N.D.A.G. Letter to Hanson (Aug. 18, 1986)

August 18, 1986

Honorable Robert E. Hanson
State Treasurer
Office of the Treasurer
State Capitol
Bismarck, North Dakota 58505

Dear Mr. Hanson:

Thank you for your letter of June 4, 1986, in which you inquired as to the legality of price promotion programs offered by brewers to North Dakota wholesalers. You specifically asked whether such a program constitutes "price fixing" in violation of N.D.C.C. § 5-04-09. I apologize for the delay in responding to your letter.

The promotional program entitles the wholesaler to receive a discount from the brewer, up to a predetermined maximum amount, if the wholesaler matches the brewer's discount and deducts the combined total from the price to the retailer. The price promotion program runs for a specified period of time. Your letter suggests that the wholesaler's decision to participate in the program is voluntary and not a condition of the franchise license.

INTRODUCTION

N.D.C.C. § 5-04-09 states as follows:

> 5-04-09. PRODUCT PRICE. No brewer, whether by means of a term or condition of an agreement or otherwise, shall fix or maintain the price at which the wholesaler shall sell any alcoholic beverage. [Emphasis supplied.]

The policy underlying N.D.C.C. Ch. 5-04 is to insulate North Dakota beer wholesalers from the potential coercive practices that may arise due to the unequal bargaining positions of wholesalers and brewers. Specifically, N.D.C.C. §5-04-09 is intended to preserve the freedom of wholesalers to determine their pricing strategies.

Additionally, under both North Dakota and federal antitrust law, attempts to vertically integrate resale price agreements may be illegal. N.D.C.C. §51-08-01; 15 U.S.C.A. 1 (West 1967) (Section One of the Sherman Antitrust Act); 15 U.S.C.A. 45 (West 1973) (Federal Trade Commission Act).

Federal cases analyzing vertical resale price maintenance agreements have articulated two policies of Section One of the Sherman Act. First, the preservation of the ability of the trader to make pricing decisions unencumbered by vertical restraints and pressures ("freedom of traders" policy). Second, insuring that resale price maintenance agreements

have a pro-competitive impact in the marketplace ("competitive impact" policy). As will be discussed below, the Supreme Court has largely rejected the "freedom of traders" policy in favor of a "competitive impact" analysis in determining whether vertical resale price agreements violate antitrust law.

The "freedom of traders" policy underlying N.D.C.C. §5-04-09 is not congruous with the Supreme Court's recently favored "competitive impact" test in judging vertical resale price maintenance agreements. Nevertheless, as the law enforcement officer entrusted with primary responsibility for enforcing North Dakota's antitrust laws, it is appropriate that I consider the legality of the price promotion program in light of relevant antitrust law. Additionally, the antitrust cases provide a useful analytical framework for reviewing the policy of N.D.C.C. §5-04-09.

DISCUSSION OF ANTITRUST LAW

The antitrust principles set forth in N.D.C.C. §51-08-01 have not been developed by the North Dakota judiciary. In the absence of such guidance, the well-developed federal case law concerning the Sherman Act's prohibition on price fixing is persuasive.

The Supreme Court has rendered two decisions concerning vertical integration of maximum price fixing. In Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc., 340 U.S. 211 (1951), two affiliated liquor distillers insisted that their wholesale customers reduce the price at which liquor was furnished to retailers. In Albrecht v. Herald Co., 390 U.S. 145 (1968), a newspaper insisted that its distributor reduce the price charged to subscribers.

Kiefer-Stewart disposed of the antitrust argument by stating that maximum price agreements, "no less than those to fix minimum prices, cripple the freedom of traders and thereby restrain their ability to sell in accordance with their own judgment." 340 U.S. at 213. Albrecht repeated this theme. 390 U.S. at 152. The emphasis on "freedom of traders" in these cases relied primarily upon the Court's reasoning in United States v. Arnold Schwinn & Co., 388 U.S. 365, 378 (1967), that restricted distribution practices limit "the retailer's freedom as to where and to whom it will resell the products" and, consequently, "violates the ancient rule against restraints on alienation." Id. at 380.

The Supreme Court has overruled Schwinn and explicitly rejected any analysis that makes antitrust cases turn on the "autonomy of independent businessmen." Continental T.V., Inc. v. G.T.E. Sylvania, Inc., 433 U.S. 36, 53 n.21 (1977). Thus, arguments about the effect of a practice on quantity and price, not arguments about the "freedom of traders," control antitrust analysis.

Prior to Sylvania, the Court frequently employed a per se rule to invalidate price fixing agreements. Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911), Kiefer-Stewart, 340 U.S. 211, Albrecht, 390 U.S. 145. The doctrine of per se illegality has evolved in the case law to obviate the need for litigation where the practice in question can have no possible effect other than to unreasonably restrain trade.

Subsequent to the Sylvania decision, however, the Court has emphasized that the per se rule should be employed only after thorough study suggests that almost every instance of the practice sought to be condemned is harmful. See, e.g., Catalano, Inc. v. Target Sales, Inc., 446 U.S. 643, 649 (1980) (per se rule applies if "a particular concerted activity entails an obvious risk of anticompetitive impact with no apparent potentially redeeming value"); Broadcast Music, Inc. v. Columbia Broadcasting Systems, Inc., 441 U.S. 1, 9-10, 19 & n.33, 22 n.40 (1979) (emphasizing the need for "considerable" experience with a practice before per se condemnation); National Society of Professional Engineers v. U.S., 435 U.S. 679, 692-93 (1978) (per se rule applies only to agreements "whose nature and necessary effect are so plainly anticompetitive that no elaborate study of the industry is needed").

Thus, there is no reason to apply a per se rule unless it appears that "the practice facially appears to be one that would almost always tend to restrict competition and decrease output" rather than one designed to "increase economic efficiency and render markets more, rather than less, competitive." Columbia Broadcasting Systems, 441 U.S. 1, 19-20 (1979).

The Supreme Court has never attempted to determine whether vertical integration of promotional pricing schemes almost always would "tend to restrict competition and decrease output." However, several lower courts have rejected such rule, in favor of a rule of reason analysis, in reviewing promotional pricing mechanisms.

In Butera v. Sun Oil Company, 496 F.2d 434, 437 (1st Cir. 1974), based on Pearl Brewing Company v. Anheuser-Busch, Inc., 339 F. Supp. 945 (S.D. Texas 1972), the court, in dicta, suggests that for a supplier to condition a cut in the wholesale price to his dealers on their agreeing to pass it on to the consumer by lowering their prices is a form of price fixing. But more recent cases hold to the contrary. Jack Walters & Sons Corp. v. Morton Building, Inc., 737 F.2d 698 (7th Cir. 1984); Lewis Service Center, Inc. v. Mack Trucks, Inc., 714 F.2d 842, 846 (8th Cir. 1983); AAA Liquors, Inc. v. Joseph E. Seagram & Sons, Inc., 705 F.2d 1203, 1206 (10th Cir. 1982).

In Jack Walters, the manufacturer (Morton) would advertise special deals for its product. The advertising was directed to the consuming public and mentioned special prices at which consumers could buy the buildings from dealers. To ensure that the dealers did not charge a price higher than the advertised price, Morton took various steps, including threatening the dealers with termination if they went above that price, threatening to sell directly to the public at the advertised price, and checking up on the dealers to see whether they were charging the advertised price.

Recognizing the manufacturer's vital interest in the retail price of its product and the pro-competitive impact of Morton's conduct, the court rejected the notion that the practice constituted price fixing in violation of Section One of the Sherman Act. Jack Walters, 737 F.2d at 707-708.

In accord with the court's conclusion in Jack Walters that vertical integration of price promotion schemes that are pro-competitive do not violate antitrust laws is Lewis Service Center v. Mack Trucks, 714 F.2d 843 (8th Cir. 1983). In Mack Trucks, Mack's dealers were entitled to participate in a sales assistance program, under which Mack reduced its standard wholesale price to dealers on a case-by-case basis. The purpose of the program was to meet interbrand competition from other truck dealers. Lewis, one of Mack's dealers, contended that Mack's sales assistance program constituted resale price maintenance in violation of Section One of the Sherman Act. Lewis argued that Mack set its standard wholesale price artificially high, forcing Lewis to apply for sales assistance and restricting its freedom to negotiate its prices.

The Eighth Circuit rejected the district court's use of a per se rule and applied a rule of reason analysis. Id. at 845. The court articulated the rule of reason test as follows:

> The ultimate test of legality, under the rule-of-reason analysis is whether the particular restraint increases or impairs competition.

Id. at 847 (quoting AAA Liquors v. Joseph E. Seagram & Sons, 705 F.2d 1203, 1208 (10th Cir. 1982)).

Employing the above test to Mack's sales assistance program, the court recognized the pro-competitive effect of the program. "Thus, the effect of the discount program . . . is to lower retail prices to customers and increase interbrand competition." Id. at 748. Therefore, the practice was held not to violate the Sherman Act.

In AAA Liquors, the Tenth Circuit addressed the situation whereby Seagram's discount to a wholesaler was being passed down to only selected large volume retailers. Midwest, an independent liquor wholesaler, was the exclusive distributorship for Seagram's products in the Denver area. The plaintiffs, disgruntled small retailers, contended that Seagram's requirement that Midwest pass the discount through to certain large retailers had the effect of fixing prices.

The court rejected the retailers' contention, relying heavily on the pro-competitive effects of such a discount program.

Rather, it is clear that the purposes of the discount program was to increase sales of Seagram's products vis-a-vis the major competing brands. . . The record establishes that the discount program had the effect of lowering retail prices to consumers and increasing interbrand competition.

Id. at 1207-1208.

The court also held that requiring discounts to be passed on to retailers did not constitute coercion. The court recognized that "a supplier who grants discounts to a retailer to permit the retailer to charge competitive prices has a legitimate interest in making sure the retailer receiving the discount is not pocketing the price support instead of passing it on to

consumers." Id. at 1206 (quoting Lehrman v. Gulf Oil Corp., 464 F.2d 26, 40 (5th Cir. 1972)).

It is significant to note that the court in AAA Liquors rejected the conclusion of Pearl Brewing, 339 F. Supp. 945, a case involving a promotional scheme analogous to the plan proposed by the brewers to the North Dakota wholesalers.

In Pearl Brewing, defendants Anheuser-Busch and Schlitz employed price promotions pursuant to which their wholesale distributors reduced their wholesale price on cases of particular brands of beer to retailers for a specified period of time. Id. at 949. In conducting the price promotions, it was the practice of the defendants to condition price reductions to wholesale distributors on the agreement that the wholesaler reduce its prices to the retailer.

Relying on U.S. v. Socony-Vacuum Oil Company, 310 U.S. 150 (1940), Albrecht, 390 U.S. 145, and Kiefer-Stewart, 340 U.S. 211, the court set forth its test as follows:

> These cases would indicate that the test to be employed in determining a violation is whether the agreement, or conduct, interferes with the freedom of sellers or traders in such a manner as to prohibit or restrain their ability to sell in accordance with their own judgment, and not what particular effect the agreement or conduct has on the actual prices.

Pearl Brewing, 339 F. Supp. at 952. Reasoning that the defendant's promotional plan interfered with the "reseller's freedom of decision," the court declared the plan an "unlawful price fixing combination." Id. at 955.

In terms of federal antitrust law, it is clear that the reasoning of Pearl Brewing is of questionable validity. It foregoes any analysis of "competitive impact" and relies entirely on the "freedom of traders" rationale. Thus, I do not find it persuasive in resolving the present issue.

Having said all of this, I am afraid that I cannot give you a definitive answer on the antitrust question presented. It would be inappropriate for me to provide prior approval to any private enterprise contemplating a price promotion scheme in North Dakota. Although my discussion of federal case law indicates that the proposed price promotion scheme would not violate antitrust law, this should not be regarded as legal clearance for the proposed price promotion scheme.

DISCUSSION OF N.D.C.C. CH. 5-04

Absent a violation of its antitrust laws, the state does not have jurisdiction, regulatory or otherwise, to enforce the provisions of N.D.C.C. Ch. 5-04. The wholesalers' remedy when a brewer fails to comply with the provisions of N.D.C.C. Ch. 5-04 is legislatively prescribed as follows:

> 5-04-08. JUDICIAL REMEDIES. If a brewer engages in conduct prohibited under this chapter, a wholesaler, with whom the brewer has an agreement pursuant to this chapter, may maintain a suit against the brewer. The court may grant equitable relief as is necessary to remedy the effects of conduct which it finds to exist and which is prohibited under this chapter, including, but not limited to, declaratory judgment and injunctive relief. The court may award actual damages and costs. If the court finds the brewer has acted in bad faith in invoking amendment, termination, cancellation, or nonrenewal under this chapter or has unreasonably withheld its consent to any assignment, transfer, or sale of the wholesaler's agreement, the court may also award reasonable attorney's fees.

Whether the "freedom of traders" policy underlying N.D.C.C. § 5-04-09 is violated by the proposed price promotion program involves a question of fact which I cannot help resolve.

Sincerely,

Nicholas J. Spaeth

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