Managing Distribution:
How to Develop a Corporate Legal Compliance Program

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Every business in this country that markets its products and services in any manner faces potential exposure under the antitrust laws and other laws and regulations. That risk is heightened if the business people involved, from the chief executive to the salesperson on the street, do not know what types of conduct the laws may prohibit. Thus, from a legal standpoint, managing the distribution aspects of any business involves training client personnel, at every level from top management to street salespeople, to recognize legal issues and minimize legal risks. The problem may be particularly acute when a foreign business is involved, in which assumptions about antitrust, franchise, labor and securities laws may be quite different from those of U.S. law.

For that reason, one of the corporate or outside counsel's important roles is the development of a legal compliance program that will:

- ♦ Inform company personnel how to perform their jobs without creating antitrust and other legal problems;
- ♦ Assist them in resolving legal questions as they arise; and
- ♦ Monitor compliance so that the business as a whole is not placed in jeopardy by the misconduct or carelessness of a single employee.

This article is intended to assist counsel in developing such a program. It will address the various areas that should be included in a compliance program, but obviously it is not a complete survey of relevant applicable law. The focus is on U.S. federal antitrust law, but it should be remembered that most states also have their own antitrust laws and many other laws are applicable to businesses in general and to specific industries in particular. Moreover, in the global marketplace, the antitrust and competition law of other nations must be considered as well. In addition, this article deals only with issues of day-to-day relevance to a distribution business, and does not address other topics raising legal issues, such as mergers and acquisitions, which are less routine events and in which counsel should certainly be involved from the beginning.

PREPARING TO DEVELOP A COMPLIANCE PROGRAM ♦ Counsel's first task is to persuade top management that a compliance program is not only necessary, but desirable. No compliance program can succeed without solid management support. Given recent corporate scandals and mandated personal responsibility imposed on executives by such laws as the Sarbanes-Oxley Act of 2002, corporate CEOs are currently relatively receptive to compliance issues. But if company personnel think management is "winking" when the program is presented, or is just going through the motions to satisfy the lawyers, you have no chance for success. Unless the sales force, for example, understands that management is committed to antitrust compliance that it

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will consider performance in compliance training as part of annual employee evaluations, will condition promotions, bonuses and salary increases on successful completion of training, and will impose sanctions, up to and including dismissal, for violations of company policy in this area   they will abide by the antitrust laws only so long as their sales are not impaired. The same principle applies equally to all other operating areas of your company.

Arguments for a Compliance Program

Thus, the first question counsel must be able to answer is fundamental: Why should management support a program?

The Cost of Litigation

Even "run of the mill" litigation today is, unfortunately, an extremely expensive process. Antitrust litigation is even more so. The trial of even a simple dealer termination can easily cost hundreds of thousands of dollars in legal bills if the dealer can make a colorable claim under federal or state antitrust laws, franchise and dealer protection laws, or various common law theories of wrongful termination, and then demand detailed nationwide discovery to show that his treatment diverged from the supplier's normal practices. That does not include the considerable loss of employee and executive time that must be devoted to defending a suit and the extraordinary burden of discovery (including disclosure of what clients may consider "personal" files), nor does it include damages if the case is lost.

Treble Damages

A victorious antitrust plaintiff is entitled to treble damages and attorneys' fees. The exposure in an antitrust action thus can be extremely high. If the termination of a distributor causes him to go out of business, or if a competitor is driven out of business by predatory pricing, the stakes are increased even further, as damages can become relatively speculative. While court decisions have made proof of antitrust violations more difficult for terminated distributors,[1] and the Supreme Court's 2007 *Leegin* decision,[2] discussed below, may accelerate that effect, antitrust claims still appear with some frequency in termination cases, and must be defended.

Criminal Sanctions

Jail terms are not uncommon for antitrust violations. Maximum fines were increased in 2004 to $1 million for individuals and $100 million for corporations.[3] Moreover, violation of the Sherman Act is felony. Conviction entails not only fines and jail, but loss of civil rights such as the right to vote and the right to hold many public offices. Amended Sentencing Guidelines effective November 1, 1991 substantially increased the likelihood of jail for individuals convicted of antitrust violations.[4] Violations − especially horizontal ones − are still prosecuted. In recent years, both federal and state antitrust officials have dramatically increased prosecution of vertical violations as well.

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[1] *See Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988); *Monsanto v. Spray-Rite Corp.*, 465 U.S. 752 (1984).

[2] *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. ____, 2007 WL1835892 (2007) (hereafter, "Leegin").

[3] Antitrust Criminal Penalty Enhancement and Reform Act of 2004, Pub. L. No. 108-237, 118 Stat. 665 (codified at 15 U.S.C. §§ 1, 2, 3 and 16); TRADE REG. REP. (CCH) ¶ 27,750; (enacted 6/22/2004)

[4] Criminal Penalty Enhancement and Reform Act of 2004 TRADE REG. REP. (CCH) ¶ 13,250; U.S. Sentencing Guidelines Part R.

Business Advantages

If a company's personnel regularly act in areas raising antitrust and other legal risks, they expose the company to risks that may well outweigh the business advantages gained. By the same token, failure to undertake a legal course of conduct for fear of violating the law may prevent the company from competing as effectively as it might. A program that educates the company's staff as to the kinds of things they may and may not do and provides the opportunity for counsel to participate in crafting sales, marketing, or other business plans so as to minimize legal risks can assure that a business takes only responsible, acceptable risks while it does not forgo any competitive advantages to which it is entitled.

Exculpatory Value

Even if litigation is not entirely avoided by a compliance program, the existence of a real, substantial compliance program, administered without "winks," can constitute exculpatory evidence. Such a program might persuade government investigators not to prosecute or a judge or jury not to convict or find liability.[5] Under the Amended Sentencing Guidelines, fines are imposed based upon a complex formula significantly influenced by an organization's "culpability score." That score can be substantially reduced if there is an effective compliance program "to prevent and detect violations of law."[6] In addition, because the Supreme Court has held mandatory sentencing guidelines unconstitutional,[7] the guidelines are now advisory only. Although the government typically urges courts to adhere to the guidelines, a strong compliance program could support a downward departure and convince a court to impose a non-guideline sentence.

Moreover, such a compliance program may lead to discovery of a violation that may make it desirable to report the matter to the Department of Justice under its Corporate Leniency Policy. This policy provides for leniency[8] to corporations (and their directors, officers and employees who admit involvement) reporting their illegal antitrust activity at an early stage if the following conditions are met:

1. The corporation, upon its discovery of the illegal activity being reported, took prompt and effective action to terminate its part in the activity;
2. The corporation reports the wrongdoing with candor and completeness and provides full, continuing and complete cooperation to the Division;
3. The confession of wrongdoing is truly a corporate act, as opposed to isolated confessions of individual executives or officials; and
4. Where possible, the corporation makes restitution to injured parties;

and one of the following two sets of conditions are met:

a. The report is made before an investigation has begun;

b. At the time the corporation reports the illegal activity, the Division has not received information about the illegal activity being reported from any other source; and

[5] *See Garrett's, Inc. v. Farah Mfg. Co.*, 412 F. Supp. 656 (D.S.C. 1976).

[6] U.S. Sentencing Guidelines § 8C2.5(f).

[7] *United States v. Booker*, 543 U.S. 220, 125 S.Ct. 738 (2005).

[8] In this context, "leniency" means not bringing criminal charges. Legislation enacted in 2004 extended the benefits of the program, limiting civil liability of participants in the program to single, rather than treble, damages, in certain circumstances until 2009. "Antitrust Criminal Penalty Enhancement and Reform Act of 2004," Pub. L. No. 108-237, 118 Stat. 665 (codified at 15 U.S.C. §§ 1, 2, 3 and 16); TRADE REG. REP. (CCH) ¶ 27,750; (enacted 6/22/2004); U.S. Sentencing Guidelines Part R.

c. The corporation did not coerce another party to participate in the illegal activity and clearly was not the leader in, or originator of, the activity;

OR

a. The corporation is the first one to come forward and qualify for leniency with respect to the illegal activity being reported;

b. The Division, at the time the corporation comes in, does not yet have evidence against the company that is likely to result in a sustainable conviction; and

c. The Division determines that granting leniency would not be unfair to others, considering the nature of the illegal activity, the confessing corporation's role in it, and when the corporation comes forward.[9]

The Department has also instituted an "Individual Leniency Policy" for individuals who report illegal antitrust activity to the Antitrust Division on their own behalf, and not as part of a corporate proffer or confession.[10] This incentive for individuals to come forward if the corporation does not suggests yet another justification for a corporate program designed both to prevent and to identify antitrust violations.

Businesses should proceed with caution under the leniency programs, given the risk that they may be disqualified from leniency (for example, by virtue of a prior report by another participant in the scheme) and the risk of private treble damage actions if misconduct is admitted. For international businesses, there is also a risk that foreign antitrust regulators will not respect U.S. leniency policy. Increasingly, international cooperation agreements decrease this risk, but the existence and extent of such agreements in relevant jurisdictions needs to be investigated. Certainly at the initial stages, the identity of the client should not be disclosed.

Understanding the Business

Counsel cannot prepare a useful antitrust compliance program until he or she has gained a thorough understanding of the business. No "cookie-cutter" program can be effective. Rather, it is essential to tailor the program to the particular business involved by relating the significant antitrust laws to the operations of the company. Counsel must examine the company's methods of operation closely, especially in the sales and marketing areas, should interview both executives and sales staff, and should review at least the following documents:

- Customer correspondence;
- Field reports;
- Files of sales executives;
- Sales literature;
- Distributor contracts; and
- Pricing documents.

Such an "antitrust audit" should be repeated periodically.

Pricing

9 *See* U.S. Department of Justice, Antitrust Division, *Corporate Leniency Policy*, TRADE REG. REP. ¶ 13,113 (August 10, 1993).

10 *See* U.S. Department of Justice, Antitrust Division, *Leniency Policy for Individuals*, TRADE REG. REP. ¶ 13,114 (August 10, 1994).

Counsel's education concerning the pricing aspects of the business should include the following areas:

- How is the product priced?
- Are there quantity or other discounts that could raise Robinson-Patman Act questions?[11]
- Who determines list prices?
- Who has authority to modify prices to meet competition? The lower in the sales organization this authority is placed, the more difficult assuring compliance becomes.
- Is there any control against pricing below marginal or average variable cost, so that a predation claim can most readily be defeated?[12]
- If feasible for the particular business, counsel should review price lists and discount programs, as well as exceptions to them, before they are implemented.
- Are any kind of promotional or advertising allowances provided? Are they available to all competing customers on a proportionately equal basis?[13]

Nature of Competition

Counsel should analyze the nature of the competition:

- What are the most important competitive factors?
- Does price competition predominate or are other factors, such as service, quality, and promotional efforts, more significant?
- How does the company get its product to move?

The answers to these questions will enable counsel to determine whether any nonpricing restraints imposed by the business on its customers, such as territorial restrictions or service requirements, are justifiable.[14]

Market Structure

Counsel should be aware of how the business "fits" in the general structure of the market.

- What is the level of concentration in the market?
- Where does the company rank in terms of market share?
- Does it have substantial market power? For example, market concentration coupled with a company's strong market power will lead to heightened scrutiny of that company's nonprice vertical restraints or proposed merger.[15] The Supreme Court in *Leegin*, in overturning the *per se* rule against resale price maintenance ("RPM") and making such vertical price restraints governed by the rule of reason, stressed that market power by either a manufacturer or a reseller could convert an otherwise lawful RPM program into an unlawful one. Conversely, most – but not all – courts have held

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[11] *See* 15 U.S.C. § 13 *et seq.*

[12] *See, e.g., William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 668 F.2d 1014, 1041 (9th Cir. 1981), *cert. denied*, 459 U.S. 825 (1982). ("If the plaintiff does prove pricing below average variable cost, the burden shifts to the defendant to establish a legitimate business justification for its conduct.")

[13] *See* 15 U.S.C. § 13(d), (e); Federal Trade Commission Guides for Advertising Allowances and Other Merchandising Payments and Services, 16 C.F.R. Part 240.

[14] *See Leegin, supra; Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 26 (1977); *Graphic Products Distrib. v. Itek Corp.,* 717 F.2d 1560 (11th Cir. 1983).

[15] *See* Nat'l Ass'n of Attorneys General, *Vertical Restraints Guidelines*, § 4.9 (adopted 12/4/85, amended 12/8/88); Department of Justice, Antitrust Division, *Guidelines for Vertical Restraints*, 50 Fed. Reg. 6263 (1985); Department of Justice, Antitrust Division, *Merger Guidelines*, 49 Fed. Reg. 26823 (1984).

that in the absence of market power, nonprice vertical restraints do not violate the antitrust laws.[16]

Note that the answers to these questions depend on defining the relevant markets and submarkets in which the company competes. Relevant market definition is beyond the scope of this article.[17]

Competitive Contacts

Another aspect counsel should examine is the type of contacts the business has with its competitors.

- ♦ Are there opportunities for contact with competitors?
- ♦ If so, at what level in the sales organization?
- ♦ Who attends industry trade association meetings or trade shows?

Relations with Customers

Another source of potential antitrust problems involves customer relations.

- ♦ Who in the organization has the primary customer contacts?
- ♦ To what extent is there written communication with customers?
- ♦ Are there any efforts to set resale prices or any other restrictions on resale, such as by geographic territories or customer classifications? Can these be justified as procompetitive?
- ♦ Are there potential tying problems?
- ♦ How does the company respond to distributors' complaints about pricing or other practices of other distributors?

A review of the type just described − commonly known as an antitrust audit − is obviously important before setting up a compliance program. It also should be undertaken on a regular basis thereafter, to make sure the compliance program is directed at the right areas and that new problems have not cropped up without counsel learning of them.

STRUCTURING THE COMPLIANCE PROGRAM ♦ Once the areas to be addressed have been identified, a program designed both to prevent and to detect violations can be established. Obviously prevention is the most desirable outcome, but if violations occur, early detection can minimize the accrual of damages, as well as enhance the ability to seek leniency. The Sentencing Guidelines identify seven criteria for an effective compliance program:[18]

- ♦ Clear compliance standards and procedures
- ♦ Specific high-level executives assigned oversight responsibility for compliance

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[16] *See, e.g., Graphic Products Distrib. v. Itek Corp.,* 717 F.2d 1560 (11th Cir. 1983); *Valley Liquors v. Renfield Importers, Ltd.*, 678 F.2d 742 (7th Cir. 1982); *Muenster Butane v. Stewart Co.*, 651 F.2d 292 (5th Cir. 1981); *Ron Tonkin Gran Turismo v. Fiat Distrib.*, 637 F.2d 1376 (9th Cir), *cert. denied.*, 454 U.S. 831 (1981); *but see New York v. Anheuser-Busch*, 673 F. Supp. 664 (E.D.N.Y. 1987).

[17] Note, however, that single-brand markets are rarely found, and that an effort must be made to determine what products or mix of products represent an effective alternative to the company's offerings. *See*, *e.g.*, *Green Country Food Market, Inc. v. Bottling Group*, LLC, 371 F.3d 1275 (10th Cir. 2004) (Pepsi branded beverages not a relevant product market; relevant market likely consisted of companies that would offer competitive package to mix of brands offered by defendant distributor.)

[18] U.S. Sentencing Guidelines Manual §8A1.2, comment (n.3(k)). *See also* W.J. Kolasky, "Antitrust Compliance Programs: The Government Perspective," www.usdoj.gov./atr/public/speeches/11534.htm, *reported at* "DOJ Official Offers View on Compliance Programs," 83 ANTITRUST & TRADE REG. REP. 59 (2002).

- ♦ Due care to avoid delegation of responsibility to employees with a propensity for illegal conduct
- ♦ Effective communication of standards and procedures to employees
- ♦ Reasonable steps to achieve compliance with standards, (*e.g.*, monitoring, auditing and reporting systems)
- ♦ Consistent enforcement, with appropriate discipline
- ♦ Reasonable steps when an offense occurs to respond and prevent further violations.

The use of a compliance committee, a compliance manual, technology-based compliance programs and presentations to employees are elements of a program that can help meet these requirements. Active training through these and other methods (such as newsletters, telephone question and answer sessions and periodic e-mails) is essential, as is a reporting mechanism for employees who learn of violations. Reporting can be encouraged by various means ─ an open door policy for corporate counsel, an e-mail link on a compliance website, or an anonymous hot line are but a few examples. (Note, however, that anonymous hot lines, while mandated for some purposes for U.S. public companies under Sarbanes-Oxley, have been found to violate some European data protection laws.[19] Companies with European operations or employees must tread carefully in this area.) Compliance materials and methods should be tailored to the risks associated with particular employees' responsibilities.[20] Sales staff or marketing personnel will have different concerns from managers attending trade association meetings or those responsible for contract bidding. Employees dealing with international commerce may need training regarding differing laws of other countries, which are irrelevant to employees with purely domestic responsibilities. Providing an employee with material extraneous to her needs may lead to inattention to relevant information, assuring that one size fits none.

THE COMPLIANCE COMMITTEE ♦ The creation of a compliance committee consisting of both corporate and outside counsel and senior management can be an effective tool to insure compliance efforts keep up with the business. The committee should meet periodically to discuss legal developments that may affect the business and business developments with possible legal consequences. The sales staff should be instructed to refer any questions they think may have legal ramifications to a committee member. Certain steps should require approval of the compliance committee, including:

- ♦ Distributor and dealer changes (terminations, additions, or changes in territories);
- ♦ Territorial restrictions on distributors and dealers;
- ♦ Resale price restrictions on customers;
- ♦ Responses to distributor complaints;
- ♦ Business contacts with competitors; and
- ♦ If feasible for the particular company, price changes to meet competition.

TECHNOLOGY-BASED PROGRAMS ♦ Computer-based training tools, such as online simulations, offer the opportunity to reach more effectively the many people who learn better by becoming engaged in a situation and considering options than by reading or listening. Such tools

[19] *E.g., CE Bsn Glasspack, syndicat CGT / Bsn Glasspack*, Tribunal de grande instance de Libourne Ordonnance de référé 15 Septembre 2005, http://www.legalis.net/jurisprudence-decision.php3?id_article=1497.)

[20] T. Banks, "Are You Still Using the Blunderbuss" Approach to Antitrust Compliance?" ABA CORPORATE COUNSELING REP. (Summer 2002).

may be made available by network server, website or CD, and can be structured to track training needs, to require participation at specified intervals and record accomplishments, as well as to tailor programs to specific job responsibilities. Off-the shelf programs may well meet a substantial portion of training needs, with the rest met by traditional methods, but fully customized solutions are also available or can be developed in-house, albeit at higher cost.[21] Video and audio based tools are also available or can be developed. In all cases, human assistance from counsel must be available in some form to support the technology-based training.

The Compliance Manual ♦ Counsel should prepare a manual explaining, in lay terms that are directly related to the business, the sorts of conduct that are and are not permitted under the antitrust laws. Company policies and procedures with legal implications should be explained clearly. The company may wish to adopt policies even stricter than those required by law. This offers two advantages. First, stiffer policies may avoid even the suspicion of violations of law. Second, if an employee does violate company policy, it is more difficult for plaintiff's counsel or a prosecutor to argue that the company's manual acknowledged the transgression to be a violation of law. The contents of the manual and the emphasis to be placed on specific points will vary from company to company, but a number of general items should probably go into any manual, especially those of a company with many distributors.

Policy Statement

A cover letter from the President should accompany the manual. It should state the company's insistence on legal compliance, emphasize the importance of reading and understanding the manual, and encourage questions. It should explain that the manual is not a substitute for legal advice, but rather a tool to help identify when legal advice should be sought. It should point out that by consulting counsel before acting, company personnel can find ways of accomplishing objectives that minimize antitrust risks. If questions are not asked, solutions will not be found and unnecessary risks will be taken by the company.

Introduction

The scope of the manual should be explained. It should state that it is only an overview, and that the details of applicable law require consultation with counsel when specific situations raising questions arise. The purpose of the manual is to enable personnel to recognize these situations when they occur. The basic purpose of the antitrust laws − to increase competition − should be discussed.

Responding to Government and Other Inquiries

Employees should be instructed to refer any government inquiries − including those from investigatory agencies such as the FBI − to the company's compliance committee or the appropriate company officer immediately. The government official should be told that company policy is to cooperate fully with government investigations, but that its cooperation has to be coordinated through counsel. Similarly, employees should be instructed not to provide business information to third parties without clearance from counsel. The New York Court of Appeals has held that adverse counsel may conduct *ex parte* interviews of former and *current* employees of corporate parties, except those whose acts or omissions in the case are binding on the corporation

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[21] For further discussion of technology-based compliance training, see Banks & Banks (eds.), Corporate Legal Compliance Handbook (Aspen Law & Business), Chapter 13. For examples of providers of such tools, visit www.integrity-interactive.com or www.wecomply.com.

or who are implementing the advice of counsel.[22] Various bar association opinions have approved such contacts with *former* employees.[23] To minimize potential damage from such interviews, employees should be advised to notify counsel of any such contacts and to avoid any response unless authorized by counsel. Provisions containing such an obligation after termination should be considered for inclusion in employment contracts and severance agreements.

Recordkeeping

The importance of clear, complete and accurate records should be discussed. Any record retention and destruction policies should be set forth and explained thoroughly. Particular attention should be given to e-mail, which is often treated by users as informally as casual conversation, but which is a discoverable writing likely to persist through all efforts to delete it, as copies will exist on the systems of both the sender and all recipients, as well as on backups of all of them. A study of millions of Enron e-mails that were released by the Federal Energy Regulatory Commission in connection with its investigation of charges Enron manipulated energy prices found that 4% – or tens of thousands – posed liability risks of one kind or another.[24] Discovery can be had in electronic form, which permits large quantities of electronic documents, including "deleted" e-mails and internal memoranda, to be searched and sorted quickly and efficiently by software according to author, date, recipient, subject line or even the use of a particular term within the text of the documents.

Relations with Competitors

Any contact with a competitor could present antitrust problems. No such contacts relating to business matters should take place without compliance committee clearance. Discussions of price, other terms of sale, production, and customers should be strictly forbidden. The high personal, as well as corporate, risks of these discussions should be explained, as well as the various ways − in addition to direct agreement − that illegal price-fixing can manifest itself, such as bid-rigging, price signaling, and information exchange on prices. The fact that mere circumstantial evidence can be enough for an antitrust conviction should be explained.[25]

Detailed discussion may be appropriate for the following areas:

Price Fixing

The *per se* rule should be explained. Any agreement or understanding among competitors affecting price is an antitrust violation, regardless of justification.[26]

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[22] *Nieseg v. Team I,* 559 N.Y.S.2d 493 (N.Y. 1990). *Contra Public Service Electric & Gas Co. v. Associated Electric & Gas*, 745 F. Supp. 1037 (D.N.J. 1990).

[23] *See* ABA Standing Committee on Ethics and Professional Responsibility, Formal Opinion 91-359 (1991); Alaska Bar Ass'n Ethics Committee, Opinion 91-1 (1991).

[24] "Enron E-mail Study Shows Liability Nightmare, "TechWeb News," http://www.techweb.com/wire/ebiz/5300195 (Nov. 17, 1004.)

[25] *See, e.g., United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 532 n.12 (1973) ("circumstantial evidence is the lifeblood of antitrust law").

[26] *See, e.g., United States v. Socony-Vacuum Oil Co.,* 310 U.S. 150 (1940).

Exchange of Price Information

These exchanges may allow the inference of a price-fixing agreement.[27] No such exchanges should take place without the approval of counsel. Indeed, in a concentrated industry, no public dissemination of current or future pricing information should be made without a legal review to make sure that a legitimate business justification exists for the announcement, with respect to the kind of pricing information disseminated, the persons to whom it is disseminated and the timing of the announcement.[28] Information obtained through legitimate market channels, such as from customers, should be documented as to source, but distributors in concentrated industries should be circumspect in providing competitive pricing information to suppliers, as such communications could form the basis of a claim that the distributor is the hub of a supplier-level conspiracy to exchange pricing data and thereby facilitate price fixing.

Exchange of Other Information

Agreements among competitors concerning credit terms are forbidden.[29] Thus, exchanges of credit information should be supervised by counsel, should be limited to past credit performances of specific accounts (*e.g.*, the customer regularly pays 90 days late) when this information is unavailable from other sources, and should avoid agreement or discussion about the credit actions taken based upon the facts exchanged (*e.g.*, the customer has been put on C.O.D. only).

The *per se* rule is also applicable to agreements about production quantities or exchange of production information, and no justification for these agreements will be heard.

Division of Markets

The *per se* rule again applies to an allocation of markets by competitors, whether by area, by customer, or by some other classification.

Refusal to Deal/Group Boycotts

Any communication with a competitor about problems with a customer could lead to an inference of group boycott if the company and the competitor stop dealing with the customer. Absent clearance from counsel or the compliance committee, these discussions should be avoided.

Trade Associations

The fact that competitors come together to discuss business concerns presents antitrust risks. Clients often erroneously believe that subjects which could not otherwise be discussed by competitors are somehow permissible if undertaken within a trade association. They should be disabused of this notion. Indeed, trade associations are viewed with particular suspicion by government enforcement authorities.

The compliance committee should be made aware of all participation in trade association activities. Employees should be instructed to leave any meeting at which prices, sales terms and conditions, and production quantities are discussed. Minutes of all meetings should be obtained and should be reviewed by company counsel.

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[27] *See, e.g., United States v. United States Gypsum Co.*, 438 U.S. 422, 441 n.16 (1978).

[28] *See, e.g., In re Coordinated Pretrial Proceeding in Petroleum Products Antitrust Litigation*, 906 F.2d 432 (9th Cir. 1990)(finding disclosure of retail, but not wholesale, prices justified by customer needs).

[29] *See, e.g., Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643, 648 n.11 (1980) (when reporting of credit information is an agreement as to uniform credit terms, a Sherman Act violation may be found).

Relations with Customers

A major part of the compliance manual should deal with customer relations.

Price Discrimination

Broadly speaking, under the Robinson-Patman Act, price discrimination is prohibited. You cannot sell the same product to different competing purchasers at different prices if the effect is anticompetitive. The big purchaser may not be favored over the small one. Any quantity discounts must be cost-justified, and, because this defense is particularly difficult to establish, should be approved by counsel. Prices may be lowered to meet, but not beat, a competitor's price, but only if there is a good-faith basis for believing that the competitor actually made a lower offer. If a copy of the competitor's invoice or price quotation cannot be obtained, the company should gather as much information as possible to support the belief that the competitor in fact offered the lower price. The information could include:

- Evidence of similar discounts to other customers;
- The reasonableness of the lower price;
- The customer's history of honesty; or
- The customer's statement that it will take its business elsewhere if the price is not met.

The lower price must not, however, be confirmed with the competitor.[30] The information supporting the price reduction should be recorded for future use in the event of any price-discrimination challenge. The Robinson-Patman Act also requires promotional programs to be available to customers on a proportionally equal basis. In general, to the extent possible, the client should consult with counsel on price-discrimination and promotional program issues because of the complexity of the law and the importance of the factual context.

Resale Price Maintenance

For a century, minimum resale price maintenance was *per se* illegal. In 1997, the Supreme Court changed the rule for agreements as to maximum resale prices, and held that they were to be judged by the rule of reason.[31] In 2007, in *Leegin*, the Supreme Court threw out the *per se* rule against vertical price-fixing entirely, holding that resale price maintenance programs were to be judged under the rule of reason. Nevertheless, in doing so, the Supreme Court took pains to address circumstances under which RPM might be found unlawful – circumstances that seem broader that might make non-price vertical restraints, such as exclusive territories, be suspect:

> "Resale price maintenance, it is true, does have economic dangers. If the rule of reason were to apply to vertical price restraints, courts would have to be diligent in eliminating their anticompetitive uses from the market."

This suggests that, despite being judged by the rule of reason, vertical price-fixing may be subject to greater scrutiny. Moreover, a bill is pending in Congress that would overturn *Leegin* and restore the *per se* rule against resale price maintenance.[32] Thus, until the fate of this bill is determined, and until the lower courts have clarified how such arrangements will be reviewed, any controls over resale prices should be reviewed by counsel and the compliance committee in advance. It would seem that the traditional *Colgate* approach of unilaterally announcing a price

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[30] *See United States v. United States Gypsum Co.*, 438 U.S. 422 (1978).

[31] *State Oil Co. v. Kahn*, 522 U.S. 3, 118 S. Ct. 275 (1997).

[32] S. 2261, 110th Congress, 1st Session (2007) ("Discount Pricing Consumer Protection Act," referred to Judiciary Committee, 10/30/2007).

policy and then simply terminating those who do not adhere, still provides a safe harbor.[33] But it is an extremely limited one and probably should not be the basis for advice for clients, because anything beyond this bare announcement of policy and simple termination may take one out of the safe harbor. It is the rare business whose sales personnel are so disciplined that they will not try to persuade an errant distributor to mend its ways before dropping the axe. Such jawboning can vitiate the safe harbor protection.

Instead, if the client wishes to go beyond merely suggesting resale prices and making clear to the distributor that it is free to determine its own prices, a more detailed analysis is required. The Supreme Court in *Leegin* identified several areas of concern:

♦ An RPM program may facilitate horizontal price-fixing by suppliers, either by helping identify price-cutting suppliers if the reduced price shows up at retail, or by discouraging suppliers from cutting prices, because they will not benefit from increased sales if retail prices do not increase.

♦ An RPM program may facilitate horizontal price-fixing by resellers, where the RPM program is originated by a group of dealers and then foisted upon their supplier as an enforcement mechanism. The supplier then is at risk of becoming part of a horizontal, *per se* unlawful, price-fixing conspiracy among its customers.

♦ A reseller with market power may call for an RPM program from its supplier to reduce competition from more efficient, discounting competitors.

♦ A supplier with market power may use RPM to give resellers an incentive not to sell the products of the supplier's smaller rivals and new market entrants.

Consequently, the Supreme Court suggested in *Leegin* several factors relevant to the rule of reason inquiry of an RPM program:

♦ *The number of suppliers using RPM in the industry*. The more manufacturers who use RPM, the more likely that it could facilitate a supplier or dealer cartel.

♦ *The source of the restraint*. If dealers are "the impetus for a vertical price restraint, there is a greater likelihood the restraint facilitates a [dealer] cartel or supports a dominant, inefficient [dealer]."

♦ *Whether a supplier or reseller has market power*.

In considering whether to approve a proposed RPM program, counsel needs to review all the facts and determine whether any of these factors are present, or if there are other indications that the proposed program will have anticompetitive effects rather than enhancing interbrand competition. On the flip side, counsel needs to consider the extent to which use of RPM in the particular circumstances will foster intrabrand competition by enabling or encouraging dealers to offer more services to consumers and by giving consumers greater choice of purchasing the product (but not the brand) from higher price-higher service dealers, low price-low service dealers or dealers offering a middle ground.

Territorial and Customer Restrictions

Company policy with respect to limiting dealer resales to specific territories or categories of customers, or restricting use of certain channels, such as online sales, should be established in

[33] *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919); *Russell Stover Candies, Inc. v. Federal Trade Commission*, 718 F.2d 156 (8th Cir. 1983).

light of the applicable "rule of reason" legal standard for non-price vertical restraints and industry market conditions.[34]

Requirements Contracts and Exclusive Dealing Agreements

Requirements and exclusive dealing contracts are prohibited if their effect is anticompetitive.[35] The typical agreements or likely situations in which these issues might arise for the particular company should be analyzed under the rule of reason and a policy established.

Tie-In Agreements

A supplier may not require its customers to purchase one product (the "tied product") to be able to purchase another product (the "tying product") if the supplier has substantial economic power in the tying product market and a " 'not insubstantial' amount of commerce in the tied product" is affected.[36]

One of the difficult questions to be resolved in a tie-in analysis is whether there are in fact two distinct products, one of which is forced on customers who would not otherwise purchase it as a result of market power with respect to the other.[37] A similar standard may apply in some circumstances to reciprocal dealing when instead of using market power as a supplier to force purchases of another product, a company uses its purchasing power to force a supplier to purchase the supplier's needs from it.[38]

Distributor Complaints

Distributors often complain to their suppliers about the conduct of competing distributors. Complaints may concern pricing practices, territory infringement, advertising, or other matters. If the supplier takes any action on such a complaint, especially regarding prices, it could be considered as evidence of an unlawful agreement with the complaining distributor. As noted above, *Leegin* specifically cites resale price maintenance initiated by dealers, rather than by suppliers, as a factor that could render such program unlawful.

Even before *Leegin*, the Supreme Court in the *Monsanto* decision raised the level of proof required of a terminated distributor who alleges an illegal agreement based on complaints to the supplier by other distributors.[39] Nevertheless, if a distributor is in fact terminated as a result of such a complaint, that fact may constitute part of the required evidence "that tends to exclude the possibility that the manufacturer and non-terminated distributors were acting independently" and "that reasonably tends to prove that the manufacturer and others 'had a conscious commitment to a common scheme designed to achieve an unlawful objective.' "[40] Complaints from multiple

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34 *See Continental T.V., Inc. v. G.T.E. Sylvania, Inc.*, 433 U.S. 36 (1977); *Graphic Products Distributors Inc. v. Itek Corporation*, 717 F.2d 1560 (11th Cir. 1983).

35 *See Tampa Electric Co. v. Nashville Coal Co.,* 365 U.S. 320 (1961); *Standard Oil Co. of California v. United States*, 337 U.S. 293 (1949).

36 *See United States Steel Corporation v. Fortner Enterprises, Inc.*, 429 U.S. 610, 611 (1977) (citing *Fortner Enterprises, Inc. v. United States Steel Corp.*, 394 U.S. 495 (1969)); *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594, 608-9 (1953); *Northern Pacific Ry. Co. v. United States*, 356 U.S. 1 (1958).

37 *See Jefferson Parish Hospital District No. 2. v. Hyde*, 104 S. Ct. 1551 (1984).

38 *See United States v. General Dynamics Corp.*, 258 F. Supp. 36 (S.D.N.Y. 1966); 2 Kintner, *Federal Antitrust Law* "10.65 *et seq.* (Anderson Pub. Co., Cincinnati 1980); Flinn, *Reciprocity and Related Topics Under the Sherman Act*, 37 Antitrust L.J. 156, 158-59 (1966).

39 *Monsanto Co. v. Spray-Rite Service Corp.*, 104 S. Ct. 1464 (1984).

40 *Id.* at 1471 (quoting *Edward J. Sweeney & Sons, Inc. v. Texaco Inc.*, 637 F.2d 105, 111 (3d Cir. 1980), *cert. denied*, 451 U.S. 911 (1981)).

distributors are particularly dangerous, as they pose the risk of involving the supplier in a horizontal conspiracy at the distributor level.[41]

Thus, even after *Monsanto*, suppliers still should not encourage complaints and should tell complaining dealers that the supplier will not act on the complaints. Distributors should not be used as the source of pricing or marketing information concerning other distributors. Under no circumstances should a complaint be reported to the distributor complained about. Suppliers should make clear that any action will be taken based on compliance with the supplier's policies, not as a result of complaints. Any documentation of a termination decision should describe those policies and the steps taken to determine the dealer's compliance.

Distributor Terminations

Termination of distributors and dealers is one of the most frequent sources of litigation under the antitrust laws and related state statutes and common law. It is thus important that company records adequately and accurately reflect the reasons for termination. Procedures for recording unsatisfactory performance or conduct of distributors should be considered, if the supplier can be counted upon to act consistently in making termination decisions, but such documentation should be reviewed by counsel. Inconsistent application of standards for termination will lend support to a distributor's claim that the stated ground for termination was pretextual and that the actual reason was some unlawful one. It is also important that termination not be threatened, explicitly or implicitly, without legal investigation and advice.

In light of the variety of state law restrictions on termination, nonrenewal, and modification − such as appointment of additional dealers − of certain distributor arrangements, it is particularly important not to act without counsel. State "franchise" and "business opportunity" statutes often are far broader in scope than their names might indicate, and care should be taken to consider their impact before initiating or altering distributor arrangements. Legal advice is desirable even for addition of distributors, so that the client is fully aware of the consequences of that step in the particular state and so that efforts, including careful contract drafting and perhaps restructuring of the details of the relationship, can be made to avoid falling within any state distributor protection laws.

General Dealer Relations

Sales personnel should be advised to use care in discussions with distributors. They should avoid promises of long-term relationships or statements like, "If you keep your sales up, there will be no problems." Such oral statements may be held enforceable, particularly if there is no written contract.[42] Similarly, conversations about dealer's resale prices should be avoided. Dealers have been known to record such conversations, and the tapes have sufficed to allow the dealer to reach a jury.[43]

The sales force should also be advised of proper pre-termination procedures. They should not gather customer lists, sales reports or other proprietary information belonging to the customer, as this can lead to claims of misappropriation, unfair competition and bad faith termination. (Distribution contracts might provide that such information is not proprietary to the

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[41] *See Lovett v. General Motors Corp.*, BUS. FRAN. GUIDE (CCH) ¶ 9860 (D. Minn. 1991).

[42] *See, e.g., McEvoy Travel Bureau, Inc. v. Norton Co.*, 408 Mass. 704, 563 N.E.2d 188 (Mass. Sup. Jud. Ct. 1990) (giving effect to oral assurances that contractual termination provision was meaningless and relationship was long-term); *see also Commercial Property Investments, Inc. v. Quality Inns International, Inc.* , 938 F.2d 870 (1991) (finding oral representations supported claim of fraud despite contractual disclaimer of reliance on any such representations).

[43] *See, e.g., World of Sleep, Inc. v. La-Z-Boy Chair Co.,* 756 F.2d 1467 (10th Cir. 1985).

distributor and must be shared with the supplier.) Contemplated distributor changes should be reviewed with counsel in advance and the termination procedure agreed upon in advance. Counsel should review in advance all correspondence regarding actual or threatened termination, pricing policies, dealer complaints and communications with competitors.

Documentation by the sales force of distributor problems can be dangerous, as such documents often provide ammunition to a terminated distributor. Any such memoranda and any letters to distributors concerning performance problems should be cleared by counsel.

E-mail is a particularly dangerous medium, as it tends to be used internally with little forethought or drafting care. E-mails from Bill Gates featured prominently in the Microsoft antitrust litigation, and e-mail has provided damaging evidence in many other cases.

Client personnel should be taught to avoid the colorful language of war so often used in business. Talk of "punishing" dealers and "annihilating" the competition, or instructions to "Do whatever it takes. Squish him like a bug,"[44] while perhaps useful to impress superiors or to motivate sales people, can be used to great effect by an adversary before a jury. A perfect example is the $36 million jury verdict against high school yearbook publisher Jostens Inc., in which the evidence included the revisionist "I have a dream" speech of a sales executive who dressed up as General George S. Patton and inspired his troops as follows: "I have a dream that in three to five years, Jostens . . . will be the only national yearbook company in the industry," urged the sales force to "take Taylor [Jostens' principal competitor] out of the business, promised that he would pay to bail out of jail any sales representatives who were caught "kicking butt," and expressed the "need to put a real hurting'" on one particular Taylor representative.[45]

Similarly, documents emblazoned with "Confidential," "Eyes Only!" and "Top Secret" are red flags to a judge or jury, useful principally to identify important documents for the other side.

PRESENTATIONS TO SALES FORCES ♦ Even if a compliance manual is distributed and read, it is advisable to have counsel address the sales staff regularly on the same subjects. Annual presentations to the entire sales force are advisable, with perhaps semiannual presentations to regional sales managers and higher sales executives. These presentations can focus on particular areas that have been problematic for the company recently, and can allow anecdotal presentations based on counsel's experience that can "hit home" far more than the general informative discussions in a manual. Handouts on specific problem areas, such as the following sample "Dos and Don'ts of Distributor Relations" can be distributed and discussed. Use of varied media, from videotapes to interactive computer-based training on CD-ROM or over a corporate intranet, and of different formats, such as role-playing games, board games, compliance quizzes and the like, should be considered to help boost interest and attentiveness.

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[44] *See Browning-Ferris Industries v. Kelco Disposal, Inc.*, 492 U.S. 257, 109 S. Ct. 2909, 2912 (1989) (affirming $6 million punitive damages award).

[45] *Advisors Get Caught in the Middle As Yearbook Publishers Wage War*, THE WALL STREET JOURNAL, June 25, 1998, p. A1, A8.

Whatever presentation methods are used, it is critical to offer extensive opportunity for questions and answers, in small groups if possible. Counsel should always be sensitive to the potential conflict between the corporation and individual employees, including the top officers. it is important to make clear that counsel represents the corporation, not the employee, and to offer independent counsel if the need arises, so as to avoid the awkward situation that can arise if, under the belief that the attorney-client privilege exists, misconduct is disclosed which counsel then must take to the board of directors.[46]

OTHER AREAS OF CONCERN ♦ Obviously, the discussion above has focused on antitrust issues, which, while of particular relevance to distribution, are hardly the sole area in which legal risks can be reduced. Employment practices, discrimination and sexual harassment, use of the client's own intellectual property and that of others, environmental, health and safety and products liability concerns, securities laws, conflicts of interest, export controls and procurement regulations are among the areas that can profit from a legal audit and client education and training. Also beyond the scope of this article, but of critical importance to reducing legal risks in a distribution business, is the crafting of a distribution agreement tailored to the particular company, industry and jurisdiction. Such an agreement can avoid the applicability of franchise and other dealer protection laws, define distributor rights and responsibilities clearly and thus avoid disputes, and provide for efficient dispute resolution mechanisms.[47]

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[46] *See* J.I. Bloom, *Ethical Dilemmas in Corporate Representation*, LEGAL ECONOMICS, October 1987, at 33.

[47] *See* A.R. Jaglom, *Distribution Contracts*, THE DISTRIBUTION COUNSELOR, No. 56 (August 2005), ALI-ABA COURSE MATERIALS JOURNAL, Vol. 22, No. 4 (August 1998) at 29; A. R. Jaglom, *The Broad Scope of Franchise Laws: Traps for the Distribution Contract Drafter*, THE ANTITRUST COUNSELOR, No. 116 (August 15, 2005).

Dos and Don'ts of Distributor Relations

- ☺ Do read and understand the Company Policy Manual.
- ☺ Do make sure your records, correspondence, and memos are accurate, clear, and precise.
- ☺ Do tell your distributors that your price suggestions are only suggestions, and they are free to set their prices as they wish, unless you have the express approval of the Legal Department to do otherwise.
- ☺ Do discuss with distributors their sales and promotion performance and record your specific complaints regarding performance in a memorandum to the Senior Vice President – Sales, but do ***not*** discuss the distributor's pricing in criticizing performance without the express approval of the Legal Department.
- ☺ Do get legal advice before you terminate or threaten to terminate a distributor.
- ☺ Do get legal advice before you add a distributor or change the territory or product line of a distributor.
- ☺ Do feel free to seek advice on any issue or to consult the Compliance Committee if you feel that any of these rules prevent the company from competing successfully.

- ☠ Do not discuss with distributors the prices at which they resell company products, beyond merely providing a suggested price, without express approval from the Legal Department.
- ☠ Do not coerce or pressure a distributor about its prices.
- ☠ Do not offer special prices, discounts, promotions, or other sales terms unless equivalent terms are available to all competing distributors.
- ☠ Do not try to restrict the territory in which a distributor sells company products, beyond any restriction in the distributor's contract. If you believe that a distributor's sales outside of its area are injuring the company, consult with the Compliance Committee.
- ☠ Do not participate in or discuss any arrangements among distributors as to prices, territories, or other business issues without getting legal advice. If you believe such arrangements may exist, contact the Compliance Committee.
- ☠ Do not discuss distributors' complaints about each other – especially as to prices – with the complained-of distributor, unless you have the express approval of the Legal Department. Tell the complaining distributor that you are not interested in hearing about other distributor's prices, and that you will not discuss his complaint with the other distributor.