

Does Your Company's Distribution Strategy Create Legal Risk?

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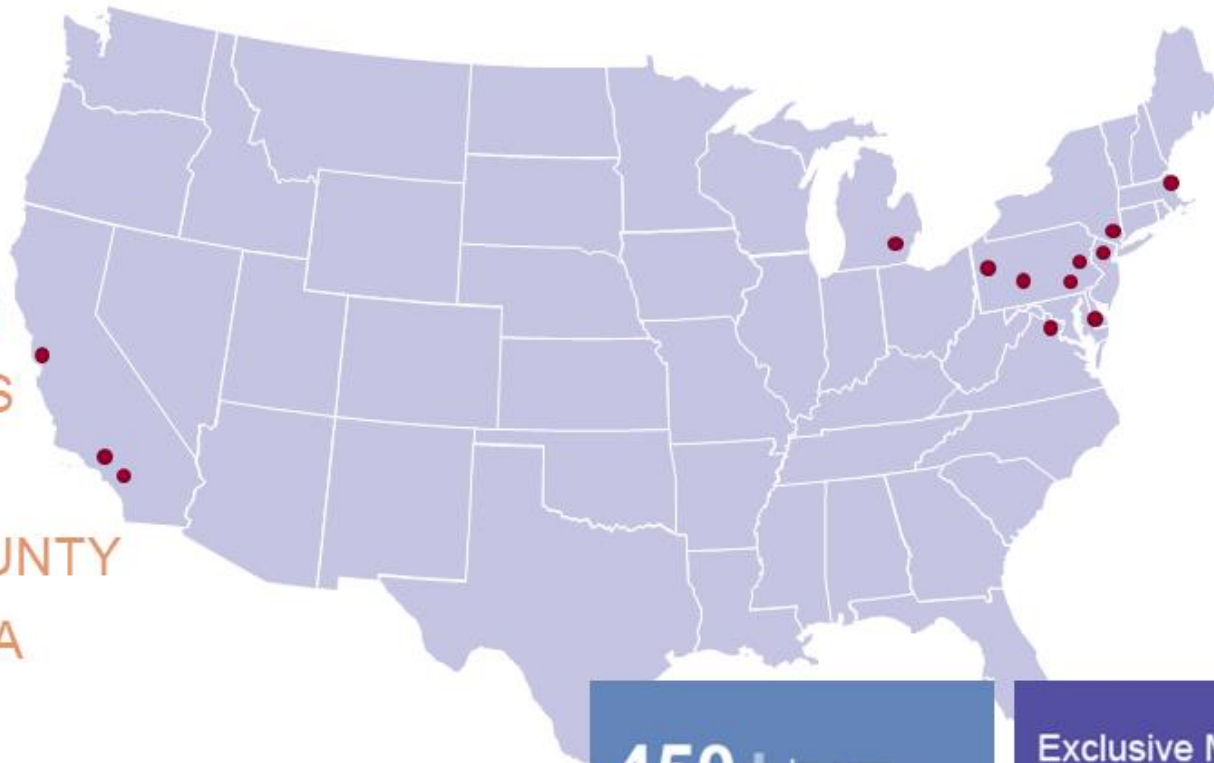
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Resale Price Maintenance: A Decade After *Leegin* – What Has Changed . . . What Hasn't?

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U.S. Competition Laws

Principal Statutes

- ▶ Sherman Act
 - Unreasonable trade restraints
 - Dominant Firm
- ▶ Robinson-Patman Act
- ▶ FTC Act
- ▶ Parallel State Laws

U.S. Enforcers

- ▶ Antitrust Division, Department of Justice
- ▶ Bureau of Competition, Federal Trade Commission
- ▶ State Attorneys General
- ▶ Private Plaintiffs

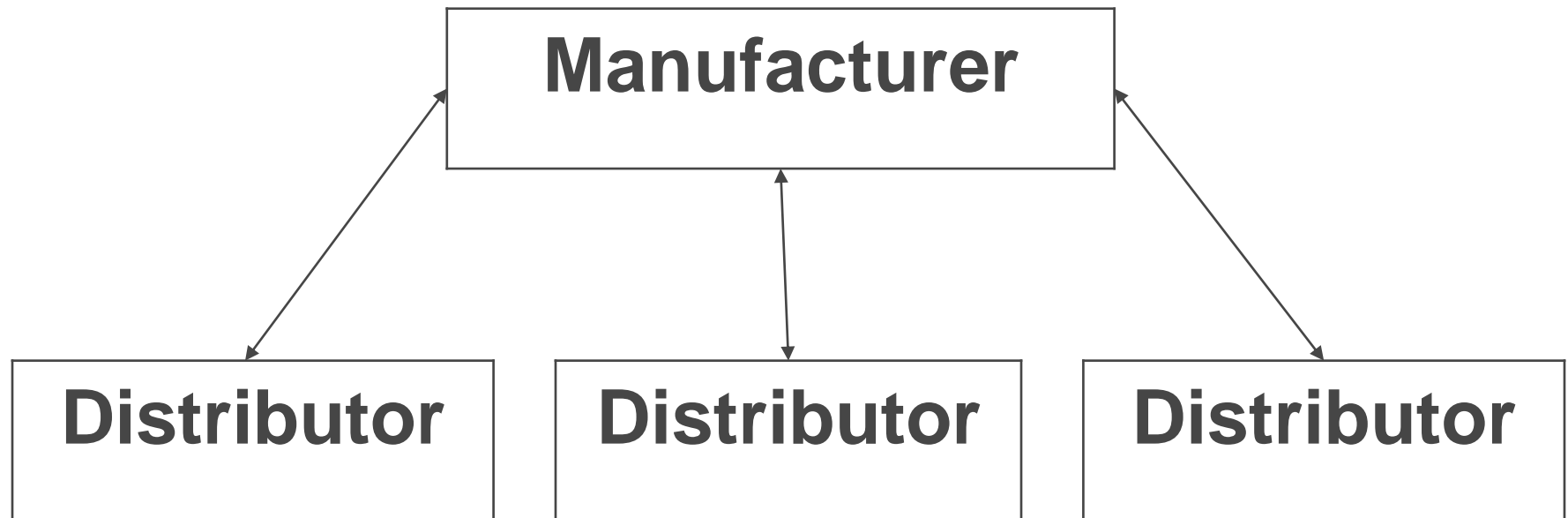
Sherman Act - Section 1

- ▶ “Every contract, combination . . . or conspiracy in restraint of trade or commerce . . . is declared to be illegal.”
- ▶ Case law interprets as prohibition against only **unreasonable** restraints that injure competition
- ▶ Clayton Act § 4 (15 U.S.C. § 15) authorizes private rights of action for treble damages and attorney’s fees

Per Se v. Rule of Reason

- ▶ *Per se* violations are conclusively presumed to be *unreasonable* restraints of trade. Plaintiff or government does not need to prove this element
 - Defendant cannot offer efficiency or procompetitive justifications or defenses
- ▶ Rule of reason violations are restraints – the anticompetitive effects of which outweigh the procompetitive effects
 - Unreasonable means an adverse effect on competition, not competitors

Vertical Restraints of Trade



Resale Price Maintenance

- ▶ Resale price maintenance: When a manufacturer and a reseller agree to a resale price
- ▶ Two types of resale price maintenance:
 - Maximum resale price fixing
 - Minimum resale price fixing

Colgate

- ▶ *United States v. Colgate Co.*, 250 U.S. 300 (1919).
 - *Colgate Resale Price Policy* – Manufacturer unilaterally suggests minimum or actual resale price and refuses to supply any reseller that does not comply
 - Cannot be a Sherman Act violation without an agreement
 - Manufacturers are free to choose with whom they do business

Colgate Policies

- ▶ Not without difficulty
 - Reseller are free to discount
 - Termination is the only option for discounting resellers
 - Also risk that any discussions with resellers or second chances to confirm to policy will be viewed as an agreement

Maximum Resale Price Maintenance

- ▶ **Maximum Resale Price Maintenance:**
 - Subject to rule of reason analysis. See generally *State Oil v. Khan*, 522 U.S. 3, 19 (1997).
 - But note, that supposed maximum resale prices can easily become *minimum* resale prices as a factual matter . . .

Minimum Resale Price Maintenance

- ▶ *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 127 S. Ct. 2705 (2007).
- ▶ *Leegin's* Legal Arguments:
 - No clear anticompetitive effect that supports per se treatment of resale price maintenance
 - Per se treatment of RPM harms competition
 - minimum resale price agreements must be judged under rule of reason analysis

Leegin

- ▶ *Leegin's* Business Reasons:
 - Induce retailer to promote and carry Leegin products by ensuring them a higher margin
 - Higher margin for resellers would encourage longer hours of operation, improved sales facilities, better trained personnel
 - Uniform prices for Leegin products in all locations

Can Manufacturers Hang Their Hats on *Leegin*?

- ▶ A decade after the Supreme Court's *Leegin* decision, what has changed?
- ▶ Can manufacturers safely institute minimum resale pricing policies?
- ▶ Under federal law, yes assuming rule of reason analysis is satisfied (policies are not *per se* lawful)
- ▶ Several states, however, have explicitly rejected *Leegin* and others have remained silent.
 - During *Leegin*, 33 state attorney generals signed amicus brief arguing RPM should remain *per se* illegal

Online Sales

- ▶ Expands the reach of products but also subjects manufacturers to more jurisdictions
 - Can subject manufacturers to state antitrust law and international competition law
- ▶ EU Competition Law generally more strict than U.S.
 - Minimum resale price maintenance generally considered illegal except under very limited circumstances

California

Attorney General maintains that Cartwright Act provides that RPM agreements are per se illegal -- achieved judgments by consent in 2010 and 2011 against two companies that restricted resale prices



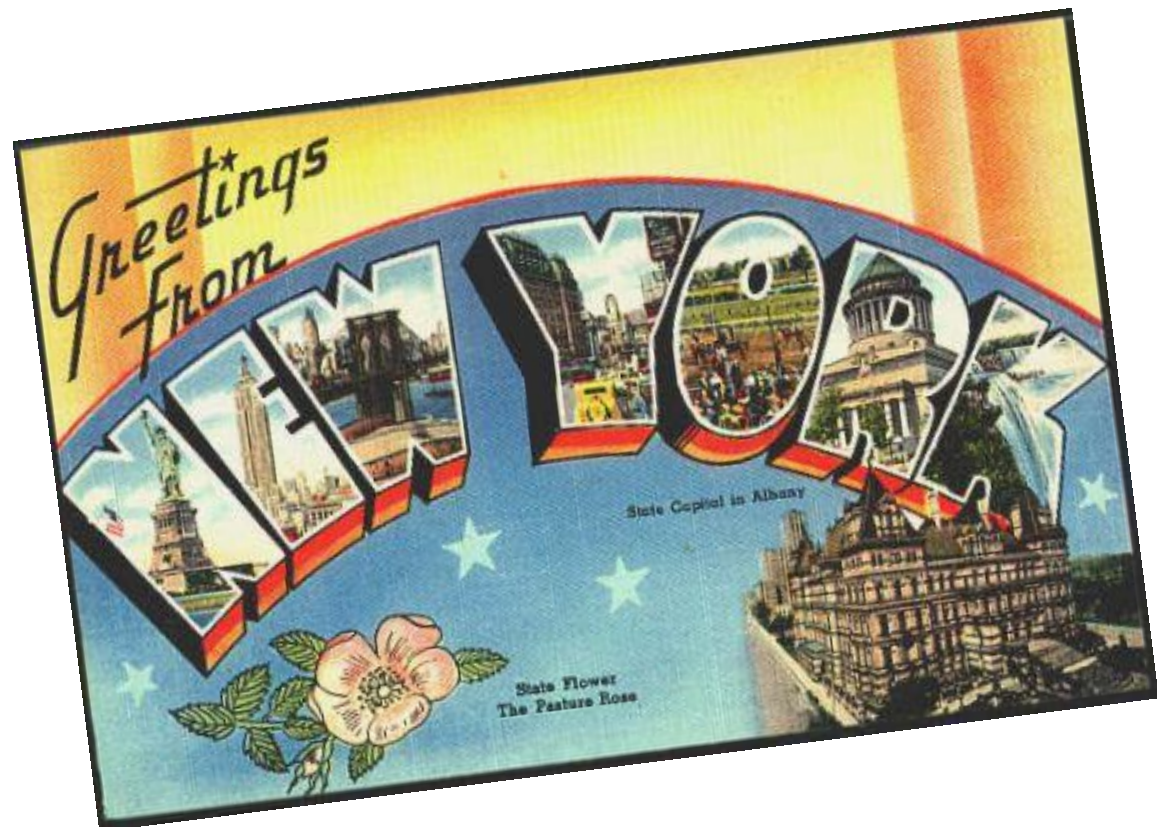
Maryland

Md. Code Ann., Comm. Law § 11-204(b):
“a minimum price below which a retailer, wholesaler, or distributor may not sell a commodity or service is an unreasonable restraint of trade or commerce.”



New York

People v. Tempur-Pedic Int'l Inc., 944 N.Y.S. 2d 518 (2012) – NY Supreme Court holds that RPM agreements are unenforceable, but not illegal



North Carolina Asst. AG Statement



... considers RPM to be per se illegal under state's law ... that

Costco v. Johnson & Johnson Vision Care

- ▶ Costco filed suit against Johnson & Johnson Vision Care in March 2015 in the District Court for the Northern District of California.
- ▶ Johnson & Johnson instituted what it termed a Unilateral Pricing Policy (“UPP”) which set a minimum price for contact lenses
- ▶ Costco alleged that Johnson & Johnson engaged in price-fixing with distributors by way of enforcing a minimum retail price, in violation of Section 1 and state antitrust law (CA, NY, and MD).
- ▶ Parties jointly dismissed the suit in May 2016 after Johnson & Johnson withdrew the policy.
- ▶ Follow-on litigation by MD AG and private plaintiffs.

State of Maryland v. Johnson & Johnson

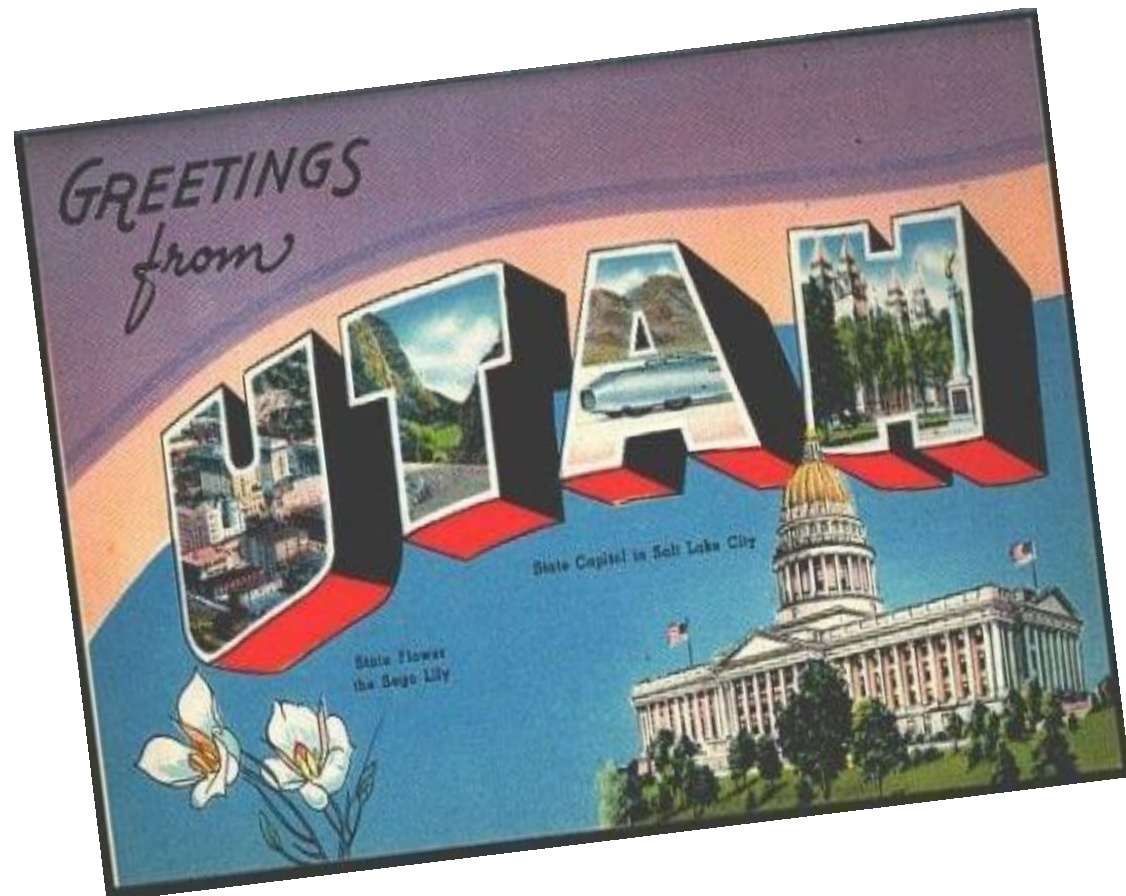
- ▶ In February 2016, Maryland's Attorney General brought an action against Johnson & Johnson for violation of the Maryland Antitrust Act.
- ▶ Complaint premised upon allegation that the renegotiation of the RPM policy with Costco was an agreement and thus policy was not unilateral.
- ▶ On March 20, 2017, the attorney general announced a settlement.
 - Johnson & Johnson agreed that all such policies had been, and would remain, discontinued.
 - Johnson & Johnson agreed to pay \$50,000 to the state as a civil penalty

Multi-District Contact Lens Litigation

- ▶ MDL consolidated in the District Court for the Middle District of Florida.
- ▶ The Third Amended Class Action Complaint alleges that manufacturer defendants, including Johnson & Johnson, entered into horizontal price-fixing schemes in violation of federal law; and additionally, that distributors were also engaging in price-fixing.
- ▶ State law claims for violation of the Maryland Consumer Protection Act dismissed; federal and state antitrust claims remain in the case with trial set for 2019.

Utah

“A contact lens manufacturer or a contact lens distributor may not . . . take any action, by agreement, unilaterally, or otherwise, that has the effect of fixing or otherwise controlling the price that a contact lens retailer charges or advertises for contact lenses.” Utah Code Section 58-16a-905.1.



So What Is a Manufacturer To Do?



Practical Advice

Traditional Colgate Policy is still safest option

- ▶ Not a silver bullet, however, and must proceed with caution
- ▶ Unilateral conduct is key
- ▶ Policy only – not by agreement
- ▶ Do not involve distributors in developing the policy
- ▶ Limit warnings and second chances
- ▶ Uniform enforcement
- ▶ Tight administration, training and supervision
- ▶ Must understand industry and distribution chain to understand impact
- ▶ Consider MSRP and MAP

Managing Internet Commerce and Exclusive Territories

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Distribution & Franchise Agreements

- ▶ Contract will determine rights
- ▶ Reserve the right to sell over the internet
- ▶ If existing exclusive territories, amend contract to make clear that: manufacturer/distributor/franchisor may sell to end users via the internet, or
- ▶ exempt internet sales from promise not to compete in exclusive territories, or
- ▶ establish that internet sales occur at the seller's processing facility and not at any other place

Uniform Commercial Code

- ▶ State law establish rights of parties if distribution agreement is silent on internet sales
- ▶ Under the UCC, a sale is defined as the “passing of title from the seller to the buyer for a price.”
- ▶ In the e-commerce space, when exactly does title pass?
- ▶ This is potentially problematic when a distributor or franchisor which granted exclusive territories decides to sell its products online.
- ▶ There is little case law providing guidance.

Pro Golf of Florida v. Pro Golf of America

- ▶ Pro-Golf America (PGA), the franchisor, wanted to engage in e-commerce.
- ▶ It's contract with Pro Golf of Florida (PGF), the franchisee with an exclusive sales territory, was silent on the issue.
- ▶ PGF refused to enter into a supplemental agreement that would have provided for commissions in exchange for, *inter alia*, permitting PGA from selling directly to consumers located in the exclusive territory via the internet.

Pro Golf of Florida v. Pro Golf of America

- ▶ PGF sued and argued that any online sale to a customer in its exclusive territory (Florida) violated the franchise agreement as a matter of law.
- ▶ PGA argued that the sale happened either (a) where the sale was accepted and processed or (b) where its warehouse and shipping facilities were located.
- ▶ As the franchise agreement was silent, the court looked to the UCC and Michigan law to interpret where title passed, concluding that under Michigan law, it occurs “at the time and place at which the seller completes his performance with reference to the physical delivery of the goods” unless “otherwise explicitly agreed.”
- ▶ In the e-commerce context, this would be based on the shipping terms for Internet sales, which neither party made part of the record. Therefore, summary judgment was denied.

In the Matter of Hales v. Conroy's, Inc. (1-800-Flowers)

- ▶ JAMS Arbitration
- ▶ Franchise agreement predated Internet sales but franchisor reserved the right to “use other systems and technology” when assigning orders to participating franchisees.
- ▶ Panel ruled for franchisor.
 - Focused on the language of the franchise agreement, not the UCC.
 - The franchise agreement did not guarantee exclusivity.
 - The reservation to use “other technology” preserved franchisor’s right to use the Internet.

Emporium Drug Mart, Inc. v. Drug Emporium, Inc.

- ▶ Franchise agreement granted exclusivity rights to franchisees to operate “bricks and mortar” low price drugstores.
- ▶ Franchisor launched a website which it promoted as a “full-service online drugstore”
- ▶ Franchisor argued exclusivity applied only to physical stores, not an e-commerce platform.
- ▶ The panel ruled for franchisees.
 - No “other technology” term in the agreement.
 - Website offered heavy discounts on the same products sold at bricks and mortar stores evidencing direct competition.
 - Franchisor previously honored exclusive territories and even offered compensation during website test period establishing franchisees’ reasonable expectation they would not compete against franchisor

Robinson-Patman Act: Viability and Risk of Claims as E-Commerce Continues Its Ascent

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Robinson-Patman Act

- ▶ Amendment of the Clayton Act targeting the perceived harm to competition occasioned by powerful buyers, rather than sellers
- ▶ Act generally only applicable when the buyers are competing for customers, i.e., they are resellers
- ▶ Broadly, claims come in two forms:
 - Price discrimination – Section 2(a)
 - Indirect discrimination through promotional allowances – Sections 2(d) and 2(e)

Price Discrimination

- ▶ Section 2(a) prohibits price discrimination between buyers of “commodities of like grade and quality” where the effect of such discrimination may be “substantially to lessen competition”
- ▶ Notable Elements:
 - Difference in price (“net” price) in completed sales to two or more buyers
 - Sales must be reasonably contemporaneous
 - “Commodity” products of “like grade and quality”
 - Competitive injury

Price Discrimination - Defenses

- ▶ Meeting competition – seller may meet (but not beat) its competitor's price
- ▶ Cost justification – seller may pass cost savings to buyers through lower prices (delivery costs most viable)
- ▶ Changing conditions – seller may respond to market conditions such as seasonability or obsolescence of product
- ▶ Functional availability – was the lower price available to the disfavored buyer?
- ▶ Functional discount – was the discount based on a function or service performed by the favored buyer?

Discrimination Regarding Promotions

- ▶ Sections 2(d) and 2(e) originally designed to protect smaller businesses from indirect price discrimination
- ▶ 2(d) prohibits the seller from making a promotional payment to a buyer not offered to other similar buyers
 - Ex. ABC Industries provides Distributor X with \$1000/quarter for ad placements, but does not provide the same funds to Distributor Y
- ▶ 2(e) prohibits the seller from offering promotional services only to a favored buyer
 - Ex. ABC Industries provides Distributor X with advertising displays for a new product launch, but does not provide them to Distributor Y
- ▶ These sections are considered together as a “harmonious” whole

Discrimination Regarding Promotions

- ▶ Contemporaneous sales requirement – seller does not need to offer promotions indefinitely
- ▶ Availability must be made on “proportionately equal terms”
 - Reasonably informing competing buyers of the promotion
 - Practical and functional ability to take advantage of the promotion
- ▶ No requirement to show competitive injury, must still show “antitrust injury”
- ▶ Meeting competition defense
- ▶ No cost justification defense

Discrimination Regarding Promotions

- ▶ *FTC Fred Meyers Guides*
 - Notice
 - Functional Availability
- ▶ Updated in 2014 – reflects government’s position that traditional distribution outlets and online distribution outlets are in competition with each other
- ▶ No additional guidance that clarifies how to make promotions functionally available in equal terms to both traditional and online retailers
- ▶ https://www.ftc.gov/system/files/documents/federal_register_notices/2014/09/140929fredmeyerfrn.pdf

Recent Case Law

- ▶ Who brings these claims?
 - FTC
 - Private Plaintiffs
- ▶ *Woodman's Food Market, Inc. v. Clorox Co.*, No. 14-cv-734, 2015 U.S. Dist. LEXIS 11656 (W.D. Wis. Feb. 2, 2015), *rev'd*, 833 F.3d 743 (7th Cir. 2016) (Wood, C.J.)
 - Bulk packaging not a promotional allowance under Section 2(e)
 - Leaves open question of whether lower unit cost provided only to some buyers through bulk packaging is price discrimination under Section 2(a)
- ▶ *ABC Distrib., Inc. v. Living Essentials LLC*, No. 15-cv-02064, slip op. (N.D. Cal Jan. 15 2016) (denying motion to dismiss); 2017 U.S. Dist. LEXIS 53912 (N.D. Cal. Apr. 7, 2017) (denying class certification)
- ▶ *Satnam Distribs., LLC v. Commonwealth-Altadis, Inc.*, 140 F. Supp. 3d 405 (E.D. Pa. 2015) (Restrepo, J.) (denying motion to dismiss)
- ▶ *Matthew Enter., Inc. v. Chrysler Gp. LLC*, No. 13-cv-04236, 2016 U.S. LEXIS 108693 (N.D. Cal. Aug. 15, 2016) (denying summary judgment); slip. op. (N.D. Cal. Apr. 20, 2017) (denying motion for re-trial)

E-commerce Application

- ▶ Few RPA cases thus far regarding online distribution
- ▶ *Stillwell v. Radioshack Corp.*, No. 07-cv-0607, 2007 U.S. Dist. LEXIS 103212 (S.D. Cal. Dec. 18, 2007) (dismissing RPA claims)
 - Radioshack made direct customer sales through radioshack.com (and other outlets) at lower prices than it sold products to its franchisees
 - No RPA claim due to lack of allegations regarding competitive injury
 - In a later summary judgment decision, court held that Radioshack's direct sales through its website did not breach terms of contract because they were not sales from a brick and mortar store and thus did not invade the plaintiffs' Areas of Primary Responsibilities
- ▶ *House of Brides, Inc. v. Alfred Angelo, Inc.*, No. 11-cv-7834, 2014 U.S. Dist. LEXIS 1850 (N.D. Ill. Jan. 8, 2014) (granting motion to dismiss)
 - Defendant set MSRP and MPP policies that would have effectively eliminated the competitive advantage of plaintiff, who primarily operated online
 - Plaintiff failed to allege that it *paid* higher prices for products as opposed to being restricted from *charging* lower prices
 - Court left open whether "any price differentials between online and brick-and-mortar distributors are justifiably procompetitive"

E-commerce Hypos

- ▶ Ned Flanders owns and operates several brick-and-mortar locations of the Leftorium, a store specializing in products for left-handed people. His best selling products are a series of left-handed scissors manufactured by Milhouse Blades, Inc. This scissors line is also distributed by Lefty Mania, which sells solely through its website leftymaniacom. Placing value on brick-and-mortar distribution, Milhouse offers Leftorium a 15% discount that it does not offer to Lefty Mania.
- ▶ Has Milhouse committed price discrimination? Are there any defenses?
- ▶ Does the Leftorium compete with Lefty Mania?
- ▶ Could the 15% differential serve as a functional discount?
- ▶ How could Milhouse lessen risk?



E-commerce Hypos

- ▶ Duff Brewery sells cases of Duff Beer to distributors nationwide. It would like to increase sales in areas where it has particularly heavy competition from other breweries. Acknowledging that internet advertising has become more effective than traditional methods, Duff offers to:
 - Pay 50% of its distributors' website hosting fees and internet advertising costs for six months up to 5% of the distributor's purchases for that period;
 - Provide Duff promotional graphics for the websites; and
 - Make special products available to distributors depending on the number of website hits
- ▶ The distributors that maintain their own websites are typically large buyers with multiple locations. Is there any risk of RPA claims from smaller competing distributors?
- ▶ Implicates Sections 2(d) and 2(e)
- ▶ Is it proportionally available to all distributors?
- ▶ How do you value graphics and other electronic advertisements?
- ▶ What is the risk of making special products available only to larger distributors?



RPA – Practical Application

- ▶ Will these claims remain viable?
- ▶ You can win, but is it worth the risk and cost?
- ▶ How to manage risks:
 - Use contract terms to define competition between distributors (exclusivity, etc.) and limit the contours of online distribution if possible
 - Functional availability is key when creating discount programs and other contractual terms implicating price
 - For promotions and allowances, consult *Fred Meyers Guides* as a starting point even though there is limited guidance on internet sales
 - Design incentive and promotional programs that account for differences between the value of brick-and-mortar outlets versus the value of online presence; will require creative approaches where there are particular business objectives regarding e-commerce. Feel free to consult outside counsel!

Questions & Answers

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