



Submission to the Harper Review – Response to Draft Report

14 November 2014

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## 1. Introduction

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- 1.1. Jones Day welcomes the opportunity to make a submission to the Harper Review Panel (**Panel**) in response to the Draft Report dated September 2014 (**draft report**).
- 1.2. In this submission Jones Day focuses on the Panel's views expressed in the draft report on the prohibition on resale price maintenance (**RPM**). In particular the Panel states, at page 236 of the draft report:

There is not a sufficient case for changing the prohibition of RPM from a per se prohibition to a competition-based test.

Nevertheless, the notification process should be extended to RPM, to provide a quicker and less expensive exemption process for business.

The prohibition should also be amended to include an exemption for RPM conduct between related bodies corporate, as is the case under section 45 and 47.

- 1.3. Jones day is of the view that RPM would benefit from a reform to adopt a competition-based test. Our reasons are presented below. In the event that the Panel is not minded to recommend the competition-based test, Jones Day submits, at the minimum, the Panel's recommendation in the draft report, to extend the notification process to RPM conduct, must be implemented. If such an approach is adopted, guidance from the Panel to the ACCC as to the matters to be considered in respect of a notification of RPM would be invaluable.

## 2. The per se prohibition against RPM

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- 2.1. The theory behind the prohibition for RPM is that it is likely that retailers would be discouraged from competing on price, resulting in some consumers paying more for a product. RPM has been presumed to be anti-competitive on the basis that it:
  - 2.1.1. Facilitates collusion between suppliers or distributors;
  - 2.1.2. Drives up prices for the brand(s) concerned;
  - 2.1.3. Leads to the exclusion of smaller competitors; and
  - 2.1.4. Undermines innovation or dynamism in distribution.
- 2.2. Jones Day submits that maintaining the present per se approach is out of step with modern economic thinking, which recognises that resale price maintenance is not always objectionable and has the potential to create both pro- and anti-competitive effects. Australian competition law needs to promote competition rather than undermine it.
- 2.3. Competition law analysis often focuses on price because it is an easily quantifiable variable and it can often be assumed that the other dimensions of competition are similarly affected. Nevertheless it is well accepted that there are many more important facets or dimensions to competition not merely price.
- 2.4. For example, even if a State regulator sets taxi prices, there can still be extensive and important competition between taxi operators and taxi network operators to make taxis plentiful where and when they are needed, to select comfortable vehicles and drivers that are polite.
- 2.5. In many markets the following dimensions of competition may be as important, or more important than price: a range of product features that appeal to particular customers; high quality service accompanying products and product innovation. Often the most significant contribution that competition can make is over multiple dimensions at one time.
- 2.6. The problem that can emerge with section 48 of the *Competition and Consumer Act (CCA)* is that it intrudes into, and closely regulates, conduct over the “last mile” of just one dimension of competition in a way that interferes with competition over pricing decisions at the wholesale level or the provision of service or quality.
- 2.7. Since the CCA was first enacted, there has been a strong push away from legalistic approaches to prohibitions and towards economic based decision making. A number of

important economic concepts are simply not recognised by section 48 or even section 48 works counter to those economic concepts.

- 2.8. For example, most elementary economic text books recognise that certain classes of goods are unusual in that their consumption increases as price increases (ie upward sloping demand curves). Griffen goods are not particularly relevant to this discussion but Veblen goods are. Consumers of Thorsetn Veblen found that for many premium branded goods, consumers actually gain more utility and enjoyment when the products cost more. Most obviously this relates to a small group of consumers who value engaging in conspicuous consumption but almost all consumers value occasional moments of celebration or an ability to make a gesture by consuming or giving a gift of a highly priced luxury good to mark a special occasion or relationship.
- 2.9. Prohibiting resale price maintenance works to actually rob Veblen goods of a significant part of the value they impart to consumers.
- 2.10. More generally branding is an extremely important tool in informing the market. Of course most suppliers claim to have the best products who has the best product is very important for competition. However, how do we know whether to believe claims that a product is the “best”? Branding is the long run means by which suppliers and consumers converse with each other and make and substantiate claims of quality.
- 2.11. Competition over branding is not often well catered for by overly simplistic assumptions about how competition works. Branding experts suggest that competition plays out in important ways well before the ‘last mile’ pricing decisions with which the section 48 prohibition is concerned. Competition over brands occurs right back at the branding concept stage where the quality attributes are formulated based on what the supplier considers customers most want. Before the process has run its course, there is competition to establish the message of the brand, raise awareness and then generate profitable sales.
- 2.12. One aspect of the branding message is price. Consumers often do not know in non-concentrated markets for differentiated products what quality level to expect. There are too many brands to know which are top, medium or bottom level products. Price is an important means of communicating with the consumer what quality level to expect. If a premium product is discounted heavily, it may often not be purchased because it is assumed to be inferior. The consumer actually suffers from that product having been effectively excluded from their menu of choices within the quality range they seek.
- 2.13. Internationally, this sentiment is evidenced by:
  - 2.13.1. The approach of the EC in its 2010 guidance on vertical arrangements which acknowledged the potential for efficiency justifications;

- 2.13.2. In Europe, RPM is generally presumed to be anti-competitive. However, most European countries allow this presumption to be rebutted with proof of offsetting efficiency benefits;
  - 2.13.3. The U.S. Supreme Court in *Leegin v PSKS* which established that minimum resale price agreements are to be evaluated on a case-by-case basis under the “rule of reason”, allowing potential benefits to competition to be weighed against potential anti-competitive effects;
  - 2.13.4. Canada’s replacement in 2009 of its price maintenance rule with a civil regime having the effect of allowing suppliers to set resale prices for their products, provided the relevant conduct does not lead to an adverse effect on competition;
  - 2.13.5. In 2008, as part of its process of carefully identifying a leading competition law, Singapore resolved that RPM ought only be prohibited where the conduct mounts to an abuse of dominance.
- 2.14. Economists have long recognised that there are circumstances in which RPM offers efficiency benefits and may therefore be pro-competitive:
- 2.14.1. One such benefit is when a retailer provides services that enhance the value of the manufacturer’s products. Without RPM, there is a risk that consumers will “free ride” on the services provided by one retailer, while making their actual purchases from a third-party “deep discount” retailer. This possibility discourages the full -service retailer from investing in services to consumers in connection with the product, thereby leading to an overall lessening of service levels associated with the product. Without price restraint incentives, retailers may not want to invest in services that enhance the competitive aspects of the brand;
  - 2.14.2. Similarly, when one retailer invests heavily to enter a new market, it does not want a second retailer to follow and undercut its prices, while at the same time benefiting from the first retailer’s initial investment;
  - 2.14.3. For high-end brands, the establishment of a minimum retail price counters the threat of discounting, which can cheapen the image of the brand in the eyes of consumers. Consumers expect luxury goods to come with a certain level of service. The economics of their business model dictate that discount retailers may not be capable of providing that level of service;
  - 2.14.4. RPM may help suppliers launch a new product and penetrate the competition the market place by incentivising distributors to invest in creating a market for a new product in the launch phase. By ensuring a profitable margin to the

retailer, resale price maintenance can induce retailers to make the necessary investment of capital and labor needed to introduce the consumer to a new brand;

- 2.14.5. RPM may be necessary to effectively run short-term price-based promotions certain distribution networks;
- 2.14.6. RPM may help address free riding on presales services (this is particularly relevant for complex products);
- 2.14.7. These agreements can also serve as an efficient means of encouraging retailers to develop value-added services to the retail experience, without having to engage in the inefficient means of setting out what services should be added to each individual distributor. The margins, maintained in a pricing agreement, would encourage retailers to enhance their ability to drive traffic to their business over someone else's business;
- 2.14.8. Current economic literature shows that RPM actually increases competition in the market place and has a net positive benefit for consumers by promoting interbrand competition – *“competition between manufacturers selling different brands of the same type of product by reducing intrabrand competition – the competition among retailers selling the same brand.”*<sup>1</sup> By removing the ability of different retailers to haggle over the price of the same brand of a product, retailers are able to refocus their attention on value-added services for the benefit of the customer, allowing them more choice, and the benefit of competitive brands in the marketplace trying to distinguish them.

*Application to luxury or branded goods*

- 2.15. Jones Day considers that these efficiency justifications are equally applicable to luxury or branded goods as these sophisticated goods are enhanced by the provision of personalised presale services.
- 2.16. RPM for luxury or famous brands maintains brand integrity by preventing merchants from drastically discounting underperforming or slow moving products. Luxury brand owners strive to promote a certain product identity and a certain exclusiveness. Discounting is contrary to their brand identity.

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<sup>1</sup> LEEGIN CREATIVE LEATHER PRODUCTS, INC. v. PSKS, INC., DBA KAY S KLOSET . . . KAYS SHOES CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT No. 06-480. Argued March 26, 2007—Decided June 28, 2007 <http://www.justice.gov/atr/cases/f225000/225037.htm>



*Proposed amendment to section 48.*

- 2.17. Jones Day considers that, in-line with international practices, RPM ought to be considered under a competition-based test in consideration of:
- 2.17.1. If the company is in possession of a very small market share;
  - 2.17.2. If the company lacks the power to control prices or exclude competition in a market;
  - 2.17.3. There are a significant number of other larger suppliers;
  - 2.17.4. Whether competing companies do not have similar arrangements (because the court may view it as a step away from facilitating collusion);
  - 2.17.5. The products are complex and highly-differentiated in nature;
  - 2.17.6. The potential for RPM to limit free-riding by discount retailers that do not invest in pre-sale and post-sale services but benefit from other retailers having done so;
  - 2.17.7. The likelihood that setting minimum resale prices would limit free riding by encouraging retailers to offer better services rather than lower prices to attract customers;
  - 2.17.8. The nature and extent of pre-sales and post-sales services provided by retailers

### 3. Notification

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- 3.1. Until very recently the authorisation process had not been pursued in relation to RPM. The opportunity to authorise RPM has been available for nearly 20 years but has not until now been accessed. Even the current application<sup>2</sup>, still at the draft determination stage at the time of writing, is proposed to be subject to conditions. Jones Day is concerned that the current application will be an isolated or at least unique case. The authorisation process requires an applicant to establish that the ACCC must be satisfied that the proposed conduct will, or will be likely to, result in a benefit to the public such that it should be allowed to take place (Section 90(8)(a) CCA).
- 3.2. Notification affords market participants with a faster and quicker means to obtain statutory protection. Jones Day considers that notification, granted within 14 days unless the ACCC objects would prove an attractive mechanism for manufacturers faced with free-rider issues which are increasing present thanks to on-line retailing.

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<sup>2</sup> Application by Tooltechnic Systems (Aust) Pty Ltd – A 91433 made 20.06.2014.