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Vertical Restraints:
Federal and State Enforcement of Vertical Issues

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I. WHY VERTICAL ENFORCEMENT MATTERS

Most consumers buy manufactured goods from someone other than the manufacturer. By the time an individual consumer purchases a product, the item typically has passed through the hands of several middlemen in a chain of distribution stretching back, ultimately, to the manuf

power.

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[2]Robert H. Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 HASTINGS L.J. 65, 76 (". . . Congress decided that consumers were entitled to the benefits of a competitive economic system.").

[3]Jay L. Himes, *Exploring the Antitrust Operating System: State Enforcement of Federal Antitrust Law in the Remedies Phase of the* Microsoft *Case*, 11 GEO. MASON L. REV. 37, 108 (2002) ("An overarching principle of the American system of government is distrust of power in both the public and the private sector.").

[4]Kenneth G. Elzinga, *Controversy: Are Antitrust Laws Immoral? A Response to Jeffrey Tucker*, 1 J. MARKETS & MORALITY 83, 86 (1998) ("To John Q. Public and Mary Q. Public, free enterprise connotes not only freedom of contract among sellers but the freedom to shop among alternative sources of supply. . . . To tell John Q. Public and Mary Q. Public, whose freedom to shop among alternative sources of supply has been curtailed by mergers, . . . 'that no monopoly is permanent' may be true, but not fully responsive to their concerns."), *available at* http://www.acton.org/publicat/m_and_m/1998_mar/elzinga.html.

[5]Neil W. Averitt & Robert H. Lande, *Consumer Sovereignty: A Unified Theory of Antitrust and Consumer Protection Law*, 65 ANTITRUST L. J. 713, 719 (1997). Of course, sometimes the manufacturer's preferred price is the competitive price.

[6]*See, e.g.*, Sharon Oster, *The FTC vs. Levi Strauss: An Analysis of the Economic Issues, in* IMPACT EVALUATIONS OF FEDERAL TRADE COMMISSION VERTICAL RESTRAINT CASES 48 (Ronald N. Lafferty et al. eds., 1984) (finding that imperfect information on the part of a clothing manufacturer led it to continue using resale price maintenance longer than was optimal).

[7]*See* Warren S. Grimes, *Spiff, Polish and Consumer Demand Quality: Vertical Price Restraints Revisited*, 80 CAL. L. REV. 815, 834-36 (1992) (resale price maintenance can provide larger dealer margins, which in turn, create an incentive for a merchant to "push" consumers towards particular brands of product, even when those brands might be inferior to competing brands within the same price range).

intervened.[13] In contrast, maximum resale price-fixing and non-price vertical restraints have been subject to various swings in judicial policy, being judged at some times according to the *per se* illegality standard of the antitrust laws, and at other times under the rule of reason.[14] Indeed, changes in non-price vertical jurisprudence have occurred over particularly short time spans.[15]

Swings in enforcement policy, at least on the federal side, have been equally radical.[16] State attorneys general, on the other hand, have consistently viewed most

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[13]Until repealed by the Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 801, 15 U.S.C.A. § 1, 45(a), the Miller-Tydings Resale Price Maintenance Act (Act of Aug. 17, 1937, Pub. L. 314, ch. 690, Title III, 50 Stat. 693, 15 U.S.C.A. § 1) and McGuire-Keogh Fair Trade Enabling Act (Act of July 14, 1952, Pub. L. 543, ch. 745, 66 Stat. 631, 15 U.S.C.A. § 45), allowed the laws of most states to permit resale price maintenance contracts prescribing minimum prices for certain commodities. Such contracts held substantial sway over much of the American economy.

[14]*See* State Oil Co. v. Khan, 522 U.S. 2 (1997) (maximum resale price maintenance); *Continental T.V.*, 433 U.S. 36 (1977) (non-price vertical restraints).

[15]*See supra* note 11.

[16]Sandy Litvack, as the Assistant Attorney General ("AAG") in charge of the Antitrust Division of the U.S. Department of Justice ("DOJ") under President Carter, indicted Cuisinarts for resale price maintenance. *See* In re Grand Jury Investigation of Cuisinarts, Inc., 665 F.2d 24, 29 (2nd Cir. 1981). Similarly, the State of New York prosecuted and obtained criminal convictions of a group of milk dealers for vertical price fixing in 1981. *See* New York State v. Dairylea Cooperative, Inc., 187 N.Y.L.J., No. 107 at 13, 1982-83 Trade Cases (CCH) ¶ 65,072 (NY Sup. Ct., Tr. Term, Bronx 1982) (denial of motion to dismiss indictment). William Baxter, the next head of the DOJ Antitrust Division under President Reagan, would have made vertical price restraints subject to the rule of reason analysis and most non-price vertical restraints of trade subject to a rule of presumptive legality, as demonstrated by the government's *amicus* brief in the *Monsanto* case. Brief for the United States as *Amicus Curiae* at 19 ("[R]esale price maintenance should not be deemed per se unlawful.") and at 11, 16 and 22 (*citing* Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6 (1981)), Montsanto Co. v. Spray-Rite Service Corp., 465 U.S. 752, *rhg. denied*, 466 U.S. 994 (1984); *see also Oversight Hearings on Antitrust Div. of the Dept. Of Justice Before the Subcomm. on Monopolies and Commercial Law of the House Comm. On the Judiciary*, 97th Cong., 1st & 2nd Sess. (1981-82) (in 1981, AAG Baxter advised Congress that "there is no such thing as a harmful vertical practice"). The U.S. Supreme Court made elliptical reference in its opinion, 466 U.S. at 761 n.*7*, to the fact that Congress had inserted language into DOJ's appropriation (Act of Nov. 28, 1983, Pub. L. No. 98-166, § 510) prohibiting argument of

from enthusiastic cooperation to straight-out antagonism, then witnessed their improvement to studied indifference and, finally, grudging respect and cooperation. There remains, however, a significant gap in their relative enthusiasm for challenging vertical restraints of trade. State enforcement officials are still much more likely than their federal counterparts to pursue serious vertical enforcement cases. This phenomenon may be caused, in large part, by the different remedies available to state versus federal enforcers.

IV. INFLUENCE OF VERTICAL RESTRAINTS REMEDIES

[20]15 U.S.C.A. § 15c

[21]*See* California v. Frito-Lay, Inc., 474 F. 2d 774 (9th Cir. 1973).

[22]*See* New Jersey v. Chas. Pfizer & Co, Inc., 1973-1 Trade Cas. (CCH) ¶ 74,343 (S.D.N.Y. 1973).

[23]Florida ex rel. Shevin v. Exxon Corp. 526 F.2d 266 (5th Cir. 1976); In re Chicken Antitrust Lit., CA No. C74-2454A (N.D. Ga. 1974) (Massachusetts) and C75-362A (N.D. Ga. 1977) (New Jersey); Nash Co. Bd. of Ed. v. Biltmore Co., 640 F. 2d 484 (4th Cir. 1981) (North Carolina).

As part of this trend, state attorneys general frequently have brought civil treble damage litigation in the vertical restraints area on behalf of both individual and governmental consumers. Building on their existing foundation of consumer litigation experience, the states have developed and honed their skills in damages litigation. It is, therefore, not at all surprising to find that states are more aggressive in pursuing vertical restraint cases than are their federal counterparts. And while all differences between federal and state vertical enforcement cannot be explained by the availability of remedies, the states' ability to use *parens patriae* authority to extract monetary relief arguably makes it comparatively more efficient to allocate greater antitrust enforcement to the states.[24]

In contrast, federal authorities have tended to focus their vertical efforts on cases where injunctive relief was needed or where the law might be clarified, as opposed to cases seeking monetary remedies. Therefore, while they may have less experience than the states when it comes to damages litigation, federal enforcers have greater experience in the areas of economic analysis, injunctive remedies, and litigation of the fact of an antitrust violation, both civilly and criminally.

I would argue that, over the last two decades, the relative gap in expertise and

[24]*See* Stephen Calkins, *Perspective on State and Federal Antitrust Enforcement*, 53 DUKE L.J. ___ (2004) (forthcoming) (finding that states possess three comparative advantages in antitrust enforcement: familiarity with local markets; familiarity with and representation of state and local institutions; and ability to compensate parties injured by antitrust violations).

[25]265 F. Supp. 2d 310 (S.D.N.Y. 2003)

[26]Additional information and materials are available on the NAAG website at

[28]The consent order entered in the Commission's compact disc MAP case is discussed in the Appendix of Selected Cases, *infra*.

[29]*CD MAP Litigation*, 138 F. Supp. 2d at 27.

[30]According to the settlement administrator's website, distribution of settlement funds is

1. DOJ Investigation of Most Favored Nations Provisions Relating to Orbitz

On July 31, 2003, DOJ closed its three-year investigation of Orbitz, a website jointly owned by United Airlines, Continental Airlines, Delta Airlines and Northwest Airlines.[32] Orbitz offers discounted airfares for flights on its owner airlines as well as 40 other domestic and foreign airlines known as "charter associates." DOJ's investigation focused on whether a most favored nation ("MFN") agreement between the owner airlines and the charter associates reduced competition and increased prices for consumers. Additionally, DOJ considered whether the agreement might give Orbitz a dominant position and effectively eliminate competing channels of distribution for discounted airline tickets.

According to the DOJ press release and attached background information, the MFN agreement raised several concerns.

> First, in theory, the Orbitz MFN agreement undercuts the participating airlines' incentives to compete by offering discount airfares, because those fares must be offered on the Orbitz website where customers might instead buy from another carrier. Second, the MFN prevents these carriers from offering their best fares only on their individual websites, generally their lowest cost distribution channel. Third, the Orbitz MFN could provide a convenient means for the airlines to monitor each other's fares. By improving monitoring, Orbitz might facilitate collusion among the participating airlines and thereby curtail discounting. Fourth, the improved monitoring could also curtail discounting by allowing competitors to match a carrier's discounts more quickly. Rapid matching results in revenue dilution, thus reducing the sales bump or first mover advantage of offering a low web fare.[33]

During its investigation, however, DOJ found that there had been no decrease in the availability of discounted fares, either by Orbitz members or by non-member

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[32]Statement by Assistant Attorney General R. Hewitt Pate Regarding the Closing of the Orbitz Investigation (July 31, 2003), *available at* http://www.usdoj.gov/atr/public/press_releases/2003/201208.htm.

[33]*Id*. (explanatory statement attached to press release).

[34]United States v. Microsoft Corp., 2002 WL 31654530 (D.D.C. Nov. 12, 2002) (entry of consent decree, as amended), appeal pending, No. 03-5030 (D.C. Cir.); *see also* http://www.usdoj.gov/atr/cases/ms_index.htm#settlement (DOJ index of documents relating to *Microsoft* settlement). While this case has been placed in the "federal" category of this paper, it

A report of the findings of these hearings is forthcoming. GPO practices are also a continuing area of concern for the Sena

Providers), *available at* http://www.ftc.gov/reports/hlth3s.htm.

[38]*Hospital Group Purchasing: Has the Market Become More Open to Competition?, Hearing Before the Subcomm. On Antitrust, Competition, and Consumer Rights of the Senate Judiciary Comm.* (July 16, 2003), *available at* http://judiciary.senate.gov/ hearing.cfm?id=859; *Hospital Group Purchasing: Lowering Costs at the Expense of Patient Health and Medical Innovations?, Hearing Before the Subcomm. On Antitrust, Competition, and Consumer Rights of the Senate Judiciary Comm.* (April 30, 20022), *available at* http://judiciary.senate.gov/hearing.cfm?id=236.

[39]Dkt. No. 02-1865 (Sup. Ct. 2003).

I. FEDERAL CASES

Nintendo of America Inc., 114 F.T.C. 702 (1991) (consent order).

The Commission prohibited Nintendo, for five years, from terminating dealers on the basis of the resale price they charge. Although I was not at the Commission when it considered the *Nintendo* matter, I do not think it is merely a coincidence that the complaint also alleged that Nintendo accounted for more than 80% of all home video game equipment sales. The presence of market power makes vertical restraints far more suspect because of the potential for even nonprice restraints to have anticompetitive effects. *Nintendo*-like relief also may be appropriate in egregious situations where a manufacturer demonstrates a willful disregard of the law on *per se* vertical price restraints – for example, if a manufacturer continues to engage in unlawful RPM after repeated enforcement warnings.

Kreepy Krauly, 114 F.T.C. 777 (1991) (consent order).

The Commission alleged that a Florida manufacturer of swimming pool cleaning equipment entered into written agreements with dealers to maintain resale prices. Kreepy Krauly settled with Commission and agreed to rescind the paragraph of its dealer agreements that required dealers to agree to maintain resale prices, and to cease including that paragraph in dealer agreements. The consent order also prohibited Kreepy Krauly from entering into agreements with dealers to maintain resale prices.

United States v. Delta Dental Plan of Arizona, Inc., 1995-1 Trade Cas. (CCH) ¶ 71,048 (D. Ariz. 1995) (final judgment).

DOJ alleged that the defendant and co-conspirators agreed to restrain or eliminate the discounting of fees for dental services to other dental plans or consumers in the state of Arizona in violation of the Sherman Act. Delta contracted with dentists to provide pre-paid dental services to employers. Delta's participating dentist agreements contained MFN clauses that required each dentist to charge Delta the lowest price the dentist charged any patient or competing dental care plan. If dentists wished to reduce their fees for dental services to any other plan or patient, the MFN required them to reduce their fees to Delta as well. Before the MFN was enforced, many Arizona dentists chose to reduce their fees to participate in various competing managed-care

agreements with certain dealers to fix and maintain the resale prices of its products. California SunCare settled with DOJ and agreed to refrain from price-fixing, announcing a pricing policy, or threatening to terminate or actually terminating for non-compliance with suggested retail prices for a period of five years.

Keds Corporation, 117 F.T.C. 389 (1994) (consent order).

The Commission settled charges that Keds Corporation allegedly had agreed with some dealers to maintain resale prices on certain types of athletic and casual shoes, solicited commitments from dealers regarding pricing, and encouraged dealers to report noncomplying dealers. The consent order required Keds to refrain from: fixing the prices at which any dealer may advertise or sell the product; coercing any dealer to adopt or adhere to any resale price; attempting to secure commitments from dealers about the prices at which they would advertise or sell the products; or requiring or even suggesting that dealers report other dealers who advertise or sell any Keds products below a suggested resale price. The order also required Keds to inform its dealers that they were free to advertise and sell Keds products at prices of their own choosing. For five years, the order required Keds to incorporate a similar statement in any materials sent to dealers suggesting resale prices.

Baby Furniture Plus Association, Inc., 119 F.T.C. 96 (1995) (consent order).

The Commission entered a consent order with a trade association, a buying cooperative and its members for allegedly threatening to boycott children's furniture manufacturers who sold their products to discount catalog merchants. The consent order prohibited coercion of baby furniture manufacturers by means of actual or threatened refusals to deal.

Reebok International, 120 F.T.C. 20 (1995) (consent order).

The FTC alleged that Reebok and Rockport fixed the resale prices of their products. The settlement prohibited both companies from fixing the prices at which dealers advertised or sold athletic or casual footwear products to consumers. The settlement also prohibited the companies from coercing or pressuring any dealer to maintain or adopt any resale price, or from attempting to secure their commitment to any resale price. The order required Reebok and Rockport to inform their dealers in writing that dealers were free to advertise and sell Reebok and Rockport products at any price they chose, despite any suggested retail price established by the companies.

United States v. Playmobil USA, Inc., 1995-1 Trade Cas. (CCH) ¶ 71,000 (D.D.C. 1995) (final judgment).

Playmobil USA had maintained a Retailer Discount Policy that provided for the termination of any Playmobil dealer that failed to adhere to certain Playmobil suggested price ranges. In January 1995, DOJ filed a civil suit that alleged that Playmobil enforced this policy in a manner that violated the antitrust laws by reaching agreements with some of its retailers about what their retail prices would be. DOJ and Playmobil entered a settlement decree prohibiting Playmobil from reaching agreements with its dealers on retail price levels, and also from threatening dealers with termination for discounting off the retail price.

Onkyo U.S.A. Corporation, 1995-2 Trade Cas. (CCH) ¶ 71,111 (D.D.C. 1995) (final judgment).

Onkyo U.S.A. Corporation, a manufacturer of audio components, agreed to settle FTC charges that it violated a 1982 FTC order under which it agreed not to fix prices or engage in unlawful resale price maintenance. The complaint alleged that Onkyo sales representatives violated the terms of the order by: agreeing with a dealer to establish resale prices for the Onkyo products the dealer outlets sold to consumers; requesting that the dealer adhere to specified resale prices or price levels, informing the dealer that its prices were too low; directing the dealer to raise those prices, asking retailers to report other dealers who deviated from Onkyo's pricing policy; and responding to such deviations with threats and intimidation. Under the settlement, Onkyo paid $225,000 in civil penalties for violation of the original order.

RxCare of Tennessee, Inc., 121 F.T.C. 762 (1996) (consent order).

The Commission settled charges involving the use of an MFN clause by RxCare, the leading pharmacy network in Tennessee. The Commission concluded that a most-favored-customer clause in RxCare's contracts with participating pharmacies tended to keep reimbursement rates high by discouraging selective discounting and the development of rival networks. The primary theory of the case was that the most-favored-customer provisions facilitated horizontal coordination by the pharmacists. This "facilitating practices" theory is distinct from the equally interesting"raising rivals' costs" theory behind some recent DOJ cases involving most- favored-customer provisions.

New Balance Athletic Shoe, Inc., 122 F.T.C. 137 (1996) (consent order).

The Commission charged that New Balance entered into RPM agreements with some of its retailers, in which such dealers agreed to raise retail prices on New Balance’s products, maintain certain prices or price levels set by New Balance, or refrain from discounting New

An association of auto dealers settled charges that it threatened to boycott Chrysler if the manufacturer did not agree to change its vehicle allocation system to restrict vehicle supply to discounters engaged in Internet sales.

Nine West Group, Inc., 65 Fed. Reg. 13386 (March 13, 2000) (proposed consent agreement).
The Commission ordered a manufacturer of women's shoes to cease seeking agreements by retailers to fix, raise or stabilize shoe prices to consumers.

In the Matter of Sony Music Entertainment, Inc.; In the Matter of Time Warner, Inc; In the Matter of BMG Music, d.b.a. "BMG Entertainment"; In the Matter of Universal Music & Video Distribution Corp. and UMG Recordings, Inc.; and In the Matter of Capitol Records, Inc., d.b.a. "EMI Music Distribution" et al., 65 Fed. Reg. 31319 (May 17, 2000) (proposed consent agreements).
The Commission settled charges that the five largest manufacturers of CDs and the three largest distributors of CDs entered into MAP agreements to fix CD prices at higher than competitive levels, thereby forcing retailers to charge higher CD prices to consumers.

Toys R Us, Inc. v. FTC, 221 F.3d 928 (7th Cir. 2000).
A major toy retailer unlawfully enforced multiple vertical agreements in which each manufacturer promised the retailer that it would restrict distribution of its products to low-priced warehouse club stores, on the condition the other manufacturers would do the same.

II. STATE CASES

New York, et al v. Nintendo of America, Inc., 775 F.Supp. 676 (S.D.N.Y. 1991).
RPM suit against the manufacturer of Nintendo game machines, filed by all states, was settled with $5 rebate coupons distributed to over five million consumers.

In re Clozapine Antitrust Litigation, MDL 874 (N.D. Il. 1992).
Settlement of claims against a drug manufacturer that tied the sales of its prescription drug to the purchase of patient diagnostic services. The 35 litigating states and private class representatives settled the claims with injunctive relief, a 15% discount for future sales to patients on Social Security Disability Income until September 16, 1994 (almost two years), cash payments to each qualified purchaser in the amount of $38.92 per week purchased (up to a total of $10 million), $3 million credits to state mental health agencies, $3 million to a patient advocacy group earmarked for the treatment of new patients, and $2.08 million for attorneys fees and costs of litigation.

Maryland, et al v. Mitsubishi Electronics of America, Inc., 1992-1 Trade Cases (CCH) ¶ 69,743 (D. Md. 1992).
Fifty states and the District of Columbia obtained *parens patriae* damages and injunctive relief against an electronics manufacturer that engaged in resale price maintenance.

suit and fees. The consumer portion of the funds was distributed in proportionate shares by the states for charitable purposes related to women's health, women's educational/vocational training, and/or safety programs.

In re Disposable Contact Lens Antitrust Litigation, MDL 1030 (M.D. Fl. 2001).

Settlement of state *parens patriae* claims plus class action claims for all states other than Tennessee and Georgia against contact lens manufacturers who restricted the distribution of their products in distribution channels that competed with eye care professionals. In addition to injunctive relief the court approved a settlement of cash and benefits worth over $90.5 million, to be delivered to consumers.

New York et al v. Salton, Inc., 265 F. Supp. 2d 310 (S.D.N.Y. 2003).

See supra page 10.

In re Compact Disc Minimum Advertised Price Antitrust Litigation, 2003 U. S. Dist. LEXIS 12663 (D.Me. July 9, 2003).

See supra page 11.