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Going to Market in Asia and Around the World:

U.S. Competition Rules for Distribution

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The Association of Southeast Asian Nations (ASEAN) nations (Vietnam, Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore and Thailand) agreed to adopt competition laws by 2015. Half of them have; half have yet to do so. The laws in place, and those that can be anticipated, vary in some important respects from the rules applicable in the U.S., Europe and Latin America, and can significantly affect the way companies distributing goods to these nations structure their relationships. This paper summarizes the key competition rules in the United States governing vertical restraints,[1] to provide a benchmark for comparison with the rules in other regions and those that the ASEAN nations may develop.

1. **Resale price maintenance (supplier control of reseller's pricing)**

Federal law in the United States judges resale price maintenance ("RPM") under the rule of reason[2], and usually permits it, ever since the U.S. Supreme Court's 2007 decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*[3] (*Leegin* overruled the previously applicable rule that vertical agreements "to maintain prices and stifle competition" were *per se* illegal, which had governed RPM for nearly a century, since *Dr. Miles Medical Co. v. John D. Park & Sons Co*., 220 U.S. 373 (1911).

But there are circumstances discussed by the Supreme Court where such restrictions could be found unlawful even under *Leegin*. The Supreme Court identified various scenarios involving RPM programs which "may have anticompetitive effects":

♦ An RPM program may facilitate horizontal price-fixing by suppliers, either by helping identify price-cutting suppliers if the reduced price shows up at retail, or by discouraging suppliers from cutting prices, because they will not benefit from increased sales if retail prices do not increase.[4]

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[1] "Vertical" refers to relationships between buyers and sellers, and "vertical restraints" are those agreed on by suppliers and their customers. In contrast, "horizontal" relationships are those between competitors at the same level of distribution, and "horizontal restraints" are those agreed upon by competitors. Horizontal conduct and its legal implications are beyond the scope of this paper.

[2] Under the rule of reason, the court weighs the anticompetitive effects of a restraint (often on intrabrand competition between resellers of the supplier's brand) against the procompetitive effects (often on interbrand competition between the supplier's brand and those of competing suppliers), and if the latter outweigh the former, the restraint will be found lawful. *See Continental T.V., Inc. v. GTE Sylvania Inc*., 433 U.S. 36 (1977); *Graphic Products Distributors Inc. v. Itek Corporation*, 717 F.2d 1560 (11th Cir. 1983). In contrast, restraints that are *per se* unlawful will be found illegal regardless of the procompetitive justifications that may be offered in their defense. *See, e.g., United States v. Socony-Vacuum Oil Co.,* 310 U.S. 150 (1940).

[3] 551 U.S. 877 (2007).

[4] *Id.* at 892.

♦ An RPM program may facilitate horizontal price-fixing by resellers, where the RPM program is originated by a group of dealers and then foisted upon their supplier as an enforcement mechanism. The supplier then is at risk of becoming part of a horizontal, *per se* unlawful, price-fixing conspiracy among its customers.[5]

♦ A reseller with market power may call for an RPM program from its supplier to reduce competition from more efficient, discounting competitors.[6]

♦ A supplier with market power may use RPM to give resellers an incentive not to sell the products of the supplier's smaller rivals and new market entrants.[7]

Consequently, the Supreme Court suggested in *Leegin* several factors relevant to the rule of reason inquiry of an RPM program:

♦ *The number of suppliers using RPM in the industry*. The more manufacturers who use RPM, the more likely that it could facilitate a supplier or dealer cartel.[8]

♦ *The source of the restraint*. If dealers are "the impetus for a vertical price restraint, there is a greater likelihood the restraint facilitates a [dealer] cartel or supports a dominant, inefficient [dealer]."[9]

♦ *Whether a supplier or reseller has market power.*[10]

In considering whether to approve a proposed RPM program, counsel needs to review all the facts and determine whether any of these factors are present, or if there are other indications that the proposed program will have anticompetitive effects rather than enhancing interbrand competition. On the flip side, counsel needs to consider the extent to which use of RPM in the particular circumstances will foster intrabrand competition by enabling or encouraging dealers to offer more services to consumers and by giving consumers greater choice of purchasing the product (but not the brand) from higher price-higher service dealers, low price-low service dealers or dealers offering a middle ground.

Moreover, individual States within the U.S. have their own state antitrust laws, and not all follow the new federal rule. Thirteen states have antitrust statutes that explicitly bar RPM programs or render them unenforceable, and other states are expressly not bound to follow federal precedent in interpreting their state antitrust laws.[11] As a consequence, at least some state

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[5] *Id.* at 893.

[6] *Id.* at 893.

[7] *Id.* at 893.

[8] *Id.* at 897.

[9] *Id.* at 897-98.

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

[11] *See* R.A. Duncan, A.K. Guernsey, *Waiting for the Other Shoe to Drop: Will State Courts Follow 'Leegin'?*, 27-Franchise L.J. 173, 174, Winter 2008 (ABA), *available at* http://www2.mnbar.org/sections/antitrust/Duncan-Guernsey.pdf; Michael A. Lindsay, *Price Maintenance and the World After 'Leegin,'* Vol. 22, No. 1 Fall 2007. Examples of state statutes prohibiting RPM include California (Cal. Bus. & Prof. Code § 16720(e)), Kansas (Kan. Stat. Ann. § 50-112), Maryland (Md Code Ann., Com. Law § 11-204(b)) and New York (N.Y. Gen Bus. Law § 369-a).

attorneys general are likely to continue to address RPM schemes under state law using the *per se* rule.

For example, in March 2008, the State of New York filed an antitrust complaint against Herman Miller, Inc. in connection with the company's resale price-fixing.[12] "Although filed post-*Leegin*, in keeping with the New York Attorney General's *per se* stance, the complaint pled only *per se* violations of Section 1 of the Sherman Act and the New York, Illinois, and Michigan antitrust statutes."[13] Herman Miller settled for $750,000 and agreed to a court order that prohibits it from agreeing on retail prices with its retailers, from passing on retail prices among its retailers, and from coercing its retailers to agree on a retail price. Additionally, Herman Miller must notify retailers of their right to set their own prices.[14]

In the end, a patch-work of states accepting or rejecting the *Leegin* approach in enforcing the individual state's antitrust law appears to be developing.[15] Consequently, counsel must carefully examine each relevant state's treatment of RPM, especially as state law continues to develop, before implementing any RPM Program.

Businesses should be hesitant to adopt RPM programs in this environment, notwithstanding the widely held, but erroneous, belief that the Supreme Court made resale price-fixing lawful in *Leegin*. If an RPM program is to be implemented, counsel needs to review all the facts and determine whether any of the factors described by the Supreme Court in *Leegin* are present, or if there are other indications that the proposed program will have anticompetitive effects rather than enhancing interbrand competition. In addition, a careful analysis needs to be made of the applicable state laws in each state in which the firm does business, to avoid state enforcement and private actions under state antitrust laws.[16]

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[12] *State of New York, et al. v. Herman Miller, Inc.*, No. 08-CV-02977 (S.D.N.Y. March 21, 2008).

[13] *FTC Approves Resale Price Maintenance Agreements under Rule of Reason But State AGs Appear Undeterred*, Morgan Lewis antitrust lawflash (May 14, 2008); *see also* New York State Attorney General, Antitrust Bureau Feature release *available at* http://www.oag.state.ny.us/bureaus/antitrust/feature.html.

[14] Other examples: In March 2010, the New York Attorney General filed a state court action against Tempur-Pedic, a memory-foam mattress supplier, under a state law making resale price agreements unenforceable. *New York v. Tempur-Pedic Int'l, Inc.*, No. 400837/10 (Sup.Ct. N.Y. Co. filed Mar. 29, 2010). In February 2010 the California Attorney General filed a complaint and stipulated final judgment against DermaQuest, Inc., alleging an RPM agreement to constitute a *per se* violation of state antitrust and unfair competition law. *California v. DermaQuest, Inc.*, Case No. RG10497526 (Super. Ct. Calif. Alameda Co., Complaint filed Feb. 5, 2010, Proposed Final Judgment Including Permanent Injunction file Feb. 23, 2010). DermaQuest agreed to notify all its customers with whom it had RPM agreements disavowing those agreements, and not to enter RPM agreements in the future. It also paid $120,000 in civil penalties and attorneys' fees.

[15] In addition to the New York and California cases discussed above, for example, the Kansas Supreme Court held in 2012 that Leegin's vertical price fixing was *per se* illegal. *O'Brien v. Leegin Creative Products, Inc.*, 2012 WL 1563976 (Kan. Sup. Ct. May 4, 2012), but the Kansas legislature is considering legislation to overturn that decision. Maryland passed a statute in response to *Leegin* making minimum resale price maintenance unlawful. Md Code Ann., Com. Law §11-204(b). Other states have followed *Leegin. E. g., Van Hoose v. Gravois*, 70 So.3d 1017, 1023 (La.Ct.App.2011). For a table listing the state of affairs in each State, see M.A. Lindsay, "Overview of State RPM," *Antitrust Source* (www.antitrustsource.com)(April 2013).

[16] While the focus of this article is on compliance with U.S. law, it is worth noting that the rules of other jurisdictions vary widely, and are developing. A 2012 Chinese court decision is in substantial accord with *Leegin. Johnson & Johnson*, Shanghai no.1 People's Court, *reported in Chinese Legal Daily*, May 18, 2012, *reported* in "Resale Price Maintenance – are China and America singing the same tune?," *available at* www.Lexology.com/library/detail.aspx?g=0eec010b-38ba-47cb-800c-f7ed76553d59. Similarly, Canada repealed its *per se* rule against resale price maintenance in 2009 when it drastically overhauled its Competition Act, R.S.C. 1985, c.C-34. RPM has effectively been decriminalized, subject only to injunctive relief, not damages, and is

2. **Alternative pricing constraints (e.g., suggested pricing, minimum advertised price (MAP) programs)**

It is perfectly lawful in the U.S. for a supplier to suggest resale prices, so long as there is no enforcement mechanism and the customer remains truly free to set its own prices. In addition, a supplier may establish a *unilateral* policy against sales below the supplier's stated resale price levels and *unilaterally* choose not to business with those that do not follow that policy, because it is only *agreements* on resale pricing that may be *per se* unlawful. *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919). But care must be taken not to take steps that would convert such a unilateral policy into an agreement. However, when a manufacturer's actions go beyond mere announcement of a policy and it employs other means to obtain adherence to its resale prices, an RPM agreement can be created.[17] *Colgate* policies can be notoriously difficult to administer, because it is in a salesperson's DNA to try to persuade a customer to adhere to the policy rather than be cut off (with the resulting loss of sales to the salesperson), rather than simply to terminate sales upon a violation, but such efforts can be enough to take the seller out of the *Colgate* safe harbor and into a potentially unlawful RPM situation.

Minimum advertised price ("MAP") policies that control the prices a supplier advertises, but not the actual sales price, are also generally permitted, although the issue of what constitutes an advertised price for online sales can have almost metaphysical dimensions. In order to avoid classification as RPM, the MAP policy must not control the actual resale price, but only the advertised price. The closer to the point of sale that advertising is controlled, the greater the risk. Thus, in the bricks and mortar world, policies restricting advertising in broadcast and print media are more likely to be permitted; restrictions on in-store signage would be riskier, and restriction on actual price tags and labels on merchandise most likely to be deemed a restriction on actual, rather than advertised, price. Online, sellers have most often restricted banner ads and the price shown when an item is displayed, while restrictions on the price shown once a consumer places an item in his or her shopping cart carry a greater risk, which explains why some items are displayed with the legend "Place item in cart for lower price". Cooperative advertising programs that condition reimbursement of all or a portion of the cost of an advertisement on compliance with a supplier's MAP policy are judged under the rule of reason, but are not free from risk.[18]

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presumptively legal unless challenged and shown to have an adverse effect on competition. Even then, several statutory affirmative defenses are available. There have been no private challenges to, or enforcement proceedings against, resale price maintenance since the new regime was adopted.

In contrast, Europe still treats resale price maintenance as a "hard core restriction," except in certain narrow circumstances. European Commission Guidelines on Vertical Restraints, OJ 2010 C130/1 ¶223 (April 2010).

[17] *United States v. Parke, Davis & Co.*, 362 U.S. 29, 45-46 (1960).

[18] *In the Matter of Sony Music Entertainment, Inc.*, (FTC) File No. 971-0070 (May 10, 2000) involved charges by the Federal Trade Commission MAP programs were unlawful under the rule of reason. Five leading U.S. music companies each settled the FTC's charges that the defendants tried to eliminate discounting by conditioning cooperative advertising payments on advertising of CD prices at or above the supplier's MAP price – not only for broadcast and print advertising, but also for signs inside retail stores, and included advertising funded entirely by the

3. **Exclusive territories and customer allocation**

Ever since the decision of the U.S. Supreme Court in *Continental T.V., Inc. v. GTE Sylvania Inc.*[19], non-price vertical restraints, such as exclusive territories, have been judged by the rule of reason in the U.S. and are generally permitted, in the absence of market power. Customer allocation by competitors, however, is a horizontal arrangement rather than a vertical one and is *per se* illegal[20]. It is thus critical that the impetus for exclusive territories come from the supplier in a vertical arrangement and not from dealers or distributors making a horizontal allocation of territories.

It is worth noting that a system of exclusive territorial distributorships contains two aspects: a promise by the supplier not to permit others to sell into a distributor's territory or to do itself, and a promise by the distributor not to transship the products outside its territory. Both aspects are judged under the rule of reason in the U.S. and will be permitted, absent market power. [21]

Where the restriction is based on types of customers as opposed to geographic location, the result is no different.[22]

The references to market power above arise because many U.S. cases have applied a so-called "market power screen" in rule of reason cases, and uphold non-price vertical restraints whenever the defendant lacks market power. For example, the U.S. Court of Appeals for the Seventh Circuit put it as follows in *Valley Liquors, Inc. v. Renfield Importers, Ltd.*[23]:

> A threshold inquiry in any Rule of Reason case is whether the defendant had market power, that is, the "power to raise prices significantly above the competitive level without losing all of one's business." (citations omitted) ... Only if [a plaintiff] can allege facts that give rise to an inference that [the defendant] had sufficient market power to control liquor prices must we proceed to the first step of the Rule of Reason analysis, which is to balance the effect, the vertical restraint has on intrabrand and interbrand competition.

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retailer and not part of the co-op program.

[19] 433 U.S. 36 (1977).

[20] *See CDC Tech., Inc. v. IDEXX Labs, Inc*., 186 F.3d 74, 80-81 (2d Cir. 1999) (unlike horizontal agreements between competitors, vertical exclusive distributorships are presumptively legal).

[21] *See International Logistics Group, Ltd. v. Chrysler Corporation,* 884 F.2d 904 (6th Cir. 1989) *cert. denied*, 494 U.S. 1066 (1990) (summary judgment for defendant that terminated distributor that bought for export and then sold to domestic dealers);.Bruce Drug, Inc. v. Hollister Inc., 688 F.2d 853, 859-860 (1st Cir. 1982) (manufacturer's termination of transshipping dealer was justified where reasons included "controlling the distribution of its products in foreign markets" where a variety of factors had "the overall effect of promoting vigorous interbrand competition.").

22 *Matrix Essentials, Inc. v. Emporium Drug Mart, Inc.,* 1993-1 Trade Cas. (CCH) ¶ 70,196 (5th Cir. 1993) (upholding requirement that distributor sell only to hair-styling salons, not to retail stores*; Tripoli Co., Inc. v. Wella Corp.,* 425 F.2d 932, 936 (3d Cir. 1970) (upholding restriction on distributors reselling product intended for professional use to retail end users).

[23] 822 F.2d 656, 666 (7th Cir.), *cert. denied*, 484 U.S. 977 (1987).

4. **Restrictions on active or passive selling out of assigned territory**

U.S. antitrust law does not make a distinction between active and passive selling, and it is generally permissible for a supplier to prohibit all out-of-territory sales by a distributor, both active and passive, in the absence of market power. The general rule judging non-price vertical restraints under the rule of reason is applicable.

5. **Restrictions on Internet sales**

Restrictions on online sales are viewed as a non-price vertical restraint like exclusive territories, and so are judged by the rule of reason and generally permitted, in the absence of market power. Courts have upheld prohibitions on mail order and telephone sales under the rule of reason,[24] and an absolute prohibition on Internet sales should be judged no differently. Lesser restrictions on online sales would be similarly upheld.

6. **Restrictions on parallel (grey market) imports**

Parallel importing is not generally viewed as an antitrust issue. For trademarked goods, however, importation of goods bearing the trademark, even if genuine, can be blocked through the U.S. Customs and Border Patrol Service, provided the non-U.S. manufacturer is not affiliated with the U.S. trademark owner, under § 526(a) of the Tariff Act,[25] which prohibits the importation of a product manufactured abroad "that bears a trademark owned by a citizen of … the United States and … registered in the U.S. Patent and Trademark Office." In addition, where the parallel imported goods are materially different from the U.S. goods in quality, features, warranty or the like, it may be possible to take action on a theory of trademark infringement where customer confusion is likely to result.[26]

There is much less ability to restrict gray market importation under a copyright theory. The Supreme Court held just this year, in *Kirtsaeng v. John Wiley & Sons, Inc.*[27], that a copyright owner cannot exercise any control over a copyrighted work after its first sale, even if that first sale occurs abroad. Moreover, reliance on an insubstantial element of a product protected by copyright to attempt to block parallel imports may be held to be copyright misuse, which blocks enforcement of the copyright.[28]

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[24] *H.L. Hayden Co. of New York, Inc. v. Siemens Med. Sys., Inc.*, 879 F.2d 1005, 1014 (2d Cir. 1989); *National Marine Elec. Distribs., Inc. v. Raytheon Co.*, 778 F.2d 190 (4th Cir. 1985); *O.S.C. Corp. v. Apple Computer, Inc.*, 792 F.2d 1464, 1468 (9th Cir. 1986).

[25] 19 U.S.C. § 1526.

[26] *E.g.*, *Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.*, 816 F.2d 68 (2d Cir. 1987); *Dial Corp. v. Manghnani Inv. Corp.*, 659 F. Supp. 1230 (D.Conn. 1987).

[27] 133 S. Ct. 1351 (2013)

[28] *Costco Wholesale Corp. v. Omega S.A.*, 2011 U.S. Dist. LEXIS 155893 (E.D. Cal. Nov. 9, 2011).

7. **Restrictions on sales of competing products**

In the absence of market power, a supplier generally is free to restrict a distributor's sales of competing products, [29] although some state laws limit this ability. [30] Restrictions that extend beyond the term of a distribution agreement are disfavored in some states, and restrictions on competing products generally must be "ancillary" to the contract and in furtherance of its lawful purposes,[31] as well as reasonable as to the products restricted, geographic scope and duration. [32] Where a supplier provides a turnkey operation, as in a classic franchise, such post-term restrictions may be more broadly permitted, particularly if they are short in duration and restrict a limited geographic area.[33]

However, where exclusive dealing requirements are so broad as to foreclose a substantial portion of the market, they may be found unlawful. [34]

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29 *See, e.g., Roland Machinery Co. v. Dresser Industries, Inc.,* 749 F.2d 380, 395 (7th Cir. 1984) (restriction on competing products eliminates divided loyalties and free riding);. *In re Super Premium Ice Cream Distribution Antitrust Litigation,* 691 F.Supp. 1262 (N.D. Cal. 1988) (exclusive dealing prevents free riding, promotes distributor commitment), *aff'd sub nom.* Haagen-Dazs Co., Inc. v. Double Rainbow Gourmet Ice Cream, Inc., 895 F.2d 1417 (9th Cir. 1990); *Joyce Beverages, Inc. v. Royal Crown Cola Co.,* 555 F. Supp. 271, 276 (S.D.N.Y. 1983) (restriction on competing products encourages distributor loyalty, incentive to make supplier's brand succeed)..

[30] *See, e.g., Cottman Transmission Sys., Inc. v. Melody*, 851 F. Supp. 660 (E.D.Pa. 1994) (Calif. law); *Scott v. Snelling and Snelling, Inc.*, 732 F. Supp. 1034 (N.D. Cal. 1990).

[31] *See United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 282 (6th Cir. 1898), *modified and aff'd*, 175 U.S. 211 (1899) ("[N]o conventional restraint of trade can be enforced unless the covenant embodying it is merely ancillary to the main purpose of a lawful contract, and necessary to protect the covenantee in the enjoyment of the legitimate fruits of the contract, or to protect him from the dangers of an unjust use of those fruits by the other party").

[32] A case in New York held that a one year non-compete clause was unreasonable in duration as applied to an editor for a technology information publication, because of the speed at which the Internet industry moves. In that context, the court held, one year is "several generations, if not an eternity." *Earth Web, Inc. v. Schlack*, 71 F. Supp. 2d 299, 316 (S.D.N.Y. 1999).

[33] *See*, *e.g.*, *Wilkinson v. Manpower, Inc.*, 531 F.2d 712 (5th Cir. 1976) (in a six-county area; for two years); *Meineke Discount Muffler Shops, Inc. v. Bleier*, Civ. Act. No. H-80-2495 (S.D. Tex. 1981) (25-mile radius of former shop; for one year); *Shakie's, Inc. v. White*, No. 77-106, slip op. (E.D. Mo. 1977) (within 30 miles of the franchised location; for one year); *Snelling & Snelling, Inc. v. Dupay Enters., Inc.*, 125 Ariz. 362, 609 P.2d 1063 (1980) (within 35 miles of franchised location; for three years).

[34] *Standard Oil Co. v. United States,* 337 U.S. 293 (1949) (foreclosure of 6.7% of market was presumptively unlawful where competitors also used exclusive dealing); *United States v. Dentsply Int'l Inc.,* 399 F.3d 181 (3d Cir. 2005) (foreclosed competitors from the most important distributors); *Interface Group v. Mass. Port Authority,* 816 F.2d 9, 11 (1st Cir. 1987) ("Exclusive dealing arrangements may sometimes be found unreasonable under the antitrust laws because they may place enough outlets, or sources of supply, in the hands of a single firm (or small group of firms) to make it difficult for a new, potentially competing firms to penetrate the market."); *Twin City Sportservice, Inc. v. Charles O. Finley & Co.,* 676 F.2d 1291 (9th Cir.), *cert. denied,* 459 U.S. 1009 (1982) (long-term foreclosure of 24% of market was unlawful).

But see Jefferson Parish Hospital District No. 2 v. Hyde, 466 U.S. 2, 45 (1984) ("Exclusive dealing is an unreasonable restraint on trade only when a significant fraction of buyers or sellers are frozen out of a market by the exclusive deal." An exclusive arrangement with a hospital with a 30% market share was upheld.) (O'Connor, J. concurring), *overruled on other grounds* by *Illinois Tool Works Inc. v. Independent Ink, Inc*., 547 U.S. 28 (2006); *Satellite Television & Associated Resources, Inc. v. Contractual Cablevision, Inc.,* 714 F.2d 351 (4th Cir. 1983), *cert. denied,* 465 U.S. 1027 (1984) (foreclosure of 8% of households lawful); *Beltone Electronics Corp.,* 100 F.T.C. 68 (1982) (upholding exclusive dealing arrangements covering 16% of the hearing aid market pursuant to a rule of

reason analysis); *Sewell Plastics, Inc. v. The Coca-Cola Co.,* 720 F. Supp. 1196 (W.D.N.C. 1989) (exclusive contracts foreclosed for 40% of the market, there was still adequate competition, so no "undue" foreclosure of market was found).