# Costco v. J&J: The Latest and Largest in a Long Line of Pricing Cases

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It's not often that one Fortune 50 company sues another – but that's what happened earlier this week when Costco sued Johnson & Johnson (J&J) in California federal court over J&J's attempts to limit Costco's resale prices of J&J's contact lenses. For antitrust practitioners, however, the case is of interest because of its potential lessons about manufacturers' efforts regarding resale prices. Initially, however, the case might provide more lessons about another age-old antitrust question – what's sufficient to allege and then prove agreement?

Some manufacturers seem to think the struggle to control resale prices began with Amazon and the Internet. Antitrust law, however, has been debating that issue since at least when a big manufacturer – Dr. Miles Medical Company – sued to stop to stop the "cut-rate" resale prices charged by a big retailer – John D. Park & Sons – for patent medicines. When the Supreme Court ruled that resale price maintenance (that is, an agreement between a manufacturer and retailer regarding resale price or RPM) was per se illegal in 1911's *Dr. Miles*, manufacturers had to develop other ways to affect retailers' prices.

Some of those methods had only an indirect effect on resale prices. For instance, requirements that the retailers sell only from approved locations or nice showrooms might raise retailers' costs and make it less likely that any two could

effectively compete – but the retailers are still free to set any price. Minimum advertised price programs also allow any resale price – but any ads for the product cannot contain a price that is "too low" or otherwise degrade the reputation of the product.

The only direct way to control the retailer's price of the product was to not sell to the discounting retailer in the first place. In 1919, the Court in *Colgate* reiterated the "long recognized right" of a manufacturer to "freely exercise his own independent discretion as to parties with whom he will deal." Since then, manufacturers have struggled to maintain the rigid discipline that *Colgate* programs require: Announce a policy to deal only with retailers who resell at the "right price" and simply terminate, not coerce, any discounting retailers so as to avoid the finding of an "agreement."

When the Court overruled *Dr. Miles* in 2007 in *Leegin* and found that RPM should be judged under the rule of reason, some thought these RPM-substitutes would no longer be needed. But as several states, such as California, have interpreted their antitrust statutes as making RPM per se illegal, manufacturers that sell nationally have continued to use them.

The J&J policy to which Costco objects clearly is meant to be a *Colgate* program. In the copy of the program attached to the complaint, J&J says "This policy is unilateral and does not represent an agreement between [J&J] and its authorized distributors or resellers…. Resellers are free to advertise and sell any [covered] product at a price of their own choosing, however violations will result in loss of product supply." J&J even calls the program its "Unilateral Price Policy" or UPP.

Costco alleges in ways small and large that the UPP is really RPM. As to the former, Costco repeatedly calls J&J's policy the "RPM Policy" and not UPP. More substantively, Costco describes the discussions J&J had with Costco and the high price retailers (Eye Care Professionals or ECPs) both before and after the UPP was implemented. Those discussions led to five different versions of the UPP, all attached to the complaint, which made several changes to the UPP to allow some forms of discounting. Costco describes those changes as an agreement between J&J and Costco and ECPs on RPM. These discussions and changes might end up being interpreted as the type of persuasion and coercion that changes a *Colgate* program into RPM, especially because it appears some of them took place after the program started.

Those five iterations of the UPP do show how difficult *Colgate* programs are to set up and implement. Here, the Frequently Asked Questions portion of the written program went from 10 questions in June 2014 to 19 in October's fifth version. That final version covered such details as bundling the contact lenses with other products not subject to the UPP; discounts with in-office or in-store credit; military and employee discounts; and a "club store retailer amendment" seemingly designed to meet Costco's concerns. For practitioners, these details emphasize the need to understand the client's business and strategy before implementing such a program.

As part of proving that the UPP really is RPM and a Section 1 violation, Costco will need to prove an agreement. Some of the complaint's assertions made it appear that Costco would allege a horizontal agreement, either at the manufacturer or distributor level. After all, *Leegin* warned that one way RPM could violate the rule of reason is if it merely implements a horizontal conspiracy at either the wholesale or retail level of distribution. Costco alleges that all of J&J's major competitors adopted similar pricing policies within months of each other and that the industry settled claims of vertical and horizontal conspiracies many years ago. The Section 1 cause of action, however, only alleges an agreement between J&J and the ECPs and distributors, not any of its competitors.

In a putative class action filed in the same court and only days later, plaintiff contact lens purchasers <u>do</u> claim that J&J and its competitors conspired with each other as well as ECPs, a key distributor and a trade association. In addition to the evidence alleged by Costco, the putative class points to trade association activities of J&J and its competitors, including a group that instituted a sales information exchange contemporaneously with these pricing policies.

In its description of the vertical agreement, Costco doesn't seem to be alleging that J&J was just enforcing an agreement among the ECPs or distributors. The phrase "hub and spoke conspiracy" is never used. Instead, Costco alleges a vertical agreement by describing the multiple meetings J&J had with various resellers while it was developing and adjusting the UPP.

Surely, J&J will claim that such communication represents only helpful feedback from those closer to the customer so it can better make unilateral decisions. In doing so, though, it will have to explain some statements in its retailer communication that made it into the complaint, like: "implement the changes you

told us were needed” and “further demonstrate [J&J’s] commitment to [ECPs]”. Costco also includes another troublesome quote, though the source is unclear: the purpose of the UPP is to “improve [the ECP] capture rate in the office [because] now the patient has no incentive to shop around.”

Given the importance of the program to J&J, an early settlement doesn’t seem likely. Given the size of the companies, good lawyering on both sides seems likely. So while this case could be seen as just another in the long line of pricing disputes between manufacturers and retailers, perhaps this one will provide helpful post-*Leegin* guidance to practitioners.