An FTC Guide to

Dealings in the Supply Chain

Manufacturer-imposed Requirements

REASONABLE PRICE, TERRITORY, AND CUSTOMER RESTRICTIONS on dealers are legal. Manufacturer-imposed requirements can benefit consumers by increasing competition among different brands (*interbrand competition*) even while reducing competition among dealers in the same brand (*intrabrand competition*). For instance, an agreement between a manufacturer and dealer to set maximum (or "ceiling") prices prevents dealers from charging a non-competitive price. Or an agreement to set minimum (or "floor") prices or to limit territories may encourage dealers to provide a level of service that the manufacturer wants to offer to consumers when they buy the product. These benefits must be weighed against any reduction in competition from the restrictions.

UNTIL RECENTLY, courts treated minimum resale price policies differently from those setting maximum resale prices. But in 2007, the Supreme Court determined that all manufacturer-imposed vertical price programs should be evaluated using a rule of reason approach. According to the Court, "Absent vertical price restraints, the retail services that enhance interbrand competition might be underprovided. This is because discounting retailers can free ride on retailers who furnish services and then capture some of the increased demand those services generate." Note that this change is in federal standards; some state antitrust laws and international authorities view minimum price rules as illegal per se.

If a manufacturer, on its own, adopts a policy regarding a desired level of prices, the law allows the manufacturer to deal only with retailers who agree to that policy. A manufacturer also may stop dealing with a retailer that does not follow its resale price policy. That is, a manufacturer can implement a dealer policy on a "take it or leave it" basis.

Limitations on how or where a dealer may sell a product (that is, customer or territory restrictions) are generally legal–*if they are imposed by a manufacturer acting on its own.* These agreements may result in better sales efforts and service in the dealer's assigned area, and, as a result, more competition with other brands.

Antitrust issues may arise if a manufacturer agrees with competing manufacturers to impose price or non-price restraints up or down the supply chain (that is, in dealings with suppliers or dealers), or if suppliers or dealers act together to induce a manufacturer to implement such restraints. Again, the critical distinction is between a unilateral decision to impose a restraint (lawful) and a collective agreement among competitors to do the same (unlawful). For example, a group of car dealers threatened not to sell one make of cars unless the manufacturer allocated new cars on the basis of sales made to customers in each dealer's territory. The FTC found the dealers' actions unreasonable and designed primarily to stop one dealer from selling at low "no haggle" prices and via the Internet to customers all over the country.

A MANUFACTURER MAY SUGGEST PRICES TO DEALERS, AND THEN DEAL ONLY WITH SELLERS WILLING TO COMPLY WITH THE PRICE DEMANDS.

Determining whether a restraint is "vertical" or "horizontal" can be confusing in some markets, particularly where some manufacturers operate at many different levels and may even supply important inputs to their competitors. The label is not as important as the effect: Does the restraint unreasonably reduce competition among competitors at any level? Is the vertical restraint the product of an agreement among competitors? And labeling an agreement a vertical arrangement will not save it from antitrust scrutiny when there is evidence of anticompetitive horizontal effects. For instance, the FTC has stopped exclusive distribution agreements that operated as market allocation schemes between worldwide competitors. In this situation, the competitors agree not to compete by designating one another as an exclusive distributor for different geographic areas

Q: One of my suppliers marks its products with a Manufacturer Suggested Retail Price (MSRP). Do I have to charge this price?

A: The key word is "suggested." A dealer is free to set the retail price of the products it sells. A dealer can set the price at the MSRP or at a different price, as long as the dealer comes to that decision on its own. However, the manufacturer can decide not to use distributors that do not adhere to its MSRP.

Q: I am a manufacturer and I occasionally get complaints from dealers about the retail prices that other dealers are charging for my products. What should I tell them?

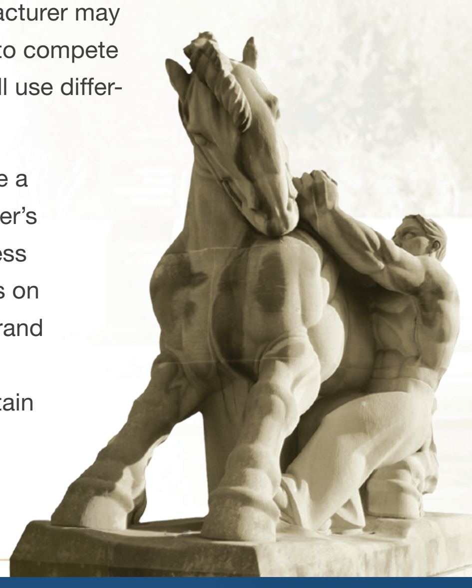
A: Competitors at each level of the supply chain must set prices independently. That means manufacturers cannot agree on wholesale prices, and dealers cannot agree on retail prices. However, a manufacturer can listen to its dealers and take action on its own in response to what it learns from them.

Many private antitrust cases have involved a manufacturer cutting off a discounting dealer. Often there is evidence that the manufacturer received complaints from competing dealers before terminating the discounter. This evidence alone is not enough to show a violation; the manufacturer is entitled to try to keep its dealers happy with their affiliation. Legal issues may arise if it appears that the dealers have agreed to threaten a boycott or collectively pressure the manufacturer to take action.

Q: I would like to carry the products of a certain manufacturer, but the company already has a franchised dealer in my area. Isn't this a restriction on competition?

A: Under federal antitrust law, a manufacturer may decide how many distributors it will have and who they will be. From a competition viewpoint, a manufacturer may decide that it will use only franchised dealers with exclusive territories to compete more successfully with other manufacturers. Or it may decide that it will use different dealers to target specific customer groups.

There are pros and cons to being a franchised dealer. By agreeing to be a franchised dealer, you likely would have to comply with the manufacturer's requirements for selling the product, such as operating hours, cleanliness standards, and the like. These restrictions are seen as reasonable limits on how you run your business in exchange for dealing in an established brand that consumers associate with a certain level of quality or service. For instance, a brewer may require all retail stores to store its beer at a certain



temperature to preserve its quality, because consumers are likely to blame poor quality on the manufacturer–thus reducing sales at all outlets–rather than blaming the retailer's inadequate storage method.

Q: My supplier offers a cooperative advertising program, but I can't participate if I advertise a price that is below the supplier's minimum advertised price. I think that's unfair.

A: The law allows a manufacturer considerable leeway in setting the terms for advertising that it helps to pay for. The manufacturer offers these promotional programs to better compete against the products of the other manufacturers. There are limited situations when these programs can have an unreasonable effect on price levels. For instance, the FTC challenged the Minimum Advertised Price (MAP) policies of five large distributors of pre-recorded music because the policies were unreasonable in their reach: they prohibited ads with discounted prices, even if the retailer paid for the ads with its own money; they applied to in-store advertising; and a single violation required the retailer to forfeit funds for all of its stores for up to 90 days. The FTC found that these policies, in effect for more than 85 percent of market sales, were unreasonable and prevented retailers from telling consumers about discounts on records and CDs. Issues involving advertising allowances may become of less practical concern as manufacturers adjust to new standards that allow more direct influence on retail prices.

Q: I am a health care provider and I want to join a new insurance group to provide services to a large employer in my town. My agreement with another insurance group requires that I give them the lowest price on my services. If I join the new group, do I have to lower my prices for the other insurance group?

A: These provisions, referred to as "most-favored-nations (MFN) clauses," are quite common. Generally, an MFN promises that one party to the agreement will treat the other party at least as well as it treats others. In most circumstances, MFNs are a legitimate way to reduce risks. In some circumstances, however, MFNs can unreasonably limit the offering of targeted discounts and create a de facto industry price. The FTC challenged an MFN clause used by a pharmacy network in individual contracts with its member pharmacies that discouraged them from discounting on reimbursement rates. The network was a group of more than 95 percent of the competing pharmacies in the state. The MFN discouraged any individual pharmacy from offering lower prices to another plan because any discounts would have to be applied to all its other sales through the network.