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## (Minimum) Resale Price Maintenance Under the New Guidelines: A Critique and A Suggestion

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### I. INTRODUCTION

During its recent revision of rules regarding vertical agreements, which culminated in a revised block exemption for certain such agreements and new Guidelines on Vertical Restraints,<sup>2</sup> the European Commission initiated a debate on the treatment of (minimum) resale price maintenance (“RPM”) under EU competition rules. From the perspective of the supplier of a product, RPM consists of fixing or imposing a minimum retail price that the distributor must charge to consumers. To some degree, the debate in Europe was spurred by the *Leegin* decision of the U.S. Supreme Court in 2007 which overturned a long standing precedent, *Dr. Miles*, that treated minimum RPM as a *per se* violation of U.S. antitrust rules, in favor of a rule of reason analysis.<sup>3</sup> Some commentators have suggested that, given the fact that defendants often succeed in lower courts when restraints are examined under the rule of reason, *Leegin* would cause minimum RPM to be treated as, in effect, *per se* legal in many situations.<sup>4</sup>

In Europe, RPM has long been treated as a “hardcore” restriction of competition falling within the prohibition of Article 101(1) of the Treaty on the Functioning of the European Union (“TFEU”) with virtually no scope for meeting the strict conditions for exemption under Article 101(3). The latter provision enables the defendant to put forward an efficiency defense that will be balanced against the detrimental effects of the restraint. Given the fact that this defense was de facto unavailable for RPM, this practice has often been considered as a *per se* violation of EU competition rules.<sup>5</sup> In practice, this meant that suppliers could not impose RPM on their dealers in the EU.

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<sup>2</sup> The new block exemption regulation, Commission Regulation 330/2010, 2010 O.J. (L 102) 1 (hereinafter BER), and the Guidelines, Commission Notice: Guidelines on Vertical Restraints, 2010 O.J. (C 130) 1, are conveniently available at [http://ec.europa.eu/competition/consultations/2009\\_vertical\\_agreements/index.html](http://ec.europa.eu/competition/consultations/2009_vertical_agreements/index.html).

<sup>3</sup> *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 127 S. Ct. 2705 (2007); *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 US 373 (1911).

<sup>4</sup> See, e.g., Marina Lao, *Free Riding: An Overstated, and Unconvincing, Explanation For Resale Price Maintenance*, in HOW THE CHICAGO SCHOOL OVERSHOT THE MARK: THE EFFECT OF CONSERVATIVE ECONOMIC ANALYSIS ON U.S. ANTITRUST, OXFORD UNIVERSITY PRESS (Robert Pitofsky, ed.) (2008); John B. Kirkwood, *Rethinking Antitrust Policy Toward RPM*, ANTITRUST BULL., 2010; Seattle University School of Law Legal Research Paper 10:05, available at SSRN: <http://ssrn.com/abstract=1559377>.

<sup>5</sup> See, Frederik Van Doorn, *Resale Price Maintenance in EC Competition Law: The Need for a Standardised Approach* (November 6, 2009), available at SSRN: <http://ssrn.com/abstract=1501070>. But see Eric Gippini-Fournier, *Resale Price Maintenance in the EU: In Statu Quo Ante Bellum ?* (September 21, 2009). Fordham Corp. L. Inst - 36th Annual Conference on International Antitrust Law and Policy, 2009 (B. Hawk ed., 2010), available at SSRN: <http://ssrn.com/abstract=1476443>.

The draft Guidelines, which were published for consultation in the summer of last year, marked a relative softening of the Commission's policy towards RPM. Under the draft, RPM would still be categorized as a hardcore restriction of competition. However, the use of RPM would not necessarily mean that it would be *per se* illegal. RPM would continue to be presumed (i) to fall within Article 101(1) and (ii) to be unlikely to fulfill the conditions for exemption under Article 101(3). But the Commission would make the presumption rebuttable, leaving open the possibility for firms to plead an efficiency defense. In cases where the efficiency defense was sufficiently supported, the Commission, national competition authority, or court would then have to assess the likely negative effects on competition prior to ruling on whether RPM fulfills the conditions of Article 101(3). The new Guidelines, adopted by the Commission on 20 April 2010, maintain this rebuttable presumption. They also provide insights into the motives for treating RPM as a hardcore restriction and suggest circumstances in which RPM is likely to generate overriding efficiencies.<sup>6</sup>

In this commentary, we discuss the Commission's new approach toward RPM. We also discuss an alternative approach to the assessment of RPM. Before doing so, it is important to note that, although much has been written since *Leegin* about RPM by economists and legal practitioners alike, there is relatively little empirical evidence on the actual effect of RPM on consumer welfare. At the same time, there seems to be broad recognition that RPM is generally harmful to consumers where there is either a certain degree of market power or a widespread use of RPM in a given market.<sup>7</sup> Conversely, it is equally recognized that RPM can generate efficiencies overriding the negative price effect when it is used by a single or only a handful of suppliers without market power.

## II. WHY TREAT RPM AS A "HARDCORE" RESTRICTION OF COMPETITION?

The Commission does not clearly lay out why it believes RPM is so inherently suspect or bad for competition and consumers that it should be treated as a hardcore restriction. The new Guidelines do discuss several ways in which the Commission believes RPM "may restrict competition."<sup>8</sup> Recognizing, however, that this discussion comes after the Commission has already presumed not only that all RPM arrangements<sup>9</sup> violate Article 101(1) but also that none of them qualifies for exemption under Article 101(3), the Commission must be presuming that in every RPM situation at least one of those possible restrictions in fact arises. We discuss each in turn.<sup>10</sup>

### A. Facilitating Cartel Behavior

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<sup>6</sup> Guidelines on Vertical Restraints, O.J. C 130, 19.05.2010, p. 1, ¶¶223-225.

<sup>7</sup> See, Brief of *Amici Curiae* Economists in Support of Petitioner (22 January 2007), in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 127 S. Ct. 2705 (2007); Opinion of the EAGCP, Hardcore restrictions under the Block Exemption Regulation on vertical agreements: An economic view, by the Vertical Restraints subgroup, September 2009, available at <http://ec.europa.eu/dgs/competition/economist/eagcp.html> (visited on 21 May 2010); see also Kenneth Elzinga & David E. Mills, *Leegin and Procompetitive Resale Price Maintenance*, in ABA SECTION OF ANTITRUST LAW, ISSUES IN COMPETITION LAW AND POLICY (Kenneth G. Elzinga & David E. Mills, eds., 2008) (hereinafter Elzinga & Mills, *Leegin and Procompetitive RPM*).

<sup>8</sup> See Guidelines at ¶ 224.

<sup>9</sup> We note that the Guidelines make clear that treatment as hardcore RPM also applies to "indirect" mechanisms such as agreements on distribution margins, maximum resale discounts, or linking promotional support to observing minimum resale prices.

<sup>10</sup> The Commission enumerates seven, but we treat two at once, namely the possible facilitation of collusion among (1) suppliers and (2) dealers.

First, the Guidelines contend that RPM can facilitate cartel behavior among suppliers or dealers. The Commission believes that, at the supplier level, RPM used in a coordinated fashion can increase transparency and make it easier for cartelists to detect deviation, thus facilitating cartels, even if it is not the main mechanism by which a cartel can take shape.<sup>11</sup> The Commission sees the same risk when RPM is imposed by suppliers at the request of dealers. In that scenario, dealers might use RPM to enforce a cartel among them, but it is equally not a necessary element for a cartel to take shape at the dealer level. The Guidelines also envisage the adoption of RPM to facilitate tacit coordination. However, under well-established principles identified in the context of the EU Merger Regulation, tacit coordination requires additional ingredients for RPM to be effective in reaching an anticompetitive outcome.<sup>12</sup> In particular, as a facilitating tool for tacit collusion, RPM must operate in an oligopolistic market with relatively high barriers to entry, limited innovation, and lack of countervailing buyer power.

The main objection to the perceived risk of facilitating cartels is that despite decades of successful enforcement against cartels of many kinds, there have been very few (if any) cases where RPM was actually identified as a focal point for the functioning of a cartel. The Guidelines refer to none, and we are not aware of any. A second objection is that non-price vertical restraints may, when used in parallel by many or all suppliers, achieve the same collusive outcome. For instance, parallel networks of exclusive distributors with minimum purchase requirements may yield a similar market price outcome to RPM. Yet rather than treat non-price vertical restraints as hard-core restrictions, the Commission left them free of presumed negative effect. Instead, the Commission introduced the possibility for national authorities to withdraw block exemptions to parallel networks of vertical restraints that have significant restrictive effects on the affected market.<sup>13</sup> The Commission offers no justification for these very different treatments of apparently similar vertical arrangements.

## **B. Softening Competition**

Second, the Commission considers that RPM softens competition in the specific context of “interlocking” relationships, whereby suppliers use the same retailers to distribute their products and where RPM is used pervasively. Again, there is *prima facie* nothing wrong with the idea that this constitutes a risk. But, as was the case for the Commission’s first reason, it is the use by many or all suppliers in a given market that creates the risk, not the use by a given supplier individually.

## **C. Price Increase**

The third reason put forward by the Commission is somewhat circular. In substance, the Guidelines state that RPM causes prices to go up. The Commission is right: The immediate effect of the restraint is a price increase. However, it seems to us that the key issue is not whether prices of the RPM supplier’s product will go up. Rather, the real question is whether RPM has *appreciable* effects on prices in the relevant product market.<sup>14</sup> This “appreciable” standard is inherent to the application of Article 101(1) to any vertical restraint. The Commission must

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<sup>11</sup> See, e.g., Ittai Paldor, *The Vertical Restraints’ Paradox: Justifying the Different Legal Treatment of Price and non-Price Vertical Restraints* (January 24, 2007), available at <http://ssrn.com/abstract=951609>.

<sup>12</sup> Case T-342/99, *Airtours v. Commission*, Judgment of the Court of First Instance, [2002] ECR II-2585, ¶¶ 61-62.

<sup>13</sup> Recital 14 and Article 6 of the BER and the Guidelines on Vertical Restraints, O.J. C 130, 19 May 2010, p. 1, ¶ 78.

<sup>14</sup> Case C-27/87, *Erauw-Jacquery*, [1988] ECR 1919, ¶¶ 12 and seq.

prove that the particular RPM has an appreciable effect on competition for that specific restraint to fall within Article 101(1). We, therefore, question the initial presumption in the Guidelines that all RPM falls within Article 101(1).<sup>15</sup> The Commission should not through the Guidelines simply transfer the burden of proof to the defendant, arguing that the immediate effect of RPM is almost always a price increase.

#### **D. Commitment Problem**

The Commission's fourth reason concerns the "commitment problem" of a monopolist. By adopting RPM, a supplier with significant market power can "commit" itself not to follow its otherwise natural propensity to lower the wholesale price charged to new dealers in order to raise his market share. While this situation is no doubt plausible, it requires a certain degree of market power for RPM to result in detrimental effects on competition and consumers.

#### **E. Foreclosure of Competing Suppliers.**

The fifth concern that the Commission has with RPM is that a firm with some degree of market power might impose such a measure to induce retailers to deny access to rival brands. But whether this form of inter-brand competition injures consumers or competition must depend on more than just success in inducing retailers to favor one brand over another. Again, for RPM to affect competition appreciably, it would be necessary to establish that the supplier and/or the retailer has sufficient market power so that RPM is likely to foreclose competitors from being able to compete. This requires an initial assessment of the likely foreclosure effects and the risk that foreclosure poses to consumer welfare, rather than a presumption that all RPM that induces brand-shifting is detrimental.

#### **F. Foreclosure of Innovative Retailers**

Finally, the Commission cites the possibility that RPM could reduce retailer innovation and entry by low-cost retailers. On this view, RPM can operate as a barrier to entry against innovative dealers. This view sounds intuitively appealing but seems to lack empirical support. The Guidelines seem to equate innovation with low retail prices or low pre-sale service and support. But for low-price or low-cost retailers to be hindered in any significant way, RPM should presumably be pervasive in the relevant market, including all relevant, competing brands. This concern would thus not materialize if RPM is engaged in by only a limited number of suppliers operating in a relatively unconcentrated market.

The Commission's apparent reasons for black-listing RPM thus rest upon three perceived risks: (i) collusion (tacit or explicit) among suppliers or retailers, (ii) foreclosure by a dominant supplier or a supplier with some degree of market power, and (iii) the widespread use of RPM in a given market.

### **III. SHIFTING THE BURDEN OF PROOF**

Under the Commission's framework, every RPM is presumed to fall under Article 101(1) and it is for the defendant to adduce convincing evidence that RPM generates pro-competitive

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<sup>15</sup> Cf. Eric Gippini-Fournier, *Resale Price Maintenance in the EU: In Statu Quo Ante Bellum?* [citation] (Sept. 21, 2009) ("The reference to a double "presumption" is novel and does not appear to find an obvious basis in existing case law.").

effects that justify exemption under Article 101(3).<sup>16</sup> The Commission's approach raises at least two concerns.

First, and most significant, there may be many situations where RPM could be used outside of the anticompetitive scenarios outlined by the Commission in the Guidelines. Without providing much explanation, the Commission considers that all such situations will be presumed to fall within Article 101(1) and firms will have to come up with a forceful efficiency defense.<sup>17</sup> This approach skips the requirement for the Commission, national authority, court, or complainant to establish the existence of *appreciable* effects on competition prior to finding that the restraint falls within the scope of Article 101(1).<sup>18</sup>

Even assuming that—despite the Guidelines—the parties would not be prevented from arguing that their particular use of RPM did not even violate Article 101(1), the Commission's approach effectively shifts the entire burden of proof onto the parties. Following the Commission's logic, pro-competitive efficiencies have to be provided by the supplier in a precise and articulate way while there is no *a priori* indication why RPM used in the individual context raises competition concerns. The onus is thus on the parties to justify a practice for which there is no initial evidence that it should be a concern in the first place.

Before going straight to the efficiency defense under Article 101(3), one should at least consider the potential harmful effects that RPM may have in individual cases. In other words, the standard screening under Article 101(1) should be carried out. As RPM entails a loss of intrabrand competition and hinders the ability of dealers to lower their price to meet interbrand competition, one should in particular assess the existence of constraints resulting from interbrand competition. The stronger the competitive pressure exerted by other suppliers and retailers, the less likely RPM will result in market-wide price increases. Likewise, low barriers to entry should be an indicator that RPM is unlikely to result in a significant price increase if a supra-competitive price is likely to attract new entrants. Finally, the position of buyers may make RPM difficult to sustain over time. A large buyer may have the ability and incentives to ignore the RPM clause because its volume of sales significantly contributes to the penetration of the supplier's brand in a given market.

Once these market conditions are taken into account, can the defendant assess the extent of pro-competitive efficiencies necessary to override the likely harmful effects of RPM? Similar to a merger control analysis, efficiencies need not be significantly greater than the perceived harm to competition.<sup>19</sup> In other words, the lower the risk posed by RPM to effective competition in a retail market, the lower the efficiencies need to be to meet the conditions of Article 101(3).

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<sup>16</sup> Guidelines, at ¶¶ 47 and 223.

<sup>17</sup> The Guidelines do not indicate a specific level of persuasion applicable to all "efficiency defenses" but regarding elimination of free riding, "[t]he parties will have to convincingly demonstrate" relevant facts. Guidelines at ¶ 225.

<sup>18</sup> Indeed, the Guidelines only contemplate that the parties using RPM would offer an efficiency defense under Article 101(3); there is no mention of an opportunity to demonstrate—at any level of persuasion—that the facts show no violation of Article 101(1) in the first place. *See*, Guidelines on the application of Article 101(3) TFEU, O.J. C 101, 27 April 2004, p. 97, ¶ 16.

<sup>19</sup> *See*, Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, O.J. C 31, 5 February 2004, p. 5, ¶ 84. *See also* Guidelines on the application of Article 101(3) TFEU, O.J. C 101, 27 April 2004, p. 97, ¶ 43.



However, the Guidelines do not suggest that authorities and complainants embark on such an analysis. Rather, they suggest that, irrespective of the market share held by the supplier or its dealers, and ignoring the competitive constraints exerted by rivals and buyers, efficiencies will have to be substantiated in detail for a supplier to engage in RPM with its dealers. For example, before using RPM to resolve a free-riding problem, the supplier will need to “convincingly demonstrate that the RPM agreement can be expected to not only provide the means but also the incentive” for dealers to provide pre-sale services and that “the pre-sales services overall benefit consumers.”<sup>20</sup>

Second, the Commission’s Guidelines discuss potential efficiencies in only three sets of circumstances: (i) the launch of a new product, (ii) a short-term, low-price campaign in a franchise or similar distribution system, and (iii) the elimination of free riding by some retailers on the provision of additional pre-sale services by other retailers of “experience” or “complex” goods.<sup>21</sup> Beyond those circumstances, the Guidelines do not provide a method or guidance on the type of efficiencies that ought to be put forward by those considering making use of RPM for the distribution of their product. As noted in the previous section, RPM may serve other legitimate purposes that enhance interbrand competition, particularly in markets with low concentration of suppliers and distributors, easy entry, or limited use of the RPM mechanism. Parties using RPM when market conditions do not suggest that appreciable anticompetitive effects are likely thus face significant uncertainty about whether the Commission would challenge their RPM and, if so, how to defend against it.

In light of the foregoing, it is difficult to reconcile this allocation of the burden of proof with the view, shared by the Commission, that RPM only entails significant harmful effects when there is either some degree of market power or pervasive usage of RPM in a relevant market.

#### **IV. PRACTICAL IMPLICATIONS FOR SUPPLIERS AND RETAILERS**

RPM is often portrayed as a straightforward and easily administered mechanism to align the interests of dealers with those of the supplier. RPM may not fully address all the concerns that the supplier may have all at once. For instance, while better retail services generally raise consumer demand, fixing the retail price may not cause all dealers to provide the pre-sale services that the supplier expects them to provide, or to stock or shelve more of the RPM’ed products. But it is at least a relatively simple and convenient way to achieve some degree of commitment on the part of a sufficiently large number of dealers to support and invest efforts in the RPM’ed product at low marketing and monitoring costs for the supplier.<sup>22</sup> Alternative and possibly less restrictive ways to achieve a similar outcome may not always be available and suitable in a particular context, as they may prove very costly for the supplier to implement and monitor. For instance, providing subsidies to retailers in exchange for service may use up a significant portion of the marketing budget or generate monitoring costs that a supplier cannot afford for a particular line of product. Likewise, the supplier may not have a sophisticated view of the types of selective distribution criteria that ought to be implemented in a network.

For all these reasons, RPM may indeed improve distribution of products. Yet the Commission’s Guidelines make it questionable whether suppliers would turn to RPM to align their interests with those of dealers. The Commission’s aggressive shifting of the burden of proof

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<sup>20</sup> See, Guidelines, ¶ 225.

<sup>21</sup> See Guidelines at ¶ 225.

<sup>22</sup> See, John B. Kirkwood, *supra* note 3, at p. 25.

causes a great deal of legal uncertainty as it requires the supplier to articulate an efficiency defense before any assessment of harmful effects and, importantly, stops short of providing clear guiding principles.

As a result, many suppliers and distributors across the EU might be deterred from entering into RPM arrangements. This appears not only inconsistent with the perceived competitive risks that RPM entails, but also deprives the business community and competition authorities alike of badly needed experience in this field. Experience with a restraint would inform about the frequency and conditions under which negative effects do in fact arise and, in turn, would allow the Commission and national competition authorities to make more thorough appraisals when confronted with RPM in individual cases.

#### V. ALTERNATIVE METHOD TO ASSESS RPM?

There is scope to devise a more flexible and practical approach consistent with the concerns identified by the Commission. The Commission recognizes that RPM need be feared primarily when it facilitates cartelization of suppliers or dealers or when it forecloses distribution to competing suppliers or by competing retailers. The Commission also seems to recognize that RPM is pro-competitive when it stimulates retailers to provide better services to consumers and encourages interbrand competition. Since RPM is likely to raise significant concerns only when there is some degree of market power or where it is used pervasively, RPM should not be treated as hardcore below certain thresholds. The Commission can build on a regulatory mechanism already in place to give effect to these insights.

During the consultation on the draft Guidelines, the *Economic Advisory Group on Competition Policy* suggested that the market share test in the *De Minimis* Notice<sup>23</sup> could prove useful to screen clearly inoffensive RPM from those requiring further inquiry. We propose taking this suggestion one step further by amending the Notice to apply directly to RPM.

The *De Minimis* Notice provides thresholds under which vertical agreements do not fall within the scope of the prohibition of Article 101(1). In particular, under the Notice, the Commission holds that an agreement does not appreciably restrict competition where the market share of the supplier and the distributor does not exceed 15 percent on the relevant markets affected by the agreement. Suppliers with low market shares should therefore find comfort under the Notice and no further antitrust analysis should be required. This threshold recognizes that in most circumstances restraints affecting 15 percent or less of the market are unlikely to cause any anticompetitive effects.

However, since it is nearly ten years old, the Notice still reflects the Commission's historical view that RPM is always an anticompetitive restriction. This means that even below the market share threshold of 15 percent, RPM is blacklisted.

The Notice's absolute blacklisting is no longer fully consistent with the Commission's partial, if arguably inadequate, opening of the door to potentially pro-competitive RPM programs. Amendment of the Notice to conform to the new Guidelines would thus be appropriate and also presents the opportunity to begin addressing the problems raised by the new Guidelines.

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<sup>23</sup> 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*), O.J. C 368, 22.12.2001, p. 13.



In particular, we suggest that the Notice be amended to remove RPM entirely from the black list of clauses that prevent application of the Notice. That would permit RPM to be used when the market shares of the supplier and the dealer fall to or below 15 percent.<sup>24</sup> Above the threshold of 15 percent, RPM would be examined under the approach set out by the Guidelines.

Although this approach does not fully resolve concerns about the new Guidelines, it would help to accumulate experience with RPM in the future. The Commission, courts, and parties required to “self-assess” the legality of their agreements would hopefully learn more about when RPM is, in fact, problematic. Such experience would also help the Commission to apply the Guidelines flexibly, with due regard for when actual facts should overcome the double presumption of illegality.

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<sup>24</sup> The Notice provides that when a restrictive practice is used pervasively in a relevant market, the market share threshold falls to 5 Percent. It states also that a “cumulative foreclosure effect is unlikely to exist if less than 30 percent of the relevant market is covered by parallel (networks of) agreements having similar effects.”