COOPERATIVE ADVERTISING PROGRAMS 
AND MINIMUM ADVERTISED PRICE POLICIES: 
CHANGING THE ANTITRUST RULES

By M. Howard Morse

Twenty-eight state attorneys general recently filed suit accusing the world’s five largest recording companies and three large music retailers of “fixing prices” of compact discs. The states are seeking hundreds of millions of dollars based on the record labels’ adoption of minimum advertised price (“MAP”) policies in the mid-1990s. The states’ lawsuit follows Federal Trade Commission consent agreements reached in May with the record labels based on the same conduct.

These legal actions collectively call into question the legality of at least some MAP cooperative advertising programs under which dealers are reimbursed for the cost of advertising so long as the advertised price is not below a specified minimum, which are in common use across many industries. The actions suggest that in order to minimize antitrust risks from MAP programs, manufacturers should follow a couple of rules:

1. Ensure that cooperative advertising programs do not restrict the price actually charged by dealers to their customers;

2. Ensure cooperative advertising programs do not prevent dealers from advertising discounted prices in advertising not paid for by the supplier;

3. Limit the definition of “advertising” so cooperative advertising programs do not prevent in-store promotion of discounted prices;

4. Do not make cooperative advertising contributions so large that they exceed retailers’ actual promotional costs; and

5. Do not impose excessive penalties for minor or isolated violations.

Limitations on dealers’ advertising of discounts on the Internet may also be problematic, at least where websites take purchase orders and posted prices might be considered the equivalent of in-store price stickers. With these caveats, in most industries, properly structured MAP programs should not run afoul of the antitrust law’s prohibition on resale price maintenance.

**The Rule Against Vertical Price Fixing**

A brief overview of the rule against resale price maintenance is in order to understand the latest actions. Vertical price fixing agreements between a supplier and its dealers setting the price at which the dealer can resell goods to downstream customers have long been considered per se illegal. While this rule has been subject to spirited debate over the last 25 years, the Supreme Court has repeatedly reaffirmed that resale price maintenance is considered per se illegal under Section 1 of the Sherman Act. As recently as 1997, the Supreme Court ruled that “arrangements to fix minimum prices remain illegal per se” while at the same time abolishing the per se rule against maximum resale prices.
In other words, while manufacturers and their dealers can generally agree as to the maximum price charged to downstream customers, they cannot reach agreements regarding minimum resale prices.

Confusion in this area of the law is compounded by the fact that manufacturers can adopt suggested resale prices, pre-ticket suggested prices on products, and advertise suggested prices directly to customers. They can even establish a policy of unilaterally terminating dealers who do not follow announced prices. But they risk being found to have entered into an illegal agreement regarding such prices if they “pressure” or “coerce” customers into following such policies.

Since the Sherman Act prohibits only “agreements in restraint of trade,” manufacturers can unilaterally announce in advance that they will deal only with distributors who adhere to their pricing policies and can terminate those who depart from such a policy. On the other hand, a manufacturer that goes further and, confronted with a distributor that is not complying with its pricing policy, rather than terminate the distributor, coerces or induces the distributor into changing its prices, may violate the law. The problem is that subsequent compliance in response to pressure may be considered to form an “agreement” on prices. Thus, while “exposition, persuasion or argument” to influence dealers is generally allowed, threats of sanctions, policing, requiring approval of deviations, retaliatory price increases, and the like may support a finding of an illegal agreement, when they succeed in securing some indication of a dealer’s assent. Failure to abide by the strictures of these somewhat surreal rules can result in government actions and private treble damage litigation.

While there was little government enforcement in this area in the 1980s, in recent years, the Antitrust Division of the Department of Justice, the Federal Trade Commission, and state attorneys general have actively pursued resale price maintenance enforcement actions. Federal and state cases have been brought against well known firms such as American Cyanamid, Keds, Minolta, Mitsubishi, Nintendo, Panasonic, Playmobil, Reebok, and Zeneca, as well as less known firms such as Kreepy Krawley, U.S.A., Inc., which manufacturers swimming pool cleaning devices, and California SunCare, Inc., which manufactures indoor tanning products. No company is immune if the government learns of a possible violation.

### Past Precedents Involving Cooperative Advertising

The 1970s generated conflicting rules on the legality of manufacturer-imposed price restrictions in cooperative advertising programs, from litigation challenging Nissan Motor Co.’s practices. One court struck down a Nissan cooperative advertising plan, finding Nissan “strongly recommended” that its dealers adhere to suggested prices and enforced that policy through dealer policing and a requirement that dealers not receive co-op funds if their advertisements contained suggestions of price competition among dealers. At about the same time, the Department of Justice entered a consent judgment with Nissan enjoining the company from refusing to provide co-op advertising funds to dealers whose ads contained discount prices.

The Fifth Circuit, meanwhile, upheld a jury verdict finding a Nissan program lawful, even though dealers received partial reimbursement for advertising only if the advertising contained the manufacturer’s suggested retail price or no price at all. “After all,” the court reasoned, “there is nothing unreasonable per se about a manufacturer’s suggested retail prices.” The court recognized there could be sound business reasons for specific advertising require-
ments, especially where Nissan was partially paying for the advertising and refused to condemn Nissan’s practice as unreasonable as long as dealers were free to sell at whatever price they wished and free to advertise at any price at their own expense.  

The FTC initially declined to follow the Fifth Circuit’s Nissan decision. In 1980, the FTC issued a policy statement suggesting all co-op advertising programs conditioning payments on a dealer either advertising at not less than a specified price or not advertising at discount prices would deter dealers from engaging in price competition and would be considered per se illegal. The Reagan Administration’s FTC, however, in 1987, changed course and allowed cooperative advertising programs with MAP components.

The Reagan FTC reasoned that the per se rule applies only to vertical agreements to fix resale prices that "prevent the dealer from making independent pricing decisions," and the fact that a distribution restraint may have an “incidental effect” on price is not enough to condemn it as per se unlawful. This is consistent with the Supreme Court’s 1988 reasoning in Business Electronics Corp. v. Sharp Electronics Corp. that a vertical restraint is only illegal per se if it includes some agreement or “price on price levels.”

In 1997, a majority of the Clinton Administration’s FTC took the position that cooperative advertising programs will be judged “under the rule of reason as long as the arrangements do not limit the dealers’ right: (1) to discount below the advertised price, and (2) to advertise at any price when the dealer itself pays for the advertisement.”

The FTC’s Consent Agreements With The Recording Industry

The FTC’s recent complaints against and consent agreements with the five major prerecorded music distributors – BMG, BMG, EMI, Sony, Time-Warner and Universal – are virtually identical. The complaints allege that entry by large consumer electronic chains, such as Best Buy and Circuit City, selling compact discs (CDs) and competing “aggressively” on price, led to a “retail price war.” In response, with pressure from traditional retailers for “margin protection” and concerned about the effect of the retail price war on wholesale prices, each recording company implemented a MAP program, setting forth minimum advertised prices for most prerecorded music products. The FTC complaints allege that each major distributor “significantly tightened” its MAP policy in 1995 and 1996, effectively precluding retailers from communicating prices below the minimum advertised prices to their customers. According to the FTC complaints, retail prices increased in 1995 and 1996 and, since 1997, wholesale prices have also increased.

The FTC specifically alleged that any retailer who advertised or promoted prices below the established minimum advertised prices – including using in-store displays and signs other than the pre-printed sticker on the product – would lose all cooperative advertising and promotional funds for some period, typically 60 or 90 days, whether or not the retailer paid for the offending advertisement or promotion in its entirety.

The FTC, in its Analysis to Aid Public Comment and in a Statement issued unanimously by Democratic and Republican Commissioners, made clear that several features of the music industry’s tightened MAP policies were considered improper.
the policies encompassed advertising regardless of the funding source, including advertising paid for entirely by the retailer;

the advertising subject to the MAP policy included all in-store signs and displays, preventing retailers from effectively communicating discounts to consumers, and eliminating the incentive to actually sell product at a discount; and

a single violation by a single store could subject a retailer to loss of all cooperative advertising and promotional funds for an extended period, a severe and disproportionate penalty that along with “high profile enforcement actions” that received “wide publicity,” coerced retailers into abandoning advertising and curtailed discounting.

The Commission recognized, however, that “retailers were free to sell at any price” under the MAP policies, some retailers advertised that product was available at a “guaranteed low price,” and some retailers did sell product at a discount. The Commission reluctantly concluded it did not have “sufficient evidence of an agreement by retailers to charge a minimum price” and therefore could not condemn the MAP policies as illegal per se.

The FTC nonetheless had no problem quickly condemning the MAP policies under a “rule of reason” analysis. The FTC complaints assert that each distributor adopted its MAP policy “to eliminate aggressive retail pricing and to stabilize overall prices in the retail marketplace” and that those policies were “successful.” FTC Chairman Pitofsky went further in the Commission press release, stating the FTC “estimates that U.S. consumers may have paid as much as $480 million more than they should have for CDs and other music because of these policies over the last three years.” Not surprisingly, industry officials have questioned that estimate.12

The Commission’s Analysis to Aid Public Comment specifically rejected efficiency justifications for the MAP policies, concluding the policies were not motivated by “free-riding” concerns. The Analysis, which clearly went beyond the facts alleged in the complaints, asserted that the new retailers provided services that were as good as or superior to those provided by higher priced retailers. Presumably the distributors would have disputed this assertion in a trial, given the apparent difference in the volume of CDs carried by most traditional retailers as compared to consumer electronic stores and mass merchants, and would have argued that maintaining a broad selection of inventory is a valuable service to consumers.

Significantly, while the Commission included allegations regarding the concentrated “market structure” of the prerecorded music industry in its complaints, there is no assurance it would not attack similar conduct in unconcentrated markets in the future. The FTC’s complaints allege the five major distributors have an 85% market share, and the Commission’s Analysis to Aid Public Comment states the five companies “collectively dominate” the wholesale market for prerecorded music and there is reason to believe the MAP provisions may “materially facilitate interdependent conduct.” The Analysis asserts that the history of the distributors’ contemporaneous adoption of MAP policies “indicates a propensity for interdependent behavior.” Apparently relying on its allegation of subsequent wholesale price increases, the Commission concluded that “when considered together, the arrangements constitute practices that facilitate horizontal collusion among the distributors.” Despite these allegations based on the structure of the music industry, the Commissioners warned that in the future they will “view with great skepticism” cooperative advertising programs that “effectively eliminate the ability of dealers to sell product at a
discount” and said that they “will henceforth consider unlawful” similar arrangements “even adopted by a manufacturer that lacks substantial market power.”

The FTC Consent Orders would prohibit, for twenty years, conduct that the agency considers to be illegal:

1. controlling dealers’ resale prices;
2. conditioning the availability of cooperative advertising or other promotional funds on a dealer’s actual selling price;
3. restricting the availability of such funds based on an advertisement for which the dealer does not seek any contribution; and
4. maintaining a MAP program with payments that exceed the dealer’s actual advertising or promotion costs.

The Orders would also impose “fencing in” provisions prohibiting legal conduct for shorter periods in order “to restore retail price competition”: (1) taking away the respondents’ rights to unilaterally terminate dealers for failure to comply with a minimum advertised or resale price, for five years; and (2) requiring the distributors to discontinue their MAP programs altogether, for seven years.

In today’s e-commerce world, it is also worth considering the applicability of these legal theories to electronic commerce. The FTC Bureau of Competition staff has noted the Internet raises “some interesting questions” regarding minimum advertised price policies. The staff has suggested it would be “easy” to condemn restrictions on specific web pages not supported by cooperative advertising payments. The opposite ought also be true. That is, MAP restrictions on banner ads to which a manufacturer contributes ought to be legal. But the FTC staff suggests that even if a manufacturer pays a percentage of the cost of a website, if the site takes orders, it would not be considered “simply an advertisement,” as the posted prices would be the “equivalent of in-store price stickers” and any MAP restrictions “the exact functional equivalent of resale price maintenance.”

Companies must be wary of restricting dealers’ prices in these circumstances.

**States Seek Treble Damages**

This August, three months after the FTC consent orders were announced, 28 state attorneys general filed suit seeking “hundreds of millions of dollars” in damages on behalf of consumers for “price fixing” based on the same conduct at issue in the FTC actions.

The state suit names as defendants three retailers, Musicland Stores Corp., which owns the Sam Goody chain, Trans World Entertainment Corp., which owns the Camelot Music chain, and Tower Records, as well as the five major distributors. The suit quotes at length a speech given by Musicland’s CEO in 1995 encouraging the music labels to strengthen their MAP policies “to prevent the devaluation of CDs.”

While state officials have in the past questioned all MAP programs, the National Association of Attorneys General in a press release announcing the suit accepted that the initial MAP policies adopted by the music labels in 1992 were “legal.” But the states’ complaint alleges that the music industry’s more stringent MAP programs adopted in 1995-1996 were “in commercial reality and practical effect agreements on resale prices.” Proceeding even more aggressively than the FTC, or at least hedging their bets for litigation, the states therefore allege
that those agreements were *per se* as well as rule of reason violations of the Sherman Act. While additional guidance for businesses may be forthcoming if the case is litigated to a decision, no one will be surprised to see a settlement after initial skirmishes.

The New York Attorney General was quoted in press reports as stating that the FTC’s $480 million damage figure was “a number that fair minded people can rely upon,” suggesting a potential treble damages judgment in excess $1 billion. Thus, while the FTC relief consists merely of a cease and desist order, the states’ lawsuit threatens the companies’ pocketbooks.

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Companies and their counselors are forewarned by these actions that both federal and state antitrust enforcement authorities are taking a fresh, close look at vertical restraints. In short, they should reexamine existing MAP policies to ensure they comply with current enforcement standards in Washington and in the states.

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2. See *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911).


12. See, e.g., Letter from Pamela Horovitz, President, National Association of Recording Merchandisers to Robert Pitofsky (May 26, 2000).

