Law Council
OF AUSTRALIA
Business Law Section

General Manager
Small Business, Competition and Consumer Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600
Via email: competition@treasury.gov.au

29 May 2015

Dear Sir or Madam,

Competition Policy Review – Final Report

Introduction

The Law Council of Australia, is the peak national body representing the legal profession in Australia.

The Small and Medium Enterprise Business Law Committee of the Business Law Section of the Law Council of Australia (SME Committee) makes this submission in response to the Government's consultation on the Competition Policy Review's Final Report, released by the Government on 31 March 2015 (**Final Report**).

The SME Committee has as its primary focus the consideration of legal issues affecting small businesses and medium enterprises in the development of national legal policy in that domain. Its membership is comprised of legal practitioners who are extensively involved in legal issues affecting SME's.

Please also note that our submissions may differ from those made by other Committees of the Law Council, for example the Competition and Consumer Committee.

The SME Committee also refers to its three earlier submission to the Harper Review, dated 2 July 2014, 15 August 2014 and 24 November 2014. We have attached a copy of our submission dated 24 November 2014 for your information – Attachment A.

Introductory comments

The SME Committee's primary concern with the Final Report is the absence of practical ideas aimed at providing support and assistance to the small business sector. The SME Committee raised this particular concern in relation to the Draft Report and made a number of practical suggestions as to how this issue may be addressed. However, it appears that none of the ideas suggested by the SME Committee have been picked up in the Final Report.

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It is also unfortunate that the Harper Review has continued to make the claim that various of its recommendations will assist small businesses, when these recommendations are, in the opinion of the SME Committee, likely to have the opposite effect. Again it appears that the Harper Review has not had regard to the comments made by the SME Committee about these issues.

As stated in our earlier submission, many of the proposed recommendations in the Final Report are likely to further damage the ability of small businesses to compete with their larger competitors in the market place. For example, the relaxation of trading hours and changes to planning and zoning laws will not assist small business. Rather, these changes will place small businesses under significantly greater competitive pressure in the marketplace.

Finally, the SME Committee is disappointed that the Harper Review does not seem to have gained a deep understanding of the various pressures facing many small businesses.

Recommendations supported by the SME Committee
The SME Committee supports the following recommendations contained in the Final Report, as it believes that these recommendations are likely to benefit small business:

- Recommendation 8 — Regulation review
- Recommendation 15 — Competitive neutrality policy
- Recommendation 16 — Competitive neutrality complaints
- Recommendation 17 — Competitive neutrality reporting
- Recommendation 18 — Government procurement and other commercial arrangement
- Recommendation 23 — Competition law simplification
- Recommendation 24 — Application of the law to government activities
- Recommendation 37 — Trading restrictions in industrial agreements
- Recommendation 38 — Authorisation and notification
- Recommendation 49 — ACCC functions to be retained in a single agency

The SME Committee also supports the following recommendations subject to a number of additional observations.

Recommendation 35 – Mergers
The SME Committee supports this recommendation subject to the following comment. The SME Committee has noted a number of submissions to the Harper Review to the effect that the ACCC's informal merger clearances process should be amended so that ACCC would be unable to rely on any evidence provided by third parties, including small businesses, unless it has first disclosed this information to the merging parties.

The SME Committee is concerned that third parties that provide confidential information to the ACCC may not be willing to disclose their identities or information to the merger parties for a variety of reasons, including but not limited to, retribution from the merger parties following the merger or acquisition. By way of example, such retribution could take the form of reduced trading terms or the termination of supply. The SME Committee is of the view that the ACCC must adhere to its current merger clearance processes so that small businesses have the confidence to continue providing confidential assistance to the ACCC in relation to proposed mergers and acquisitions.

Recommendation 36 — Secondary boycotts
The SME Committee supports the Review's recommendations in relation to secondary boycotts. The SME Committee notes that enforcement of these provisions could be enhanced if other agencies, at both the state and federal level, were given standing to take action in relation to alleged secondary boycott conduct.

Recommendation 39 — Block exemption power
The SME Committee supports this recommendation subject to reviewing the draft legislation. Unfortunately, the goal of greater simplicity can often be lost by poor legislative drafting.

Recommendation 41 — Private actions
While this recommendation will address a number of the issues which arise in relation to "coat tails" actions following an ACCC settlement, it does not address concerns about the effect of costs orders in deterring private plaintiff actions.

Recommendation 43 — Australian Council for Competition Policy — Establishment
The SME Committee supports this recommendation, subject to the ACCP having small business representation on its governing body. In our view, small business interests were not properly represented following the Hilmer Review in the composition of the National Competition Council.

Recommendation 54 — Collective bargaining
The SME Committee supports this recommendation, subject to reviewing the draft legislation. The SME Committee is concerned that the utility of earlier proposals to improve small business access to collective bargaining were undermined by the complex and unwieldy nature of the final legislation. The SME Committee would hope that such a outcome is avoided in relation to any future changes to collective bargaining laws.

Recommendation 53 — Small business access to remedies
While the SME Committee supports any efforts to improve access to justice for small businesses, the Harper Review's recommendation in this regard is very disappointing. This recommendation does not provide small businesses with any tangible legal rights.

Area of significant concern

Recommendation 9 — Planning and zoning
The SME Committee repeats the submissions made in its earlier submission, dated 24 November 2014.

Recommendation 12 — Retail trading hours
The SME Committee repeats the submissions made in its earlier submission, dated 24 November 2014.

Recommendation 28 — Exclusionary provisions
The SME Committee repeats the submissions made in its earlier submission, dated 24 November 2014.

Recommendation 30 — Misuse of market power
The SME Committee sees some benefits in the proposed changes to section 46.

As stated in our earlier submission, the SME Committee sees section 46 as simply one element of a suite of small business protections provided in the CCA. In our view, the unconscionable conduct provisions and the soon to be introduced unfair contracts legislation in relation to small business standard form contracts will supplement section 46 in terms of providing important small business protections. However, in our view, the protections provided by the proposed unfair contract terms extension have been significantly watered down in the draft legislation, by limiting the law to transactions below unreasonably low monetary thresholds.

The SME Committee believes that the proposed section 46 should be amended, in the following manner, so that it provides greater protections for small businesses:

> A corporation that has a substantial degree of power in a market shall not engage in conduct if the conduct has the purpose or would have or be likely to have the effect, of substantially lessening competition in that market or in any other market including by preventing, restricting or deterring the potential for competitive conduct in a market or new entry to a market.
>
> By way of guidance, conduct that may fall for consideration in the application of section 46 would, include:
>
> *(a)* conduct by a vertically integrated supplier in reducing or squeezing the margin available to an unintegrated customer which is in competition with the supplier;
>
> (*b*) acquisition by a supplier of the business of a customer which would otherwise be available to a competitor of the supplier, or the acquisition by a customer of the business of a supplier which would otherwise be available to a competitor of the customer;
>
> (*d*) the selective and/or temporary introduction of loss leader brands to the market;
>
> (*e*) entering into agreements for the acquisition of scarce facilities or resources which are required by a competitor for the operation of their business, with the object of withholding the facilities or resources from the market;
>
> (*f*) purchasing products to prevent the erosion of existing price levels;
>
> (*g*) adoption of product specifications that are incompatible with products produced by a competitor;

(*h*) requiring or inducing a supplier to sell primarily or exclusively to certain customers, or to refrain from selling to a particular competitor;

(*i*) selling goods at a price lower than the acquisition price on a sustained basis; and

(j) the introduction of additional capacity to a market without a legitimate business rational or justification.

Authorisation would be available in relation to section 46 where the conduct can be shown to have countervailing public benefit.

Recommendation 32— Third-line forcing test
The SME Committee repeats the submissions made in its earlier submission, dated 24 November 2014.

Recommendation 33 — Exclusive dealing coverage
The SME Committee repeats the submissions made in its earlier submission, dated 24 November 2014.

Recommendation 34 — Resale price maintenance
The SME Committee repeats the submissions made in its earlier submission, dated 24 November 2014. In addition, the SME Committee would like to draw the Review's attention to research conducted in the US about the price effects which followed the Supreme Court's decision in Leegin – Attachment B.

Recommendation 53 — Small business access to remedies
The SME Committee is disappointed that the Harper Review has not been able to put forward more substantive final recommendations in relation to this issue. In the following we repeat a number of the proposals put forward in our earlier submission:

SME Submission dated 24 November 2014
Our Committee does not understand why the focus of the discussion on how to provide small businesses with better access to justice always focuses on informal mechanism of justice, such as ADR. Small businesses are just as willing as larger businesses to pursue their legal rights through courts and tribunals. Unfortunately, the costs of pursuing those rights are often prohibitive.

In our view, the first step is to try to identify ways in which small businesses can assert their legal rights in courts and tribunals in more cost effective ways.

One novel solution may be to explore the possibility of state and territory Tribunals being given jurisdiction to adjudicate simple competition law matters. Currently, many small businesses pursue ACL issues, including unconscionable conduct allegations, through state tribunals such as the NCAT, QCAT and VCAT, with some measure of success.

There is no reason in principle why a small business would not be able to pursue a complaint involving a less complex competition law issue through a state tribunal. For example, it seems that a small business which was the subject of third line forcing arrangement or a resale price maintenance arrangement should be able to pursue that issue through a

tribunal by seeking an order that the relevant agreement was void and unenforceable. Small businesses could also have the right to seek compensation from the Tribunal in relation such conduct.

The SME Committee also believes that it would be feasible for tribunals to be called upon to adjudicate on small business complaints involving other types of exclusive dealing arrangements. In these matters, the small business would be required to demonstrate on the balance of probabilities that the particular conduct was likely to substantially lessen competition. The main concern is that most tribunals may not have sufficient expertise with CCA provisions or concepts. However, these issues could be overcome by providing additional training.

Another initiative which could be explored is the creation of a pro-bono law firm panel for the provision of competition and consumer law advice to small businesses. The idea would be for particular firms with expertise in competition and consumer law matters to be appointed to a pro-bono panel for the purpose of providing small businesses with initial free advice in relation to competition and consumer law issues. Through this process, many small businesses would be able to understand the reasons why their particular complaint may not raise an actionable breach of competition or consumer laws.

If on the other hand the small business complaint had merit, the pro-bono law firm could either:

(1) provide free legal advice to the small business about how to draft a simple initial complaint letter to the ACCC; or
( ) be engaged by the small business to draft a more complex initial complaint letter to the ACCC raising the allegations.

This pro-bono panel could also be extended to providing free legal advice to small businesses which had become the subject of an ACCC investigation or ACCC litigation. The pro-bono firm would be able to provide the small business with advice on common issues arising in the course of an ACCC investigation, particularly in relation to their legal obligations in responding to statutory notices and the legal implications of entering into a section 87B undertaking. Other areas of advice could include the small business's obligations in relation to substantiation notices, infringement notices and public warning notices.

Finally, the pro-bono law firms could be called upon to give free advice to small businesses which become involved in ACCC investigations or litigation either as a witness or as a recipient of an ACCC statutory notice or subpoena.

In relation to access to justice through mediation, the SME Committee notes that the various Small Business Commissioners have been providing a valuable mediation function to many small businesses. The Committee believes that these initiatives should be supported and if possible extended.

The SME Committee does not support the ACCC having a mediation role in small business disputes. Such a role would invariably create conflicts of interests which would blur the ACCC's role as an enforcement agency.

Small business access to justice

The SME Committee recognises that many small business disputes are not competition issues but rather involve misleading, unconscionable, or unfair conduct issues outside of CCA. Consequently any small business access regime has to cover the range and not focus only on competition issues.

Further SME Committee acknowledges that there is not usually only one solution to each small business problem. Rather a holistic approach is needed which involves small business itself, "big" businesses, regulatory agencies, trade associations, legal professional associations and governments working together.

The SME Committee believes the following three part framework may provide a helpful starting point in terms of addressing some of the concerns associated with small business access to justice issues.

The SME Committee believes that a working part should be established consisting of Small Business Commissioners and the ACCC which would be responsible for further developing and driving the framework. This working party would need the full support of relevant Federal, State and Territory Ministers.

First - **avoid disputes**

- Identify and implement voluntary codes of conduct in particular "problem areas" e.g. motor vehicle repairers, magazine distributors, telecommunications, banking, etc.
- Small business to be encouraged to pursue ACCC authorisation of industry voluntary codes.
- ACCC to make their authorisation processes simpler and more user friendly.
- Small Business Commissioners and the ACCC to co-operate on the development of industry codes which are aimed at reducing disputes.
- Review of unfair business to business contracts to reduce disputes.
- Trade associations to be encouraged and funded to handle and filter a greater number of small business complaints and disputes.
- ACCC to make it clearer to small businesses through speeches and publications that they are not a complaints handling body but rather have been established to pursue systemic non-compliance issues.
- Collective bargaining regimes to be simplified and the ACCC to make it clear that boycotts will be permitted in particular situations.
- ACCC to better communicate with small business complainants about their reasons for deciding not to pursue their complaint.

Second - enhanced dispute/complaint handling processes.

- Small Business Commissioners to be appointed in each State and Territory and given wide powers.
- State and Territory consumer affairs agencies to be provided with additional resources and powers in order to handle small business disputes.
- Commercial (Super) Tribunals to be established in each State and Territory and provided with broader jurisdiction in relation to small business disputes.
- Small business complaint and advice free clinics to be established and operated by legal professional associations, and Law Schools on a regular basis with government funding or support.

- Commonwealth and State Governments, ACCC, legal professional associations and business associations to develop and fund a pro bono regime to assist small business in taking matters to Tribunals – similar to Public Interest Law Clearing House (PILCH).
- Law firms encouraged to enter into low cost retainers with small business groups to provide advice and representation in relation to small business issues

Third – greater use of Courts/Tribunals

- Jurisdiction of Super Tribunals to be expanded initially to include a range of competition issues – i.e. third line forcing, exclusive dealing, resale price maintenance.
- Further training provided to Super Tribunal members concerning competition provisions as well as unconscionability and unfair contract terms legislation.
- Small businesses to be encouraged to take their own private action in Tribunals.
- Trade Associations to have standing in Tribunals to act on behalf of members.
- Courts to further develop fast track low cost or fixed cost regimes.
- Australian Law Reform Commission (ALRC) to do a review of costs issues in various courts, particularly in the Federal Court system.
- ALRC to look at feasibility of no costs order regime in relation litigation taken by private parties with a public interest component.

Recommendation 51 — ACCC governance

The SME Committee does not support this recommendation. In the SME Committee's view, the ACCC's full time Commissioners already have enormous workloads. Accordingly, we do not believe that it would be sensible to replace a relatively small number of full time Commissioners with a significantly larger pool of part time Commissioners.

The SME Committee is also concerned about the potential for conflicts of interest to arise if the Commission was staffed by part time commissioners, rather than full time commissioners.

Furthermore, the SME Committee disagrees with the recommendation to effectively remove the Small Business Commissioner role from the ACCC. This recommendation will diminish the ACCC's understanding of, and focus on, small business issues. Indeed, such a move would ultimately render small business issues all but irrelevant in the ACCC's performance of its functions. The current position should be retained.

Further discussion

The SME Committee would be happy to discuss any aspect of this submission.

Please contact Coralie Kenny, the Chair of the SME Committee, on 0409 919 082 if you would like to do so.

Yours faithfully

John Keeves, Chairman
Business Law Section

Enc.

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24 November 2014

Dear Sir or Madam,

Introduction

The Law Council of Australia, is the peak national body representing the legal profession in Australia.

The Small and Medium Enterprise Business Law Committee of the Business Law Section of the Law Council of Australia (SME Committee) makes this submission in response to the Draft Report, dated September 2014 released by the Competition Policy Review (Harper Review).

The SME Committee has as its primary focus the consideration of legal issues affecting small businesses and medium enterprises in the development of national legal policy in that domain. Its membership is comprised of legal practitioners who are extensively involved in legal issues affecting SMEs.

Please also note that our submissions may differ from those made by other Committees of the Law Council because of our Committee members' perspectives and experiences as advisers to SMEs.

Introductory comments

The SME Committee understands the size and complexity of the task set for the Harper Review in the Terms of Reference. Having said that, the SME Committee believes the Harper Review's Draft Report could benefit from further consideration of a number of important issues.

In the SME Committee's view, the Harper Review should carefully investigate and consider the actual policy objectives of the CCA, rather than accept as valid the often-repeated mantra that the overriding policy objective of the CCA is "to protect competition, not competitors". We will discuss this issue in more detail below.

The SME Committee also considers that the Draft Report should include practical ideas aimed at providing support and assistance to the small business sector. The SME Committee does not believe, as the Harper Review suggests in a number of places, that various of its recommendations will actually assist small businesses.

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In the SME Committee's view, many of the proposed recommendations in the Draft Report are more likely to further damage the ability of small businesses to compete with their larger competitors in the market place, rather than assisting small business. For example, the relaxation of trading hours and changes to planning and zoning laws will place small businesses under significantly greater competitive pressure in the marketplace, rather than assisting small business.

The SME Committee also believes that the Harper Review needs to gain a deeper understanding of the various pressures facing many small businesses. For example, one of the primary concerns of small businesses - namely that they are unable to buy goods from their suppliers at wholesale prices which are lower than the retail prices being offered for the same products by their major competitors - does not appear to be well understood by the Review.

Policy objective of the CCA

The Harper Review appears to have accepted the claim that the sole policy objective of the CCA is to "protect competition and not competitors". However, in the SME Committee's view, when one more carefully considers this question it becomes apparent that the policy objectives of the CCA are much broader and more multifaceted.

Section 2 of the CCA states:

> *The object of this Act is to enhance the welfare of Australian through the promotion of competition and fair trading and the provision of consumer protection.*

The CCA is aimed at the promotion of both competition and fair trading. It is implicit in the term "fair trading" that the CCA is aimed at preventing companies from engaging in unfair trading practices towards both consumers and their competitors.

The Second Reading Speech for the *Trade Practices Act* also makes it clear that the policy objective of the CCA involves a wider range of considerations than suggested in the Draft Report. As stated by the Hon. Senator Murphy on 30 July 1974:

> *The purpose of the Bill is to control restrictive trade practices and monopolisation and to protect consumers from unfair commercial practices. The Bill will replace the existing Restrictive Trade Practices Act, which has proved to be one of the most ineffectual pieces of legislation ever passed by this Parliament. The Bill will also provide on a national basis long overdue protection for consumers against a wide range of unfair practices. Restrictive trade practices have long been rife in Australia. Most of them are undesirable and have served the interests of the parties engaged in them, irrespective of whether those interests coincide with the interests of Australians generally. These practices cause prices to be maintained at artificially high levels. They enable particular enterprises or groups of enterprises to attain positions of economic dominance which are then susceptible to abuse; they interfere with the interplay of competitive forces which are the foundation of any market economy; they allow discriminatory action against small businesses, exploitation of consumers and feather-bedding of industries.*

In the view of the SME Committee, the policy objectives of the TPA/CCA are much broader than the promotion of competition, but rather extend to the removal of unfair practices including the prevention of discriminatory action against small businesses.

Similarly, Senator Murphy noted the policy objectives behind section 46 in his Second Reading speech:

> *The clause [46] covers various forms of conduct by a monopolist against his competitors or would-be competitors. A monopolist for this purpose is a person who substantially controls a market. The application of this provision will be a matter for the Court. An arithmetical test such as one third of the market- as in the existing legislation- is unsatisfactory. The certainty which it appears to give is illusory.*
>
> *Clause 46 as now drafted makes it clear that it does not prevent normal competition by enterprises that are big by, for example, their taking advantage of economies of scale or making full use of such skills as they have; the provision will prohibit an enterprise which is in a position to control a market from taking advantage of its market power to eliminate or injure its competitors.*
>
> *The provision will not apply merely because a person who is in a position to control a market engages in conduct within one of the classes set out in the clause. It will be necessary for the application of the clause that, in engaging in such conduct, the person concerned is taking advantage of the power that he has by virtue of being in a position to control the market. For example, a person in a position to control a market might use his power as a dominant purchaser of goods to cause a supplier of those goods to refuse to supply them to a competitor of the first mentioned person- thereby excluding him from competing effectively. In such circumstances the dominant person has improperly taken advantage of his power.*

Again, the policy objective behind section 46 was and is to prevent firms with market power from engaging in conduct which will eliminate or injure their competitors. Implicit in Senator Murphy's speech is a recognition that competition does not occur in a vacuum, but rather manifests itself in a practical sense through rivalrous behaviour between competing firms.

In the SME Committee's view, there is a need for better recognition and acknowledgement by the Harper Review of the multifaceted policy objectives behind the CCA. Of particular importance is recognition and acknowledgement of the clear policy objective of providing competitors, particularly small businesses, with protections from unfair trading and abuses of market power. In the Committee's view, such recognition and acknowledgement is essential for successful outcomes from the Review.

Small business protections

In the SME Committee's view, the debate concerning how to provide small businesses with a greater level of protection should focus less on ways of trying to "fix" section 46 of the CCA. In the Committee's view, section 46 at its best will only ever be a blunt instrument in terms of protecting small businesses from the abusive practices of larger firms.

The SME Committee believes that other proposed changes to the CCA and ACL are likely to provide small businesses with a much greater degree protection than continual tinkering with section 46.

For example, the recent cases taken by the ACCC against a supermarket chain for alleged unconscionable conduct show the ways in which these provisions may be used to provide protections to small and medium sized businesses. In the past, the ACCC was likely to have looked at the conduct described in these cases under section 46, rather than appreciating the potential of using the unconscionable conduct provisions to challenge such conduct.

The proposed extension of the Unfair Contract Terms legislation to business standard form contracts will also provide small businesses with greater protection in their dealings with larger businesses. Indeed, in the SME Committee's view, this particular legislative change is likely to have a profound effect in terms of improving the fairness of contractual relations between large and small businesses in Australia.

Finally, in the SME Committee's view, the introduction of a mandatory Grocery Code, along the lines of the UK Groceries Code, would also have a significant impact in terms of leveling the playing field between small/medium suppliers and the major grocery retailers.

Response to recommendations:

In the following, we will endeavour to respond to each of the recommendations made in your Draft Report:

Draft Recommendation 1— Competition principles

The Panel endorses competition policy that focuses on making markets work in the long-term interests of consumers. The following principles should guide Commonwealth, state and territory and local governments in implementing competition policy:

- legislative frameworks and government policies binding the public or private sectors should not restrict competition;
- governments should promote consumer choice when funding or providing goods and services and enable informed choices by consumers;
- the model for government provision of goods and services should separate funding, regulation and service provision, and should encourage a diversity of providers;
- governments should separate remaining public monopolies from competitive service elements, and also separate contestable elements into smaller independent business activities;
- government business activities that compete with private provision, whether for-profit or not-for-profit, should comply with competitive neutrality principles to ensure they do not enjoy a net competitive advantage simply as a result of government ownership;

- a right to third-party access to significant bottleneck infrastructure should be granted where it would promote a material increase in competition in dependent markets and would promote the public interest; and
- independent authorities should set, administer or oversee prices for natural monopoly infrastructure providers.

Applying these principles should be subject to a 'public interest' test, so that:

- the principle should apply unless the costs outweigh the benefits; and
- any legislation or government policy restricting competition must demonstrate that:
  - it is in the public interest; and
  - the objectives of the legislation or government policy can only be achieved by restricting competition.

The SME Committee agrees with this recommendation.

A simple way in which governments may encourage a diversity of providers is to ensure that contractual arrangements between government and small businesses are not overly complex and onerous. Many small businesses are deterred from seeking government work due to the complexity and one-sided nature of contractual arrangements, including the requirement to obtain excessive and expensive insurance coverage.

Draft Recommendation 2— Human services

Australian governments should craft an intergovernmental agreement establishing choice and competition principles in the field of human services.

The guiding principles should include:

- user choice should be placed at the heart of service delivery;
- funding, regulation and service delivery should be separate;
- a diversity of providers should be encouraged, while not crowding out community and voluntary services; and
- innovation in service provision should be stimulated, while ensuring access to high-quality human services.

Each jurisdiction should develop an implementation plan founded on these principles that reflects the unique characteristics of providing human services in its jurisdiction.

The SME Committee supports this recommendation.

The SME Committee would like to reiterate that the simplest way of encouraging a diversity of providers, including small business providers, is to ensure that contractual arrangements between governments and small businesses are not overly complex and onerous.

Draft Recommendation 3— Road transport

Governments should introduce cost-reflective road pricing with the aid of new technologies, with pricing subject to independent oversight and linked to road construction, maintenance and safety.

To avoid imposing higher overall charges on road users, there should be a cross-jurisdictional approach to road pricing. Indirect charges and taxes on road users should be reduced as direct pricing is introduced. Revenue implications for different levels of government should be managed by adjusting Commonwealth grants to the States and Territories.

The SME Committee understands the economic benefits associated with more efficient road pricing.

However, the SME Committee notes that such changes are likely to have a particularly negative effect on road transport operators, the vast majority of which are small and medium sized business. The SME Committee believes that many small and medium sized road transport operators would have considerable difficulty passing on the additional costs associated with "efficient road pricing" to their customers, particularly on to large retail customers.

Furthermore, we believe that this recommendation is likely to have a negative effect on the small business sector, in their capacity as a purchaser of goods, by raising their cost of goods.

Draft Recommendation 4— Liner shipping

The Australian Government should repeal Part X of the CCA.

A block exemption granted by the ACCC should be available for liner shipping agreements that meet a minimum standard of pro-competitive features (see Draft Recommendation 35). The minimum standard of pro-competitive features to qualify for the block exemption should be determined by the ACCC in consultation with shippers and the liner shipping industry.

Other agreements should be subject to individual authorisation by the ACCC.

Repeal of Part X will mean that existing agreements are no longer exempt from the competition provisions of the CCA. Transitional arrangements are therefore warranted.

A transitional period of two years should allow for authorisations to be sought and to identify agreements that qualify for the proposed block exemption.

The SME Committee agrees with this recommendation.

Part X is an anomaly, particularly as the Part does not require any analysis of the allegedly pro-competitive features of such agreements. In our view, there are few pro-competitive benefits from the day-to-day operation of Part X.

Draft Recommendation 5— Coastal shipping

Noting the current Australian Government Review of Coastal Trading, the Panel considers that cabotage restrictions should be removed, unless they can be shown to be in the public interest and there is no other means by which public interest objectives can be achieved.

The SME Committee agrees with this recommendation.

Cabotage restrictions are an anomaly. In the Committee's view, the cabotage restrictions are anti-competitive restrictions aimed at preserving employment opportunities for the members of a particular employee organisation.

Draft Recommendation 6— Taxis

States and Territories should remove regulations that restrict competition in the taxi industry, including from services that compete with taxis, except where it would not be in the public interest.

If restrictions on numbers of taxi licences are to be retained, the number to be issued should be determined by independent regulators focused on the interests of consumers.

The SME Committee understands the economic benefits associated with the deregulation of the taxi industry.

However, the SME Committee notes that such changes are likely to have a particularly negative effect on existing taxi operators, the vast majority of which are small businesses.

Draft Recommendation 7— Intellectual property review

The Panel recommends that an overarching review of intellectual property be undertaken by an independent body, such as the Productivity Commission.

The review should focus on competition policy issues in intellectual property arising from new developments in technology and markets.

The review should also assess the principles and processes followed by the Australian Government when establishing negotiating mandates to incorporate intellectual property provisions in international trade agreements.

Trade negotiations should be informed by an independent and transparent analysis of the costs and benefits to Australia of any proposed IP provisions. Such an analysis should be undertaken and published before negotiations are concluded.

The SME Committee agrees with this recommendation.

We believe that such a review is particularly timely given overseas developments in relation the use of intellectual property, primarily patents, to achieve anti-competitive outcomes in various industries, particularly in relation to pharmaceuticals and electronic devices.

Draft Recommendation 8— Intellectual property exception

The Panel recommends that subsection 51(3) of the CCA be repealed.

The SME Committee agrees with this recommendation.

We believe that such exceptions are not appropriate as they have the potential to exempt conduct which has significant anti-competitive effects.

Draft Recommendation 9— Parallel imports

Remaining restrictions on parallel imports should be removed unless it can be shown that:

- they are in the public interest; and
- the objectives of the restrictions can only be achieved by restricting competition.

The SME Committee understands the economic benefits associated with the removal of parallel import restrictions.

However, the SME Committee notes that a major beneficiary of such restrictions are small businesses, for example independent book sellers and music stores. In our view, one of the primary reasons why governments have maintained parallel import prohibitions is due to the concern that the removal of such laws may have a particularly devastating effect on various small business sectors.

Draft Recommendation 10— Planning and zoning

All governments should include competition principles in the objectives of planning and zoning legislation so that they are given due weight in decision-making.

The principles should include:

- a focus on the long-term interests of consumers generally (beyond purely local concerns);
- ensuring arrangements do not explicitly or implicitly favour incumbent operators;
- internal review processes that can be triggered by new entrants to a local market; and
- reducing the cost, complexity and time taken to challenge existing regulations.

Again, the SME Committee understands the economic benefits associated with the removal of planning and zoning restrictions.
However, the SME Committee notes that often the main beneficiaries of such restrictions are small businesses, for example independent grocery stores and specialty food retailers.

The Harper Review should note that one of the primary reasons why governments have preserved restrictions on planning and zoning laws is because of the concern that the removal of such laws may have a particularly devastating effect on various small business sectors.

Draft Recommendation 11— Regulation review

All Australian governments, including local government, should review regulations in their jurisdictions to ensure that unnecessary restrictions on competition are removed.

Regulations should be subject to a public benefit test, so that any policies or rules restricting competition must demonstrate that:

- they are in the public interest; and
- the objectives of the legislation or government policy can only be achieved by restricting competition.

Factors to consider in assessing the public interest should be determined on a case-by-case basis and not narrowed to a specific set of indicators.

Jurisdictional exemptions for conduct that would normally contravene the competition laws (by virtue of subsection 51(1) of the CCA) should also be examined as part of this review, to ensure they remain necessary and appropriate in their scope. Any further exemptions should be drafted as narrowly as possible to give effect to their policy intent.

The review process should be transparent, with highest priority areas for review identified in each jurisdiction, and results published along with timetables for reform.

The review process should be overseen by the proposed Australian Council for Competition Policy (see Draft Recommendation 39) with a focus on the outcomes achieved, rather than the process undertaken. The Australian Council for Competition Policy should conduct an annual review of regulatory restrictions and make its report available for public scrutiny.

The SME Committee agrees with this recommendation.

However, the SME Committee believes that as part of its consideration of the public benefit, any such regulation review should also consider the likely impact of changes on the small business sector. In our view, there is a likelihood that many of these regulations are driven by the broader policy objective of providing support and opportunities for local small and medium sized businesses.

Draft Recommendation 12— Standards review

Given the unique position of Australian Standards under paragraph 51(2)(c) of the CCA, the Australian Government's Memorandum of Understanding with Standards Australia should require that non-government mandated standards be reviewed according to the same process specified in Draft Recommendation 11.

The SME Committee supports this recommendation.

The SME Committee is aware of at least one situation some years ago where two large businesses sought to use their membership of an Australian Standards Committee to introduce an Australian Standard which would have eliminated import competition. In that case, the ACCC were successful in taking steps to prevent the conduct.

However, the SME Committee is concerned that large businesses may be able to use their membership of Australian Standards Committees to introduce Australian Standards which will unduly raise compliance costs for small business or may even have the effect of excluding imports from the market all together.

Draft Recommendation 13— Competitive neutrality policy

All Australian governments should review their competitive neutrality policies. Specific matters that should be considered include: guidelines on the application of competitive neutrality during

the start-up stages of government businesses; the period of time over which start-up government businesses should earn a commercial rate of return; and threshold tests for identifying significant business activities.

The review of competitive neutrality policies should be overseen by an independent body, such as the proposed Australian Council for Competition Policy (see Draft Recommendation 39).

The SME Committee agrees with this recommendation.

Draft Recommendation 14— Competitive neutrality complaints

All Australian governments should increase the transparency and effectiveness of their competitive neutrality complaints processes. This should include at a minimum:

- assigning responsibility for investigation of complaints to a body independent of government;
- a requirement for the government to respond publicly to the findings of complaint investigations; and
- annual reporting by the independent complaints bodies to the proposed Australian Council for Competition Policy (see Draft Recommendation 39) on the number of complaints received and investigations undertaken.

The SME Committee agrees with this recommendation.

A number of members of the SME Committee have been involved in the competitive neutrality complaint processes in the past. We agree that the government bodies responsible for investigating these complaints have generally not investigated such matters in a rigorous and transparent matter. A more transparent process is needed to remove any inference that the government agency investigating the competitive neutrality complaint has a conflict of interest.

A further concern is that the government agencies charged with investigating such competitive neutrality complaints often do not have appropriately trained investigatory staff. The SME Committee believes it is important therefore for the proposed Australian Council for Competition Policy to be appropriately staffed with trained investigators.

Draft Recommendation 15— Competitive neutrality reporting

To strengthen accountability and transparency, all Australian governments should require government businesses to include a statement on compliance with competitive neutrality principles in their annual reports.

The SME Committee agrees with this recommendation.

Greater transparency in competitive neutrality reporting is essential given past failures in this area.

Draft Recommendation 16— Electricity, gas and water

State and territory governments should finalise the energy reform agenda, including through:

- application of the National Energy Retail Law with minimal derogation by all National Electricity Market jurisdictions;
- deregulation of both electricity and gas retail prices; and
- the transfer of responsibility for reliability standards to a national framework.

The Panel supports moves to include Western Australia and the Northern Territory in the National Electricity Market, noting that this does not require physical integration.

All governments should re-commit to reform in the water sector, with a view to creating a national framework. An intergovernmental agreement should cover both urban and rural water and focus on:

- economic regulation of the sector; and
- harmonisation of state and territory regulations where appropriate.

Where water regulation is made national, the body responsible for its implementation should be the Panel's proposed national access and pricing regulator (see Draft Recommendation 46).

While SME Committee members do not have a great deal of expertise in these particular areas, we support this recommendation.

Draft Recommendation 17— Competition law concepts

The Panel recommends that the central concepts, prohibitions and structure enshrined in the current competition law be retained because they are the appropriate basis for the current and projected needs of the Australian economy.

While the SME Committee supports this recommendation, it reiterates its concerns about the apparent confusion throughout the Draft Report about the actual objects of the CCA. The objects of the CCA are not the promotion of competition to the exclusion of all else. Furthermore, there is no mention of the term "efficiency" in section 2.

We believe that it is unhelpful for groups to be advocating a view of the objects of the CCA which is incomplete and in some respects misleading. While the CCA is directed to promoting competition, it is also directed to the promotion of fair trading between businesses.

Draft Recommendation 18— Competition law simplification

The competition law provisions of the CCA should be simplified, including by removing overly specified provisions, which can have the effect of limiting the application and adaptability of competition laws, and by removing redundant provisions.

The Panel recommends that there be public consultation on achieving simplification.

Some of the provisions that should be removed include:

- subsection 45(1) concerning contracts made before 1977;
- sections 45B and 45C concerning covenants; and
- sections 46A and 46B concerning misuse of market power in a trans-Tasman market.

This task should be undertaken in conjunction with implementation of the other recommendations of this Review.

While the SME Committee agrees with this recommendation, it sees this change as inconsequential given the infrequent use of any of these provisions.

Draft Recommendation 19— Application of the law to government activities

The CCA should be amended so that the competition law provisions apply to the Crown in right of the Commonwealth and the States and Territories (including local government) insofar as they undertake activity in trade or commerce.

The SME Committee agrees with this recommendation.

The current tests for determining jurisdiction in relation to government activities are too complex. This recommendation will reduce this complexity.

Draft Recommendation 20— Definition of market

The current definition of 'market' in the CCA should be retained but the current definition of 'competition' should be re-worded to ensure that competition in Australian markets includes competition from goods imported or capable of being imported into Australia and from services supplied or capable of being supplied by persons located outside of Australia to persons located within Australia.

The SME Committee agrees with this recommendation.

The SME Committee is of the view that this recommendation would be a formalisation of current ACCC practice when it seeks to define the relevant market for the purposes of the CCA.

Draft Recommendation 21— Extra-territorial reach of the law

Section 5 of the CCA should be amended to remove the requirement that the contravening firm has a connection with Australia in the nature of residence, incorporation or business presence and to remove the requirement for private parties to seek ministerial consent before relying on extra-territorial conduct in private competition law actions.

The in-principle view of the Panel is that the removal of the foregoing requirements should also be removed in respect of actions under the Australian Consumer Law.

The SME Committee agrees with the first part of this recommendation.

We also agree that the requirement for a private party to seek ministerial consent before relying on the extra-territorial provisions should be removed.

Draft Recommendation 22— Cartel conduct prohibition

The prohibitions against cartel conduct should be simplified and the following specific changes made:

- the provisions should apply to cartel conduct affecting goods or services supplied or acquired in Australian markets;
- the provisions ought be confined to conduct involving firms that are actual competitors and not firms for whom competition is a mere possibility;
- a broad exemption should be included for joint ventures and similar forms of business collaboration (whether relating to the supply or the acquisition of goods or services), recognising that such conduct will be prohibited by section 45 of the CCA if it has the purpose, effect or likely effect of substantially lessening competition;
- an exemption should be included for trading restrictions that are imposed by one firm on another in connection with the supply or acquisition of goods or services (including IP licensing), recognising that such conduct will be prohibited by section 47 of the CCA (revised in accordance with Draft Recommendation 28) if it has the purpose, or has or is likely to have the effect or likely effect of substantially lessening competition.

The SME Committee agrees with this recommendation.

Draft Recommendation 23— Exclusionary provisions

The CCA should be amended to remove the prohibition of exclusionary provisions in subparagraphs 45(2)(a)(i) and 45(2)(b)(i).

The SME Committee does not agree with this recommendation. A compelling case has not been made for the repeal of these provisions.

Draft Recommendation 24— Price signalling

The 'price signalling' provisions of Division 1A of the CCA are not fit for purpose in their current form and should be repealed.

Section 45 should be extended to cover concerted practices which have the purpose, or would have or be likely to have the effect, of substantially lessening competition.

The SME Committee agrees that the 'price signalling' provisions of Division 1A of the CCA are inappropriate to the extent that they only apply to the banking sector. However, the SME Committee does not agree with the proposal to exclude public price signalling from the reach of the CCA.

As stated in our initial submission, our preferred approach in relation to price signalling is to introduce a general prohibition in relation to price signalling, which is in line with the law in both the US and the EU.

Draft Recommendation 25— Misuse of market power

The Panel considers that the primary prohibition in section 46 should be re-framed to prohibit a corporation that has a substantial degree of power in a market from engaging in conduct if the proposed conduct has the purpose, or would have or be likely to have the effect, of substantially lessening competition in that or any other market.

However, the Panel is concerned to minimise unintended impacts from any change to the provision that would not be in the long-term interests of consumers, including the possibility of inadvertently capturing pro-competitive conduct.

To mitigate concerns about over-capture, the Panel proposes that a defence be introduced so that the primary prohibition would not apply if the conduct in question:

- would be a rational business decision or strategy by a corporation that did not have a substantial degree of power in the market; and
- the effect or likely effect of the conduct is to benefit the long-term interests of consumers.

The onus of proving that the defence applies should fall on the corporation engaging in the conduct.

The Panel seeks submissions on the scope of this defence, whether it would be too broad, and whether there are other ways to ensure anti-competitive conduct is caught by the provision but not exempted by way of a defence.

Such a re-framing would allow the provision to be simplified. Amendments introduced since 2007 would be unnecessary and could be repealed. These include specific provisions prohibiting predatory pricing, and amendments clarifying the meaning of 'take advantage' and how the causal link between the substantial degree of power and anti-competitive purpose may be determined.

The SME Committee is somewhat surprised that the Harper Review in its Draft Report has recommended making such significant changes to section 46 without first discussing whether the section is currently operating effectively, particularly given the data provided in our submission and a number of other submissions about the ACCC's success in pursuing section 46 cases. The Harper Review seems to have assumed the section is not working effectively and that, as a result, requires major changes.

The SME Committee believes it is incumbent on the Harper Review to consider and then determine whether there is a particular problem with the operation of particular legislation before recommending significant changes. In our view, there is a crucial difference between, on

the one hand, legislation which is ineffective due to its drafting and, on the other hand, legislation which is effective but which is not being enforced often enough.

The SME Committee does not believe that the Harper Review's proposed changes to section 46 will make it easier for the ACCC to pursue section 46 cases. Rather in our view, the proposed changes will make it harder for the ACCC to be successful in section 46 cases.

First, the introduction of a substantial lessening of competition test is likely to make the provision more difficult for both the ACCC and private litigants to bring successful actions.

Second, the proposal to introduce two defences in section 46 will make the provision all but unworkable.

In the SME Committee's view, the first proposed defence (ie whether the conduct would be a rational business decision by a corporation that did not have a substantial degree of market power) is simply the reintroduction of the taking advantage limb as a defence. In our view, this change will do nothing to improve the Court's ability to interpret and apply this concept.

In our view, the second defence (ie whether the conduct in question would be likely to have the effect of advancing the long-term interests of consumers) is also unworkable because of its scope is too broad and open-ended.

The SME Committee believes that a straightforward prohibition on a firm with a substantial degree of market power using its market power for the purpose or effect of damaging or preventing competition by competitors in a market would be preferable.

If the Harper Review was committed to the idea of introducing a defence, the preferred approach would be to introduce a general business justification defence along the lines of the test which is applied in US monopolization cases.

The SME Committee is also concerned at the Harper Review's apparent cursory treatment of the question of whether a divestiture remedy should be introduced for proven breaches of section 46.

First, there is no discussion in the Draft Report of the various situations where the remedy has been used in the US and whether the remedy was used successfully in those cases to achieve pro-competitive outcomes.

Second, it appears to the SME Committee that the Harper Review has assumed that the use of a divestiture remedy "is likely to have broader impacts on the efficiency of the firm." There is simply no basis for stating that a divestiture remedy is "likely" to have this effect.

In our view the Harper Review would benefit from undertaking a more rigorous and in-depth analysis of the arguments for and against the introduction of a divestiture remedy for proven breaches of section 46.

Draft Recommendation 26— Price discrimination

A specific prohibition on price discrimination should not be reintroduced into the CCA. Where price discrimination has an anti-competitive impact on markets, it can be dealt with by the existing provisions of the law (including through the recommended revisions to section 46, see Draft Recommendation 25).

Attempts to prohibit international price discrimination should not be introduced into the CCA on account of significant implementation and enforcement complexities and the risk of negative unintended consequences. Instead, the Panel supports moves to address international price discrimination through market solutions that empower consumers. These include the removal of restrictions on parallel imports (see Draft Recommendation 9) and ensuring that consumers are able to take legal steps to circumvent attempts to prevent their access to cheaper legitimate goods.

While the SME Committee does not support the reintroduction of a specific price discrimination provision, it considers the Harper Review would benefit from discussing this important issue more rigorously.

As stated above, a major problem which many small businesses face is that they are unable to buy products from their suppliers at a wholesale price which is lower than the retail prices being offered for the same products by their major retail competitors. It is important for the Harper Review to fully investigate and gain an understanding of this problem before dismissing any potential solutions.

Draft Recommendation 27— Third-line forcing test

The provisions on 'third-line forcing' (subsections 47(6) and (7)) should be brought into line with the rest of section 47. Third-line forcing should only be prohibited where it has the purpose, or has or is likely to have the effect, of substantially lessening competition.

The SME Committee does not agree with this recommendation.

The SME Committee understands that the Harper Review has evaluated third line forcing through the lens of competition law. However, in our view, there is an equally valid way of considering the prohibition on third line forcing – namely that it promotes freedom of contract.

In the Committee's view, the prohibitions in subsections 47(6) and (7) are aimed at preventing interference with freedom of contract. In other words, these provisions preserve the freedom of a party not to have to agree to purchase goods or services which they do not want or need from a party, whom they do not want to contract with.

Furthermore, the Committee suggests that the Harper Review should consider the likely effect that this recommendation will have in the marketplace. We believe that if this recommendation were to be implemented there would be a dramatic upsurge of tied sales in a wide range of industries. Furthermore, it is likely that the main group which would end up being subject to such tied arrangements would be small businesses.

Draft Recommendation 28— Exclusive dealing coverage

Section 47 should apply to all forms of vertical conduct rather than specified types of vertical conduct.

The provision should be re-drafted so it prohibits the following categories of vertical conduct concerning the supply of goods and services:

- supplying goods or services to a person, or doing so at a particular price or with a particular discount, allowance, rebate or credit, subject to a condition imposed on the person that has the purpose, or has or is likely to have the effect, of substantially lessening competition; and
- refusing to supply goods or services to a person, or at a particular price or with a particular discount, allowance, rebate or credit, for the reason that the person has not agreed to a condition imposed on the person that has the purpose, or has or is likely to have the effect, of substantially lessening competition.

The provision should also prohibit the following two reciprocal categories of vertical conduct concerning the acquisition of goods and services:

- acquiring goods or services from a person, or doing so at a particular price or with a particular discount, allowance, rebate or credit, subject to a condition imposed on the person that has the purpose, or has or is likely to have the effect, of substantially lessening competition; and
- refusing to acquire goods or services from a person, or at a particular price or with a particular discount, allowance, rebate or credit, for the reason that the person has not agreed to a condition imposed on the person that has the purpose, or has or is likely to have the effect, of substantially lessening competition.

The SME Committee agrees with this recommendation. The existing provisions of section 47 are unnecessarily complex.

Draft Recommendation 29— Resale price maintenance

The prohibition on resale price maintenance (RPM) should be retained in its current form as a per se prohibition, but the notification process should be extended to include resale price maintenance

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

The SME Committee does not agree with this recommendation for the same reasons it does not agree with the recommendation concerning third line forcing.

The SME Committee understands that the Harper Review has evaluated resale price maintenance (RPM) through the lens of competition law. However, in our view, there is an equally valid way of considering the prohibition on RPM – namely that it promotes freedom of contract.

In the Committee's view, the prohibition on RPM is aimed at preventing interference with freedom of contract. In other words, these provisions preserve the freedom of a party to sell a

product, which they have purchased and in which they have title, at any price that they wish, rather than being forced to sell the product at a price determine by another party.

Again, the SME Committee considers the Harper Review would benefit from considering the likely effect of the implementation of this recommendation in the marketplace. We believe that if this recommendation were to be implemented there would be a dramatic upsurge of the incidence of RPM. Again, it is likely that the main group which would end up being subject to RPM would be small businesses.

Draft Recommendation 30— Mergers

There should be further consultation between the ACCC and business representatives with the objective of delivering more timely decisions in the informal review process.

The formal merger exemption processes (i.e. the formal merger clearance process and the merger authorisation process) should be combined and reformed to remove unnecessary restrictions and requirements that may have deterred their use. The specific features of the review process should be settled in consultation with business, competition law practitioners and the ACCC. However, the general framework should contain the following elements:

- the ACCC should be the decision-maker at first instance;
- the ACCC should be empowered to approve a merger if it is satisfied that the merger does not substantially lessen competition or it is satisfied that the merger results in public benefits that outweigh the anti-competitive detriments;
- the formal process should not be subject to any prescriptive information requirements, but the ACCC should be empowered to require the production of business and market information;
- the formal process should be subject to strict timelines that cannot be extended except with the consent of the merger parties; and
- decisions of the ACCC should be subject to review by the Australian Competition Tribunal under a process that is also governed by strict timelines.

The SME Committee does not agree with this recommendation.

It appears to the Committee that the effect of this recommendation will be to further curtail the timelines available to the ACCC under the formal merger exemption processes. In our view, these timelines, particularly the merger authorization timeframes, are already too short to allow proper consideration of the competitive effects of mergers.

Section 50 of the CCA is aimed at preventing mergers which will or are likely to have the effect of substantially lessening competition. The use of the word “likely” suggests a legislative intention for the ACCC and the Australian Competition Tribunal to err on the side of caution and to block mergers which “may” lessen competition.

In our view, shortening the timelines under the CCA will make it even more difficult for the ACCC to obtain the evidence it requires to prevent anti-competitive mergers.

The SME Committee also believes that the Harper Review would benefit from giving more detailed consideration to the processes which apply overseas, which generally have much longer timelines than exist in Australia.

Draft Recommendation 31— Secondary boycotts enforcement

The ACCC should include in its annual report the number of complaints made to it in respect of secondary boycott conduct and the number of such matters investigated and resolved each year.

The SME Committee believes the Harper Review would benefit from a more robust treatment of secondary boycott enforcement. For example, the Harper Review should have undertaken a deeper analysis of the ACCC's record in enforcing secondary boycott provisions. There was considerable information provided to the Harper Review about this issue in submissions, particularly in the Committee's initial submission.

While the SME Committee agrees with this recommendation, the more important issue which the Harper Review Committee should consider is whether jurisdiction over secondary boycotts should remain with the ACCC or be transferred to a specialist body. In our view, this is the issue of primary importance in relation to secondary boycott laws.

Draft Recommendation 32— Secondary boycotts proceedings

Jurisdiction in respect of the prohibitions in sections 45D, 45DA, 45DB, 45E and 45EA should be extended to the state and territory Supreme Courts.

The SME Committee understands that the State and Territory Supreme Courts do have jurisdiction in relation to these provisions.

Draft Recommendation 33— Restricting supply or acquisition

The present limitation in sections 45E and 45EA, such that the prohibitions only apply to restrictions affecting persons with whom an employer 'has been accustomed, or is under an obligation' to deal with, should be removed.

The Panel invites further submissions on possible solutions to the apparent conflict between the CCA and the Fair Work Act including:

- **a procedural right for the ACCC to be notified by the Fair Work Commission of proceedings for approval of workplace agreements which contain potential restrictions of the kind referred to in sections 45E and 45EA, and to intervene and make submissions;**
- **amending sections 45E and 45EA so that they expressly include awards and enterprise agreements; and**
- **amending sections 45E, 45EA and possibly paragraph 51(2)(a) to exempt workplace agreements approved under the Fair Work Act.**

While the SME Committee agrees with this recommendation, it does not consider that there is a significant practical problem in relation to the perceived overlap between the CCA and the FWA.

Draft Recommendation 34— Authorisation and notification

The authorisation and notification provisions in the CCA should be simplified:

- to ensure that only a single authorisation application is required for a single business transaction or arrangement; and
- to empower the ACCC to grant an exemption (including for per se prohibitions) if it is satisfied that either the proposed conduct is unlikely to substantially lessen competition or that the proposed conduct is likely to result in a net public benefit.

The SME Committee agrees with this recommendation.

Draft Recommendation 35— Block exemption power

Exemption powers based on the block exemption framework in the UK and EU should be introduced to supplement the authorisation and notification frameworks.

While the SME Committee is generally supportive of this recommendation, it is keen to see further detail about how this particular recommendation would operate in practice.

Draft Recommendation 36— Section 155 notices

The ACCC should review its guidelines on section 155 notices having regard to the increasing burden imposed by notices in the digital age.

Either by law or guideline, the requirement of a person to produce documents in response to a section 155 notice should be qualified by an obligation to undertake a reasonable search, taking into account factors such as the number of documents involved and the ease and cost of retrieving the documents.

The SME Committee agrees that the ACCC should update its guidelines in relation to section 155 and understands that the ACCC is already in the process of undertaking such an update.

However, the SME Committee does not agree with the proposal to qualify the obligations required under section 155 to require the recipient to undertake a "reasonable search". Section 155 is intended to be a powerful investigatory tool which the ACCC seeks to use to obtain potentially incriminating evidence about serious contraventions of the CCA. In our view, the section 155 power should not be "watered down" be allowing recipients to define what constitutes a reasonable search and rather should continue to require recipients to undertake a thorough and exhaustive search.

The SME Committee believes the Harper Review would benefit from gaining a better understanding of the way in which other leading anti-trust/competition regulators conduct their investigations into cartels and other serious competition law breaches. It is almost standard practices for leading regulators overseas to commence the overt phase of their investigations with the execution of a search warrant (in the US) or by conducting a dawn raid (in the EU). Furthermore, in the USA, the Department of Justice works closely with in the Federal Bureau of Investigation in its cartel investigations, while also making extensive use of the grand jury system.

The SME Committee believes there is a strong case that the ACCC's investigatory powers, particularly in relation to serious cartel conduct, need to be strengthened rather than weakened.

Draft Recommendation 37— Facilitating private actions

Section 83 should be amended so that it extends to admissions of fact made by the person against whom the proceedings are brought in addition to findings of fact made by the court.

The SME Committee agrees with this recommendation.

However, the Committee believes that much more has to be done to facilitate private actions. In this regard, the Committee believes that the Harper Review should consider other more meaningful ways of seeking to facilitate private actions, such as allowing treble damages awards and making changes to the usual costs rules which apply in litigation.

The SME Committee is of the view that it is important for the Harper Review to carefully consider the implications of section 79B of the CCA which states that the Court is required to give preference to an order of compensation over the award of a pecuniary penalty under section 76. As far as the Committee is aware, a Court has never been called upon to exercise this jurisdiction, primarily because the ACCC does not generally seek both a pecuniary penalty and compensation in its cases under the CCA.

An interesting question is whether Parliament's decision to enact section 79B could be interpreted as a directive to the ACCC that it should be seeking to pursue both pecuniary penalties and compensation as part of its cases under the CCA. If the ACCC were to take this approach, it seems to the SME Committee that the Courts would be required to give preference to the payment of compensation to victims over the imposition of a large pecuniary penalty against the firm/s.

In the SME Committee's view, if the ACCC were to pursue both pecuniary penalties and compensation as part of its proceedings, this would provide a significant benefit to small and medium sized businesses. Small and medium sized businesses are often the victims of

competition law contraventions, particularly cartel conduct and misuses of market power. If the ACCC were to take this more expansive approach to their litigation, it is likely that many small and medium-sized business would be in a much better position to receive compensation as well as being spared the cost and frustration of commencing their own private or class actions.

Draft Recommendation 38— National Access Regime

The declaration criteria in Part IIIA should be targeted to ensure that third-party access only be mandated where it is in the public interest. To that end:

- criterion (a) should require that access on reasonable terms and conditions through declaration promote a material increase in competition in a dependent market;
- criterion (b) should require that it be uneconomical for anyone (other than the service provider) to develop another facility to provide the service; and
- criterion (f) should require that access on reasonable terms and conditions through declaration promote the public interest.

The Competition Principles Agreement should be updated to reflect the revised declaration criteria.

The Australian Competition Tribunal should be empowered to undertake merits review of access decisions while maintaining suitable statutory time limits for the review process.

The Panel invites further comment on:

- **the categories of infrastructure to which Part IIIA might be applied in the future, particularly in the mining sector, and the costs and benefits that would arise from access regulation of that infrastructure; and**
- **whether Part IIIA should be confined in its scope to the categories of bottleneck infrastructure cited by the Hilmer Review.**

While members of the SME Committee do not have a great deal of expertise in this area, we are generally supportive of this recommendation.

Draft Recommendation 39— Establishment of the Australian Council for Competition Policy

The National Competition Council should be dissolved and the Australian Council for Competition Policy established. Its mandate should be to provide leadership and drive implementation of the evolving competition policy agenda.

The Australian Council for Competition Policy should be established under legislation by one State and then by application in all other States and the Commonwealth. It should be funded jointly by the Commonwealth, States and Territories.

Treasurers, through the Standing Committee of Federal Financial Relations, should oversee preparation of an intergovernmental agreement and subsequent legislation, for COAG agreement, to establish the Australian Council for Competition Policy.

The Treasurer of any jurisdiction should be empowered to nominate Members of the Australian Council for Competition Policy.

The SME Committee supports this recommendation.

An organization such as the ACCP is required as an advocate for competition policy. It is not appropriate for a law enforcement agency such as the ACCC to be called on or expected to provide policy advice to government. Policy advice in relation to competition law should be the exclusive domain of a policy agency, such as the ACCP.

Indeed, there is an argument that the remit of the ACCP should be extended to include consumer protection policy and provide a small business perspective. In this way, the ACCC would not be required or expected to provide government with policy advice on consumer protection or small business issues.

Draft Recommendation 40— Role of the Australian Council for Competition Policy

The Australian Council for Competition Policy should have a broad role encompassing:

- advocate and educator in competition policy;
- independently monitoring progress in implementing agreed reforms and publicly reporting on progress annually;
- identifying potential areas of competition reform across all levels of government;
- making recommendations to governments on specific market design and regulatory issues, including proposed privatisations; and
- undertaking research into competition policy developments in Australia and overseas.

The SME Committee agrees with this recommendation. The proposed role of the ACCP is appropriate.

Draft Recommendation 41— Market studies power

The proposed Australian Council for Competition Policy should have the power to undertake competition studies of markets in Australia and make recommendations to relevant governments on changes to regulation or to the ACCC for investigation of potential breaches of the CCA.

The Panel seeks comments on the issue of mandatory information-gathering powers and in particular whether the PC model of having information-gathering powers but generally choosing not to use them should be replicated in the Australian Council for Competition Policy.

The SME Committee supports the recommendation to create a market studies function. In the Committee's view, the ACCP is the appropriate body to carry out such reviews. The Committee also believes that the ACCP should have mandatory information gathering powers.

It is also important for the ACCP to be appropriately resourced with adequately trained staff so that it can properly carry out its market studies function.

Draft Recommendation 42— Market studies requests

All governments, jointly or individually, should have the capacity to issue a reference to the Australian Council for Competition Policy to undertake a competition study of a particular market or competition issue.

All market participants, including small business and regulators (such as the ACCC), should have the capacity to request market studies be undertaken by the Australian Council for Competition Policy.

The work program of the Australian Council for Competition Policy should be overseen by the Ministerial Council on Federal Financial Relations to ensure that resourcing addresses priority issues.

The SME Committee supports this recommendation.

Draft Recommendation 43— Annual competition analysis

The Australian Council for Competition Policy should be required to undertake an annual analysis of developments in the competition policy environment, both in Australia and internationally, and identify specific issues or markets that should receive greater attention.

The SME Committee agrees with this recommendation, subject to the ACCP being required to seek input from the ACCC about areas which it considers to be of particular importance.

Draft Recommendation 44— Competition payments

The Productivity Commission should be tasked to undertake a study of reforms agreed to by the Commonwealth and state and territory governments to estimate their effect on revenue in each jurisdiction.

If disproportionate effects across jurisdictions are estimated, the Panel favours competition policy payments to ensure that revenue gains flowing from reform accrue to the jurisdictions undertaking the reform.

Reform effort would be assessed by the Australian Council for Competition Policy based on actual implementation of reform measures, not on undertaking reviews.

The SME Committee agrees with this recommendation.

Draft Recommendation 45— ACCC functions

Competition and consumer functions should be retained within the single agency of the ACCC.

The SME Committee agrees with this recommendation.

In our view, no compelling case has been made for separating the ACCC's competition and consumer functions into two separate agencies. Indeed, over recent years there has been a great deal of evidence which demonstrates the synergies which exist between the ACCC's competition

law and consumer law functions. This is particularly true in terms of the interrelationship between section 46 and the unconscionable conduct provisions.

Draft Recommendation 46— Access and pricing regulator functions

The following regulatory functions should be transferred from the ACCC and the NCC and be undertaken within a single national access and pricing regulator:

- the powers given to the NCC and the ACCC under the National Access Regime;
- the powers given to the NCC under the National Gas Law;
- the functions undertaken by the Australian Energy Regulator under the National Electricity Law and the National Gas Law;
- the telecommunications access and pricing functions of the ACCC;
- price regulation and related advisory roles under the *Water Act 2007* (Cth).

Consumer protection and competition functions should remain with the ACCC.

The access and pricing regulator should be established with a view to it gaining further functions as other sectors are transferred to national regimes.

The SME Committee sees the benefits of this particular recommendation, but believes a great deal more consultation needs to be undertaken before committing to such a change.

The fact that State governments are particularly strong supporters of a structural separation of the ACCC and AER is a compelling reason why the Harper Review should exercise considerable caution. The Committee suspects that State governments may in fact be supportive of this change because they hope or expect that a stand-alone regulator may take a less robust approach to regulation than is occurring currently.

Draft Recommendation 47— ACCC governance

The Panel believes that incorporating a wider range of business, consumer and academic viewpoints would improve the governance of the ACCC.

The Panel seeks views on the best means of achieving this outcome, including but not limited to, the following options:

- **replacing the current Commission with a Board comprising executive members, and non-executive members with business, consumer and academic expertise (with either an executive or non-executive Chair of the Board); or**
- **adding an Advisory Board, chaired by the Chair of the Commission, which would provide advice, including on matters of strategy, to the ACCC but would have no decision-making powers.**

The credibility of the ACCC could also be strengthened with additional accountability to the Parliament through regular appearance before a broadly-based Parliamentary Committee.

The SME Committee does not support the proposal to replace the current ACCC Commission with a Board comprising executive members. No compelling case has been made for such a change. Indeed, in our view, such a change would seriously weaken the effectiveness and independence of the ACCC. The Committee is concerned that Board appointments would become politicised, which would significantly undermine the independence of the ACCC.

The SME Committee believes that there is some merit in the second proposal – namely, to create an Advisory Board. Currently the ACCC has a number of advisory committees which have a broad membership base. However, in the SME Committee's view it is quite difficult to determine what contributions these existing advisory committees are making to the operations and direction of the ACCC. This is because these advisory committees do not publish reports or issue any minutes of their meetings with the ACCC.

The SME Committee believes that there is merit in establishing an Advisory Board which operates in a more transparent manner. For example, there should be a legislative requirement for the Advisory Board to prepare a separate annual report summarising its interactions with the ACCC. The Advisory Board should also be required to publish the minutes of its meetings with the ACCC, subject to appropriate confidentiality restrictions.

The SME Committee also believes that it is important for representatives of the peak legal bodies, such as the Law Council of Australia, and various State and Territory Law Societies and Bar Associations to have representation on this Advisory Board. The SME Committee thinks it is important for members of the Advisory Board to have both legal and business expertise if they are to make a valuable contribution to the ACCC's operations.

Draft Recommendation 48— Media Code of Conduct

The ACCC should also develop a Code of Conduct for its dealings with the media with the aim of strengthening the perception of its impartiality in enforcing the law.

The SME Committee strongly supports this recommendation.

The SME Committee believes it is vitally important for the ACCC to develop a Code of Conduct in relation to its media interactions. This Code should include an absolute prohibition on the ACCC commenting in any way on the merits of the cases which it has before the courts, particularly criminal prosecutions.

Draft Recommendation 49— Small business access to remedies

The ACCC should take a more active approach in connecting small business to alternative dispute resolution schemes where it considers complaints have merit but are not a priority for public enforcement.

The Panel invites views on whether there should be a specific dispute resolution scheme for small business for matters covered by the CCA.

Resourcing of the ACCC should allow it to test the law on a regular basis to ensure that the law is acting as a deterrent to unlawful behaviour.

The SME Committee believes the Harper Review should be putting forward more substantive recommendations in relation to this issue.

In our view, the Harper Review should initially try to identify ways in which small businesses can assert their legal rights in courts and tribunals in more cost effective ways, and then look to alternative avenues for better access to justice, such as through ADR.

One solution may be to explore the possibility of State and Territory tribunals being given jurisdiction to adjudicate in relation to simple competition law matters. Currently, many small businesses pursue ACL issues, including unconscionable conduct allegations, through State tribunals such as the NCAT, QCAT and VCAT, with some measure of success.

There is no reason in principle why a small business would not be able to pursue a complaint involving less complex competition law matters through a State tribunal. For example, a small business which was the subject of third line forcing or a resale price maintenance arrangement should be able to pursue that issue through a tribunal by seeking an order that the relevant agreement was void and unenforceable. Small businesses could also have the right to seek compensation from the tribunal in relation such conduct.

The SME Committee also believes that it would be feasible for tribunals to be called upon to adjudicate on small business complaints involving other types of exclusive dealing arrangements. In these matters, the small business would be required to demonstrate on the balance of probabilities that the particular conduct was likely to substantially lessen competition.

The primary concern about this proposal would be that most tribunals might not have sufficient expertise to deal with CCA provisions or concepts. However, these issues could be easily overcome by the provision of additional training to tribunal members.

Other options for improving small business access to justice would include encouraging the ACCC to pursue both pecuniary penalties and compensation as part of its CCA cases. Section 79B would then come into play, with the Court being required to give preference to compensation for the victims of the anti-competitive conduct, over the imposition of large pecuniary penalties.

Other options which could be explored include the introduction of US-style incentives for private actions, such as a right to treble damages awards and changes to the usual cost orders for competition law private actions – that is with costs to be born by each party rather than costs following the event.

Another initiative which could be explored is the creation of a pro-bono law firm panel for the provision of free competition and consumer law advice to small businesses. This would involve particular law firms with expertise in competition and consumer law matters being appointed to a pro-bono panel for the purpose of providing small businesses with initial free advice in relation to competition and consumer law issues. Through this process, many small businesses would be able to understand the reasons why their particular complaint may not raise an actionable breach of competition or consumer laws.

If on the other hand the small business complaint had merit, the pro-bono law firm could either:

(1) provide free legal advice to the small business about how to draft a simple complaint letter to the ACCC; or
(2) be engaged by the small business to draft an initial complaint letter to the ACCC raising the allegations.

This pro-bono panel could also be extended to providing free legal advice to small businesses which are the subject of an ACCC investigation or ACCC litigation. The firms would be expected to provide small businesses with advice on such issues as ACCC investigation processes, particularly in relation to the small business's legal obligations in responding to statutory notices as well as the legal implications of entering into a section 87B undertaking. Other areas of advice could include explaining to the small business their legal obligations in relation to substantiation notices, infringement notices and public warning notices.

Finally, the pro-bono law firms could be called upon to give free advice to small businesses which become involved in ACCC investigations or litigation either as a witness or as a recipient of an ACCC statutory notice or subpoena.

In relation to access to justice through mediation, the SME Committee notes that the various Small Business Commissioners already providing a very valuable mediation function to many small businesses. The SME Committee believes that these initiatives should be supported and if possible extended.

The SME Committee does not support the ACCC having a mediation role in relation to small business disputes. Such a role would invariably create conflicts of interests, which would blur the ACCC's role as an enforcement agency.

Having said this, the SME Committee believes that the ACCC could be more deliberate in terms of ensuring that it has exhausted all dispute resolution options before commencing any legal actions against a small business.

Draft Recommendation 50— Collective bargaining

The CCA should be amended to introduce greater flexibility into the notification process for collective bargaining by small business. One change would be to enable the group of businesses covered by a notification to be altered without the need for a fresh notification to be filed (although there ought to be a process by which the businesses covered by the notification from time to time are recorded on the ACCC's notification register).

The ACCC should take actions to enhance awareness of the exemption process for collective bargaining and how it might be used to improve the bargaining position of small businesses in dealings with large businesses.

The SME Committee agrees with this recommendation.

Draft Recommendation 51— Retail trading hours

The Panel notes the generally beneficial effect for consumers of deregulation of retail trading hours to date and the growth of online competition in some retail markets. The Panel recommends that remaining restrictions on retail trading hours be removed. To the extent that jurisdictions choose to retain restrictions, these should be strictly limited to Christmas Day, Good Friday and the morning of ANZAC Day.

The SME Committee understands the economic benefits associated with the deregulation of the retail trading hours.

However, the SME Committee notes that such changes are likely to have a particularly negative effect on existing retailers, the vast majority of which are likely to be small and medium sized businesses. Therefore, we think that it is important for the Harper Review to consider the impact of this proposed change on both consumers and small businesses.

Draft Recommendation 52— Pharmacy

The Panel does not consider that current restrictions on ownership and location of pharmacies are necessary to ensure the quality of advice and care provided to patients. Such restrictions limit the ability of consumers to choose where to obtain pharmacy products and services, and the ability of providers to meet consumers' preferences.

The Panel considers that the pharmacy ownership and location rules should be removed in the long-term interests of consumers. They should be replaced with regulations to ensure access and quality of advice on pharmaceuticals that do not unduly restrict competition.

Negotiations on the next Community Pharmacy Agreement offer an opportunity for the Australian Government to remove the location rules, with appropriate transitional arrangements.

The SME Committee understands the economic benefits associated with the deregulation of the pharmacy sector.
However, the SME Committee notes that such changes are likely to have a particularly negative effect the existing pharmacies, the vast majority of which are small businesses. Therefore, we think that it is important for the Harper Review to consider the impact of this proposed change on both consumers and the relevant small businesses

Further discussion

The SME Committee would be happy to discuss any aspect of this submission.

Please contact Coralie Kenny, the Chair of the SME Committee, on 0409 919 082 if you would like to do so.

Yours faithfully

John Keeves, Chairman
Business Law Section

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Via email: contact@competitionpolicyreview.gov.au

24 November 2014

Dear Sir or Madam,

Introduction

The Law Council of Australia, is the peak national body representing the legal profession in Australia.

The Small and Medium Enterprise Business Law Committee of the Business Law Section of the Law Council of Australia (SME Committee) makes this submission in response to the Draft Report, dated September 2014 released by the Competition Policy Review (Harper Review).

The SME Committee has as its primary focus the consideration of legal issues affecting small businesses and medium enterprises in the development of national legal policy in that domain. Its membership is comprised of legal practitioners who are extensively involved in legal issues affecting SMEs.

Please also note that our submissions may differ from those made by other Committees of the Law Council because of our Committee members' perspectives and experiences as advisers to SMEs.

Introductory comments

The SME Committee understands the size and complexity of the task set for the Harper Review in the Terms of Reference. Having said that, the SME Committee believes the Harper Review's Draft Report could benefit from further consideration of a number of important issues.

In the SME Committee's view, the Harper Review should carefully investigate and consider the actual policy objectives of the CCA, rather than accept as valid the often-repeated mantra that the overriding policy objective of the CCA is "to protect competition, not competitors". We will discuss this issue in more detail below.

The SME Committee also considers that the Draft Report should include practical ideas aimed at providing support and assistance to the small business sector. The SME Committee does not believe, as the Harper Review suggests in a number of places, that various of its recommendations will actually assist small businesses.

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In the SME Committee's view, many of the proposed recommendations in the Draft Report are more likely to further damage the ability of small businesses to compete with their larger competitors in the market place, rather than assisting small business. For example, the relaxation of trading hours and changes to planning and zoning laws will place small businesses under significantly greater competitive pressure in the marketplace, rather than assisting small business.

The SME Committee also believes that the Harper Review needs to gain a deeper understanding of the various pressures facing many small businesses. For example, one of the primary concerns of small businesses - namely that they are unable to buy goods from their suppliers at wholesale prices which are lower than the retail prices being offered for the same products by their major competitors - does not appear to be well understood by the Review.

Policy objective of the CCA

The Harper Review appears to have accepted the claim that the sole policy objective of the CCA is to "protect competition and not competitors". However, in the SME Committee's view, when one more carefully considers this question it becomes apparent that the policy objectives of the CCA are much broader and more multifaceted.

Section 2 of the CCA states:

> *The object of this Act is to enhance the welfare of Australian through the promotion of competition and fair trading and the provision of consumer protection.*

The CCA is aimed at the promotion of both competition and fair trading. It is implicit in the term "fair trading" that the CCA is aimed at preventing companies from engaging in unfair trading practices towards both consumers and their competitors.

The Second Reading Speech for the *Trade Practices Act* also makes it clear that the policy objective of the CCA involves a wider range of considerations than suggested in the Draft Report. As stated by the Hon. Senator Murphy on 30 July 1974:

> *The purpose of the Bill is to control restrictive trade practices and monopolisation and to protect consumers from unfair commercial practices. The Bill will replace the existing Restrictive Trade Practices Act, which has proved to be one of the most ineffectual pieces of legislation ever passed by this Parliament. The Bill will also provide on a national basis long overdue protection for consumers against a wide range of unfair practices. Restrictive trade practices have long been rife in Australia. Most of them are undesirable and have served the interests of the parties engaged in them, irrespective of whether those interests coincide with the interests of Australians generally. These practices cause prices to be maintained at artificially high levels. They enable particular enterprises or groups of enterprises to attain positions of economic dominance which are then susceptible to abuse; they interfere with the interplay of competitive forces which are the foundation of any market economy; they allow discriminatory action against small businesses, exploitation of consumers and feather-bedding of industries.*

In the view of the SME Committee, the policy objectives of the TPA/CCA are much broader than the promotion of competition, but rather extend to the removal of unfair practices including the prevention of discriminatory action against small businesses.

Similarly, Senator Murphy noted the policy objectives behind section 46 in his Second Reading speech:

> *The clause [46] covers various forms of conduct by a monopolist against his competitors or would-be competitors. A monopolist for this purpose is a person who substantially controls a market. The application of this provision will be a matter for the Court. An arithmetical test such as one third of the market- as in the existing legislation- is unsatisfactory. The certainty which it appears to give is illusory.*
>
> *Clause 46 as now drafted makes it clear that it does not prevent normal competition by enterprises that are big by, for example, their taking advantage of economies of scale or making full use of such skills as they have; the provision will prohibit an enterprise which is in a position to control a market from taking advantage of its market power to eliminate or injure its competitors.*
>
> *The provision will not apply merely because a person who is in a position to control a market engages in conduct within one of the classes set out in the clause. It will be necessary for the application of the clause that, in engaging in such conduct, the person concerned is taking advantage of the power that he has by virtue of being in a position to control the market. For example, a person in a position to control a market might use his power as a dominant purchaser of goods to cause a supplier of those goods to refuse to supply them to a competitor of the first mentioned person- thereby excluding him from competing effectively. In such circumstances the dominant person has improperly taken advantage of his power.*

Again, the policy objective behind section 46 was and is to prevent firms with market power from engaging in conduct which will eliminate or injure their competitors. Implicit in Senator Murphy's speech is a recognition that competition does not occur in a vacuum, but rather manifests itself in a practical sense through rivalrous behaviour between competing firms.

In the SME Committee's view, there is a need for better recognition and acknowledgement by the Harper Review of the multifaceted policy objectives behind the CCA. Of particular importance is recognition and acknowledgement of the clear policy objective of providing competitors, particularly small businesses, with protections from unfair trading and abuses of market power. In the Committee's view, such recognition and acknowledgement is essential for successful outcomes from the Review.

Small business protections

In the SME Committee's view, the debate concerning how to provide small businesses with a greater level of protection should focus less on ways of trying to "fix" section 46 of the CCA. In the Committee's view, section 46 at its best will only ever be a blunt instrument in terms of protecting small businesses from the abusive practices of larger firms.

The SME Committee believes that other proposed changes to the CCA and ACL are likely to provide small businesses with a much greater degree protection than continual tinkering with section 46.

For example, the recent cases taken by the ACCC against a supermarket chain for alleged unconscionable conduct show the ways in which these provisions may be used to provide protections to small and medium sized businesses. In the past, the ACCC was likely to have looked at the conduct described in these cases under section 46, rather than appreciating the potential of using the unconscionable conduct provisions to challenge such conduct.

The proposed extension of the Unfair Contract Terms legislation to business standard form contracts will also provide small businesses with greater protection in their dealings with larger businesses. Indeed, in the SME Committee's view, this particular legislative change is likely to have a profound effect in terms of improving the fairness of contractual relations between large and small businesses in Australia.

Finally, in the SME Committee's view, the introduction of a mandatory Grocery Code, along the lines of the UK Groceries Code, would also have a significant impact in terms of leveling the playing field between small/medium suppliers and the major grocery retailers.

Response to recommendations:

In the following, we will endeavour to respond to each of the recommendations made in your Draft Report:

Draft Recommendation 1— Competition principles

The Panel endorses competition policy that focuses on making markets work in the long-term interests of consumers. The following principles should guide Commonwealth, state and territory and local governments in implementing competition policy:

- legislative frameworks and government policies binding the public or private sectors should not restrict competition;
- governments should promote consumer choice when funding or providing goods and services and enable informed choices by consumers;
- the model for government provision of goods and services should separate funding, regulation and service provision, and should encourage a diversity of providers;
- governments should separate remaining public monopolies from competitive service elements, and also separate contestable elements into smaller independent business activities;
- government business activities that compete with private provision, whether for-profit or not-for-profit, should comply with competitive neutrality principles to ensure they do not enjoy a net competitive advantage simply as a result of government ownership;

- a right to third-party access to significant bottleneck infrastructure should be granted where it would promote a material increase in competition in dependent markets and would promote the public interest; and
- independent authorities should set, administer or oversee prices for natural monopoly infrastructure providers.

Applying these principles should be subject to a 'public interest' test, so that:

- the principle should apply unless the costs outweigh the benefits; and
- any legislation or government policy restricting competition must demonstrate that:
  - it is in the public interest; and
  - the objectives of the legislation or government policy can only be achieved by restricting competition.

The SME Committee agrees with this recommendation.

A simple way in which governments may encourage a diversity of providers is to ensure that contractual arrangements between government and small businesses are not overly complex and onerous. Many small businesses are deterred from seeking government work due to the complexity and one-sided nature of contractual arrangements, including the requirement to obtain excessive and expensive insurance coverage.

Draft Recommendation 2— Human services

Australian governments should craft an intergovernmental agreement establishing choice and competition principles in the field of human services.

The guiding principles should include:

- user choice should be placed at the heart of service delivery;
- funding, regulation and service delivery should be separate;
- a diversity of providers should be encouraged, while not crowding out community and voluntary services; and
- innovation in service provision should be stimulated, while ensuring access to high-quality human services.

Each jurisdiction should develop an implementation plan founded on these principles that reflects the unique characteristics of providing human services in its jurisdiction.

The SME Committee supports this recommendation.

The SME Committee would like to reiterate that the simplest way of encouraging a diversity of providers, including small business providers, is to ensure that contractual arrangements between governments and small businesses are not overly complex and onerous.

Draft Recommendation 3— Road transport

Governments should introduce cost-reflective road pricing with the aid of new technologies, with pricing subject to independent oversight and linked to road construction, maintenance and safety.

To avoid imposing higher overall charges on road users, there should be a cross-jurisdictional approach to road pricing. Indirect charges and taxes on road users should be reduced as direct pricing is introduced. Revenue implications for different levels of government should be managed by adjusting Commonwealth grants to the States and Territories.

The SME Committee understands the economic benefits associated with more efficient road pricing.

However, the SME Committee notes that such changes are likely to have a particularly negative effect on road transport operators, the vast majority of which are small and medium sized business. The SME Committee believes that many small and medium sized road transport operators would have considerable difficulty passing on the additional costs associated with "efficient road pricing" to their customers, particularly on to large retail customers.

Furthermore, we believe that this recommendation is likely to have a negative effect on the small business sector, in their capacity as a purchaser of goods, by raising their cost of goods.

Draft Recommendation 4— Liner shipping

The Australian Government should repeal Part X of the CCA.

A block exemption granted by the ACCC should be available for liner shipping agreements that meet a minimum standard of pro-competitive features (see Draft Recommendation 35). The minimum standard of pro-competitive features to qualify for the block exemption should be determined by the ACCC in consultation with shippers and the liner shipping industry.

Other agreements should be subject to individual authorisation by the ACCC.

Repeal of Part X will mean that existing agreements are no longer exempt from the competition provisions of the CCA. Transitional arrangements are therefore warranted.

A transitional period of two years should allow for authorisations to be sought and to identify agreements that qualify for the proposed block exemption.

The SME Committee agrees with this recommendation.

Part X is an anomaly, particularly as the Part does not require any analysis of the allegedly pro-competitive features of such agreements. In our view, there are few pro-competitive benefits from the day-to-day operation of Part X.

Draft Recommendation 5— Coastal shipping

Noting the current Australian Government Review of Coastal Trading, the Panel considers that cabotage restrictions should be removed, unless they can be shown to be in the public interest and there is no other means by which public interest objectives can be achieved.

The SME Committee agrees with this recommendation.

Cabotage restrictions are an anomaly. In the Committee's view, the cabotage restrictions are anti-competitive restrictions aimed at preserving employment opportunities for the members of a particular employee organisation.

Draft Recommendation 6— Taxis

States and Territories should remove regulations that restrict competition in the taxi industry, including from services that compete with taxis, except where it would not be in the public interest.

If restrictions on numbers of taxi licences are to be retained, the number to be issued should be determined by independent regulators focused on the interests of consumers.

The SME Committee understands the economic benefits associated with the deregulation of the taxi industry.

However, the SME Committee notes that such changes are likely to have a particularly negative effect on existing taxi operators, the vast majority of which are small businesses.

Draft Recommendation 7— Intellectual property review

The Panel recommends that an overarching review of intellectual property be undertaken by an independent body, such as the Productivity Commission.

The review should focus on competition policy issues in intellectual property arising from new developments in technology and markets.

The review should also assess the principles and processes followed by the Australian Government when establishing negotiating mandates to incorporate intellectual property provisions in international trade agreements.

Trade negotiations should be informed by an independent and transparent analysis of the costs and benefits to Australia of any proposed IP provisions. Such an analysis should be undertaken and published before negotiations are concluded.

The SME Committee agrees with this recommendation.

We believe that such a review is particularly timely given overseas developments in relation the use of intellectual property, primarily patents, to achieve anti-competitive outcomes in various industries, particularly in relation to pharmaceuticals and electronic devices.

Draft Recommendation 8— Intellectual property exception

The Panel recommends that subsection 51(3) of the CCA be repealed.

The SME Committee agrees with this recommendation.

We believe that such exceptions are not appropriate as they have the potential to exempt conduct which has significant anti-competitive effects.

Draft Recommendation 9— Parallel imports

Remaining restrictions on parallel imports should be removed unless it can be shown that:

- they are in the public interest; and
- the objectives of the restrictions can only be achieved by restricting competition.

The SME Committee understands the economic benefits associated with the removal of parallel import restrictions.

However, the SME Committee notes that a major beneficiary of such restrictions are small businesses, for example independent book sellers and music stores. In our view, one of the primary reasons why governments have maintained parallel import prohibitions is due to the concern that the removal of such laws may have a particularly devastating effect on various small business sectors.

Draft Recommendation 10— Planning and zoning

All governments should include competition principles in the objectives of planning and zoning legislation so that they are given due weight in decision-making.

The principles should include:

- a focus on the long-term interests of consumers generally (beyond purely local concerns);
- ensuring arrangements do not explicitly or implicitly favour incumbent operators;
- internal review processes that can be triggered by new entrants to a local market; and
- reducing the cost, complexity and time taken to challenge existing regulations.

Again, the SME Committee understands the economic benefits associated with the removal of planning and zoning restrictions.
However, the SME Committee notes that often the main beneficiaries of such restrictions are small businesses, for example independent grocery stores and specialty food retailers.

The Harper Review should note that one of the primary reasons why governments have preserved restrictions on planning and zoning laws is because of the concern that the removal of such laws may have a particularly devastating effect on various small business sectors.

Draft Recommendation 11— Regulation review

All Australian governments, including local government, should review regulations in their jurisdictions to ensure that unnecessary restrictions on competition are removed.

Regulations should be subject to a public benefit test, so that any policies or rules restricting competition must demonstrate that:

- they are in the public interest; and
- the objectives of the legislation or government policy can only be achieved by restricting competition.

Factors to consider in assessing the public interest should be determined on a case-by-case basis and not narrowed to a specific set of indicators.

Jurisdictional exemptions for conduct that would normally contravene the competition laws (by virtue of subsection 51(1) of the CCA) should also be examined as part of this review, to ensure they remain necessary and appropriate in their scope. Any further exemptions should be drafted as narrowly as possible to give effect to their policy intent.

The review process should be transparent, with highest priority areas for review identified in each jurisdiction, and results published along with timetables for reform.

The review process should be overseen by the proposed Australian Council for Competition Policy (see Draft Recommendation 39) with a focus on the outcomes achieved, rather than the process undertaken. The Australian Council for Competition Policy should conduct an annual review of regulatory restrictions and make its report available for public scrutiny.

The SME Committee agrees with this recommendation.

However, the SME Committee believes that as part of its consideration of the public benefit, any such regulation review should also consider the likely impact of changes on the small business sector. In our view, there is a likelihood that many of these regulations are driven by the broader policy objective of providing support and opportunities for local small and medium sized businesses.

Draft Recommendation 12— Standards review

Given the unique position of Australian Standards under paragraph 51(2)(c) of the CCA, the Australian Government's Memorandum of Understanding with Standards Australia should require that non-government mandated standards be reviewed according to the same process specified in Draft Recommendation 11.

The SME Committee supports this recommendation.

The SME Committee is aware of at least one situation some years ago where two large businesses sought to use their membership of an Australian Standards Committee to introduce an Australian Standard which would have eliminated import competition. In that case, the ACCC were successful in taking steps to prevent the conduct.

However, the SME Committee is concerned that large businesses may be able to use their membership of Australian Standards Committees to introduce Australian Standards which will unduly raise compliance costs for small business or may even have the effect of excluding imports from the market all together.

Draft Recommendation 13— Competitive neutrality policy

All Australian governments should review their competitive neutrality policies. Specific matters that should be considered include: guidelines on the application of competitive neutrality during

the start-up stages of government businesses; the period of time over which start-up government businesses should earn a commercial rate of return; and threshold tests for identifying significant business activities.

The review of competitive neutrality policies should be overseen by an independent body, such as the proposed Australian Council for Competition Policy (see Draft Recommendation 39).

The SME Committee agrees with this recommendation.

Draft Recommendation 14— Competitive neutrality complaints

All Australian governments should increase the transparency and effectiveness of their competitive neutrality complaints processes. This should include at a minimum:

- assigning responsibility for investigation of complaints to a body independent of government;
- a requirement for the government to respond publicly to the findings of complaint investigations; and
- annual reporting by the independent complaints bodies to the proposed Australian Council for Competition Policy (see Draft Recommendation 39) on the number of complaints received and investigations undertaken.

The SME Committee agrees with this recommendation.

A number of members of the SME Committee have been involved in the competitive neutrality complaint processes in the past. We agree that the government bodies responsible for investigating these complaints have generally not investigated such matters in a rigorous and transparent matter. A more transparent process is needed to remove any inference that the government agency investigating the competitive neutrality complaint has a conflict of interest.

A further concern is that the government agencies charged with investigating such competitive neutrality complaints often do not have appropriately trained investigatory staff. The SME Committee believes it is important therefore for the proposed Australian Council for Competition Policy to be appropriately staffed with trained investigators.

Draft Recommendation 15— Competitive neutrality reporting

To strengthen accountability and transparency, all Australian governments should require government businesses to include a statement on compliance with competitive neutrality principles in their annual reports.

The SME Committee agrees with this recommendation.

Greater transparency in competitive neutrality reporting is essential given past failures in this area.

Draft Recommendation 16— Electricity, gas and water

State and territory governments should finalise the energy reform agenda, including through:

- application of the National Energy Retail Law with minimal derogation by all National Electricity Market jurisdictions;
- deregulation of both electricity and gas retail prices; and
- the transfer of responsibility for reliability standards to a national framework.

The Panel supports moves to include Western Australia and the Northern Territory in the National Electricity Market, noting that this does not require physical integration.

All governments should re-commit to reform in the water sector, with a view to creating a national framework. An intergovernmental agreement should cover both urban and rural water and focus on:

- economic regulation of the sector; and
- harmonisation of state and territory regulations where appropriate.

Where water regulation is made national, the body responsible for its implementation should be the Panel's proposed national access and pricing regulator (see Draft Recommendation 46).

While SME Committee members do not have a great deal of expertise in these particular areas, we support this recommendation.

Draft Recommendation 17— Competition law concepts

The Panel recommends that the central concepts, prohibitions and structure enshrined in the current competition law be retained because they are the appropriate basis for the current and projected needs of the Australian economy.

While the SME Committee supports this recommendation, it reiterates its concerns about the apparent confusion throughout the Draft Report about the actual objects of the CCA. The objects of the CCA are not the promotion of competition to the exclusion of all else. Furthermore, there is no mention of the term "efficiency" in section 2.

We believe that it is unhelpful for groups to be advocating a view of the objects of the CCA which is incomplete and in some respects misleading. While the CCA is directed to promoting competition, it is also directed to the promotion of fair trading between businesses.

Draft Recommendation 18— Competition law simplification

The competition law provisions of the CCA should be simplified, including by removing overly specified provisions, which can have the effect of limiting the application and adaptability of competition laws, and by removing redundant provisions.

The Panel recommends that there be public consultation on achieving simplification.

Some of the provisions that should be removed include:

- subsection 45(1) concerning contracts made before 1977;
- sections 45B and 45C concerning covenants; and
- sections 46A and 46B concerning misuse of market power in a trans-Tasman market.

This task should be undertaken in conjunction with implementation of the other recommendations of this Review.

While the SME Committee agrees with this recommendation, it sees this change as inconsequential given the infrequent use of any of these provisions.

Draft Recommendation 19— Application of the law to government activities

The CCA should be amended so that the competition law provisions apply to the Crown in right of the Commonwealth and the States and Territories (including local government) insofar as they undertake activity in trade or commerce.

The SME Committee agrees with this recommendation.

The current tests for determining jurisdiction in relation to government activities are too complex. This recommendation will reduce this complexity.

Draft Recommendation 20— Definition of market

The current definition of 'market' in the CCA should be retained but the current definition of 'competition' should be re-worded to ensure that competition in Australian markets includes competition from goods imported or capable of being imported into Australia and from services supplied or capable of being supplied by persons located outside of Australia to persons located within Australia.

The SME Committee agrees with this recommendation.

The SME Committee is of the view that this recommendation would be a formalisation of current ACCC practice when it seeks to define the relevant market for the purposes of the CCA.

Draft Recommendation 21— Extra-territorial reach of the law

Section 5 of the CCA should be amended to remove the requirement that the contravening firm has a connection with Australia in the nature of residence, incorporation or business presence and to remove the requirement for private parties to seek ministerial consent before relying on extra-territorial conduct in private competition law actions.

The in-principle view of the Panel is that the removal of the foregoing requirements should also be removed in respect of actions under the Australian Consumer Law.

The SME Committee agrees with the first part of this recommendation.

We also agree that the requirement for a private party to seek ministerial consent before relying on the extra-territorial provisions should be removed.

Draft Recommendation 22— Cartel conduct prohibition

The prohibitions against cartel conduct should be simplified and the following specific changes made:

- the provisions should apply to cartel conduct affecting goods or services supplied or acquired in Australian markets;
- the provisions ought be confined to conduct involving firms that are actual competitors and not firms for whom competition is a mere possibility;
- a broad exemption should be included for joint ventures and similar forms of business collaboration (whether relating to the supply or the acquisition of goods or services), recognising that such conduct will be prohibited by section 45 of the CCA if it has the purpose, effect or likely effect of substantially lessening competition;
- an exemption should be included for trading restrictions that are imposed by one firm on another in connection with the supply or acquisition of goods or services (including IP licensing), recognising that such conduct will be prohibited by section 47 of the CCA (revised in accordance with Draft Recommendation 28) if it has the purpose, or has or is likely to have the effect or likely effect of substantially lessening competition.

The SME Committee agrees with this recommendation.

Draft Recommendation 23— Exclusionary provisions

The CCA should be amended to remove the prohibition of exclusionary provisions in subparagraphs 45(2)(a)(i) and 45(2)(b)(i).

The SME Committee does not agree with this recommendation. A compelling case has not been made for the repeal of these provisions.

Draft Recommendation 24— Price signalling

The 'price signalling' provisions of Division 1A of the CCA are not fit for purpose in their current form and should be repealed.

Section 45 should be extended to cover concerted practices which have the purpose, or would have or be likely to have the effect, of substantially lessening competition.

The SME Committee agrees that the 'price signalling' provisions of Division 1A of the CCA are inappropriate to the extent that they only apply to the banking sector. However, the SME Committee does not agree with the proposal to exclude public price signalling from the reach of the CCA.

As stated in our initial submission, our preferred approach in relation to price signalling is to introduce a general prohibition in relation to price signalling, which is in line with the law in both the US and the EU.

Draft Recommendation 25— Misuse of market power

The Panel considers that the primary prohibition in section 46 should be re-framed to prohibit a corporation that has a substantial degree of power in a market from engaging in conduct if the proposed conduct has the purpose, or would have or be likely to have the effect, of substantially lessening competition in that or any other market.

However, the Panel is concerned to minimise unintended impacts from any change to the provision that would not be in the long-term interests of consumers, including the possibility of inadvertently capturing pro-competitive conduct.

To mitigate concerns about over-capture, the Panel proposes that a defence be introduced so that the primary prohibition would not apply if the conduct in question:

- would be a rational business decision or strategy by a corporation that did not have a substantial degree of power in the market; and
- the effect or likely effect of the conduct is to benefit the long-term interests of consumers.

The onus of proving that the defence applies should fall on the corporation engaging in the conduct.

The Panel seeks submissions on the scope of this defence, whether it would be too broad, and whether there are other ways to ensure anti-competitive conduct is caught by the provision but not exempted by way of a defence.

Such a re-framing would allow the provision to be simplified. Amendments introduced since 2007 would be unnecessary and could be repealed. These include specific provisions prohibiting predatory pricing, and amendments clarifying the meaning of 'take advantage' and how the causal link between the substantial degree of power and anti-competitive purpose may be determined.

The SME Committee is somewhat surprised that the Harper Review in its Draft Report has recommended making such significant changes to section 46 without first discussing whether the section is currently operating effectively, particularly given the data provided in our submission and a number of other submissions about the ACCC's success in pursuing section 46 cases. The Harper Review seems to have assumed the section is not working effectively and that, as a result, requires major changes.

The SME Committee believes it is incumbent on the Harper Review to consider and then determine whether there is a particular problem with the operation of particular legislation before recommending significant changes. In our view, there is a crucial difference between, on

the one hand, legislation which is ineffective due to its drafting and, on the other hand, legislation which is effective but which is not being enforced often enough.

The SME Committee does not believe that the Harper Review's proposed changes to section 46 will make it easier for the ACCC to pursue section 46 cases. Rather in our view, the proposed changes will make it harder for the ACCC to be successful in section 46 cases.

First, the introduction of a substantial lessening of competition test is likely to make the provision more difficult for both the ACCC and private litigants to bring successful actions.

Second, the proposal to introduce two defences in section 46 will make the provision all but unworkable.

In the SME Committee's view, the first proposed defence (ie whether the conduct would be a rational business decision by a corporation that did not have a substantial degree of market power) is simply the reintroduction of the taking advantage limb as a defence. In our view, this change will do nothing to improve the Court's ability to interpret and apply this concept.

In our view, the second defence (ie whether the conduct in question would be likely to have the effect of advancing the long-term interests of consumers) is also unworkable because of its scope is too broad and open-ended.

The SME Committee believes that a straightforward prohibition on a firm with a substantial degree of market power using its market power for the purpose or effect of damaging or preventing competition by competitors in a market would be preferable.

If the Harper Review was committed to the idea of introducing a defence, the preferred approach would be to introduce a general business justification defence along the lines of the test which is applied in US monopolization cases.

The SME Committee is also concerned at the Harper Review's apparent cursory treatment of the question of whether a divestiture remedy should be introduced for proven breaches of section 46.

First, there is no discussion in the Draft Report of the various situations where the remedy has been used in the US and whether the remedy was used successfully in those cases to achieve pro-competitive outcomes.

Second, it appears to the SME Committee that the Harper Review has assumed that the use of a divestiture remedy "is likely to have broader impacts on the efficiency of the firm." There is simply no basis for stating that a divestiture remedy is "likely" to have this effect.

In our view the Harper Review would benefit from undertaking a more rigorous and in-depth analysis of the arguments for and against the introduction of a divestiture remedy for proven breaches of section 46.

Draft Recommendation 26— Price discrimination

A specific prohibition on price discrimination should not be reintroduced into the CCA. Where price discrimination has an anti-competitive impact on markets, it can be dealt with by the existing provisions of the law (including through the recommended revisions to section 46, see Draft Recommendation 25).

Attempts to prohibit international price discrimination should not be introduced into the CCA on account of significant implementation and enforcement complexities and the risk of negative unintended consequences. Instead, the Panel supports moves to address international price discrimination through market solutions that empower consumers. These include the removal of restrictions on parallel imports (see Draft Recommendation 9) and ensuring that consumers are able to take legal steps to circumvent attempts to prevent their access to cheaper legitimate goods.

While the SME Committee does not support the reintroduction of a specific price discrimination provision, it considers the Harper Review would benefit from discussing this important issue more rigorously.

As stated above, a major problem which many small businesses face is that they are unable to buy products from their suppliers at a wholesale price which is lower than the retail prices being offered for the same products by their major retail competitors. It is important for the Harper Review to fully investigate and gain an understanding of this problem before dismissing any potential solutions.

Draft Recommendation 27— Third-line forcing test

The provisions on 'third-line forcing' (subsections 47(6) and (7)) should be brought into line with the rest of section 47. Third-line forcing should only be prohibited where it has the purpose, or has or is likely to have the effect, of substantially lessening competition.

The SME Committee does not agree with this recommendation.

The SME Committee understands that the Harper Review has evaluated third line forcing through the lens of competition law. However, in our view, there is an equally valid way of considering the prohibition on third line forcing – namely that it promotes freedom of contract.

In the Committee's view, the prohibitions in subsections 47(6) and (7) are aimed at preventing interference with freedom of contract. In other words, these provisions preserve the freedom of a party not to have to agree to purchase goods or services which they do not want or need from a party, whom they do not want to contract with.

Furthermore, the Committee suggests that the Harper Review should consider the likely effect that this recommendation will have in the marketplace. We believe that if this recommendation were to be implemented there would be a dramatic upsurge of tied sales in a wide range of industries. Furthermore, it is likely that the main group which would end up being subject to such tied arrangements would be small businesses.

Draft Recommendation 28— Exclusive dealing coverage

Section 47 should apply to all forms of vertical conduct rather than specified types of vertical conduct.

The provision should be re-drafted so it prohibits the following categories of vertical conduct concerning the supply of goods and services:

- supplying goods or services to a person, or doing so at a particular price or with a particular discount, allowance, rebate or credit, subject to a condition imposed on the person that has the purpose, or has or is likely to have the effect, of substantially lessening competition; and
- refusing to supply goods or services to a person, or at a particular price or with a particular discount, allowance, rebate or credit, for the reason that the person has not agreed to a condition imposed on the person that has the purpose, or has or is likely to have the effect, of substantially lessening competition.

The provision should also prohibit the following two reciprocal categories of vertical conduct concerning the acquisition of goods and services:

- acquiring goods or services from a person, or doing so at a particular price or with a particular discount, allowance, rebate or credit, subject to a condition imposed on the person that has the purpose, or has or is likely to have the effect, of substantially lessening competition; and
- refusing to acquire goods or services from a person, or at a particular price or with a particular discount, allowance, rebate or credit, for the reason that the person has not agreed to a condition imposed on the person that has the purpose, or has or is likely to have the effect, of substantially lessening competition.

The SME Committee agrees with this recommendation. The existing provisions of section 47 are unnecessarily complex.

Draft Recommendation 29— Resale price maintenance

The prohibition on resale price maintenance (RPM) should be retained in its current form as a per se prohibition, but the notification process should be extended to include resale price maintenance

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

The SME Committee does not agree with this recommendation for the same reasons it does not agree with the recommendation concerning third line forcing.

The SME Committee understands that the Harper Review has evaluated resale price maintenance (RPM) through the lens of competition law. However, in our view, there is an equally valid way of considering the prohibition on RPM – namely that it promotes freedom of contract.

In the Committee's view, the prohibition on RPM is aimed at preventing interference with freedom of contract. In other words, these provisions preserve the freedom of a party to sell a

product, which they have purchased and in which they have title, at any price that they wish, rather than being forced to sell the product at a price determine by another party.

Again, the SME Committee considers the Harper Review would benefit from considering the likely effect of the implementation of this recommendation in the marketplace. We believe that if this recommendation were to be implemented there would be a dramatic upsurge of the incidence of RPM. Again, it is likely that the main group which would end up being subject to RPM would be small businesses.

Draft Recommendation 30— Mergers

There should be further consultation between the ACCC and business representatives with the objective of delivering more timely decisions in the informal review process.

The formal merger exemption processes (i.e. the formal merger clearance process and the merger authorisation process) should be combined and reformed to remove unnecessary restrictions and requirements that may have deterred their use. The specific features of the review process should be settled in consultation with business, competition law practitioners and the ACCC. However, the general framework should contain the following elements:

- the ACCC should be the decision-maker at first instance;
- the ACCC should be empowered to approve a merger if it is satisfied that the merger does not substantially lessen competition or it is satisfied that the merger results in public benefits that outweigh the anti-competitive detriments;
- the formal process should not be subject to any prescriptive information requirements, but the ACCC should be empowered to require the production of business and market information;
- the formal process should be subject to strict timelines that cannot be extended except with the consent of the merger parties; and
- decisions of the ACCC should be subject to review by the Australian Competition Tribunal under a process that is also governed by strict timelines.

The SME Committee does not agree with this recommendation.

It appears to the Committee that the effect of this recommendation will be to further curtail the timelines available to the ACCC under the formal merger exemption processes. In our view, these timelines, particularly the merger authorization timeframes, are already too short to allow proper consideration of the competitive effects of mergers.

Section 50 of the CCA is aimed at preventing mergers which will or are likely to have the effect of substantially lessening competition. The use of the word “likely” suggests a legislative intention for the ACCC and the Australian Competition Tribunal to err on the side of caution and to block mergers which “may” lessen competition.

In our view, shortening the timelines under the CCA will make it even more difficult for the ACCC to obtain the evidence it requires to prevent anti-competitive mergers.

The SME Committee also believes that the Harper Review would benefit from giving more detailed consideration to the processes which apply overseas, which generally have much longer timelines than exist in Australia.

Draft Recommendation 31— Secondary boycotts enforcement

The ACCC should include in its annual report the number of complaints made to it in respect of secondary boycott conduct and the number of such matters investigated and resolved each year.

The SME Committee believes the Harper Review would benefit from a more robust treatment of secondary boycott enforcement. For example, the Harper Review should have undertaken a deeper analysis of the ACCC's record in enforcing secondary boycott provisions. There was considerable information provided to the Harper Review about this issue in submissions, particularly in the Committee's initial submission.

While the SME Committee agrees with this recommendation, the more important issue which the Harper Review Committee should consider is whether jurisdiction over secondary boycotts should remain with the ACCC or be transferred to a specialist body. In our view, this is the issue of primary importance in relation to secondary boycott laws.

Draft Recommendation 32— Secondary boycotts proceedings

Jurisdiction in respect of the prohibitions in sections 45D, 45DA, 45DB, 45E and 45EA should be extended to the state and territory Supreme Courts.

The SME Committee understands that the State and Territory Supreme Courts do have jurisdiction in relation to these provisions.

Draft Recommendation 33— Restricting supply or acquisition

The present limitation in sections 45E and 45EA, such that the prohibitions only apply to restrictions affecting persons with whom an employer 'has been accustomed, or is under an obligation' to deal with, should be removed.

The Panel invites further submissions on possible solutions to the apparent conflict between the CCA and the Fair Work Act including:

- **a procedural right for the ACCC to be notified by the Fair Work Commission of proceedings for approval of workplace agreements which contain potential restrictions of the kind referred to in sections 45E and 45EA, and to intervene and make submissions;**
- **amending sections 45E and 45EA so that they expressly include awards and enterprise agreements; and**
- **amending sections 45E, 45EA and possibly paragraph 51(2)(a) to exempt workplace agreements approved under the Fair Work Act.**

While the SME Committee agrees with this recommendation, it does not consider that there is a significant practical problem in relation to the perceived overlap between the CCA and the FWA.

Draft Recommendation 34— Authorisation and notification

The authorisation and notification provisions in the CCA should be simplified:

- to ensure that only a single authorisation application is required for a single business transaction or arrangement; and
- to empower the ACCC to grant an exemption (including for per se prohibitions) if it is satisfied that either the proposed conduct is unlikely to substantially lessen competition or that the proposed conduct is likely to result in a net public benefit.

The SME Committee agrees with this recommendation.

Draft Recommendation 35— Block exemption power

Exemption powers based on the block exemption framework in the UK and EU should be introduced to supplement the authorisation and notification frameworks.

While the SME Committee is generally supportive of this recommendation, it is keen to see further detail about how this particular recommendation would operate in practice.

Draft Recommendation 36— Section 155 notices

The ACCC should review its guidelines on section 155 notices having regard to the increasing burden imposed by notices in the digital age.

Either by law or guideline, the requirement of a person to produce documents in response to a section 155 notice should be qualified by an obligation to undertake a reasonable search, taking into account factors such as the number of documents involved and the ease and cost of retrieving the documents.

The SME Committee agrees that the ACCC should update its guidelines in relation to section 155 and understands that the ACCC is already in the process of undertaking such an update.

However, the SME Committee does not agree with the proposal to qualify the obligations required under section 155 to require the recipient to undertake a "reasonable search". Section 155 is intended to be a powerful investigatory tool which the ACCC seeks to use to obtain potentially incriminating evidence about serious contraventions of the CCA. In our view, the section 155 power should not be "watered down" be allowing recipients to define what constitutes a reasonable search and rather should continue to require recipients to undertake a thorough and exhaustive search.

The SME Committee believes the Harper Review would benefit from gaining a better understanding of the way in which other leading anti-trust/competition regulators conduct their investigations into cartels and other serious competition law breaches. It is almost standard practices for leading regulators overseas to commence the overt phase of their investigations with the execution of a search warrant (in the US) or by conducting a dawn raid (in the EU). Furthermore, in the USA, the Department of Justice works closely with in the Federal Bureau of Investigation in its cartel investigations, while also making extensive use of the grand jury system.

The SME Committee believes there is a strong case that the ACCC's investigatory powers, particularly in relation to serious cartel conduct, need to be strengthened rather than weakened.

Draft Recommendation 37— Facilitating private actions

Section 83 should be amended so that it extends to admissions of fact made by the person against whom the proceedings are brought in addition to findings of fact made by the court.

The SME Committee agrees with this recommendation.

However, the Committee believes that much more has to be done to facilitate private actions. In this regard, the Committee believes that the Harper Review should consider other more meaningful ways of seeking to facilitate private actions, such as allowing treble damages awards and making changes to the usual costs rules which apply in litigation.

The SME Committee is of the view that it is important for the Harper Review to carefully consider the implications of section 79B of the CCA which states that the Court is required to give preference to an order of compensation over the award of a pecuniary penalty under section 76. As far as the Committee is aware, a Court has never been called upon to exercise this jurisdiction, primarily because the ACCC does not generally seek both a pecuniary penalty and compensation in its cases under the CCA.

An interesting question is whether Parliament's decision to enact section 79B could be interpreted as a directive to the ACCC that it should be seeking to pursue both pecuniary penalties and compensation as part of its cases under the CCA. If the ACCC were to take this approach, it seems to the SME Committee that the Courts would be required to give preference to the payment of compensation to victims over the imposition of a large pecuniary penalty against the firm/s.

In the SME Committee's view, if the ACCC were to pursue both pecuniary penalties and compensation as part of its proceedings, this would provide a significant benefit to small and medium sized businesses. Small and medium sized businesses are often the victims of

competition law contraventions, particularly cartel conduct and misuses of market power. If the ACCC were to take this more expansive approach to their litigation, it is likely that many small and medium-sized business would be in a much better position to receive compensation as well as being spared the cost and frustration of commencing their own private or class actions.

Draft Recommendation 38— National Access Regime

The declaration criteria in Part IIIA should be targeted to ensure that third-party access only be mandated where it is in the public interest. To that end:

- criterion (a) should require that access on reasonable terms and conditions through declaration promote a material increase in competition in a dependent market;
- criterion (b) should require that it be uneconomical for anyone (other than the service provider) to develop another facility to provide the service; and
- criterion (f) should require that access on reasonable terms and conditions through declaration promote the public interest.

The Competition Principles Agreement should be updated to reflect the revised declaration criteria.

The Australian Competition Tribunal should be empowered to undertake merits review of access decisions while maintaining suitable statutory time limits for the review process.

The Panel invites further comment on:

- **the categories of infrastructure to which Part IIIA might be applied in the future, particularly in the mining sector, and the costs and benefits that would arise from access regulation of that infrastructure; and**
- **whether Part IIIA should be confined in its scope to the categories of bottleneck infrastructure cited by the Hilmer Review.**

While members of the SME Committee do not have a great deal of expertise in this area, we are generally supportive of this recommendation.

Draft Recommendation 39— Establishment of the Australian Council for Competition Policy

The National Competition Council should be dissolved and the Australian Council for Competition Policy established. Its mandate should be to provide leadership and drive implementation of the evolving competition policy agenda.

The Australian Council for Competition Policy should be established under legislation by one State and then by application in all other States and the Commonwealth. It should be funded jointly by the Commonwealth, States and Territories.

Treasurers, through the Standing Committee of Federal Financial Relations, should oversee preparation of an intergovernmental agreement and subsequent legislation, for COAG agreement, to establish the Australian Council for Competition Policy.

The Treasurer of any jurisdiction should be empowered to nominate Members of the Australian Council for Competition Policy.

The SME Committee supports this recommendation.

An organization such as the ACCP is required as an advocate for competition policy. It is not appropriate for a law enforcement agency such as the ACCC to be called on or expected to provide policy advice to government. Policy advice in relation to competition law should be the exclusive domain of a policy agency, such as the ACCP.

Indeed, there is an argument that the remit of the ACCP should be extended to include consumer protection policy and provide a small business perspective. In this way, the ACCC would not be required or expected to provide government with policy advice on consumer protection or small business issues.

Draft Recommendation 40— Role of the Australian Council for Competition Policy

The Australian Council for Competition Policy should have a broad role encompassing:

- advocate and educator in competition policy;
- independently monitoring progress in implementing agreed reforms and publicly reporting on progress annually;
- identifying potential areas of competition reform across all levels of government;
- making recommendations to governments on specific market design and regulatory issues, including proposed privatisations; and
- undertaking research into competition policy developments in Australia and overseas.

The SME Committee agrees with this recommendation. The proposed role of the ACCP is appropriate.

Draft Recommendation 41— Market studies power

The proposed Australian Council for Competition Policy should have the power to undertake competition studies of markets in Australia and make recommendations to relevant governments on changes to regulation or to the ACCC for investigation of potential breaches of the CCA.

The Panel seeks comments on the issue of mandatory information-gathering powers and in particular whether the PC model of having information-gathering powers but generally choosing not to use them should be replicated in the Australian Council for Competition Policy.

The SME Committee supports the recommendation to create a market studies function. In the Committee's view, the ACCP is the appropriate body to carry out such reviews. The Committee also believes that the ACCP should have mandatory information gathering powers.

It is also important for the ACCP to be appropriately resourced with adequately trained staff so that it can properly carry out its market studies function.

Draft Recommendation 42— Market studies requests

All governments, jointly or individually, should have the capacity to issue a reference to the Australian Council for Competition Policy to undertake a competition study of a particular market or competition issue.

All market participants, including small business and regulators (such as the ACCC), should have the capacity to request market studies be undertaken by the Australian Council for Competition Policy.

The work program of the Australian Council for Competition Policy should be overseen by the Ministerial Council on Federal Financial Relations to ensure that resourcing addresses priority issues.

The SME Committee supports this recommendation.

Draft Recommendation 43— Annual competition analysis

The Australian Council for Competition Policy should be required to undertake an annual analysis of developments in the competition policy environment, both in Australia and internationally, and identify specific issues or markets that should receive greater attention.

The SME Committee agrees with this recommendation, subject to the ACCP being required to seek input from the ACCC about areas which it considers to be of particular importance.

Draft Recommendation 44— Competition payments

The Productivity Commission should be tasked to undertake a study of reforms agreed to by the Commonwealth and state and territory governments to estimate their effect on revenue in each jurisdiction.

If disproportionate effects across jurisdictions are estimated, the Panel favours competition policy payments to ensure that revenue gains flowing from reform accrue to the jurisdictions undertaking the reform.

Reform effort would be assessed by the Australian Council for Competition Policy based on actual implementation of reform measures, not on undertaking reviews.

The SME Committee agrees with this recommendation.

Draft Recommendation 45— ACCC functions

Competition and consumer functions should be retained within the single agency of the ACCC.

The SME Committee agrees with this recommendation.

In our view, no compelling case has been made for separating the ACCC's competition and consumer functions into two separate agencies. Indeed, over recent years there has been a great deal of evidence which demonstrates the synergies which exist between the ACCC's competition

law and consumer law functions. This is particularly true in terms of the interrelationship between section 46 and the unconscionable conduct provisions.

Draft Recommendation 46— Access and pricing regulator functions

The following regulatory functions should be transferred from the ACCC and the NCC and be undertaken within a single national access and pricing regulator:

- the powers given to the NCC and the ACCC under the National Access Regime;
- the powers given to the NCC under the National Gas Law;
- the functions undertaken by the Australian Energy Regulator under the National Electricity Law and the National Gas Law;
- the telecommunications access and pricing functions of the ACCC;
- price regulation and related advisory roles under the *Water Act 2007* (Cth).

Consumer protection and competition functions should remain with the ACCC.

The access and pricing regulator should be established with a view to it gaining further functions as other sectors are transferred to national regimes.

The SME Committee sees the benefits of this particular recommendation, but believes a great deal more consultation needs to be undertaken before committing to such a change.

The fact that State governments are particularly strong supporters of a structural separation of the ACCC and AER is a compelling reason why the Harper Review should exercise considerable caution. The Committee suspects that State governments may in fact be supportive of this change because they hope or expect that a stand-alone regulator may take a less robust approach to regulation than is occurring currently.

Draft Recommendation 47— ACCC governance

The Panel believes that incorporating a wider range of business, consumer and academic viewpoints would improve the governance of the ACCC.

The Panel seeks views on the best means of achieving this outcome, including but not limited to, the following options:

- **replacing the current Commission with a Board comprising executive members, and non-executive members with business, consumer and academic expertise (with either an executive or non-executive Chair of the Board); or**
- **adding an Advisory Board, chaired by the Chair of the Commission, which would provide advice, including on matters of strategy, to the ACCC but would have no decision-making powers.**

The credibility of the ACCC could also be strengthened with additional accountability to the Parliament through regular appearance before a broadly-based Parliamentary Committee.

The SME Committee does not support the proposal to replace the current ACCC Commission with a Board comprising executive members. No compelling case has been made for such a change. Indeed, in our view, such a change would seriously weaken the effectiveness and independence of the ACCC. The Committee is concerned that Board appointments would become politicised, which would significantly undermine the independence of the ACCC.

The SME Committee believes that there is some merit in the second proposal – namely, to create an Advisory Board. Currently the ACCC has a number of advisory committees which have a broad membership base. However, in the SME Committee's view it is quite difficult to determine what contributions these existing advisory committees are making to the operations and direction of the ACCC. This is because these advisory committees do not publish reports or issue any minutes of their meetings with the ACCC.

The SME Committee believes that there is merit in establishing an Advisory Board which operates in a more transparent manner. For example, there should be a legislative requirement for the Advisory Board to prepare a separate annual report summarising its interactions with the ACCC. The Advisory Board should also be required to publish the minutes of its meetings with the ACCC, subject to appropriate confidentiality restrictions.

The SME Committee also believes that it is important for representatives of the peak legal bodies, such as the Law Council of Australia, and various State and Territory Law Societies and Bar Associations to have representation on this Advisory Board. The SME Committee thinks it is important for members of the Advisory Board to have both legal and business expertise if they are to make a valuable contribution to the ACCC's operations.

Draft Recommendation 48— Media Code of Conduct

The ACCC should also develop a Code of Conduct for its dealings with the media with the aim of strengthening the perception of its impartiality in enforcing the law.

The SME Committee strongly supports this recommendation.

The SME Committee believes it is vitally important for the ACCC to develop a Code of Conduct in relation to its media interactions. This Code should include an absolute prohibition on the ACCC commenting in any way on the merits of the cases which it has before the courts, particularly criminal prosecutions.

Draft Recommendation 49— Small business access to remedies

The ACCC should take a more active approach in connecting small business to alternative dispute resolution schemes where it considers complaints have merit but are not a priority for public enforcement.

The Panel invites views on whether there should be a specific dispute resolution scheme for small business for matters covered by the CCA.

Resourcing of the ACCC should allow it to test the law on a regular basis to ensure that the law is acting as a deterrent to unlawful behaviour.

The SME Committee believes the Harper Review should be putting forward more substantive recommendations in relation to this issue.

In our view, the Harper Review should initially try to identify ways in which small businesses can assert their legal rights in courts and tribunals in more cost effective ways, and then look to alternative avenues for better access to justice, such as through ADR.

One solution may be to explore the possibility of State and Territory tribunals being given jurisdiction to adjudicate in relation to simple competition law matters. Currently, many small businesses pursue ACL issues, including unconscionable conduct allegations, through State tribunals such as the NCAT, QCAT and VCAT, with some measure of success.

There is no reason in principle why a small business would not be able to pursue a complaint involving less complex competition law matters through a State tribunal. For example, a small business which was the subject of third line forcing or a resale price maintenance arrangement should be able to pursue that issue through a tribunal by seeking an order that the relevant agreement was void and unenforceable. Small businesses could also have the right to seek compensation from the tribunal in relation such conduct.

The SME Committee also believes that it would be feasible for tribunals to be called upon to adjudicate on small business complaints involving other types of exclusive dealing arrangements. In these matters, the small business would be required to demonstrate on the balance of probabilities that the particular conduct was likely to substantially lessen competition.

The primary concern about this proposal would be that most tribunals might not have sufficient expertise to deal with CCA provisions or concepts. However, these issues could be easily overcome by the provision of additional training to tribunal members.

Other options for improving small business access to justice would include encouraging the ACCC to pursue both pecuniary penalties and compensation as part of its CCA cases. Section 79B would then come into play, with the Court being required to give preference to compensation for the victims of the anti-competitive conduct, over the imposition of large pecuniary penalties.

Other options which could be explored include the introduction of US-style incentives for private actions, such as a right to treble damages awards and changes to the usual cost orders for competition law private actions – that is with costs to be born by each party rather than costs following the event.

Another initiative which could be explored is the creation of a pro-bono law firm panel for the provision of free competition and consumer law advice to small businesses. This would involve particular law firms with expertise in competition and consumer law matters being appointed to a pro-bono panel for the purpose of providing small businesses with initial free advice in relation to competition and consumer law issues. Through this process, many small businesses would be able to understand the reasons why their particular complaint may not raise an actionable breach of competition or consumer laws.

If on the other hand the small business complaint had merit, the pro-bono law firm could either:

(1) provide free legal advice to the small business about how to draft a simple complaint letter to the ACCC; or
(2) be engaged by the small business to draft an initial complaint letter to the ACCC raising the allegations.

This pro-bono panel could also be extended to providing free legal advice to small businesses which are the subject of an ACCC investigation or ACCC litigation. The firms would be expected to provide small businesses with advice on such issues as ACCC investigation processes, particularly in relation to the small business's legal obligations in responding to statutory notices as well as the legal implications of entering into a section 87B undertaking. Other areas of advice could include explaining to the small business their legal obligations in relation to substantiation notices, infringement notices and public warning notices.

Finally, the pro-bono law firms could be called upon to give free advice to small businesses which become involved in ACCC investigations or litigation either as a witness or as a recipient of an ACCC statutory notice or subpoena.

In relation to access to justice through mediation, the SME Committee notes that the various Small Business Commissioners already providing a very valuable mediation function to many small businesses. The SME Committee believes that these initiatives should be supported and if possible extended.

The SME Committee does not support the ACCC having a mediation role in relation to small business disputes. Such a role would invariably create conflicts of interests, which would blur the ACCC's role as an enforcement agency.

Having said this, the SME Committee believes that the ACCC could be more deliberate in terms of ensuring that it has exhausted all dispute resolution options before commencing any legal actions against a small business.

Draft Recommendation 50— Collective bargaining

The CCA should be amended to introduce greater flexibility into the notification process for collective bargaining by small business. One change would be to enable the group of businesses covered by a notification to be altered without the need for a fresh notification to be filed (although there ought to be a process by which the businesses covered by the notification from time to time are recorded on the ACCC's notification register).

The ACCC should take actions to enhance awareness of the exemption process for collective bargaining and how it might be used to improve the bargaining position of small businesses in dealings with large businesses.

The SME Committee agrees with this recommendation.

Draft Recommendation 51— Retail trading hours

The Panel notes the generally beneficial effect for consumers of deregulation of retail trading hours to date and the growth of online competition in some retail markets. The Panel recommends that remaining restrictions on retail trading hours be removed. To the extent that jurisdictions choose to retain restrictions, these should be strictly limited to Christmas Day, Good Friday and the morning of ANZAC Day.

The SME Committee understands the economic benefits associated with the deregulation of the retail trading hours.

However, the SME Committee notes that such changes are likely to have a particularly negative effect on existing retailers, the vast majority of which are likely to be small and medium sized businesses. Therefore, we think that it is important for the Harper Review to consider the impact of this proposed change on both consumers and small businesses.

Draft Recommendation 52— Pharmacy

The Panel does not consider that current restrictions on ownership and location of pharmacies are necessary to ensure the quality of advice and care provided to patients. Such restrictions limit the ability of consumers to choose where to obtain pharmacy products and services, and the ability of providers to meet consumers' preferences.

The Panel considers that the pharmacy ownership and location rules should be removed in the long-term interests of consumers. They should be replaced with regulations to ensure access and quality of advice on pharmaceuticals that do not unduly restrict competition.

Negotiations on the next Community Pharmacy Agreement offer an opportunity for the Australian Government to remove the location rules, with appropriate transitional arrangements.

The SME Committee understands the economic benefits associated with the deregulation of the pharmacy sector.
However, the SME Committee notes that such changes are likely to have a particularly negative effect the existing pharmacies, the vast majority of which are small businesses. Therefore, we think that it is important for the Harper Review to consider the impact of this proposed change on both consumers and the relevant small businesses

Further discussion

The SME Committee would be happy to discuss any aspect of this submission.

Please contact Coralie Kenny, the Chair of the SME Committee, on 0409 919 082 if you would like to do so.

Yours faithfully

John Keeves, Chairman
Business Law Section

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The Empirical Effects of Minimum Resale Price Maintenance

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This paper also can be downloaded without charge from the
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The Empirical Effects of Minimum Resale Price Maintenance

Alexander MacKay and David Aron Smith*

June 16, 2014

This study is the first to estimate the empirical effects of minimum resale price maintenance (RPM) across a broad variety of products. We analyze conflicting theories using an exogenous state-level law change resulting from the 2007 *Leegin* Supreme Court decision. In states where RPM contracts are treated under the more relaxed rule-of-reason standard, prices increased. We estimate the welfare impact and find that, in aggregate, consumers are worse off in the rule-of-reason states. Though welfare decreased and prices increased, we find little support for the broad application of any particular theory.

JEL Classification: L42, D22, L10, D40, K21

For much of the past century, minimum resale price maintenance (RPM) contracts have been illegal in the United States. For that reason, empirical analysis on the effect of vertical price agreements is sparse. As noted in the literature, "the absence of significant empirical evidence is surely the greatest remaining impediment to a comprehensive analysis of RPM" (Marvel and McCafferty, 1985). This paper advances the analysis of RPM by providing the first estimates of empirical effects across a broad range of goods and by conducting tests of multiple candidate theories.

There is disagreement in the existing literature over the effects of minimum RPM on consumer welfare. The welfare-reducing view contends that vertical

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price agreements allow firms to exert market power. Several studies, such as Shepard (1978), Ornstein and Hanssens (1987), and Mueller and Geithman (1991) find evidence of such anticompetitive effects in limited product markets.[1] The opposing view is that RPM contracts can solve market failures and incentivize non-contractible behavior by retailers, enhancing consumer welfare. Ippolito (1991) identifies many RPM cases where procompetitive theory is likely to apply.

What has yet to be understood is the relative impact of the procompetitive and anticompetitive effects to consumers. Antitrust policy is determined at the state or federal level, and as such, it impacts products that have great variety in market structure. There is almost certainly heterogeneity in effects across different kinds of products. We contribute to the literature by offering the first paper to quantify the aggregate impacts of RPM across a broad variety of products. Under our assumptions, we identify the policy-relevant treatment effect of relaxing the legal treatment of RPM to a rule of reason. This effect is of interest to consumer welfare advocates such as state legislators and attorneys general, as well as to manufacturers and retailers that may want a broader understanding of the legal landscape when considering vertical price agreements.

Further, we identify products that are likely to have been affected by the change in RPM policy using a statistical approach. Within the products we identify, we test specific implications of different theories. This detailed, theory-based analysis of empirical effects is essential for understanding the motivation behind RPM contracts. This paper provides the first such analysis across several competing theories. Though our findings on this front are limited by the data, we hope that it serves as a guide to future research.

The 2007 Supreme Court decision in *Leegin*[2] established that minimum RPM agreements should be judged under a rule-of-reason standard, rather than being per se illegal[3] at the federal level. Because states vary both in their adherence to federal precedent and in their statutes regarding vertical price agreements, the decision resulted in state-by-state variation in the treatment of minimum RPM. This state-level variation allows us to identify the impact of minimum RPM on the prices and quantities of various products.

Using a relatively new dataset on consumer purchases over time and by state, we design a natural experiment to estimate the effects of *Leegin* on product

[1] For the purposes of this paper, we use a consumer welfare standard for the terms anticompetitive and procompetitive.

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

[3] A per se violation means that the conduct is prohibited whether or not there is evidence of harm.

prices and quantities. Treatment states are those that adhere strongly to federal precedent and have no state laws forbidding vertical price agreements. In these states, *Leegin* changed the legal standard for judging RPM to a rule of reason. Control states are those that have laws forbidding vertical price agreements. These laws supersede the *Leegin* decision and limit its impact on the legal standard in control states.

Our results indicate that prices and quantities have indeed changed as a result of *Leegin*. We find that 8.4 percent of products exhibited a statistically significant price increase in our treatment states, with a median increase of 5.3 percent. Additionally, 9.4 percent of products experienced declining quantities. As a result of *Leegin,* products were most likely to see a price increase combined with a quantity decrease. This combination indicates movement along the demand curve and suggests the exercise of market power. We estimate an overall price increase of 0.33 percent and an overall quantity decrease of 3.8 percent.

In addition to estimating the effects on prices and quantities, we estimate how the change in policy affects consumer welfare. We use a simple demand model to estimate a decrease in revenue and a net consumer welfare decrease of 3.1 percent.

Multiple candidate theories explain the motivations, costs, and benefits of RPM contracts, with no empirical studies to test which theories are representative of the real world.[4] In the words of Mathewson and Winter (1998), "What is the empirical evidence to differentiate across these candidate explanations? The answer is that there is not a great deal of evidence." Our main results give weight to the anticompetitive theories of minimum RPM. In addition, we test the implications of the leading procompetitive and anticompetitive theories, and we do not find broad support for the predictions of any particular theory. We believe that our results are muted by observing a mix of multiple theories across different products, but we do find that the retailer concentration is an important determinant of effective RPM policy in general. We hope these results guide future research into product-specific effects of RPM and help state antitrust divisions and legislators to assess the benefits and costs of vertical pricing agreements.

[4]For a detailed discussion, see Elzinga and Mills (2008, 2010) and Gilligan (1986).

1. Background

1.1. Dr. Miles and Leegin

After the Supreme Court's 1911 decision in *Dr. Miles*,[5] RPM was considered a per se violation under Section 1 of the Sherman Act, with some statutory exemptions.[6] In the 1950s, state fair trade laws provided firms with opportunities to create RPM contracts. During this period, the use of such contracts was extensive. Studies of RPM in the 1950s—a period of legal minimum RPM in the U.K. as well—found that almost 44 percent of consumer expenditures in the U.K. and up to 10 percent of expenditures in the U.S. were on goods subject to RPM (Overstreet, 1983). In 1975, the Consumer Goods Pricing Act[7] put state fair-trade laws back within the prohibitions of the Sherman Act, rendering RPM once more illegal. For a legal history of minimum RPM in the U.S., see Moloshok (2007).

On June 28, 2007, the Court ruled in *Leegin* that minimum RPM was no longer per se illegal.[8] In the decision, the Court acknowledged that minimum RPM agreements can increase interbrand competition and encourage the provision of demand-enhancing services. Such vertical price agreements can benefit consumers. The Court maintained that per se treatment should be reserved for categories of agreements that would almost always damage competition. As a result of *Leegin*, antitrust investigators must provide evidence of quantifiable competitive harm in order to file suit.

Roughly one year after *Leegin*, reports of "price-fixing" among firms utilizing minimum RPM began hitting newsstands. Firms mentioned in these articles include manufacturers and suppliers of childcare and maternity gear, light fixtures and home accessories, pet food and supplies, and rental cars. Sony has publicly used minimum RPM on electronics such as camcorders and video game consoles, and as of mid-2012, Sony and Samsung began enforcing minimum RPM on their televisions.[9] Other retailers do not comment on whether or not they enter minimum RPM agreements, perhaps due to negative consumer sentiment associated

[5] *Dr. Miles Med. Co. v. John D. Park & Sons*, 220 U.S. 373 (1911).

[6] See Overstreet (1983). Limited exceptions were later allowed under *Colgate* and *General Electric*. The *Colgate* decision allowed a firm to unilaterally announce a given price and withhold products from discounting retailers.

[7] Pub. L. No. 94-145, 89 Stat. 801

[8] The Supreme Court made a similar decision regarding maximum RPM in *State Oil Co. v. Khan.* 522 U.S. 35 (1997)

[9] See Ann Zimmerman, "Sony, Samsung Rein In Retailers' Discounts on TVs," *The Wall Street Journal*, May 23, 2012, available at http://online.wsj.com/article/SB10001424052702304791704577420383631021786.html (accessed November 2012).

with higher prices.[10]

This policy change has generated activity from legislators at the state and federal level. In October of 2009, Maryland passed a bill explicitly making minimum RPM agreements illegal under state law.[11] In response to a Kansas trial court decision, the Kansas House of Representatives passed a bill in 2012 explicitly allowing a rule-of-reason treatment of minimum RPM. The bill was subsequently defeated in the State Senate. Since *Leegin*, Senator Herb Kohl, whose family founded and operated the national Kohl discount chain until the 1980s, has on three separate occasions introduced bills in the Senate "to restore the rule that agreements between manufacturers and retailers, distributors, or wholesalers to set the minimum price below which the manufacturer's product or service cannot be sold violates the Sherman Act."[12]

Prominent antitrust institutions and consumer welfare advocates have also argued for the repeal of *Leegin*. The bills introduced by Senator Kohl in 2009 were endorsed by former FTC Chairman Robert Pitofsky and then-FTC Commissioner Pamela Jones Harbour. In addition, the attorneys general of 38 states submitted joint letters to Congress urging enactment of the 2009 Senate and House bills—up from the 34 state attorneys general supporting the 2007 Senate bill.[13] Consumer groups and non-governmental organizations urging the legislative repeal of *Leegin* include the American Antitrust Institute, the Consumer Federation of America, the Consumers Union, the National Consumers League, and the U.S. Public Interest Research Group.[14]

The *Leegin* decision has sparked interest in the antitrust community, extending to international policy as well.[15] However, limited empirical work has been done since the *Leegin* decision. The only recent empirical study of minimum RPM looks at video game prices after the enactment of the 2009 law that banned

[10]See, for example, Joseph Pereira, "Price-Fixing Makes Comeback After Supreme Court Ruling," *The Wall Street Journal*, August 18, 2008, available at http://online.wsj.com/article/SB121901920116148325.html (accessed November 2012).

[11]Annotated Code of Maryland Commercial Law §11-204(a)(1) (2009).

[12]Discount Pricing Consumer Protection Act, S. 2261, 110th Cong. (2007); Discount Pricing Consumer Protection Act, S. 148, 111th Cong. (2009); Discount Pricing Consumer Protection Act, S. 75, 112th Cong. (2011). Similar bills were also introduced into the House: Discount Pricing Consumer Protection Act of 2009, H.R. 3190, 111th Cong. (2009); Discount Pricing Consumer Protection Act of 2011, H.R. 3406, 112th Cong. (2011). None of the bills had been brought to a vote.

[13]See Table 15 for a list of states associated with the letters to Congress.

[14]See Joint Letter to Subcommittee on Courts and Competition Policy, Committee on the Judiciary, House of Representatives (May 18, 2009), http://www.antitrustinstitute.org/files/RPM%20Letter%20to%20Johnson5.18_051920091041.pdf (accessed July 2012).

[15]See, for example, Competition Policy International's second October issue of the Antitrust Chronicle.

RPM in Maryland, using nearby Virginia as a control (Bailey and Leonard, 2010). The authors find no statistically or economically significant effect on prices. This is not surprising, as a law enacted in a single state to ban RPM is likely to reflect an environment already hostile to such agreements. Indeed, Maryland's Assistant Attorney General Alan Barr was an outspoken opponent to minimum RPM at the time of the law's passage. Our paper contributes to the discussion by providing a broad empirical analysis and evaluations of different theories.

1.2. Theories of Minimum RPM

The theoretical literature on resale price maintenance can be divided into procompetitive and anticompetitive theories, where "procompetitive" means demand-enhancing and "anticompetitive" means an exercise in market power (i.e., a shift along the demand curve). For an insightful analysis of the theories, see Klein (2009).

1.2.1. Procompetitive Theories

Price increases accompanied by increasing quantities are indicative of procompetitive uses of minimum RPM, as they are likely the result of increases in demand, increased distribution, or increased inventories.[16] The following theories explain different ways this can occur.

- Enhancing Retailer Services by Solving the Free-Rider Problem

  By restricting price competition between retailers, RPM can incentivize firms to engage in nonprice competition by offering additional services, which may include knowledgeable personnel, in-store advertisements and displays, and post-sale services. These services increase consumer demand, which in turn increases product sales, benefiting the retailer, the manufacturer, and the consumer. The free-rider problem argues that some of these welfare-enhancing services may not be offered without the enforcement of minimum RPM. For example, shoppers may pass through service-providing retailers to gather information, only to purchase the good from a discount

[16] As explained in Marvel and McCafferty (1985) and Deneckere et al. (1996, 1997), it is not necessarily the case that prices will increase as a result of RPM. If the costs of retailer services are fixed rather than variable in the long-run, and if these services result in an isoelastic increase in demand, prices will not increase. Additionally, under the Adequate Inventories theory discussed below, the quantity-weighted average price may decrease under RPM. If prices were to fall after RPM was legalized, it would be difficult to determine if RPM was the cause. However, it still would be evidence that the rule-of-reason legality of RPM is not harmful.

retailer that can price lower as a result of saving on services. By preventing discounting, RPM eliminates the discount retailer's price advantage, solves this free-rider problem, and can increase total welfare.[17] For products where these services are important, such as televisions, computers, and refrigerators, RPM can result in a increase in quantity in addition to an increase in price.[18] Minimum RPM has become increasingly important for brick-and-mortar stores like Best Buy due to the recent growth of online retailers and warehouse club operators, such as Amazon.com, eBay, and Costco Wholesale.[19] Online retailers may be reluctant to sign RPM agreements, as a key comparative advantage over their brick-and-mortar competitors is lower prices Fabricius (2007).

- Enhancing Retailer Services via Implicit Contracts

  Klein and Murphy (1997) interpret a manufacturer's RPM policy as a "contract enforcement mechanism" to ensure that retailers supply demand-enhancing services that are not contractible and are not likely to exist otherwise. Due to monitoring costs, it is not practical to write and enforce contracts based on the retailer's performance of these services. RPM incentivizes firms to promote the products in order to meet a quantity threshold, which is easier for the manufacturer to monitor than the actual services. Dealers are motivated to comply by the future premiums received from the increased price. This use of RPM solves cases where dealers engage in free riding between the dealer and the manufacturer, in addition to the free riding among dealers discussed above.

- Increasing Retailer Distribution

  When demand is positively related to the number of retail outlets, the manufacturer has an incentive to increase the distribution of the product. The higher margin guaranteed by RPM allows outlets that would otherwise be unprofitable to sell the product. Klein (2009) provides the release of Windows 95 as an example, where Microsoft more than doubled the number of outlets from the previous release of Windows to obtain "the broadest possible distribution." Consumers benefit because they can obtain the product

[17] See Scherer (1983) and Klein (2009) for a theoretical justification of this argument. Marvel and McCafferty (1984) extend the argument beyond services into product quality, arguing that retailers with established reputations effectively certify quality for products they sell, and that RPM combined with a manufacturer's refusal to sell to low-quality stores prevents free-riding on retailer reputation.

[18] See Telser (1960) and Mathewson and Winter (1998) for more details on this theory.

[19] See Lieber and Syverson (2012) for growth rates of the online retail sector, and Basker (2007) for a discussion of Costco's growth.

more easily and they may receive additional value if reputation or network effects are present. We test this theory via two measures of distribution in Section 4.3.

- Adequate Inventories under Uncertain Demand

  Manufacturers may use the increased margins from RPM to incentivize retailers to carry larger inventories. RPM prevents retailers from slashing prices to near zero in the state of low demand, which limits losses and encourages retailers to increase their inventory. Increased inventory reduces shortages when demand is high and benefits consumers as a whole.[20] Without minimum RPM, individual retailers have an incentive to drop prices in the state of low demand, which does not increase the aggregate quantity sold but instead steals sales from other retailers. This outcome is similar to the outcome describe in Prescott's "hotels" model (Prescott, 1975). If shortages occur, minimum RPM can be Pareto improving, and the quantity-weighted average price may even fall.[21] If retailers carry sufficient inventory on their own accord, implementing minimum RPM can transfer welfare from consumers to manufacturers without affecting total welfare. The adequate inventory theory of RPM is particularly applicable when demand is highly variable or when inventories are perishable or costly to carry. We run a test for this theory in Section 4.4.

1.2.2. Anticompetitive Theories

The *Leegin* Court identified four sources of potential anticompetitive effects. If RPM is being used anticompetitively, we would expect to find price increases followed by quantity decreases. Such effects are evidence that RPM is being used to transfer welfare from consumers to either manufacturers or retailers, or both. The following theories explain how this can happen. In Section 4.2 we analyze the empirical evidence for each of these potential causes.

- Downstream Collusion

  RPM may be used to help facilitate the establishment and enforcement of a price-fixing cartel of retailers. This requires that the cartel of retailers

[20] There are distribution effects for consumers. Consumers purchasing the product when demand is low pay a higher price under minimum RPM, whereas consumers purchasing the product when demand is high benefit from fewer shortages.

[21] Without RPM, non-discount retailers offset losses from unsold products in the low state of demand by charging higher prices in the high state of demand. See Deneckere et al. (1996, 1997) for more details on this theory.

have monopsony power to ensure compliance from the manufacturer.[22]

- Upstream Collusion

  Manufacturers in a cartel could use RPM as a vehicle to reduce the profitability of offering secret discounts to retailers, thus reducing the benefit of defection. RPM also could discourage a manufacturer from cutting prices to retailers, which would remove the concomitant benefit of cheaper prices to consumers.[23] With many retail prices now available online, defection may be easier to detect. Websites such as MAPtrackers.com are devoted to "creating an easy and effective way for the monitoring of product prices across the Internet."[24]

- Exclusion of Rivals

  Rather than using additional margins to incentivize retail services, larger manufacturers may use RPM to reduce retailer incentives to carry competing products, particularly from smaller rivals or new entrants. In variations of this theory, accommodating entry results in lower retailer profits.[25]

- Forestalled Innovation

  A dominant retailer may request RPM from a manufacturer to "forestall innovation in distribution that decreases costs," thus preventing consumer-enhancing innovation by competing retailers.[26]

1.3. Minimum Advertised Price Policies as an Alternative to RPM

In practice, many firms implement minimum advertised price (MAP) policies. These policies are often attempts to actually enforce RPM, and in these instances no distinction can be made between the two kinds of policies. In many cases, however, MAP policies intend to do what the name would suggest: enforce a minimum advertised price, but allow for discounting once the customer is inside of the store. MAP policies of this nature may achieve the same procompetitive ends as RPM policies, as the restriction on advertised prices limits intrabrand competition among retailers. In addition to value-adding services, retailers can use in-store discounts to further enhance interbrand competition. We look at the support for MAP policies combined with in-store discounts in Section 4.5.

[22] See Overstreet (1983) and Rey and Vergé (2010) for formal treatments of this theory.
[23] See Jullien and Rey (2007) and Rey and Vergé (2010) for formal treatments of this theory.
[24] http://maptrackers.com/about_us.php, accessed August, 2012.
[25] See Marvel and McCafferty (1985) and Asker and Bar-Isaac (2013) for more details on this theory.
[26] See Overstreet (1983) and Marvel and McCafferty (1985) for more details on this theory.

2. Data and Empirical Methodology

2.1. Experimental Design

We evaluate price and quantity changes using a natural experiment: the law change of the *Leegin* Supreme Court decision. We use the variation in existing state law on minimum RPM to identify the impact of a regime change from per se illegality to a rule-of-reason standard. Fifteen states fall into our treatment group ("Rule of Reason" states), and nine states are identified as a control group ("Per Se" states). We use a regression analysis that controls for pre-period differences, common trends, state fixed effects, and macroeconomic variables. Our pre period is the year before the *Leegin* decision, and we analyze a two-year period starting six months after the decision.

We claim that the observed effects are from a change in the legal environment. Though we do not directly observe contracts, there is anecdotal evidence that these agreements are taking place (see Section 1). Furthermore, agreements are not necessary to cause firms to change behavior. The legal right to create and enforce such contracts may be enough to raise prices. For example, it is less costly for firms to unilaterally set price floors[27] as prosecutors and plaintiffs must now show consumer harm in addition to demonstrating that the unilateral action was in fact an agreement. Finally, we believe that our instrument is exogenous. The state statues regarding vertical price agreements and the ties between state and federal law were in place for decades before the Supreme Court decided to hear *Leegin*.[28] We do not expect states to have adopted language guiding judges to adhere to federal precedent in anticipation of a federal decision on minimum RPM. Any increase in prices is likely due to the change in legal environment resulting from *Leegin*, rather than the years-old politics that led to state-level adherence to federal law or restrictions on price agreements.

2.2. Assigning States to Treatment and Control

By selecting a group of states that are likely to treat minimum RPM under the rule of reason, we can observe how prices changed in the states where firms can most safely take advantage of the permissive environment provided by *Leegin*. These states are our treatment group. Similarly, by selecting a group of states likely to treat minimum RPM as per se illegal, we can observe how prices have

[27] Unilateral price floors were previous allowed under the *Colgate* exception.

[28] Many of these state statutes specifying the ties to federal antitrust law or specifically outlawing minimum RPM contracts were passed in the 1970s. See Duncan and Guernsey (2007) for details on the relevant state laws and statutes.

changed absent a change in law. These states are our control group. To assign states to one of these two groups, we follow the legal analysis of Duncan and Guernsey (2007) and Lindsay (2007, 2009). States with existing statues that effectively prohibit RPM presumably did not change the legal treatment as a result of *Leegin*, and are in the control group. States that, by law, adhere strongly to federal precedent, form the treatment group. These states should have adopted the rule of reason espoused in the *Leegin* decision.

For firms to benefit from agreements enforcing minimum RPM in a given region, there must be reason to believe that their behavior will not be deemed illegal by federal or state authorities. After *Leegin*, firms can safely assume that the mere existence of a minimum RPM agreement is not illegal at the federal level. Due to differences in state laws, however, minimum RPM is not treated uniformly across the country. Every state has its own antitrust statutes or consumer protection laws that regulate anticompetitive conduct, and most states do not specify whether they treat vertical pricing agreements as per se illegal. In addition, there are varying degrees to which courts in a given state are expected to follow federal precedent when interpreting statutes and laws. Some states have language in their the business and commercial codes guiding state judges to closely adhere to federal precedent. Texas law, for example, provides that its antitrust laws "shall be construed in harmony with federal judicial interpretations of comparable federal antitrust statutes to the extent consistent with this purpose." In other states, a lack of any relevant statutes or decisions from the highest state court makes it uncertain how courts will use federal precedent to interpret state laws. See Table 15 for a summary of federal adherence and minimum RPM law by state, and see Lindsay (2009) for a chart of state statues and legal decisions related to minimum RPM.

While no state had explicitly outlawed minimum RPM as of 2007, there were a number of states whose laws indicated that they would treat instances of minimum RPM as per se illegal. For example, California's Cartwright Act prohibiting trusts has been described as creating "perhaps the strongest case to be made for an existing state prohibition on minimum RPM agreements" (Lindsay, 2007). According to Duncan and Guernsey (2007), there are "eleven states whose antitrust and trade regulation statues appear to go beyond the Sherman Act in prohibiting vertical price-fixing."[29] For all but two of these states, there was no legal challenge to minimum RPM that would affect firm behavior during the

[29]The states are California, Connecticut, Kansas, Mississippi, Montana, Nevada, New Hampshire, Ohio, South Carolina, Tennessee, and West Virginia. Maryland passed a law in 2009 explicitly prohibiting minimum RPM, but as this was near the end of our data, it was excluded.

relevant period (2007-2009).[30] For these nine states, their respective attorneys general signed letters to both the House of Representatives and the Senate in support of the 2007 and 2009 bills outlawing minimum RPM. With the exception of the Nevada attorney general, they also signed the amicus brief in *Leegin* urging the Supreme Court to keep minimum RPM per se illegal under the Sherman Act. These acts by the attorneys general indicate that they are not friendly to firms engaging in minimum RPM. We group together these nine states as Per Se states, and we assume that firms do not change their behavior in these states as a result of *Leegin*.

Of the states that do not have state-specific laws against vertical pricing agreements, eighteen have laws that strongly or moderately strongly adhere to federal precedent as a guide for interpreting their own antitrust and consumer protection laws (Duncan and Guernsey, 2007; Lindsay, 2009).[31] We exclude Michigan from this group because it joined Illinois and New York in a 2008 lawsuit against Herman Miller regarding suggested resale prices.[32] Though the case ultimately ended in a settlement, the lawsuit indicated that the complaining states disapprove of vertical pricing restrictions. We also exclude Alaska and Hawaii because they are not included in the Nielsen data. The remaining fifteen states[33] make up the Rule of Reason group. Figure 2 shows a map of the United States with the Per Se group indicated in dark gray and the Rule of Reason group in light gray. Each group is diverse with respect to geographic location, which gives us greater confidence that our results are general.

2.3. Nielsen Consumer Panel Data

To perform the analysis in this paper, we use a relatively new longitudinal dataset: the Nielsen Consumer Panel Data.[34] These data include purchases across all retailers that are logged by consumers using an optical scanner. They

[30] In *Spahr v. Leegin Creative Leather Products*, No. 07-CV-187, 2008 WL 3914461 (E.D. Tenn. Aug. 20, 2008), a federal district court in Tennessee dismissed a complaint alleging that Leegin's RPM agreements with independent resellers violated federal and Tennessee law, effectively rejecting per se treatment of minimum RPM. In *O'Brien v. Leegin Creative Leather Products Inc.,* No. 04-CV-1668 (Kan. 8th Dist. July 9, 2008), a Kansas trial court rejected a per se analysis of a minimum RPM agreement and concluded that the state Supreme Court would apply the rule of reason. Because these cases were decided during the relevant period, we ignore these two states in our analysis.

[31] See Table 15 for this identification by state.

[32] *New York v. Herman Miller, Inc.*, 08-cv-2977 (S.D.N.Y. Mar. 25, 2008).

[33] Alabama, Delaware, Florida, Idaho, Iowa, Massachusetts, Missouri, Nebraska, New Mexico, Oklahoma, Pennsylvania, Rhode Island, Texas, Virginia, and Wisconsin.

[34] The dataset is available through the Kilts-Nielsen Data Center at The University of Chicago Booth School of Business. Information on availability and access to the data is available at http://research.chicagobooth.edu/nielsen.

include a number of variables per item, such as Universal Product Code (UPC), description, brand, price, retail chain code, and the first three digits of the retailer zip code.[35] The intent of the data is to provide a representative sample of consumer purchases between 2004 and 2009 that are intended for personal, in-home use. Nielsen estimates that roughly 30 percent of household consumption is accounted for by the categories in the dataset. Importantly for this paper, the dataset captures sales for products previously subjected to minimum RPM by manufacturers.[36] Further, the theories of RPM are quite general; firms have an incentive to exercise market power for any product, and nearly all retail outlets engage in promotional activity of some kind, whether through product placement or employee training.

Each of the 1.4 million unique products is organized by Nielsen into one of ten departments, and one of 1,082 product modules.[37] See Table 1 for summary statistics by department. Modules are fairly specific categories, such as "Brandy," "Light Beer," "Sleeping Aids," etc. For our analysis, we evaluate changes separately for each product module. Because the theories of RPM concern products that are branded by the manufacturer, we ignore private label or store-brand products sold exclusively by a single retailer. Roughly 29% of products are considered private label, and they are particularly represented in the Dairy, Deli, and Frozen Foods Departments.

2.4. Identifying Changes in Prices and Quantity

We implement a separate difference-in-differences model for each product module to determine the price change resulting from the *Leegin* decision:

$$\begin{aligned}\ln P_{jrst} = \alpha + \beta_1 ror_s + \beta_2 L_t + \gamma(ror_s \times L_t) + \phi \cdot macro_{st} \\ + \sum_{j'} \delta_{j'} prod_{j'} + \sum_{r'} \eta_{r'} ret_{r'} + \sum_{s'} \xi_{s'} st_{s'} + \sum_{t'} \lambda_{t'} wk_{t'} + \varepsilon_{jrst}.\end{aligned} \tag{1}$$

We control for macroeconomic variables to account for differential macroeconomic variation over the period analyzed. In this equation, $\ln P_{jsrt}$ is the log

[35] Store IDs and three-digit zip codes are provided for 33.7 percent of the 55.5 million trips in our dataset and 46 percent of the product-level observations used in our main regressions. For the other trips, we impute states using the state of the household. Within our dataset, for trips where we have the store location, 95.2 percent of purchases are made within the same state of the household. By using store zip codes where they are available and consumer states otherwise, this should result in a roughly 3 percent mismatch for states.

[36] See Overstreet (1983) and Ippolito (1991) for examples of products that allegedly have been subject to minimum RPM. See Gilligan (1986) for a list of manufacturers alleged to have utilized minimum RPM.

[37] Department code 99 ("Magnet Data") consists of 36 products without a UPC code. As there is limited information about these products, they are not used in our analysis.

price of product j sold by retailer r in state s and week t; ror_s is an indicator variable that takes the value of 1 if s is in the Rule of Reason treatment group, and 0 for states grouped as Per Se[38]; L_t is an indicator variable that takes the value of 1 after the *Leegin* decision (June 28, 2007); $macro_{st}$ is a vector of state-month log measures of total population, population unemployed, per-capita income, and gasoline prices; $prod_{j\prime}$ is an indicator variable that takes on the value of 1 if $j = j'$ and zero otherwise; $ret_{r'}$ is an indicator variable that takes on the value of 1 if the product is sold by retailer r and zero otherwise; $st_{s'}$ is an indicator variable that takes on the value of 1 if the product is sold in state s and zero otherwise; $wk_{t'}$ is an indicator variable that takes on the value of 1 if $t = t'$; ε_{jrst} is an error term. The standard difference-in-differences coefficients on ror_s and L_t are redundant with time and state fixed effects; we drop the extra covariates during estimation.

To calculate the price of a product, we take a quantity-weighted average price by state for each retailer. Our time period consists of the twelve months before *Leegin* and the two years starting six months after *Leegin*. We leave out the six months following *Leegin*, as we consider this to be a transition period for firms choosing to implement minimum RPM. Only products with sales in both the first three and last three months of our time period are included to control for any change in the mix of products offered. We run regressions with product, retailer, state, and time fixed effects, along with the aforementioned BLS and gas price covariates. We are interested in the estimate for γ, which can be interpreted as the post-*Leegin* impact on prices in states with a rule-of-reason regime. We convert the coefficients, which are in log points, to percentages. We use a similar model to determine the change in quantity resulting from the *Leegin* decision:

$$\begin{aligned}\ln Q_{jrst} = \alpha + \beta_1 ror_s + \beta_2 L_t + \mu(ror_s \times L_t) + \phi \cdot macro_{st} \\ + \sum_{j'} \delta_{j'} prod_{j'} + \sum_{r'} \eta_{r'} ret_{r'} + \sum_{s'} \xi_{s'} st_{s'} + \sum_{t'} \lambda_{t'} wk_{t'} + \varepsilon_{jrst}.\end{aligned} \tag{2}$$

Here, $\ln Q_{jrst}$ is the log quantity of product j purchased at retailer r in state s and week t. Our coefficient of interest in (2) is now μ, to reduce confusion. For both models, we drop regressions with zero degrees of freedom.

Following the recommendation of Cameron et al. (2008), we implement a Wild bootstrap procedure to evaluate the significance of our estimates. We run restricted regressions with the null hypothesis of no effect imposed (i.e., γ and μ set equal to 0). We then create artificial data by applying Rademacher weights to the resulting residuals by cluster. We run regressions (1) and (2) using 200

[38]See Section 2.2 for details on state treatment.

samples of the bootstrapped data to construct p-values.

3. Results for Prices and Quantities

In this section, we address the question of whether the *Leegin* decision had an impact on manufacturer and retailer behavior at the basic level of prices and quantities.

3.1. Summary of Price Changes

A simple examination of product prices, shown in Figure 1, reveals that prices have increased in Rule of Reason states relative to Per Se states since *Leegin*.[39] Each time series is simple average across Laspeyres quantity-weighted price indices for each product module.[40] The price paths are similar before the *Leegin* decision and diverge starting in 2008. The similarity in the pre-decision price paths mitigates concerns that treatment is exogenous.

We examine whether the changes are statistically significant in Table 2. For each module and treatment group, we use the Laspeyres indices to compare the first half of 2007 and the last half of 2009 by department. The overall difference in mean price is 1.1 percent, which has a p-value of 0.036 for the one-sided test. This differential change in prices is consistent with the increased use of RPM policies.

3.2. Main Results - Price and Quantity Effects

Our main results—those from equations (1) and (2)—can be found in Tables 3 and 4, respectively. We find a large number of statistically significant price increases across departments, both as a percentage of all modules and as relative to the number of price decreases.

Of the 986 modules tested, 8.4 percent exhibited statistically significant price increases in Rule of Reason states. On the other hand, only 5.3 percent of modules saw significant price decreases. Further, 58.6 percent of all price coefficients were positive. The magnitude of the median significant price increase within each department ranged from 1.9 percent to 10.2 percent. The results with respect to quantities were also notable: 9.4 percent of modules exhibited a significant

[39] The time series is calculated in six-month periods. The base period is the first half of 2007, before the *Leegin* decision. We keep only UPCs that have positive quantities in the first half of 2007 and the second half of 2009, for both treatment and control.

[40] Quantities are adjusted using a projection factor provided by Nielsen to account for sample bias within each Scantrack market.

quantity decrease, whereas fewer than 2 percent of modules had a significant quantity increase. A list of modules with significant price or quantity changes can be found in Appendix C.

We expect heterogenous effects on prices and quantities; for this reason, we evaluate each regression separately. For all departments except Fresh Produce, positive price coefficients were more often paired with negative quantity coefficients.[41] Our findings provide some support for the anticompetitive theories discussed in Section 1.2. It should be noted that price increases and quantity decreases may still be consistent with increased demand, as long as the demand-enhancing effect is outweighed by firms exercising market power.

3.3. Aggregate Impact

The results in the previous section estimate the impact separately by product module. From a broader standpoint, we seek to understand the overall impact of the *Leegin* decision on prices and quantities and the overall significance of the results reported in the previous section. We identify three outcomes for prices: (1) the percentage of modules with price increases; (2) the percentage of modules with statistically significant price increases; and (3) the percentage of modules with statistically significant price decreases. We focus on analogous outcomes for quantities. To analyze the joint distribution of price and quantity changes, we calculate the percentage of coefficient pairs that fall in each of the four quadrants of the price-quantity plane. We use the same aggregate measures from the 200 iterations of our randomization test to construct a simulated p-value.

Table 5 summarizes the significance of our aggregate statistics. Treatment increased the proportion of positive price coefficients and significant positive price coefficients at the 10 percent significance level. Our point estimates suggests that quantities fell, though this occurred at low levels of significance. Notably, the p-value of finding the proportion of price increases and quantity decreases that we find is 0.105, which suggests that treatment causes the combinations of price increases and quantity decreases to occur more often. We conclude that states in the Rule-of-Reason regime experienced statistically significant price increases, and that these price increases are most often combined with quantity decreases. Our findings are consistent with the anticompetitive hypothesis that a legal environment favorable to vertical price agreements will result in a exercise of market power and a decrease in consumer surplus.

Finally, we report the overall effect on prices and quantities in Table 6. We

[41] For the distribution of price and quantity coefficients, see Table 16 in the Appendix.

pool coefficients using a standard meta-analysis approach,[42] which weighs each point estimate by the inverse of the variance. We estimate an overall increase in prices of 0.33 percent and an overall decrease in quantities of 3.8 percent. The aggregate change in prices is significant at $\alpha = 0.10$, and it is economically meaningful as it averages the effects across affected and unaffected products.

4. Evaluating the Theories

The previous section provides empirical support for the claim *Leegin* led to more RPM contracts and prices increases. In this section, we will evaluate various hypotheses for the motivation and the impact of RPM contracts. For this purpose, we identify qualifying RPM modules as product modules that exhibit statistically significant price increases. These are the products for which we have some evidence that the contracts were in force. We focus on this subset to restrict our analysis to changes within the RPM framework.

Given that we are presenting a large number of test statistics, we expect to find several of them that would meet a significance threshold. Thus, we take a more cautious approach, looking at the overall picture rather than assigning great importance to any one result. Additionally, many of these test suffer from lack of power due to measurement error and a small number of candidate RPM modules. For this reason, the picture we paint should serve as guidance to future research with more detailed data.

4.1. The Effect on Quantities

Anticompetitive theories of RPM state that the primary purpose of the contract is to exercise market power, restricting quantity below the competitive level. Procompetitive theories argue for the demand-enhancing benefits of RPM, which is often, but not necessarily, associated with a quantity increase. In our data, we observe that products that have a statistically significant price increase are associated with declining quantities, with an average decline of 2.5 percent.

Table 7 shows the pooled quantity coefficient for qualifying RPM modules. The resulting estimate is suggestive but not statistically significant. The most significant declines occur in Dry Grocery and General Merchandise, with declining quantities of 3.85 percent and 4.82 percent. These estimates are toward the lower tail of the bootstrapped distributions, with significance values of 0.190

[42] We were not able to run the pooled regressions due to computational limitations and the size of the dataset.

and 0.165, respectively. As mentioned above, these tests may suffer from lack of power, as we have few potential RPM modules within each department.

Declining quantities and increasing prices are consistent with a decrease in consumer welfare. We look at the overall impact of the policy change on consumer welfare in Section 5.

4.2. Market Power

The exercise of market power is easier in more concentrated markets, as there are fewer participants to cheat on the agreement and monitoring costs are lower. However, any contract is easier to enforce in a more concentrated market due to the same reasons. In Section 1.2, we outline four cases that the Court identified as potential causes of anticompetitive behavior. To evaluate each potential cause, we use a related measure of concentration. For each product module, we calculate the pre-period five-firm concentration ratio (C5) and HHI[43] for both retailers and manufacturers across all Rule of Reason states. We also calculate the share of the largest manufacturer and the largest retailer, which would correspond to the dominant manufacturer theory of exclusion of rivals and the dominant retailer theory of forestalled innovation, respectively. We regress our measures of concentration on the estimated coefficients for prices and quantities for both all products and qualifying RPM products.

Table 8 displays the results. The evidence suggests that within qualifying RPM products a higher retailer concentration leads to greater price increases. The coefficient on retailer C5 is highly significant, and the coefficient on retailer HHI is meaningful. The HHI coefficient of 0.266 implies that moving from a market structure of four equal-share firms to two equal-share firms is associated with an RPM-associated price increase of 6.9 percent.[44] This fits with the idea that RPM policies are easier to implement when a manufacturer has fewer distributors, as the manufacturer can better monitor the distribution network. A positive relationship between price increases and concentration alone is not evidence of anticompetitive behavior. It does support the idea that a more concentrated market is able to more effectively implement an RPM policy, but this policy may be used for either procompetitive or anticompetitive ends. Though the quantity point estimates for retailer concentration are all negative, none of them are significant, giving weak support for the downstream collusion theory.

On the manufacturer side, the price coefficients on C5 and HHI are smaller than their retailer counterparts, though the the price coefficient on C5 is also sig-

[43] We use these measures due to their ubiquitousness in the industrial organization literature.
[44] This change in market structure increases HHI by 0.25.

nificant. Greater concentration among manufacturers is associated with greater price increases. This supports the idea that it is easier to implement an effective RPM policy as a manufacturer when you have fewer competitors. The coefficients on quantities are small and not significant. As the relationship between manufacturer C5 and quantity change in positive, the data do not support the theory of upstream collusion.

Neither the share of the largest retailer nor the share of largest manufacturer is strongly related (in a statistical or economic sense) to price or quantity changes, giving little support to dominant firm theories such as forestalled innovation.

Given the magnitude on price coefficients on the manufacturer and retailer measures of C5 and HHI, it appears that retailer concentration is a more important determinant of the effectiveness of an RPM policy than manufacturer concentration. This finding is in line with anecdotal evidence we heard in interviews with retailers and manufacturers.

4.3. Increased Distribution

If demand increases with the distribution of the product, then we would expect RPM contracts to allow retail outlets to carry the product that could not profitably do so otherwise. We use two measures of distribution to test this theory. The first measure is the number of unique store IDs that sell a UPC-level product in a month in a given state. Unfortunately, we only have store IDs for 46 percent of the data, thus this measure comes with a large amount of error. Missing store IDs are given the same code, so observations with missing stores are treated as coming from the same store in a given state-month period. The second measure is the number of unique household zip codes that purchase an individual product in a month in a given state. One advantage of this measure is that we have it for every observation. We create these measures for qualifying RPM modules, then run separate regressions by department to calculate the change due to *Leegin* according to the following model:

$$\begin{aligned} Outlets\, measure_{jst} = \alpha + \beta_1 ror_s + \beta_2 L_t + \psi(ror_s \times L_t) + \phi \cdot macro_{st} \\ + \sum_{j'} \delta_{j'} prod_{j'} + \sum_{s'} \xi_{s'} st_{s'} + \sum_{t'} \lambda_{t'} month_{t'} + \varepsilon_{jst}. \end{aligned}$$

As shown in the equation above, we control for fixed effects at the product, state, and month levels, as well as macroeconomic variables.

Table 9 presents the results for both measures. There is little evidence that increased distribution occurs across a broad variety of products, as the point es-

timates are near zero in most of the departments. Only in Fresh Produce is the increase meaningful, and it is not significant. This department sees an increase of approximately 8 percent in households and 13 percent in zip codes. The coefficient of 0.504 implies that, on average, half of the Fresh Produce products are carried in a new store across the Rule of Reason states. As this department contains the most perishable products, the higher margins due to RPM may encourage stocking items that are bought too infrequently to be profitable otherwise. An increase in retail outlets suggests distributional welfare effects that will be ignored in our welfare analysis in Section 5.

4.4. Adequate Inventories

As noted by Carlton and Dana (2008), firms will respond to demand uncertainty "by stocking low cost, low quality products as an alternative to high cost, high quality products that are occasionally stocked out." This is one explanation of the existence of private label products, which have historically been considered lower-quality substitutes of branded products.[45] Therefore, in the event of a shortage on a branded product, we expect to see some consumers substituting towards the private label alternative. Under the theory of adequate inventories discussed above, retailers reduce the frequency of shortages on branded products by holding greater inventories of goods subject to minimum RPM. This results in an increase in expected quantity sold across demand states.[46] If manufacturers are using minimum RPM to ensure adequate inventories are held by retailers, we would expect the share of branded products sold to increase relative to private-label substitutes.

To test this prediction, we implement a difference-in-differences model by department to determine the change in the share of branded products sold after *Leegin:*

$$\begin{aligned} Branded\_share_{ist} = \alpha + \beta_1 ror_s + \beta_2 L_t + \psi(ror_s \times L_t) + \phi \cdot macro_{st} \\ + \sum_{i'} \zeta_{i'} mod_{i'} + \sum_{s'} \xi_{s'} st_{s'} + \sum_{t'} \lambda_{t'} month_{t'} + \varepsilon_{ist} \end{aligned}$$

where $Branded\_share_{ist}$ is the quantity sold of branded products in module i divided by the total quantity sold in module i in state s during month t. We control for product module, state, retailer, and month fixed effects, as well as

[45] Perceptions of private label product quality has improved among consumers in recent years, as discussed on Nielsen's website: http://www.nielsen.com/us/en/insights/press-room/2008/nearly_three-quarters.html (accessed October 2012).

[46] See Deneckere et al. (1996), Section II.C

the macroeconomic variables described in Section 2.4. To create our individual observations, we aggregate separately all branded and private label product quantities by retailer-module-state-month. We include only product modules for which the aggregated branded share is between 0.05 and 0.95 in the pre period. This allows us to ignore modules for which there is no relevant mix of private and branded labels, and hence no substitution to private label due to stock outs of branded products.[47] We restrict our analysis to qualifying RPM modules, recognizing that the use of RPM to increase inventories could theoretically reduce the average price of goods sold.

The results of our regression can be found in Table 10. Overall, there is no indication that this mechanism is an important aspect of RPM, as the average estimated change is near zero.

4.5. MAP Policies and In-Store Discounts

For a manufacturer, enforcing a minimum advertised price while simultaneously allowing in-store discounts is one way to prevent free riding between retailers but increase interbrand competition once the customer is inside the store. From our discussions with manufacturers, we understand that the use of MAP policies increased greatly after the *Leegin* decision, which gave much more legal freedom to implement these agreements. While some of these policies were de facto RPM policies, many resulted in a increase in advertised prices only.[48] If MAP policies were indeed encouraged by the *Leegin* decision, then we would expect to see greater increases in list prices in Rule of Reason states. To test this, we repeat our main price regressions from Equation 1 with list prices used in place of the actual transaction price. We obtained similar results to our main transaction price regressions, with 8.6 percent or the 986 products seeing significant price increases and 5.4 percent seeing significant price decreases.

Though the percent of significant price increases is not substantially different from the results of the transaction price regressions, the products that had a significant and positive coefficient changed. There were 26 products that had a significant price increase for the list price but not for the transaction price. We call these products "MAP products," as they are candidates for the procompet-

[47] This removes roughly 31 percent of state-retailer-module-month observations, prior to further restricting the data to qualifying RPM modules.

[48] Innovation in discounting, often against the wishes of the manufacturer, is one way that MAP policies intended as RPM policies were in effect MAP policies. In online markets, innovations included a) presenting a new price at checkout and b) presenting an item-specific coupon next to the purchase button. For in-person sales, the tried-and-true method of price negotiation is still in use.

itive story of firms using in-store discounts to promote intrabrand competition. Conversely, there were 24 products that had a significant price increase for the transaction price but not for the list price. One explanation for this finding is that these products experienced discounting prior to the *Leegin* decision. Afterward, firms used retail price maintenance to enforce prices closer to the list price. We label these products "restricted discount products." Table 11 provides a list of products for each type.

Both MAP products and restricted discount products had an overall increase in transaction price of 1.7 percent.[49] Though the average price increases were the same for both types of products, the average quantity changes were quite different: -1.7 percent for restricted discount products, compared to -3.6 percent for MAP products. Though differences across product markets need to be accounted for, this difference in quantity changes may indicate that consumers are sensitive to the advertised price and not entirely informed about the true transaction price. MAP products had an average list price increase of 2.4 percent, whereas restricted discount products only had a list price increase of 1.0 percent. The implied elasticity with respect to the advertised price, holding the transaction price fixed, is -1.4. Our findings suggest that RPM policies used to limit discounting may be more procompetitive than MAP policies, as an increase in advertised prices outweighs the potential demand-enhancing effects of MAP policies.

5. Welfare Effects

In this section, we estimate the impact of a rule-of-reason regime on consumer welfare in the twenty-four states in our analysis. While we find more price increases and quantity decreases than other price-quantity combinations in Section 3, our methods above do not compare the magnitudes of these changes across products. In order to capture the aggregate effects of these price and quantity changes, we use our regression results and a simple demand system to evaluate the effect on consumer welfare.

For each module, we simulate counterfactual price and quantity changes, where the mean and standard deviation of these changes are determined by the point estimates ($\hat{\gamma}$, $\hat{\mu}$) and standard errors ($\hat{\sigma}_\gamma$, $\hat{\sigma}_\mu$) from regressions (1) and (2). We calibrate two heuristic demand systems (constant elasticity and linear) to the observed and counterfactual equilibria. In effect, we construct demand curves for each product module at the state-retailer-week level. We make the simplify-

[49]The average is calculated here using inverse variance weights.

ing assumptions that demand for products are independent across modules and that the elasticity does not change between the counterfactual states. The latter is akin to choosing the same markup for both equilibria. While we ignore potentially meaningful substitution patterns, our methodology can be thought of as a weighted aggregation of the changes in prices and quantities, where the weights are based on a demand approximation. The difference in consumer surplus between these two demand systems is our estimate of the impact of a rule-of-reason regime. Appendix D details our methodology and calculations.

In either demand system, the assumption of unchanging equilibrium elasticity implies that the change in consumer surplus is proportional to the change in revenue from the observed equilibrium to the counterfactual equilibrium.[50] Consumer surplus can be calculated for each product, using a different elasticity for each product. If we assume identical elasticities across the aggregated products, the percent change in consumer surplus is identical to the percent change in aggregate revenue from those products.

Our simulations estimate a range of consumer welfare loss by department of -7.6 percent to 0.8 percent, with a total of -3.1 percent across departments.[51] Table 13 shows further details by department. In these table, we show the counterfactual change in revenue due to a rule-of-reason regime, and we provide the standard deviation to account for the randomness in our estimates. We also provide state-by-state estimates of the change in revenue. State-by-state welfare effects fall between -3.6 percent and -2.2 percent.

The value in revenue in Table 13 is equivalent to the consumer welfare loss under the assumption of constant elasticity demand and 50 percent margins. It is straightforward to use the multipliers provided in Table 12 to calculate the welfare loss for different demand and elasticity combinations. The multiplier ranges from 2 to 1/20 under plausible demand elasticity assumptions. These multipliers give a range in total welfare loss of $571 million to $22.8 billion.

Our results show that across both states and departments, minimum RPM was generally welfare-reducing. As our results aggregate varying welfare effects across a broad variety of goods, the use of minimum RPM may be welfare-enhancing for some individual products. The only department that shows an increase in revenue and consumer surplus is Fresh Produce. This estimate should be treated with caution, as the standard deviation is approximately equal to the point estimate. One reason for increased revenues for Fresh Produce is increased

[50] A proof of this is provided in Appendix D.

[51] Different elasticity assumptions will result in different weightings by product or by department.

distribution, as shown in Section 4.3.

As shown in Table 14, consumer surplus impacts are directionally consistent across states. Differences in state-level impacts occur due to variation in the bundle of goods consumed across states. Notably, the counterfactual welfare impacts are greater in the Rule of Reason states compared to the Per Se states. This reflects the fact that our methodology does not incorporate all of the behavioral responses to a policy change. The Rule of Reason states show a larger change because consumers are more likely to substitute to lower-price products, thus lowering revenues even further. This difference further supports the broad impact of RPM policy and indicates that the magnitudes of our estimates of the impact on welfare are likely upper bounds.

6. Conclusion

Our analysis shows that a legal environment friendly to minimum RPM contracts results in price increases across a broad variety of consumer goods. The price increases are generally accompanied by decreases in output and net harm to consumers. We find that a more favorable legal environment for RPM results in a loss in consumer welfare. To be clear, we do not claim these results necessarily stem from the execution and enforcement of explicit minimum RPM agreements between manufacturers and retailers, but rather from a more permissive legal environment where allegations of anticompetitive uses of minimum RPM are examined on a case-by-case basis.

Though we capture a significant portion of household expenditures across a broad variety of goods, future research that includes nearly all household spending would be valuable in evaluating the overall impact of the change in RPM policy. More comprehensive data may also be able to answer the question of which consumer goods demonstrate welfare-enhancing effects empirically, a result that has so far eluded the literature.

We test implications from several of the prevailing theories about RPM, and we find little evidence for the broad applicability of any particular theory. However, we find evidence that retailer concentration is more relevant than manufacturer concentration for implementing an effective RPM policy, regardless of the intention of the agreement. As there is heterogeneity in effects across different goods, there is an opportunity for future research to more precisely determine which theory applies best to each good. Such research would allow for a more nuanced estimate of the welfare impact of the policy change and would help inform antitrust enforcement authorities as to which particular RPM agreements

are anticompetitive.

We find some evidence that firms use RPM policies to enforce minimum advertised prices while allowing in-store discounts. Our work suggests future research that combines estimates of consumer response to advertised prices with RPM theory to evaluate the welfare impacts of MAP policies and understand optimal in-store discounting.

There are reasons to believe that the effects of *Leegin* would be less pronounced than if minimum RPM received a rule-of-reason treatment with certainty across the U.S. The lack of uniformity of laws across states increases the risk of litigation and complicates contract negotiations between large manufacturers and national retailers, increasing the cost of implementing minimum RPM agreements. If these costs are different for firms intending to increase retailer services than they are for firms seeking to exert market power, then our results may not extend to a national rule-of-reason treatment.

Firms may be still be held liable for anticompetitive behavior resulting from RPM contracts. Because of this, they may not be not acting as anticompetitively as they might if RPM were per se legal. Still, whether through undetected anticompetitive behavior or unsuccessful retailer service strategies, a simple welfare analysis of the rule-of-reason environment shows that the harm to consumers outweighs the benefits.

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Table 1: Summary Statistics of Nielsen Consumer Panel Data

				Percent	Products per Module		
Dept Code	Dept. Description	Modules	Products	Private Label	25th Percentile	Median	75th Percentile
0	Health & Beauty Aids	173	242,564	26.4	163	463	1,455
1	Dry Grocery	416	499,943	34.0	140	419	1,130
2	Frozen Foods	85	83,209	39.3	94	443	1,171
3	Dairy	45	63,782	40.2	463	879	1,756
4	Deli	16	23,667	37.8	349	646	2,106
5	Packaged Meat	13	23,981	25.8	229	1,725	2,108
6	Fresh Produce	21	18,378	16.8	214	406	1,068
7	Non-Food Grocery	136	172,308	28.8	97	403	1,285
8	Alcoholic Beverages	30	40,303	2.4	250	566	922
9	General Merchandise	147	256,283	19.2	62	287	1,493
	Total	1,082	1,424,418	28.8	125	441	1,301

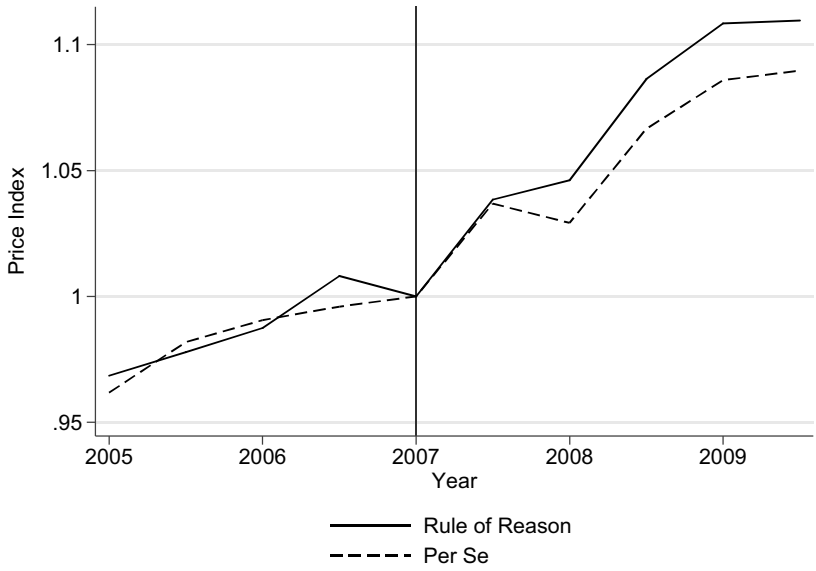
Source: Calculated based on data from The Nielsen Company (US), LLC.

Table 2: Mean Percent Price Changes of Modules in Rule of Reason vs. Per Se States (2007-2009)

Dept Code	Dept. Description	Per Se	Rule of Reason	Difference
0	Health & Beauty Aids	2.9	4.9	2.0
1	Dry Grocery	11.1	13.2	2.2
2	Frozen Foods	9.1	15.6	6.5
3	Dairy	6.7	8.8	2.0
4	Deli	7.9	12.2	4.4
5	Packaged Meat	9.2	11.4	2.2
6	Fresh Produce	0.6	-0.4	-1.0
7	Non-Food Grocery	10.7	8.5	-2.1
8	Alcoholic Beverages	5.2	7.8	2.6
9	General Merchandise	11.1	13.9	2.8
	All Modules	8.9	11.0	1.1
			t-statistic	1.798
			p-value	0.036

Notes: The price change for each module is calculated as the change in a Laspeyres quantity-weighted price index from first half of 2007 to the second half of 2009. Included are branded products that had at least one observation in both periods for both Per Se and Rule of Reason States. The mean price change within a department is a simple average of price changes across modules. The p-value is for a one-sided test.
Source: Calculated based on data from The Nielsen Company (US), LLC.

Figure 1: Price Index by Legal Treatment



Notes: The price index displayed is a simple average across Laspeyres quantity-weighted price indices for each product module. Each Laspereyes price index is benchmarked to the first half of 2007, and includes only branded UPCs that have positive quantities in the first half of 2007 and the second half of 2009.
Source: Calculated based on data from The Nielsen Company (US), LLC.

Table 3: Price Regressions by Module

Department Description	Number of Regressions	Significant $\gamma > 0$			Significant $\gamma < 0$			Percent Positive
		Count	Percent	Median[a]	Count	Percent	Median[a]	
Health & Beauty Aids	158	11	7.0	5.6	11	7.0	-7.5	51.9
Dry Grocery	402	40	10.0	5.6	28	7.0	-4.5	60.7
Frozen Foods	79	8	10.1	3.6	1	1.3	-6.1	72.2
Dairy	41	0	0.0		0	0.0		73.2
Deli	16	0	0.0		0	0.0		62.5
Packaged Meat	13	3	23.1	2.1	2	15.4	-13.6	76.9
Fresh Produce	21	2	9.5	10.2	0	0.0		61.9
Non-Food Grocery	118	9	7.6	1.9	3	2.5	-1.8	52.5
Alcoholic Beverages	30	2	6.7	6.4	3	10.0	-5.8	43.3
General Merchandise	108	8	7.4	7.5	4	3.7	-6.3	52.8
All Departments	986	83	8.4	5.3	52	5.3	-4.8	58.6

Notes: Significance is determined by one-sided tests at a significance level of 0.05. p-values are calculated using 200 iterations of a Wild bootstrap with clustering at the state level and the null hypothesis imposed.

Source: Calculated based on data from The Nielsen Company (US), LLC.

a. The column "Median" gives the median coefficient as a percent change.

Table 4: Quantity Regressions by Module

Dept.	Number of	Significant $\mu > 0$			Significant $\mu < 0$			Percent
Description	Regressions	Count	Percent	Median[a]	Count	Percent	Median[a]	Positive
Health & Beauty Aids	158	3	1.9	45.1	15	9.5	-19.3	29.7
Dry Grocery	402	9	2.2	30.2	39	9.7	-15.1	32.8
Frozen Foods	79	1	1.3	54.1	5	6.3	-13.3	35.4
Dairy	41	1	2.4	37.5	1	2.4	-6.8	31.7
Deli	16	0	0.0		1	6.2	-27.6	43.8
Packaged Meat	13	0	0.0		0	0.0		46.2
Fresh Produce	21	0	0.0		0	0.0		57.1
Non-Food Grocery	118	2	1.7	56.8	12	10.2	-21.3	24.6
Alcoholic Beverages	30	1	3.3	10.6	4	13.3	-19.0	20.0
General Merchandise	108	0	0.0		16	14.8	-20.6	27.8
All Departments	986	17	1.7	37.5	93	9.4	-16.2	31.4

Notes: Significance is determined by one-sided tests at a significance level of 0.05. p-values are calculated using 200 iterations of a Wild bootstrap with clustering at the state level and the null hypothesis imposed.

Source: Calculated based on data from The Nielsen Company (US), LLC.

a. The column "Median" gives the median coefficient as a percent change.

Table 5: Aggregate Indicators: Coefficient Counts

Included Coefficients	Percent of Main Results	p-value
Price		
Positive	58.6	0.065
Significant & Positive	8.4	0.090
Significant & Negative	5.3	0.490
Quantity		
Negative	68.6	0.220
Significant & Negative	9.4	0.170
Significant & Positive	1.7	0.770
Coefficient Pairs		
Quadrant 1 ($P\uparrow, Q\uparrow$)	18.6	0.690
Quadrant 2 ($P\uparrow, Q\downarrow$)	40.0	0.105
Quadrant 3 ($P\downarrow, Q\downarrow$)	28.5	0.365
Quadrant 4 ($P\downarrow, Q\uparrow$)	12.9	0.845

Notes: The p-values in this table correspond to seeing if the relevant percentage of coefficients increased. p-values are calculated using 200 iterations of a Wild bootstrap with clustering at the state level and the null hypothesis imposed. Quadrants refer locations on the price-quantity plane, with price on the y-axis and quantity on the x-axis.
Source: Calculated based on data from The Nielsen Company (US), LLC.

Table 6: Pooled Percent Changes for Prices and Quantities

	Price		Quantity	
Department	Coefficient	p-value	Coefficient	p-value
Health & Beauty Aids	0.00	0.480	-5.04	0.150
Dry Grocery	0.47	0.150	-3.37	0.195
Frozen Foods	1.00	0.060	-2.27	0.290
Dairy	0.52	0.235	-2.75	0.265
Deli	0.11	0.400	-3.14	0.235
Packaged Meat	0.81	0.025	-2.24	0.225
Fresh Produce	0.35	0.180	0.05	0.500
Non-Food Grocery	0.20	0.145	-4.38	0.140
Alcoholic Beverages	-0.03	0.540	-7.76	0.075
General Merchandise	0.10	0.300	-5.97	0.105
All Departments	0.33	0.095	-3.80	0.170

Notes: Coefficients are reported as percent changes and are pooled according to a standard meta-analysis approach, which weighs each coefficient by the inverse of the variance of the estimator. p-values are calculated using 200 iterations of a Wild bootstrap with clustering at the state level and the null hypothesis imposed. The relevant tests for this table correspond to seeing if prices increased and quantities decreased. The total number of observations is 41,799,260 for the price regressions and 41,984,540 for the quantity regressions.
Source: Calculated based on data from The Nielsen Company (US), LLC.

Table 7: Pooled Percent Changes for Candidate RPM Modules

	Price		Quantity	
Department	Coefficient	p-value	Coefficient	p-value
Health & Beauty Aids	4.19	0.000	-1.68	0.350
Dry Grocery	2.56	0.000	-3.85	0.190
Frozen Foods	2.70	0.005	-1.09	0.395
Dairy				
Deli				
Packaged Meat	1.57	0.010	-2.15	0.250
Fresh Produce	4.75	0.020	2.52	0.665
Non-Food Grocery	1.45	0.005	-0.65	0.420
Alcoholic Beverages	4.01	0.035	1.29	0.515
General Merchandise	2.87	0.000	-4.82	0.165
All Departments	2.32	0.000	-2.50	0.245

Notes: This table shows pooled coefficients for modules with significant and positive price coefficients. Coefficients are reported as percent changes and are pooled according to a standard meta-analysis approach, which weighs each coefficient by the inverse of the variance of the estimator. p-values are calculated using 200 iterations of a Wild bootstrap with clustering at the state level and the null hypothesis imposed. The relevant tests for this table correspond to seeing if prices increased and quantities decreased. The total number of observations is 4,248,135 for the price regressions and 4,265,566 for the quantity regressions.
Source: Calculated based on data from The Nielsen Company (US), LLC.

Table 8: Regressions of Estimated Coefficients on Concentration Measures

	Price		Quantity	
	Coefficient	p-value	Coefficient	p-value
Retailer HHI	0.266	0.122	-0.012	0.967
Retailer C5	0.223	0.002	-0.113	0.361
Retailer C1	0.034	0.760	-0.055	0.763
Manufacturer HHI	0.063	0.216	-0.039	0.646
Manufacturer C5	0.150	0.004	0.032	0.722
Manufacturer C1	0.041	0.367	-0.015	0.846

Notes: The coefficients are calculated by regressing the estimated difference-in-difference coefficients on measures of retailer and manufacturer concentration for products with price coefficients that are significant and positive. The concentration measures use revenue shares in the year prior to the *Leegin* decision (i.e., the pre-period). The relevant tests for this table use standard OLS t-statistics for two-sided tests.
Source: Calculated based on data from The Nielsen Company (US), LLC.

Table 9: Outlets Test: Change in Number of Retailers for Candidate RPM Modules

	Store IDs			Household Zip Codes			
Dept. Description	Coefficient	Baseline	p-value	Coefficient	Baseline	p-value	Observations
Health & Beauty Aids	-0.013	1.504	0.555	0.007	1.653	0.485	52,501
Dry Grocery	-0.001	2.753	0.505	0.011	3.229	0.450	705,637
Frozen Foods	0.001	2.331	0.505	0.040	2.740	0.370	186,357
Dairy							
Deli							
Packaged Meat	-0.017	2.990	0.565	0.034	3.743	0.395	180,684
Fresh Produce	0.504	6.112	0.345	1.533	11.120	0.240	14,438
Non-Food Grocery	-0.018	2.315	0.625	0.013	2.835	0.440	272,882
Alcoholic Beverages	-0.077	1.339	0.710	-0.144	1.534	0.705	5,316
General Merchandise	0.010	1.209	0.260	0.027	1.385	0.245	133,366
Weighted Average	0.005	1.382	0.425	0.019	1.623	0.345	1,551,181

Notes: We use two measures of retailer outlets in this analysis: unique store IDs and unique household zip codes for each product-state-month observation. Observations with missing store IDs are counted as a single store for a given retailer. Store IDs are present in 46 percent of the product-level observations. We have household zip codes for every observation. The baseline is the average value of the measure in the pre-period. p-values are calculated using 200 iterations of a Wild bootstrap with clustering at the state level and the null hypothesis imposed. There are no results for Deli nor Dairy as there are no candidate RPM modules in either department.
Source: Calculated based on data from The Nielsen Company (US), LLC.

Table 10: Inventory Test: Change in Branded Share for Candidate RPM Modules

Dept. Description	Percent Change	p-value	Observations
Health & Beauty Aids	0.40	0.325	34,969
Dry Grocery	-0.15	0.730	275,174
Frozen Foods	-0.33	0.660	54,037
Dairy			
Deli			
Packaged Meat	0.02	0.515	61,378
Fresh Produce	-0.30	0.630	21,575
Non-Food Grocery	0.13	0.435	79,350
Alcoholic Beverages			
General Merchandise	0.02	0.500	25,693
Average	-0.03	0.620	552,176

Notes: p-values are calculated using 200 iterations of a Wild bootstrap with clustering at the state level and the null hypothesis imposed. There are no results for Deli nor Dairy as there are no candidate RPM modules in either department. There are no results for Alcoholic Beverages as there are no candidate RPM modules that had a mix of private label and branded products in period before *Leegin*.
Source: Calculated based on data from The Nielsen Company (US), LLC.

Table 11: MAP Products and Restricted Discount Products

MAP Products	**Restricted Discount Products**
Cosmetics-Foundation-Cream And Powder	Baby Accessory
Depilatories - Women's	Hair Preparations-Men's
Minerals	Nasal Product Internal
Shave Creams - Women's	Sleeping Aids
Skin Cream-Special Purpose	Sunburn Aids
Unclassified Baby Needs	Cereal - Hot
Baby Food - Strained	Chili-Shelf Stable
Honey	Cooking Sprays
Oriental Foods-Ramen Noodles	Corn/Potato Starch
Relishes	Mexican Sauce
Snacks - Remaining	Rice - Mixes
Syrup-Chocolate	Seafood - Shrimp - Canned
Vegetables-Beans-Green-Canned	Entrees - Mexican - 1 Food - Frozen
Vegetables-Onions-Canned	Entrees - Remaining - 2 Food - Frozen
Bakery-Breakfast Cakes & Sweet Rolls-Frozen	Frozen Hors d'Oeuvres & Snacks
Dinners-Frozen	Lunchmeat-Sliced-Refrigerated
Pasta-Plain-Frozen	Bags - Freezer
Vegetables - Broccoli - Frozen	Cigarettes
Whipping Cream	Fabric Softeners-Liquid
Fruit Salads-Refrigerated	Pre-Moistened Towelettes
Pasta - Refrigerated	Water Conditioners Filters And Units
Pet Treatments External	Tequila
Soap - Liquid	Automotive Combinations
Water Filtration Storage Container	Hairstyling Appliance And Accessory
Wine-Sweet Dessert-Domestic	
Mouse & Rat & Mole Traps	

Notes: MAP products are those that have a significant positive coefficient when the dependent variable is the list price, but not for the transaction price. Restricted discount products are those that have a significant positive coefficient for the transaction price, but not for the list price. p-values are calculated using 200 iterations of a Wild bootstrap with clustering at the state level and the null hypothesis imposed. Products are sorted by department.

Table 12: Consumer Surplus as a Fraction of Revenue

Demand System	$\lvert\varepsilon\rvert = 1.5$	$\lvert\varepsilon\rvert = 2$	$\lvert\varepsilon\rvert = 4$	$\lvert\varepsilon\rvert = 10$
Constant Elasticity	2	1	$1/3$	$1/9$
Linear	$2/3$	$1/4$	$1/8$	$1/20$

Notes: For Constant Elasticity and Linear demand systems, consumer surplus is calculated as $CS = \frac{1}{|\varepsilon|-1}PQ$ and $CS = \frac{1}{2|\varepsilon|}PQ$, respectively, where PQ are revenues.

Table 13: Change in Revenue by Department for Per Se and Rule of Reason States (in millions of dollars)

Dept. Description	Percent Change	Mean	SD
Health & Beauty Aids	-5.1	-1,834	91
Dry Grocery	-3.1	-4,558	288
Frozen Foods	-1.9	-608	111
Dairy	-0.8	-182	86
Deli	-3.2	-254	56
Packaged Meat	-0.9	-118	64
Fresh Produce	0.8	89	60
Non-Food Grocery	-1.0	-521	220
Alcoholic Beverages	-7.6	-1,423	149
General Merchandise	-6.9	-2,022	132
All Departments	-3.1	-11,432	475

Notes: We simulate change in revenue by drawing 500 price and quantity changes from a normal distribution for each product module, with the mean equal to the point estimate from our main regressions and the standard deviation given by the standard deviation of coefficient estimates in 200 bootstrap simulations.
Source: Calculated based on data from The Nielsen Company (US), LLC.

Table 14: Change in Revenue by State (in millions of dollars)

State	Mean Percent Change	Mean	Std. Dev
Per Se			
CA	-2.7	-2,034	302
OH	-2.6	-667	108
SC	-2.5	-234	38
CT	-2.2	-214	38
NV	-2.3	-165	32
MS	-2.9	-130	18
WV	-2.5	-116	21
NH	-2.4	-90	16
MT	-2.6	-72	11
Rule of Reason			
TX	-3.6	-1,766	192
FL	-3.4	-1,560	182
PA	-3.2	-979	129
VA	-3.5	-592	68
WI	-3.4	-460	59
MO	-3.2	-455	60
MA	-3.1	-420	55
AL	-3.4	-373	47
OK	-3.3	-266	36
IA	-3.5	-264	35
NM	-3.5	-145	19
NE	-3.5	-145	17
ID	-3.4	-126	17
RI	-3.2	-90	12
DE	-3.0	-69	10

Notes: We simulate change in revenue by drawing 500 price and quantity changes from a normal distribution for each product module, with the mean equal to the point estimate from our main regressions and the standard deviation given by the standard deviation of coefficient estimates in 200 bootstrap simulations.
Source: Calculated based on data from The Nielsen Company (US), LLC.

A. Assignment to Treatment and Control

The figure below shows the geographic distribution of treatment and control states. Table 15 provides the legal justification for the categorization of the states.

Figure 2: Map of Grouped States

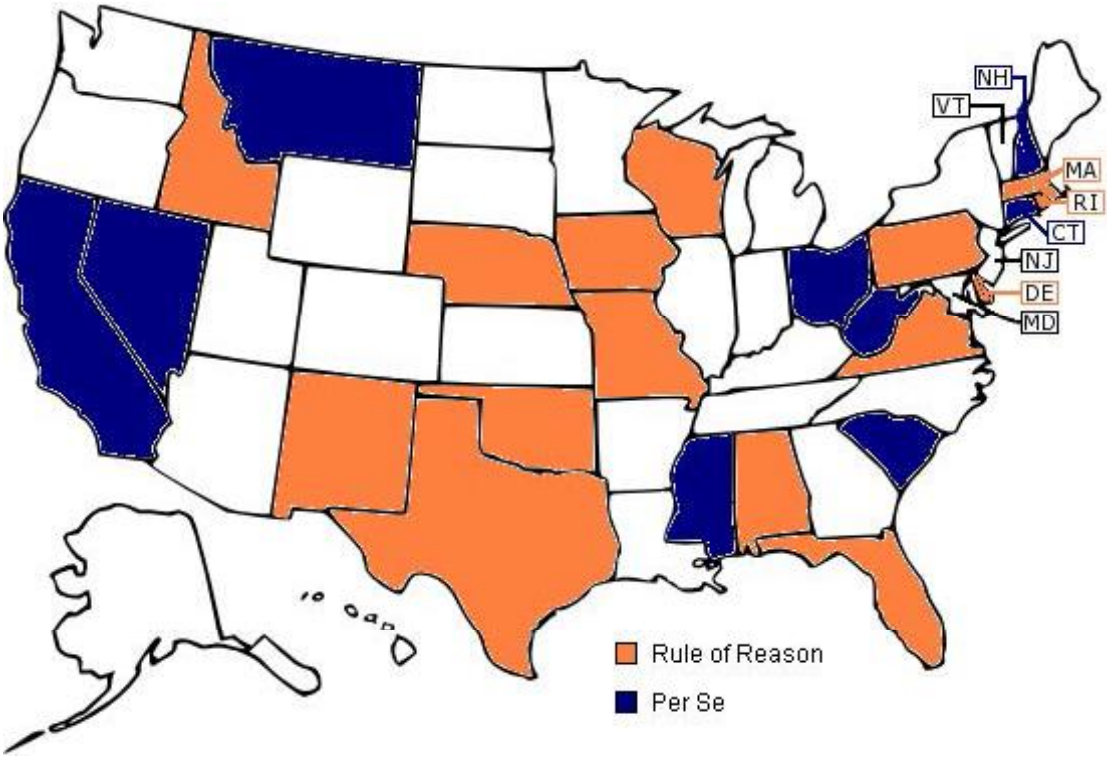


Table 15: State Law and Actions of State Attorneys General Regarding *Leegin* and Minimum RPM

State	Strongly Adheres	State Law Restricting RPM	Documents Supported by State AG				State	Strongly Adheres	State Law Restricting RPM	Documents Supported by State AG			
			Leegin Amicus	S.2261	S.148	HR.3190				*Leegin Amicus*	S.2261	S.148	HR.3190
AL	•						MT		•	•	•	•	•
AK	•						NE	•		•			
AZ				•	•	•	NV	•	•		•	•	•
AR				•	•	•	NH		•	•	•	•	•
CA		•		•	•	•	NJ	•	•	•	•	•	•
CO							NM	•		•	•	•	•
CT	•	•	•	•	•	•	NY		•		•	•	•
DE	•		•	•	•	•	NC			•		•	•
FL	•		•		•	•	ND				•	•	•
GA							OH		•	•	•	•	•
HI	•		•	•	•	•	OK	•		•	•	•	•
ID	•		•	•	•	•	OR			•	•	•	•
IL				•	•	•	PA	•		•	•	•	•
IN							RI	•			•	•	•
IA	•		•	•	•	•	SC	•	•	•	•	•	•
KS		•	•	•	•	•	SD			•			
KY			•	•			TN		•				
LA			•		•	•	TX	•					
ME			•	•	•	•	UT			•	•	•	•
MD		•	•	•	•	•	VT			•	•	•	•
MA	•		•	•	•	•	VA	•				•	•
MI	•		•				WA			•		•	•
MN			•	•	•	•	WV	•	•	•	•	•	•
MS		•	•	•	•	•	WI	•					
MO	•		•	•	•	•	WY			•	•	•	•

Notes: States that "Strongly Adhere" give strong deference to federal decisional law when interpreting state antitrust statutes. Bullets under "Supported by State Attorney General" indicate that the relevant state attorney general has signed the document indicated in the header line. Documents include a brief *amicus curiae* in support of the respondents in *Leegin* and letters to senators and congressmen in support of relevant legislative bills. Bills refer to: Discount Pricing Consumer Protection Act, S. 2261, 110th Cong. (2007); Discount Pricing Consumer Protection Act, S. 148, 111th Cong. (2009); Discount Pricing Consumer Protection Act of 2009, H.R. 3190, 111th Cong. (2009).

Sources: Brief for States of New York et al. as *Amici Curiae* Supporting Respondents, *Leegin Creative Leather Products v. PSKS*, 551 U.S. 877 (2007); Letters of the States; Duncan and Guernsey (2008).

B. Distribution of Coefficients by Department

Table 16: Joint Distribution of Price and Quantity Coefficient Point Estimates

All Departments			
		Quantity	
		-	+
Price	+	0.40	0.19
	-	0.28	0.13

Health & Beauty			
		Quantity	
		-	+
Price	+	0.37	0.15
	-	0.33	0.15

Dry Grocery			
		Quantity	
		-	+
Price	+	0.42	0.18
	-	0.25	0.15

(a) All, Departments 0 and 1

Frozen Foods			
		Quantity	
		-	+
Price	+	0.43	0.29
	-	0.22	0.06

Dairy			
		Quantity	
		-	+
Price	+	0.56	0.17
	-	0.12	0.15

Deli			
		Quantity	
		-	+
Price	+	0.38	0.24
	-	0.19	0.19

Meat			
		Quantity	
		-	+
Price	+	0.46	0.31
	-	0.08	0.15

(b) Departments 2-5

Fresh Produce			
		Quantity	
		-	+
Price	+	0.24	0.38
	-	0.19	0.19

Non-Food Grocery			
		Quantity	
		-	+
Price	+	0.36	0.17
	-	0.40	0.08

Alcohol			
		Quantity	
		-	+
Price	+	0.30	0.13
	-	0.50	0.07

General Merch.			
		Quantity	
		-	+
Price	+	0.37	0.16
	-	0.35	0.12

(c) Departments 6-9

Source: Calculated based on data from The Nielsen Company (US), LLC.

C. Modules with Significant Price or Quantity Changes

The following tables provide the descriptions of modules that experienced a significant price or quantity change, as determined by regressions (1) and (2).

Table 17: Modules with Significant Price or Quantity Changes

Module Description	$\gamma > 0$	$\gamma < 0$	$\mu > 0$	$\mu < 0$
Department 0: Health & Beauty Aids				
Adhesive Bandages - Liquid - Powder - Paste		•		
Baby Accessory	•			
Baby Bib And Burp Cloth				•
Baby Bottles & Nipples			•	
Baby Care Products-Bath				•
Baby Care Products-Lotions				•
Contact Lens Solution				•
Cosmetics-Foundation-Liquid				•
Cosmetics-Halloween/Costume Make-Up		•		
Cough Drops	•			
Denture Adhesives				•
Deodorants - Cologne Type				•
Depilatories - Men's				•
Diuretic Remedies	•			
Feminine Hygiene-Douches				•
First Aid - Thermometers		•		
Hair Preparations-Men's	•			
Insoles		•		
Insulin Syringes			•	
Jock Itch Products		•	•	
Lip Remedies - Remaining				•
Medical Accessory-Remaining		•		•
Men's Gift Sets & Travel Kits				•
Nasal Product Internal	•			
Pain Remedies - Alkalizing Effervescents	•			
Pain Remedies - Back & Leg				•
Pain Remedies - Children's Liquid	•			
Pain Remedies - Headache				•
Petroleum Jelly	•			
Pregnancy Test Kits	•			
Sleeping Aids	•			
Sunburn Aids	•			
Toothbrushes		•		
Unclassified Cosmetics		•		
Unclassified Hair Care		•		
Unclassified Sanitary Protection		•		
Vaporizing Products		•		
Vitamins/Tonics-Liquid & Powder				•
Department 1: Dry Grocery				
Baby Cereal & Biscuits		•		
Baby Food - Junior	•			
Baby Juice				•
Bakery-Rolls-Fresh	•			
Baking Chips - Milk Chocolate			•	
Baking Chips Other Than Chocolate		•		
Barbecue Sauces				•
Breading Products	•			
Breath Sweeteners		•		
Butter-Fruit & Honey	•			•
Candy-Chocolate	•			
Candy-Dietetic - Non-Chocolate		•		
Candy-Lollipops				•
Candy-Non-Chocolate-Miniatures				•
Canned Fruit - Berries		•		
Canned Fruit - Oranges	•			
Canned Fruit - Peaches - Freestone	•			
Canned Fruit - Prunes		•		
Canned Fruit - Remaining	•			
Canned Fruit-Grapefruit	•			
Capers	•			
Cereal - Granola & Natural Types		•		
Cereal - Hot	•			
Cherries-Maraschino	•			
Chili Sauce				•
Chili-Shelf Stable	•			
Cocktail Onions		•		
Cocoa	•			
Cooking Sprays	•			
Corn/Potato Starch	•			
Corned Beef - Canned				•
Crackers - Flavored Snack		•		
Creamers - Powdered		•		
Dip - Canned				•
Dog Food - Dry Type		•		
Dog Food - Moist Type		•		
Fruit Drinks & Juices-Cranberry	•			
Fruit Juice - Pineapple		•		
Fruit Juice-Orange-Canned			•	
Fruit Pectins				•
Fruit Spreads	•			
Garlic Spreads	•			
Gravy Aids & Beef Extract			•	
Gum-Chewing				•
Home Canning Seasonings				•
Hot Sauce		•		
Ice Pops - Unfrozen				•
Instant Meals		•		
Lard	•			
Marmalade	•			
Mayonnaise				•
Meat Sauce		•		
Mexican Sauce	•			
Mexican Shells				•
Milk - Canned	•			
Milk - Powdered	•			
Milk-Shelf Stable		•		
Mixes - Cake/Layer - 10 Oz & Under				•
Mixes-Frosting			•	
Mixes-Muffin		•		
Monosodium Glutamate & Flavor Enhancers				•
Olives - Green				•
Oriental Canned Vegetables				•
Peas & Lentils & Corn - Dry	•			
Pet Care - Pet Food				•
Pickled Vegetables & Fruit		•		•
Pickles - Sweet	•			
Pimentos - Canned				•
Pizza Pie And Crust Mixes		•		
Popcorn - Popped	•			
Potato Salad-Canned		•		
Remaining Drinks & Shakes Non-Refrigerated		•	•	
Rice - Canned	•			
Rice - Mixes	•			
Roast Beef - Canned		•		
Salad And Cooking Oil				•
Salt - Cooking/Edible/Seasoned	•			
Salt - Table				•
Salt Substitutes			•	
Sauce Mix - Cheese	•			
Scrapple & Mush		•		
Seafood - Sardines - Canned	•			
Seafood - Shrimp - Canned	•			

Table 18: Modules with Significant Price or Quantity Changes

Module Description	$\gamma > 0$	$\gamma < 0$	$\mu > 0$	$\mu < 0$
Department 1: Dry Grocery (continued)				
Seafood-Clams-Canned				•
Seasoning Mix - Chili			•	
Snacks - Corn Chips	•			•
Snacks - Meat				•
Snacks - Potato Sticks	•			
Snacks - Puffed Cheese				•
Soft Drinks - Low Calorie		•		
Soft Drinks - Powdered	•			
Soup Mixes - Dry & Bases				•
Syrup - Sorghum & Sugar				•
Tapioca - Pure			•	
Tea - Instant		•		•
Vegetable Juice - Tomato				•
Vegetables - Potatoes - Specialty - Dehydrated				•
Vegetables - Red Cabbage - Canned		•	•	
Vegetables-Asparagus-Shelf Stable	•			•
Vegetables-Beans-Garbanzo - Canned	•			
Vegetables-Beans-Lima-Canned				•
Vegetables-Beans-Pinto-Canned				•
Vegetables-Onions-Canned				•
Vegetables-Peas & Carrots-Canned	•			
Vegetables-Peas-Canned				•
Vegetables-Spinach-Canned		•		
Vegetables-Succotash-Canned				•
Vienna Sausage - Canned	•			
Worcestershire Sauce				•
Department 2: Frozen Food				
Entrees - Italian - 1 Food - Frozen				•
Entrees - Meat - 1 Food - Frozen	•			
Entrees - Mexican - 1 Food - Frozen	•			
Entrees - Remaining - 1 Food - Frozen	•			
Entrees - Remaining - 2 Food - Frozen	•			
Frozen Hors D' Oeuvres & Snacks	•			
Frozen Poultry				•
Fruit Juice - Apple - Frozen			•	
Meal Starters		•		
Pizza Crust-Frozen				•
Sauces & Gravies-Frozen/Refrigerated	•			
Seafood-Fish-Unbreaded-Frozen				•
Vegetables - Carrots - Frozen	•			
Vegetables - Mixed - Frozen	•			
Vegetables - Mushrooms - Breaded - Frozen				•
Department 3: Dairy				
Cheese - Natural - Variety Pack			•	
Margarine And Spreads				•
Department 4: Deli				
Pizza-Refrigerated				•
Department 5: Packaged Meat				
Bacon-Beef & Canned		•		
Bratwurst & Knockwurst		•		
Lunchmeat-Deli Pouches-Refrigerated	•			
Lunchmeat-Sliced-Refrigerated	•			
Sausage-Breakfast	•			
Department 6: Fresh Produce				
Fresh Cranberries	•			
Fresh Lettuce	•			

Module Description	$\gamma > 0$	$\gamma < 0$	$\mu > 0$	$\mu < 0$
Department 7: Non-Food Grocery				
Bags - Freezer	•			
Bags - Trash/Trash Compactor		•		•
Bags - Waste				•
Brushes - Miscellaneous				•
Cigarettes	•			
Cleaners - Powders				•
Cloth-Polishing/Cleaning		•		
Drain Pipe Openers				•
Fabric Softeners-Dry				•
Fabric Softeners-Liquid	•			
Facial Tissue	•			
Laundry Bar Soap				•
Lighter Fluid & Flints				•
Pet Care - Flea & Tick Products		•		
Pet Care - Flea Collars				•
Pet Incontinence Product			•	
Polishes				•
Pre-Moistened Towelettes	•			
Spot & Stain Removers	•			
Thermometers-Household/Outdoor				•
Toilet Bowl - Deodorizers	•			
Unclassified Pet Care			•	
Water Conditioners Filters And Units	•			
Water Softeners & Conditioners				•
Wood Chips-Cooking	•			
Department 8: Alcohol				
Bourbon-Straight/Bonded				•
Gin			•	
Light Beer (Low Calorie/Alcohol)		•		
Tequila	•			
Wine - Non Alcoholic		•		
Wine-Domestic Dry Table				•
Wine-Flavored/Refreshment		•		•
Wine-Sake	•			
Wine-Vermouth				•
Department 9: General Merchandise				
Air Purifier And Cleaner Appliances	•			
Artist And Hobby Paint And Supply	•			
Automotive Combinations	•			
Drinkware Container Set				•
Flashlights				•
Food Processor And Grinder Appliance				•
Garden, Lawn & Plant Chemicals & Additives	•			
Hairstyling Appliance And Accessory	•			
Insect Repellents		•		
Insecticide - House & Garden - Aerosol				•
Insecticide - Remaining Miscellaneous Products				•
Insecticide-Flying Insect-Aerosol				•
Insecticide-Wasp & Hornet				•
Lawn And Soil Fertilizer And Treatment	•			
Markers	•			
Mixer Appliance				•
Motor Oil Fluid And Lube		•		•
Motorized Vehicle Cleaner And Protectant				•
Oil-Lubricants-Remaining		•		•
Popcorn Popper Appliance	•			
School And Office Storage And Dispensers				•
Unclassified Cookware		•		
Unclassified Kitchen Gadgets				•
Unclassified Photographic Supplies				•
Unclassified Stationary, School Supplies				•
Vacume And Carpet Cleaner Appliance				•

D. Welfare Simulation Methodology

D.1. Constant Elasticity Demand (log-linear)

We aggregate our data to prices and quantities at the module level for each state, week, and retailer. A module price is simply the quantity-weighted average price of UPCs within that module. We then keep all modules for which we were able to estimate coefficients on both price and quantity, and we leave out 24 modules for which the standard errors on the coefficients of interest are greater than 0.1 for price or 0.35 for quantity. We leave out coefficients that were imprecisely estimated as these could have large effects on our estimates of consumer surplus despite their lack of precision.

With constant elasticity demand, the demand function is of the form:

$$Q = AP^{\varepsilon}$$

where $\varepsilon < -1$. With equilibrium price and quantities (P_0, Q_0), consumer surplus is equal to

$$\begin{aligned} CS_0 &= \int_0^{Q_0} (A^{-\frac{1}{\varepsilon}} Q^{\frac{1}{\varepsilon}} - P_0) dQ \\ &= A^{-\frac{1}{\varepsilon}} \frac{\varepsilon}{1+\varepsilon} Q_0^{\frac{1+\varepsilon}{\varepsilon}} - P_0 Q_0 \end{aligned} \tag{3}$$

In order to calculate the counterfactual *CS*, we calculate counterfactual prices and quantities, assuming unchanging equilibrium elasticities (from the Lerner Equation, $\frac{1}{|\varepsilon|} = \frac{P-C}{P} \equiv m$, unchanging equilibrium elasticity implies a constant margin). We then calibrate the model by solving for the residual demand component, A. For example, we calculate the change in *CS* for the Per Se states as follows:

1. Aggregate the data in the post-*Leegin* period to the state-retailer-module-week level. For each state-retailer-module-week, we calibrate the demand curve by solving $A_0 = Q_0 P_0^{-\varepsilon}$.

2. Use the regression coefficients $\hat{\gamma}$, $\hat{\mu}$,and the standard errors $\hat{\sigma}_\gamma$,$\hat{\sigma}_\mu$ to draw 100 log changes from a normal distribution, $x \sim N(\hat{\beta}, \hat{\sigma}^2)$

3. Estimate the counterfactual prices and quantities using the observed values:
$$\left.\begin{aligned} P_1 &= P_0 exp(x_p) \\ Q_1 &= Q_0 exp(x_q) \end{aligned}\right\} \longrightarrow (P_0, Q_0, x_p, x_q).$$

4. Calculate the residual $A_1 = Q_1 P_1^{-\varepsilon}$ for counterfactual equilibria.

5. Use (A_0, P_0, Q_0) and (A_1, P_1, Q_1) to calculate observed and counterfactual CS with equation (3), then take the difference.

6. Take the sum of $CS_1 - CS_0$ across retailers, weeks, and modules to arrive at a total change in consumer surplus per state in the post-*Leegin* period.

For the Rule of Reason states, we instead use observed price and quantity for (P_1, Q_1), and calculate the counterfactual by using $P_0 = P_1 exp(\text{-}x_p)$. We calculate the change in revenue, relating it to the change in consumer welfare using Table 12. The elasticities of -1.5, -2, -4, and -10 in the table imply margins of 67 percent, 50 percent, 25 percent, and 10 percent, respectively.

D.2. Linear Demand

We specify a differentiated product demand system of the form

$$Q = a - bP$$

for each product. For equilibrium price and quantities (P_0, Q_0), consumer surplus is given by

$$\begin{aligned} CS_0 &= \int_0^{Q_0} (\frac{a}{b} - \frac{1}{b}Q - P_0)dQ \\ &= (\frac{a}{b} - P_0)Q_0 - \frac{1}{2b}Q_0^2 \end{aligned}$$

In order to calculate counterfactual CS, we calculate counterfactual prices and quantities. We assume Bertrand pricing and unchanging equilibrium elasticities. From the Lerner equation, $\frac{1}{|\varepsilon|} = \frac{P-C}{P} \equiv m$, unchanging equilibrium elasticity implies a constant margin. The equilibrium elasticity of demand for this system is

$$\varepsilon = \frac{dQ}{dP}\frac{P_0}{Q_0} = \text{-}b\frac{P_0}{Q_0}$$

Thus, given ε, we can solve for $b = -\varepsilon\frac{Q_0}{P_0}$. Using the demand function, we can then solve for a.

$$\begin{aligned} a &= Q_0 + bP_0 \\ &= Q_0 - \varepsilon Q_0 \\ &= (1 - \varepsilon)Q_0 \\ &= \frac{m+1}{m}Q_0 \end{aligned}$$

To calculate the change in *CS*, we follow a similar method that we specify above with constant elasticity demand.

D.3. Relating Changes in Consumer Surplus to Revenues

The relationship of consumer surplus to revenue is a mathematical result that makes our welfare calculations convenient is a mathematical result. Under assumptions of constant elasticity of demand, we can rewrite equilibrium consumer surplus by plugging for A using our formula for demand:

$$\begin{aligned} CS_0 &= A^{\text{-}\frac{1}{\varepsilon}} \frac{\varepsilon}{1+\varepsilon} Q_0^{\frac{1+\varepsilon}{\varepsilon}} - P_0 Q_0 \\ &= Q_0^{\text{-}\frac{1}{\varepsilon}} P_0 \frac{\varepsilon}{1+\varepsilon} Q_0^{\frac{1+\varepsilon}{\varepsilon}} - P_0 Q_0 \\ &= P_0 Q_0 (\frac{\varepsilon}{1+\varepsilon} - 1) \\ &= \frac{1}{|\varepsilon| - 1} P_0 Q_0 \\ &= \frac{m}{1-m} P_0 Q_0 \end{aligned}$$

Thus, holding elasticity (and therefore margins) fixed, a percent change in consumer surplus is equal to the percent change in revenues.

For linear demand, we can similarly plug in for a and b in equilibrium:

$$\begin{aligned} CS_0 &= (\frac{a}{b} - P_0) Q_0 - \frac{1}{2b} Q_0^2 \\ &= \left(\frac{(1-\varepsilon) Q_0}{\text{-}\varepsilon Q_0 / P_0} - P_0 \right) Q_0 - \frac{1}{2} \frac{P_0}{Q_0} \frac{\text{-}1}{\varepsilon} Q_0^2 \\ &= (\frac{\varepsilon - 1}{\varepsilon} - 1) P_0 Q_0 - \frac{1}{2} \frac{\text{-}1}{\varepsilon} P_0 Q_0 \\ &= \frac{1}{2|\varepsilon|} P_0 Q_0 \\ &= \frac{1}{2} m P_0 Q_0 \end{aligned}$$

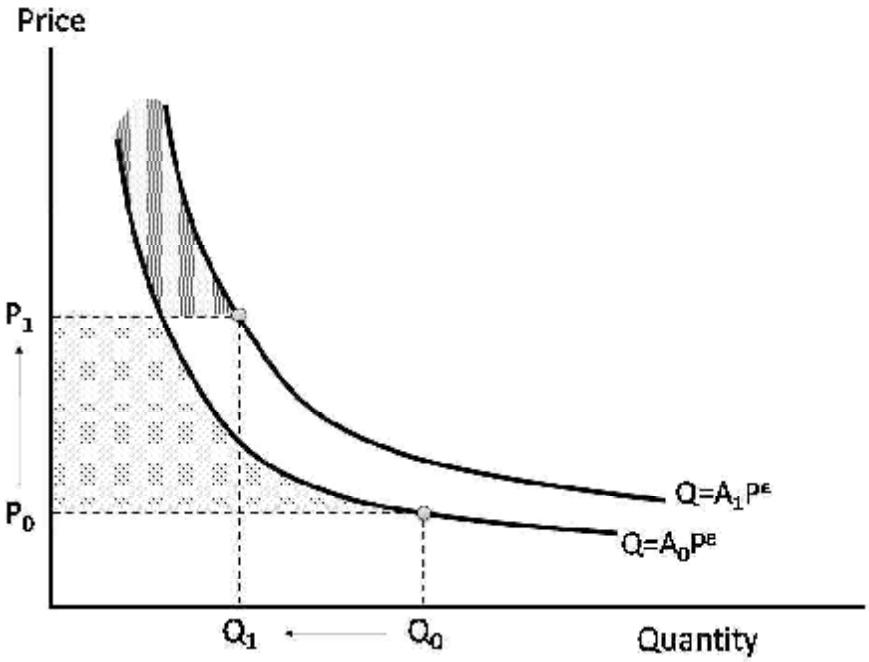
We see that consumer surplus for linear demand is also a linear function of revenues, and that percent change in consumer surplus is equal to the percent change in revenues. Thus, while elasticities (and margins) are unchanging, any change prices and quantities will result in an identical percent change in consumer surplus for both linear and constant elasticity demand. With the same equilibrium price, quantity, and elasticity, the consumer surplus from a linear demand system is smaller than a constant elasticity demand system by a factor of $\frac{|\varepsilon|-1}{2|\varepsilon|}$ or $\frac{1}{2}(1-m)$. Table 12 compares consumer surplus (as a fraction of

revenues) for the two demand systems for the elasticities used in our simulations.

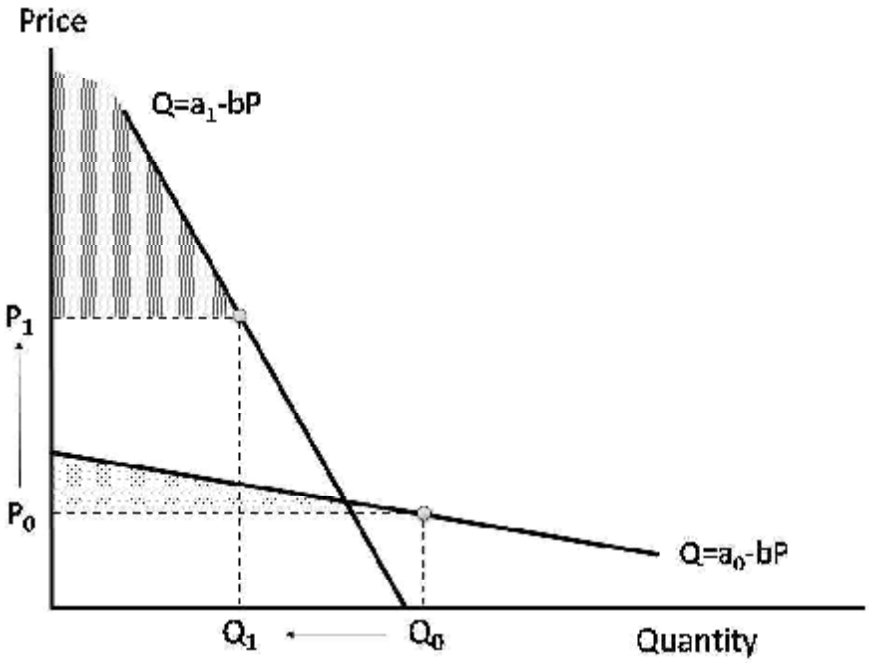
D.4. Graphs

Figures 4a and 4b show a graphical representation of a hypothetical observed equilibrium (P_0, Q_0) and a counterfactual equilibrium (P_1, Q_1). The lightly-shaded regions indicate consumer surplus lost as a result of the rule-of-reason regime, and the darkly-shaded regions represent consumer surplus gained.

Figure 3: Demand Calibration



(a) Constant Elasticity Demand



(b) Linear Demand