SUPPLYING PRODUCTS & MANAGING MARGIN DOWN UNDER: ONLINE PRICE EROSION STRATEGIES FOR PRODUCT MANUFACTURERS IN AUSTRALIA AND NEW ZEALAND

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Competition Law

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The Australian and New Zealand markets present a dilemma for manufacturers. Both are highly developed economies with wealthy, well-educated consumers who are amongst the world's most enthusiastic adopters of new technologies.[1] It has made them popular test markets for new products and new ways of doing business. The markets are well- and lightly-regulated, supported by good infrastructure and culturally similar to those in the United States and the European Union.[2]

For all those attractions, they are small markets located literally "at the other end of the world" for many manufacturers, which can present logistics, distribution and management challenges. The high fixed costs of establishing distribution networks and operations in these small markets means it is critical for manufacturers to manage margins and protect against price erosion.

In another respect, Australia and New Zealand can present significant challenges for manufacturers/brand owners: both retain outright prohibitions on resale price maintenance, or RPM (the ability of a brand owner or product manufacturer to exert control over the price at which its products are advertised and sold in the distribution channel), subject to some complicated exceptions. For manufacturers/brand owners looking to develop and supply products into Australia and New Zealand, a knowledge of the relevant laws and the strategies that can be used to maintain revenue streams of their local businesses is vital.

This Insight examines traditional approaches that manufacturers and importers may adopt to combat price erosion in Australian and New Zealand - and considers new ways of thinking to better manage the supply chain and margins.

THE AUSTRALIAN AND NEW ZEALAND RPM LAWS

Since the mid-1980s, Australia and New Zealand have pursued "closer economic relations," which includes aligning business regulation. As a result, Australia's *Competition and Consumer Act 2010* (**CCA**) and New Zealand's *Commerce Act 1986* (**Commerce Act**) share a similar structure and much detail.

The RPM provisions are the same in most respects.

First, both are "per se" prohibitions. No assessment of the effect on competition is required to show a contravention; the fact that a corporation engaged in the conduct is itself (*per se)* illegal. This is unlike the approach in the United States, which applies a flexible "rule of reason" analysis, or the European Union which, although stricter, still considers the effect on competition.[3]

Second, each prohibition is based on a list of types of conduct that are defined to be RPM. With a few exceptions, each defined type of conduct is quite specific but the overall coverage is broad. All of the types of conduct involve the supplier (A) establishing a "specified price" (which includes mechanisms such as a formula to arrive at a price) and then seeking to ensure the second person (B) does not sell below that price. So, both lists include:

1. making it known that A will not supply goods unless B agrees not to sell the goods at less than the specified price
2. inducing, or attempting to induce, B not to sell, at a price less than specified price
3. entering into an agreement, or offering to enter into an agreement, one of the terms of which is that B will not sell the goods at a price less than the specified price
4. *withholding* supply if B has in the past supplied the goods at less than the specified price, or has refused to agree not so supply the goods at less than the specified price.

In the CCA (but not the Commerce Act) RPM also occurs if a supplier simply uses a price that is "likely to be understood" as the price below which the goods are not to be sold.

Because of the detailed structure of the provisions, the Australian courts similarly take a very strict approach to deciding cases, in which the focus of the decisions is on whether a price was in fact "specified" or the particular reason for withholding supply was because of the price. The effect on competition or the economic rationale for the conduct is seldom addressed.

The recent cases of *Coty Germany GmbH v. Parfümerie Akzente GmbH[4] in Europe, Leegin Creative Leather Products, Inc. v. PSKS, Inc.[5] in the U.S., and Rainbow Medical Equipment v. Johnson & Johnson*[6] in China, are revolutionalising the legality of RPM around the world in recent years - to date, the Australian and New Zealand Courts have not followed suit (driven in part by the wording of the legislation).

Even a recent "root and branch" review of the Australian's competition laws[7] did not find a compelling case to move away from the "per se" approach. However, the review acknowledged developments overseas (referred to in the previous paragraph) and concluded the preferable approach was to simplify administrative processes for "authorising" RPM conduct. This is discussed below.

EXCEPTIONS TO RPM

To date, the general approach taken by manufacturers that wish to have a greater level of control over the channel/retail pricing, has been to focus on exceptions included in the legislation.

The first is to use a recommended price policy that provides some, but not complete certainty. Manufacturers must ensure that the recommended price is just that – recommended. Once a manufacturer puts pressure on the resale price, it risks contravening Australian and New Zealand law.

A second possibility, though one not always commercially viable, is to maintain control of ownership of the product throughout the distribution chain. This agency or consignment model is employed successfully by some large household appliance manufacturers and does offer not only compliant control of retail pricing but also branding and pre- and post-sales service. The model does come with higher costs of maintaining a supply chain, as well as additional administrative and commercial issues (such as effectively 'financing' the channel - by having goods with the channel on consignment - and taking greater risk of managing bad debts) and may only be suitable for high-value, low quantity goods.

The third approach is to seek authorisation from the national competition regulators, the Australian Competition and Consumer Commission (ACCC) and New Zealand Commerce Commission. While the processes are similar, only the Australian process is addressed here. Authorisation is an administrative process where the ACCC can grant immunity from legal sanctions for conducts that would otherwise be a contravention of the CCA.

In 2014, Tooltechnic Systems (Aust) Pty Ltd (Tooltechnic) was granted authorisation to set minimum retail prices on its power tools on the basis of addressing the market failure of "free riding", despite recognising that the conduct may result in consumers paying higher prices.[8] Tooltechnic was the exclusive importer and wholesaler of Festool power tools, which was characterised by substantial pre-sales services (including demonstrations and "try before you buy" arrangements) and post-sales services (including training, support and repair). The ACCC accepted that some retailers that did not invest in the pre- and post- sale services were "free riding"/benefiting from the services offers by other retailers. In summary, the ACCC said:

> *In this case, the ACCC accepts that the Proposed Conduct will eliminate price competition between Festool dealers for Festool products. This will result in a clear public detriment as some customers will face a higher retail price for Festool products. However, the extent of this detriment is likely to be limited by:*
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> - *the wide range of alternative trade quality power tools available to customers*
> - *the fact that Tooltechnic has little incentive to set minimum retail prices above competitive levels because doing so would likely reduce sales of Festool products overall.*

The ACCC also:

- considered there was limited opportunity for coordinated conduct because of the availability of numerous other, differentiated power tools (interbrand competition) and the importance of innovation in the market and
- acknowledged that the quality and extent of after sales service was an important part of Festool's brand profile.

In granting the authorisation, the ACCC imposed conditions including a requirement that Tooltechnic report annually on pricing and sales information on the relevant products and provide any additional information should the ACCC request.

While the test for granting authorisation for RPM is differently phrased (whether the likely public benefit would outweigh the likely public detriment), the ACCC's reasoning in granting authorisation in Tooltechnic is consistent with the U.S. rule of reason doctrine.

A recent change to the law (in November 2017) provided manufacturers/brand owners with the opportunity to lodge a notification to the ACCC seeking an exemption from liability for RPM. Notification is an alternative process to authorisation, providing a quicker and less expensive means of obtaining an exemption.

Similar the authorisation, the test is whether the likely public benefit would outweigh the likely public detriment.[9] However, the conduct can continue unless the ACCC commences action to revoke the notification, in effect reversing the procedural onus.

Notification as an exemption for RPM conduct came into effect on 6 November 2017, after the Australian Government recognised that RPM may be pro-competition and beneficial for consumers.[10] While RPM continues to be a per se contravention in Australia, this recent change brings Australian RPM law closer to the U.S. and EU approach.

There are also other more limited exceptions to the RPM prohibition, such as where the manufacturer, withholds supply in circumstances where the reseller has on-sold the goods at less than their cost to the reseller.

CONCLUSION & INNOVATIVE APPROACHES TO SUPPLY CHAIN MANAGEMENT

The Australian RPM law is undoubtedly stricter in its condemnation of RPM than the equivalent laws in the United States or European Union, which consider the conduct's effect on competition. Despite the outright prohibition on RPM, there are various options that manufacturers may adopt in overcoming the issue of price erosion in Australia.

In light of the differences in RPM law throughout the world, manufacturers would be wise to adopt flexible global distribution and pricing strategies.

K&L Gates' Antitrust, Competition & Trade Regulation group has extensive experience designing and

implementing coordinated strategies throughout different regions of the world, including Australia and Asia Pacific, to combat online price erosion. In particular, our team is a leader at working with clients to adopt:

- a sophisticated selective distribution model
- a distribution model having objective criteria tailored for both "bricks & mortar" online channels
- ongoing vigilance/monitoring for compliance with distribution criteria, including private enforcement.

Notes:

[1] For example, EY reports Australia is fifth out of 20 developed economies for adoption of fintech innovations, located here; and Deloitte reports Australia remains one of the leading global adopters of smartphone, located here.

[2] New Zealand ranks first and Australia 14th (out of 190 countries) the in the World Bank's "Ease of Doing Business" rankings for 2018, located here.

[3] See K&L Gates article "EU Selective Distribution Update: Recent Developments Regarding Marketplace Bans and the Requirement for a Physical Point of Sale", located here.

[4] *Coty Germany GmbH v Parfümerie Akzente GmbH,* Case C-230/16 (ECJ Dec. 6 2017)

[5] *Leegin Creative Leather Products, Inc. v. PSKS, Inc.,* 551 U.S. 877 (2007)

[6] *Beijing Rainbow Yonghe Science and Technology Trade Company v. Johnson & Johnson Medical (Shanghai) Ltd., Johnson &Johnson Medical (China) Ltd,* (2012) Hu Gao Min San (Zhi) Zhong Zi No.63

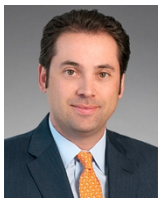
[7] Competition Policy Review Final Report (released 31 March 2015), located here.

[8] ACCC, Determination in Authorisation A91433, Tooltechnic Systems (Aust) Pty Ltd, 5 December 2014, located here.

[9] ACCC, *Resale Price Maintenance Notification Guidelines*, 2017, located here.

[10] Explanatory Memorandum, Competition and Consumer Amendment (Competition Policy Review) Bill 2017

KEY CONTACTS



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