

COMPETITION ALERT

JULY 2007

RESALE PRICE MAINTENANCE: *PER SE* ILLEGAL, OR BEST CONSIDERED UNDER A "RULE OF REASON"?

Auckland Competition Contacts:

Andrew Peterson, Partner
e: andrew.peterson@russellmcveagh.com
DDI: + 64 9 367 8315
m: +64 (0) 27 560 5021

Sarah Keene, Partner
e: sarah.keene@russellmcveagh.com
DDI: + 64 9 367 8133
m: +64 (0) 27 535 5034

Wellington Competition Contacts:

Derek Johnston, Partner
e: derek.johnston@russellmcveagh.com
DDI: +64 4 819 7535
m: +64 (0) 27 446 6848

Pat Bowler, Partner
e: pat.bowler@russellmcveagh.com
DDI: +64 4 819 7500
m: +64 (0) 27 442 8040

James Palmer, Partner
e: james.palmer@russellmcveagh.com
DDI: +64 4 819 7370
m: +64 (0) 27 580 1616

David Clarke, Partner
e: david.clarke@russellmcveagh.com
DDI: +64 4 819 7516
m: +64 (0) 27 244 5658

Introduction

In the recent decision of the Supreme Court of the United States, *Leegin Creative Leather Products, Inc v PSKS, Inc.*,¹ a majority of the Court overruled its decision in *Dr Miles*,² a case decided in 1911 which, for almost a century, had established that agreements giving effect to minimum resale price maintenance were *per se* illegal. Resale price maintenance, or "RPM" as it is usually described, generally arises when a supplier either agrees with a reseller, or induces a reseller, not to resell goods at less than specified minimum prices.

The case is important as it marks a move away from regarding RPM as prohibited regardless of its effect on competition, and now requires vertical price restraints to be judged by a "rule of reason" test involving an assessment of the *actual effect* of the conduct.

The *Leegin* case is relevant to New Zealand as section 37(1) of the Commerce Act 1986 provides that RPM is illegal *per se* - similar to the position which existed in the United States under *Dr Miles*. While *Leegin's* direct application may therefore be fettered by the statutory prohibition in the Commerce Act, the decision is nevertheless welcome for two main reasons: first, because it represents a positive development in the understanding of the economic effect and underlying rationale for RPM at a highly influential judicial level, and secondly, because as part of the current review of Part V of the Commerce Act, the Ministry of Economic Development has invited comment on whether the Act should be amended to allow for a clearance process for restrictive trade practices, which would also apply to *per se* offences such as RPM, effectively allowing RPM to be "cleared" if it did not substantially lessen competition (similar to the approach under a "rule of reason" analysis).

Vertical price maintenance in *Leegin*

The facts of *Leegin* are these: Leegin designed, manufactured and sold leather goods to retailers. In 1997 Leegin instituted a retail pricing and promotion policy to sell goods only to speciality stores that offered customers "quality merchandise and a superior service". As part of that policy, Leegin refused to sell to retailers that discounted goods below Leegin's suggested resale prices. Their reasoning was that discounting harmed Leegin's brand image and reputation. When PSKS refused to cease discounting Leegin's products, Leegin refused to continue supplying their products to the store.

In the District Court, PSKS successfully claimed that Leegin had violated the Sherman Act by "entering into agreements with retailers to charge only those prices fixed by Leegin". On appeal, Leegin did not dispute that it had entered into RPM agreements, but contended that a "rule of reason" analysis should apply, and that under this analysis, Leegin's marketing policy had no anti-competitive effects. Leegin argued that it was important to distinguish between restraints with anti-competitive effects that are harmful to consumers and those with pro-competitive effects that are in the consumer's best interests (or have no effect on competition).

The Court of Appeals, however, rejected the argument that a rule of reason approach should be adopted, and refused to consider the testimony of Leegin's economic expert (as had the

1. 06-480, 551 U.S. (3/26/07) Roberts CJ, Scalia, Thomas and Alito JJ for the majority. Breyer, Stevens, Souter and Ginsburg JJ dissenting. Judgment available at: <http://www.supremecourtus.gov/opinions/06pdf/06-480.pdf>.

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

District Court) on the basis that it was bound by *Dr Miles*, and the *per se* rule rendered all justifications for RPM irrelevant.

The Supreme Court majority judgment

The majority of the Supreme Court in *Leegin* noted that "it cannot be stated with any degree of confidence that resale price maintenance always or almost always tend[s] to restrict competition and decrease output".³ Instead, they held that the potential economic effects of RPM agreements should be examined to see whether the *per se* rule was in fact appropriate. As part of this process, the majority reached the following conclusions:

- The *per se* rule should not be adopted for administrative convenience alone; doing so may have the effect of prohibiting pro-competitive conduct that anti-trust laws should encourage as RPM agreements can have either pro- or anti- competitive effects, depending on the circumstances in which they are formed;
- The *per se* rule should not be justified only by the possibility of higher prices to the consumer if no other anti-competitive conduct or effect is found;
- Permitting a manufacturer to control resale prices may promote inter-brand competition and consumer welfare in a variety of ways; and
- Absent RPM agreements, retail services that enhance inter-brand competition might be underprovided because discounting retailers would be able to "free ride" on the efforts of retailers who furnish such services by capturing some of the demand those services generate, without having to fund them.

In considering reasons why the *per se* rule should remain, the majority recognised the risk that RPM agreements may have anti-competitive effects, including that they might:

- Result in unlawful price fixing designed solely to obtain monopoly profits;
- Facilitate manufacturer or retailer cartels; and/or
- Discourage a manufacturer from cutting prices to retailers.

However, given the diversity of effects, the majority considered that the better position was that a rule of reason rather than a *per se* approach is warranted, and accordingly, ruled that the *Dr Miles* decision was no longer good law.

The New Zealand position compared to *Leegin*

If New Zealand does adopt a clearance process for restrictive trade practices (as discussed above), this would put us somewhere between the US position before and after *Leegin*. This may be a preferable position to be in if the pro-competitive effects of resale price maintenance are to be recognised and accepted, while still safe guarding against the possibility of anti-competitive effects. It would certainly allow the underlying economic and commercial rationale for such conduct to be explored, which can only be a good thing. These factors were clearly in the minds of the majority on the Supreme Court.

As noted in our previous Alert, submissions on the Ministry of Economic Development's review of Part V close on Friday 10 August 2007.

NEWS FLASH:

In June 2007 Deborah Battell was appointed Director, Competition Branch of the Commerce Commission. Deborah has been the head of the Fair Trading Branch since June 2001, overseeing in her tenure a number of high profile investigations and prosecutions.

[The decision]... represents a positive development in the understanding of the economic effect and underlying rationale for RPM at a highly influential judicial level.

"[I]t cannot be stated with any degree of confidence that resale price maintenance always or almost always tend[s] to restrict competition and decrease output".

If New Zealand does adopt a clearance process..., this would put us somewhere between the US position before and after Leegin..., a preferable position to be in if the pro-competitive effects of resale price maintenance are to be recognised..., while still safe guarding against the possibility of anti-competitive effects.

3. *ibid* n1, in the Majority opinion at pp 14 - 19.