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Questioning The Legality Of Minimum RPM Agreements

Law360, New York (February 23, 2011) -- Although it used to be a well-settled area of the law, manufacturers now cannot be sure whether the law allows them to require their distributors and retailers to adhere to minimum resale prices. For decades, the setting of maximum or minimum prices to be charged by resellers — known as resale price maintenance (RPM) or vertical price-fixing — was illegal per se.

The clear rules prohibiting RPM no longer exist, however. In State Oil Co. v. Kahn,[1] the Supreme Court unanimously overruled the rule that maximum RPM is per se illegal, and instead held that maximum RPM is subject to the rule of reason.

Ten years later, in Leegin Creative Leather Products Inc. v. PSKS Inc.,[2] the Supreme Court similarly held that minimum RPM is not a per se violation of Section 1 the Sherman Act. Under federal law today, a court addressing a challenge to maximum or minimum RPM balance the pro-competitive benefits and anti-competitive effects of the RPM to determine whether it constitutes a violation of the antitrust laws.

Even during the days when maximum RPM was illegal per se, many legal commentators viewed the practice as pro-competitive. As a practical matter, the Supreme Court's decision in Kahn appears to have eliminated any significant risks associated with such programs.[3]

Indeed, we are not aware of any cases under state or federal antitrust law finding a maximum RPM arrangement to be unlawful under the rule of reason. The benefits of minimum RPM, in contrast, has always been viewed more skeptically, and the Leegin decision has caused considerable uncertainty regarding when the practice will be held lawful, particularly under state antitrust law.

Not all states have decided to follow the Leegin decision. While some states provide either by statute or through judicial rule that their antitrust statutes must be interpreted in conformity with federal law, other states do not follow federal law and one expressly prohibits minimum RPM agreements.

In October 2009, Maryland became the first state to pass legislation providing that minimum RPM is per se illegal under the Maryland Antitrust Act.[4] Even where state law does not expressly provide for per se condemnation of minimum RPM, state enforcers have recently brought actions under state law to challenge such agreements.

In March 2010, the New York attorney general's office filed a lawsuit against Tempur-Pedic International Inc., the well-known mattress manufacturer, accusing it of violating New York state law by enforcing minimum retail prices for its products. The complaint alleged that Tempur-Pedic unlawfully prohibited dealers from discounting, by not doing "business with any retailer that charges retail prices that differ from the prices set by Tempur-Pedic."[5]

The lawsuit sought an injunction barring Tempur-Pedic from enforcing the anti-discounting policy and restitution for those consumers who had been adversely affected by the practice.

New York challenged the legality of Tempur-Pedic's resale price policy under New York General Business Law § 369(a), which states that "any contract provision that purports to

restrain a vendee of a commodity from reselling … at less than the price stipulated by the vendor or producer" is unenforceable."

The attorney general argued that the title of Section 369(a) — "Price Fixing Prohibited" — showed a clear legislative intent to make contracts restraining resale pricing illegal, that Tempur-Pedic's resale price policy violated Section 369(a), and that Tempur-Pedic's repeated and persistent engagement in this illegal act enabled the attorney general to seek injunctive relief under New York Executive Law § 63(12).[6]

Section 63(12) allows the attorney general to seek injunctive relief if a person is engaging in "repeated fraudulent or illegal acts" in transacting business. The New York Supreme Court ultimately rejected the attorney general's arguments this January, finding that the specific New York law at issue (which was not New York's general antitrust law) does not prevent a vendor from restraining a reseller's right to discount the resale price.[7]

The Supreme Court held that resale price maintenance is not an "illegal act" and that the language of the applicable provision makes such contracts unenforceable, but not illegal.[8] The Supreme Court also held that Tempur-Pedic's resale price policy did not contractually bind retailers to adhere to the suggested minimum resale price. Rather, the policy only suggested that not doing so would negatively affect their standing as a Tempur-Pedic retailer and therefore, it was not an unenforceable contract for purposes of section 369(a).[9]

Because the attorney general notably did not bring suit under federal or state antitrust laws,[10] the holding does not establish any rule for judging minimum RPM agreements under the state's antitrust law. However, it does provide a state-law endorsement of the legality of unilateral suggested resale pricing policies. It remains unclear whether minimum RPM will be per se illegal under the Donnelly Act, New York's state antitrust law.

On the same day as the New York Supreme Court decided the Tempur-Pedic case, the California Office of the Attorney General entered into a settlement with Bioelements Inc., a Colorado-based manufacturer of skin care products sold to beauty salons throughout California and to online retailers — several dozen of which are physically located in California.[11]

In its complaint, the California attorney general accused Bioelements of engaging in what it described as a "blatant price fixing scheme" — namely, entering into dozens of contracts (internet-only accounts agreements) with third-party companies that required them to sell Bioelements' products online for at least as much as the suggested retail price set by Bioelements. The attorney general contended that this conduct violated California's Cartwright Act (California's general antitrust law) and California's Unfair Competition Law (UCL).[12] Under the settlement, Bioelements is required to:

- Permanently refrain from fixing resale prices for its merchandise.
- Inform distributors and retailers with whom Bioelements made price-fixing contracts that Bioelements considers the contracts void and will not enforce them.
- Pay a total of $51,000 in civil penalties and attorneys' fees.[13]

This action against Bioelements is another example of the California attorney general's aggressive stance against minimum RPM schemes after the Supreme Court's ruling in Leegin. In February 2010, the attorney general successfully obtained an injunction under

the Cartwright Act and the UCL against another cosmetics company, DermaQuest Inc., for similarly entering into contracts that prevented third parties from selling their products below a suggested retail price set by DermaQuest.[14]

The attorney general has also focused on the federal legislative front by sending two open letters to Congress in the last three years urging it to reinstate federal safeguards against minimum RPM schemes.

In tandem with state enforcement efforts, Sen. Herb Kohl of Wisconsin recently introduced legislation that would overturn the holding in Leegin by making all minimum RPM agreements a per se violation of the Sherman Act. The Discount Pricing Consumer Protection Act has been introduced for the third year in a row by Kohl, and has been endorsed by the National Association of Attorneys General, 38 state attorneys general, and several consumer advocacy groups.

One of the major concerns raised by Kohl is that the Leegin case may deter smaller discount retailers from bringing RPM lawsuits due to the high burden of establishing an antitrust violation under the "rule of reason" standard.

As a result, manufacturers should still be wary about implementing minimum RPM schemes, both with brick-and-mortar retailers and with online retailers. Although Leegin has eliminated the per se rule against minimum RPM under federal antitrust law, state laws still have teeth. In its press release announcing its settlement with Bioelements, the California attorney general emphasized that while Leegin "sharply curtailed federal antitrust laws pertaining to vertical price fixing," the decision had no effect on both the interpretation and enforcement of California's "strict antitrust laws."

For manufacturers and distributors who wish to prevent their downstream suppliers from offering their products at discount prices, the bottom line is that they should proceed with caution. Any restriction on discounting should be carefully considered by weighing the potential business benefits of brand protection with the legal risks still posed by the current uncertainty in the state of the law.

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[1] 522 U.S. 3 (1997).

[2] 551 U.S. 877 (2007).

[3] Note that even before Kahn, the Supreme Court had already limited the risks associated with maximum RPM agreements in Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328 (1990) where it held that plaintiffs must suffer "antitrust injury" from predatory pricing resulting from a maximum RPM scheme in order to have standing to bring a private lawsuit under § 4 of the Clayton Act.

[4] Md. Code Ann., Com. Law §§ 11-201 et seq.

[5] People of the State of New York v. Tempur-Pedic Int'l Inc., 2010 WL 4919531, at *3 (Trial Pleading)(N.Y. Sup. Mar. 29, 2010).

[6] People of the State of New York v. Tempur Pedic Int'l Inc., 2011 WL 198019, at 5* (N.Y. Sup. Ct. Jan. 14, 2011).

[7] Id. at 6.

[8] Id.

[9] Id. at 15.

[10] It is likely the attorney general did not did not bring federal or state antitrust claims because of Leegin Creative Leather Products Inc. v. PSKS Inc., 552 U.S. 877 (2007). Although New York courts are not bound by federal antitrust decisions, they often rely on federal case law in deciding cases brought under the Donnelly Act. Optivision Inc. v. Syracuse Shopping Center Assocs., 472 F. Supp. 665 (N.D.N.Y. 1979).

[11] Complaint at 3, People v. Bioelements Inc., No. INC 10011659 (Cal. Super. Ct. Dec. 30, 2010).

[12] Id.

[13] Judgment at 3-5, People v. Bioelements Inc., No. INC 10011659 (Cal. Super. Ct. Jan. 11, 2011).

[14] Judgment at 3-4, People v. DermaQuest Inc., No. RG10497526 (Cal. Super. Ct. Feb. 23, 2010).