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RESALE PRICE MAINTENANCE IN E.U. COMPETITION LAW: THOUGHTS IN RELATION TO THE VERTICAL RESTRAINTS REVIEW PROCEDURE

Nikolaos Verras

I. INTRODUCTION

Resale Price Maintenance (RPM) refers to an agreement between a supplier and a distributor by virtue of which the parties agree to set either a (1) fixed, (2) minimum, (3) maximum, or (4) recommended resale price. The first two forms, on which this paper will focus, are considered to have more severe anticompetitive effects such as a) elimination or reduction of intra-brand competition and b) increase in price transparency that might facilitate horizontal collusion upstream or downstream.¹ Therefore, these agreements are generally treated more strictly by competition law.

The anticompetitive or pro-competitive effects of RPM and what this diversity of effects shall mean for competition law analysis has been a long debate among economists and lawyers. The issue of how the E.C. Competition Law shall treat RPM has come to the center of interest in the context of the ongoing review of the Vertical Restraints Block Exemption by the European Commission.² At the same time, the appropriate treatment of RPM was brought to the center of attention in the United States in the *Leegin* case,³ where the Supreme Court decided by a weak majority of 5 against 4 to abandon the long-standing *Dr. Miles*⁴ *per se* rule and apply to RPM the rule of reason.

¹ FRANK WIJCKMANS, FILIP TUYTSCHAEVER & ALAIN VANDERELST, VERTICAL AGREEMENTS IN EC COMPETITION LAW 157–58 (2006).

² On July 28, 2009, the European Commission published drafts of a revised vertical agreements block exemption regulation, *Draft Commission Regulation on the Application of Article 81(3) of the Treaty to Categories of Vertical Agreements and Concerted Practices* (July 28, 2009), [hereinafter Draft BER], and accompanying revised guidelines on vertical restraints, *Draft Commission Notice for Guidelines on Vertical Restraints* (July 28, 2009), [hereinafter Draft Guidelines], and initiated the consultation period on the above documents that ended on September 28, 2009. The Draft BER will replace the current vertical agreements block exemption which entered into force for a period of ten years on June 1, 2000. Commission Regulation 2790/1999, On the Application of Article 81(3) of the Treaty to Categories of Vertical Agreements and Concerted Practices, 2009 O.J. (L 336) 21 (EC), [hereinafter BER]. The scope of the BER was to determine specific prerequisites under which a vertical agreement would be exempted from the application of Article 81(1) E.C. and therefore provide legal certainty. The BER tries to determine agreements that are likely to fall within the Article 81(3) E.C. exemption due to their characteristics and refers to all types of agreements between parties active at different levels in the production line, including selective distribution and agency arrangements. Current guidelines on vertical restraints provide a commentary on the BER and determine the methodology under which the Commission approaches vertical restraints. *Commission Notice for Guidelines on Vertical Restraints*, C (2000) 291 (Oct. 13, 2000) [hereinafter Guidelines]. See generally BELLAMY & CHILD: EUROPEAN COMMUNITY LAW OF COMPETITION 405–23 (Peter R oth & Vivien Rose eds., 2008).

³ *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007).

⁴ *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911).

II. PROPOSED CHANGES UNDER DRAFT BER AND DRAFT GUIDELINES

Under the current legal framework in the European Union, fixed and minimum RPM falls outside the scope of the vertical agreements block exemption regulation (BER) because it is considered a hardcore restriction.⁵ This means that it is “presumed illegal” and considered to have as its *object* the restriction of competition, and is therefore expressly prohibited by Article 81(1)(a) E.C. and very unlikely to be exempted under Article 81(3) E.C.⁶

The characterization of strict RPM as a hardcore restriction is retained under the Draft BER,⁷ although the Commission tried to soften the strictness of the rules’ application by setting out in the Draft Guidelines the positive effects that RPM may have for competition and by expressly mentioning that there is ground for exemption under Article 81(3) E.C.⁸ In paragraph 221 of the Draft Guidelines, the Commission acknowledges that RPM may lead to efficiencies in cases of introduction of a new brand or entrance in a new market. Moreover, fixed RPM is considered to be beneficial for consumers in cases of a short term low price campaign for the purpose of organizing a franchise or similar distribution system and in cases of a distributor’s significant market power that may lead it to use a particular brand as a loss leader.

III. PRO-COMPETITIVE EFFECTS

Literature regarding the effects of RPM is not consistent, and although the anticompetitive effects of RPM have been proved in many papers,⁹ there are also significant pro-competitive effects. We will try to present in brief some of the main situations where RPM may have pro-competitive effects:¹⁰

- a) Strict RPM may help overcome the free-rider problem that occurs in cases where a retailer offers pre-sale services to consumers and includes these services in the price, while another retailer does not provide pre-sale services, and therefore does not bear the

⁵ See BER, *supra* note 2, art. 4(a); Guidelines, *supra* note 2, ¶ 47.

⁶ Fixed and minimum RPM is also treated as hardcore restrictions under the *De Minimis Notice*. Commission Notice on Agreements of Minor Importance Which Do Not Appreciably Restrict Competition Under Article 81(1) of the Treaty Establishing the European Community (De Minimis), ¶ 11, C (2001) 387 (Dec. 22, 2001), [hereinafter *De Minimis Notice*]. However it is argued that in cases of very small market shares strict RPMs may fall outside Article 81(1) E.C. See BELLAMY & CHILD: EUROPEAN COMMUNITY LAW OF COMPETITION, *supra* note 2, at 436.

⁷ Draft BER, *supra* note 2, art. 4(a).

⁸ Draft Guidelines, *supra* note 2, ¶ 219–25. More specifically, the Commission acknowledges that in cases in which RPM will lead to efficiencies, it may have to “effectively assess—and not just presume—the likely negative effects on competition.” *Id.*, ¶ 219.

⁹ For a discussion of the so-called commitment effect theory, see Oliver Hart & Jean Tirole, *Vertical Integration and Market Foreclosure*, BROOKINGS PAPERS ON ECON. ACTIVITY: MICROECON. 205 (1990); Daniel O’Brien & Greg Shaffer, *Vertical Control with Bilateral Contracts*, 23 RAND J. ECON. 299 (1992); Patrick Rey & Thibaud Verge, *Bilateral Control with Vertical Contracts*, 35 RAND J. ECON. 728, 740 (2004). For a discussion of the facilitation of manufacturers’ or retailers’ collusion, see Bruno Jullien & Patrick Rey, *Resale Price Maintenance and Collusion*, 38 RAND J. ECON. 983 (2007); Frank Mathewson & Ralph Winter, *The Law and Economics of Resale Price Maintenance*, 13 REV. INDUS. ORG. 57, 65 (1998). For a discussion of the anticompetitive effects of slotting allowances and RPM, see Greg Schaffer, *Slotting Allowances and Resale Price Maintenance: A Comparison of Facilitating Practices*, 22 RAND J. ECON. 120 (1991).

¹⁰ See also Frederik Van Doorn, *Resale Price Maintenance in EC Competition Law: The Need for a Standardized Approach*, SOC. SCI. RES. NETWORK 12–15 (2009), <http://ssrn.com/abstract=1501070> (last visited Dec. 3, 2009).

- extra cost and can offer the goods at a reduced price, taking advantage of the pre-sale services provided by the first retailer.¹¹ Strict RPM may also be used to force retailers to provide after-sales services that increase consumers' welfare and which the retailer may not intend to provide in order to avoid the extra cost.¹²
- b) Strict RPM may also help in cases where a retailer tries to free-ride on the reputation that another retailer who provides high quality products has developed by stocking similar products; the supplier can overcome this problem by posing minimum or fixed RPM in order to "purchase" quality certification from its distributors.¹³
 - c) Strict RPM may also be used for the protection of a very well-known and prestigious brand name from widespread use that might deteriorate it.¹⁴
 - d) Strict RPM is also very effective in treating retailers' risk aversion in cases of uncertain consumer demand.¹⁵
 - e) Strict RPM may also have positive effects in cases where a supplier has to decide among the already used bricks and mortar retail network and the potential online retail network. The latter bears less promotional, inventory, and distribution costs and therefore can offer lower prices and damage the viability of the bricks and mortar retail network. By posing fixed or minimum RPM the supplier can retain the bricks and mortar retail network, while providing the consumer with the option to buy the same products online.

IV. TOWARDS A MORE EFFECT-BASED ANALYSIS OF RPM?

Usually in the literature¹⁶ the treatment of strict RPM as an object or an effect of anticompetitive behavior is combined with the answer to the question "which of the two effects of RPM (pro-competitive and anticompetitive) is most likely to prevail?" I believe that it is impossible to balance the two effects, especially due to the lack of adequate empirical evidence. Moreover, as soon as strict RPM has some significant pro-competitive effects that cannot be underestimated,¹⁷ the Commission shall provide this RPM with the chance to be exempted. As we mentioned above, although the Commission softened its approach against strict RPM it still considers it a hardcore restriction, and the fact that there is no case in which the Commission has exempted a strict RPM illustrates that the Commission's approach is closer to *per se* illegality.¹⁸ Therefore, the express reference in the Draft Guidelines of the possibility of an exemption under Article 81(3) E.C. does not change the current situation, as the Commission's position and the retained

¹¹ Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86, 89–96 (1960); Benjamin Klein, *Competitive Resale Price in the Absence of Free Riding* (Apr. 3, 2009), <http://cdn.law.ucla.edu/SiteCollectionDocuments/workshops%20and%20colloquia%202/klein,%20leow.pdf>.

¹² ROGER VAN DEN BERGH & PETER CAMESASCA, *EUROPEAN COMPETITION LAW AND ECONOMICS: A COMPARATIVE PERSPECTIVE* 244 (2006).

¹³ DORIS HILDEBRAND, *ECONOMIC ANALYSES OF VERTICAL AGREEMENTS—A SELF-ASSESSMENT* 15 (2005).

¹⁴ Howard Marvel & Stephen McCafferty, *Resale Price Maintenance and Quality Certification*, 15 RAND J. ECON. 346 (1984); MICHAEL UTTON, *MARKET DOMINANCE AND ANTITRUST POLICY* 238 (2003).

¹⁵ Patrick Rey & Jean Tirole, *The Logic of Vertical Restraints*, 76 AM. ECON. REV. 921 (1986).

¹⁶ See, e.g., Van Doorn, *supra* note 10.

¹⁷ For example, for a critical analysis of the pro-competitive effects of RPM, see Marina Lao, *Resale Price Maintenance: A Reassessment of its Competitive Harms and Benefits*, SOC. SCI. RES. NETWORK (2009), <http://ssrn.com/abstract=1434984> (last visited Dec. 3, 2009).

¹⁸ See *Linklaters LLP Submission in Response to the European Commission's Consultation Process Regarding the Competition Rules Applicable to Vertical Agreements*, 14–16 (2009).

strong presumption of illegality discourage companies from taking the risk to defend their RPM policies. Therefore, in my opinion, further steps for the real enforcement of Article 81(3) E.C. in cases of strict RPM have to be taken by the Commission.

The exemption of hardcore restrictions and the application of an effects-based analysis to RPM will lead to fairer treatment. An effects-based analysis means that the proof of violation of Article 81(1) E.C. rests with the Commission and it is only if it succeeds that the parties bear the burden of proving that their agreement entailing strict RPM has pro-competitive effects. Some argue¹⁹ that this will cause a significant regulatory cost, as a) this will increase the RPM cases before the Commission and b) the Commission will have the aforementioned burden of proof of the infringement, which, given the complexity and uncertainty of the issue, will require the use of experts. I believe that this is not the case, given the existence of case-law precedents finding that strict RPM infringes competition law; the main burden of proof rests on the parties to present well-founded arguments that the agreement has a positive effect on consumer welfare.

The main disadvantage for the parties asking for an exemption of a strict RPM agreement at the moment is the lack of empirical evidence and case-law precedents. In an attempt to overcome this situation and create a clear framework for RPM, the Commission could establish, for a trial period, a notification system similar to the one that existed before Regulation 1/2003 came into force for the exemptions under Article 81(3) E.C. Adoption of a system like that would, on the one hand, allow the Commission to place the burden of proof and the relevant cost on the parties' side and therefore make them bring forward only claims that have a strong possibility to succeed, and, on the other hand, increase the relevant case law and create a framework regarding the specific circumstances under which a strict RPM has a positive effect on consumers' welfare. Moreover, the Commission should take into consideration the fact that, as has been argued,²⁰ the anticompetitive effect of strict RPM has a connection with the market powers in the two markets involved in the agreement (the suppliers' and the retailers' markets). The Commission could a) use the market share as a screen in prioritizing the cases and therefore deal mainly with the cases where there is a large market share and the anticompetitive effects of RPM are more likely to take place, and b) remove RPM from the hardcore restraints in the *De Minimis Notice*, at least for a trial period.²¹

V. CONCLUSION

The attempt of the Commission to soften the treatment of strict RPM as a hardcore restriction in the context of the Vertical Restraints Review is welcome, but further steps have to be taken. The example of the United States, which moved to a more effects-based analysis by adopting the rule

¹⁹ See Van Doorn, *supra* note 10, at 20–23.

²⁰ The small market share was one of the main reasons why the Court in *Leegin* decided that there was no fear of anticompetitive effect. For a discussion of the relationship between market share and RPM, see Foros Øystein et al., *Resale Price Maintenance and Restrictions on Dominant Firm and Industry-Wide Adoption* (CESifo, Working Paper Series No. 2032, 2007), available at <http://www.ssrn.com/abstract=996795>; Warren S. Grimes, *The Path Forward After Leegin: Seeking Consensus Reform of the Antitrust Laws of Vertical Restraints*, 75 ANTITRUST L.J. 467, 469 (2008).

²¹ See White & Case LLP Comments on the Draft Commission Regulation on the Application of Article 81(3) of the Treaty to Categories of Vertical Agreements and Concerted Practices and the Draft Commission Notice—Guidelines on Vertical Restraints, 7 (2009).

of reason in the *Leegin* case, could be an indication that time has come for a change in the European Union as well. The change does not need to be radical and immediate. A gradual change with the adoption of a trial notification procedure before the Competition Authorities could offer a chance to the parties to defend their strict RPM agreements without the Commission undertaking the entire burden of proof. This would contribute to the creation of a pool of empirical evidence that could be used as a guide for future treatment of strict RPM.