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As a general rule, vertical restraints – those entered between firms at different levels of distribution that affect intrabrand competition – are judged under the rule of reason, which generally seeks to evaluate the restraint's positive (procompetitive) and adverse (anticompetitive) effects on price, quality, and consumer choice. There are, however, two important and related exceptions. First, many state Attorneys General consider vertical price restraints, primarily resale price maintenance (RPM) agreements, to be per se unlawful, and that interpretation finds support in some states' laws. In addition, the federal antitrust enforcement agencies, primarily the Federal Trade Commission, have in recent years expressed skepticism about the consumer benefits from RPM and advocated a more rigorous analysis under some "truncated" form of the rule of reason. Second, under Section 1 of the Sherman Act and most if not all state laws (though perhaps not the FTC Act), a unilateral decision to impose or comply with a vertical restraint fails to establish the requisite "agreement" and is therefore per se lawful.

This article discusses the interplay between these somewhat confusing and potentially conflicting rules and enforcement regimes. It also discusses the most prevalent types of vertical price and non-price restraints.

UNILATERAL CONDUCT – THE COLGATE DOCTRINE

In the early development of U.S. antitrust law, most vertical restraints were considered per se illegal. Partly to mitigate that harsh result, a companion rule was established. The Colgate doctrine provides that a firm may "exercise his own independent discretion as to parties with whom he will deal; and, of course, he may announce in advance the circumstances under which he will refuse to sell." Thus, under Colgate, unilateral vertical price restraints are per se legal under Section 1 because they do not trigger the "contract, combination or conspiracy" requirement. Because state antitrust law tends to explicitly or implicitly follow decisions interpreting the Sherman Act, the Colgate doctrine is generally recognized under state law as well.

The Colgate doctrine can seem conceptually difficult or even artificial in practice, and is perhaps unique among antitrust regimes worldwide. Nevertheless, because most firms are not monopolists (in which case anticompetitive unilateral conduct would violate Sherman Act Section 2), the Colgate doctrine remains an important antitrust defense for all forms of vertical restraints.
VERTICAL PRICE RESTRAINTS - RESALE PRICE MAINTENANCE AND MINIMUM ADVERTISED PRICING

Federal Antitrust Law - The Sherman Act

For decades, vertical price restraints of any type (that were agreed, not unilateral) were considered per se illegal under Section 1 of the Sherman Act.\(^7\) More recently, the Supreme Court reversed its early precedent, holding that both maximum, and later minimum, resale price maintenance have potential procompetitive effects and should be judged under the rule of reason.\(^8\) As the Supreme Court noted in \textit{Leegin}, minimum RPM agreements can "stimulate interbrand competition," encourage "retailers to invest in tangible or intangible services or promotional efforts that" increase competition, eliminate free riding, and have "the potential to give consumers more options."\(^9\)

\textit{Leegin} noted that by protecting retail margins, vertical price restraints enable retailers to provide quality displays, product demonstrations, well-trained staff, as well as more intangible "quality certification," without fear of being undercut by a free-riding intrabrand competitor.\(^10\) By protecting dealer investment in "promotional services and sales efforts," a manufacturer can "increase the attractiveness of its product."\(^11\) Thus, "the use of RPM generally [is] consistent with demand-increasing activities by retailers."\(^12\)

This is especially true for innovative and untested products, which often require "missionary work" by retailers to develop consumer acceptance.\(^13\) Vertical price restraints can increase competition by "facilitating market entry for new firms and brands," which is "essential to a dynamic economy."\(^14\)

The Supreme Court, however, identified certain "red flags" that might suggest a heightened risk of anticompetitive effects from RPM, leading to "more careful scrutiny." Those include situations in which "many competing manufacturers adopt the practice," when many "retailers were the impetus" for the adoption of RPM (perhaps signaling the existence of a retailer cartel), or when the practice is likely to increase prices because a manufacturer or retailer is a dominant player in the market in which it competes.\(^15\)

Finally, there may be a concern when a dominant manufacturer adopts vertical price restraints because it "might use resale price maintenance to give retailers an incentive not to sell the products of smaller rivals or new entrants."\(^16\)

State and FTC Enforcement

State laws and enforcement policies relating to RPM differ. Many states follow Sherman Act jurisprudence in interpreting their own antitrust laws, and some are required by statute to do so. Others need not, and some explicitly do not when it comes to RPM. A number of state attorneys general filed an \textit{amicus} brief in \textit{Leegin} advocating retention of the per se rule, and several have since taken the position that minimum RPM

\(^9\) \textit{Leegin}, 551 U.S. at 890.
\(^10\) \textit{Leegin}, 551 U.S. at 890-91.
\(^14\) \textit{Leegin}, 551 U.S. at 891.
\(^15\) \textit{Leegin}, 551 U.S. at 897-98. \textit{See Toys "R" Us, Inc. v. FTC}, 221 F.3d 928, 937-38 (7th Cir. 2000); Babyage.com v. Toys "R" Us, Inc., 558 F.Supp.2d 575, 583 (E.D. Pa. 2008) (holding post-\textit{Leegin} that "harm to intrabrand competition is cognizable when brought about by the demands of a ‘dominant’ retailer").
\(^16\) \textit{Leegin}, 551 U.S. at 894.
agreements are still per se illegal under their states' antitrust laws. Since Leegin, for example, the California Attorney General has prosecuted at least two RPM agreements.

The application of Leegin by the Federal Trade Commission is also less certain. Not long after the Supreme Court's decision, the Commission vacated a consent decree prohibiting Nine West from entering into an RPM agreement with its retailers. But the Commission also noted that enforcement agencies need to be "diligent" in evaluating RPM agreements and must "take careful account of possible anticompetitive harms in the treatment of RPM matters under a rule of reason framework." Drawing on the Court's analysis in Leegin, the FTC in Nine West identified, but found absent, "conditions in which RPM posed greater anticompetitive potential."  

While the law relating to restrictions on advertised prices is less extensive, such restraints are generally agreed to pose a lower risk of competitive harm, and might not be considered price restraints at all. Prior to Leegin, some courts viewed minimum advertised price (MAP) restraints as "non-price restrictions" and not "proof of a vertical agreement to fix prices." MAP agreements allow more pricing flexibility, and create a somewhat different balance of competitive effects. Because Leegin weakened the distinction between price and non-price vertical restraints, the focus going forward, at least under federal law, will be on the actual effect of MAP on retail prices, balanced against procompetitive effects. In industries where negotiating from an advertised price is commonplace, MAP will have less effect on actual prices.

VERTICAL NON-PRICE RESTRAINTS - TERRITORIAL RESTRICTIONS

It is now settled that non-price vertical restraints are subject to the rule of reason under


20 Nine West Order at 9-10. The FTC suggested a "truncated rule of reason analysis" as adopted in Polygram Holdings, Inc. v. FTC, 416 F.3d 29 (D.C. Cir. 2005). Id. at 11-12.

21 Nine West Order at 9-10.


both federal and state law. Although territorial restraints have the effect of reducing, or even eliminating, intrabrand competition, their potential benefit to interbrand competition is the "primary concern of antitrust law." "Established manufacturers can use them to induce retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their products." New entrants can use territorial restraints to "induce competent and aggressive retailers" to invest "capital and labor that is often required" to promote an unknown product. They can also be used to prevent free riding. These principles apply equally to restrictions on online sales, which are considered "territorial" despite the Internet's role as a frequent source of discounted prices.

Because of these recognized benefits, most territorial restrictions have been upheld under the rule of reason. However, cases involving manufacturers with high market shares have recognized that the benefits to interbrand competition may be outweighed by the harm to consumers from the reduction of intrabrand competition. Courts will also call into question territorial restraints that lack a valid business purpose.

26 Sylvania, 433 U.S. at 52 n.19.
27 Sylvania, 433 U.S. at 55.
28 Sylvania, 433 U.S. at 55.
29 See ABA SECTION OF ANTITRUST LAW, ANTITRUST HANDBOOK FOR FRANCHISE AND DISTRIBUTION PRACTITIONERS III-12 (2008).
30 ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS, p. 159 (7th ed. 2012).
31 Graphic Prods Distribs. v ITEK Corp., 717 F.2d 1560, 1578 (11th Cir. 1983) (affirming judgment against "airtight" territorial restraint where manufacturer had 70-75% of market, superiority of product limited interbrand competition, and jury found that harm to intrabrand competition outweighed proffered procompetitive justifications); Tunis Bros. Co., Inc. v. Ford Motor Co., 696 F.Supp. 1056, 1061 (E.D. Pa. 1988) (denying summary judgment due to possibility of "a diminution in intrabrand competition in an oligopolistic market exercised by one with considerable market power").
32 See Eiberger v. Sony Corp. of America, 622 F.2d 1068, 1076-78 (2d Cir. 1980) (affirming finding that warranty program was unreasonable vertical restraint where primary purpose was to enforce a territory restriction, not to enhance warranty service, it eliminated intrabrand competition, and any benefit to interbrand competition was "at most 'slight'").