Minimum resale price policy, price-cutters

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A winery client of ours had a big problem in the marketplace. A well-known retailer was advertising the client's wines below wholesale cost to lure consumers into the store. But on arrival, consumers were told the wine had "sold out" and were offered alternate products—some of them the retailer's own private-label brands—as a substitute for the advertised wines.

In addition to denigrating our client's brand, this below-cost tactic was creating serious issues with other retail customers who threatened to pull the brand because consumers believed they could get the wines cheaper elsewhere—and at a price the other retailers could not afford to offer.

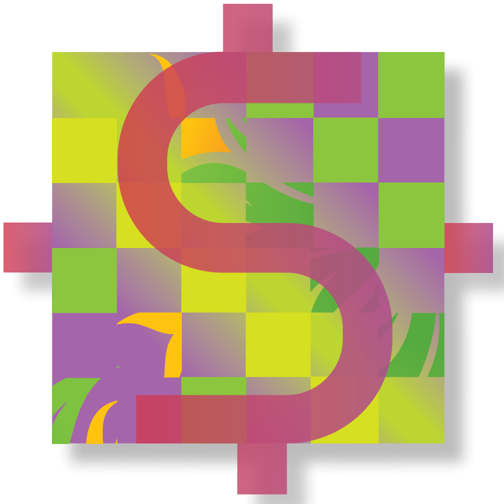
As it turned out, many of our supplier clients were facing the same dilemma, and almost all of our clients (including retail clients who could not match the prices advertised by the below-cost advertiser) had the same question: Is there anything we can do to stop this—or better yet prevent it in the first place?

These clients had been told (often by their distributors) that any attempts to stop these unfair practices would violate antitrust laws forbidding agreements to set a minimum price for products and could also violate alcoholic beverage laws in those states that prohibited suppliers from discriminating among retailers.

Was this true? Yes and no. While resale price maintenance is a tricky business and the law is still evolving in this area, it is possible to establish and maintain a **minimum resale price policy** that would stand up to legal challenges under federal and most state laws.

Background

Prior to 2007, any agreement between a supplier and reseller to set a minimum price threshold for a product was considered "per se," or automatically, illegal under federal antitrust laws. This changed when the U.S. Supreme Court held in *Leegin Creative Leather Products Inc. v. PSKS Inc.* that this type of price-fixing agreement may be legal so long as it does not unreasonably injure competition.[1]



In other words, rather than automatically finding such an arrangement illegal, courts were instructed to analyze the price policy in question under what is known as a "rule of reason" rather than finding a per se violation of law.

Unfortunately, federal antitrust law does not preempt state antitrust law,[2] and states are free to decide whether to continue making a vertical (between supplier and a downstream reseller) price-fixing agreement per se illegal.

For example, California's Cartwright Act continues to make such arrangements illegal.[3] Suppliers can avoid this result, however, by establishing a minimum resale price policy (known in legal circles as a "Colgate policy") that unilaterally announces a minimum resale price for the supplier's products.

Under the long-standing doctrine established in *United States v. Colgate & Co.*,[4] if a manufacturer unilaterally announces a sales policy and a reseller unilaterally decides to comply with that policy, there is no illegal "agreement" between manufacturer and reseller unless the manufacturer used coercive means to ensure compliance.

Simply stated, the manufacturer can announce its resale prices in advance and refuse to deal with those who do not comply. The most important aspect of such a policy is **the absence of an agreement,** express or implied, between supplier and reseller. The policy must be one-sided and non-negotiable, and it cannot be adjusted to fit the circumstances of a particular reseller.

Note, however, that while the price policy must be uniformly applied, this does not mean the policy will necessarily have the same effect upon differently situated resellers. If the resale price policy prohibits sales that are below cost rather than sales that are below a set dollar figure, for example, one reseller could be in violation of the policy for selling the product at a certain price while another reseller with a lower cost of doing business[5] would not be in violation of the policy for selling the product at the same price.

Also, a retailer that obtains a quantity discount and purchases a larger volume of product at a lower cost will naturally be able to offer the product at a lower retail price to consumers (while still selling the product above cost) than another retailer that paid more for the product.

Suppliers that elect to prohibit sales below cost rather than below a set dollar figure should think in terms of similarly situated retailers—that is, retailers that paid the same amount for the product and have similar costs of doing business—when applying their resale price policy to various retail accounts.

The policy must have at least one business rationale behind it, and the more business reasons asserted (and existing) as justification for adopting the policy, the better. It is important that the policy not simply be something that sits on a shelf, to be introduced to a single retailer upon that retailer's use of predatory pricing.

Instead, the supplier should provide its policy to all retailers prior to its implementation, both to avoid any accusation of retailer discrimination and to make clear this is the producer's uniform policy throughout the marketplace, independent of the circumstances or its relationships with any single retailer.

Here is suggested wording for a minimum resale price policy:

Minimum resale price policy

Dear Retailer,

This letter serves as an announcement of our resale policy with respect to our products (specify brands defined, hereinafter "products") sold at retail throughout the United States. We do not and will not make our products available to retailers who price them below our minimum price, which is $00 (or, below producer's cost, which we define as the retailer's cost to purchase the products from the wholesaler plus the retailer's cost of doing business.

(Some producers add additional anti-competitive and/or illegal practices, such as bait-and-switch tactics,[6] that would trigger the producer's refusal to deal with that retailer.)

We also will not make available to our distributors any marketing funds or promotional programs for the purpose of promoting products that are priced below the price(s) set forth in this policy. We have determined this policy is necessary in the competitive marketplace for the following reasons:

• Pricing our products below our minimum resale price (or cost) is a predatory practice that is harmful to our brand image and undermines our marketing efforts with respect to our brand(s).

• Pricing our products below our minimum resale price (or cost) causes a decrease in sales of our products by other retailers and wholesalers that cannot match such predatory pricing.

• Pricing our products below our minimum resale price (or cost) is an unfair business practice that threatens to decrease competition in the marketplace, to the detriment of our customers.

This minimum resale policy is non-negotiable. You are free to decide whether to follow this policy or not. This policy does not constitute an agreement between us and you, and we are not seeking a response from you. This policy applies to all retailers that sell our products throughout the United States.

Resale price policy in a three-tier system

An obvious stumbling block to implementing such a policy is what to do about the fact that in almost all cases it is the **distributor** who sells to the retailer, not the producer. (The exception is when a winery selling within its own state elects to bypass the distributor and sell directly to retailers, in which case the resale policy outlined above may be used.)

Wouldn't any agreement between producer and distributor to cut off any retailer that violated the price policy run afoul of these same antitrust laws? If that is the case, and no producer and distributor enter into such an agreement, then what is the distributor's independent incentive to decide not to sell to the retailer?

Our solution is to make clear to distributors that no marketing or promotional funds, bill-backs or depletion allowances will be provided for the purpose of promoting the products in retail accounts that price products below the producer's announced minimum price (or that otherwise engage in predatory or unfair practices outlined in the producer's policy).

Note this must be presented as the producer's independent policy and cannot be presented as an opportunity to negotiate with the distributor. The producer must further be willing to follow through on this policy and not negotiate or make allowances with a distributor for a particular promotional program or important retailer. The producer can take this a step further by including a statement in its agreements (or terms and conditions of sale on its invoices) with distributors that acknowledges the producer's policy, such as:

"Supplier has established a resale policy for its products to protect the brand image and value by refusing to deal with accounts that engage in practices that harm the brand, that are anti-competitive or that violate the law of any state. Supplier's resale policy is set forth below (or, is set forth as Exhibit 00 to this agreement)."

The suggested resale policy provided above (with slightly revised wording to fit the context) can then be included directly in the terms and conditions of sale or added as an exhibit to the distribution agreement.

Producers that are particularly risk-averse or that are dealing with a distributor in a state that has expressly elected not to follow *Leegin* (such as Maryland) may choose to not include this language in their written agreements for those states lest it be construed as an agreement between the producer and the distributor to maintain a minimum price.

Other laws in addition to anti-trust laws

Distributors often push back by arguing that refusing to deal with a particular retailer runs afoul of alcoholic beverage laws in some states that prohibit discrimination among retailers by a supplier. Our response is that the resale policy should make clear it applies across the board to all retailers and is thus a uniform and non-discriminatory policy.

Moreover, many of the retailer practices specified as harmful in a producer's resale policy, such as below-cost pricing, are illegal under many states' laws, including California's, which further supports the legality of the producer's policy. PWV

The viewpoints expressed in this article are the opinion of the writer, are provided for educational and informational use only and are not to be construed as legal advice. If you need legal advice, please consult with your counsel.

End Notes

1. *Leegin Creative Leather Products Inc. v. PSKS Inc.*, 551 U.S. 877 (2007).
2. See, *e.g.*, *California v. ARC America Corp.*, 490 U.S. 93 (1989).
3. *California's Business & Professions Code §16726* makes any trust unlawful. A "trust" includes an agreement in which the parties "[b]ind themselves not to sell, dispose of or transport any article or any commodity or any article of trade, use, merchandise, commerce or consumption below a common standard figure, or fixed value." *CA Bus. & Prof. Code §16720(e)(1).*
4. *United States v. Colgate & Co.*, 250 U.S. 300 (1919).
5. In California, cost is defined as the cost of purchasing the product plus the cost of doing business, which is presumed to be 6% in the absence of any other proof of the cost of doing business. See *CA Bus. & Prof. Code §§17026, 17030, 17043, 17044.*
6. "Bait-and-switch" is an industry term for selling a product at less than cost "[w]here the purpose is to induce, promote or encourage the purchase of other merchandise," is also illegal under California law. *CA Bus. & Prof. Code §17030(a).*