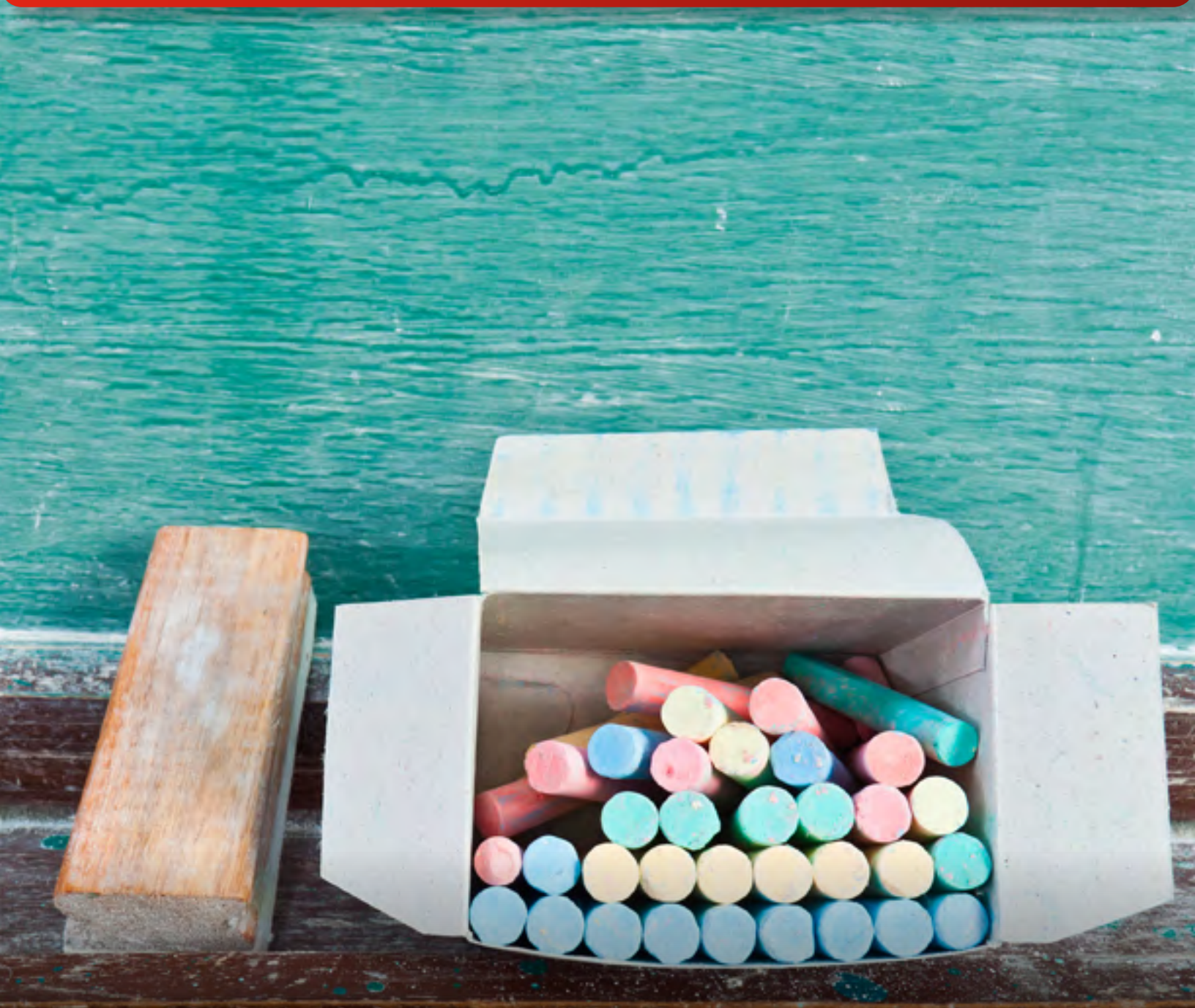
IDENTIFYING AN APPROPRIATE LEGAL FRAMEWORK FOR MINIMUM RESALE PRICE MAINTENANCE: EXPERIENCES FROM THE EU AND THE U.S.



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Identifying an Appropriate Legal Framework for Minimum Resale Price Maintenance: Experiences from the EU and the U.S.

By Zhu Li

Antitrust legal frameworks around the world have long been hostile to minimum resale price maintenance ("RPM"). Contemporary U.S. antitrust law is more hospitable towards RPM arrangements than EU law is. Chinese courts and antitrust agencies have conflicting practices of minimum RPM enforcement. This paper evaluates the existing evidence, economic analysis, and legal framework - structured rule of reason versus hardcore restraint - regarding the effects of minimum RPM across different jurisdictions. It then proposes a structured rule of reason analysis to minimum RPM based on two factors: (1) the market power of the supplier or the dealer; and (2) the consumer price increase plus the sale quantity decrease. When either of the two factors is shown, it could be presumed that the minimum RPM is anticompetitive.

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The antitrust legal frameworks throughout the world have long been hostile to minimum resale price maintenance ("RPM"). In the European Union ("EU"), minimum RPM has generally been treated as a hardcore restriction. Including minimum RPM in an agreement gives rise to the presumption that the agreement restricts competition and thus falls within Article 101(1) of Treaty on the Functioning of the European Union ("TFEU").[2] In the United States ("U.S."), minimum RPM was treated as a per se violation for nearly 100 years. But recently, the U.S. legal framework applied to vertical restraints experienced a sea change. In 2007, the U.S. Supreme Court in Leegin abandoned the per se prohibition on minimum resale price maintenance and put it under a rule of reason analysis.[3] Contemporary U.S. antitrust law is now more hospitable towards RPM arrangements than EU law is, regarding them as a normally efficient means to get to market and rarely capable of aggrandizing market power.

The *Leegin* decision aroused a fierce controversy over the appropriate legal rule governing minimum RPM both in theory and practice. This controversial debate has not settled down even today.[4] This controversy echoed in China. Chinese courts and agencies have conflicting practices of minimum RPM enforcement. Courts have generally ruled that the minimum RPM arrangement was not sufficient for a finding of a monopolistic agreement without evidence of anticompetitive effects.[5] In contrast, China's National Development and Reform Commission ("NDRC") clarified that the fundamental approach to be taken in determining the legal status RPM is "principle of prohibition, individual exemptions."[6]

The aim of my paper is to identify the proper legal treatment of minimum RPM. This paper is divided into four parts. Part I explores the legal framework of minimum RPM in legislation and practice in EU and some member states. In this part I explain that the non-economic goals of EU competition law affect the legal treatment of minimum RPM and that viewing RPM as hardcore restraint is not economically sensible. Part II addresses the legal development of minimum RPM in the United States. I show in this part that not all the relevant factors articulated by the *Leegin* Court for concluding that RPM is likely anticompetitive make sense. Part III discusses the conflicting practices of legal enforcement of minimum RPM in China. Part IV begins with a discussion of the theoretical and empirical evidence regarding the effects of minimum RPM then summarizes the different legal frameworks of minimum RPM and analyzes their merits and demerits. I show that the economic evidence and enforcement experience from the U.S. and EU indicate that a structured rule of reason for minimum RPM may be appropriate to minimize the sum of error cost and direct cost. I set out a revised and structured rule of reason for minimum RPM in the end.

I. MINIMUM RESALE PRICE MAINTENANCE IN EUROPEAN UNION: HARDCORE RESTRAINT

A. The Legal Framework for RPM In EU

EU law in the field of vertical restraints is characterized by a high degree of regulatory intervention. Article 101 of TFEU prohibits both horizontal and vertical agreements restricting competition that negatively affect inner market trade.[7] Many kinds of vertical restraints are treated as hardcore restraints, which are presumed to likely have anticompetitive effects and cannot profit from the benefit of the group exemption. According to Article 4(a) of the Block Exemption Regulation on Vertical Restraints ("VBER"), minimum RPM arrangements are hardcore restraints, which fallen categorically into Article 101(1) of TFEU because they have their "direct or indirect object to restrict competition,"[8] even if they cover only

2 European Commission: Commission Notice – Guidelines on Vertical Restraints, SEC (2010) 411, 2.10, especially paragraph 223.

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

4 See, e.g. Thomas A. Lambert, A Decision-Theoretic Rule of Reason for Minimum Resale Price Maintenance, 55 *ANTITRUST BULL*. 167 (2010); Christine A. Varney, A Post-Leegin Approach to Resale Price Maintenance Using a Structured Rule of Reason, 24 *ANTITRUST* 22 (Fall 2009); 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* 215-16 (Robert Pitofsky ed. 2008); Thomas A. Lambert & Michael Sykuta, Why the New Evidence on Minimum Resale Price Maintenance Does not Justify a Per Se or "Quick Look" Approach, *CPI ANTITRUST CHRON.* (Nov. 2013), *available at* https://www.competitionpolicyinternational.com/file/view/7019; Alber Foer & Sandeep Vaheesan, Action Needed to Address Resale Price Maintenance in Contact Lenses and Countless Other Markets, The American Antitrust Institute Public Letter to Chairwoman of Federal Trade Commission (October 24, 2014); Joshua D. Wright, The Economics of Resale Price Maintenance and Implications for Competition Law and Policy, London, United Kingdom (April 9, 2014); Maria Ioannidou & Julian Nowag, Can two wrongs make it right? Reconsidering minimum resale price maintenance in the light of *Allianz Hungária*, available at http://qmro.qmul.ac.uk/xmlui/handle/123456789/12202.

5 *Beijing Ruibang Yonghe Science and Technology Trade Company v. Johnson & Johnson Medical (Shanghai) Ltd., Johnson & Johnson Medical (China) Ltd.*, Third Civil Trial Division of Shanghai High Court (2012) (Zhi) zhongzi No. 61.

6 Lu Yanchun and Su Hua, Thoughts on Several Issues in Drafting the Auto Industry Antitrust Guidelines, 3 *PRICE SUPERVISION AND ANTIMONOPOLY IN CHINA* 37 (2016), at 39.

7 *Consten And Grundig v. Commission*, Case 56-58/64, EU:C:1965:60.

8 See European Commission: Commission Notice – Guidelines on Vertical Restraints, SEC (2010) 411, 2.10, especially paragraph 223.

a small part of the relevant market.[9] Therefore, minimum RPM arrangements are presumed anticompetitive and the block exemption does not apply.[10] Minimum RPM arrangements include both direct agreements on fixed or minimum resale prices and agreements achieving resale price maintenance through indirect means, such as fixed distribution margins, maximum discount levels, rebates dependent on the observance of a given price level or the termination of deliveries as a response to a given price level.[11]

Although there is the possibility that minimum RPM could be exempted from Article 101(1) by an efficiency defense under Article 101(3) in an individual case, it is difficult for RPM to fulfil the conditions of Article 101(3).[12] For example, in *SA Binon & Cie v. SA Agence et Messageries de la Presse* ("AMP"),[13] which concerned the legality of a clause in AMP's selective distribution system according to which the distributor reserved the right to fix prices and compel retailers to respect those prices, the European Court of Justice ("ECJ") held that "any price-fixing agreement constitutes, of itself, a restriction on competition and is, as such, prohibited by [Article 101(3) TFEU]."[14] The ECJ acknowledged that RPM may benefit from an exemption under Article 101(3) TFEU, but only under rigidly defined conditions:

> In considering the availability of exemption account should be taken of the possibility that the fixing of the retail price by publishers constitutes the sole means of supporting the financial burden resulting from the taking back of unsold copies and the possibility that the latter practice constitutes the sole method by which a wide selection of newspapers and periodicals can be made available to readers.[15]

B. The Reasons for the Harsh Treatment of RPM Under EU Competition Law

The Guidelines on Vertical Restraints explain in detail the competitive risks of RPM. RPM may facilitate collusion among suppliers or distributors lessening intrabrand and interbrand competition, soften competition between manufacturers and/or between retailers, ensuring price increase, foreclose smaller rivals and reduce dynamism and innovation at the distribution level.[16] The Guidelines acknowledge that RPM may also lead to efficiencies, such as inducing distributors to better promote new products, organizing a coordinated short-term low-price campaign, or helping to prevent free-riding at the distribution level.[17] However, the parties must prove that RPM achieve important distribution efficiencies is too much of a burden. The parties have to "convincingly demonstrate that the RPM agreement can be expected to not only provide the means but also the incentive to overcome possible free-riding between retailers on these services and that the pre-sales services overall benefit consumers as part of the demonstration that all the conditions of Article 101(3) are fulfilled."[18]

Besides the above economic reasons for the treatment of minimum RPM as hardcore restraint, the non-economic considerations also play an important role in the harsh treatment of vertical restraints in EU law. Today, EU competition law is best understood as a means to accomplish the broader tasks of the Union: the internal market and the social market economy.[19] The Article 3(3) TFEU states the goal of the law: "The Union shall establish an internal market. It shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. It shall promote scientific and technological advance."

9 See Article 4(a) of Block Exemption Regulation on Vertical Restraints (VBER).

10 It needs to note that, there are three kinds of RPM in EU law, minimum RPM, maximum RPM, and recommended RPM. The block exemption does apply to maximum RPM and recommended RPM, but these two kinds of RPM are not the subject of this paper.

11 See European Commission: Commission Notice – Guidelines on Vertical Restraints, SEC (2010) 411, 2.10, especially paragraph 48.

12 See European Commission: Commission Notice – Guidelines on Vertical Restraints, SEC (2010) 411, 2.10, especially paragraph 223.

13 Case 243/83, Court of Justice, [1985] ECR 2015, [1985] 3 CMLR 800.

14 *Ibid.* paragraph 44.

15 *Ibid.* paragraph 46.

16 See European Commission: Commission Notice – Guidelines on Vertical Restraints, SEC (2010) 411, 2.10, especially paragraph 223.

17 *Ibid.* especially paragraph 224.

18 *Ibid.* especially paragraph 225.

19 Roger Van den Bergh, Vertical Restraints: The European Part of the Policy Failure, 61(1) *The Antitrust Bulletin* 167, 178 (2016).

Thus, the objectives of EU competition law include achieving a single market (market integration), sustaining progress and innovation, and realizing social equality and fairness.[20] The single-market objective focuses EU competition law on a combined pro-competition and pro-integration goal. Vertical restraints, such as minimum RPM, selective distribution and market partitioning by territory or customer group, could be used by manufacturers to resurrect the trade barriers between member states. To prevent this outcome, EU competition law shows severe attitude to vertical restraints including minimum RPM and does not fully consider its redeeming efficiencies.

C. The Failure of the EU Approach

The EU approach views minimum RPM as a hardcore restraint which is presumed to almost always have anticompetitive effects, such as facilitating horizontal or vertical collusion, lessening intrabrand and interbrand competition, maintaining high prices, and excluding competitors, regardless of the market share of the parties. This approach is not based on a sound economic foundation.

For risk of collusion, although RPM could be used to police agreed price and detect cheating, only in very limited circumstances could RPM facilitate manufacturers' or distributors' collusion. For manufacturers' collusion through via RPM arrangements, at least the following conditions are required: the colluding manufacturers must be capable of exercising market power by reducing output collectively in a relevant market; the RPM arrangements used by manufacturers must cover a substantial portion of the market and manufacturers must not have the ability to cheat; and the distributors must not be able to use non-price promotions as a substitute for price cuts.[21] Similarly, RPM arrangements could assist a distributors' collusion only when at least the following conditions are met: the goods over which the distributors would like to collude must be absent of competition; the barriers of entry into retailing of the products are so high that the manufacturers could not shift their distribution to new retailers.[22] If one of the above conditions is not satisfied, the collusion of manufacturers or distributors is difficult to happen or easy to collapse.

EU law also addresses the concern that manufacturer or distributor with market power might adopt RPM to exclude its rivals. For this kind of exclusionary effect to work, several conditions would have to be satisfied. In order for RPM to succeed as an exclusionary device by a dominant manufacturer, the RPM must guarantee enough retail profits to induce dealers to drop or demote products of the manufacturer's rival, and the RPM must apply to enough retailers so that the manufacturer could substantially foreclose its rivals from access to available retailers and therefore raise rivals' costs.[23] In order for RPM to be used by dominant retailer to limit competition from more efficient rivals, RPM policies must be implemented so widely that those rivals cannot gain an effective foothold in the retail market. At a minimum, the brands upon which a dominant retailer procures RPM must comprise a significant portion of sales within the relevant retail market.[24]

In reality, these conditions will rarely be satisfied. Most RPM arrangements will not be anticompetitive except in limited and special circumstances. The presumption that RPM is anticompetitive will be based on the illusory foundations.

The strict prohibition of RPM in EU law has had negative effects. In order to evade the legal problems concerning RPM, the parties have to switch to arrangements with higher costs but less legal risk. For instance, the manufacturer and distributor may use principle-agent arrangements to replace RPM agreements because principle-agent arrangements fall outside of the scope of Article 101 of TFEU.[25] In member state level, particular interest groups may try to lobby national governments to circumvent the EU prohibitions of RPM.[26] In Germany, RPM arrangements for book price were legal until the European Commission held these arrangements violated EU law to the extent that they also hindered interstate trade.[27] In response Germany passed specialized statutes immunizing RPM for agricultural products, press products, the

20 See European Economic & Marketing Consultants GmbH: THE FRAME – A genuine European approach in EU competition law, available at www.ee-mc.com/fileadmin/user_upload/ccr_en/The_Frame_part_1.pdf.

21 See, Thomas A. Lambert, A Decision-Theoretic Rule of Reason for Minimum Resale Price Maintenance, 55 ANTITRUST BULL. 167 (2010), at 183.

22 See similarly, Thomas A. Lambert & Michael Sykuta, Why the New Evidence on Minimum Resale Price Maintenance Does not Justify a Per Se or "Quick Look" Approach, CPI ANTITRUST CHRON. (Nov. 2013), available at https://www.competitionpolicyinternational.com/file/view/7019.

23 See Thomas A. Lambert, A Decision-Theoretic Rule of Reason for Minimum Resale Price Maintenance, 55 ANTITRUST BULL. 167, 184 (2010).

24 See Thomas A. Lambert, A Decision-Theoretic Rule of Reason for Minimum Resale Price Maintenance, 55 ANTITRUST BULL. 167, 183 (2010).

25 See European Commission: Commission Notice – Guidelines on Vertical Restraints, SEC (2010) 411, 2.10, especially paragraph 14.

26 Roger Van den Bergh, Vertical Restraints: The European Part of the Policy Failure, 61(1) *The Antitrust Bulletin* 167, 182-185 (2016).

27 Commission Decision 25.11.1981, Case VBBB/VBVB, O.J. 25.02.82, L 54/36.

supply of water, and books.[28] The fact that so many industrial fields are exempted from RPM prohibition in the largest EU member indicates the failure of EU approach.

II. RESALE PRICE MAINTENANCE IN UNITED STATES: THE EVOLUTION OF LEEGIN AND THE STRUCTURED RULE OF REASON

A. The Evolution of Leegin

In the U.S., both RPM and vertical nonprice restraints are challenged under Section 1 of the Sherman Act as contracts, combinations or conspiracies in restraint of trade. Similar to EU law, U.S. antitrust law had long been hostile to RPM. More than one hundred years ago, in *Dr. Miles Medical Co. v. John D. Park and Sons*,[29] the U.S. Supreme Court held that a massive minimum RPM scheme was unenforceable and offended Section 1 of the Sherman Act. The decision rested on the assertion that RPM is indistinguishable in economic effect from naked horizontal price fixing by a cartel. However, in *Dr. Miles*, the Supreme Court never distinguished horizontal from vertical price fixing and did not discuss either the market share or horizontal collusion issues in a way that explained RPM's underlying rationale. Subsequent decisions characterized *Dr. Miles* as holding that RPM is unlawful *per se*.

After nearly a century of debate among academics and lawyers, Supreme Court overruled *Dr. Miles* in its 2007 divided (5-4) *Leegin* decision.[30] The defendant Leegin was a manufacturer of leather garments which it sold through specialty retailers under the "Brighton" brand. The plaintiff PSKS was a discount retailer that operated "Kay's Kloset" and refused to abide by the resale prices that Leegin specified as a condition of supply. The Court found that the reasons upon which *Dr. Miles* relied do not justify a *per se* rule, and it is therefore necessary to examine the economic effects of vertical agreements to fix minimum resale prices, and reexamine whether the *per se* rule is nonetheless appropriate.

The Court first enumerated the procompetitive effects of RPM, such as enhancing interbrand competition by prevent free riding, facilitating market entry for new firms and brands and encouraging retailer services that would not be provided even absent free riding.[31] Then, the Court identified four ways in which RPM might be anticompetitive. It could facilitate a manufacturers' cartel; facilitate a dealer cartel; be used by a manufacturer with market power to protect that power by providing its dealers with an incentive not to sell the products of the manufacturer's smaller rivals or new entrants; and be used by a dealer with market power to forestall innovation in lower cost methods of distribution.[32] Notwithstanding the risks of unlawful conduct, the Court opined it cannot be stated with any degree of confidence that RPM "always or almost always tend[s] to restrict competition and decrease output."[33] Instead, the Court found that RPM can have "either procompetitive or anticompetitive effects, depending upon the circumstances in which they are formed."[34] "As the rule would proscribe a significant amount of procompetitive conduct, these agreements appear ill suited for per se condemnation."[35] Thus, according to the Court, the rule of reason is the appropriate vehicle for assessing RPM.

In order to give some guidance to apply rule of reason, the Court described three factors relevant to find anticompetitive RPM under a rule of reason analysis: (1) the scope of use of minimum RPM in a market; (2) the source of the restraint, i.e. whether it originated with the supplier or its dealers; and (3) the market power of the supplier and the dealer.[36] In fact, the Court suggested a structured rule of reason treatment to minimum RPM to provide more guidance to both courts and businesses.

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28 Section 28 ACR (agriculture); Art. 30 ACR (press products); Art. 31 (water supply); Section 5 of the Law on Book Price Maintenance. See Boris Rigod, Resale Price Maintenance Under German Competition Law - FCO Imposes Fines on Furniture Manufacturers, available at https://www.hausfeld.com/news/eu/resale-price-maintenance-under-german-competition-law.

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

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

31 *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 890-892 (2007).

32 *Ibid.* at 892-894.

33 *Ibid.* at 894 (quoting *Business Electronics* at 723, 108 S.Ct. 1515).

34 *Ibid.* at 894.

35 *Id.*

36 *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 897-898 (2007).

B. Minimum RPM After Leegin

Although the Leegin Court has set out a rule of reason treatment for minimum RPM, efforts to reinstate a per se illegal rule for minimum RPM arrangement are ongoing in U.S..[37] At the federal level, Congress had held hearings on legislation seeking to repeal the Leegin decision.[38] The attorneys general of 27 states submitted comments opposing a post-Leegin petition seeking modification of a FTC order that prohibited Nine West from using vertical pricing agreements with its dealers.[39] To date, at the state level, minimum RPM arrangements are still prohibited under state law of Maryland and California.[40] In New York, the Attorney General pursued a similar per se illegal interpretation of New York state law but has not persuaded the courts to agree.[41] In 2015, after contact lens manufacturers adopted minimum RPM policies, Utah enacted a statute prohibiting the enforcement of minimum RPM policies or agreements against contact lens retailers in Utah.[42] There are still several cases challenging minimum RPM policy on contact lenses and sports ticket, some are settled with manufacturers discontinuing minimum RPM practices, some are still pending.[43]

The commentators also have different opinions over what version of the rule of reason should apply to RPM. Some commentators have called for a full-blown rule of reason analysis which means the plaintiff should bear the burden of proving an actual anticompetitive effect.[44] Some suggest treating RPM agreements as presumptively or prima facie illegal because they are "inherently suspect."[45] Under this approach, parties engaged in RPM would have the initial burden of justifying it. Others have advocated structured approaches that would presume the anticompetitive RPM under the certain factors.[46] In sum, the legal landscape of RPM is far from clear in U.S. today.

C. Reconsidering Three Leegin Factors

In Leegin the Court listed three factors relevant to a rule of reason analysis. In the Court's view, each of these factors might help to identify instances in which RPM is more likely to be anticompetitive. A close examination of these factors can reveal that the Court's decision to base its methodology on certain factor may be wrong.

The first factor is the scope of use of RPM in a market. In Leegin the Court explained that the number of manufacturers that make use of minimum RPM in a given industry can provide important information. When only a few manufacturers lacking market power adopt minimum RPM practice, it is unlikely to be facilitating a manufacturer cartel because of the pressure of interbrand competition. In contrast, if many competing manufacturers adopt minimum RPM practice, it should be subject to more careful scrutiny.[47] Although widespread use of minimum RPM could suggest that the practice has anticompetitive potential to facilitate a dealer or manufacturer cartel, the widespread use of minimum RPM could also suggest

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37 Joseph Pereira, Price-Fixing Makes Comeback After Supreme Court Ruling, WALL ST. J., Aug. 10, 2008, at A1, available at http://online.wsj.com/article/SB121901920116148325.html?mod=hps_us_pageone. For a follow-up on RPM policies and the use of third party monitors, see Joseph Pereira, Discounters, Monitors Face Battle on Minimum Pricing, WALL ST. J., Dec. 4, 2008 at A1, available at http://online.wsj.com/article/SB122835660256478297.html.

38 See, e.g. *Bye Bye Bargains? Retail Price Fixing, the Leegin Decision, and Its Impact on Consumer Prices: Hearing Before the Subcomm. on Courts and Competition Policy of the Comm. on the Judiciary*, 111th Cong. (2009), available at http://judiciary.house.gov/hearings/hear_090428_1.html.

39 See Amended States' Comments Urging Denial of Nine West's Petition, Nine West Group Inc., FTC Docket No. C-3937 (Jan. 17, 2008), available at http://www.oag.state.ny.us/bureaus/antitrust/pdfs/Amended_State_ comments_011708-9west.pdf. The comments were originally submitted on December 28, 2007, and were amended on January 17, 2008, to add additional states. The FTC granted Nine West's petition in part. Order Granting in Part Petition to Reopen and Modify Order Issued April 11, 2000, Nine West Group Inc., FTC Docket No. C-3937 (May 6, 2008), available at http://www.ftc.gov/os/caselist/9810386/080506order.pdf.

40 See Michael A. Lindsay, Contact Lenses and Contact Sports: An Update on State RPM Laws, the antitrust source (April 2017); Michael A. Lindsay, Repatching the Quilt: An Update on State RPM Laws, The Antitrust Source (February 2014); Michael A. Lindsay, Overview of State RPM, The Antitrust Source (October 2014).

41 See Michael A. Lindsay, Contact Lenses and Contact Sports: An Update on State RPM Laws, the antitrust source (April 2017).

42 UTAH CODE ANN. § 58-16a-905.1.

43 See Michael A. Lindsay, Contact Lenses and Contact Sports: An Update on State RPM Laws, the antitrust source (April 2017).

44 See, e.g. Thomas A. Lambert, *A Decision-Theoretic Rule of Reason for Minimum Resale Price Maintenance*, 55 ANTITRUST BULL. 167 (2010); Christine A. Varney, *A Post-Leegin Approach to Resale Price Maintenance Using a Structured Rule of Reason, Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007),24 ANTITRUST 22 (Fall 2009).

45 See Alber Foer & Sandeep Vaheesan, Action Needed to Address Resale Price Maintenance in Contact Lenses and Countless Other Markets, The American Antitrust Institute Public Letter to Chairwoman of Federal Trade Commission (October 24, 2014), at 8.

46 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 215-16 (Robert Pitofsky ed. 2008).

47 *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 897 (2007).

that it is widely perceived to be an efficient marketing practice by many firms in an industry.[48] Sometimes, the more efficient the minimum RPM is, the wider it is used. So the scope of use of minimum RPM in a market is not an appropriate factor to help finding anticompetitive minimum RPM.

Secondly, there is the source of the RPM restraint. In Leegin the Court argued that the source of the restraint may be an important consideration.[49] Retailer-initiated minimum RPM has a greater likelihood to facilitate a retailer cartel or support a dominant, inefficient retailer. By contrast, manufacturer-initiated minimum RPM independent of retailer pressure is less likely to promote anticompetitive conduct because the manufacturer has an incentive to protest inefficient retailer-induced RPM.[50] However, the Court's theory does not make sense. Manufacturers and retailers may both have an incentive to adopt RPM practice when there is a free riding problem. The amounts of products sold at retail substantially depend on point-of-sale services, including consumer education and product testing, which require a considerable investment on the part of the dealer.[51] Discount dealer free-riding takes place if consumers first visit the full-service retailer to obtain valuable promotional services and then purchase the product from a second discount dealer who does not provide those services. This kind of free-riding will discourage retailers' promotional efforts and decrease sales.

In this situation, the retailer and the manufacturer have common interest and incentive to use minimum RPM to prevent free-ridding by eliminating retail discounting. The identity of the initiating party is irrelevant to the competition effect of minimum RPM. Whether or not minimum RPM originated from a manufacturer or a retailer, the competition effect of minimum RPM in a concrete situation does not change. Focusing on where minimum RPM originates might well "divert attention and litigation resources from the more central question of evaluating the competitive effects of the practice and might not be necessarily probative of the practice's anti-or procompetitive effects."[52]

Thirdly, the market power of the supplier or the dealer. This factor is closely relevant to the competition effect of minimum RPM practice. As the Court noted in its Leegin explanation, the anticompetitive effects of minimum RPM may not be "a serious concern unless the relevant entity has market power."[53] If a retailer lacks market power, manufacturers likely can sell their goods through rival retailers. And if a manufacturer lacks market power, there is less likelihood it can use the practice to keep competitors away from distribution outlets.[54]

Among the three Leegin factors, only the factor of market power is closely related to the high probability of anticompetitive effect of minimum RPM. The structured rule of reason analysis of minimum RPM suggested by the Court in Leegin should be refined.

III. THE ENFORCEMENT PRACTICES OF RESALE PRICE MAINTENANCE IN CHINA: CONFLICTS BETWEEN AGENCIES AND COURTS

A. Resale Price Maintenance Under the Anti-Monopoly Law of China

Article 13 of China's Anti-Monopoly Law ("AML") prohibits horizontal agreements, that is, agreements between undertakings competing with one another. Article 14 of the AML prohibits vertical monopoly agreements, which include RPM arrangements. This article states:

> Undertakings are prohibited from concluding the following monopoly agreements with their trading counterparts:
>
> (1) on fixing the prices of commodities resold to a third party;
> (2) on restricting the lowest prices for commodities resold to a third party; and
> (3) other monopoly agreements confirmed as such by the authority for enforcement of the Anti-monopoly Law under the State Council.[55]

48 Andrew Gavil , William Kovacic, Jonathan Baker & Joshua Wright, *Antitrust Law in Perspective: Cases, Concepts and Problems in Competition Policy* (3rd edition)(2016), at 944.

49 *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 897 (2007).

50 *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 897 (2007).

51 Lester G. Telser, Why Should Manufacturers Want Fair Trade, 3 J. L. & ECON. 86 (1960).

52 Andrew Gavil, William Kovacic, Jonathan Baker & Joshua Wright, *Antitrust Law in Perspective: Cases, Concepts and Problems in Competition Policy* (3rd edition)(2016), at 944.

53 *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 898 (2007).

54 *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 898 (2007).

55 Article 14 of Chinese Anti-Monopoly Law.

Article 15 of the AML enumerates the agreements that will be exempted from Article 13 and 14. From the language of Article 14, it seems that fixed or minimum RPM is absolutely prohibited and per se illegal, thus there is no need to scrutinize competitive consequences of it. But the term "monopoly agreement" in Article 13 is defined to only include any "agreement, decision or concerted action which eliminate or restrict competition."[56] This is the only definition of the terms of "monopoly agreement" in the AML. If Article 14 is explained in light of this definition of "monopoly agreement," it becomes clear that the competitive effect of an agreement has to be taken into account before it is found to constitute a violation of the AML. The ambiguity and potential contradiction create legal limbo for certain forms of conduct that constitute agreements but may or may not have adverse competitive consequences.[57] The different understandings of Article 14 result in conflicting legal enforcement practices of RPM between Chinese courts and agencies.

B. The Enforcement Landscape of the NDRC and Its Subordinate Institution

The NDRC opined that, taking Article 14 and Article 15 as a whole, the fundamental approach of AML to determining RPM is "principle of prohibition, individual exemptions."[58] That is, the NDRC determined that any RPM arrangement is illegal per se and can only be exempted in narrowly defined situations. The NDRC's opinion on RPM is reflected in its newly published State Council Antimonopoly Commission's Consultation Proposals of Antimonopoly Guideline for Automotive Industry (Consultation Proposals).[59] The NDRC is entrusted by the State Council Antimonopoly Commission to take the lead in drafting the Consultation Proposals. The Consultation Proposals provide detailed guidance on issues specific to the automotive industry, with a focus on the vertical restrictions between auto manufacturers and distributors.[60] Notably, the Consultation Proposals state that RPM arrangements have obvious anticompetitive effects, inter alia, maintaining high prices, promoting horizontal and vertical collusion, weakening intrabrand and interbrand competition, and excluding competitors.[61] The Consultation Proposal illustrated four situations where RPM arrangements may be exempted on an individual basis: RPM for new energy automobiles during the promotional period and RPM imposed on three kinds of distributors who only act as an intermediary party.[62]

The NDRC's "principle of permission, individual prohibition" approach makes the assessing of competitive effects of minimum RPM unnecessary, which facilitates its enforcement of the AML on RPM.

1. The High-end Liquor Price Monopoly Case. Guizhou Development and Reform Commission, one of the NDRC's subordinate branches in provincial level, released an administrative penalty decision fining Guizhou Mao-tai, a Chinese well-known high-end liquor producer, RMB 247 million for its RPM conduct. Sichuan Development and Reform Commission together published an administrative penalty decision, fining the other state-owned producer of high-end liquor, Wuliangye, RMB 202 million for the same reason same day.[63]

2. Infant Formula Milk Powder Price Monopoly Case. On April, 2013, the NDRC initiated an investigation of milk powder producers —Biostime, Mead Johnson, Dumex, Abbott Laboratories, Friesland, Fonterra, Wyeth, Beingmate and Meiji —for their monopoly price conduct. NDRC held that the undertakings' conducts in fact achieved the effect of fixing or restricting the products' resale price, which falls within the scope of Article 14 of AML. Maintaining the price of milk powder at a higher level may exclude or restrain the intra-brand competition meanwhile weakens the brands' internal competition, as a result of destroying the fair and orderly market competition principle and harming the consumer welfare. During the investigation, each undertaking involved confessed their conduct was illegal and could not prove their alleged conduct could be exempted under Article 15 of AML. In the end, the NDRC imposed fines totaling of RMB 668.73 million on the six undertakings involved.[64]

3. Ophthalmic Lens Manufacturer Case. In June, 2014, the Shanghai Price Bureau confirmed that Essilor and Johnson violated Article 14 (1) of AML by reaching and implementing monopoly agreements of fixing resale price, which in fact excludes and restrains relevant

56 Article 13 of Chinese Anti-Monopoly Law, Paragraph 2.

57 See Wentong Zheng, Competition law in China, in COMPARATIVE COMPETITION LAW (John Duns, Arlen Duke and Brendan Sweeney eds.), Edward Elgar Publishing Limited (2015), p 450.

58 Lu Yanchun and Su Hua, Thoughts on Several Issues in Drafting the Auto Industry Antitrust Guidelines, 3 PRICE SUPERVISION AND ANTIMONOPOLY IN CHINA 37, 39 (2016).

59 The Consultation Proposals of Antimonopoly Regulation for Automotive Industry, available at http://www.sdpc.gov.cn/fzgggz/jgjdyfld/fjgld/201603/t20160323_795741.html.

60 See the Consultation Proposals of Antimonopoly Regulation For Automotive Industry, Chapter 2, Part 3, section 1, paragraph 2 and 3.

61 See the Consultation Proposals of Antimonopoly Regulation For Automotive Industry, Chapter 2, Part 3, section 1, paragraph 2.

62 See the Consultation Proposals of Antimonopoly Regulation for Automotive Industry, Chapter 2, Part 3, section 2.

63 Source: http://www.chinanews.com/cj/2013/02-22/4588678.shtm.

64 Source: http://xwzx.ndrc.gov.cn/xwfb/201308/t20130807_552992.html.

market competition and harms consumer welfare. Essilor was fined RMB 8.7 million which accounted for 2 percent of its turnover in 2012, and Johnson was fined RMB 3.6 million which accounted for 1 percent of its turnover in 2012.[65]

4. Haier Air Conditioner Price Monopoly Case. In August, 2016, under the guidance of the NDRC, the Shanghai Price Bureau imposed fines totaling RMB 12.348 million on Chongqing Ririshun Household Appliance Sales Co., Ltd (Shanghai Branch), Chongqing Haier Household Appliance Sales Co., Ltd (Shanghai Branch) and Chongqing Haier Electrical Appliance Sales Co., Ltd (Shanghai Branch) for their reaching and implementing of RPM agreements. The Shanghai Price Bureau confirmed that the conducts of undertakings involved violating Article 14(2) of AML, which excludes and restrains competition in the market and harm consumer welfare.[66]

5. Medical Field Price Monopoly Case. In December, 2016, the Shanghai Price Bureau confirmed that Smith & Nephew Medical Products (Shanghai) International Trade Co., Ltd. violated Article 14(1) by fixing resale price, which excludes and restrains competition in the market and harms consumer welfare. Smith & Nephew was fined RMB 742,147.98, which accounted for 6% of its relevant turnover in year of 2014.[67]

6. Automobile Price Monopoly Cases *(Chrysler/Faw-Volkswagen/Mercedes-Benz/ Dongfeng Nissan/ Hankook Tire/SAIC-GM)*. In June of 2014, Chrysler was fined RMB 31.68 million by the Shanghai Price Bureau for its RPM arrangements.[68] In September of 2014, the Hubei Price Bureau held Faw-Volkswagen violates Article 14 of AML by fixing resale price and limiting the minimum resale price and fined Faw-Volkswagen RMB 248.58 million, which accounts for 6 percent of its relevant turnover in last year.[69] In April of 2015, Mercedes was fined RMB 350 million by the Jiangsu Price Bureau for its concluding and implementing price monopoly agreement of fixing resale price and limiting the minimum resale price of level-E, level-S finished automobiles and parts with its distributors in Jiangsu Province.[70] In September of 2015, Dongfeng Nissan was fined RMB 123.3 million by the Guangdong Development and Reform Commission for its RPM arrangement.[71] In April of 2016, the Shanghai Price Bureau fined Hankook Tire RMB 217.52 million for its RPM agreements which accounted for 1 percent of the relevant turnover in 2014.[72]In December of 2016, the Shanghai Price Bureau fined SAIC-GM RMB 201 million for its RPM practices.[73]

C. Rule of Reason Analysis of RPM in Courts

Chinese courts' understanding of the application of Article 14 of the AML to RPM agreements is different from the NDRC's approach. The Supreme People's Court of China promulgated a Judicial Interpretation on Civil Litigation of AML Cases in May of 2012.[74] Article 7 of the Judicial Interpretation provides that where the alleged monopolistic conduct is found to be a monopolistic agreement in accordance with the conditions stipulated in Article 13, paragraph 1(1) — (5) of Anti-monopoly Law, the defendant shall have the burden of proving that the alleged monopolistic agreement does not have the effect of eliminating or restricting competition. This means the horizontal agreements stipulated in Article 13, paragraph 1(1) — (5) are presumed to be anticompetitive but the vertical agreements in Article 14 are not presumed to be anticompetitive. Therefore, under Article 14, the plaintiff should shoulder the burden of proving that vertical agreements including RPM have actual or potential anticompetitive effects.[75] This indicates that the courts will take the rule of reason analysis to RPM practices. The following cases explicitly show Chinese courts' rule of reason approach to minimum RPM.

65 Source: http://www.shdrc.gov.cn/info/iList.jsp?cat_id=10010&cur_page=4.

66 Source: http://www.shdrc.gov.cn/fzgggz/jggl/jghzcfjds/24137.htm.

67 Source: http://www.shdrc.gov.cn/fzgggz/jggl/jghzcfjds/25365.htm.

68 Source: http://news.xinhuanet.com/fortune/2014-09/11/c_1112443669.htm.

69 Source: http://finance.sina.com.cn/chanjing/gsnews/20140911/144220266697.shtml.

70 Source: http://news.qq.com/a/20150423/017671.htm.

71 Source: http://finance.sina.com.cn/chanjing/cyxw/20150910/104323209643.shtml.

72 Source: http://www.shdrc.gov.cn/fzgggz/jggl/jghzcfjds/23432.htm.

73 Source: http://www.shdrc.gov.cn/fzgggz/jggl/jghzcfjds/25286.htm.

74 Provisions on the Application of the Antimonopoly Law in the Trial of Civil Disputes Arising from Monopolistic Conduct(adopted at the 1539th Session of the Judicial Committee of the Supreme People's Court on January 30, 2012, and shall come into force on June 1, 2012; hereafter "Judicial Interpretation"), available at http://www.wipo.int/edocs/lexdocs/laws/zh/cn/cn375zh.pdf.

75 See Li Zhu, Understanding And Applying The Judicial Interpretation of Provisions on the Application of the Antimonopoly Law in the Trial of Civil Disputes Arising from Monopolistic Conduct and How, 15 People's Judicature 42, 46 (2012).

In August 2013, in *Rainbow v. Johnson & Johnson*,[76] the Shanghai high court held that the showing of anti-competitive effects is an indispensable requirement when determine the legality of the minimum RPM agreement and the plaintiff (Rainbow) should bear the burden of proving both the existence of and anti-competitive of effects the RPM practice. The Court then set out four factors to evaluate the competitive effects of RPM agreements: (1) Whether there is sufficient competition in the relevant market (primary condition); (2) Whether the defendant has a strong market position (prerequisite and basis); (3) The motivation of the defendant to conduct RPM (important factor); (4) The effects of RPM on competition (both anti-competitive and pro-competitive effects shall be considered).[77] After elaborating and examining these four factors, the Court found the effects of Johnson & Johnson's minimum RPM practices were to restrain and exclude competition in the relevant market, and had no obvious and sufficient contribution to the promotion of competition, and thus violated Article 14 of AML.

In the *Gree Air-conditioner* case[78] the Guangzhou Intellectual Property Court held that the disputed minimum RPM agreement did not constitute a monopoly agreement as prohibited under the AML because it did not result in anticompetitive effects in a relevant market. There the Court found that there is sufficient competition on air-conditioner market and that the distributors can still compete among one another in terms of pre-sale marketing, sale promotions and after-sale services.[79]

The National People's Congress of China now is considering amending Article 14 of the AML and clarifying the legal treatment to minimum RPM to eliminate the conflicts between courts and antitrust agencies.[80]

IV. WHAT CAN WE LEARN FROM U.S. AND EU: TOWARD A WAY OF EVIDENCE-BASED AND EFFECT-ORIENTED ANALYSIS?

The failure regarding the treatment minimum RPM as a hardcore restraint in EU, the ongoing controversy over the legal treatment to minimum RPM in U.S. and the conflicts of legal enforcement to minimum RPM between courts and agencies in China call for identifying the appropriate legal treatment to minimum RPM. The appropriate legal approach to minimum RPM ultimately depends on what we know about the competitive effect of minimum RPM. I will first summarize the existent theoretical and empirical evidence on competitive effects of minimum RPM. I divide this discussion into three parts: I begin by discussing the procompetitive effects of minimum RPM identified by economic theory, then the anti-competitive effects before assessing the available empirical evidence. Then I conclude this section by discussing the cost and benefits of various legal approaches.

A. The Procompetitive Effects of Minimum RPM

The procompetitive effects of RPM include enhancing interbrand competition by prevent free riding, facilitating market entry for new firms and brands and encouraging retailer services that would not be provided even absent free riding. Economic theory has long recognized the potential for RPM to reduce free-riding by retailers that fail to provide point-of-sale services. Consider, for example, two television retailers, one that has a showroom where consumers can assess picture quality and a second retailer that does not invest in a showroom. In the absence of minimum RPM, the second retailer would have lower costs and so could profitably undercut the first retailer's price leading some consumers to purchase televisions from the second retailer after visiting the first retailer's showroom.

As discussed in Section II.C, above, this kind of free-riding reduces retailers' incentive to provide point-of-sale services, and increases their incentive to compete on the basis of price. Imposing minimum RPM eliminates retail price competition and forces retailers to compete on

76 *Beijing Ruibang Yonghe Science and Technology Trade Company ("Rainbow") v. Johnson & Johnson Medical (Shanghai) Ltd., Johnson & Johnson Medical (China) Ltd.* (collectively "Johnson & Johnson"), (2012)Third Civil Trial Division of Shanghai High Court (Zhi) zhongzi No. 61.

77 *Beijing Ruibang Yonghe Science and Technology Trade Company ("Rainbow") v. Johnson & Johnson Medical (Shanghai) Ltd., Johnson & Johnson Medical (China) Ltd.* (collectively "Johnson & Johnson"), Third Civil Trial Division of Shanghai High Court, (2013) Zhi zhongzi No. 61.

78 *Dongguan GengliGuochang Electrical Appliance Shop v. Dongguan Shengshixinxing Gree Ltd. and Dongguang Heshi Ltd.*, Guangzhou Intellectual Property Court, (2015) Yuezhifashangminchuzi No. 33.

79 For a summary of the cases on RPM in 2016 in China, see Qing Ren, Anti-Monopoly Litigation in China: A Review for the Year of 2016, Competition Policy International (March, 2017).

80 See Draft Amendment of Anti-Monopoly Law of the People's Republic of China (Oct. 23, 2021), available at http://www.npc.gov.cn/flcaw/more.html, or https://new.qq.com/omn/20211024/20211024A018J400.html.

the basis of service quality, and high-quality point-of-sale services enhance the competitiveness of the manufacturer's product.[81] Returning to the example of the two television retailers, after minimum RPM was imposed, consumers would be less likely to buy a television elsewhere after visiting a showroom because other retailers would not be able to undercut the minimum RPM. Imposing minimum RPM strengthens the incentive to invest in point-of-sale services such as showrooms by eliminating consumers' incentive to use one retailer's point-of-sale services and then purchase from a second retailer with lower prices.

Similarly, in the absence of minimum RPM, free-riding can make it unprofitable for any retailer to provide a high level of point-of-sale services if most of the consumers who use these services end up purchasing from a discounter. If few retailers provide a high level of service it will not be profitable for manufacturers to introduce products that require a high level of point-of-sale services to generate significant sales.

For example, luxury cars can have difficulty generating significant sales without a dealer network that can provide maintenance and repairs. If a luxury car manufacturer distributed included discount retailers in its dealer network that did not provide maintenance and repair services they would be able to undercut full-service dealers' prices and, in the a absence of full-service dealers, the manufacturer's sales would suffer. Under RPM the manufacturer is able to set the retailer's margin and incentivize the desired service level. Consequently, as the Court observed in *Leegin*, minimum RPM can "give consumers more options so that they can choose among low-price, low-service brands; high-price, high-service brands; and brands that fall in between."[82]

Minimum RPM can also facilitate market entry by new firms and brands. This is because retailers typically must offer a higher level of point-of-sale services in order to make consumers aware of the existence, characteristics and benefits of new products. Alternatively, consumers may prefer to purchase new products from retailers that have invested in a reputation for providing high quality merchandise. In either case, the manufacturer of a new product can provide retailers with an incentive to provide the necessary service level using minimum RPM.[83] In the absence of minimum RPM, discount retailers can free-ride off the point-of-sale services or reputation of the higher-cost higher-service-level retailers. By imposing minimum RPM, the manufacturer of a new product can create a strong incentive for higher-cost retailers to carry their product speeding consumer adoption of new products.

In *Leegin*, the Court also noted the procompetitive effects of RPM in "encouraging retailer services that would not be provided even absent free riding."[84] It may be impractical for a manufacturer to make a contract with a retailer that specifying all the different services they require the retailers to perform or qualities they require the retailer have (e.g. how attentive and well-informed salespeople are or how much inventory is kept on hand …). Even in cases where it is possible to specify all of the services a retailer must provide it is often inefficient to measure how well they perform those services.

In many cases, offering the retailer a guaranteed margin and threatening termination can be the most efficient way for the manufacturer to induce the retailer to perform as desired while allowing it to use its own experience and expertise to provide retail services in the most efficient way.[85] By conditioning a retailer's ability to continue selling its product and earning the associated stream of profits on the retailer's performance, the manufacturer can use RPM to create a very strong incentive for the retailer to perform as required.

B. The Anticompetitive Effects of Minimum RPM

In *Leegin*, the U.S. Supreme Court relied heavily on economic theory and the economic literature on RPM. In abandoning the per se prohibition on RPM the Court explained that "economics literature is replete with procompetitive justifications for a manufacturer's use of resale price maintenance."[86] As mentioned above, the Court also identified two types scenarios under which RPM is likely to be anticompetitive: (1) when used to facilitate a cartel; and (2) when used to maintain or extend dominance.[87]

81 Marvel & McCafferty, The Welfare Effects of Resale Price Maintenance, 28 J. Law & Econ. 363, 373 (1985)

82 *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 887 (2007).

83 Marvel & McCafferty, The Welfare Effects of Resale Price Maintenance, 28 J. Law & Econ. 363, 373 (1985)

84 *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 878 (2007).

85 Klein & Murphy, Vertical Restraints as Contract Enforcement Mechanisms, 31 J. Law & Econ. 265, 295 (1988)

86 *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 878 (2007).

87 *Ibid.* at 892-894.

Economic theory teaches that a successful cartel must be able to detect and deter cheating by its members.[88] RPM makes this task easier for the members of a manufacturer cartel by reducing members' incentives to cheat on the cartel agreement by lowering wholesale prices and increasing sales. RPM limits the ability of retailers to reduce retail prices in response to wholesale prices because retailers cannot reduce their prices below the RPM. For those retailers who were already pricing at the RPM, the impact of a reduction in wholesale price is limited to an increase in promotional effort (and possibly a decrease in efforts to promote substitute products). Consequently, a given reduction in wholesale price will produce a smaller increase in sales than would have occurred in the absence of RPM and cartel members will have less of an incentive to cheat on the cartel by cutting wholesale prices. Similarly, in Leegin, the Court noted that a "group of retailers might collude to fix prices to consumers and then compel a manufacturer to aid the unlawful arrangement with resale price maintenance."[89] In this scenario, the manufacturer monitors the members of the retail cartel to make sure that they do not cheat on the cartel agreement by charging a price below the RPM. The manufacturer also deters cheating by withdrawing its product from retailers who charge a price below the RPM.

In *Leegin*, the court also discussed the possibility that a dominant retailer could compel a manufacturer to adopt RPM in an effort to prevent or forestall the entry of new lower cost retailers. By setting an RPM that is equal to the dominant retailer's price, the manufacturer prevents other, potentially lower-cost retailers from using lower prices to gain market share. The entry of lower-cost retailers would be expected to reduce retail margins, letting the manufacturer increase sales or wholesale prices. Imposing an RPM in this scenario would go against the manufacturer's economic interests, as it would prevent or slow the growth of lower-cost retailers by preventing them from using lower prices to attract consumers.[90] However, a manufacturer might be forced to accept the demand for a restrictive RPM if it came from a retailer with sufficiently high market share.

Finally, the Court noted that a manufacturer with market power might "use resale price maintenance to give retailers an incentive not to sell the products of smaller rivals or new entrants."[91] While the Court did not explain the mechanism, others have suggested that a dominant firm may use RPM "as a way to pay retailers for de facto exclusive dealing."[92] By setting a sufficiently high RPM manufacturer can control both the retail and wholesale prices of its product and set the profit margin that retailers earn. A manufacturer with a dominant market share could use RPM together with a refusal to supply retailers that carried the products of smaller rivals or new entrants to induce its retailers to become exclusive dealers. If enough retailers become exclusive dealers competing products will lack the distribution necessary to reach efficient scale, foreclosing their growth and entry.

Each of the scenarios discussed above in which RPM has anticompetitive effects involves the exercise or maintenance of market power. Importantly, the procompetitive effects of RPM, which the court enumerated before turning to the anticompetitive scenarios discussed above, need not depend whether or not market power is present. As discussed above, the procompetitive effects of RPM include enhancing interbrand competition by prevent free riding, facilitating market entry for new firms and brands and encouraging retailer services that would not be provided even absent free riding.

C. The Empirical Evidence on Competition Effects of Minimum RPM

To date, the existing empirical evidences show minimum RPM arrangements more likely benefit competition rather than harm competition.[93] In a research of all FTC RPM cases from mid-1965 through 1982 and catalogued existing empirical studies of RPM, a researcher concluded that RPM arrangements in most instances were pro-competitive because they occurred in markets that could support neither dealer nor manufacturer collusion.[94] Another study in 1991 examined 203 reported RPM cases from 1975 to 1982, the period during which U.S. federal antitrust law treated RPM as illegal *per se*.[95] This study hypothesized that "if the plaintiff had any evidence that the practice at issue in the litigation was used to support collusion, we would expect to see horizontal price-fixing allegations in these cases, in addition to the RPM allegation."[96] The researcher

88 Osborne, Cartel Problems, 66 American Economic Review 835, 835 (1976)

89 *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 893 (2007).

90 Klein, Competitive Retail Price Maintenance, 76 Antitrust Law Journal 431, 470-471 (2009).

91 *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 894 (2007).

92 Klein p. 468.

93 See generally, Joshua D. Wright, The Economics of Resale Price Maintenance and Implications for Competition Law and Policy, London, United Kingdom (April 9, 2014).

94 Thomas R. Overstreet, Jr., Resale Price Maintenance: Economical Theories and Empirical Evidence, Bureau of Economics Staff Report to the Federal Trade Commission, 1983.

95 Pauline M. Ippolito, Resale Price Maintenance: Empirical Evidence from Litigation, 34 J. L. & ECON. 263 (1991).

96 Pauline M. Ippolito, Resale Price Maintenance: Empirical Evidence from Litigation, 34 J. L. & ECON. 263 (1991), at 281.

found in all these cases, allegations of collusion appeared in only 9.8 percent of private cases and 13.1 percent of the entire sample. By contrast, a majority of the cases involved facts that were more consistent with procompetitive than anticompetitive uses of RPM. Then, the researcher concluded that service-and-sales-enhancing theories appear to have greater potential to explain the RPM practices than do collusion-based explanations.[97]

However, it should be noted that there are two recent studies which support the view that minimum RPM is more frequently anti-competitive than pro-competitive. In a study of June 2014, Alexander MacKay and David Aron Smith compared post-*Leegin* changes in price and output levels in states retaining a rule of *per se* illegality with those in states likely to assess minimum RPM under the rule of reason, aiming to conduct "a natural experiment to estimate the effects of *Leegin* on product prices and quantity."[98] They find that the price of product were most likely to increase combined with a quantity decrease as a result of *Leegin*. They estimated an overall price increase of 0.33 percent, an overall quantity decrease of 3.8 percent and a net consumer welfare decrease of 3.1 percent.[99] Therefore, they conclude that a more favorable legal environment for minimum RPM results in a loss in consumer welfare.[100] Some commentators have already pointed out that this study does not support a more restrictive policy towards minimum RPM.[101] Merely 1.6 percent of the product categories surveyed had both an increase in price *and* a decrease in quantity in states that shifted to the rule of reason.[102] Moreover, the study does not purport to actually present evidence that minimum RPM agreements were implemented for any of the product categories where price increases or output reductions were found.[103] This is particularly problematic because the study utilizes consumer product data for the grocery retail industry, where minimum RPM arrangements traditionally have not been employed and many products are distributed nationally so it is unlikely that manufacturers have entered into minimum RPM agreements on a state-by-state basis.[104]

In a study of February 2017, Matthias Hunold and Johannes Muthers challenged the efficiency defense for minimum RPM.[105] Using a theoretical model of two manufacturers with common retailers, they find minimum RPM increases consumer prices and can create a prisoner's dilemma for manufacturers without increasing, and possibly even reducing, the overall level of retail services.[106] This study does not support a more restrictive policy towards minimum RPM. The outcome of this study is strictly limited to the scenario of two manufacturers with common retailers. Further, encouraging retail services is only one of the pro-competitive effects of minimum RPM, this study cannot deny other pro-competitive effects of minimum RPM.

D. The Cost-Benefits Analysis of Different Approaches to Minimum RPM

Based on the existing empirical and theoretical evidence, we can conduct a cost-benefit analysis of different approaches to minimum RPM. We assume that the economic objective of the appropriate legal framework of minimum RPM is to minimize the sum of administrative costs and error costs, thereby maximizing the net social benefits of minimum RPM regulation. There is a wide-range of approaches for analyzing minimum RPM under antitrust law, with per se illegality and full-blown rule of reason at the two opposite far ends and a structured rule of reason based on various factors in the middle.

1. The Per Se Illegal or Hardcore Restraint Approach. Under this approach, minimum RPM is presumed to be anticompetitive and illegal. This approach may decrease administrative costs because of the bright line it provides. But just as the Leegin Court pointed out, admin-

97 *Ibid.* at 291-292.

98 Alexander MacKay and David Aron Smith, The Empirical Effects of Minimum Resale Price Maintenance (June 16, 2014), Kilts Center for Marketing at Chicago Booth – Nielsen Dataset Paper Series 2-006. Available at SSRN: https://ssrn.com/abstract=2513533 or http://dx.doi.org/10.2139/ssrn.2513533.

99 *Ibid.* at 3.

100 *Ibid.* at 24.

101 See Joshua D. Wright, The Economics of Resale Price Maintenance and Implications for Competition Law and Policy, London, United Kingdom (April 9, 2014); Thomas A. Lambert & Michael Sykuta, Why the New Evidence on Minimum Resale Price Maintenance Does not Justify a Per Se or "Quick Look" Approach, CPI ANTITRUST CHRON. (Nov. 2013), available at https://www.competitionpolicyinternational.com/file/view/7019.

102 See Joshua D. Wright, The Economics of Resale Price Maintenance and Implications for Competition Law and Policy, London, United Kingdom (April 9, 2014).

103 *Id.*

104 *Id.*

105 Matthias Hunold and Johannes Muthers, Resale price maintenance and manufacturer competition for retail services, 48 The RAND Journal of Economics 3–23 (2017).

106 *Id.*

istrative cost is only part of the equation.[107] As mentioned above, the existent evidence has shown that minimum RPM arrangements are more likely benefit competition rather than harm competition. The *per se* illegal or hardcore restraint approach will increase error cost in practices by prohibiting procompetitive conduct the antitrust laws should encourage. A typical example is the failure of EU approach we have discussed above. This approach also may increase litigation costs by promoting frivolous suits against legitimate practices.[108] The administrative advantages are "not sufficient in themselves to justify the creation of *per se* rules."[109]

2. The Full-blown Rule of Reason Approach. Under this approach, the plaintiff bears the initial burden of producing evidence of anticompetitive effect, and both the anti-competitive and pro-competitive effects should be fully examined and balanced. Obviously, this approach will decrease the false positive cost and simultaneously increase the administrative costs. Given the difficulty of showing anticompetitive effects, the full-blown rule of reason approach indicates high administrative costs. The high administrative costs will discourage the plaintiff to file suit, which increases the false negative cost.

3. The Structured Rule of Reason Based on Certain Factors. The U.S. Supreme Court suggested this approach in *Leegin*. Under this approach, when certain factor(s) are found in a specific situation, it will presume that the minimum RPM in that situation has anti-competitive effects, and then the defendant should bear the burden of proof to show any redeeming pro-competitive effects. Because it need not fully examine the pro-competitive and anti-competitive effects of minimum RPM arrangement, this approach will have lower administrative costs than the full-blown rule of reason approach. Simultaneously, this approach will have lower error costs than the *per se* illegal or hardcore restraint approach if it is based on sound economical evidence and theory. This approach may be the "a fair and efficient way to prohibit anticompetitive restraints and to promote procompetitive ones."[110] Thus, a structured rule of reason for minimum RPM may very well offer a superior legal rule.[111] The critical element of an appropriate structure of rule of reason for minimum RPM is that the relevant analytical factors correctly match the economic evidence.[112]

E. Redesigning the Structured Rule of Reason Approach to Minimum RPM

We have shown that two of the *Leegin* factors, the scope of use of minimum RPM in a market and the source of the RPM restraint, do not match the sound economic theory. Only the factor of market power is appropriate. But there may be other options for a structured rule of reason approach that are consistent with the economic evidence. Next, we will explore other factors to identify the proper factors matching the relevant economic theories.

1. Price Increase. There are some suggestions that if the consumer price has risen, the minimum RPM arrangement would be presumed anti-competitive.[113] We should be cautious about these suggestions. Higher consumer prices do not necessarily mean there has been an anticompetitive market effect. The goal of antitrust law is to promote consumer welfare. An increase in price may cause a decrease in consumer welfare, but it may also be the result of an increase in consumer welfare. If a price increase is the result of decreased quantity, there is a net loss of consumer welfare. Alternatively, the price may increase because there is an increase in demand.[114] Economic theory has found that minimum RPM may have a role to play in the context of Veblen goods (e.g. luxury cosmetics, luxury cars, designer handbags, and high-class wines).[115] As demand for Veblen goods ultimately depends on the conspicuous utility derived, the demand for this product could decrease if the real price has

107 *Leegin*, at 895.

108 *Id.*

109 *GTE Sylvania*, 433 U.S. 49–50.

110 *Leegin*, at 898.

111 See Joshua D. Wright, The Economics of Resale Price Maintenance and Implications for Competition Law and Policy, London, United Kingdom (April 9, 2014).

112 *Id.*

113 See, e.g. Brief for the American Antitrust Institute as Amici Curiae in Support of Appellant and Reversal, *PSKS, Inc. v. Leegin Creative Leather Prods., Inc.* (5th Cir. 2009) (No. 09-40506); Amended States' Comments Urging the Denial of Nine West's Petition, *In re* Nine West Group, Inc., No. C-3937 (F.T.C. Jan. 17, 2008) (available at http://www.ftc.gov/os/comments/ninewestgrp/080117statesamendedcomments.pdf).

114 See Nathaniel J. Harris, Leegin's effect on Prices: An Empirical Analysis, 9 J.L. Econ. & Pol'y 251, 273-274(2013).

115 See Andrés Font-Galarza, Frank P. Maier-Rigaud, &Pablo Figueroa, RPM Under EU Competition Law: Some Considerations From a Business and Economic Perspective, CPI Antitrust Chronicle November 2013 (1).

been eroded by discounts.[116] In this situation, if the RPM arrangement increases the consumer price, the consumer welfare will increase too because of the increased sales or additional services provided.

We should also notice that RPM may give consumers more options to choose among low-price, low-service brands; high-price, high-service brands; and brands falling in between.[117] Moreover, just as the *Leegin* Court had mentioned, many decisions a manufacturer makes and carries out through concerted action can lead to higher prices.[118] The manufacturer strives to improve its product quality or to promote its brand because it believes this conduct will lead to increased demand despite higher prices. The same can hold true for minimum RPM.[119] For example, a manufacturer might hire an advertising agency to promote awareness of its goods. Yet no one would think this action would violate antitrust law because it leads to higher prices.[120]

Therefore, a consumer price increase is not sufficient to establish anticompetitive effects. A price increase may be anti-competitive or pro-competitive depending on if it was caused by an increase or decrease in quantity sold.[121] Consequently, the consumer price increase plus the output or sale decrease is the proper factor to determine whether minimum RPM in a specific case is anti-competitive or pro-competitive.

2. No Free-riding. Some commentators suggest that if the minimum RPM was imposed on homogeneous products that are not sold with freerideable point-of-sale services, the minimum RPM practice should be presumed to have anti-competitive effects. This suggestion bases on the presumption that the free-riding is the single justification of minimum RPM. But this presumption is not true. Even absent free riding, minimum RPM arrangement can be able to be used pro-competitively by manufacturers to provide a financial incentive for retailers to implement strategies for promoting the manufacturer's product.[122] There is a prevalent incentive conflict between manufacturers and retailers with respect to retailer's point-of-sale promotional effort. Retailers generally have an insufficient incentive to provide promotional services from the manufacturer's point of view.[123] Therefore, manufacturers may use minimum RPM to induce dedicated retailer promotional efforts regardless of free-riding.

Moreover, when there is no risk of free-riding point-of-sale service, the optimal inventory problem may also drive manufacturers to implement minimum RPM. With fluctuating demand under uncertainty, minimum RPM can induce more appropriate inventory holding by retailers.[124] If demand declines, the value of retailer inventories would decline and may force the retailers to sell their stock at lower prices. As a result, retailers will hold inefficiently low stocks. Minimum RPM would eliminate an inventory devaluation, which would allow retailers to hold efficient stock levels benefitting the manufacturer and, under certain circumstances, also consumers.[125]

Minimum RPM can be pro-competitive even in the absence of free-riding because of the existence of other justifications of RPM. Non-existence of free-riding risk is not sufficient to establish anticompetitive effects of minimum RPM. The appropriate legal framework for minimum RPM analysis should not be based on this factor.

V. CONCLUSION

The appropriate legal treatment of minimum RPM will ultimately depend on the empirical evidence and development of economic knowledge. Economic analysis and actual practice of evading of EU law show the failure of regarding minimum RPM as hardcore restraint. The existing

116 Named after Thorstein Veblen who first described the underlying effects in his work THE THEORY OF THE LEISURE CLASS (1899). See H. Leibenstein, *Bandwagon, Snob, and Veblen Effects in the Theory of Consumers Demand*, 64 QUARTERLY J. ECON. 183-207 (1950); See Andrés Font-Galarza, Frank P. Maier-Rigaud, &Pablo Figueroa, RPM Under EU Competition Law: Some Considerations From a Business and Economic Perspective, CPI Antitrust Chronicle November 2013 (1).

117 *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 878 (2007).

118 *Ibid.* at 895.

119 *Id.*

120 *Id.*

121 See Nathaniel J. Harris, Leegin's effect on Prices: An Empirical Analysis, 9 J.L. Econ. & Pol'y 251, 274(2013).

122 See Benjamin Klein, Competitive Resale Price Maintenance in the Absence of Free Riding, 76 ANTITRUST L.J. 431 (2009).

123 *Ibid.* at 449-56.

124 See R. Deneckere, H.P. Marvel, & J. Peck, *Demand Uncertainty, Inventories, and Price Maintenance*, 111 QUARTERLY J. ECON. 885-913 (1999).

125 See R. Deneckere, H.P. Marvel, & J. Peck, *Demand Uncertainty and Price Maintenance: Markdowns as Destructive Competition*, 87 AMER. ECON. REV. (1997).

evidence and cost-benefit analysis tell us that a structured rule of reason for minimum RPM may very well offer a superior legal rule. But the structured rule of reason analysis suggested by the *Leegin* Court do not all match the sound economic theory. Considering the existing empirical evidence and economic theory, we should structure a rule of reason analysis to minimum RPM based on two factors: (1) the market power of the supplier or the dealer; and (2) the consumer price increase plus the sale decrease. When either of the two factors is shown, it could be presumed that the minimum RPM is anticompetitive. Then the defendant should bear the burden of proof showing the pro-competitive effects the minimum RPM may have. Courts can identify other factors with the judicial learning and the development of Economics to structure the legal framework for minimum RPM.

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