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Resale Price Maintenance: Explaining the Controversy, and Small Steps Towards a More Nuanced Policy

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Abstract

Part I of this Essay sets out why the legal framework in the EU amplifies what are, in reality, relatively small differences in thinking about resale price maintenance ("RPM"). This amplification is primarily due to the fact that the legal system asks economists, in the name of legal certainty, to draw a false dichotomy between those agreement and practices that are harmful and those that are beneficial. For practices like naked price-fixing, it is relatively easy for economists to agree on an answer. It is harder, however, for practices like RPM, which can give rise to serious anticompetitive harm, but can also prove to be indispensable for important and valuable benefits to consumers. Part II therefore provides a summary of the economic literature on RPM and emphasizes the need for further empirical research in this area. Within the current legal framework, there is not yet sufficient evidence to justify moving RPM out of the EU's "presumed illegality" or "object" box and into a case-by-case assessment of "effect" box. It is clear, however, that this approach will sometimes presume that some RPM arrangements are illegal when in fact they either do not restrict competition or, if they do, they are nevertheless justified by generating consumer benefits. Accordingly, we would have significant reservations about a legal framework that goes beyond "presumed illegality," for example making RPM de facto illegal or even per se illegal, as in the United States before Leegin. On the basis of these beliefs, Part III suggests several small steps that can be taken towards assessing RPM within a "presumed illegality" framework without sacrificing too much of the legal certainty that is realized under the current approach. First, we argue that it is important to ensure that any presumption of illegality is truly rebuttable, and provide some thoughts as to how this might work. This includes the requirement that the authority should set out at least one plausible "theory of harm" that is consistent with known facts. Second, we suggest that a series of screens might usefully be adopted for considering whether there is likely to be a credible theory of harm in any particular case of RPM, and for prioritizing cases on this basis. Third we recognize that a prioritization approach may not be as effective in a system such as the United States, where competition law is primarily enforced via cases brought by private litigants. There may, nevertheless, be some potential to use screens of this sort to help define a legal standard. Under this approach, failure of the screens would demonstrate that there is no credible theory of harm associated with a particular case of RPM and the presumption of illegality could be rebutted. This approach would be similar to the screens that are commonly applied in the EU in article 102 TFEU ("Treaty on the Functioning of the European Union") (article 82 EC ("Treaty Establishing the European Community")) abuse-of-dominance cases.

ESSAYS

RESALE PRICE MAINTENANCE: EXPLAINING THE CONTROVERSY, AND SMALL STEPS TOWARDS A MORE NUANCED POLICY

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INTRODUCTION

Resale price maintenance ("RPM") is the practice by which a manufacturer directly sets the retail price for which a downstream retailer can sell its goods.[1] Over recent years, there have been important divergences in thinking among economists and lawyers about the appropriate treatment of RPM under competition law. In the United States, these divergences were brought into focus by the *Leegin* case,[2] in which the U.S. Supreme Court concluded that RPM should no longer be viewed as per se illegal under domestic antitrust law.[3] In the European Union ("EU"), the debate was precipitated by the European Commission's ("Commission") review of its vertical restraints block exemption and guidance.[4]

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1. This Essay uses the term resale price maintenance ("RPM") to encompass both fixed-price RPM (in which the manufacturer sets a specific retail price) and minimum RPM (in which the manufacturer sets the minimum retail price but allows the retailer to set prices above this); both are covered by the arguments made throughout. The Essay is not intended to cover maximum RPM, which is typically viewed as unlikely to be anticompetitive.

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

3. *Id.* at 907 ("Vertical price restraints are to be judged under the rule of reason.").

4. *See* Commission Regulation on the Application of Article 81(3) of the Treaty on the Functioning of the European Union to Categories of Vertical Agreements and

Part I of this Essay sets out why the legal framework in the EU amplifies what are, in reality, relatively small differences in thinking about RPM. This amplification is primarily due to the fact that the legal system asks economists, in the name of legal certainty, to draw a false dichotomy between those agreements and practices that are harmful and those that are beneficial. For practices like naked price-fixing, it is relatively easy for economists to agree on an answer. It is harder, however, for practices like RPM, which can give rise to serious anticompetitive harm, but can also prove to be indispensable for important and valuable benefits to consumers.

Part II therefore provides a summary of the economic literature on RPM and emphasizes the need for further empirical research in this area. Within the current legal framework, there is not yet sufficient evidence to justify moving RPM out of the EU's "presumed illegality" or "object" box and into a case-by-case assessment or "effect" box. It is clear, however, that this approach will sometimes presume that some RPM arrangements are illegal when in fact they either do not restrict competition or, if they do, they are nevertheless justified by generating consumer benefits. Accordingly, we would have significant reservations about a legal framework that goes beyond "presumed illegality," for example making RPM de facto illegal or even per se illegal, as in the United States before *Leegin*.[5]

On the basis on these beliefs, Part III suggests several small steps that can be taken towards assessing RPM within a "presumed illegality" framework without sacrificing too much of the legal certainty that is realized under the current approach. First, we argue that it is important to ensure that any presumption of illegality is truly rebuttable, and provide some thoughts as to how this might work. This includes the

Concerted Practices, No. 330/2010, 2010 O.J. L 102/1 (reevaluating European Union ("EU") antitrust policy on vertical agreements); Commission Notice, 2010 O.J. C 130/1 (promulgating new guidelines on vertical restraints).

5. *See* Dr. Miles Medical Co. v. John D. Park & Sons, Co., 220 U.S. 373 (1911), *overruled by Leegin*, 551 U.S. at 907. This rule was based on a restrictive reading of section 1 of the Sherman Act, which prohibits "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States." Sherman Act § 1, ch. 647, 26 Stat. 209 (1890) (codified as amended at 15 U.S.C. § 1 (2006)).

requirement that the authority should set out at least one plausible "theory of harm" that is consistent with known facts. Second, we suggest that a series of screens might usefully be adopted for considering whether there is likely to be a credible theory of harm in any particular case of RPM, and for prioritizing cases on this basis. Third we recognize that a prioritization approach may not be as effective in a system such as the United States, where competition law is primarily enforced via cases brought by private litigants. There may, nevertheless, be some potential to use screens of this sort to help define a legal standard. Under this approach, failure of the screens would demonstrate that there is no credible theory of harm associated with a particular case of RPM and the presumption of illegality could be rebutted. This approach would be similar to the screens that are commonly applied in the EU in article 102 TFEU ("Treaty on the Functioning of the European Union") (article 82 EC ("Treaty Establishing the European Community")) abuse-of-dominance cases.[6]

These steps require varying degrees of further work, with the third being the most controversial and raising the most significant issues. However, we believe they all hold the potential to substantially ameliorate many current reservations, while preserving legal clarity in a position where RPM will, for the most part, remain unlawful. Such steps would also have the benefit of avoiding cases—arguably, such as *Leegin*—where there is no clear credible theory of harm and thus carry the potential to bring the entire competition system into disrepute by making it appear out of touch with reality.

I. *LEGAL AND ECONOMIC BACKGROUND: THE ROOT OF DISAGREEMENT*

From an economic standpoint, competition law ensures competitive markets, which generate benefits for consumers and

6. Consolidated Version of the Treaty on the Functioning of the European Union art. 102, 2008 O.J. C 115/47, at 89 [hereinafter TFEU]; Consolidated Version of the Treaty Establishing the European Community art. 82, 2006 O.J. C 321 E/37, at 74–75 [hereinafter EC Treaty].

drive productivity.[7] As such, a key objective of any system of competition law should be to prevent firms from engaging in practices and signing agreements that appreciably prevent, restrict, or distort competition, such that there is detriment to consumers that is not counterbalanced by benefits to consumers.

The language of EU competition law on agreements, article 101 TFEU (article 81 EC), is in line with this economic thinking. The first of the above principle corresponds precisely to article 101(1) TFEU, which prevents agreements or concerted practices that "have as their object or effect the prevention, restriction or distortion of competition within the internal market."[8] The second aspect of the objective outlined above corresponds, more approximately, to article 101(3) TFEU, which makes article 101(1) inapplicable where the agreement or practice in question "contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not . . . impose on the undertakings concerned restrictions which are not indispensable to the attainment of those objectives."[9]

Difficulties arise, however, in the practical application of these provisions. On its face, the law seems to suggest the need to review every agreement or practice on a case-by-case basis to assess whether there is an anticompetitive object or effect and, if so, then determine if the anticompetitive effect is counterbalanced by the benefit to consumers. In practice however, there is a need for far greater legal certainty than a case-by-case analysis can provide.

The need for greater legal certainty is the result of two key factors. First, a case-by-case approach places a high burden on firms, who are not in position to carry out this sort of economic

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7. *E.g.*, ROBERT H. BORK, THE ANTITRUST PARADOX 7 (2d ed. 1993); RICHARD A. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE 8–22 (1976). *See generally* Joseph F. Brodley, *The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress*, 62 N.Y.U. L. REV. 1020 (1987) (articulating the efficiency and productivity goals of competition law).

8. TFEU, *supra* note6, art. 101(1), 2008 O.J. C 115, at 88. Notably, the pre-Lisbon Treaty on Establishing the European Community ("EC Treaty") used the phrase "*common* market" instead of "internal market." EC Treaty, *supra* note 6, art. 81(1), 2006 O.J. C 321 E, at 73 (emphasis added).

9. TFEU, *supra* note 6, art. 101(3)(a), 2008 O.J. C 115, at 89.

analysis for each and every agreement that they enter. Consequently, there is a risk that firms will simply avoid engaging in particular agreements or practices, even when they would be beneficial. This would clearly be detrimental to both competition and economic efficiency. Second, and conversely, a case-by-case approach places a high burden on competition authorities and private parties that bring antitrust actions, which could lead to under-enforcement and therefore insufficient deterrence of anticompetitive behavior. These concerns are especially acute for less-mature regimes or smaller, under-resourced authorities. Again, this would be detrimental to a competitive economy.

A. *Creating Legal Certainty in the Law on Agreements*

For the reasons outlined above, there have been moves—on both sides of the Atlantic—to put certain types of agreement and practice into particular "boxes," removing the need for case-by-case analysis of the likely harmful effects of such practices.[10] The following figure sets out some of the most common "boxes" that have been used, along a spectrum which runs from "definitely illegal" to "definitely legal."

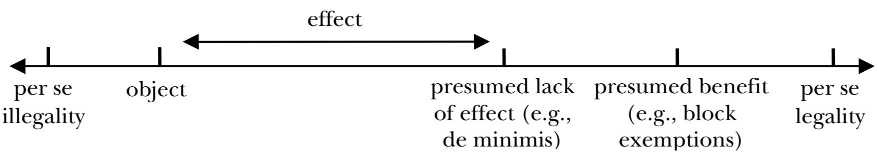

Figure 1. Linear representation of artificial "boxes" used by competition authorities to assess agreements.

10. *See* Dr. Miles Medical Co. v. John D. Park & Sons, Co., 220 U.S. 373 (1911) (sustaining RPM agreements as per se illegal under the Sherman Act in the United States as a matter of law); T-Mobile Netherlands BV v. Raad van Bestuur van de Nederlandse Mededingingsautoriteit, [2009] 5 C.M.L.R. 1701, 1737–38 (confirming that harmful effects may be presumed in "object" cases in the EU because practices therein "can be regarded, by their very nature, as being injurious to the proper functioning of normal competition"). It is worth noting that even in object cases parties may adduce evidence to meet the exemption criteria under article 101(3), even though the burden of proof is on them to prove that the criteria are satisfied. Matra Hachette SA v. Commission, Case T-17/93, [1994] E.C.R. II-595, 631, ¶ 104.

"Per se illegality," on the left hand side of the spectrum, is a box used in the United States, but not in the EU.[11] Under this approach, there is no potential to rebut the presumption of anticompetitive harm, nor to show that the agreement has efficiency benefits that might counterbalance any harm. Price-fixing is the classic "per se illegal" agreement.[12] *Leegin* focused on whether RPM, which had historically also been "per se illegal,"[13] should be taken out of this box.[14]

In the EU, the distinction is instead between "object" and "effect" infringements. Practices that are anticompetitive by "object" are presumed anticompetitive.[15] For these cases, a competition authority is not required to provide any real economic (or other) evidence of likely anticompetitive harm. It is sufficient to demonstrate that the practice fits into the "object" box and hence is illegal. However, the "object" box differs from the U.S. "per se illegality" box in two ways, at least conceptually. First, the presumption of anticompetitive harm, while strong, is nevertheless theoretically rebuttable if compelling evidence is adduced that the agreement could not have been expected to have an anticompetitive effect. Second, an object infringement can still, in theory, be exempted from article 101(1) if it meets all of the conditions under article 101(3).[16] In reality, as will be explained in Part III.A, the extent to which the "object" box differs from "per se illegality" depends on the extent to which competition authorities and courts are open to accepting

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11. *See* Luc Peeperkorn, *Resale Price Maintenance and Its Alleged Efficiencies*, 4 EUR. COMPETITION J. 201, 201-03 (2008) (contrasting the EU system of individualized assessment and the U.S. per se approach). It bears note that per se treatment of RPM was eventually overruled by the U.S. Supreme Court in *Leegin*. *See supra* note 3.

12. *See* Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 885 (2007) (endorsing a U.S. Court of Appeals holding that "[the Supreme] Court has consistently applied the *per se* rule to [vertical minimum price-fixing] agreements").

13. *See supra* note 5.

14. *Id.* ("We [the Supreme Court] granted certiorari to determine whether vertical minimum resale price agreements should continue to be treated as *per se* unlawful.").

15. Commission Notice, 2000 O.J. C 291/1, at 3 [hereinafter Guidelines on Vertical Restraints] ("[I]n the case of restrictions by object . . . the Commission is not required to assess the actual effects on the market.").

16. TFEU, *supra* note 6, art. 101(3)(a), 2008 O.J. C 115, at 89. Specifically, the treaty requires that the agreement create efficiency benefits, that a fair share of these benefits pass to consumers, that the restrictions are indispensable and that there is no elimination of competition. TFEU, *supra* note 6, art. 01(3)(a), 2008 O.J. C 115, at 89.

rebuttal arguments under article 101(1) or efficiency arguments under article 101(3). Should such arguments be dismissed without due consideration, there would be little in practice to differentiate the two approaches.

At the other end of the spectrum, there are a variety of boxes under which an agreement or practice may be judged (likely to be) legal. Some practices are simply "per se legal," on the basis of being viewed as unlikely to have an anticompetitive object or effect. Other agreements and practices are considered so unlikely to restrict competition appreciably that they are classed in a "presumed lack of effect" box. The EU de minimis doctrine is a good example.[17] Likewise, for particular types of agreement and particular market share thresholds, it can be presumed that, even if there is anticompetitive harm, it is counterbalanced by efficiency benefits.[18] The various EU block exemptions are good examples.[19]

These various boxes clearly have the potential to provide a fair degree of legal certainty. The appropriate box, if any, for a particular agreement or practice will effectively depend on how likely it is that the agreement or practice in question would be

17. *See* Commission Notice, 1997 O.J. C 372/13 (defining the market thresholds under which all non-object agreements are presumed lawful). Again, this de minimis presumption can theoretically be rebutted. The current market share thresholds, which relate to the aggregate market shares held by all of the participating undertakings, are five percent for horizontal agreements and ten percent for vertical agreements. *Id.*, 1997 O.J. C 372/13, at 14. Another good example is the European Commission's ("Commission") guidance that buying groups are unlikely to be found unlawful if the parties to the agreement have a combined market share of below fifteen percent on the purchasing market(s) as well as a combined market share of below fifteen percent on the selling market(s). *See* Commission Notice, 2001 O.J. C 3/2, at 19.

18. Commission Regulation on the Application of Article 81(3) of the Treaty to Categories of Vertical Agreements and Concerted Practices, No. 2790/1999, pmbl., 1999 O.J. L 336/21, at 21 ("Experience acquired to date makes it possible to define a category of vertical agreements which can be regarded as normally satisfying the conditions laid down in Article 81(3) [EC (article 101(3) TFEU)].").

19. *See* Council Regulation on Application of Article 85(3) of the Treaty to Certain Categories of Agreements and Concerted Practices, No. 19/65/EEC, art. 1, 36 J.O. 533 (1965), O.J. Eng. Spec. Ed. 1965–66, at 35 (enabling legislation providing authority to declare certain categories of agreements as exempt under article 101(3) TFEU (article 81(3) EC) by regulation). It is worth noting that block exemptions provide more legal certainty than a simple rebuttable presumption. If an agreement is covered by the criteria in a block exemption, then the benefit of the block exemption has to be explicitly removed before that agreement can be found unlawful. *See* Commission Notice, 2000 O.J. C 291/1, at 17–18.

found illegal if a careful, case-specific "effects" analysis were carried out. For example, practices such as naked price-fixing are regularly expected to be found illegal under a case-by-case analysis and, therefore, it is appropriate to put such agreements into the "object" (or even "per se illegality") box. Practices such as exclusive distribution by firms without significant market power, on the other hand, are regularly expected to be found legal under a case-by-case analysis because harm is either unlikely or counter-balanced by efficiency benefits and, therefore, it is appropriate to place such agreements into the "presumed lack of effect" (or even "presumed benefit") box.

Agreements that do not fall into any of these boxes continue to require a full case-by-case "effects" analysis. The EU does provide some further guidance, within its various guidelines, as to the circumstances under which it might expect to find particular agreements or practices lawful or unlawful.[20] Beyond this, however, there has been relatively little work done on "screens" that might help firms or regulators in deciding whether a particular agreement is lawful or unlawful under an "effects" analysis.

B. *Comparison with Article 102 TFEU*

It is interesting to contrast this situation with article 102 TFEU (article 82 EC),[21] the EU law relating to abuse of a dominant position. Under article 102, practices are not compartmentalized into "boxes" in quite the same way as article 101. There is no general doctrine that certain conduct is by its very nature regarded as being injurious to the proper functioning of normal competition.[22] Indeed, it could be argued that all article 102 practices are assessed on an "'effect'" basis. However within this "'effect'" category, the approach taken is fairly nuanced. The courts and the Commission have, over time,

20. *See* Commission Notice, 2000 O.J. C 291/1, at 17–18.

21. TFEU, *supra* note 6, art. 102, 2008 O.J. C 115, at 89; EC Treaty, *supra* note 6, art. 82, 2006 O.J. C 321 E, at 74–75.

22. *See* James S. Venit, *Article 82: The Last Frontier—Fighting Fire with Fire?*, 28 FORDHAM INT'L L.J. 1157, 1166–67 (2005) ("[W]hereas [a "box"] approach may be justified by the express reference in Article 81 to the 'object *or* effect,' of a restrictive agreement, there is no textual basis for such an approach under Article 82 which is why the case law requires an analysis of effects.").

established "screens" that help determine both whether the practice can be presumed pro- or anticompetitive, and what proof is needed to change this presumption.[23] For example, firms have no duty to deal (that is, refusing to supply a new customer is presumed a valid practice) unless there exist certain "exceptional circumstances," specifically that the product is indispensable for competition, the refusal eliminates competition, and there is no clear objective justification.[24]

Another contrast with article 102 is also worth discussing. In theory, an agreement or practice which falls within the "effect" box under article 101 is not presumed lawful or unlawful, absent a full effects analysis. Nevertheless, it is, our opinion, based on our experience of working at an enforcing agency, that practices or agreements which fall into the "effect" box are often viewed as roughly legal. At the very least, there seems to be an expectation among firms that the competition authority or private plaintiff will face an uphill struggle in proving why an agreement or practice is likely to be anticompetitive under a full "effects" analysis and should therefore be found illegal. If so, it would be unsurprising for firms to make the calculated decision to accept the risk of litigation and engage in the behavior.[25]

Under article 102, by contrast, there is certainly no presumption that all behavior of dominant firms is roughly

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23. *See, e.g.*, Manufacture Française de Pneumatiques Michelin v. Commission, Case T-203/01, [2003] E.C.R. II-4071, ¶ 56 (holding that loyalty rebates are presumptively illegal); AZKO Chemie BV v. Commission, Case C-62/86, [1991] E.C.R. I-3359, ¶ 71 (holding that predatory pricing is presumptively illegal when below average variable costs).

24. Oscar Bronner GmbH & Co. KG v. Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co. KG, Case C-7/97, [1998] E.C.R. I-7791. It is worth noting that the Commission's recent guidance on enforcement priorities under article 102 provides additional screens—in particular price-cost-based screens—which arguably go beyond current case precedent. *See* Commission Communication, 2009 O.J. C 45/7. However, these are, at least theoretically, intended to set enforcement priorities rather than legal standards. *See id.*, 2009 O.J. C 45/7.

25. In reality, the extent to which this last point concern is valid is linked to the standard of proof required by courts in order to show anticompetitive effect. If this standard of proof is set too high, then it will be more rational for firms to engage in anticompetitive behavior, since the risk of effective litigation is low. This suggests less difference between the "effect" box and "per se legality" than might have been expected. Such a situation arguably in turn increases the pressure to put into the "object" box agreements and practices which are fairly, but perhaps not very, likely to be harmful.

lawful, absent an examination of the "screens." This perception has been reinforced by the extremely high fines imposed by the Commission in recent abuse cases.[26]

C. *Implications for RPM*

Based on the above, the key question from a legal perspective is whether it is appropriate to put RPM in any of the boxes above. To assess this, the core question would seem to be: how often would RPM, if assessed on a case-by-case basis, be found illegal (that is, anticompetitive and without countervailing efficiency benefits)? If the answer is "usually" or "very often," then the approach described above suggests that RPM should fall within the "object" box.

Unfortunately, economists dread this core question because they find it exceptionally hard to answer. As discussed below, the difficulty is that, from an economic perspective, RPM sits rather awkwardly on the spectrum displayed in figure 1. There is no doubt that it can be anticompetitive. But it can also give rise to important consumer benefits and, in some cases, will be indispensable for achieving those consumer benefits. Many economists would agree that RPM is, if anything, slightly closer to the left hand side of the above figure than the right hand side.[27] But we believe that most economists would agree that it does not squarely sit on the left hand side with naked price-fixing or bid-rigging and, moreover, its precise position in any given case will depend on market circumstances.

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26. *See, e.g.*, Commission Decision No. COMP/C-3/37.990, slip op. (Eur. Comm'n May 13, 2009), *cited in* 2009 O.J. C 227/13 (Intel) (fining Intel €1.6 billion); Commission Decision No. COMP/C-3/37.792, 2007 O.J. L 32/23, at 28 (Microsoft) (fining Microsoft €497,196,304).

27. *See* Frank Mathewson & Ralph Winter, *The Law and Economics of Resale Price Maintenance*, 13 REV. OF INDUS. ORG. 57, 81–82 (1998) ("At the policy level, it is our view, shared with others, that economic efficiency is best served if resale price maintenance is judged according to a rule of reason or a per se legality standard."); *see also* Francine Lafontaine & Margaret Slade, *Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy*, *in* HANDBOOK OF ANTITRUST ECONOMICS 391 (Paolo Buccirossi ed., 2008) ("[V]ertical restraints in manufacturer/retailer settings are publically desirable when privately desirable, and thus government intervention is not warranted in those situations. This is not to say that the use of VR should never be questioned, but the presumption should not be that they are detrimental to consumers . . . .").

Faced with the alternatives that RPM is mostly harmful or mostly beneficial, some economists (ourselves included) will gravitate towards the left side of the spectrum and settle for RPM to be an "object" infringement. Others cannot accept the fact that this approach has the implication of presuming unlawful, on the one hand, agreements that could not possibly have an anticompetitive effect and, on the other hand, agreements that have real efficiency benefits. These economists settle for RPM to be an "effect" infringement.

What is interesting is that there is not necessarily a great deal of difference between the views of these two sets of economists. Rather, they are making different choices from what seems—from an economic perspective—to be an unappetizing menu of options. Relatively small differences in view are therefore amplified by the legal framework with which economists are presented.

II. *INTRODUCTION TO THE ECONOMICS OF RPM*

Part II looks further at the economics of RPM, including the possible benefits from RPM, the possible theories of harm, and why economists find the choice described above so difficult.

A. *Efficiency Benefits of RPM*

There is a large amount of literature on RPM,[28] but the literature on the efficiency benefits of RPM is, for the most part, older and more well-established than that on its anticompetitive effects. There are essentially three broad economic arguments in support of RPM.

The first, which formed the basis of the submissions of the U.S. Department of Justice and Federal Trade Commission in the *Leegin* case,[29] is that while RPM reduces intra-brand price competition, it can promote interbrand competition by

28. *See generally, e.g.*, Emanuele Giovannetti and David Stallibrass, *Three Cases in Search of a Theory: Resale Price Maintenance in the UK*, 5 EUR. COMPETITION J. 641 (2009) (analyzing the anticompetitive effects of resale price maintenance); Peeperkorn, *supra* note 11 (analyzing the efficiency effects of resale price maintenance).

29. *See* Brief for the United States as Amicus Curiae Supporting Petitioner at 10–12, Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877 (2007) (No. 06-480).

providing quality certification[30] or reducing free riding at the distribution level on aspects such as service provision.[31] The idea here is straightforward: Where retailers carry out some form of service on behalf of manufacturers that involves the retailers incurring a cost, there is a risk, absent RPM, that retailers whom do not provide the service could cut prices and win business away from retailers that do. A typical concern might be a customer spending time in the testing room of a high-end shop, comparing a variety of speakers, and then buying the speakers elsewhere from the cheapest outlet. If this occurs, then clearly the retailers' incentives to provide these services will be reduced, which is bad for both the manufacturer and consumers.[32]

The second argument relates to the "indispensability" question involved in assessing efficiency benefits under article 101(3) TFEU (article 81(3) EC).[33] While other vertical restraints can achieve some of the same benefits as RPM, there will be circumstances (for example, the presence of risk aversion) in which RPM is more effective than these other restraints. An intuitive example might be a supplier of a branded product who primarily sells through a specialist bricks-and-mortar retail network that is approached by an internet retailer. The supplier is concerned that if he supplies the internet retailer, absent RPM, then the internet retailer could price low and damage the

30. *See* Howard P. Marvel & Stephen McCafferty, *Resale Price Maintenance and Quality Certification*, 15 RAND J. ECON. 346, 358 (1984).

31. *See* Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86, 104 (1960).

32. *See* Peeperkorn, *supra* note 11, at 208 (explaining the claim that resale price maintenance reduces free riding by distributors). The quality certification literature is essentially the same, but the "service" that the retailer provides is a form of "quality certification" service. *See* Marvel & McCafferty, *supra* note 30, at 347 (proposing a model in which a retailer provides a service by "ascertaining the quality or stylishness of commodities" for the consumer). When a reputable retailer stocks a given product they implicitly guarantee the quality of that product in the eyes of consumers. By way of example, a department store that stocks a particular perfume raises the brand profile of that perfume. There is a cost involved in running a department store, however, so if all customers just go and buy the perfume more inexpensively elsewhere, the department store will not be able to survive. This will in turn not only remove a valued outlet for customers but also an important quality certification mechanism for suppliers. In practice, of course, the department store is more likely simply to refuse to stock any perfume for which this is likely to happen.

33. TFEU, *supra* note 6, art. 101(3)(a), 2008 O.J. C 115, at 89; EC Treaty, *supra* note 6, art. 81(3)(a), 2006 O.J. C 321 E, at 74.

viability of the bricks-and-mortar network. The supplier can either (1) refuse to supply the internet retailer, by excluding the retailer from his (legal) selective distribution system, or (2) agree to supply him on an RPM basis. If, as here, the alternative to RPM is not to supply at all, then RPM may in fact be the more efficient and procompetitive option.

The third argument is based on the standard Chicago school argument that, in any given market, there is only one monopoly profit.[34] An upstream monopolist has no ability to increase its profits through RPM, since it should in any case be able to extract the full monopoly market rent through its wholesale pricing structure (at least so long as nonlinear pricing is possible). As such, the argument runs, RPM cannot be welfare-reducing and, if it is undertaken, should be assumed beneficial.[35]

B. *Anticompetitive Effects of RPM*

While the literature setting out procompetitive rationales for RPM has existed for some time, the anticompetitive literature is relatively more recent and still developing. Part II.B classifies the literature under five general theories of harm.[36]

The first theory of harm relates to RPM as a facilitating practice to sustain upstream collusion, which relates to inter-brand competition. When upstream firms wish to collude, and concomitantly negotiate contracts with wholesalers or retailers in

34. *See, e.g.*, Stuart Minor Benjamin & Arti K. Rai, *Fixing Innovation Policy: A Structural Perspective*, 77 GEO. WASH. L. REV. 1, 15 (2008). For more information about the interface of Chicago-school economics and antitrust law, see generally POSNER, *supra* note 7.

35. *See, e.g.*, Thomas M. Melsheimer, *Economics and Ideology: Antitrust in the 1980s*, 42 STAN. L. REV. 1319, 1330–31 (1990) ("[M]any vertical restrictions, such as resale price maintenance, might have efficiency-enhancing, procompetitive effects."). It should be highlighted that the elimination of double marginalization is *not* a good argument for the imposition of RPM, since it is in fact solved by maximum RPM, which is typically legal. *See* Roger D. Blair & Francis Lafontaine, *Analysis of Maximum Resale Price Maintenance*, 18 J. PUB. POL'Y & MARKETING 25, 25 (1999) ("For all intents and purposes, [Supreme Court precedent] permits maximum resale price restraints.") (citing *State Oil Co. v. Khan*, 522 U.S. 3 (1997)); Benjamin Klein, *Distribution Restrictions Operate by Creating Dealer Profits: Explaining the Use of Resale Price Maintenance in* State Oil v. Khan, 7 SUP. CT. ECON. REV. 1, 48 (1999) (stating that a manufacturer may use maximum resale price maintenance to control double marginalization).

36. Each of these effects is robust to the Chicago critique described above. *See supra* note 34 and accompanying text.

private, it can be difficult for any collusive agreement to be monitored; rival wholesale prices cannot be monitored and enforced, and retail prices are an imperfect proxy. Jullien and Rey have shown that, in this context, upstream firms can use RPM as a facilitating practice for collusion since it brings the publicly observable element of price under their control.[37]

The second theory of harm relates to RPM as a facilitating practice to sustain downstream collusion. This can occur where downstream firms wish to engage in collusion. They can use the imposition of multiple RPM agreements by an upstream firm (acting as a "common agent") to facilitate downstream price collusion. The enforcement of RPM can facilitate agreement on prices, monitoring of prices, and even punishment for breaching the collusive agreement. In some instances, the RPM is effectively no more than a "sham" vertical agreement, masking a purely horizontal agreement.[38]

The third theory of harm relates to the use of RPM as a commitment device to protect upstream monopoly rents. This relates to a well-known monopoly commitment problem, originally identified by Hart and Tirole.[39] A monopolist maximizes its profit by selling the right to distribute to only one downstream player. However, ex post it has an incentive to break this agreement and sell to additional downstream players. The overall effect is that, absent a commitment device, the upstream firm is unable to extract the full rent associated with its market power, because it cannot commit itself to not cutting prices on later contracts. RPM can solve this problem, by allowing the

37. Bruno Jullien & Patrick Rey, *Resale Price Maintenance and Collusion*, 38 RAND J. ECON. 983, 996 (2007).

38. *See, e.g.*, Argos Ltd. v. Office of Fair Trading [2006] EWCA (Civ) 1318, [141], [2006] U.K.C.L.R. 1135 (Eng.) (holding that "if (i) retailer A discloses to supplier B its future pricing intentions in circumstances where A may be taken to intend that B will make use of that information to influence market conditions by passing that information to other retailers (of whom C is or may be one), (ii) B does, in fact, pass that information to C in circumstances where C may be taken to know the circumstances in which the information was disclosed by A to B and (iii) C does, in fact, use the information in determining its own future pricing intentions, then A, B and C are all to be regarded as parties to a concerted practice having as its object the restriction or distortion of competition.").

39. Oliver Hart & Jean Tirole, *Vertical Integration and Market Foreclosure*, 1990 BROOKINGS PAPERS ON ECON. ACTIVITY 205, 208 (describing the monopoly commitment problem in a Cournot setting).

upstream firm to commit to the monopoly price and extract its full monopoly rents. This theory has also been shown under different assumptions by O'Brien and Shaffer,[40] and Rey and Vergé.[41]

The fourth theory of harm relates to the use of RPM as a means either to soften downstream competition or deter downstream entry. Shaffer has shown that downstream firms may have a unilateral incentive to ask the upstream firm to implement RPM as a means to soften competition between themselves.[42] More generally, RPM can benefit downstream firms by making it harder for cut-price entrants to steal business by undercutting competitors. Such entrants can still make additional profits through greater efficiencies, but they cannot use these efficiencies to steal business through lower prices.[43]

The final theory relates to the use of RPM as a means to dampen system competition through networks of interlocking RPM agreements. The simplest example would be a market where there is a duopoly of manufacturers upstream and a duopoly of retailers downstream and both retailers carry the products of both manufacturers—a situation defined as "double common agency." Dobson and Waterson have shown that in a bargaining framework, RPM can reduce retailers' incentives to negotiate on wholesale prices by preventing downstream undercutting.[44] This, in turn, dampens upstream competition

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40. Daniel P. O'Brien & Greg Shaffer, *Vertical Control with Bilateral Contracts*, 23 RAND J. ECON. 299, 305–06 (1992) (discussing resale price maintenance and the commitment problem in a differentiated product market).

41. Patrick Rey & Thibaud Vergé, *Bilateral Control with Vertical Contracts*, 35 RAND J. ECON. 728, 740 (2004) (confirming the findings of O'Brien and Shaffer).

42. Greg Shaffer, *Slotting Allowances and Resale Price Maintenance: A Comparison of Facilitating Practices*, 22 RAND J. ECON. 120, 130 (1991) (describing the potential benefits of resale price maintenance to a downstream firm).

43. *See* OFFICE OF FAIR TRADING, AN EVALUATION OF THE IMPACT UPON PRODUCTIVITY OF ENDING RESALE PRICE MAINTENANCE ON BOOKS (2008) (U.K.), *available at* http://www.oft.gov.uk/shared_oft/economic_research/oft981.pdf; Stephen Davies et al., *The Benefits from Competition: Some Illustrative UK Cases* 31–46 (Dep't of Trade and Indus. Economic Paper No. 9, 2004) (U.K.) (describing the impact of resale price maintenance in the British book market).

44. Paul W. Dobson & Michael Waterson, *The Competition Effect of Industry-Wide Vertical Price Fixing in Bilateral Oligopoly*, 25 INT'L J. INDUS. ORG. 935, 953–54 (2007) ("In the present context, firms facing the prospect of intense retail rivalry destroying profits for all industry members will have a joint interest in avoiding such destructive

and creates higher retail prices, to the detriment of consumers.[45] More generally, Rey and Vergé have shown that RPM can potentially eliminate "any effective competition—at the interbrand level as well as at the intrabrand level—and yield instead the monopoly outcome" if used jointly with franchise fees.[46]

C. *The Dreaded Question: How Often is RPM Likely to be Harmful on Balance?*

Given that there is the potential for both anticompetitive harm and efficiency benefits from RPM, which of these is most likely to be dominant? Put another way, how likely are these theories of harm, and how significant are the efficiencies likely to be?

It is worth noting that there is not particularly strong empirical literature regarding RPM. Lafontaine and Slade provide the most recent summary of the existing empirical evidence on RPM.[47] Within a broader analysis of vertical restraints, they identify three empirical research papers looking at RPM.[48] One of these papers examined cases where RPM was imposed by government,[49] while two of them examined cases in which RPM was imposed by firms.[50] Lafontaine and Slade conclude that self-imposed RPM cases have an overall positive

competition. An industry-wide move to RPM or exclusivity would be a way of avoiding this outcome when it allows for higher combined profits.").

45. *Id.* at 954 ("[RPM] would be against consumer interests. A move to RPM would maintain the same level of variety in the market, but lead to higher prices.").

46. Patrick Rey & Thibaud Vergé, *Resale Price Maintenance and Horizontal Cartel* 4 (Ctr. for Mkt. & Pub. Org. Working Paper No. 02/047, 2004).

47. Francine Lafontaine & Margaret Slade, *Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy*, *in* HANDBOOK OF ANTITRUST ECONOMICS 391 (Paolo Buccirossi ed., 2008).

48. *Id.* at 406 tbl.10.2, 407 tbl.10.3 (citing Thomas W. Gilligan, *The Competitive Effects of Resale Price Maintenance*, 17 RAND J. ECON. 544 (1986); Pauline M. Ippolito & Thomas R. Overstreet, *Resale Price Maintenance: An Economic Assessment of the Federal Trade Commission's Case Against the Corning Glass Works*, 39 J.L. & ECON. 285 (1996); Stanley I. Ornstein & Dominique M. Hanssens, *Resale Price Maintenance: Output Increasing or Restricting? The Case of Distilled Spirits in the United States*, 36 J. INDUS. ECON. 1 (1987)).

49. *Id.* 407 tbl.10.3 (classifying Ornstein and Hanssen's study as an "[e]mpirical assessment of effects of *mandated* vertical restraints") (emphasis added).

50. *Id.* at 406 tbl.10.2 (classifying both Gilligan's and Ippolito and Overstreet's studies as "[e]mpirical assessment[s] of effects of *voluntary* vertical restraints") (emphasis added).

impact, while the exogenously imposed ones have a negative impact.[51] However, the authors themselves caution against drawing strong policy conclusions given the limited quantity and quality of the empirical work.[52]

An examination of actual cases can be misleading, too, since these cases are selected by the competition authorities. That said, the U.K. Office of Fair Trading ("OFT") has intervened against RPM on a number of occasions, and in each case the evidence supported the view that the RPM in question was anticompetitive and not outweighed by efficiency benefits. For example, two recent OFT infringement decisions were closely interlinked with theories of coordination, although it was not always explicitly stated within the decision.[53]

On the benefit side, the OFT commissioned research on the impact of the removal of RPM in the retail book market, which was previously regulated by the "Net Book Agreement."[54] This agreement, which was in place from 1901 until 1997, allowed publishers to set the retail prices of books.[55] In 1962, when the agreement was given legal sanction under the Restrictive Trade Practices Act,[56] many efficiency arguments were made as to how removal of this longstanding agreement would damage the market for books.[57] The agreement was disbanded in 1995,

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51. *Id.* at 408.

52. *Id.* at 407–08 (discussing the limitations of the data examined).

53. *See* Decision of the Office of Fair Trading, Price Fixing of Replica Football Kit, No. CA98/06/2003 (August 1, 2003), *available at* http://www.oft.gov.uk/shared_oft/ca98_public_register/decisions/replicakits.pdf [hereinafter Replica Football Kit]; Decision of the Office of Fair Trading, Agreements between Hasbro U.K. Litd., Argos Ltd. and Littlewoods Ltd. Fixing the Price of Hasbro Toys and Games, No. CA98/8/2003 (November 21, 2003), *available at* http://www.oft.gov.uk/shared_oft/ca98_public_register/decisions/hasbro3.pdf [hereinafter Hasbro]. For a discussion of these two cases, see Giovannetti & Stallibrass, *supra* note 28, at 649–52.

54. OFFICE OF FAIR TRADING, *supra* note 43.

55. *See* Davies et al., *supra* note 43, at 31 ("[The Net Book Agreement] was used to artificially constrain the retail price of book [sic], by preventing any bookseller from selling a book under the publisher's chosen (net) price, without facing a publisher-wide refusal to supply future books."); Sharon Billington, Note, *Relief from Online Used Book Sales During New Book Launches*, 29 COLUM. J.L. & ARTS 497, 520 n.139 (2006) (noting the duration of the Net Book Agreement).

56. Restrictive Trade Practices Act, 1956, 4 & 5 Eliz. 2, c. 68.

57. *See* Davies et al., *supra* note 43, at 32 ("In 1962 the Restrictive Practices Court considered the illegality of the NBA [Net Book Agreement], and contrary to initial intuition, its judgement [sic] exempted the NBA, allowing it to continue. In the

following pressure from the competition authorities.[58] In practice, and contrary to expectations, the research found that total sales volumes for books increased, as did the number of titles published.[59] There was also a significant increase in retail diversity, with the growth of new retail formats facilitated by their ability to offer discounted books.[60] The U.K. situation also compared positively with Germany, where RPM was maintained.[61]

On balance, it is far from obvious which way the scales tip on RPM. As the academic literature acknowledges, the body of research is simply not large enough to suggest strong conclusions either way. More empirical evidence would be invaluable.[62] However, on the basis of the evidence available to date, and if we had to make a binary choice between object and effect, we believe that there is simply not enough evidence to conclude that RPM should be moved from the "object" category into the "effect" box. Two main factors tip us towards this view.

The first is the role of RPM in facilitating coordination, a role that other vertical restraints do not seem to have. We believe this is not just a minor theoretical point, as illustrated by the recent OFT infringement cases described above.[63]

The second factor is the fact that many of the benefits provided by RPM may also, at least in theory, be secured by other vertical restraints. While there are some cases (for example, risk aversion) in which RPM may be more efficient than other types of restraints, it is unclear how frequently these situations occur in practice.

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judgement [sic], Mr. Justice Buckley famously emphasized that 'Books are different', and considered the NBA to be in society's interest.")

58. *See id.* at 32 ("Eventually, the pressures became too strong and the Publishers' Association disbanded the NBA, making it effectively inoperable for publishers, in September 1995.").

59. OFFICE OF FAIR TRADING, *supra* note 43, at 42 figs.6.1–6.2 (showing the increase in the volume of books sold in the U.K. from 1995–2006 and showing the increase in the number of titles published in the U.K. from 1990–2005, respectively).

60. *Id.* at 43 tbl.6.1 (showing the rise of grocery stores, mail-order suppliers, and the Internet at the expense of independent bookstores).

61. *See id.* at 76–89 (comparing the results from Germany and the United Kingdom).

62. *See* Lafontaine & Slade, *supra* note 47, at 409 ("[M]uch more empirical evidence is needed before we can draw more definitive conclusions . . . .").

63. *See supra* note 53 and accompanying text.

III. *SMALL STEPS TOWARDS A MORE NUANCED POLICY?*

Given the legal framework described in Part I, we on balance support the retention of RPM within the "object" box. However, the preceding discussion illustrates some reservations about a legal framework that, in the name of legal certainty, presumes as illegal agreements and practices that either do not restrict competition or that would nevertheless be justified by the efficiency benefits they may generate. This issue is particularly relevant to the case of RPM.

Part III sets out a few small steps that might be taken towards a slightly more nuanced approach to assessing RPM. These would substantially ameliorate our current reservations, while preserving a position where RPM will, for the most part, remain unlawful.

A. *Ensuring that the Presumption of Illegality is Truly Rebuttable*

Our first proposal towards a more nuanced approach is relatively straightforward and uncontentious: widen the gap between the EU "object" box and the U.S. "per se illegality" box. Under the former, there is potential for parties to rebut a presumption of illegality, and we believe that the potential for rebuttal should be given more serious consideration, either because there is no possible restriction of competition (that is, no infringement under article 101(1) TFEU) or because there are countervailing consumer benefits (that is, exemption under article 101(3) TFEU).[64]

In order to facilitate rebuttal where appropriate, we would also argue that the authority should set out one or more "theories of harm." These would not need to be "proven"—this

64. TFEU, *supra* note6, art. 101(1), 101(3), 2008 O.J. C 115, at 88–89. In this light, we are pleased to note that there have been changes proposed to European Commission regulations that stress the importance of efficiency arguments in the context of article 101(3). *See, e.g.*, Commission Regulation on the Application of Article 81(3) of the Treaty on the Functioning of the European Union to Categories of Vertical Agreements and Concerted Practices, No. 330/2010, pmbl., 2010 O.J. L 102/1 (acknowledging that "[v]ertical agreements of the category defined in this Regulation can improve economic efficiency within a chain of production or distribution by facilitating better coordination between the participating undertakings; in particular, they can lead to a reduction in the transaction and distribution costs of the parties and to an optimization of their sales and investment levels.").

change should not be seen as moving to the "effect" box via the back door—but merely "plausible." That is, they would need to be consistent with the facts, including the market circumstances in which RPM had been applied.

In order to preserve legal certainty, we would propose that the hurdle for rebuttal should be fairly high. For example, it would not be enough for a party to state that "the authority has not proven that this instance of RPM was likely to have a harmful effect." Rather, the burden would be on the party to demonstrate that "this instance of RPM could not possibly have been expected to have a harmful effect, as evidenced by the fact that the authority cannot come up with a theory of harm which is consistent with the known facts."

B. *Use of Screens for Prioritizing RPM Cases*

The second step we propose is a series of screens to consider whether there is likely to be a credible theory of harm in any particular case of RPM, and to prioritize cases on this basis.

Returning to the earlier discussion of the existing economic literature in this area, we have attempted to identify three relatively simple screens, at least one of which would need to hold in order for there to be the possibility of a credible theory of harm associated with the RPM:

First, is there unilateral market power or concentration upstream? Without upstream market power there is unlikely to be a theory of harm associated with protecting that market power, nor is there likely to be a strong theory of facilitating upstream coordination if the upstream market is fragmented.

Second, is there significant downstream buyer power or concentration? If there is no downstream buyer power or concentration, then there is unlikely to be a strong theory of harm regarding RPM facilitating downstream coordination or deliberately foreclosing downstream entry. We note that this screen could be further strengthened by evidence that the manufacturer, rather than the retailer, instigated the RPM.

Third, and finally, are there networks of RPM agreements involving a number of upstream suppliers who account for a significant share of the upstream market? If not, there is unlikely to be a theory of harm regarding RPM as a vehicle for facilitating upstream market coordination.

If none of these three elements hold in a particular case, there is unlikely to be a credible theory of harm, and therefore the case would not be prioritized.

We recognize that there is room for further study in this area. For example, how exactly does one define concentration? Indeed, a more definitive view on screens may require further developments in the economic literature. Nevertheless, we see real potential for the use of screens by competition authorities for purposes of case prioritization.

C. *Use of Screens Within a Legal Standard*

The final step discussed in this section is perhaps more controversial, but we think it is nevertheless worthy of further consideration.

While the use of screens for prioritization of RPM cases may have a positive impact in the EU, we recognize that a prioritization approach may not be effective in a system such as the United States, where competition law is primarily enforced via cases initiated by private litigants. However, screens may also carry over in helping to define a legal standard. Under this approach, the plaintiff would have to demonstrate that at least one of the screens was satisfied before the court would take the case. Failing every screen could demonstrate that there is no credible theory of harm associated with a particular case of RPM and, in such circumstances RPM would be viewed as legal.

We believe that this approach would still leave most potential cases of RPM illegal and preserve legal clarity, but it would avoid cases—such as *Leegin* (arguably)—that lack a credible theory of harm, and have the potential to bring the competition system into disrepute by making it appear out of touch with reality.

There are, however, some noteworthy disadvantages to this approach. Some would no doubt argue that blurring the lines of "object" infringement will prevent firms from assessing themselves, smaller retailers from standing up to powerful suppliers attempting to impose RPM, and authorities from bringing cases, with the net result being a system that inappropriately resembles a standard "effects" analysis. For us, however, a more compelling concern is that the screens outlined above not only relate to the practices and position of the parties involved in a particular RPM agreement, but it also relates to the concentration in the relevant market and whether there is a network of similar RPM agreements across the entire market. If this approach prevents firms from credibly assessing the legality of their own RPM without knowing (possibly secret) information about its competitors, then it may prove unworkable.

Nevertheless, we think a system of screens is worthy of further research and study. Moreover, it would have similarities to the sorts of screens that are commonly applied in the EU when assessing abuse of dominance cases under article 102 of the TFEU.[65]

CONCLUSION

Within the current legal framework, there is not yet sufficient evidence available to justify moving RPM out of the "presumed illegality" or "object" box and into a case-by-case "effect" box. However, it is clear that RPM falls far short of more extreme anticompetitive behavior such as naked horizontal price-fixing. In an ideal world, the law would reflect this difference, and Part III of this Essay sets out some small steps towards a slightly more nuanced approach to assessing RPM. While further work is required before these could be fully implemented, we believe that these small changes could significantly reduce our reservations about the current treatment of RPM, but preserve a legal regime in which RPM will, for the most part, remain unlawful.

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65. *See* TFEU, *supra* note 6, art. 102, 2008 O.J. C 115, at 89.