrary cannot stand.… *General Electric* holds that a principal-agent relationship is not an agreement for antitrust purposes, while *Leegin* only addressed the circumstances under which an agreement proven to exist is reasonable under § 1.").

[177] *Id.* at 290 ("[C]ourts have read *Simpson* to require a careful inquiry into a purported agency agreement, in order to determine whether it is genuine or a sham."). *See also id.* at 294 ("Under *General Electric*, manufacturers can use the agency method to distribute their products. Yet under *Simpson*, a distribution method labeled 'agency' but that in substance is simply an agreement between manufacturers and retailers to fix prices can create liability under § 1.").

[178] 433 U.S. 36 (1977).

> to substitute a different brand of the same product.[179]

Stated differently, even though the imposition of a vertical nonprice restraint may limit or chill intrabrand competition, a manufacturer's exercise of market power derived from that restraint will still be constrained by interbrand competition from other branded products. Accordingly, under such market conditions, the restraint may not raise serious competitive concerns, particularly from the standpoint of interbrand competition, which "is the primary concern of antitrust law."[180]

Taking guidance from this footnote in *GTE Sylvania*, lower courts have thus generally required—as a threshold matter under the rule of reason—a showing that the antitrust defendant also has interbrand market power, meaning that there is likely insufficient interbrand competition to discipline its exercise of market power derived from the vertical restraint.[181] Courts have therefore consi-

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[179] *Id.* at 52 n.19.

[180] *Id.*

[181] *See, e.g.,* Assam Drug Co. v. Miller Brewing Co., 798 F.2d 311, 316 (8th Cir. 1986) ("We conclude that the market power approach is sound and economically consistent with the application of the rule of reason and evaluation of vertical nonprice restraints as explained in *Sylvania*."); Graphic Prods. Distribs., Inc. v. Itek Corp., 717 F.2d 1560, 1568 (11th Cir. 1983) ("We have narrowed the broad-ranging inquiry called for by the rule of reason by insisting, at the threshold, that a plaintiff attacking vertical restrictions establish the market power of the defendant."); Valley Liquors, Inc. v. Renfield Importers, Ltd., 678 F.2d 742, 745 (7th Cir. 1982) (Posner, J.) ("A firm that has no market power is unlikely to adopt policies that disserve its consumers; it cannot afford to. And if it

dered whether the antitrust defendant has a sufficiently large share of a relevant antitrust market.[182] An insignificant market share will generally end the rule-of-reason inquiry.[183]

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blunders and does adopt such a policy, market retribution will be swift. Thus its mistakes do not seriously threaten consumer welfare, which is the objective that we are told should guide us in interpreting the Sherman Act.") (citation omitted); Muenster Butane, Inc. v. Stewart Co., 651 F.2d 292, 298 (5th Cir. Unit A July 1981) (observing that "if a firm lacks market power, it cannot affect the price of its product, and thus any vertical restraint could not be anticompetitive at the interbrand level" (quotation omitted)).

[182] *See* Valley Liquors, Inc. v. Renfield Importers, Ltd., 822 F.2d 656, 666–67 (7th Cir. 1987) (Wood, J.) (observing that a market share of 70–75% constitutes market power and a share of 20–25% or less does not constitute market power; reviewing cases from different circuits).

[183] *See, e.g.,* R.D. Imports Ryno Indus., Inc. v. Mazda Distribs., Inc., 807 F.2d 1222, 1225 (5th Cir. 1986) ("Throughout the time period relevant to this litigation, Mazda sold less than 5% of all the cars sold in Tarrant County. Without a more significant market share, the Gulf allocation system could have no injurious effect on competition."); JBL Enters., Inc. v. Jhirmack Enters., Inc., 698 F.2d 1011, 1017 (9th Cir. 1983) ("The trial court found that Jhirmack's market share was 2.3%–4.2% of beauty products sold to PST outlets (or 1%–2% of shampoos and conditioners sold by all retail outlets). These shares are too small for any restraint on intrabrand competition to have a substantially adverse effect on interbrand competition."); Copy-Data Sys., Inc. v. Toshiba Am., Inc., 663 F.2d 405, 410 (2d Cir. 1981) ("In this case, TAI was an insignificant force in the American market for copiers hoping to increase its market share primarily on the strength of a newly developed plain paper copier. To be successful in this quest, TAI not only had to develop a product the quality of which rivaled the offerings of industry giants Xerox and IBM, but also had to assure the availability of prompt and skillful after-sale service on this technically sophisticated machine.").

Khan and *Leegin* have arguably carried the notion of a "de minimis market-power" safe harbor over to a rule-of-reason analysis of vertical price restraints as well. In *Khan*,[184] one of the conclusions reached by the district court in granting summary judgment to State Oil was that the plaintiffs had not shown that State Oil had market power or that its pricing provisions affected competition in a relevant market.[185] In *Leegin*,[186] the Supreme Court would address the relevance of market power to the potential for abuse of RPM more explicitly, observing that the prospect that "a dominant manufacturer or retailer can abuse resale price maintenance for anticompetitive purposes may not be a serious concern unless the relevant entity has market power."[187] In a second appeal after remand from the Supreme Court, the Fifth Circuit concluded from that quoted passage in *Leegin* that a market-power screen would be appropriate for vertical price restraint claims as well:

> … A market-power screen is thus compatible with *Leegin* and our precedent and that of our sister circuits. To allege a vertical restraint claim

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

[185] *Id.* at 9.

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

[187] *Id.* at 898. "If a retailer lacks market power, manufacturers likely can sell their goods through rival retailers.… And if a manufacturer lacks market power, there is less likelihood it can use the practice to keep competitors away from distribution outlets." *Id.*

> sufficiently, a plaintiff must plausibly allege the defendant's market power.[188]

It remains to be seen whether other courts of appeals will adopt the same reading of *Leegin* as the Fifth Circuit did.

In response to public commentary, the NAAG Guidelines have now been revised to "articulate a market power screen that should clarify the states' approach to those non-price vertical restraints least likely to cause concern."[189] The thresholds track those set forth in the NAAG Horizontal Merger Guidelines.[190] Specifically, Section 4.7 of the NAAG Guidelines provides that "[t]he Attorneys General will attempt to ascertain the concentration levels in the supplier and dealer markets and the market shares of firms employing the vertical restraint under scrutiny."[191] In analyzing concentration levels, "the Attorneys General will be unlikely to challenge a non-price vertical restraint when the markets involved, in all of the relevant levels of distribution, have HHIs less than 1000, or when all of the relevant parties to a non-price vertical agreement

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[188] PSKS, Inc. v. Leegin Creative Leather Prods., Inc., 615 F.3d 412, 418–19 (5th Cir. 2010) (citing cases; footnotes omitted), *cert. denied*, 131 S. Ct. 1476 (2011).

[189] NAT'L ASS'N OF ATT'YS GEN., VERTICAL RESTRAINT GUIDELINES § 4 cmt. (1995) (responding to the suggestion that "[t]he guidelines could provide more guidance if they established specific market share or market power thresholds and a 'short form' rule of reason analysis."), *available at* http://www.naag.org/assets/files/pdf/at-vrest_guidelines.pdf.

[190] *Id.*

[191] *Id.* § 4.7.

have less than 10 percent of their respect markets."[192]

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[192] *Id.*