

DEALING WITH DEALERS – SOME DO’S AND DONT’S

By John A. Washburn

Manufacturer-imposed restrictions on dealers have been the focus of antitrust law since the early days of such laws. Although the law has become relatively clear as to certain types of agreements, each case is fact specific and requires analysis.

Historically, there was a concern that it would be harmful for manufacturers to retain any control over the distribution of a product once it had been sold to a distributor. However, the law has for some time recognized that certain restrictions produce benefits for the consumer. As long as the restrictions are vertical, i.e., imposed by the manufacturer, and not in effect horizontal agreements foisted upon a manufacturer by various distributors, most manufacturer restrictions are not per se illegal and will be analyzed on a “rule of reason” basis. Although various vertical restrictions may effectively limit intrabrand competition among distributors of the same manufacturers, they are viewed as fostering interbrand competition among distributors of different manufacturers and therefore treated favorably under antitrust law. The significant exception is resale price maintenance which is still illegal per se despite criticism of the rule by economists.

A. Generally Acceptable Practices.

The following restrictions in some form are now generally viewed as permissible under the law:

1. Geographic Restrictions. Geographic restrictions fall into several categories: exclusive dealerships, areas of primary responsibility (APR) agreements, location clauses agreements and territorial restriction agreements. Such provisions are understood by economists to provide benefits to consumers by creating incentives for dealers to provide better post-sale service and engage in more advertising. The dealers do a better job in these respects if they are protected from “free riders” who, but for the restrictions, might operate in the same territory and get the benefit of such post-sale services and advertising without having made any investment.

Under exclusive distributorship agreements, the manufacturer makes one distributor the sole distributor within a certain geographic area. Although these arrangements have generally been permitted by the courts, they may be subject to challenge if either the manufacturer or the distributor is dominant. APR agreements impose requirements on the distributor to meet certain sales levels in a given area, i.e., an area of primary responsibility, but do not prohibit the distributor from selling the manufactured goods outside the area. Moreover, other distributors are not prohibited from selling into the area. An agreement with a location clause restricts the dealer’s ability to sell the manufacturer’s goods to a specific location. Neither APR’s nor location clause agreements have been challenged much lately.

Agreements which prohibit dealers from selling outside of a given territory may come under somewhat greater scrutiny depending on the market power of the manufacturer and the likely effect of restrictions on competition. Analysis of these types of agreements is fact-specific. However, when these agreements can be deemed to be imposed by wholesalers or retailers as a horizontal conspiracy to reduce competition, antitrust concerns arise.

2. Customer Restraints. Restrictions which prohibit a dealer from selling to certain accounts have been affirmed by courts, but this type of restriction may be subject to more scrutiny than geographic restrictions.

3. Dual Distribution. The antitrust laws generally do not prohibit the manufacturer from selling to wholesalers and retailers simultaneously or from selling to manufacturer-owned distributors, but occasionally arrangements involving dual distribution systems have been held to be illegal.

B. Restrictions Regarding Price. The one area in which vertical restrictions imposed by a manufacturer still are subject to considerable limitation is the area of price maintenance. Although some commentators have argued that the antitrust laws should be modified to give manufacturers more control over resale prices, the case law still severely limits the manufacturer’s right to set minimum prices.

1. Maximum Price Control. Even though economically the consumer clearly is benefited from manufacturers imposing maximum prices, it was only recently that the U.S. Supreme Court declared that such manufacturer-imposed maximum price restrictions were legal. Some state laws may still prohibit this practice. Although the courts will apply a “rule of reason,” the maximum price restrictions will not be illegal per se, but minimum price restrictions are still considered illegal per se.

This article appeared in the Winter 2004 issue of the GReview.

DEALING WITH DEALERS – SOME DO’S AND DONT’S (CONTINUED)

2. Minimum Price Maintenance. An express requirement, whether written or oral, with a distributor that the distributor not sell below a certain price is illegal *per se*, i.e., it is deemed a violation of antitrust laws without any inquiry as to the actual impact of the restriction on competition. Although price maintenance agreements are illegal, some manufacturers have adopted so-called “Colgate” policies to allow them to suggest the prices at which they expect the dealers will sell their product. Terminating a dealer who fails to adhere to the suggested pricing is not automatically a violation. However, the manufacturer must not require a dealer’s commitment to adhere to the suggested price. Any conduct or statement indicating that such agreement has been given may prove fatal. If there is any indication that the termination was as a result of any agreement or understanding with another dealer, the manufacturer might find itself in trouble with the terminated dealer. Also, certain practices such as monitoring distributor prices in a coercive manner or threats of price increases for failure to adhere to the suggested pricing may give rise to a violation. Implementation of suggested retail pricing policies or the termination of dealers due to dissatisfaction with the dealer’s pricing practices are therefore matters which require careful legal review.

3. Other Suspect Practices. Minimum cooperative advertising programs require distributors to advertise the products at or above minimum advertised prices in order to receive advertising money from the manufacturer. These programs have recently been the subject of government challenges in the distribution of prerecorded music. The Government enforcement agencies have also frowned on “most favored nations” clauses in agreements between manufacturers and dominant distributors. These clauses guarantee that a distributor will be given terms no worse than the best terms given any other distributor.

4. Permitted Methods of Influencing Prices. Although minimum pricing restrictions are *per se* illegal, manufacturers may advertise suggested retail prices subject to certain limitations. As long as the dealer is free to charge prices different than the advertised price, the practice is protected, although a continuing disparity between advertised and actual prices can create exposure and may be a deceptive practice under the Federal Trade Commission Act. With respect to minimum advertising pricing, manufacturers must be careful not to engage in any of the prohibited activity discussed above with respect to securing a distributor’s consent to price at a certain level. Promotional allowances are generally all right as long as the dealer is free to set the ultimate price. Although the law is not crystal clear, it would seem that agreements requiring dealers to pass through price reductions under promotional allowance programs should survive a legal challenge.

5. Canada and Europe. There is some commonality in how antitrust laws are applied in this country and other jurisdictions, but manufacturers should be on guard when venturing into Canada or Europe with respect to cross border pricing policies. Certain policies which are acceptable in the U.S. may not pass muster under EU or Canadian antitrust laws. In addition, the particular disclaimers which may be required in order to implement the manufacturer’s minimum advertised price program may differ when distributing goods outside the boundaries of the U.S.

6. Consignments. If the arrangement between the manufacturer and the dealer is a true consignment relationship, resale price maintenance does not become an issue; however, just calling an arrangement a consignment does not mean it is one. It must be a consignment in substance to avoid antitrust scrutiny.

The foregoing is a brief summary of some of the rules affecting the manufacturer-distributor relationship, but some idea of the general principles may prove helpful in avoiding problems down the road.

*John Washburn is a Partner in Gould & Ratner’s Corporate/Commercial Group.
He may be reached at 312/899-1609 or at jwashburn@gouldratner.com.*

This article appeared in the Winter 2004 issue of the GReview.