

# The End of the Prohibition?

## The economics of minimum resale price maintenance and its relevance for South Africa

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# Minimum Resale Price Maintenance

## Prohibited *per se* under Section 5(2) of the Competition Act

- *Commission vs. Federal Mogul Aftermarkets* (2003) – R3 million
- *Commission vs. Toyota SA* (2005) – R12 million
- *Commission vs. Italtile Franchising* (2005) – R2 million
- *Commission vs. Oakley Athletic* (2006) – R212,100

## • A long history in the US

- *Dr Miles* (1911) – Vertical price fixing illegal
- *Colgate* (1919) – Unilateral action would not violate Section 1 of the Sherman Act, only bilateral agreement
- *GTE Sylvania* (1977) - Non-price vertical restraints evaluated under ‘rule of reason’ test
- *Khan* (1997) – maximum resale price maintenance evaluated under ‘rule of reason’ test

## • *Leegin*

- 28 June 2007 Supreme Court overturned *Dr Miles*
- Minimum RPM now under ‘rule of reason’
- 3 main arguments:
  - The economic effects of minimum RPM do not justify *per se* treatment
    - Not a practice that always (or almost always) harms competition
  - *Stare Decisis* was not sufficient to uphold *Dr Miles*
  - Administrative cost savings in favour of *per se* rule not sufficient to justify upholding *Dr Miles*

# Procompetitive Effects of Minimum RPM

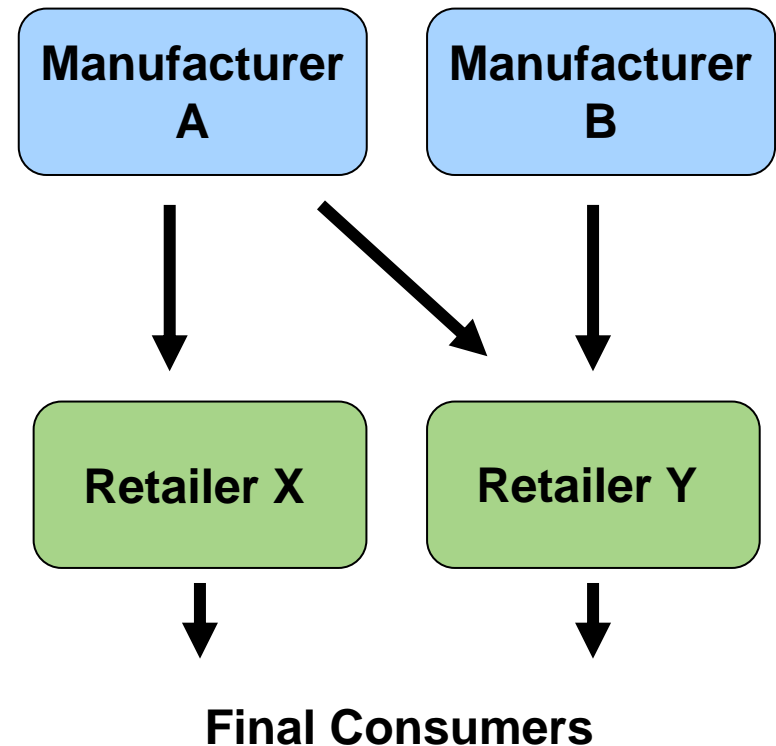
*“...it suffices to say here that economics literature is replete with procompetitive justifications for a manufacturer’s use of resale price maintenance” (Leegin Majority Decision, 2007; p9).*

- **Correcting Market Failures**

- Aligning incentives
- Free-Riding and discounters lead to sub-optimal ancillary services
- Intrabrand price competition removed –  
But intrabrand non-price competition sharpened
- There are criticisms

- **Facilitating Entry**

- **Prestige and Exclusivity**



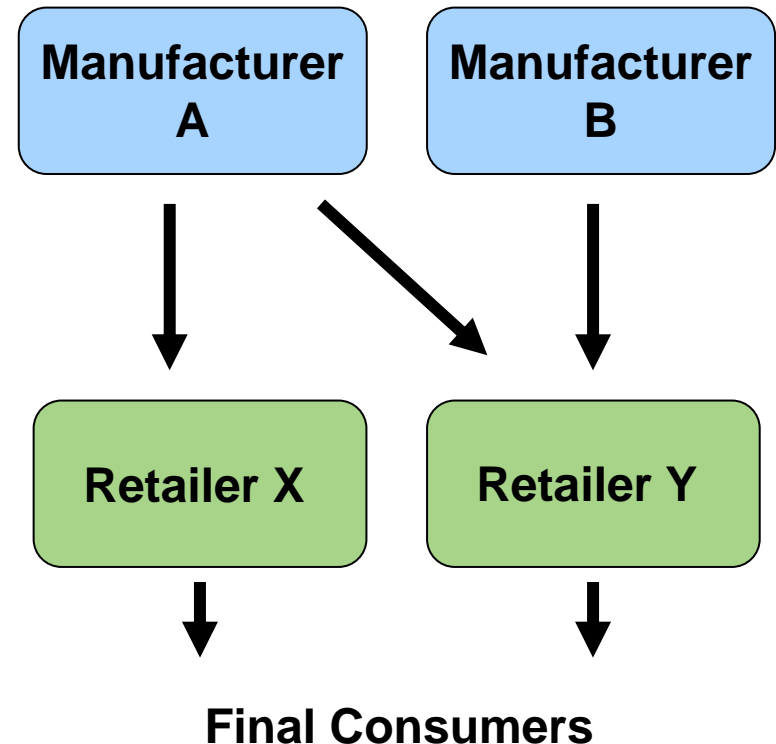
# Anticompetitive Effects of Minimum RPM

- **Facilitating Collusion**

- Manufacturer Level
  - Standardised retail prices makes cheating easier to detect
- Retailer Level
  - Coerce the manufacturer into minimum RPM
  - Makes cheating easier to observable, have manufacturer punish defectors
- However, *“The economic nexus between cartels and RPM is not robust”* (Elzinga and Mills, 2008; p6)

- **Facilitating Exclusion**

- Building entry barriers either upstream or downstream
- Market Power important



# Indicators of likely effect:

- High levels of concentration at either the manufacturer or dealer level
- The manufacturer or initiating retailer possesses market power
- Evidence of a cartel
- The retailers were the moving-force in initiating the minimum RPM
- A large proportion of the upstream market's sales are covered by minimum RPM, or a large proportion of the retail market's sales are covered by minimum resale prices
- The manufacturer uses minimum RPM in only a few markets
- The effect on output when the minimum RPM policy was implemented
- The minimum RPM is used for a homogenous product

# The Competition Act of South Africa

## ***“5. Restrictive Vertical Practices Prohibited***

- 1) An agreement between parties in a vertical relationship is prohibited if it has the effect of substantially preventing or lessening competition in a market, unless a party to the agreement can prove that any technological, efficiency or other pro-competitive, gain resulting from that agreement outweighs that effect.***
  
- 2) The practice of minimum resale price maintenance is prohibited.***
  
- 3) Despite subsection (2), a supplier or producer may recommend a minimum resale price to the reseller of a good or service provided –***
  - (a) The supplier or producer makes it clear to the reseller that the recommendation is not binding; and***
  - (b) If the product has its price stated on it, the words “recommended price” appear next to the stated price.”***

## Steps away from the *per se* rule ....

... not necessarily all the way to rule of reason at this stage

- **Offer Up-Front Exemptions**

- Responsibility on the firm to state procompetitive effects; evidence for the authorities to return to if a later investigation is needed
- *Per se* prohibition remains for those that do not get immunity
- Downside: administrative costs and regulatory hurdle for small businesses

- **Include a Market Power Screen in the *per se* rule**

- Allows small firms/entrants the opportunity to use minimum RPM
- Downside: debates on dominance

- **Presume anticompetitive unless procompetitive justification can be shown**

- Any firm could use minimum RPM if motives were good
- Responsibility on respondent
- Downside: market investigations needed

- **Structured Rule of Reason**

- Make complainant's case easier to build (compared to simple rule of reason)
- Show the presence of one or more listed adverse factors
- Respondent given the opportunity to rebut or provide procompetitive justifications

# Conclusions

- **Minimum RPM can have procompetitive and anticompetitive effects**
- **It does not always harm competition, so *per se* prohibition appears too rigid**
- **There are small steps that South Africa can take to gradually make the treatment of minimum RPM less rigid while still offering protection**
- **The authorities would be encouraged to give consideration to these steps**

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