Leegin's 10-Year Checkup: US Influence On RPM Overseas

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Law360, New York (June 27, 2017, 12:14 PM EDT) -- For nearly a century, resale price maintenance was a per se antitrust violation. Then, on June 28, 2007, the U.S. Supreme Court held that the legality of RPM should be determined on a case-by-case basis under the rule of reason.

Now that a decade has passed since the landmark ruling in Leegin Creative Leather Products Inc. v. PSKS Inc., this weeklong Expert Analysis series examines its impact.

This month marks the 10th anniversary of the U.S. Supreme Court decision in Leegin Creative Leather Products v. PSKS,[1] which represented the culmination of 30 years of re-examination of vertical restraints analysis under federal antitrust law. As a result of this reconsideration, almost all vertical restraints, including price restraints that had long been held to be per se unlawful, now are analyzed under the rule of reason.

Outside the United States, competition law practitioners in the European Union, Japan, China and Australia continue to debate the appropriate analysis to be applied to vertical restraints. Vertical restraints analysis in each of these jurisdictions has been influenced by U.S. developments, and each jurisdiction applies an analysis to vertical restraints that involves similarities to a rule of reason. But with respect to vertical price restraints, while these jurisdictions have held out the possibility of somewhat greater flexibility, none has gone so far as to adopt the Leegin result. Rather, each continues to apply a presumption of illegality to resale price agreements, although subject to rebuttal in the EU, Japan and China, and the option of applying for an exemption before entering into such an agreement in Australia.

Understanding the interplay of these legal standards is critical for companies that operate on a global basis. This article summarizes briefly the individual approaches to vertical price agreements in each of these jurisdictions and offers suggestions for ensuring that a resale price maintenance policy complies with applicable competition law.

United States

Since the early 20th century, U.S. courts have distinguished between two contrasting types of restraints when applying Section 1 of the Sherman Act. Practices such as price-fixing, market allocation, bid rigging and boycotts were identified as so likely to have a “pernicious effect on competition and lack any redeeming virtue” that they were conclusively presumed to be unreasonable and held to be per se violations of the Sherman Act.[2] Most remaining restraints violated the Sherman Act only if a plaintiff could prove, under a rule of reason analysis, that the practice in question caused or was likely to cause harm to competition that outweighed any pro-competitive justification.[3]

For many years, courts failed to differentiate carefully between horizontal and vertical restraints. Starting with the Supreme Court’s decision in Dr. Miles in 1911,[4] courts held vertical restraints on resale prices to be per se unlawful. Treatment of vertical market allocation arrangements was less consistent, but such restraints also were potentially subject to summary condemnation.[5]
The Supreme Court signaled its willingness to reconsider evaluation of vertical restraints in its GTE Sylvania decision in 1977,[6] where it stated that the rule of reason is the “prevailing standard of analysis,” and per se illegality is appropriate only with respect to conduct that is “manifestly anticompetitive.”[7] The court noted in particular the “complex” economic impact of vertical restrictions because of the potential simultaneous reduction in intrabrand competition and stimulation of interbrand competition.[8] The court followed up in 1984 in Monsanto[9] and in 1988 in Sharp Electronics,[10] both cases dealing with an alleged agreement between a manufacturer and one dealer to terminate a second, price-cutting dealer. Stressing the importance of interbrand rather than intrabrand competition, the court held in Sharp Electronics that “a vertical restraint is not illegal per se unless it includes some agreement on price or price levels.”[11]

This distinction between vertical price and nonprice agreements lasted until 1997, when the court decided State Oil v. Khan.[12] There, the court concluded that “there is insufficient economic justification for per se invalidation of vertical maximum price fixing,” and held that maximum resale price maintenance must be analyzed pursuant to the rule of reason.[13]

The court’s 2007 Leegin decision marked the final step in its reassessment of vertical practices. The court considered a minimum resale price policy instituted by Leegin, a designer and producer of women’s leather accessories. The court overturned Dr. Miles, and held that vertical price restraints, like vertical nonprice restraints, must be evaluated pursuant to the rule of reason. The court 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.’ ... Vertical agreements establishing minimum resale prices can have either procompetitive or anticompetitive effects, depending upon the circumstances in which they are formed.”[14] As a result, individual evaluation of minimum resale price restraints under the rule of reason is appropriate.

This reassessment of vertical restraints has not met with uniform approval. With respect to minimum resale price maintenance in particular, some insist that the likely loss of intrabrand competition outweighs the potential increase in interbrand competition. As a result, minimum resale price maintenance continues to be per se unlawful under the antitrust laws of a number of states.

The U.S. experience has had an impact overseas as well. In recent years, a number of foreign jurisdictions have also introduced greater flexibility into the analysis of vertical nonprice restraints, although generally they have continued to apply some form of rebuttable presumption of illegality for resale price maintenance arrangements.

**European Union**

Article 101(1) of the Treaty on the Functioning of the European Union prohibits agreements that “have as their object or effect the prevention, restriction or distortion of competition within the internal market,” including agreements that “directly or indirectly fix purchase or selling prices or any other trading conditions.” Article 101(3) provides for the possibility of an exemption from Article 101(1) if an agreement “contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit.” As with Section 1 of the Sherman Act, Article 101 applies to both vertical and horizontal agreements and leaves courts and competition authorities with a certain degree of discretion in interpreting and applying its terms.

EU competition law (at least as reflected in the approach taken by competition authorities) has evolved towards a more effects-based analysis with respect to vertical restraints. The European Commission first provided guidance for evaluating agreements under EU competition law in 1999, when it adopted the Regulation on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices.[15] Most importantly, this regulation clarified when vertical restraints could be exempted due to their pro-competitive character, thereby effectively applying an effects-based analysis. This general trend can also be observed in relation to resale price maintenance.
The commission defines resale price maintenance as "agreements or concerted practices having as their direct or indirect object the establishment of a fixed or minimum resale price or a fixed or minimum price level to be observed by the buyer."[16] For decades, the commission considered resale price maintenance as a restriction of competition by object. This corresponds to an inevitable infringement of Article 101(1) and is the approximate equivalent of a per se violation of Section 1 of the Sherman Act. In theory, parties to an agreement setting resale prices could avoid the prohibition of Article 101(1) by satisfying the cumulative conditions of Article 101(3). In practice, however, resale price maintenance clauses were unlikely to meet these conditions and the commission often considered such clauses as infringements that warranted the imposition of fines.[17]

The U.S. Supreme Court’s approach in Leegin may have influenced the subsequent assessment of resale price maintenance by the Court of Justice of the European Union. In its CEPISA decision in 2008, affirmed by the Pedro IV Servicios decision in 2009, the CJEU held that a vertical agreement containing a resale price maintenance provision does not necessarily fall within the scope of Article 101(1).[18] The CJEU held that such an agreement is to be prohibited “only where all the other conditions for applying that provision are met, that is to say, that the object or effect of the agreement is perceptibly to restrict competition within the common market and that it is capable of affecting trade between Member States.”[19]

The Leegin decision also may have impacted the commission’s revised Guidelines on Vertical Restraints, adopted in 2010. These guidelines specify that if the parties can demonstrate that likely efficiencies result from including a resale price maintenance provision in the agreement and that all the conditions of Article 101(3) are fulfilled, they may avoid prohibition under Article 101(1).[20] The guidelines even illustrate examples where such efficiencies may be found. For example, resale price maintenance may be helpful for a manufacturer introducing a new product during the initial period of expanding demand to incentivize distributors to take greater account of the manufacturer's interest in promoting the product.[21]

Despite these glimpses of a move towards a rule of reason type of assessment, little significant change has occurred in the European enforcers’ actual application of EU competition law to resale price maintenance following CEPISA and Pedro IV Servicios and the adoption of the revised Guidelines in 2010. In practice, resale price maintenance is dealt with mostly by national competition authorities of the EU Member States. These national competition authorities seem determined to keep fighting vertical restrictions, including resale price maintenance, as hardcore restrictions. There are, however, a few exceptions. The Dutch ACM, for example, explicitly acknowledged that it should consider a defense under Article 101(3) if resale price maintenance is beneficial for consumers.[22] Generally, however, it remains very difficult to persuade competition authorities that a vertical agreement containing a resale price maintenance provision produces efficiencies pursuant to Article 101(3). The Commission has also taken a similar position in its recently published E-commerce Sector Inquiry report, which considers resale price maintenance in the sector as a restriction of competition by object under Article 101(1) TFEU and announces potential further enforcement initiatives in this respect.[23] A recent case in the United Kingdom, in which a light fittings company was fined for online resale price maintenance, confirms that national competition authorities (including those that are generally more open to effects-based arguments) are closely watching online resale price maintenance practices.[24]

**Japan**

Under the Antimonopoly Act of Japan (“AMA”), various types of vertical restraints are prohibited as unfair trade practices. The concept of unfair trade practices is generally modeled on Section 5 of the U.S. Federal Trade Commission Act. Unfair trade practices include refusals to deal, discriminatory pricing, below cost pricing, resale price maintenance and abuse of superior bargaining position. In addition, the AMA allows the Japan Fair Trade Commission (“JFTC”) to designate other types of unfair trade practices that tend to impede fair competition in a market.[25] As a result, multiple types of conduct have been designated as unfair trade practices, but not all such practices have been subject to strict enforcement. Prohibition of unfair trade practices is considered to complement regulation of monopolization by preventing behavior that leads to substantial restriction of competition.

Although there is no clear distinction between per se illegality and rule of reason analysis under the AMA, vertical restraints are generally assessed in a manner similar to a rule-of-reason analysis. However, resale price maintenance has been recognized in principle as per se illegal because the JFTC has taken the position that the ability of each entrepreneur autonomously to set prices is fundamental to maintaining competition in a market.

The JFTC has issued Distribution Guidelines[26] providing guidance with respect to potential application of the AMA to common distribution practices. The Distribution Guidelines describe resale price maintenance as a situation in which a supplier maintains a resale price at a designated level by any artificial means. The
existence of an agreement between the supplier and the reseller is not a necessary element of a violation. Rather, unlawful conduct can be found if a supplier maintains resale prices by imposing disadvantageous trading terms, such as by reducing rebates to noncompliant sellers or by providing economic benefits only to retailers or distributors that sell at designated prices.[27] Moreover, the JFTC applies the same rule to minimum and maximum resale price maintenance.

In recent years, based on the regulatory reform plan of the Japanese government, the JFTC has been trying to introduce greater use of economics in its analysis of vertical restraints. While the JFTC still maintains its basic position that autonomous price setting is at the core of free competition in a market, the JFTC may now adopt a more flexible approach to resale price maintenance. This is reflected in the most recent amendments to its Distribution Guidelines, published in 2016.

The amended Distribution Guidelines include a section explaining potential justifications for resale price maintenance. The Distribution Guidelines state that vertical price fixing is allowed, to the extent necessary, where such a restriction on pricing may enhance interbrand competition, thereby increasing demand for the goods to the benefit of consumers. Vertical price fixing is permitted only if such pro-competitive effect cannot be achieved by other, less restrictive methods. The amended Distribution Guidelines also indicate that avoiding adverse effects arising from free riding is one example of a justification for resale price maintenance. Although the JFTC itself did not cite to Leegin, the Leegin decision influenced the public discussion leading up to the JFTC’s publication of its amended Distribution Guidelines in 2016.

Because the JFTC is still in the process of modernizing its assessment of vertical restraints (including resale price maintenance), the JFTC has yet to permit a particular resale price maintenance program based on the justifications described in the amended Distribution Guidelines. As a result, it remains unclear how receptive the JFTC will be to such pro-competitive arguments. For now, private parties may at least consider that, in appropriate circumstances, they can advance an argument before the JFTC that a particular resale price maintenance program may have certain pro-competitive effects that outweigh anti-competitive effects.

China

Article 14 of the Anti-Monopoly Law of China ("AML") prohibits "monopoly agreements, ” including agreements “fixing the price of commodities” or “restricting the minimum price of commodities” for resale to third parties. Enforcement of the AML follows two alternative paths: the administrative system and the court system. Administrative enforcement is led by the National Development and Reform Commission ("NDRC") for price-related violations of the AML and the State Administration of Industry and Commerce for nonprice violations of the AML. Antitrust litigation is usually heard in the first instance by the Intellectual Property Courts.

Nonprice vertical restraints are generally subject to a rule of reason type analysis under Article 14. So far there have been no published administrative penalties solely targeting non-price vertical restraints, although in the recent NDRC penalty decision against Medtronic,[28] non-price vertical restrictions such as territory and customer restrictions and exclusivity were considered as aggravating factors in resale price maintenance. The only court decisions involving non-price vertical restraints have also involved abuse of dominance.

Resale price maintenance is subject to a rebuttable presumption of illegality under AML. In the realm of vertical price restraints, the administrative and court systems appear to analyze resale price maintenance slightly differently.

The NDRC has treated resale price maintenance essentially as illegal per se in its enforcement practice. Although the AML provides for limited situations where monopoly agreements, including resale price maintenance, could be exempted, so far the NDRC has not published a single decision exempting a resale price maintenance program under the AML on the basis of pro-competitive effects that could benefit consumers in general.

Interestingly, the NDRC has recently voiced its disagreement with the Leegin approach, instead supporting its “prohibition plus case-by-case exemption” approach.[29] The NDRC is of the view that the rule of reason approach to resale price maintenance in Leegin creates uncertainties in enforcement and has imposed a disproportionate burden of proof on a plaintiff, which is usually not in position to obtain sufficient information to support its case. The NDRC recently released draft Anti-Monopoly Guidelines for the Auto Industry,[30] which provide for case-by-case exemptions of resale price maintenance in the auto industry. It remains uncertain, however, whether the provisions will survive in the final version, and if so, whether the rules would be extended to other industries as well.
In contrast to the NDRC, the court system appears to have adopted an approach closer to the rule of reason in its analysis of resale price maintenance. Specifically, in Beijing Ruibang Yonghe v. Johnson & Johnson, [31] the Shanghai High People’s Court took the view that, because resale price maintenance is alleged to be a type of “monopoly agreement” which, by definition under the AML, is “any agreement, decision, or concerted action that eliminates or restricts competition,” a plaintiff needs to provide evidence to the court that a resale price maintenance arrangement has the effect of eliminating or restricting competition. This has essentially turned the analysis on resale price maintenance into a rule of reason approach. The court also reasoned that, to evaluate whether the resale price maintenance would give rise to anti-competitive effects, the court would consider (1) whether there is sufficient competition in the relevant market(s), (2) the market position of the defendant, (3) the defendant’s motivation, and (4) the effects of the resale price maintenance on competition.

It is important to bear in mind, however, that China has a civil law system and the Shanghai High People’s Court ruling is not binding upon other courts. Furthermore, even though the court conducted a detailed analysis of the effects of resale price maintenance on competition, there has been no reported case to date where a court has granted an exemption for a resale price maintenance program based on a finding that pro-competitive effects outweigh anti-competitive effects. Therefore, despite the differences in the analytical approach of the NDRC and the courts, the reality is that it is likely to be very difficult to obtain an exemption from the general prohibition under the AML for a resale price maintenance agreement regardless of whether the matter is heard by the NDRC or a court.

Australia

In Australia, vertical restraints generally are prohibited only if they have the purpose or likely effect of a substantial lessening of competition. However, there are two specific types of vertical conduct that are perse illegal — minimum resale price maintenance[32] and third line forcing.[33] These prohibitions were all based on U.S. case law decided prior to the run-up to Australia’s 1974 competition legislation.

The Australian government considered the U.S. courts’ standards to be too inflexible, however, and decided to include a “safety valve,” known as “authorization,” based loosely on what today is Article 101(3) of the Treaty on the Functioning of the European Union. Under this process, a party may apply to the Australian Competition and Consumer Commission (“ACCC”) for authorization for a particular resale price maintenance program. Authorization provides statutory immunity from both ACCC enforcement and private litigation.

The application form is similar to a Hart-Scott-Rodino merger filing in the United States. It is advisable to support the application by including supporting materials such as signed statements from key staff of the manufacturer and of representative retailers detailing why, absent the resale price restriction, economically damaging “free riding” would occur. An expert economist’s opinion may also be advantageous. Generally, all materials are uploaded on a searchable public register, but the applicant can apply for limited information to be masked. Third parties can file material in support or in opposition. The ACCC may not grant authorization unless it is satisfied that any public benefits arising from the agreement are likely to outweigh any anti-competitive detriment.

Authorization been used for a broad range of other types of conduct since 1974 but, until the U.S. Supreme Court’s Leegin decision, the conventional wisdom was that it would never be possible to satisfy the public benefit test for resale price maintenance. Following Leegin, however, authorization appears to be possible. In 2014, Tooltechnic Systems, the Australian subsidiary of German based power tools conglomerate, filed the first application for authorization of a resale price maintenance program. The same corporate group had previously faced enforcement actions by the ACCC[34] and the Bundeskartellamt[35] in relation to resale price maintenance. Tooltechnic’s key contention was that its distributors needed “head room” to be able to provide training and maintenance services with respect to Tooltechnic tools. Tooltechnic’s application for an exemption cited the Leegin decision several times with respect to the importance of interbrand competition and the need to overcome free-riding. Tooltechnic attached a copy of the Leegin decision to its application as a supporting document. In its Determination approving Tooltechnic’s application, the ACCC cited to an amicus brief filed by economists with the U.S. Supreme Court for the proposition that, “There is consensus in the economic literature that resale price maintenance can, in certain circumstances, remedy a free riding problem and thereby increase competition and enhance consumer welfare.”[36]

Conclusion

In recent decades, as the rule of reason has been extended to analysis of vertical restraints in U.S. antitrust law, competition law regimes in other countries have likewise applied greater flexibility to the analysis of nonprice vertical restraints. Many foreign jurisdictions have not gone the final step, however, and applied the same flexible analysis to resale price maintenance. Rather, many foreign jurisdictions continue to apply
some type of presumption of illegality, albeit potentially subject to rebuttal based on individual analysis. Thus, the EU, Japan, China and Australia continue to apply presumptions of illegality to resale price agreements, although those presumptions are in theory subject to rebuttal based on individual analysis in the EU, Japan and China, and to an administrative exemption procedure in Australia. In each of those jurisdictions, specific resale price maintenance programs have been permitted, if at all, only in isolated instances, leaving open the question of how to assess the degree of risk likely to attach to a resale price maintenance program.

In light of the continued risk of liability associated with resale price maintenance in certain foreign jurisdictions, a company may decide not to pursue a single worldwide resale price maintenance program, but rather to tailor its approach on a country-by-country basis. In Australia, the authorization procedure gives a company the opportunity to obtain an advance review of its program, at the cost of some legal expense and delay. In the EU and Japan, a company may be able to reduce risk and maximize the chances of obtaining approval of a resale price maintenance program, should it be reviewed by competition authorities, by following closely the guidance to be found in the EU Guidelines on Vertical Restraints and the JFTC Distribution Guidelines respectively. Indeed, the examples in the EU guidelines could be particularly useful in that jurisdiction. A company should ensure not only that its program is structured in accordance with the guidance provided, but also that its internal and external documentation describing and justifying the program are consistent with the rationales set forth in the respective guidelines. China is the most challenging legal environment at this time. A company may want to observe future developments, including the final form and the future application of the Anti-Monopoly Guidelines for the Auto Industry, before deciding on a resale price maintenance policy for China.

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[7] Id. at 49-50.

[8] Id. at 51-57.


[13] Id. at 18, 22.


[17] Judgment of the Court of 3 July 1985, SA Binon & Cie v. SA Agence et messageries de la presse, case C-243/83; where the CJEU specified that price competition is so important that it can never be eliminated and held that resale price maintenance constituted, by its very nature, a restriction of competition pursuant to Article 101(1).


[21] Id. at paragraph 225.

[22] ACM’s strategy and enforcement priorities with regard to vertical agreements, Consultation, 20 April 2015.

[23] Final report from the Commission to the Council and the European Parliament on the E-commerce Sector Inquiry (10 May 2017), paragraph 30: “Agreements that establish a minimum or fixed resale price or price range (‘resale price maintenance’) are a restriction of competition by object under Article 101(1) TFEU.”


[27] A supplier may determine the price to a retailer, however, if a supplier transacts on its own account and bears the transaction risk, or if it transacts directly with a retailer and a wholesaler is responsible only for ancillary services such as delivery of goods and collection of payment.


[31] See the full court judgment, available in Chinese at http://www.hshfy.sh.cn/shfy/gweb2017/flws_view.jsp?pa=adGFoPaOoMjAxMqOpu6a438PxyP0o1qop1tXX1rXaNjO6xSZ3c3hoPTUPdcssz
Resale price maintenance is prohibited by Section 48 of the Competition and Consumer Act (CCA).

Third line forcing involves inter-company product bundling or tying.

