

Robinson-Patman Suits Against 5-Hour Energy Maker Provide Lessons for Other Suppliers

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Living Essentials LLC, the maker of 5-hour Energy drinks, has faced two recent suits in California federal courts alleging violations of Robinson-Patman's prohibitions on price and promotional discrimination. The suits should teach other suppliers, especially those that sell to Costco, that private RP enforcement is alive and well and still requires careful planning of prices and promotions.

Two Suits Offer a Glimpse into Complicated Pricing

In February 2018, U.S. Wholesale Outlet & Distribution Inc. filed suit in the Central District of California alleging that Living Essentials' price and promotional allowances to Costco violated Robinson-Patman Sections 2(a) and 2(d) and caused it antitrust injury. The plaintiff is a wholesaler who supplies various products, including 5-hour Energy products, to small convenience stores.

The plaintiff's lawyer in this suit also represented other wholesalers who made similar claims against Living Essentials in a suit several years ago in the Northern District of California. The earlier suit was settled in late 2017 on the eve of trial but only after class certification was denied and merits discovery was conducted. The judge denied dueling summary judgment motions in mid-2017 and, in doing so, provided a glimpse into Living Essentials' pricing strategy.

According to both the opinion denying summary judgment in the old case and the complaint in the new one, Living Essentials charges plaintiffs and similar “C-store wholesalers” a list price of \$1.45-\$1.60 per bottle. These wholesalers purchase the bottles in “master cases” of 18 twelve-packs of a single flavor and strength or similar-sized “display packs” with multiple flavors of both regular and extra strength varieties. According to the opinion, Living Essentials’ list price to Costco is lower and ranges from \$1.35-\$1.50 per bottle for a pallet of “club packs” each containing 24 bottles in a limited selection of flavors.

All parties agreed that the list price to plaintiffs was always reduced by a \$.07 per bottle “everyday discount.” According to the opinion, sometimes plaintiffs also received a \$.07 per bottle “display allowance.” Costco, according to the complaint, regularly received price allowances not available to plaintiffs, including some to cover any spoilage and for ordering electronically. In addition, the opinion and complaint state that Living Essentials paid Costco various amounts to place the product in more valuable store space, such as endcaps, and funded an instant rebate to Costco customers of between \$.15 and \$.30 per bottle. While plaintiffs and the defendant (and their experts) hotly debated which discounts to subtract to determine a net price, one internal Living Essentials memo put Costco’s average net cost at \$1.12 per bottle as compared to plaintiff’s \$1.38.

Robinson-Patman Allegations and Responses

Both suits alleged violations of Robinson-Patman Section 2(a), prohibiting price discrimination, and 2(d), prohibiting discrimination in paying for promotion of the supplier’s products. For both sections, plaintiffs had to show that they at least competed with Costco. In denying summary judgment for all parties in the earlier suit, the court focused on that question (to the exclusion of other potential defenses) and found a material question of fact as to whether the plaintiffs and Costco competed.

On that question, plaintiffs asserted that they competed with at least Costco’s Business Centers, all of which targeted retailers rather than individual consumers. In the earlier case, plaintiff’s expert tried to show competition with Costco using evidence that Costco Business Centers delivered to retailer customers in the same zip codes in which some of plaintiff’s customers were located. In addition, plaintiff offered up numerous internal Living Essentials documents obtained in discovery in which some Living Essential salespeople complained that lower prices to Costco

were hurting sales to C-store wholesalers, including the plaintiffs.

Defendants countered by asserting that plaintiffs and Costco “are differentiated by many factors, including by their product prices, product mix, product package amounts, store location, store hours, and special services they provide (like delivery or in-house credit).” Also, defendant’s internal classifications categorized Costco as a “Club Store,” not a C-store wholesaler. According to the defendant, that classification at least meant that Living Essentials would not be able to obtain the same type of value from plaintiffs from any promotional allowances provided to Costco. The court found these competing assertions raised a question of fact for the jury to decide. In the more recent case, the complaint once again asserts that the plaintiff and Costco compete based on numerous quotes from Living Essentials’ own documents.

Pricing and Robinson-Patman Lessons for Other Suppliers

While there has been no trial or final opinion on Living Essentials’ distribution strategy, it is not too early for other suppliers to derive lessons from this defendant’s experience. First, it appears that Living Essentials had separate pricing and promotional programs for customers based on whether Living Essentials classified them as “club stores” or “C-store wholesalers,” perhaps with insufficient regard to whether customers in those two categories actually competed. While such internal categories might reflect actual differences in the customers and industry “common knowledge,” they alone will not trump evidence that the two categories of customers actually do compete.

According to the opinions, Colgate might have made this same type of mistake in the recent *Woodman’s* Robinson-Patman case that ended up in the Seventh Circuit. There, Colgate allegedly reorganized its internal classifications of customers and so stopped selling “club packs” of its products to Woodman’s, a Wisconsin grocery store, that allegedly competed with Costco and others classified as “club stores.” As discussed elsewhere, Colgate eventually prevailed when the Seventh Circuit found that special sizes of packages were not “promotional allowances” in that case.

Second, it appears that Living Essentials had different – and competing – salespeople and brokers servicing Costco and plaintiffs, respectively, and neither group completely understood the pricing and promotions offered the other. As a

result, the personnel servicing plaintiffs created documents meant to excuse their reduced sales to plaintiffs and other C-store wholesalers; however, those same documents inadvertently supported plaintiffs' contentions that they competed with Costco and were injured by discriminatory discounts. These cases show the need for a coordinated pricing and promotional strategy that meets the needs of the business, complies with the requirements of Robinson-Patman and is understood by the entire organization.

Third, it might not be a coincidence that these cases, *Woodman's* and the series of cases alleging vertical or horizontal price fixing of contact lens all spring from sales to Costco. The retailer is famous for its rock-bottom costs which it passes on to its member/customers in the form of rock-bottom prices. Unlike most other stores that sell to the public, Costco seems to make most of its profits from annual membership fees. Customers are willing to pay those fees only because they believe Costco's reputation for very low prices. Suppliers who are used to retailer customers who might only partially pass on discounts to consumers might be surprised when Costco seems to pass on all of that discount. As Living Essentials has discovered, the result could be more disgruntled retailer customers than expected.

Finally, it should not surprise any supplier who sells to retailer customers with slim profit margins that such customers will be upset with even the possibility that another retailer is getting a better deal. Such disgruntled customers can take out their dissatisfaction in many ways. A Robinson-Patman lawsuit is only one. The better strategy in the long-run is a well-thought out and disciplined pricing and promotional strategy that takes RP, other legal issues and business concerns into account at the beginning of the process, not just when the RP suit is filed.