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A Contemporary Analysis of Whether the EU Should Reconsider its Rules on Resale Price Maintenance

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INTRODUCTION

The legal status of Resale Price Maintenance (RPM) agreements is a highly controversial area of competition law in Europe. This paper aims to illustrate why the European Union (EU) should reconsider its rules on RPM. This paper consists of four parts. Part 1 will provide the definition for RPM agreements which will be used throughout the rest of the paper. Having defined what RPM agreements are, Part 2 will explore the European Commission's hostile approach to these agreements. This will be contrasted with the approach taken in the United States. RPM agreements produce both pro- and anti-competitive effects. These effects will be explained in Part 3. Finally, Part 4 will draw upon the arguments advanced in this paper and will show that the European Commission should change its approach to RPM agreements.

PART 1: WHAT IS RPM?

The most commonly recognised RPM agreements are minimum RPM agreements, where upstream undertakings (manufacturers or suppliers) impose a price floor on the resale of their products or agree such a price floor with downstream undertakings (retailers or distributors). As is discussed below, these agreements are presumed illegal in the EU. Another, less recognised, RPM agreement is the maximum RPM agreement, where suppliers impose or agree a price ceiling for their products. Maximum RPM agreements have generally been viewed with more favour by the European Commission and are not considered as having as severe anticompetitive effects as the former.[1]

PART 2: THE CURRENT EU POSITION

The principal legal framework which governs RPM agreements is found in Article 101 of the Treaty on the Functioning of the European Union (TFEU).[2] This Article provides a general prohibition on agreements between undertakings, concerted practices and decisions by associations of undertakings which objectively or effectively prevent, restrict or distort competition on a relevant market.[3] An agreement which falls within the scope of Article 101(1) TFEU can be allowed to proceed if it benefits from a block exemption or an individual exemption under Article 101(3) TFEU.

In relation to RPM agreements, the relevant block exemption to consider is the vertical agreement block exemption.[4] The Block Exemption Regulation (BER) allows restrictive vertical agreements to proceed between small undertakings so long as they do not objectively restrict competition. The Commission defines restrictions by object as "[r]estrictions… that *by their very nature* have the potential of restricting competition".[5] Put simply, an agreement which aims to restrict competition will be deemed a restriction by object. As is discussed below minimum RPM agreements fall into this category because they generally soften price competition at the downstream level. The hostility of the Commission towards minimum RPM agreements can be seen when we examine the provisions of the BER. Article 4(a) of the Regulation explicitly excludes minimum RPM agreements benefitting from the block exemption, branding

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[1] Nikolaos Verras, "Resale Price Maintenance in EU Competition Law: Thoughts in Relation to the Vertical Restraints Review Procedure" [2009] 16 The Columbia Journal of European Law 37, 37.
[2] OJ C 326.
[3] Article 101(1) TFEU.
[4] Commission Regulation (EU) No 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices [2010] OJ L 102 (hereafter the Block Exemption Regulation or BER).
[5] European Commission, *Guidelines on the application of Article 81(3) of the Treaty* [2004] OJ C101/8, para 21 (emphasis added).

them a "hardcore" restriction. It is interesting to note that maximum RPM agreements do qualify for exemption under the Regulation. If we consider the economic impact of both minimum and maximum RPM agreements, the Commission's rationale becomes clearer.

Article 101(3) TFEU gives undertakings the opportunity to gain legal exemption from the Article 101(1) TFEU prohibition. However, there are strict conditions which must be met to benefit from the exemption. The agreement must:

> *"contribute to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives"*.[6]

This last condition can be considered to be a proportionality condition and is the reason why it is almost impossible for a minimum RPM agreement to benefit from the Article 101(3) TFEU exemption. Indeed, the EU Commission itself considers that minimum RPM agreements are "unlikely to fulfil the conditions of Article 101(3) [TFEU]".[7] In many cases, there will be other measures which can achieve the same goals as an RPM agreement, but restrict competition to a lesser degree. An example of this could be using franchising to set prices internally, rather than using an RPM agreement. The strict nature of these conditions mean that the event of an RPM agreement benefitting from the article 101(3) TFEU exemption is merely a theoretical possibility. It is submitted that the EU Commission's position is incoherent on this point. It could be said that there is little point in creating a possibility of exemption under Article 101(3) TFEU while stating in guidance that it would be almost impossible for such an agreement to benefit from that exemption.

Nevertheless, at first glance, the law seems to suggest that each case must be reviewed individually to identify whether an anticompetitive object or effect

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[6] Ibid.
[7] EU Commission, *Guidelines on Vertical Restraints* [2010] OJ C 130, para 224.

exists, and then evaluate whether the anticompetitive effect is outweighed by the benefit to consumers.[8] However, in practice, the EU is fuelled by a need for greater certainty than that provided by a case-by-case assessment. Thus, certain practices were tagged with specific legal outcomes to ensure certainty. Matthew Bennett, Amelia Fletcher, Emanuele Giovannetti and David Stallibrass illustrate this using a linear spectrum of artificial boxes, of which certain practices would fall into.[9] On the left side of the spectrum is "*per se* illegality" i.e. a practice tagged as conclusively illegal. On the opposite side, is "*per se* legality" i.e. a practice tagged as conclusively legal.

Bearing in mind the influence US antitrust law has had and continues to have on EU competition law, in addition to the fact that the two systems share similar aims, the comparison is extremely relevant. As is demonstrated by the US case of *Dr Miles Medical Co v John D Park and Sons Co*,[10] RPM had previously been placed in the "*per se* illegality" box. In this case, the US Supreme Court confirmed lower court decisions that a minimum RPM infringed US competition law. The reasoning behind its decision was that RPM approximated to horizontal price fixing, consequently making it "*per se* illegal". Even though the reasoning behind regulating RPM in the EU is the same as is in the US, the EU is not as harsh as early US antitrust law. This is further demonstrated by the fact that the US Supreme Court in *Albrecht v Herald Co* held that RPM in any form (be it minimum, fixed or maximum) was *per se* illegal.[11]

As abovementioned, the distinction in the EU is made between actions which have as their "object", or "effect" the restriction, prevention or distortion of competition. Practices considered as having as their "object" the restriction of competition are automatically presumed to be anticompetitive. In such cases, there is no need for the Competition Authority to show any economic harm, whereas for an "effect" based scenario, there is. However, it could be argued that

[8] Matthew Bennett and others, "Resale Price Maintenance: Explaining the Controversy, and Small Steps Towards a More Nuanced Policy" [2009] 33 Fordham International Law Journal 1278, 1281.
[9] Ibid 1282.
[10] *Dr Miles Medical Co v. John D Park and Sons Co* [1911] 220 US 373.
[11] *Albrecht v. Herald Co* 390 US 145 (1968).

defendants are still given the opportunity to plead their case under Article 101(3) TFEU. Nevertheless, minimum RPM is regarded as a hardcore restriction under Article 4(a) of the BER.[12] Thus, it is highly unlikely that a defendant would qualify for this exemption.

Over time, hesitations as to the way in which RPM is regulated began to arise. In the EU, this is illustrated by the case of *SA Binon & Cie v SA Agence et Messageries de la Presse,* where newspaper publishers sold newspapers through retail outlets and stated the price at which they were to be sold.[13] The EU Commission found that this amounted to RPM, consequently restricting competition. The German Government acknowledged the fact that these practices had pro-competitive effects and put forward certain arguments demonstrating them. Ultimately, these practices were deemed anti-competitive, and thus illegal. However, this illustrates that Member States were increasingly becoming aware of the pro-competitive effects of RPM.

The US approach to RPM was eased by the case of *State Oil v Kahn*,[14] where the US Supreme Court applied a "rule of reason" approach to maximum RPM agreements. This approach involves the court making an in-depth analysis of the effect which the agreement complained of would have on the market. The US approach was then turned on its head following the case of *Leegin Creative Leather Products Inc v PSKS, Inc.*[15] This case concerned a minimum pricing policy whereby Leegin would refuse to supply any retailer who priced below the stipulated price. Kay's Kloset (a subsidiary of PSKS) was found to be pricing below the minimum price and Leegin then broke off PSKS's supply. Aggrieved by this, PSKS raised an action seeking for Leegin's pricing policy to be held illegal under s. 1 of the Sherman Act 1890.[16] Both the District Court and the Court of Appeals for the Fifth Circuit followed the *Dr Miles* decision and held

[12] On the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices [2010] OJ 2 102/05.
[13] [1985] ECR-02015.
[14] *State Oil v Kahn* 522 US 3 (1997).
[15] *Leegin Creative Leather Products Inc v. PSKS Inc* [2007] 551 US 877.
[16] 15 USC §1.

the policy to be illegal. However, the Supreme Court held that both pro-competitive and anti-competitive effects must be examined on a case-by-case basis, ultimately using the "rule of reason" in order to reach a verdict. Given the US Supreme Court's experience with RPM, it is worthwhile to consider some of the arguments presented in order to evaluate whether the EU should reconsider its position.

PART 3: PRO-COMPETITIVE AND ANTI-COMPETITIVE EFFECTS OF RPM

Having outlined the progressive acknowledgement of pro-competitive effects of RPM, it is essential to outline some of them in this part of the paper. However, restrictions are still in place, illustrating that RPM also has anti-competitive effects. Thus, it is also necessary to outline the anti-competitive effects of RPM.

PRO-COMPETITIVE EFFECTS OF RPM

Firstly, economists have long argued that limits on intra-brand competition may have the effect of increasing inter-brand competition. With regards to price restraints it has been argued that, "by enhancing the pricing power of the retailer, the manufacturer induces the retailer to engage in activities that stimulate demand".[17] This could refer to practices such as increased quality of services in order to increase demand for a given product, consequently increasing the quantity sold. This is illustrated by Figure 1 below. This argument was made most famously by Tesler and can be best understood in a manufacturer/retailer context.[18] The service argument contends that because RPM eliminates competition on price, retailers are forced to compete with each other on the additional services given to consumers as part of the sales experience.[19] These extra services contribute to the overall consumer surplus on the product, which is shown in Figure 1 as the area between the RPM price line and the D1 curve

[17] FM Scherer, "The Economics of Vertical Restraints" [1983] 52 Antitrust Law Journal 687, 692.
[18] Lester G Tesler, "Why Should Manufacturers Want Fair Trade" [1960] 3 JL & Econ 86.
[19] Ibid 91.

(shaded area). Retailers would not ordinarily offer these services without the RPM agreement being in place because the services will increase the retailer's costs. Zevgolis argues that this is a pro-competitive effect of RPM agreements.[20]

FIGURE 1

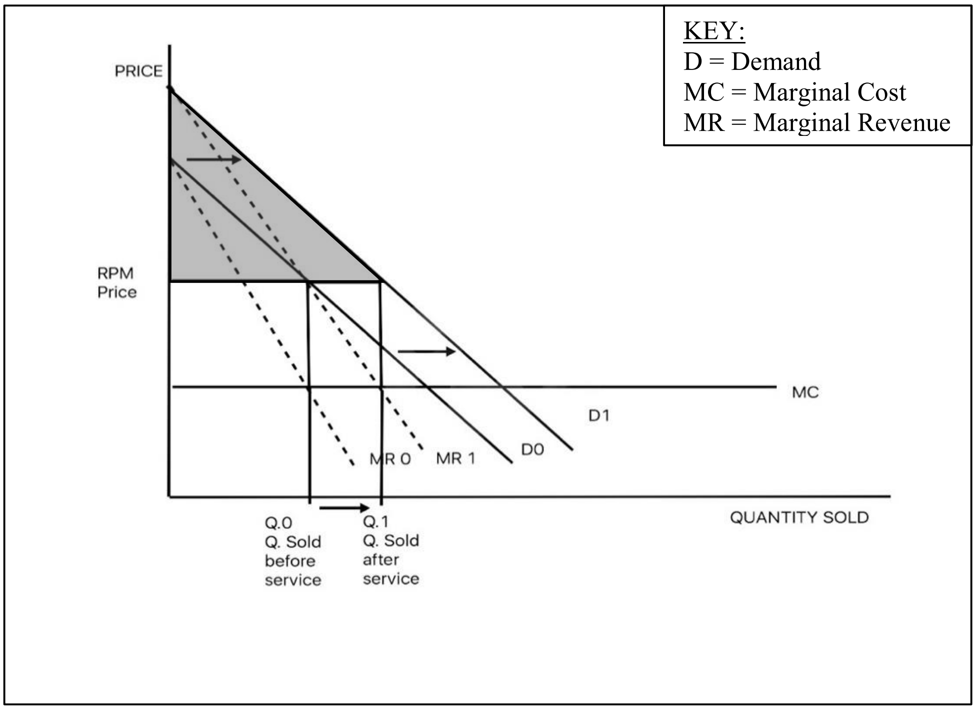

Figure 1 illustrates that retailers will seek to provide a better service for consumers. This is due to the fact that if a better experience is provided, demand for the product will shift from D0 to D1, consequently leading to a greater quantity sold (Q0 to Q1). This translates to greater profits for retailers, therefore making it desirable, whilst still being beneficial for consumers.[21]

Additionally, Tesler argued that some customers value the extra services provided, but favour lower priced products.[22] The firm wishing to provide the extra service inevitably incurs extra costs, consequently leading to higher priced products in order to cover additional costs. Given the chance, some consumers will turn to cheaper retailers who do not provide the same quality of service.

[20] Nikolaos N Zevgolis, "Resale Price Maintenance (RPM) in European Competition Law: Legal Certainty versus Economic Theory" [2013] ECLR 25, 27.
[21] For the purposes of providing a clearer example, MC is assumed to be constant. Nevertheless, in reality it would possibly rise with the extra advertisements and services.
[22] Tesler (n. 18).

They will purchase the cheaper product, after having enjoyed the service provided by higher priced competing retailers. This is known as the "free rider" problem. Tesler argues that RPM eliminates this problem.[23] With RPM all retailers will have to charge the same price for the given product, whilst competing on the quality of product-specific services provided.

Having illustrated how minimum RPM agreements may have pro-competitive effects, it is essential to illustrate how other types of RPM agreements may affect the market. It has been argued that maximum RPM agreements can assist in solving the double marginalisation problem. This problem occurs when both the supplier and distributor have a dominant position or monopoly. The result of this combination of facts is that the product is marked up twice at monopoly price. As well as inflated prices, consumer welfare is also harmed due to the dead-weight loss experienced by monopoly pricing being compounded with the double mark up. Furthermore, as Bishop and Walker explain, where the distributor is a monopolist, they will stop demanding products from the supplier at the point where their marginal revenue meets the marginal cost of the product. This makes it very easy for both the supplier and distributor to restrict output of the product because the supplier simply treats the distributor's marginal revenue curve as their demand curve.[24] A maximum RPM agreement in this circumstance will benefit consumer welfare overall. As Velez explains, the immediate impact would be a price drop for the consumer, as a monopolist distributor would be unable to impose a monopoly mark-up at their level because the price would most likely hit the price ceiling first.[25] This drop in price will also benefit the supplier and distributor owing to increased demand for the products they make and sell.

[23] Ibid 104.
[24] Simon Bishop and Mike Walker, *The Economics of EC Competition Law: Concepts, Application and Measurement* (3rd Edn, Sweet and Maxwell, 2010).
[25] Mario Velez, "The Tenuous Evolution of Resale Price Maintenance" [2011] ECLR 32(6) 297.

Moreover, it could be argued that RPM protects the image of certain well-known brand names. This is successfully identified in "Vertical Price Coordination and Brand Care".[26] "Red Bull" is used as an example in order to point out that people would not react positively to drastic falls in price.[27] Thus it could be argued that RPM keeps prices steady, which consequently protects branded products and sustains competition.

It could also be argued that RPM increases consumer welfare in the sense that greater choice is provided. It is desirable for competition policy to have situations where consumers can choose from a variety of homogeneous products, otherwise known as "demand-side substitutability". Therefore, if a consumer had the ability to choose from price-maintained and non-price maintained products, this could translate to greater consumer welfare.[28]

ANTI-COMPETITIVE EFFECTS OF RPM

Some argue that RPM facilitates upstream collusion. When upstream firms wish to collude, but also set prices for retailers, it can be difficult for an agreement to be controlled and applied, and retail prices act as an imperfect proxy.[29] Julien and Rey successfully demonstrate that if all retailers charge the same price, the market becomes extremely transparent, thereby allowing for manufacturers to observe one another, consequently leading to a convergence of prices.[30] It then becomes harder for the EU Commission to show that a concerted practice has formed because such a challenge may simply be defended by undertakings pleading that their prices are being set by ordinary market forces.

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[26] Dieter Ahlert and Benjamin Schefer, *Vertical Price Coordination and Brand Care* (Springer Berlin Heidelberg 2013).
[27] Ibid 10-11.
[28] Ibid 22.
[29] George P Kyprianides, "Should Resale Price Maintenance Be Per Se Illegal?" (Social Science Research Network 2012) SSRN Scholarly Paper ID 2377039 380. <http://papers.ssrn.com/abstract=2377039> accessed 21 October 2015.
[30] Bruno Jullien and Patrick Rey, "Resale Price Maintenance and Collusion" [2007] 38 The RAND Journal of Economics 983, 996.

Moreover, it is argued that RPM can be used in order to sustain downstream collusion.[31] This occurs when downstream firms wish to collude and use numerous RPM agreements in order to facilitate this.[32] In some instances, it could be stated that RPM is merely a "sham" vertical agreement used in order to disguise a horizontal agreement, which is undoubtedly anti-competitive.[33]

Furthermore, RPM has the effect of solving the monopoly commitment problem, originally recognized by Hart and Tirole.[34] An upstream monopolist can maximise its profit by allowing only one downstream firm to sell its products. Nevertheless, it has an incentive to sell to others as this will increase the number of products sold. However, as supply increases, prices fall, making it extremely difficult for the monopolist to extract its maximum profit. RPM can solve this problem by permitting the upstream monopolist to commit to the monopoly price, consequently extracting its full monopoly rents, whilst selling to multiple downstream firms.[35] Consequently it could be argued that in such circumstances, RPM may assist monopolists in attaining anti-competitive prices.

Finally, some argue that RPM deters downstream firms from entering the market.[36] With minimum RPM in force, distributors and retailers do not have to compete especially hard with each other to sustain their market positions because consumers are prevented from obtaining reduced prices for their desired product elsewhere. This is extremely harmful for consumer welfare. Where a new distributor seeks to enter the market, they too will be subject to the RPM agreement and cannot establish themselves on the market by reducing prices to incentivise sales. The argument that a new entrant may earn an immediate profit can be rebutted by contending that they cannot provide an incentive for consumers to buy from them. In the absence of such an incentive, it is likely that consumers will simply buy from their usual distributor. Having set out the pro-

[31] Bennett and others (n. 8) 1291.
[32] Kyprianides (n. 28) 380.
[33] *Argos Ltd v Office of Fair Trading* [2006] EWCA Civ 1381.
[34] Oliver Hart and others, "Vertical Integration and Market Foreclosure" [1990] 1990 Brookings Papers on Economic Activity. Microeconomics 205, 208.
[35] Bennett and others (n. 8) 1292.
[36] Ibid.

and anti-competitive aspects of RPM agreements, we can now determine whether the EU Commission should reform their rules governing these agreements.

PART 4: SHOULD THE EU RECONSIDER THE RULES ON RPM?

Whether the pro-competitive effects outweigh the anti-competitive effects created by RPM will determine if the EU should reconsider the way in which it is governed. If the pro-competitive effects outweigh the anti-competitive effects, then it could be argued that the EU should move towards an "effect" based approach. However, if the anti-competitive effects prevail, then it could be argued that the EU should retain its current rules.

One of the most up-to-date reviews of current empirical evidence is that of Lafontaine and Slade.[37] They identified that a fairly relaxed attitude towards vertical restraints is justifiable.[38] Thus, it could be argued that the EU's current view of RPM is unwarranted; meaning that they should consider moving towards an "effect" based approach. However, Lafontaine and Slade acknowledge the fact that further empirical evidence is needed for final conclusions to be drawn. Nevertheless, as is argued by Nikolaos Verras, the application of an "effect" based approach to RPM will consequently lead to fairer treatment.[39] This is due to the fact that RPM evidently has pro-competitive effects, and the current EU rules act as a blanket ban towards it. Even though defendants can theoretically make use of the exemption under Article 101(3) TFEU, it is highly unlikely that such an exemption will be granted, as it is regarded as a hardcore restriction under the BER. Moreover, with a blanket ban, the pro-competitive effects of RPM are lost giving the impression that competition policy is applied

[37] Francine Lafontaine and Margaret E Slade, "Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy" in Paolo Buccirossi (ed), *Handbook of antitrust economics* (MIT Press 2008).
[38] Ibid 409.
[39] Verras (n. 1) 40.

disproportionately. Thus, it can be deduced that the EU must reconsider its rules governing RPM and move towards an "effect" based approach.

CONCLUSION

Over the years, the way in which RPM is regulated has become a highly controversial issue, with two opposing schools of thought. On the one side, are those who believe that RPM should be "*per se illegal*", and on the other, those who believe that it should be governed by an "effect" based analysis. Taking all things into account, it is submitted that the current EU Commission approach is not satisfactory. It is considered that the anti-competitive effects of RPM agreements are not sufficiently serious to justify the near presumption of illegality. Moreover, the way in which the EU currently regulates RPM must be reconsidered, as it acts as a hypothetical blanket ban which does not allow for the pro-competitive effects of RPM to flourish.