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Price-Fixing Makes Comeback After Supreme Court Ruling

By JOSEPH PEREIRA
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(See Corrections & Amplifications item below.)

Manufacturers are embracing broad new legal powers that amount to a type of price-fixing -- enabling them to set minimum prices on their products and force retailers to refrain from discounting.

For the better part of a century, punishing retailers for selling at cut-rate prices was an automatic violation of antitrust law. However, a Supreme Court ruling last year involving handbag sales at a Dallas mom-and-pop store, Kay's Kloset, upended that original 1911 precedent, potentially altering the face of U.S. discount retailing.



Brighton Collectables

Price Controls

Selected manufacturers with price-setting policies:

- Britax Childcare
- Old Mother Hubbard
- Stanley Furniture
- L.D. Kichler
- Leegin Leather (shown at left)

Retailers say an array of manufacturers now require them to abide by minimum-pricing pacts, or risk having their supplies cut off. Jacob Weiss of BabyAge.com, which specializes in maternity and children's gear, says nearly 100 of his 465 suppliers now dictate minimum prices, and nearly a dozen have cut off shipments to him. "If this continues, it's going to put us out of the baby business," he says.

BabyAge is now suing about a half-dozen major baby-gear makers and retailers

alleging price collusion.

The new rules mean "it's becoming a nightmare operating a business," says Brian Okin, founder of WorldHomeCenter.com Inc., a home-improvement retailer. The company is suing lighting maker L.D. Kichler in New York state court alleging that L.D. Kichler's minimum-price policy caused the retailer to miss out on substantial profits. "It just makes it so difficult to compete," Mr. Okin says.

Manufacturers like the policies partly because discounts can tarnish a brand's image. "We don't want consumers to think we're the cheapest guys in the world," says Ray Minoff of L.D. Kichler, the lighting maker. Retailers also have more of an incentive to heavily market price-protected goods, manufacturers say.

Critics argue the policies undermine the free market by limiting shoppers' power to decide for themselves

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whether to, say, buy at rock-bottom price from a no-frills outlet, or pay full price to someone offering better service or other benefits.

"What we're seeing here is the potential for a reshaping of the retail landscape in America," says Gregory Gundlach, a marketing professor at the University of North Florida, who was an expert witness for the plaintiff in last year's Supreme Court case.

State attorneys general are warning that minimum pricing, also known as "resale price maintenance," will feed inflation. Supreme Court Justice Stephen Breyer, in his dissent in the case, estimated that legalizing price-setting could add \$300 billion to annual consumer costs.

In May, attorneys general from 35 states -- including New York, California, Massachusetts and Pennsylvania -- wrote to Congress urging passage of a law to make policies like these illegal. "As the chief antitrust enforcers in our respective States, we know all too well the harm that can be caused" by pricing pacts, the letter says.

Consumer advocates say they are seeing the impact particularly in baby goods, consumer electronics, home furnishings and pet food. Edgar Dworsky of ConsumerWorld.org, a provider of price comparisons for consumers, says retail-pricing norms have already changed significantly. "My sense is that price-fixing is becoming more common," says Mr. Dworsky, a former Massachusetts assistant attorney general who has worked on antitrust matters.

Online retailers say some policies target them specifically. Mr. Okin of WorldHomeCenter.com says L.D. Kichler's policy applies only to advertised prices -- meaning discounting is OK as long as it isn't publicized. But online shops, by definition, publicize their prices online.

Changing Notions Of Price-Fixing

1911 Precedent Set: Dr. Miles Medical Co., maker of relaxants and other medicines, sues a distributor for selling at cut-rate prices, but loses when the Supreme Court says it is treading too close to cartel-like price-fixing.

1937 Depression Rollback: As big retailers rush to underprice and crush little shops during the Depression, Congress passes the Fair Trade Law, letting states selectively allow price-fixing to protect small retailers from predatory pricing.

1960s 'Free Ride' Argument: Economist Lester Telser argues that manufacturers should be allowed to set minimum prices, to protect retailers that promote their products from discounters that benefit from a 'free ride' on the promotions.



An undated ad for a Dr. Miles relaxant.

1975 Rise of 'MSRP': Congress repeals the Fair Trade Law, saying it harmed the free market. The only price protection allowed is the 'manufacturer suggested retail price,' or MSRP, which can't be enforced.

1980 Dr. Miles Rises: In a suit over alcohol pricing, the Supreme Court rules that the Fair Trade Law's repeal makes the Dr. Miles ban on vertical price fixing effective again.

2007 Case by Case: In a lawsuit

"We are being punished by [last year's Supreme Court ruling] exactly because we're more efficient than our competitors," Mr. Okin says.

Mr. Minoff of L.D. Kichler points out the policy applies to both traditional and online retailers.

It is still illegal for a group of manufacturers or retailers (or both) to band together and fix prices. That would be a violation of the Sherman Antitrust Act, which prohibits precisely that kind of anticompetitive behavior.

The Supreme Court ruling at the heart of the recent changes dealt with a narrower issue: It ruled on a manufacturer's right to enforce minimum prices on its own products.

In the case, Leegin Creative Leather Products Inc., a maker of women's purses and accessories, was sued by



Collectibles



Brighton
Involving handbags, Supreme Court overrules Dr. Miles. It says manufacturers' price restraints aren't unlawful automatically, but should be judged case-by-case.

A bag made by Leegin Creative Leather Enterprises, a player in the 2007 case.

Kay's Kloset, a Dallas retailer, after Leegin cut off shipments to Kay's. Kay's had been discounting Leegin's wears.

The high court's June 2007 decision, written by Justice Anthony Kennedy, declared that minimum-pricing pacts between manufacturers

and retailers could benefit customers under certain circumstances. For instance, the pacts could foster competition by giving retailers enough profit to promote a brand or offer better service, Justice Kennedy wrote. Individual price-setting agreements should be examined on a case-by-case basis, the ruling said, to be sure they're not anticompetitive.

The Supreme Court's 5-4 decision in the case, *Leegin vs. PSKS Inc.* (the parent company of Kay's Kloset), reversed a precedent-setting 1911 ruling against Dr. Miles Medical Co., a maker of relaxants and sleep aids that had cut off shipments to discounters.

That case, known as the "Dr. Miles rule," kicked off a centurylong tug-of-war over policies like these. In the Great Depression, Congress passed the Fair Trade Act to let states allow price-setting pacts designed to protect smaller retailers.

By World War II the rules were tightened again. Still, academics vigorously debated the issue. In the 1960s, a well-respected group of economists tied to the University of Chicago argued in favor of minimum-pricing strategies, partly to prevent no-frills discounters from getting a "free ride" from marketing efforts of rival retailers that charged higher prices to spend more money on promotion.

In 1975 Congress repealed the Fair Trade Act, saying it harmed the free market. Studies showed that minimum-pricing pacts under Fair Trade boosted prices by 19% to 27% in states allowing them.

Last year the legal pendulum swung again, with the *Leegin* ruling.

One company quick to act on the ruling was women's-shoe maker Nine West. In November, it petitioned the Federal Trade Commission to be released from an FTC order dating from 2000, well before the *Leegin* ruling, barring Nine West from entering into minimum-pricing agreements. Nine West, a unit of Jones Apparel Group Inc., had agreed to the order. It paid \$34 million to settle FTC and state charges that it had reached pricing agreements with numerous retailers, who weren't charged in the case.

In May, the FTC granted the petition -- allowing Nine West to do what it was once barred from doing -- provided that the shoe company report periodically on its use of pricing agreements so the agency could analyze the competitive effects.

A Nine West spokeswoman declined to say whether the company had entered into new minimum-price pacts.

Of course, plenty of manufacturers still embrace discounting as a time-tested way to grab market share and move a lot of product. Some price-cuts can actually be "a good thing," says Phillip Hoffman of Gigatent Corp., a New Jersey-based maker of camping gear. It "increases the sales volume of my [retail] customer, and that probably means more reorders of my product."

It also respects retailers' competitive environment. A uniform price might not work for all shops, Mr. Hoffman says, "for the obvious reason that they could be competing against a Wal-Mart down the street from them, or they could be a boutique shop on the beach all by themselves."

Minimum-price policies have their risks. If a price gets set artificially high, cheaper rival products can gain an edge.

Another danger: Retailers and customers might rebel. One such spat broke out between Old Mother Hubbard Dog Food Co. and Morris Sussex Pet Supply, a Succasunna, N.J., pet shop.

In April, the president of Old Mother Hubbard, Michael Meyer, wrote to the shop to complain that it was selling 30-pound bags of its dog-food brand, Wellness Chicken Super5Mix, at 20 cents below the minimum \$39.99 price. Mr. Meyer said Old Mother Hubbard would stop shipping the brand to the store for as long as six months if price-cutting continued.

The pet-supply shop fought back. It placed a billboard in front of its store urging customers to "Boycott Wellness Pet Food for Price Fixing," and aggressively steered customers to other types of dog food.

"Our suppliers can set pricing policies all they want -- but it's their loss, not ours," says Nancy Ruiz, the store's manager. Morris Sussex persuaded 85% of its Wellness customers to switch to another brand, Ms. Ruiz says. It now sells only a handful of Old Mother Hubbard products.

Old Mother Hubbard, which is based in Massachusetts, declined to comment.

In addition to arguing that minimum-price deals enhance a brand's image by avoiding discount stigma, manufacturers also say they prevent customers from feeling "cheated" for having paid more. "It's plain and simple, you want consumers to trust in your product," says Jerry Kohl of Leegin.

For shoppers, the reality is that there's little to be done about minimum-pricing policies, says Lino A. Graglia, a professor at the University of Texas Law School who is studying the Leegin decision. "It's going to be so difficult to prove that these resale-price-maintenance agreements are anticompetitive," he says.

It's not only retailers that are affected. The day after the Leegin decision, Cendant Corp., which owns Avis Rent-A-Car and Budget Rent-A-Car, asked the U.S. District Court in Anchorage, Alaska, to dismiss price-fixing allegations brought against it by one of its own franchisees. The franchisee claimed that higher prices Cendant dictated for Avis rentals made it tough to compete against lower-priced rival Budget.

Judge Timothy Burgess dismissed the price-fixing allegation, citing the Supreme Court ruling. He found that while Cendant's policies reduced competition between Avis and Budget, Avis's prices were still competitive with rivals such as Hertz and National.

In a complaint filed late last year, BabyAge, the child-products retailer, alleged that six baby-goods manufacturers and the retailer Toys "R" Us Inc., parent company of Babies "R" Us, conspired to force other retailers to abide by minimum-pricing rules for a range of baby products. Joining BabyAge as a plaintiff is another online retailer, BabyCatalog.com Inc.

Joseph Randazzo, president of BabyCatalog.com, says that "more and more companies are coming out with these types of policies" since the Leegin ruling. "We've been threatened with termination [of supplies] by a number of them."

The lawsuit, brought in U.S. District Court in Philadelphia, alleges that Babies "R" Us, the largest baby-goods seller in the country, and the manufacturers are part of an illegal pact to fix minimum prices.

The defendants are units of some of the biggest makers of strollers, baby carriers and other infant goods in the world: Maclaren Ltd. of the U.K.; Italy's Peg Perego SpA; Medela Inc. of Switzerland; Sweden's

Baby Bjorn AB; the Britax Childcare unit of Carlyle Group LLC; and Kids Line LLC of Madison, Wis.

The suit contends that Babies "R" Us checked prices on the Web sites of rivals and reported violations of the manufacturers' minimum-pricing rules. Following those reports, the lawsuit alleges, the manufacturers stopped supplying their products to BabyAge and BabyCatalog.com, damaging their businesses.

The suit also alleges that Babies "R" Us, back in 2002 (a time when price-fixing of this kind would still have been illegal) canceled orders for some Medela products because Medela wasn't being tough enough on Internet retailers that didn't abide by minimum-pricing agreements. An internal Medela memo submitted in the case indicates that Medela "discontinued Internet sellers to protect BRU's [Babies 'R' Us] business and margin and therefore accepted considerable legal risk."

In court filings, all the defendants deny engaging in any illegal arrangement. In a joint memorandum, they say that allegations they conspired with Toys "R" Us lack "any 'who, what where, or when' specificity."

Officials from Maclaren and Britax said the charges are unfounded. "We are contesting the case vigorously," a Britax spokeswoman said. Medela and Kids Line didn't return calls or emails seeking comment. Peg Perego and Toys "R" Us declined to comment.

Bjorn Jakobson of Baby Bjorn says the company doesn't enforce minimum retail prices, and deals only with distributors. Lawyers for Regal Lager Inc., identified in court papers as a Baby Bjorn distributor, didn't return phone calls.

The defendants moved to dismiss the case, citing the Supreme Court's Leegin decision. Judge Anita Brody denied the motion, noting that the Leegin ruling acknowledges the possibility that a "dominant" retailer like Babies "R" Us could abuse a pricing agreement of this type in a way that could be anticompetitive.

BabyAge, founded in 1999 and based in Wilkes Barre, Pa., has a business strategy based on discounting. "The pricing policies undermine the very reason for BabyAge's existence," says Mr. Weiss, the co-founder.

Last year, he says, a cutoff of shipments put BabyAge on the brink of bankruptcy. The company survived partly by diversifying into toys, and by selling a stake in the company to raise cash.

Among the manufacturers to cut off BabyAge is Stanley Furniture Co. In March, Mr. Weiss says, Stanley told BabyAge it must raise its price for one of Stanley's Isabella-brand cribs from \$778 to the \$928 minimum set by Stanley. When BabyAge refused to comply, Mr. Weiss says, Stanley stopped its shipments to BabyAge.

Stanley didn't return calls seeking comment.

BabyAge does play ball with some manufacturers. For instance, it prices a baby car seat made by Britax, the Boulevard Convertible, at \$309.99, the manufacturer's minimum. If he didn't, Mr. Weiss says, Britax would cut off his supply of a popular product.

Britax declined to comment.

Mr. Weiss says there's plenty of profit in discounting for a low-overhead operation like his, which employs only 45 people. He says he could sell the Boulevard car seat for \$229 and still clear about \$50 in profit.

"If it weren't for minimum-pricing policies, we'd be doing at least twice as large a business as we are today," Mr. Weiss says.

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Corrections & Amplifications

The last name of University of North Florida marketing professor Gregory Gundlach was incorrectly given as Gunlach in a previous version of this page-one article on price-fixing.

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