
Resale Price Maintenance - A Dilemma in EU Competition Law

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I. Introduction

1. General Remarks

A distributor of a specific product agrees not to sell it at a price less than assigned by its manufacturer. If the agreement made by the manufacturer and its distributor is brought before the European competition authorities, the ruling will be that, on the basis of the resale price maintenance agreement alone, the law has been violated. Agreements to fix minimum resale prices are prohibited as contrary to Article 81(1) of the EC Treaty¹ and no exemption under the Article 81(3) is granted. The decisive factor in this example is the conduct of the parties, i.e. the conclusion of the price fixing agreement. In EU competition law minimum resale price maintenance (hereinafter RPM) or vertical price fixing as it is often called, is illegal *per se*.

On the face of it, this attitude seems strange. Why do the competition authorities not consider the structure of the market that is influenced by the agreement? They could for instance take into consideration the existence of similar products manufactured and distributed by other, competing manufacturers and distributors, question the motivation of the producers in concluding such agreements, ignore the fact that an agreement might be advantageous for consumers, facilitating pre-sale services for example.

The case is different when the maximum resale price maintenance is agreed. This is when a manufacturer requires its distributors not to charge above a prescribed amount. Thanks to recent changes in EU competition law they are benefited by an exemption granted in Regulation 2790/99 of the European Commission.

This article will analyse the issue outlined above: How are vertical price fixing agreements between manufacturers and distributors dealt with in EU competition laws and to what extent are the decisions of the authorities in Brussels and Luxembourg influenced by economic considerations. The significance of economics in competition is unquestionable. The key theories of competition are based on economic assumptions. Competition law is economic law and economics must play a predominant role in the examination of particular agreements.² Therefore, this evaluation of resale price maintenance will be presented through the prism of economic arguments.

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¹ Formerly Article 85(1) of the EC Treaty.

² See *Hawk*, System Failure: Vertical Restraints and EC Competition Law, 986.

2. Research Issue

The issue of resale price maintenance is often viewed as a conflict of interests between manufacturers initiating maximum RPM agreements and consumers, who are allegedly disadvantaged by the resulting high prices. Conversely it is a conflict between manufacturers and their distributors, who are supposedly discouraged by too low resale price clauses in maximum RPM contracts. This makes them unable to receive a proper return from their business. The issue of vertical price fixing is quite complicated. Arguments for and against carry substantial weight and do not always rule out each other. In certain circumstances RPM might be harmful for all participants. In another set of circumstances it might be expedient and pro-competitive. Therefore, the law should make means available that allow a tailor-made balancing of interests in each case so that all legitimate interests are protected. The resulting balance of interests has to be respected by the regulatory or enforcement authorities. This may be achieved through so called "rule of reason" analysis, under which all RPM cases should be carefully evaluated.

Further, it must be noted that resale price maintenance is seldom presented in an isolated or pure form. In most cases RPM appears combined in the same contract with different non-price vertical restraints, such as exclusive distributorship, selective distributorship and so on. Legal analysis should necessarily be conducted in a simplified environment. For the purpose of this paper RPM will be dealt in an isolated environment. In addition, the article mainly concerns the resale of finished goods and accompanying services, like pre-sale services (advertising, on-sight demonstration and stocking). Moreover, it is important to point out that between a producer and the ultimate consumer of its products there may be more than one level of distribution. A producer may sell direct to retail outlets from which the goods will be resold to the public. Alternatively it may sell goods to distributors whose business is to resell to retailers. The patterns of distribution are endlessly varied. Where there is more than one level of distribution there is more than one level at which competition could be restricted. To simplify matters the paper will use the terms retailer, wholesaler, distributor or dealer interchangeably as synonyms, where always the following uncomplicated three-chain distribution system will be assumed: Producer – distributor (dealer or retailer) – consumer.

All sources of law have to be taken into consideration: enactments, court decisions and legal doctrine. Special attention has to be paid to the case law on resale price maintenance. The point is that, due to the poor statutory framework of RPM treatment, the courts have played a paramount role in the interpretation of regulatory norms and the creation and development of new aspects concerning resale price maintenance.

II. Economic View on Resale Price Maintenance

Under a resale price maintenance agreement, a dealer agrees either to set the price at whatever level the manufacturer wishes or at least not to charge less than the manufacturer wishes. This is called the minimum resale price maintenance. Another form of RPM is the maximum resale price maintenance. Under maximum RPM a dealer agrees not to charge more than the price set by the manufacturer. The primary effect of RPM is to prevent the dealer from competing on price against other dealers of the same product. Assuming that the manufacturer imposes RPM on all its dealers the result is that this insulates each dealer from intra-brand price competition, i.e. from price competition between each other.

A minimum resale price maintenance may be initiated both by manufacturers and retailers, though the motivation and economic incentives of doing so for manufacturers and retailers are different. As regards maximum RPM, it is nearly always initiated by manufacturers.

1. Nature of Vertical Restraints

We start the discussion with a general overview of vertical restraints, as resale price maintenance is one kind of such restraints. Vertical agreements are those that arise between firms at different levels of trade or industry, for example, between manufacturers and retailers. It is possible to distinguish between vertical price and non-price agreements. The former represents vertical price fixing or resale price maintenance. The second group is often labelled as agreements on customer or territorial allocation. Under such agreements, a dealer agrees to confine its activities to certain customers (or to stay away from certain customers) or to confine its activities to certain locations or geographic areas. In the most significant versions of customer and territorial restraints, the manufacturer reciprocates by assigning certain customers or territories exclusively to a single dealer, thereby insulating the dealer from competition with other distributors.³ Specific types of contract related to the second group might be: exclusive distribution agreements, where a limited number of dealers is granted the exclusive right to distribute the company's products in their respective (exclusive) territories; exclusive purchasing agreements, wherein a dealer agrees to purchase certain goods specified in the agreement for resale only from a certain supplier; selective distribution agreements where the distribution of the products is limited to a number or class of authorised dealers who are chosen on the basis of specific criteria (e.g. to provide specific services as regards high quality and high technology products); and franchising, which involves the grant of a licence to a retailer (the franchisee) by the franchisor to use its business name or trademark with additional know how and commercial assistance.⁴ This list of agreements (vertical restraints) is not exhaustive but merely indicative of the range of options open to the manufacturer.

³ See *Hay*, Vertical Restraints, in: *International Harmonisation of Competition Policy*, *Chang/Lawrence* (eds), Dordrecht, 1995.

⁴ See *Korah/Rothnie*, *Exclusive Distribution and the EEC Competition Rules*, 2nd edition, London, 1992, 3-8.

There is diversity in opinions whether vertical restraints are competitively harmful or not. Broadly defined, two schools of thought might be distinguished. In the first group are those who believe that these species of restraints are not harmful at all, or only where there is some real degree of market power at the production level. In other words, when a manufacturer holds considerable market share that enables him to raise prices above a supra-competitive level and cut back on output without any loss to other competitors.⁵ Others adopt a stricter attitude. They believe that vertical restraints may produce a variety of anti-competitive effects, and therefore it is correct for competition policy to subject them to some scrutiny.⁶

In the end, even though resale price maintenance (minimum RPM) is generally viewed as per se illegal practice and treated less leniently than other types of vertical restraints, the majority of the arguments made by the courts and antitrust economists to justify their tolerant attitude toward non-price vertical restraints would apply to vertical price fixing alike.⁷

2. Inter-brand versus Intra-brand Competition

The distinctions between inter and intra-brand competition is central in order to explain the competitive effects of vertical agreements and resale price maintenance in this case.

Dealers are subject to two types of competition. One type of competition may come from other dealers of the product derived from the same producer. This is called intra-brand competition. An example is the competition between all the dealers selling Nokia mobile phones. The other kind of competition comes from retailers selling products of a rival supplier. This is called inter-brand competition. An example of this would be competition between a dealer selling Nokia phones and another selling Motorola, and a third selling Eriksson.

Inter-brand competition usually focuses on the fair play of market players. In other words, different enterprises compete on a certain market with different goods or services, which in the view of the consumer, are interchangeable to satisfy their needs, but still have different parameters of price, quality and various contract terms attached to them. Inter-brand competition implies that the consumer has several options for obtaining the goods or services he or she needs. The consumer may be interested in price and therefore prefer cheap outlets not tied to manufacturers, or may insist on quality and pre-sales services and therefore prefer vertical distribution systems which select and restrict the choice of

⁵ See *Bork*, *The Antitrust Paradox: A policy at War with Itself*, New York, 1978; *Posner*, *Antitrust Law - An Economic Perspective*, Chicago, 1976.

⁶ See *Scherer/Ross*, *Industrial Market Structure and Economic Performance*, 3rd edition, Boston, 1990; *Comanor*, *Vertical Price Fixing, Vertical Market Restrictions and the New Antitrust Policy*, *Harvard Law Review*, 98, 1985.

⁷ See *Jullien/Rey*, *Resale Price Maintenance and Collusion*, *Universite des Sciences Sociales*, Toulouse, 9 May, 2000, 3.

outlets. Inter-brand competition would still be operating in these cases, it will only be restricted if consumers are forced to satisfy their needs on a market without having alternative products and distribution systems to choose from.⁸

A supplier is seldom able to save dealers from inter-brand competition, if such competition exists. To do so, it would have to enter into a horizontal agreement with the competitors clearly in contradiction of competition laws of most countries. In some markets, though, there may be a less effective inter-brand competition. The supplier may be the only firm providing a product for which there are no close substitutes and which is protected by barriers to entry.⁹

As regards intra-brand competition, it is concerned with the product or service provided by an undertaking, but distributed only with certain "restraints," for instance resale price maintenance, tying agreements, or territorial protection. It might be argued that resale price maintenance, for instance, although it restricts price competition between dealers of the same supplier (i.e. intra-brand competition) may strengthen competition between different products (i.e. inter-brand competition) as it enables producers to induce their dealers to provide services valuable to consumers. In such cases it may be necessary to accept certain restrictions on intra-brand or "second-line" competition, in order to promote more effective inter-brand or "first-line" competition.¹⁰

RPM may be used in other ways to strengthen inter-brand competition. To call up a small example, if a company A wishes to ensure that its small household appliances were stocked in a wide variety of small stores, including hardware, drug, and department stores it might guarantee the dealers a sufficiently high profit margins through RPM and make it profitable for them to carry its product, despite the probable infrequency of sales. Thus, the company would surrender important ground in discount houses and mass merchandisers, where price comparisons would be lower; but it would hope to compensate by a steady stream of sales through diverse small outlets. The strategy, as claimed, is not anti-competitive. Consumers pay higher prices for the company's products, but they obtain the advantage of widespread availability. It can be said that company A has suppressed intra-brand competition on its own products in order to intensify inter-brand competition between its products and the products of others.¹¹

The importance of intra-brand competition is somehow more stressed in the European Community. Here, the weakening of intra-brand competition for the sake of an improvement of overall inter-brand competition is often challenged by the European competition authorities, initially trying to establish and now to maintain the Common European Market.

⁸ See *Reich*, *Internal Market and Diffused Interests: An Introduction to the EC Trade Law*, Part 1, Brussels 1990.

⁹ Sometimes protection may be conferred by law, through various licensing requirements; e.g. resale of alcohol by state-owned outlets.

¹⁰ See *Roth*, *Common Market Law of Competition*, 5th edition, London, 2001, point 2-060.

¹¹ See *Jones*, *Concerted Behaviour under the Antitrust Laws*, *Harvard Law Review* 96, 1985, 1995.

As European distribution systems often follow national borders, competition authorities claim that vertical restraints, and especially RPM, may lead to the partitioning of the Common Market, isolating different Member States and depriving consumers from those Member States where prices are higher to buy similar goods from dealers in the Member States where prices are lower.¹²

3. Arguments For and Against Minimum Resale Price Maintenance

In the first place it is claimed that resale price maintenance is necessary to guarantee retailers generous profit margins, so that services can be provided which are of value to consumers. Such services include: advertising and promotion, on-site demonstration, generous inventory stocking and so forth. High margins foster more retailer outlets on service, more investment in inventories and other actions that shift product demand curves. As a consequence, price competition is restricted but non-price competition is enhanced. Dealers compete in other ways, for example by providing better services and thus try to lift up a product consumption rate.¹³

The most important argument supporting vertical price fixing was advanced by *Tesler* in 1960. The essence of his “free rider” argument is that if the distributors are not protected by RPM, this enables price cutters to “free ride” on other dealers’ investments which incurred substantial costs for pre-sales services. Many customers could make their selection at an expensive shop that provides cost incurring services like product demonstration by skilled staff but order the product from a cheaper shop that does not.¹⁴ A frequently used example is that of a dealer of computer equipment. From inspection alone, the consumer may not be able to notice the virtues of a particular brand of equipment and would not be prepared to buy it because of its high price. However, if the dealer provided necessary demonstration services and well-trained personnel, consumers would experience the high quality of the computer and many of them would purchase the product.

The consequence of the scenario when “free-riding” takes place is that, in the short run, the consumer is happy and the manufacturer is indifferent because the sale is made regardless. However, over the longer run, the first dealer will no longer be willing to provide such expansive services and demand for this particular brand of computers will fall off.

The quality certification argument, put forward by *Marvel* and *McCafferty* is a modification of *Tesler’s* “free rider” argument. Briefly they argue that tangible services provided by dealers (product demonstration, for example) justifies retail price maintenance. When a manufacturer places its goods in high-priced stores, that placement certifies good quality to the consumer. Presumably, the retailer incurs certain costs trying to select goods of

¹² More on this matter, including extensive case law analysis see chapter IV, below.

¹³ See *Posner* (fn.5), Chapter VII.

¹⁴ See *Tesler*, Why Should Manufacturers Want Fair Trade? *Journal of Law and Economics*, volume. 3, 1960, 86.

high quality to put into its store. When the goods are put on the high-priced retailer's shelves, that certifies high quality and, therefore, consumers buy the product.¹⁵

Demand for some goods with so called "snob appeal", for example perfume and fashion goods is less sensitive to higher prices. Prestige and luxury connotations of the products play an important role in consumer choice, because customers of a particular product judge quality according to price. When price-cutting takes place it damages the manufacturers' reputation and drops product consumption.¹⁶

Finally, supporters of resale price maintenance claim that RPM enables small retail outlets to compete with big firms. When high retail margins are guaranteed it is relatively easy for new dealers to enter the market, provided that non-price intra-brand competition is unrestricted. Without RPM more aggressive retailers would drive smaller ones out of business and then raise prices to unreasonable levels.

None of the above provides an unqualified truth from the viewpoint of critics of minimum RPM, who propose a considerable number of contrary arguments.

Some oppose vertical price fixing indicating that the practice generally leads to higher prices on commodities and compels consumers to pay more than they otherwise would. Moreover, there is no assurance that the dealer given a firm margin over the price it pays will use it to provide the services consumers hope to receive. The dealer may prefer to promote less, but keep the high margin, relying on other dealers to provide the presale services. As a consequence, inefficient dealers may be protected against their inefficiency and efficient ones prevented from taking the advantage of their superior performance.¹⁷

Allegedly, resale price maintenance might be used as a tool for unlawful collusion between manufacturers and retailers. Such collusion may be initiated both by suppliers and retailers. The latter may persuade or coerce supplying manufacturers in the importance of maintaining resale prices. Their intention is simply to guarantee high margins between wholesale and retail prices, and prevent themselves from competition that comes from conventional retailers or so called discount houses that offer the same commodities at substantially lower prices. Manufacturers, on the other hand, operating on the same level of production may agree collectively to fix their distributor's sales prices. Thus RPM, when adopted sufficiently widely to cover most of an industry's products, removes some of the incentive for the price chiselling at the manufacturer's level, because with fixed resale prices, secret wholesale price reductions will not be so effective. In this case resale price maintenance has an effect of horizontal price fixing.¹⁸

¹⁵ See Marvel/McCaffery, Resale Price Maintenance and Quality Certification Rand, *Journal of Economics*, vol.15, 1984, 346-359.

¹⁶ See Goyder, *EC Competition Law*, 3rd edition, Oxford 1998, 271.

¹⁷ *Ibid.*

¹⁸ See Scherer/Ross (fn. 6), 555.

Further, according to the argument proposed by *Michael Spence*, even if resale price maintenance serves to increase an overall demand for the product and thereby make manufacturers better off, it does not necessarily follow that consumer welfare increases accordingly. The key to understanding this argument is to distinguish between infra-marginal consumers, those who would purchase a particular brand even without any special dealer services (because of previous knowledge, for instance, they would prefer not to have to pay the higher prices that will be used to pay the services) and marginal consumers, who are induced to buy the product precisely because of the added services (despite the somewhat higher price). Even though the total demand and number of customers increases, it is possible that the overall harm to the infra-marginal consumers outweighs the gain in consumer surplus for those consumers (the marginal consumers) who are induced to buy the product.¹⁹

Certain limitations to the free rider argument have been put forward. Firstly, it is necessary for sales of all kinds of products to provide appreciable and expansive services. To sell, say a box of cereal a supermarket does not hire well trained sales staff or provide special testing facilities.²⁰ Thus, the necessity of RPM as a means to avoid free riding is inapplicable regarding various commodities of everyday consumption. Often transparency of the product attributes enables an ordinary customer to evaluate them without the help of service personal. Alternatively products may be well-advertised or consumers might be familiar with them because of past experience. Furthermore, the necessity of vertical price fixing is ruled out in order to induce post-sales service (and avoid free-riding), since this can be charged for separately, either by the brand owner paying for the guarantee service or by the retailer making a normal charge for it. As claimed, even for pre-sale services, it may be possible to charge customers with a deduction from the purchase price for those who buy in the same shop.²¹

The certification argument advanced by *Marvel* and *McCafferty* has also been criticised. Allegedly, when the high-margin retailer chooses a good and then all the other retailers join in, it has a position akin to the innovator of some kind of technologically new product. Taking advantage of its head start, retailers charge higher margins, enough to cover quality certification. Gradually innovative products become well-established, eventually lose their status and are stocked in low-margin outlets so that a greater number of consumers can buy them. Since high-margin, high-service retailers have already gained their profit they are able to launch a new product cycle. Thus the co-existence of discount houses with high amenity shops is possible and

¹⁹ See *Comanor* (fn. 6), 991-992.

²⁰ Though a retailer may provide a valuable service by giving a particular manufacturer more or better located "shelf space" and the manufacturer may wish to compensate the retailer for this service by permitting higher retail margins.

²¹ See *Scherer/Ross* (fn. 6), 555. This raises a question of how often pre-sales services can not be charged for separately. It may be easier to charge when the cost of the pre-sales services is substantial.

even useful, because it enables large numbers of consumers to enjoy retailing innovations and allow high amenity dealers to start marketing new products and distribution circles.²²

4. Arguments For and Against Maximum Resale Price Maintenance

Compared to minimum RPM, discussed above, maximum vertical price fixing has always been regarded in antitrust economics as a less anti-competitive practice. Firstly, when resale price maintenance is initiated by manufacturers an apparent purpose of it is to keep retail prices down. Manufacturers assign certain price caps and prohibit their distributors to exceed the established level. This is especially important in cases of exclusive distribution agreements when the dealers are insulated from intra-brand competition in certain areas and, due to the market power they enjoy, are able to raise resale prices to unreasonable levels.

Secondly, the expediency of maximum resale price maintenance is often based upon the so-called “control of successive monopoly” economic paradigm developed by *Spengler*.²³ According to it, vertical price fixing typically does not arise unless participating firms have successive monopolies. Under this pattern, both the upstream firm (a manufacturer) and the downstream firm (a retailer) have a considerable degree of market power, i.e. are able to act independently of their competitors and consumers and among others raise prices without losing revenues that would make the price increases unprofitable.

In his article, *Spengler* explained why successive monopolies are harmful. First, society is better off when all stages of production and distribution are competitive. Under those circumstances, the price to consumers is lower and the quantity consumed is larger than when a monopoly is present at any stage. Therefore, public policy should challenge monopoly at any stage of production or distribution if it arose illegally.

In case of successive monopoly each stage of production and distribution is monopolised by an independent firm. To maximise profits, each monopolist will impose a monopoly surcharge on the price it charges to the good. The initial producer marks up its price over the cost of production and sells its output to the next stage. The buyer will process this intermediate good and resell it at a further mark up over cost. This sequence of successive mark ups continues through subsequent stages of production if they are also monopolised. The net result is that the price to the consumer is higher and the quantity lower than would result under competitive conditions.

Spengler has analysed the effects of vertical integration. He showed that a vertically integrated firm would make more profit by marking up the cost of producing and processing the product only once, rather than at each stage of production and distribution. In this

²² See *Scherer/Ross* (fn.6), 552-553.

²³ *Spengler* on antitrust policy, 58 *Journal of Political Economy*, 347 (1950). Description of *Spengler's* argument see in *Scherer*, *Competition Policy Domestic and International*, Cheltenham, 2000, 689-691.

market structure, vertical integration is pro-competitive, in that output expands and price falls. Integration is motivated by the producer's impulse to maximise profit. Nonetheless, the interests of suppliers and consumers coincide, and both benefit from maximum resale prices.

Maximum resale price restraint is presumed to be a contractual alternative to vertical integration, as the producer usually determines the optimal price to the consumer based on its costs and those of the distributor.²⁴ It extracts the profit through its wholesale price, which is optimally marked up above the production costs. The difference between the wholesale price and the retail price that the producer permits its distributors to charge is equal to the costs of performing the distribution function, which includes a competitive return on the distributor's investment. In this way, the producer achieves essentially the same outcome that would result from vertical integration.

Although the outcome is similar, it does not follow that they (vertical integration and RPM) are equally efficient. The cost of vertical integration is alleged to be higher compared to resale price maintenance. Vertically integrated suppliers usually are not efficient distributors: diseconomies of scale in management of a big (vertically integrated) firm may outweigh any economies in scale in production, small firms may lack sufficient resources to do all their distribution, manufacturers that distribute their own products may be unfamiliar with local conditions etc.²⁵

Thus, vertical integration may solve a problem of successive monopoly, though, it is less efficient and therefore less preferable than vertical price fixing.

From the viewpoint of opponents of maximum RPM, the market system functions best when pricing decisions are made by those who pose a direct knowledge of the local market in which they sell. Schemes to fix maximum prices may substitute the erroneous judgement of a seller for the forces of the competitive market and severely intrude upon the ability of retailers to compete and survive in the market.²⁶ Indeed, dealers operate in a diverse labour, real estate, regulatory and taxation setting. Their costs may vary accordingly as may the local demand for their products or the intensity of competition from rival dealers. Even if all of these factors were identical, each dealer might choose a different marketing strategy. One might set a high margin in order to maintain costly services. Another might decide to establish a low-margin, high-volume sales outlet.²⁷ Hence, to obtain a competitive return, each dealer needs to establish a price that adapts to such varying costs, demand and competition.

²⁴ See *Blair/Esquibel*, Maximum Resale Price Restraints in Franchising, 65 Antitrust Law Journal, 157, 1996, 354-400.

²⁵ See *Korah/Rothnie* (fn.4), 4-5.

²⁶ See Justice White's opinion in *Albrecht*, a landmark case concerning maximum RPM; *Albrecht v. Herald Company* 390 U.S. 145, 1968.

²⁷ Provided that provision of such services is not required by the supplier.

Consequently, unless a maximum resale price is set high enough to satisfy all dealers, a supplier may drive its distributors, who will lose the incentive to carry on business, into the arms of competitors. In another scenario, when the supplier possesses a market power in transactions with a dealer because of so called sunk costs, the dealer is “locked in” to its own investments and is forced to accept a low income in its capital investments.

Sunk costs are investments that can not be recovered (or the next best use of the capital might be far less valuable) if an entrepreneur sells or abandons its business.²⁸ Suppliers may encourage dealers to make substantial investments in carrying its line in return for granting the dealer an exclusive territory. It might create inequality in bargaining power and hence, allow unilateral appropriation of the cost of that investment.²⁹ Sunk costs may include: an up-front fee for dealership, investment in plant, equipment, inventory that must be resold at a loss, as well as the non-recoverable cost of training of the dealer and its employees.

As a result, when a supplier uses its market power over the distributors, who have incurred substantial sunk investments, and squeezes the retail margins below the competitive level, a dealer is forced to accept inadequate financial return on its sunk investments.³⁰ This results in unequal wealth redistribution from dealers to suppliers and injures competition. On the other hand consumers may be harmed as far as the dealers will try to offset their lower investment return by raising prices on other (ancillary) goods they sell or withhold services consumers might prefer.

Lastly, it is asserted that maximum RPM might appear to be masked by minimum vertical price fixing. When the “price caps” are set too low, retail prices of all distributors of the same product equal to fixed maximums and in practice has an effect of minimum RPM.

III. Legal Treatment of Resale Price Maintenance

1. Short Historical Retrospect on Resale Price Maintenance in Europe

Resale price maintenance has not always been an unlawful practice throughout Europe. In many European jurisdictions contracts with RPM were allowed, enforceable and widely used in past. Though gradually, largely due to the creation and development of EC competition law, a trend for abolishing or at least considerably narrowing the scope of RPM application started taking place.

²⁸ See *Korah/Rothnie* (fn. 4), 16-17.

²⁹ *Ibid.*

³⁰ Price squeezes under competitive level is common in newspaper publishing business, where newspapers receive most of their revenues from advertising. Setting low resale prices, publishers try to increase the circulation and generate revenues from advertising.

Some countries completely prohibited retail price maintenance, while others left a little room for application in their competition laws.

In France, retail price maintenance was abolished under the price ordinance in 1945 subject to the possibility of ministerial exceptions.³¹ In 1974 RPM was prohibited in Germany, although non-binding “recommended prices” continued to be legal and widely used.³² Danish Monopolies and Restrictive practices act although *prima facie* it prohibits retail price maintenance, in its X chapter offers exemption possibilities.³³ In the Benelux countries RPM is generally lawful, though in practice its application is limited to certain classes of commodities, for example books.³⁴ In the UK, Resale Price Maintenance Act consolidated in 1974 contains the description of two types of RPM: collective and individual. While collective RPM is prohibited *per se*, in case of individual RPM, exemptions might be granted on the following grounds. First, if the restriction concerns specific classes of goods referred to in the Act (for example books and medicines) and second, maintenance of a restriction is justified on the basis of specific public interests such as health, product quality, provision of necessary services, maintenance of low prices and alike. In practice, however a few exemptions were granted by the special, Restrictive Practices Court.³⁵

More recently, another group of countries, Greece, Italy, Portugal and Spain have adopted modified versions of Article 81 and thus prohibited RPM.³⁶

2. Framework for Evaluation of Resale Price Maintenance

Article 81(1) of the EC Treaty prohibits “as incompatible with the Common Market: all agreements between undertakings, decisions between associations of undertakings and concerted practices which may effect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the Common Market”. Behind the simplicity of these words, the concepts are quite vague. Therefore some points should be clarified.

First, there must be an agreement, decision or concerted practice in order for the behaviour to be caught by competition rules. Unilateral measures, such as price recommendations, are generally outside the scope of Article 81(1).

Second, to determine the meaning of the terms “object and effect to restrict or prevent competition”, the words should be read disjunctively. First, it is necessary to consider the

³¹ Ordinance was completed by Law No.73-1193 of December 1973.

³² At the time the German law was strengthened, 810 companies had RPM stipulations covering 174,000 branded articles; See *Scherer/Ross* (fn. 6), 550.

³³ See *Fejo*, Monopoly Law and Market, Deventer 1990, 159.

³⁴ See *Ottervanger*, Competition Law of the European Community, the Netherlands and Belgium, the Hague, 1998, 234.

³⁵ See *Whish*, Competition Law, 2nd edition, London, 1989, 209-214.

³⁶ See *Korah/Rothnine* (fn. 4), 271.

purpose of the agreement in question. If it is not clear that the object is to harm competition (where the objective purpose of the agreement in general, not the subjective intention of the parties is relevant), only then it should be considered whether the agreement might have such an effect. In the latter case (when the agreement might have a restrictive effect), a more exhaustive analysis of the market conditions, like ascertaining relevant product and geographical markets, will be called for.³⁷ Vertical restraints, other than minimum price fixing and export bans, are analysed in this manner.

Third, application of Article 81(1) is limited to a conduct, which may affect trade between the Member States. The notion of effect on inter-state trade is important since it defines the boundary between the areas respectively covered by the Community law and the law of the Member States. This condition is quite easily satisfied since even a practice confined to activities in a single member state may infringe Article 81(1)³⁸. In fact, there is no need to prove an actual affect on trade between states, even a potential affect is sufficient.³⁹ In some cases, the Court of Justice has applied a different, so called structural test to decide whether there had been an affect on inter-state trade. Instead of attempting to identify actual or potential affects, it suggested that the phrase is satisfied by any alteration in the structure of competition within the Common Market.⁴⁰ When there are direct restrictions on imports or exports between member states, the conditions of application for the prohibition are usually satisfied.

Lastly, the restriction on competition must be appreciable before article 81 applies. The 'appreciability threshold' consists of 10 percent of the relevant market share. Agreements below this threshold are treated as negligible or *de minimis*.⁴¹

Article 81(3) provides that agreements, decisions or practices that otherwise would be prohibited by article 85(1) may be exempted if they meet four conditions. First, two positive conditions must be satisfied: an agreement may be exempted if it (i) "contributes to production or distribution of goods or to promoting technical or economic progress" while (ii) "allowing consumers a fair share of the resulting benefit." An agreement that satisfies these criteria can be exempted only if it also (i) does not "impose on undertakings concerning restrictions that are not indispensable to the attainment of these objectives" and (ii) does not "afford such undertakings the possibility of eliminating competition with respect to a substantial part of the products in question". Exemptions are allowed either by decisions of the European Commission on individual agreements or by block exemption regulations.⁴²

³⁷ See *Whish* (fn. 35), 230-31.

³⁸ *Commercial Solvents v Commission*, ECR 223 (1974) 1 CMRL 309.

³⁹ See *Korah*, *An Introductory Guide to EC Competition Law and Practice*, 5th edition, London 1994, 52.

⁴⁰ See *Whish* (fn. 35), 248.

⁴¹ Notice on Agreements of Minor Importance, OJ C 372, 09.12.1997. Though for considerable period of time evaluation of appreciability according to the "old notice", was based on turnover threshold (i.e. size of the firm) it was a rather unacceptable approach because, from economic point of view, market power and not firm's size is the relevant consideration.

⁴² Article 81(1) is not applied to agreements that do not affect or exerts no appreciable effect on market conditions.

Moreover, Article 81(1) of the EC Treaty provides a non-exhaustive list of the kinds of agreements that are likely to have the object or effect of restricting competition within the Common Market. These include those which: "(a) directly or indirectly fix purchase or selling prices or any other conditions." The example is not limited to horizontal agreements - those made between competitors at the same level of production or distribution but equally apply to vertical agreements, i.e., *inter alia* to resale price maintenance.

The first attempt to remove vertical agreements from the field of application of Article 81 was undertaken by the Italian government, which brought an action against the Commission and the Council.⁴³ The main argument put forward by the applicant was that Article 81 did not cover the relationship between undertakings operating at different levels of the economy and consequently restrictions of competition contained in vertical agreements could be challenged only where they amounted to an abuse of a dominant position within the meaning of Article 82. The Court of Justice rejected this argument refusing to interpret either of these articles with reference to the level in the economy at which the undertakings carried on business.

In addition, the regulations 1983/83 of exclusive distribution agreements, and 4087/88 of franchising agreements reflected strong hostility of the Commission towards resale price maintenance. For application exclusive distributorship and franchising contracts must have been cleared from RPM clauses.⁴⁴

The above mentioned regulations expired on May 2000. Earlier the Commission issued a Green Paper launching a debate on possible reforms of its policy concerning vertical agreements. In December 1999 it adopted a new Regulation 2790/1999 and the Guidelines on vertical restraints, which were finally approved and published in October 2000.⁴⁵ Article 4 of the Regulation blacklists five hardcore restraints; one of them is resale price maintenance. The same article (4 (a)) excludes from the benefit of the block exemption agreements that, directly or indirectly, restrict the buyer's ability to determine its sale price. The scope of such hardcore restraint is limited by the following exception: the supplier can impose upon the buyer a maximum resale price or recommend a certain sale price, provided this does not amount, as a result of the parties behaviour (such as the pressures or incentives created by the supplier), to an obligation on the buyer to sell at a fixed price, or to a prohibition on the buyer to sell below a minimum price. Maximum and recommended resale prices, according to the regulation, do not constitute hardcore restraints, while fixed and minimum prices do.⁴⁶

⁴³ Italy v. Commission and Council [1966] ECR 389.

⁴⁴ See article 2(2) of the regulation 1983/83 and article 5(e) of the regulation 4087/88.

⁴⁵ 2000 OJ (c 291) 1.

⁴⁶ The Guidelines on Vertical Restraints, at point 47, list a series of examples of indirect means of imposing on the buyer fixed or minimum resale prices. Among these the Commission includes threats, intimidation, warnings, penalties, delay or suspension of deliveries or contract termination relation to observance of a given price.

Maximum and recommended prices normally are not caught by Article 81(1). When they are, and the Regulation 2790/99 does not apply, they need an individual exemption.⁴⁷ The Guidelines on Vertical Restraints provide some rules for assessment when maximum and recommended prices constitute violation of Article 81(1).

3. Practice of the Law Applying Authorities and Development of the Case Law on Resale Price Maintenance - EC Law

Despite the norm embedded in Article 81 of the EC Treaty, the European Competition Authorities in the beginning took a stand that purely national RPM systems did not infringe article 81. It was claimed that maintenance of resale prices in a single state could not affect inter-state trade.⁴⁸ Later, however, vertical price fixing was attacked indirectly. As it was acknowledged that the Commission must ensure that consumers should be able to obtain products at the most favourable prices from any place in the Community,⁴⁹ the Commission tried to neutralise national RPM laws by prohibiting obstacles to the free flow of goods within the Common Market. Indeed, RPM is difficult to enforce on markets, which are open to imports to similar or homogenous products. An example of this policy was Germany, where the Competition Act till 1973 permitted resale price maintenance.

In *Deutsche Grammophon v. Metro* case,⁵⁰ Metro had bought records in France produced by Deutsche Grammophon. Metro having re-imported them to Germany, sought to sell recordings there at prices well below the level at which the official German distributors (subject to German law, which allowed RPM) were allowed to sell. Deutsche Grammophon tried to obtain an injunction preventing Metro from selling the records at a price lower than that fixed by the RPM provisions. The Court of Justice held that the holder of exclusive rights was not allowed, in order to achieve the aims of an agreement, to fix selling prices, which fall within the prohibition of Article 81 and seek to exercise those rights by prohibiting the distribution of such recordings imported from another Member State.

Gradually Community institutions tended to regard national resale price maintenance as falling within their competence. In subsequent cases, the Commission and the Court of Justice interpreted the requirement as an effect on trade between member states in ways which would have made it non-reasonable for a company to impose resale price maintenance even in its own country.

⁴⁷ See *Subioto/Amato*, The Reform of the European Competition Policy Concerning Vertical Agreements, *Antitrust Law Journal*, 69, 2001, 168, note 95.

⁴⁸ In the first report on competition policy, point 55, the Commission stated: "Purely national systems of RPM do not generally come under the Community law prohibiting cartels. To the extent that they are limited to compelling retailers in a Member State to respect certain prices for the resale within that state or products supplied by a manufacturer established on that market...trade between the Member states will not, generally, be affected within the meaning of Article 81...That is why the Commission considers the question of vertical retail price maintenance is a matter of national competition policy..."

⁴⁹ *Ibid.*

⁵⁰ *Deutsche Grammophon v. Metro*, 78/70 [1971] ECR 487: CMRL631.

In *BNIC v. Clair*,⁵¹ the Court found an effect on trade despite the fact that the product in question, special spirits for use in the manufacture of cognac, was not generally traded outside the Cognac region of France. The Court based its decision on the argument that any agreement whose object or effect was to restrict competition by fixing minimum prices for an intermediate product was capable of affecting intra-community trade. In *GERO-Fabriek*⁵² concerning sales of cutlery product in the Netherlands, the Court reaffirmed that maintenance of resale prices in a single state would be likely to influence trade between member states.

Some signs of deviation from the general trend of the Community Institutions to bring national resale price maintenance systems under their jurisdiction appeared in cases involving the sale of books - considered as unique products or carrying important cultural values.

In the *VBBB/VBVB* case, the Court found a system of collective resale price maintenance for book prices operating across national borders (between Holland and Belgium, where RPM was not prohibited) to be a violation of Article 81(1). But in its judgement the Court emphasised that such proceedings would not relate to the purely national RPM systems.

In *Leclerc Books* case,⁵³ French law required every publisher and importer of books to fix prices for all books published or imported. The court upheld the basic French law but struck down some provisions, which required fixed prices to be applicable to all books, including those, which had been first exported from France and then re-imported. On the other hand, the law was allowed to apply to books exported for the sole purpose of re-importation.

The Community institutions have dealt with a different kind of resale price maintenance, so called collective RPM. It occurs when groups of suppliers (and often other possible entrants of the supply-retailing chain, like dealer.) agree to impose resale prices on their sales and purchases. Collective RPM might have an effect of horizontal agreement and its wide-spread maintenance usually leads to elimination of intra-brand competition for the product in question. For these reasons, the Court of Justice and the Commission have showed a rather stringent attitude towards this kind of vertical price fixing. Collective RPM was refused exemption under Article 81(3) in a number of occasions and exclusive distribution contracts required to be cleared from collective RPM clauses, as in the case of *Belgian Wallpapers*⁵⁴ and *Gerofabriek*.⁵⁵

⁵¹ *BNIC v. Clair*, 78/70 [1971] ECR 487: CMRL631.

⁵² *Bureau National Interprofessionnel du Cognac (BNIC) v. Clair* (1985) ECR 391.

⁵³ *Au Ble Vert Sarl v. Leclerc* ECR 32,[1985] 2 CMRL 286.

⁵⁴ *Belgian Wallpapers*, case 73/74 [1975 ECR 1491: [1976] 1 CMRL 589.

⁵⁵ *GERO-Fabriek*, OJ 1977 L.16/8.

The above- presented cases concerned mainly maintenance of minimum resale prices. The cases involving maximum RPM were extremely rare due to the Competition Authorities' tacit approval of maximum vertical price fixing (this position was formally backed by the regulation 2790/99 in 1999).

Unlike resale price maintenance, price suggestions, were treated more leniently by the Community competition authorities. In *Pronuptia*,⁵⁶ a case concerning franchising agreements, price suggestions were found not to have infringed Article 81(1). It was acknowledged that the mere suggestion of prices for the guidance of franchisees (and generally retailers) could not be regarded as a practice restricting competition.⁵⁷

In judging the cases concerning resale price maintenance, the point of departure for the Competition Authorities is to find out if the conducts of the undertakings involved, affect trade between Member States and distort competition on the Common Market. Economic considerations for evaluation seem to be much less important.

In *Hennessy/Henkell*,⁵⁸ maintenance of RPM by a French producer of cognac was condemned. The Commission refused an individual exemption, although the prices of other brands were not maintained, and there was a strong inter-brand competition in Germany. The only element of economic analysis in the decision was that the restrictions of competition and the effect on trade between Member States were appreciable because Hennessy was one of the three major producers of cognac, Henkell's turnover was 330 million DM and Germany was the third largest importer of cognac. The Commission did not allege that prices in Germany were being kept up to guarantee the margins of Hennessy's dealers in other Member States, nor did it allege that prices were maintained elsewhere in order to protect Henkell's margins, so the reasoning about the effect on inter-state trade was not as strong as might have been.

In *Louis Erauw-Jacquery v. La Hesbignonne*⁵⁹, the parties argued that RPM did not affect trade between Member States and it did not have the object or effect of restricting competition. The need to protect producers against free riders was not raised, and, on the basis of the first example given in Article 81(1), the Court assumed that the practice as such, had the object of restricting competition without considering the possibility of free riders.

⁵⁶ *Pronuptia de Paris v. Irmgard Schillgallis* [1986] ECR 353.

⁵⁷ However, the distinction between illegal vertical price fixing and lawful resale price suggestions can result in some extremely fine line drawing. Price suggestions may be regarded as concerted practices and caught by Article 81(1). Even any "indirect" requirement by a supplier or franchisor towards its distributor to observe resale prices may amount to illegal RPM. See commission regulation 4087/88 on the application of Article 81(3) of the Treaty to categories of franchise agreements; art. 5(e).

⁵⁸ *Hennessy/Henkell* [1981] 1 CMRL 601.

⁵⁹ *Louis Erauw-Jacquery v. La Hesbignonne*.

*The Metro/Saba*⁶⁰ European Court case is sometimes quoted as an example of a setback in the authorities' policy of limiting the extent to which resale price maintenance systems would be permitted.⁶¹ The Court in rejecting the claim that Saba's selective distribution system for consumer electronic goods of high quality was in breach of article 81(1), emphasised that price competition was not the only the form of competition and stated that the desire of certain speciality wholesalers and retailers to maintain certain price levels which guaranteed additional services to be provided was not an objective which was necessarily prohibited by article 81(1). The Court did not, however, go on to say that competition in price was an unimportant objective. It rather stressed that it was important that consumers had a variety of choices enabling them to choose goods provided either by selective distributors at relatively higher prices or through more "cut-price" outlets offering lower standards of services.

4. Conclusions

As our investigation has shown resale price maintenance is a very complicated matter. It is one of the most debatable and controversial issues in competition law and theory. The issues may be divided into two parts. First is a conflicting nature of arguments put forward pro and against RPM and second, finding the appropriate tools for evaluation and the legal means for judging RPM cases that will be the most effective and efficient.

As we have seen there are no "rules of thumb" justifying downright prohibition or approval of RPM. All economic considerations carry substantial intellectual merit. In the case of minimum RPM, maintenance of generous margins seems rational in order to foster provision of necessary services, avoid "free-riding" and encourage small undertakings to enter and operate in the marketplace (the latter is somehow more stressed in EC competition law). On the other hand, maintenance of indefinite, unqualified, industry-wide RPM might turned out to be anti-competitive. As the proponents of this view suggest, RPM may artificially increase prices on most commodities that do not require any cost incurring pre-sales services, might hinder product innovation circles and prevent the public from access to high-quality, low price products.

In case of maximum vertical price-fixing, maintenance of RPM is *prima facie* pro-competitive as far as it is intended to keep retailing prices down. Moreover, RPM might be a useful marketing (contractual) tool for breaking the markets with "successive monopoly" struc-

⁶⁰ *Metro/Saba*; 26/76 [1977] ECR 1875; [1978] 2 CMRL 1.

⁶¹ The Court stated: "For specialist wholesalers and retailers the desire to maintain a certain price level, which corresponds to the desire to preserve, in the interests of consumers, the possibility of the continued existence of this channel of distribution in conjunction with the new methods of distribution based on a different type of competition policy, forms one of the objectives which may be pursued without necessarily falling under the prohibition contained in Article 81(1), and if it does fall thereunder, either wholly or in part, coming within the framework of Article 81(3).

tures. However, the argument concerning dealers who incur unrecoverable (or sunk) costs must be taken into account.

The arguments described above do not exclude each other. Their co-existence in real business life is more than possible. As there are conflicting views about competitiveness of RPM among antitrust economists, the problem is which set of arguments and accordingly which side will be taken up by the relevant authorities. Law-making as well as law-applying authorities should carefully assess the weight of all views.

Regarding the legal status of RPM in EC law, minimum vertical price fixing is plainly prohibited. As regards maximum RPM it is considered as a more pro-competitive practice and is upheld in most instances. The current state of the law in this respect is reasonable as it is based on major economic assumptions acknowledging pro-competitiveness of maximum vertical price fixing. It must be admitted, however, that the state of the law regarding minimum vertical price fixing is unsatisfactory. *Per se* prohibition of minimum vertical price fixing is undesirable. Several arguments against it have been put forward, but none of them can neutralise quality certification and most importantly the free-rider argument advanced by *Telser* back in the 1960s. All the opposite views just try to narrow the scope of its application and importance and argue for other ways than RPM available for producers and retailers to counterbalance the problem of “free riding.” But efficiency and effectiveness of such ways is doubtful and raise questions against *per se* condemnation of the practice. On the other hand, there are arguments that rightly suppose negative consequences of minimum RPM, such as for instance that it may facilitate horizontal co-operation between manufacturers and retailers. The free-rider argument, itself, is not an unqualified justification in any RPM case. Much depends on the actual settings of the challenged conduct, the position of the undertakings involved, the strength of market power possessed and the level of inter-brand competition in the relevant market. So to say, vertical price fixing might be harmful for competition but not always and not in all instances. Thus, another extreme view on it, which tends to support *per se* legality of the practice, is also unacceptable. Therefore, a kind of intermediate position should be adopted which will enable law applying authorities to evaluate RPM cases, taking into account all the necessary factors and make the right solutions.

It can be noted that in many instances the purpose and to a large extent effect of resale price maintenance is the same as of other vertical restraints. Precisely, it insulates dealers of the same supplier from competition between each other in order to increase their market performance and in the end better compete with the products of a rival supplier. To put it another way, restriction of intra-brand competition is often compensated by an increase in overall or inter-brand competition. The situation is odd because other vertical restraints are treated in a more friendly way. As it has been mentioned, the aim of RPM is to increase competition on other parameters than price, for example to induce dealers to provide necessary services for consumers. Consequently, if consumers despite higher prices value those services, then the manufacturers’ output increases and the market in question is competitive enough. Where there are other interchangeable commodities avail-

able to customers, why should minimum RPM be flatly prohibited? The share of complex commodities, which require some on-site pre-sale services, is permanently increasing. On the other hand, in EC competition law market integration is the primary goal. Therefore, RPM is often seen as a practice that may lead to market partitioning and price differences in different member states. Although, in a few instances mainly related to selective distribution systems, the Court of Justice admitted a theoretical possibility of acceptance of resale price maintenance as an objective requirement for providing valuable services for consumers (cases *AEG* and *Metro*). But the issue did not go further. Again, in the case of competitive markets and strong inter-brand competition, fear for market compartment seems to be exaggerated. Therefore, resale price maintenance with those certain limitations described above must be accepted in the EC competition system.

The other side of the problem is how to find the right methods to evaluate RPM cases. These are the procedural and substantive norms that will enable authorities to evaluate costs and benefits of the challenged action. The suitability of such rules to a significant extent determines how law works and how relevant economic arguments concerning vertical price fixing are applied.

The method and framework for evaluation of vertical restrains in EC competition law has been severely criticised in recent years.⁶² The main point is that EC law gives excessive attention to form over substance in judging vertical restraints. The EC competition authorities' overriding concern for what it terms market integration and freedom of action excludes substantial economic analysis of such restraints. The absence of market power-screens mitigates against the importance of inter-brand competition. The bifurcation of Article 81 is deemed to be artificial causing an over-broad application of Article 81(1) to competitively innocuous agreements. The majority of the Court and Commission decisions on resale price maintenance, described above, failed to consider adequately whether the restraint at issue harmed competition: injured consumers and decreased output.

The solution of the problem is seen in initiating vigorous and complete economic analysis of competitive harm and benefit under Article 81(1) referred as "the European rule of reason". The second way is an amendment of Article 81 to eliminate bifurcation and thus place the entire competitive analysis under a unified norm.⁶³

To sum up, two major challenges must be solved in future antitrust policy regarding RPM. First, it is necessary to abandon *per se* prohibition on vertical price fixing and permit resale price maintenance where it enhances competition. This is where RPM introduces the provision of pre-sales services that are valuable to consumers and increases manufacturers' output. Secondly, clear and simple competition rules should be created that balance cost and time of case-based analysis of resale price maintenance.

⁶² See *Hawk* (fn. 2); *Boscheck*, *The EU Policy Reform on Vertical restraints-An Economic Perspective*.

⁶³ See *Hawk* (fn. 2), 986-988.