

Competition Implications of the California Supreme Court Decision in ABC International Traders, Inc.

02.27.1997

On February 27, 1997, the California Supreme Court issued an opinion that significantly broadened the range of exposure under the California Unfair Practices Act ("UPA") and the California Unfair Competition Act ("UCA"). In doing so, we expect to see a substantial increase in antitrust litigation in the California court system.

Summary of the Case

ABC International Traders, Inc. v. Matsushita Elec. Corp. of America ("ABC") presented two issues of significance. First, it presented the issue whether under California Business and Professions Code Section 17,045 ("17,045") a disfavored buyer can plead a cause of action against a seller, for granting an unearned discount to the buyer's competitors. The second issue was whether a plaintiff may seek restitution of money lost by the plaintiff or gained by the defendant as a result of acts of unfair competition, without also seeking an injunction against future acts of unfair competition.

The California Supreme Court reversed the decision of the Court of Appeals for the Second District and held that California Business and Professions Code Section 17,045 applied to buyers at the secondary level, as well as to sellers at the primary level. A cause of action also exists against the favored buyers who have induced the unearned discount from the seller.

Plaintiff ABC was a wholesale distributor of telephone equipment and electronic products. It brought suit against its vendor, and three of ABC's competitors. It alleged that the defendant seller had provided ABC's competitors with a discount not provided to plaintiff. Plaintiff alleged that the discount violated California Business and Professions Code Section 17,045 because it was "secret," "unearned," and that it "tended to destroy competition" among competing buyers.

For over thirty years, in *Harris v. Capitol Records etc. Corp.*, 64 Cal. 2d 454 (1966), the California Supreme Court had stated in dicta that California Business and Professions Code Section 17,045 was only applicable at the primary or seller level, and could not be extended vertically downward to the buyer or secondary level.¹ In *Harris*, the holding of the Court was that locality discrimination proscribed by California Business and Professional Code 17,031 implied a geographic price difference as a necessary element, and did not apply to a price discrimination where the defendant did not have at least two different places of business, and sold at a lower price in one than in the other. 64 Cal. 2d at p. 460.

Significantly, the *Harris* court held that an expansion of the Unfair Practices Act to increase exposure at the secondary level was inconsistent with general antitrust principles, and must be directed to the Legislature.

In ABC, however, the Supreme Court held that it is duty bound to apply the legislative intent of the Unfair Practices Act as of its enactment in the 1930s. In doing so, it has turned back the economic antitrust clock to the depths of the Great Depression.

Thus, the ABC decision may do great mischief. The rationale for the enactment of the Robinson-Patman Act was to protect small business from price competition from the expanding channel of chain store distribution. This was so at the expense of consumers. In large part, the Robinson-Patman Act was designed to prevent price erosion at the consumer level, in order to prevent the exit of smaller, and less efficient competitors. In more modern times, the accepted mission for antitrust has been to enhance consumer welfare by lower prices, as a result of interbrand competition. Where competition was enhanced, even at the expense or exit by a competitor, this was of no moment.

Mindful of a strong dissent by Justice Brown, the ABC majority states that the interpretive question under California Business and Professions Code Section 17,045 does not concern protection of "individual competitors versus competition generally,"but requires that a plaintiff prove injury to a competitor and, in addition, prove a tendency "to destroy competition."

Commentators on the California Unfair Practices Act have pointed out that it does not mirror Section 2(a) of the Robinson-Patman Act. For example, the Unfair Practices Act prohibits locality discrimination, but does not prohibit price discrimination by a seller in favor of a particular customer.^{2/}

Nevertheless, plaintiffs' counsel will certainly invite the lower courts to interpret the Unfair Practices Act "liberally," so as to mirror the application of the Robinson-Patman Act.^{3/}

Another cause for concern is the citation by the Court in Diesel Electric Sales & Service, Inc. v. Marco Marine San Diego, Inc., 16 Cal. App. 4th 202 (1993) ("Diesel"). In Diesel, the Court held that California Business and Professions Code Section 17,045 was not only actionable at the buyer level, but that there was no "intent" requirement, and that there was no "meeting competition" defense available.

Avoiding the Ramifications of ABC

One way to avoid litigation by disfavored buyers under California Business and Professions Code Section 17,045 is to ensure that any promotional allowances, rebates, refunds, commissions, or discounts are fully "earned" by the favored buyers who comply with written policies made applicable to all buyers who buy on like terms and conditions. This would imply that a seller provide each of its competing buyers who buy on like terms and conditions with a written statement of its promotional allowance policies. By doing so, each buyer should be able to "earn" any of the allowances, discounts or rebates made generally available by the seller.

Providing buyers with a promotional allowance policy statement may also avoid litigation under ABC because the "allowance" or "rebate" will not be "secret." A fair reading of ABC is that it will not be a violation for a seller, or an inducing buyer, to have given or received a discriminatory allowance, discount, or rebate so long as disfavored competing buyers are aware of the seller's policy.^{4/}

As a matter of antitrust economics, the net result of ABC should be the chilling of price competition at the seller level, greater price uniformity, and thus a net consumer welfare loss. This is a strange antitrust bedfellow for the end of the century.

A third way to avoid the procrustean bed of ABC may be to translate allowances, discounts, or rebates into a net forward-looking price. This is because the language of California Business and Professions Code Section 17,045 is expressed in terms of pay-backs, kickbacks, and other circumstances where a portion of a price is passed back by the buyer to the seller. Where the pay-back is "secret," the disadvantaged buyer cannot combat the net price difference, and the buyer, as well as consumers, may be the worse off. Only in this context can ABC be harmonized with mainstream antitrust policy.

Endnotes

1/The ABC court has limited Harris to locality discrimination, as defined in Section 17,031. 2/1 ABA Antitrust Law Section, State Antitrust Practice and Statutes (1990), California, at 6-18. By its terms, 17,045 contemplates the secret return of consideration paid by a buyer to a seller back to the buyer, in the form of "rebates, refunds, commissions, or unearned discounts." Thus, by its terms, it should not apply to a price discrimination. 3/In *G.H. I.I. v. MTS, Inc.*, 147 Cal. App. 3d 256, 271 (1983), the court stated that it would look to Section 2(b) of the Robinson-Patman Act for guidance in construing the Unfair Practices Act. 4/Even under Section 2(a) of the Robinson-Patman Act, the availability of a lower price must be known to the competing buyers, and must be "functionally" available. *FTC v. Morton Salt Co.*, 334 U.S. 37 (1948).

This article was originally published as a Litigation and Antitrust Update (March 1997), a Sheppard, Mullin, Richter & Hampton LLP publication.

© 1997 Sheppard, Mullin, Richter & Hampton LLP.

Practice Areas

Litigation