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INSTITUTE FOR STUDIES IN COMPETITION LAW AND POLICY

Queen Mary
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RESALE PRICE MAINTENANCE: ECONOMISTS VS. JUSTICE BREYER

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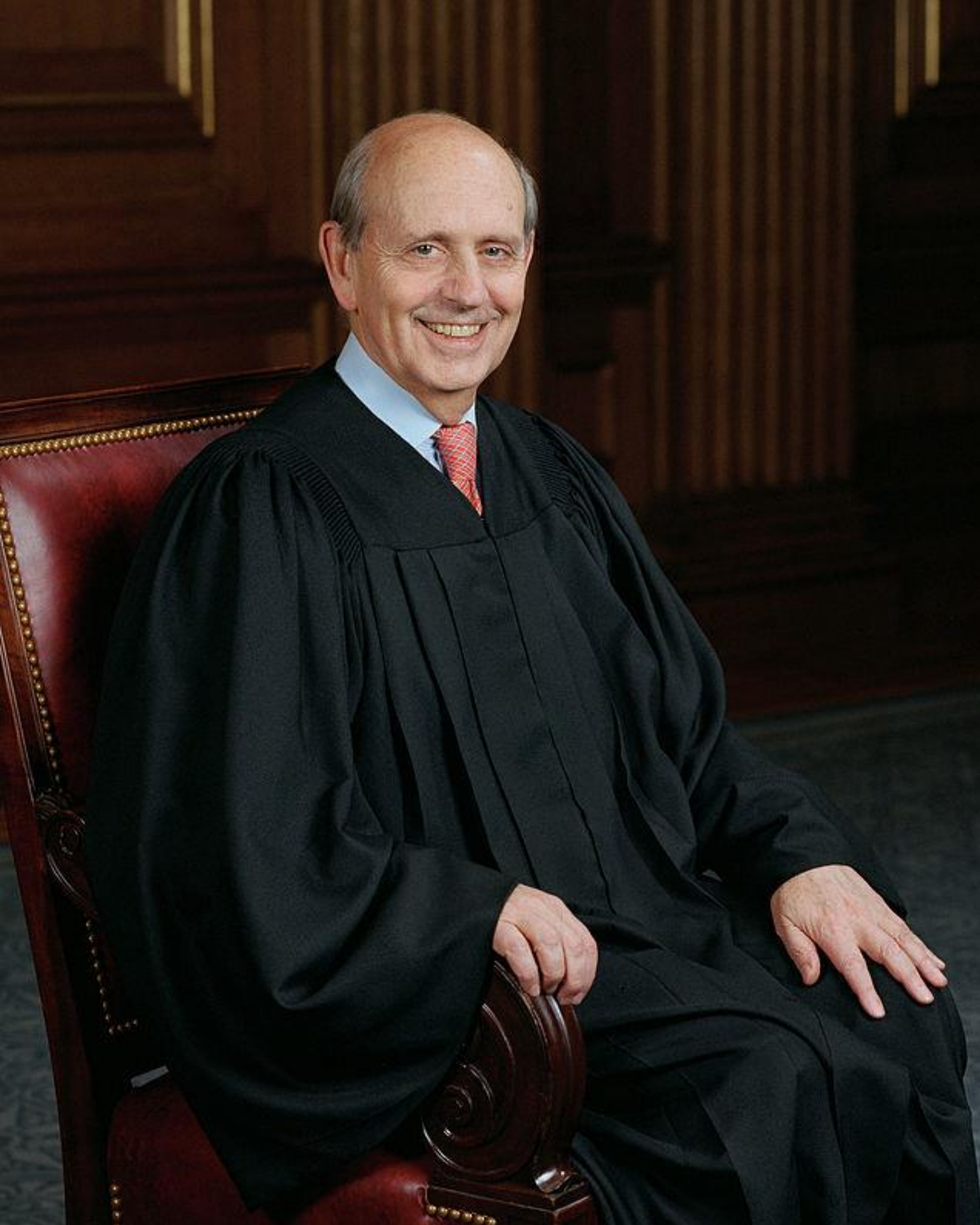


JUSTICE BREYER: Should we overturn Dr. Miles and run that risk?

MR. OLSON: In, in the vast majority of the economist whose have looked at this have come out to the opposite conclusion, Justice Breyer. Secondly -

JUSTICE BREYER: We're supposed to count economists?

MR. OLSON: No. No. I think that -

JUSTICE BREYER: Is that how we decide it? (Laughter.)

MR. OLSON: But what this Court -- -- what this Court has repeatedly said, that under circumstances such as this where there's a consensus among leading respected economists, that is one factor. There's another factor -

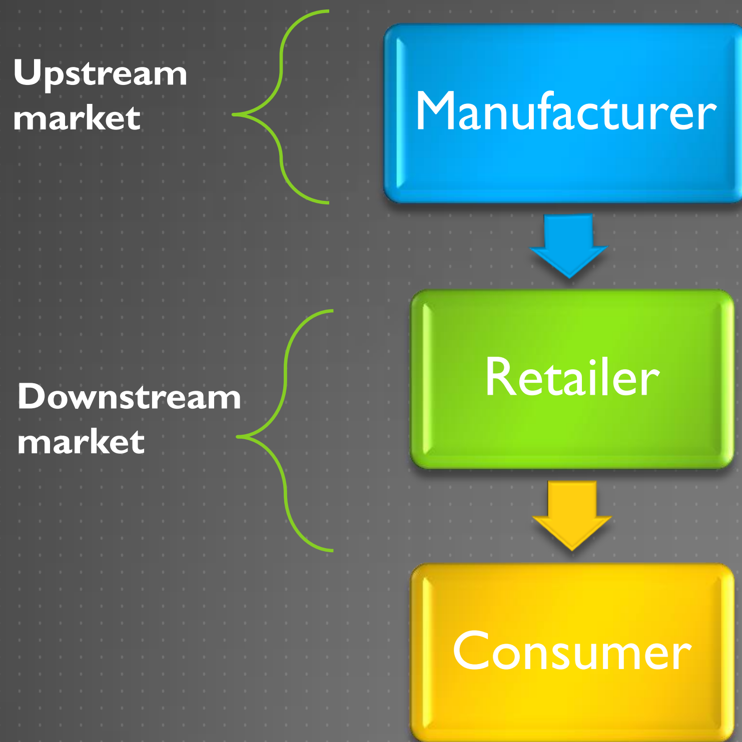
JUSTICE BREYER: Well, I haven't seen a consensus. A consensus? Isn't, doesn't Sherer and all these people, doesn't that point of view count, too?

AGENDA

- Why RPM?
- Theories of harm of RPM: an economist perspective
- Commission's Approach
- Rethink of the presumption of illegality? The US approach!
- Guide to Vertical restraint evaluation: RPM
- Recommended Approach to RPM

Problems in supply and distribution	Contractual solutions
1. Double monopoly mark-up (i.e. successive (manufacturer then retailer) mark-ups)	- Two-part tariffs (sell at marginal cost and charge franchise fee)
	- Establish sales quota (i.e. quantity requirements
	- Resale price maintenance
2. Damaging competition between retailers compromising wide availability of product	- Resale price maintenance
	- Exclusive distribution
3. Free-riding by retail price discounters on pre-sales services and/or reputation of full price dealers	- Service requirements (i.e. requiring retailers to provide certain services)
	- Resale price maintenance
	- Exclusive distribution
	- Refusal to supply
	- Exclusive dealing
	- Take over marketing effort
	- Monitor and subsidise or pay for dealers' sales effort
4. Free-riding by rival manufacturers on product's image, advertising, and customer drawing power or on investment in dealers	- Exclusive dealing
5. Providing optimal number and density of dealers and capturing economies of scale in distribution	- Resale price maintenance

RPM



- Refers particularly to vertical agreements between an undertaking in the **upstream market** controlling resale prices of another undertaking in the **downstream market**
- **Resale price maintenance** (RPM) is a **vertical price restraint** imposed by the supplier/manufacturer to the retailer/distributor in relation to the final product sold to the final consumer.
- Maximum RPM
- Minimum RPM
- If anti-competitive-> under Art 101(1) but exemptions under Art 101(3) / VBER

RPM: WHY SUCH A BIG FUSS ABOUT IT?

- Logically if a manufacturer sets a maximum resale price of the product to the retailer, that means that the retailer will buy that product, add its own profit to create the final price (keeping it under the resale price recommended)
  - This is an ideal example, where maximum RPM is used as a "combat tool" to address double marginalisation
  - It prevents retailers from fixing prices too high above competition levels (benefit for the consumers)
  - Ensures that prices of products are lower and output is consequently higher (benefit for the manufacturers)
- Problem: fixed / minimum RPM "fixed or minimum price [Article 4(a) VRBER]

THEORIES OF HARM OF RPM: AN ECONOMIST PERSPECTIVE

- Commitment device to extract monopoly profits
  - O'Brien & Schaffer, 1992 (Rand)
    - RPM can help a manufacturer to better exert its market power
    - Bilaterally negotiated price ceilings, can help prevent opportunism
  - Rey & Vergé, 2004a (Rand)
    - Industry wide price-floor would prevent the risk of opportunistic behavior and help the manufacturer to exert its market power
- Facilitate upstream collusion
  - Jullien & Rey, 2007 (Rand)
    - RPM can indeed facilitate collusion by enhancing the detection of deviations
    - RPM more effective than other vertical restraints in doing so

THEORIES OF HARM OF RPM: AN ECONOMIST PERSPECTIVE

- Limit retailer bargaining and thereby dampen upstream competition
  - Dobson & Waterson, 2007 (IJIO)
    - Bilateral Nash-bargaining between each manufacturer retailer pair over a linear wholesale price.
    - If retailers have all the bargaining power, retail prices are higher with RPM.
    - If, instead, manufacturers possess all the bargaining power, retail prices are higher without RPM due to double marginalization.
- Facilitate downstream collusion
  - Shaffer, 1991 (Rand)
    - Dampen competition if it is the retailers - not the suppliers - who have the bargaining power.
  - Martimort & Stole, 2003 (ATE)
    - NB. where the downstream rivals make the offers but the upstream monopolist eventually chooses how much to supply, the equilibrium outcome is again competitive
- Inhibit low price downstream entry
  - Office of Fair Trading/UEA, 2007

COMMISSION'S APPROACH

1
- Rebut the presumption of hardcore restrictions (art 4 VBER)

2
- No more than 30% on relevant market by both supplier and buyer (art 3 VBER)

3
- Adequate evidence satisfying Art 101(3) (four conditions)

4
- Meet high threshold of indispensability of efficiencies provided by RPM

COMMISSION'S APPROACH

- Is the agreement of a type falling within the VABER?
- Are the parties "competing undertakings"?
- Does the supplier and buyer have a market share that exceeds 30% of the relevant market?
  - If YES, the agreement does <u>not</u> meet the criteria for VABER
- Does the agreement contain any black-listed ("hardcore") restrictions within the meaning of VABER?
  - If YES, the agreement does not meet the criteria for VABER. Restriction can be presumed to be caught by Art. 101(1) prohibition (and to be unlikely to meet the conditions for individual exemption under Art. 101(3))
- Does the agreement contain any non-exempted vertical restraints within the meaning of the VABER?
  - If YES, the specific restraint cannot benefit from an exemption (but the agreement may still survive, if the specific restraint is severable)

COMMISSION'S APPROACH: MAXIMUM AND RECOMMENDED RPM

- A more economic approach
- Not included in the category of hardcore restrictions any more
- Objective is not the restriction of competition
- The Commission must examine further the effects

COMMISSION'S APPROACH: MINIMUM AND FIXED RPM

- Hardcore restriction of competition
- Falls under Article 101(1) TFEU
- Commission proven unsympathetic in the application of the legal exception of Article 101(3) TFEU
- Subjected to a de facto « per se » prohibition

COMMISSION'S ANALYSIS: THE PARAMETERS

- Supplier's market position
- Competitors' market position
- Buyer's market position
- Entry barriers
- Maturity of the market
- Level of trade (upstream/downstream)
- Nature of the product
- Other (cumulative effect)

RETHINK OF THE PRESUMPTION OF ILLEGALITY? THE US APPROACH!

The per se approach against RPM is unwarranted:

- *Dr. Miles*
- *Continental TV, Inc v GTE Slyvania*;
- *State Oil v Khan;*
- *Leegin v PSKS;*

THE NEED FOR A RETHINK OF THE PRESUMPTION OF ILLEGALITY- THE US APPROACH!

- *Dr. Miles* manufacturer's setting the minimum prices at which independent resellers may resell its products was unlawful (1911)
- *Continental TV, Inc v GTE Slyvania;* rejected per se treatment of vertical nonprice restraints because "*there ha[d] been no showing . . . either generally or with respect to Sylvania's agreements, that vertical restrictions have or are likely to have a 'pernicious effect on competition' or that they 'lack . . . Any redeeming virtue.'"*
- Per se treatment is "*appropriate only for 'conduct that is manifestly anticompetitive,' that is, conduct 'that would always or almost always tend to restrict competition and decrease output.* (1977)
- *State Oil v Khan;* overturned application of the per se rule to vertical agreements on maximum resale prices. (1997)

THE NEED FOR A RETHINK OF THE PRESUMPTION OF ILLEGALITY- THE US APPROACH

- Survey of post-Sylvania rule-of-reason case law in 1999 on rule of reason balancing in c. 25 years: 96% of Rule of Reason cases, courts do not conduct any balancing exercise.
- The courts found that the plaintiff failed to demonstrate a significant anticompetitive effect in 105 out of 118 cases (89%) involving vertical restraints."
- And generally:
  - Subsequent survey of rule-of-reason cases decided between February 2, 1999 and May 5, 2009.
  - Carrier found that of 222 decisions that reached a final determination, 215 (96.8%) "were resolved on the grounds that the plaintiff did not prove an anticompetitive effect" and only 5 cases (2.2%) performed balancing.
  - Carrier, The Real Rule of Reason: Bridging the Disconnect, 1999 B.Y.U. L. REV. 1265 (1999).

AND THEN: LEEGIN…

- Leegin: Should the Dr. Miles per se ban on minimum resale price agreement continue to be the law: Supreme Court said NO!!
- The Supreme Court acknowledged a broader range of efficiencies provided by RPM and overruled the 90-year precedent of per se illegality treatment of RPM in favour of the "rule of reason".
- The Court cited an extensive list both in favour and against RPM by experts and economists and concluded:
- *"notwithstanding the risk of unlawful conduct it cannot be stated with any degree of confidence and price maintenance 'always or almost always' tends to restrict competition and decrease output".*

FLOODGATES

You have just opened them

HAVE THE FLOODGATES OPENED??

- Courts in the few recent RPM cases that have been contested have generally ruled for defendants without engaging in rule-of-reason balancing where they could rule out the main categories of concern related to RPM as noted in the Leegin ruling
  - where the court could rule out dominance concerns (NB Mkt Def)
  - where the plaintiff failed to show an anticompetitive effect on interbrand competition
  - where the court could rule out concerns about concerted horizontal conduct at the supplier and retailer levels.

HAVE THE FLOODGATES OPENED??

- In the few post-Leegin cases involving minimum RPM that have been contested, none has reached the stage to conduct a full weighing, balancing, net effect measurements of pro- and anticompetitive effects.
- In other instances, courts have found ways to avoid full rule-of-reason analysis by dismissing the plaintiffs' claims on elemental grounds, such as failure to meet the threshold requirement of defining a bona fide relevant market
- Carrier, The Rule of Reason: An Empirical Update for the 21st Century, 16 GEO. MASON L. REV. 827, 829 (2009).

GUIDE TO VERTICAL RESTRAINT EVALUATION: RPM

- Establishment of criterion to evaluate potential effects of vertical agreements:

  a) "Per-se rule"
  b) Rule of reason
     - Effects of vertical restraints:
       - ✓ Qualitative
       - ✓ Quantitative
     - Cases of minor importance

  ✓ Justifications: Agreement allows an efficient organization of the distribution network, necessary to reduce production or distribution costs; and agreement does not eliminate efficient competition

GUIDE TO VERTICAL RESTRAINT EVALUATION: RPM

- RPM and Inter v Intrabrand competition
- To understand vertical relations and restraints, need to distinguish between two levels of competition:
  - Intra-Brand competition: competition between two different retailers of the same brand of the product.
  - Inter-Brand competition: competition between two different manufacturers/retailers with different brands the same or similar product.
- When is competition reduced or eliminated?
  - RPM usually (or always!) eliminates intrabrand price competition
  - RPM rarely eliminates interbrand price competition
  - price competition matters only?

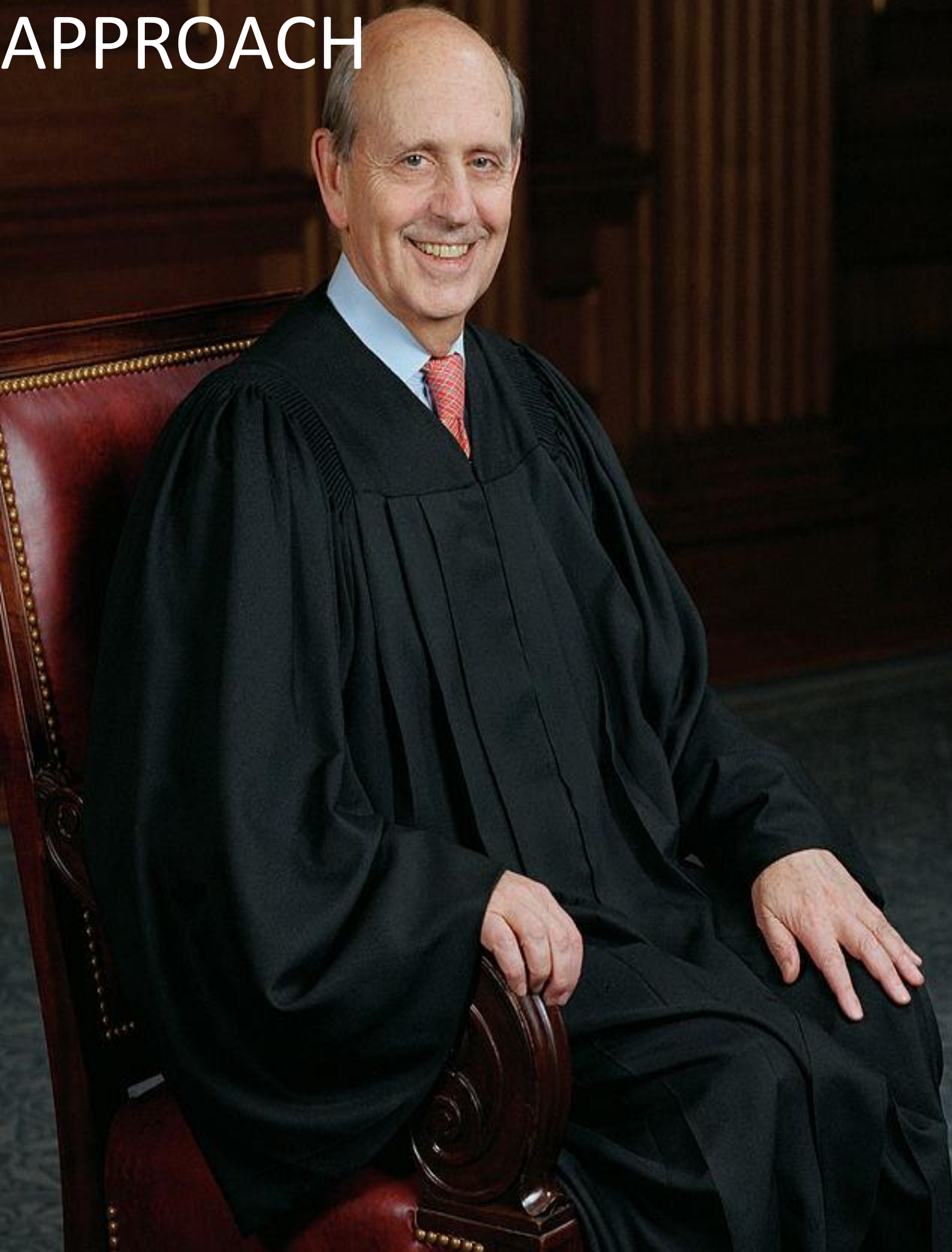
GUIDE TO VERTICAL RESTRAINT EVALUATION: RPM

- interbrand always matters
- intrabrand rarely matters
  - if there is interbrand competition
  - unless RPM is retailer-instigated
    - where the anticompetitive effects of RPM are primarily downstream, and
    - where these effects provide the anticompetitive rationale for the RPM,
    - expect to observe the RPM being instigated by retailers
      - Fletcher & Hviid, (*Retail Price MFNs*) CCP WP14-5, 2014

GUIDE TO VERTICAL RESTRAINT EVALUATION: RPM

- Giovanetti, Stallibrass (ECJ Dec 2009) & Giovanetti, Stallibrass, Fletcher, Bennett (FILJ 2011)
- Is there significant upstream market power?
  - Protection of upstream market power against commitment problem
- Are there parallel RPM agreements of rival suppliers with large market share?
  - Facilitation of collusion or parallelism

RECOMMENDED APPROACH



CHIEF JUSTICE ROBERTS: Maybe, Mr. Olson, you could give us an example where the rule of reason would find a violation in this situation?

MR. OLSON: Well, it might be a situation, the **economists have written about this, say that it would be very rare, and would require retailers with a strong powerful market power to impose a situation where the manufacturer would do that to help facilitate a horizontal cartel.**

JUSTICE BREYER: You say very. Which economists? I know the Chicago school tends to want rule of reason and so forth. Professor Sherer is an economist, isn't he? Worked at the FTC for a long time. A good expert in the field. He points out the drug industry after you got rid of -- after you got rid of resale price maintenance, the margins fell 40 percent. The drug stores it went down 20 percent. He says with blue jeans, alone, it saved American consumers $200 million to get rid of it. And his conclusion is, as in the uniform enforcement of resale price maintenance, the restraints can impose massive anti-consumer benefits. Massive.

MR. OLSON: Well –

JUSTICE BREYER: What that sounds like is that if at least he, who is an economist, thinks if you get rid of Dr. Miles, every American will pay far more for the goods that they buy at retail. Now that's one economist, of course. There are other whose think differently. So how should we decide this?

RECOMMENDED APPROACH

- Need to abandon the *hardcore approach* and move into a more *full effects-based approach* (akin to rule of reason).
- Problem: latter "takes the form of an endless economic enquiry"
- Possible solution: **rebuttable presumption with explicit exemptions or safe harbours for situations in which there is either minor or no competitive harm or where the benefits of using RPM outweigh harm.**

RECOMMENDED APPROACH

- Vertical Agreements very often entail efficiency gains: e.g., avoiding double marginalisation, protecting investments in the relationship between upstream and downstream firms
- Likely to be anti-competitive only if firm involved has substantial market power: e.g., when VAs solve the commitment problem of a monopolist, when they strategically affect inter-brand competition
  - Main concerns: Foreclosure, Facilitation of collusion , prevention of parallel imports
- Spirit of BER (not hardcore restrictions): effects-based approach.

THANK YOU ACIU

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