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Resale Price Maintenance and the Limits of Article 101 TFEU:

Reconsidering the Application of EU Competition Law to Vertical Price Restraints

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ABSTRACT

The public policy towards minimum resale price maintenance ('RPM'), or vertical price fixing, namely the practice whereby a manufacturer stipulates a retail price floor below which its products are not to be resold, has traditionally been one of the most contentious antitrust issues on both sides of the Atlantic. Economic theory suggests that RPM is capable of producing ambivalent welfare consequences, thus obscuring the intellectual debate as to the optimal antitrust response to the practice. This normative uncertainty is best reflected in the divergent approach taken to RPM under the relevant laws of the United States and the European Union, arguably the world's two most mature antitrust jurisdictions. In 2007, in its seminal *Leegin* judgment, the United States Supreme Court abolished the century-old per se ban on vertical price fixing. At the same time, under the European Commission's recent Guidelines on Vertical Restraints price floors remain subject to a quasi-conclusive presumption of illegality. The purpose of this thesis is to examine whether a more consistent approach through the relaxation of the European Commission's blanket prohibition on price floors would be feasible and, in effect, desirable. Based on insights from new institutional economics, it will be argued that RPM may on certain occasions be a substitute – however imperfect – for vertical integration, where a merger would be prohibitively costly for the parties, in which case the hierarchical form of organisation will have to be replaced by a hybrid governance structure. Under certain circumstances, a fixed retail profit margin may enhance the self-enforcing range of long-term partnerships governed by relational norms, as well as the manufacturer's control over distribution by reducing substantially the transaction costs associated with monitoring dealer performance. At the same time, however, the analysis will take into account the various objections to the practice, most notably the horizontal collusion theory, in order to argue that the approach to RPM should in principle be cautious. The discussion will culminate in the proposal for a new, workable analytical framework for the substantive assessment of vertical price fixing under EU competition law, which will be based on a – genuinely – rebuttable presumption of anti-competitive object under Article 101(1) of the Treaty on the Functioning of the European Union.

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Author's Declaration

I declare that, except where explicit reference is made to the contribution of others, that this dissertation is the result of my own work and has not been submitted for any other degree at the University of Glasgow or any other institution.

Signature ____________________________

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Introduction

1. Legal Framework

Restricted dealing is one of the most contentious antitrust issues in the European Union (‘EU’), and its treatment under Article 101 of the Treaty of the Functioning of the European Union (‘TFEU’) is consistently received with a great deal of skepticism, due to the allegedly formalistic approach taken to certain types of vertical restraints by the European Commission and Courts.

Article 101(1) declares as incompatible with the internal market ‘all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market’. In its seminal decision in *Consten and Grundig*, the Court of Justice of the European Union (‘CJEU’ or ‘Court of Justice’) confirmed that the prohibition covers not only agreements between competitors, but also restrictive agreements between undertakings operating at successive levels of the production and distribution chain.[1]

Economic and legal literature typically classifies the various types of vertical restraints in two broad categories, depending on whether they are designed to influence the resale price of the goods or services in question, or limit the distributor’s freedom of action with regard to issues other than price. Vertical price restraints, which are also referred to as resale price maintenance (‘RPM’), may take two forms. Minimum RPM is the practice whereby the manufacturer stipulates a price floor below which its products are not to be resold. Inversely, under maximum RPM distributors undertake to refrain from selling the manufacturer’s products at a price which exceeds a given price ceiling. As far as vertical non-price restraints are concerned, typical examples include single branding, exclusive or selective distribution, and tying.

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[1] Joined Cases 56 and 58/64, *Établissements Consten Sarl and Grundig-Verkaufs-GmbH v Commission* [1966] ECR 299, 339.

While restrictions of intrabrand competition are generally regarded as pro-competitive and may – in the absence of market power in the upstream and downstream markets – benefit from the Vertical Block Exemption Regulation,[2] minimum RPM and absolute territorial protection are consistently treated as restrictions of competition by object under Article 101(1), and as hardcore restraints under Article 101(3). However, by contrast to the prohibition against absolute territorial protection which has received much attention from antitrust scholars in the fifty years following *Consten and Grundig*, the treatment of minimum RPM under EU competition law has been subject to limited examination.

The law on RPM has been no less controversial on the other side of the Atlantic, as for almost a century US courts had been treating vertical price fixing as per se illegal on the basis of the Supreme Court's judgment in *Dr Miles*.[3] In response to reactions by manufacturers and retailers in an economy which had barely started to recover from the Great Depression, the enactment of the Fair Trade Acts gave the opportunity to individual States to legalise RPM under their domestic antitrust regimes. In the second half of the twentieth century proponents of the Chicago School of thought enriched the intellectual debate by suggesting various pro-competitive justifications for the use of RPM and called for the adoption of the rule of reason standard at a federal level. This came only in 2007 in the *Leegin* case,[4] where the US Supreme Court, convinced that the economic effects of the practice were ambivalent, held that RPM did not warrant per se treatment.

In the aftermath of *Leegin*, the European Commission's revised Vertical Guidelines acknowledged for the first time that vertical price fixing may on certain occasions have an efficiency-enhancing potential, and may be exempted on an individual basis under Article 101(3).[5] Nevertheless, the normative value of this observation – if any – appears to be limited. Wijckmans and Tuytschaever's brief statement is illustrative: 'there can be no misunderstanding that vertical price fixing remains as much of a hard core restriction under Regulation 330/2010 as it used to be under Regulation 2790/99'.[6]

[2] Commission Regulation (EU) No 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices [2010] OJ L102/1.
[3] *Dr Miles Medical Co v John D Park & Sons Co*, 220 US 373 (1911).
[4] *Leegin Creative Leather Products, Inc v PSKS, Inc*, 551 US 877, 907 (2007).
[5] Commission Notice – Guidelines on Vertical Restraints [2010] OJ C130/1, para 225.
[6] F Wijckmans and F Tuytschaever, *Vertical Agreements in EU Competition Law* (2nd edn, Oxford University Press 2011), p 140.

Naturally, distributorship agreements are not the only business method for the broadest possible dissemination of goods and services. Manufacturers who seek to make their products available to consumers may avoid the appointment of intermediaries simply by integrating vertically into the wholesale and retail stages. An undertaking that wishes to integrate vertically may do so either through internal expansion, for example by setting up a subsidiary entrusted with the distribution of its products in the retail market, or through a vertical merger with an existing firm, already active at a successive stage of the production and distribution chain.

In its Non-Horizontal Merger Guidelines, the European Commission not only concedes that 'non-horizontal [namely vertical and conglomerate] mergers are generally less likely to significantly impede effective competition than horizontal mergers',[7] but also acknowledges their substantial efficiency-enhancing potential.[8] At the same time, the 'single economic entity' doctrine, as formulated by the case law of the European Courts, and most notably the *Viho* case,[9] prescribes that the constituent parts of a vertically integrated firm, although having separate legal personalities, are considered as a single economic entity. A significant implication of the doctrine is that any arrangements between a parent company and its subsidiaries do not constitute 'agreements' within the meaning of Article 101 TFEU, but are instead perceived as an internal allocation of tasks.

2. Theoretical Framework and Objectives

Economic theory suggests that RPM is capable of producing ambivalent effects. Price floors are inimical to consumer welfare particularly when they are implemented in concentrated markets in order to facilitate horizontal collusion, or as exclusionary mechanisms. On the other hand, antitrust scholars have suggested compelling pro-competitive justifications mostly associated with the manufacturer's desire to enhance its

[7] Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings [2008] OJ C265/6, para 11.
[8] Ibid, para 13.
[9] Case T-102/92, *Viho Europe BV v Commission* [1995] ECR II-17 and, on appeal, Case C-73/95P, *Viho Europe BV v Commission* [1996] ECR I-5457.

control over distribution.[10] Despite the plethora of materials on RPM, the actual effects of the practice remain unknown, allowing no safe inferences as to the optimal antitrust response to the practice: otherwise insightful formal models demonstrate the likely impact of RPM upon the assumption of its implementation in extremely tight oligopolistic markets, while empirical evidence is scarce and at times not particularly enlightening.

The stringent approach to RPM is in tension with the immunity conferred upon intra-enterprise arrangements. This normative inconsistency, which is essentially a manifestation of inefficient legal reductionism, introduces an economic anomaly that is difficult to reconcile with the understanding of markets and hierarchies as alternative organisational structures, the choice of which is contingent upon the firms' desire to economise on transaction costs. In an attempt to shape a legislative framework for the assessment of vertical restraints, the Commission appears to have based the prohibition of RPM upon the assumption that any loss in allocative efficiency is the result of restrictive *agreements* between independent undertakings.

This thesis intends to identify the reasons for, as well as the particular elements of, this tension. It will be shown that RPM may on certain occasions be a substitute – however imperfect – for vertical integration, where a merger would be prohibitively costly for the parties. It will be argued that the boundaries of the firm are in reality not as sharp as competition law assumes, and that the single economic entity doctrine is only half a step towards the right direction. Vertical integration into distribution may be achieved not only by the transfer of ownership title in assets or shares, by also by contract. In light of this assumption, it will be submitted that, on certain occasions, RPM may ensure the enforceability of long-term relational contracts, which present attributes comparable to those of full vertical integration, thus generating similar transactional efficiencies. After having dealt with these normative issues, a new workable analytical framework for the substantive assessment of price floors under Article 101 TFEU will be suggested. In shaping this framework, which will be based on a rebuttable presumption of illegality, all pro- and anti-competitive theories associated with the practice will be taken into consideration.

[10] See, eg, LG Telser, 'Why Should Manufacturers Want Fair Trade?' [1960] 3 *JL & Econ* 86; JR Gould and LE Preston, 'Resale Price Maintenance and Retail Outlets' [1965] 32 *Economica* 302; R Deneckere, HP Marvel and J Peck, 'Demand Uncertainty, Inventories, and Resale Price Maintenance' [1996] 111 *QJ Econ* 885; B Klein and KM Murphy, 'Vertical Restraints as Contract Enforcement Mechanisms' [1988] 31 *JL & Econ* 265.

This analysis will also acknowledge that the US Supreme Court's judgment in *Leegin*, which put an end to the century-long per se treatment of the practice, has received considerable criticism, not unlike *Dr Miles*. Nevertheless, adversaries of the *Leegin* dictum do not typically assert that the effects of RPM are so demonstrably harmful that merit per se treatment; instead their concerns are more associated with how administrable a full-blown rule of reason analysis will be in practice.[11] The reason for these concerns may be traced in Judge Posner's frequently cited quote that 'in practice, [the rule of reason] is little more than a euphemism for nonliability'.[12]

This study will not disregard the theories of harm associated with RPM. The horizontal collusion theory was the intellectual basis for the Supreme Court's per se treatment of the practice introduced in *Dr Miles*, and has recently been confirmed by significant contributions by prominent antitrust economists.[13] Nevertheless, and despite their contribution to our understanding of the effects of RPM, these theories are not firmly supported by empirical evidence. It is characteristic that the only recent empirical study confirming that industry-wide price floors can be unambiguously anti-competitive is a paper on the effects of the French Galland Act,[14] which introduced a ban on discounts below the price quoted on the invoice produced by the wholesaler at the time of delivery. Although the efficiency considerations were comparable to those associated with RPM, the outcomes of the study are not particularly useful for public policy purposes: exogenously imposed vertical restraints are generally not driven by the typical efficiency-enhancing justifications, and have been proven to be far more detrimental to consumer welfare than those imposed voluntarily be manufacturers.[15]

At the same time, new theories have emerged which note the potentially harmful exclusionary effects of RPM, both in the upstream and the downstream markets.[16] The

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[11] See, eg, BM Brunell, 'Overruling *Dr. Miles*: The Supreme Trade Commission in Action' [2007] 52 *Antitrust Bull* 475; JB Kirkwood, 'Rethinking Antitrust Policy toward RPM' [2010] 55 *Antitrust Bull* 423; Jones Harbour P and Price LA, 'RPM and the Rule of Reason: Ready or Not, Here We Come?' [2010] 55 *Antitrust Bull* 225.

[12] RA Posner, 'The Rule of Reason and the Economic Approach: Reflections on the *Sylvania* Decision' [1977-1978] 45 *U Chi L Rev* 1, 14.

[13] B Jullien and P Rey, 'Resale Price Maintenance and Collusion' [2007] 38 *Rand J Econ* 983; P Rey and T Vergé, 'Resale Price Maintenance and Interlocking Relationships' [2010] 58 *J Ind Econ* 928.

[14] P Biscourp, X Boutin and T Vergé, 'The Effects of Retail Regulations on Prices: Evidence from the *Loi Galland*' [2013] 123 *Econ L* 1279.

[15] F Lafontaine and M Slade, 'Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy' in P Buccirossi (ed), *Handbook of Antitrust Economics* (The MIT Press 2008).

[16] I Paldor, 'RPM as An Exclusionary Practice' [2010] 55 *Antitrust Bull* 309; J Asker and H Bar-Isaac, 'Raising Retailers' Profits: On Vertical Practices and the Exclusion of Rivals' [2014] 104 *Am Econ Rev* 672.

soundness of these theories is supported also by credible empirical studies.[17] The use of RPM as a foreclosure mechanism is particularly exacerbated in light of the recent trends in retailing and the emergence of online retailing as an alternative, cost-effective distribution format.

Furthermore, it cannot escape one's attention that the timing was also unfortunate: *Leegin* was decided in the midst of a revolutionary process of emergence and expansion of electronic commerce ('e-commerce').[18] This coincidence has put into question the validity of the free rider argument, which has traditionally been the most oft-cited pro-competitive justification for vertical price fixing. More specifically, the occurrence and prevalence of free riding in the e-marketplace are juxtaposed against the ability of RPM to impede inter-type competition, namely competition between different distribution formats,[19] thus depriving online outlets of their competitive advantages.

Our understanding of antitrust law is typically guided by insights from neoclassical economics, and public policy judgments are stereotypically believed to be based on the effects of multi-lateral agreements or unilateral conduct by dominant firms on allocative and productive efficiency. In an authoritative study on EU competition policy, Odudu argues that the bifurcation of Article 101 TFEU under paragraphs 1 and 3 corresponds to two different substantive criteria, an allocative and a productive/dynamic efficiency inquiry, respectively.[20]

Oliver Williamson, whose pioneering work on new institutional economics has enhanced our understanding of the contribution of transactions costs in the structural and behavioural choices of economic actors is critical of the neoclassical preoccupation with allocative efficiency considerations 'to the neglect of organizational efficiency, in which discrete structural alternatives were brought under scrutiny'.[21] Indeed, antitrust analysis typically overlooks the contribution of transaction cost analysis, which attempts to justify

[17] E Giovannetti and L Magazzini, 'Resale Price Maintenance: An Empirical Analysis of UK Firms' Compliance' [2013] 123 *Econ J* F582.
[18] See, eg, M Lao, 'Resale Price Maintenance: The Internet Phenomenon and Free Rider Issues' [2010] 55 *Antitrust Bull* 473; Note, '*Leegin*'s Unexplored "Change in Circumstance": The Internet and Resale Price Maintenance' [2007-2008] 121 *Harv L Rev* 1600; P Jones Harbour and LA Price, *supra* n 11; GT Gundlach, JP Cannon and KC Manning, 'Free Riding and Resale Price Maintenance: Insights from Marketing Research and Practice' [2010] 55 *Antitrust Bull* 381; RD Blair and JS Haynes, 'The Plight of Online Retailers in the Aftermath of *Leegin*: An Economic Analysis' [2010] 55 *Antitrust Bull* 245; WS Comanor, 'Leegin and Its Progeny: Implications for Internet Commerce' [2013] 58 *Antitrust Bull* 107.
[19] See JC Palamountain Jr, *The Politics of Distribution* (Harvard University Press 1955).
[20] O Odudu, *The Boundaries of EC Competition Law: The Scope of Article 81* (Oxford University Press 2006).
[21] OE Williamson, *The Mechanisms of Governance* (Oxford University Press 1996), p 100.

the choice of specific contractual clauses in the market context on the basis of the influence exercised on the parties by uncertainty, complexity and specificity.[22] Naturally, this conception is not to be interpreted as suggesting that what is efficient for the parties is also desirable from a public policy perspective. However, as Almarin Philips noted in one of the first studies to apply transaction cost analysis in antitrust, 'an investigation of private motives may illuminate social consequences'.[23]

The theory of new institutional economics is based on three pillars: transaction costs, contracts and property rights. As Ménard explains:

> Transaction costs provide an explanation to the existence of alternative modes of organization as well as tools for understanding the characteristics of these arrangements. Contracts represent a focal point in [new institutional economics] because of their role in relaxing the constraints of bounded rationality, fixing schemes of references for future actions, and checking on opportunistic behavior. Lastly, relatively well-defined property rights, and institutions for implementing them, form a prerequisite for making the transfer of rights possible and the tradeoff among arrangements meaningful. Property rights thus affect contractual hazards and embed transactions into specific institutional environments'.[24]

To the very best of my knowledge, the only study which has attempted to interpret the application of the bifurcated Article 101 through the lens of new institutional economics has been produced by Professor Lianos, who asserts that

> [t]he bifurcation of Article [101] corresponds to the two dominant concepts of the limits of the firm, Article 101(1) accommodates the conception of the firm under the new institutional economics as essentially a governance structure and it makes possible the consideration of transactional efficiency gains. ... Article [101](3) incorporates the neoclassical conception of the firm as a production function.[25]

Lianos concentrates his analysis of the antitrust implications of the integration of new institutional economics in the enforcement logic of Article 101 for franchising and

[22] F Lafontaine and ME Slade, 'Transaction Cost Economics and Vertical Market Restrictions – Evidence' [2010] 55 *Antitrust Bull* 587, 590.
[23] A Phillips, 'Schwinn Rules and the "New Economics" of Vertical Relations' [1975] 44 *Antitrust LJ* 573, 577.
[24] C Ménard, 'A New Institutional Approach to Organization' in C Ménard and M Shirley (eds), *Handbook of New Institutional Economics* (Springer 2005), p 282.
[25] I Lianos, 'Commercial Agency Agreements, Vertical Restraints, and the Limits of Article 81(1) EC: Between Hierarchies and Networks' [2007] 3 *J Comp L & Econ* 625, 671.

selective distribution, and asserts that vertical restraints are excluded from the scope of the prohibition insofar as they are designed to establish a hybrid form of organisation which lies in the middle of an organisational continuum with markets and hierarchies as it polar extremes. Hybrids are defined by Ménard as ‘forms of inter-firm collaboration in which property rights remain distinct while joint decisions are made, requiring specific modes of coordination’,[26] and vertical restraints may indeed enhance their self-enforcement range by serving as *ex ante* incentive alignment mechanisms in situation where the commercial interests of the manufacturer are in tension with those of the distributors.

While reliance on transaction cost analysis is indeed enlightening with regard to our understanding of the public policy towards franchising and selective distribution under EU competition law, it is nonetheless inconsistent with the treatment of other vertical restraints, such as exclusive distribution and RPM. Particularly with regard to RPM, which is the subject-matter of this thesis, it appears that the blanket prohibition of the practice is rather to be understood through the lens of neoclassical economics primarily as a conclusive presumption of allocative inefficiency, and possibly also as a result of the integrationist concerns to which it may give rise.

The aim if this thesis is to provide answers to three questions. The first is whether there is the possibility within the current framework of EU competition law to introduce a more relaxed approach to vertical price fixing, influenced by *Leegin*’s rule of reason and based on a common understanding of the substantive economics. This question will be answered in the affirmative: it will be shown that, although competition law enforcement with regard to vertical restraints in general, and RPM in particular, has traditionally been driven by a combination of economic and integrationist objectives, the Commission, in its recent Vertical Guidelines, has made noteworthy concessions to its traditional rigid adherence to the single market imperative in an attempt to accommodate a more effects-based approach by declaring its intention to uphold even agreements that confer outright absolute territorial protection, where their aim is to promote interbrand competition.[27] The current approach, which singles out RPM as the most stringently treated vertical restraint on the basis of an conclusive presumption of illegality under Article 101(1), is rather at odds with the overall spirit of the Guidelines.

The second question which I will attempt to answer in this thesis will concentrate on what the optimal antitrust policy towards RPM within the context of Article 101 TFEU

[26] C Ménard, *supra* n 24, p 294.
[27] See Vertical Guidelines, paras 60-61.

is. Taking into consideration all pro-competitive justifications and theories of harm as suggested by economists, as well as empirical evidence from antitrust litigation and scientific publications, I will conclude that, as a general matter, a policy reform is warranted. However, although not always supported by credible empirical studies, anti-competitive theories remain compelling and advocate against a radical change in the status of RPM as a 'by-object' restriction of competition under Article 101(1) and a 'hardcore' restraint under Article 101(3). Instead, I will argue that the most appropriate normative approach would consist in a rebuttable presumption of illegality. In that regard, the CJEU's recent decision in *Cartes Bancaires* is particularly enlightening in advising undertakings on how such a presumption may be rebutted by means of an abridged effects analysis.[28]

The third main issue to be dealt with is how this approach can take shape within the current normative framework of EU competition law; in other words, which of the two paragraphs of the bifurcated Article 101 TFEU is more appropriate for the suggested substantive assessment of an RPM scheme. Building on contributions by new institutional economics and Professor Lianos' insight, it will be argued that Article 101(1) provides the most appropriate framework for this purpose. It will be argued that the pro-competitive effects of RPM coincide with the specific attributes of full vertical integration: internalisation of horizontal externalities in markets where free riding occurs, prevention of *ex post* opportunistic behaviour where idiosyncratic investments have been made, elimination of double moral hazard and, generally, centralisation of the manufacturer's control over distribution. In light of transaction cost economics, pro-competitive RPM is to be understood as a substitute of hierarchical authority, particularly where it is implemented as a monitoring mechanism of dealer compliance with the rules of long-term distribution contracts governed by relational norms.

3. Methodology

In order for the research questions outlined in the previous section to be addressed, a combination of comprehensive understanding of the law and economics of vertical price

[28] Case C-67/13P, *Groupement des cartes bancaires (CB) v Commission*, decision of 11 September 2014, not yet reported.

fixing is required. A black-letter law approach will be used for the review of the American and European case law on RPM. A more theoretical analysis, legal, economic and historical, will be used for the interpretation of the competition laws of the EU and the US and their application to agreements fixing minimum retail prices.

In addition, the comparative methodology is of central importance for the current research. The thesis will investigate methodically the evolution of the public policy towards RPM in the US and the EU, in order to conclude whether the adoption of a relatively more lenient approach to RPM, inspired by *Leegin's* rule of reason, is feasible under Article 101 TFEU. This comparative approach, however, also has a historical dimension: the purpose of the research is also to shed light on the different legal and economic environments that shaped the antitrust response to RPM in the two jurisdictions. The research will demonstrate the influence exercised by the arguably more mature American antirust experience on the competition law provisions introduced in the Treaty of Rome, as well as on their application to RPM in particular. It will be shown that the existence of different objectives pursued by the respective antitrust regimes could justify a differentiated, more stringent treatment of RPM under the European competition rules. However, it will be argued that the Commission's current policy priorities, as outlined in the recent Vertical Guidelines, appear to curtail the influence of the 'single market imperative' on EU competition policy, by placing subtle, yet obvious, emphasis on economic efficiency considerations.

Economic analysis will be of paramount importance. Vertical price fixing will be analysed not only through the lens of neoclassical economics, which focuses exclusively on price and output, but also from the perspective of new institutional economics. New institutional economics traces its origins in Ronald Coase's seminal paper 'The Nature of the Firm',[29] which explains the reasons for the emergence of the firm as an organisational structure and explores how its boundaries are defined, but has been further elaborated by the work of Oliver Williamson, who applied transaction cost analysis to interpret the interactions between economic units in light of economic actors' bounded rationality and their propensity for opportunistic behaviour.[30] By contrast to neoclassical economics,

[29] RH Coase, 'The Nature of the Firm' [1937] 4 *Economica* 386.
[30] See, eg, OE Williamson, 'Assessing Vertical Market Restrictions: Antitrust Ramifications of the Transaction Cost Approach' [1978-1979] 127 *U Pa L Rev* 953; OE Williamson, 'Economics and Organization: A Primer' [1996] 38 *Cal Mgmt Rev* 131; OE Williamson, 'The Logic of Economic Organization' [1988] 4 *JL Econ & Organ* 65; OE Williamson, 'The Vertical Integration of Production: Market Failure Considerations' [1971] 61 *Am Econ Rev* 112; OE Williamson, 'Markets and Hierarchies: Some Elementary Considerations' [1973] 63 *Am Econ Rev* 316; OE Williamson, *Markets and Hierarchies:*

which regards the firm as a production function, new institutional economics approaches it as a governance mechanism. Where the use of the market is more appealing with a view to economising on transaction costs, this governance mechanism may be replicated by means of vertical restraints, implemented with 'the purpose and effect of infusing order into a transaction where the interests of the system and the interests of the part are otherwise in conflict'.[31]

4. Structure of the Thesis

The first Chapter of this thesis will explore the origins of the prohibition against vertical price fixing, both in the US and the EU. The chapter will start by examining the RPM cases decided by English courts at the beginning of the 20th century. English courts were the first to be faced with a considerable body of RPM litigation and, in adjudicating the relevant cases, they appear to have prioritised freedom of contract over freedom of trade. The Sherman Act was designed by US Congress as a common law statute and, although economic considerations – the horizontal collusion theory in particular – partially influenced the *Dr Miles* dictum, the Supreme Court nevertheless did not sever the ties with the common law precedent, relying also on the ancient common law doctrine against restraint on alienation. The chapter will follow the evolution of US case law on RPM by presenting the most influential Supreme Court decisions until *Monsanto* and *Business Electronics*, the two last landmark cases of the per se era. Although a vertical non-price case, *Sylvania* will also be discussed as a milestone of Sherman Act litigation: in *Sylvania* the Supreme Court not only started eroding the per se rule for vertical restraints, but also heralded a new era of effects-based analysis in antitrust with far reaching implications which went beyond the narrow field of vertical restraints. The non-economic considerations that proved to be controversial in the *Leegin* case, namely the majority's decision to depart from the principle of *stare decisis* will also be presented. Then the focus will shift to EU competition law. The chapter will analyse the influence of the US

Analysis and Antitrust Implications (The Free Press 1975); OE Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting* (The Free Press 1985).

[31] OE Williamson, 'Transaction Cost Economics' in C Ménard and M Shirley (eds), *Handbook of New Institutional Economics* (Springer 2005), p 55

experience on the shaping of the European competition rules in general and the public policy towards RPM under Article 101 TFEU in particular. The stringent treatment of RPM in the EU will also be partially attributed to the single market imperative. It will be argued, however, that currently RPM is singled out as the most harshly treated vertical restraint, something which cannot be adequately explained by any integrationist objectives. Consequently, assuming an agreement on substantive economics, the question as to whether the adoption of a less rigid approach to RPM through the adaptation of the *Leegin* rule to the legal framework of Article 101 TFEU will be answered in the affirmative.

Chapter 2 will focus on the economics of distribution. After discussing the pro- and anti-competitive theories associated with RPM, the chapter will explore the nature of the firm, and look into the EU law of merger control with regard to vertical concentrations. It will be argued that, from the perspective of new institutional economics, vertical integration merely constitutes a paradigm. Against this background, and regardless of whether vertical integration is achieved through ownership – namely by merger – or by contractual means – namely long-term transactions reinforced with vertical restraints – the principle of organisational neutrality advocates for a more consistent treatment where a vertical merger, on the one hand, and price floors, on the other, are intended to economise on transaction costs associated with the centralisation of the manufacturer's control over the distribution chain.

Chapter 3 will explore the horizontal collusion objection to RPM, arguably the most prominent theory of harm associated with price floors. The analysis will stress the relevance of the source of the restraint to the competitive assessment thereof: as demonstrated by Professor Comanor,[32] and acknowledged subsequently by the majority in *Leegin*, price floors imposed at the behest of a powerful retailer or a number of retailers possessing substantial monopoly power are more likely to bring about a decrease in output, thus posing a greater threat for consumer welfare. Some relevant cases from the other side of the Atlantic, both older and more recent will also be discussed. Following the presentation of the Chicago school criticism of the cartel theory, the welfare implications of the emergence and expansion of online retailing will be examined. It will be argued that the e-marketplace is a far cry from being the manifestation of 'friction-free capitalism' that pioneers in computer sciences had foreseen. Examples of restrictive practices specific to the online environment, such as Internet minimum advertised price policies ('iMAP'), dual pricing, and across platform parity agreements ('APPAs') will also be presented to show

[32] WS Comanor, 'The Two Economics of Vertical Restraints' [1992] 21 *Sw U L Rev* 1265, 1273-1274.

how price rigidity in the online context may be reinforced. The chapter will conclude by acknowledging that the horizontal collusion theory is indeed compelling and indicates that a more cautious approach to RPM is warranted. However, it will also be argued that there are yet hardly any empirical studies demonstrating that price floors may be 'unambiguously anti-competitive', and those that are available are of questionable credibility. Against this background, and taking into account the pro-competitive theories discussed in the previous chapter, it will be argued that the optimal antitrust policy would be based on a rebuttable presumption of illegality.

Chapter 4 will investigate the concept of the agreement, focusing on the distinction between collusive and single conduct for antitrust purposes. The single economic entity will be discussed, along with the concept of vertical collusion in the EU and the US. The chapter will also present the classical, neoclassical and relational contract law theories, as developed by the pioneering scholarship of Ian Macneil. These theories are symmetrical to the three organisational forms accepted by new institutional economics, namely markets, hybrids, and hierarchies, respectively. Then the focus will be on the concept of commercial agency, and the analysis will follow the intellectual debate as to its nature as a hybrid or a hierarchy. The chapter will conclude by comparing RPM to two other forms of vertical integration by contract, selective and exclusive distribution. Following an examination of their competitive effects, it will be recognised that they are likely to be less restrictive than price floors, but at the same time it will be argued that they do not always represent interchangeable forms of restricted dealing.

Chapter 5 will discuss the application of Article 101 TFEU to RPM by the Commission, and will review the references for preliminary ruling decided by the Court of Justice. A few more recent decisions from the German and French competition authorities will also be presented. Then, the focus will shift to US antitrust law. The Supreme Court's judgment in *Leegin* will be examined in more detail, as well as the almost automatic reaction of the US Congress and state legislatures. It will be shown that *Leegin*'s rule of reason remains a mystery as to its form and the way it will be applied, as lower courts have not yet provided us with a fully developed body of RPM litigation.

Chapter 6 will criticise the current treatment of RPM under EU competition law, taking into account the contribution both of neoclassical economics and new institutional economics to our understanding of the bifurcation of Article 101 TFEU. More importantly, a new analytical framework for the substantive assessment of vertical price fixing will be suggested. The suggested framework will be based on the traditional classification of RPM as a restriction of competition by object under Article 101(1) and a hardcore restraint under Article 101(3). However, it will be argued that the correct approach is the replacement of the current quasi-conclusive presumption of illegality by a rebuttable presumption of anti-competitive object under Article 101(1). The parties should remain free to rebut the presumption in situations where the long-term contract entered into between them is governed by relational norms and involves the obligation of the members of the distribution system to undertake significant sunk investments. In such cases, the enlarged profit margin is likely to serve as an *ex ante* incentive alignment mechanism designed to limit the possibility of post-contractual opportunism while allowing the manufacturer to economise on the costs of monitoring the network. Under these circumstances, selective distribution may not be a reliable alternative, because in itself it is unable to protect the system from the opportunism of its own members.

The conclusion will summarise the discussion and outline the finding of this analysis.

Chapter 1

The Origins of the Prohibition against Resale Price Maintenance

The purpose of this chapter is to examine the early stages in the evolution of the public policy towards vertical price fixing under Section 1 of the Sherman Act and Article 101 TFEU, by investigating the non-economic considerations behind the prohibition. In the first instance, the chapter will explore the application of the common law doctrine against restraints of trade to RPM by English courts. Emphasis will be placed on the links between the per se treatment under US antitrust law and the common law tradition, given that the Sherman Act was effectively designed as a common law statute. Then, the examination of the evolution of the Supreme Court's case law will observe the passage to a more economics-based approach following *Sylvania*, which effectively heralded the erosion of the rigid per se rule in the field of vertical restraints by severing the ties of antitrust enforcement with the common law precedent.

The focus of the chapter will then shift to the examination of the ban on RPM under Article 101 TFEU. Following the investigation of the influence exerted by the American antitrust tradition in the shaping of EU competition law, it will be seen that the Treaty of Rome came into force at a time when the antitrust response to RPM under the national legal orders of various European states was characterised by a remarkable inconsistency, ranging from unequivocal permissiveness to utter hostility. In addition to underlining the undisputable influence of a considerably more mature jurisdiction, it will be argued that another credible justification for the blanket prohibition introduced by the Treaty was of a non-economic nature, being associated with the EU single market imperative promoted by the constitutional framework of the EU Treaties. The chapter will conclude by observing that, despite the initial contribution of integrationist considerations to the stringent public policy towards RPM, the current treatment of the practice should be understood primarily through the lens of economic analysis, in light the recent Vertical Guidelines and the case law of the CJEU.

1.1. The Treatment of RPM under English Common Law

The first considerable body of RPM litigation was developed under English common law. The first relevant case was *Elliman Sons & Co v Carrington & Son Ltd*[1] decided in 1901. Elliman was a company active in the production of embrocation for horses and cattle and sold its products to the wholesalers on the condition that the latter were not to resell the goods below a specified price. The wholesalers also undertook to procure a similar signed agreement from every retailer which they supplied. The defendant company failed to enter into a price fixing agreement with a specific retailer, which eventually sold the goods for less than the stipulated price. Elliman then filed a lawsuit, claiming the damages that it suffered as a result of Carrington's failure to comply with its contractual obligations. The defendant argued that the agreement in question was unenforceable as it constituted an obvious restraint of trade, since its object was 'to prevent the sale of this article to the public at a fair price regulated in the ordinary way by the laws of supply and demand'.[2]

The court, however, disagreed, and upheld the price fixing agreement. According to Kekewich J, '[i]t is said that it is in restraint of trade. In one sense it is, but it is just as much and no more in restraint of trade for Ellimans to say that they will not sell at all … [W]hat is restraint of trade as regards Carrington & Son is really the liberty of trade as regards Ellimans'.[3] Similarly, the Judge rejected the defendant's argument that the agreement was against public policy:

> It is said that the contract is against public policy; but that phrase merely embodies, for the present purpose, the great principle of restraint of trade, and to say that it is to prevent Messrs. Elliman from exercising their own discretion seems to me to be applying a well-settled principle of law to facts to which it cannot have any possible application.[4]

Two years later, in *Taddy & Co v Sterious & Co*,[5] the court dealt with the question enforceability of a vertical price fixing agreement upon subsequent purchasers. At issue was whether a price-cutting retailer could be sued for breach of contract, even though it

[1] [1901] 2 Ch 275.
[2] Ibid, 277.
[3] Ibid, 279.
[4] Ibid.
[5] [1904] 1 Ch 354.

had not entered into any form of agreement, either directly or indirectly, with the manufacturer, but had instead purchased the goods from a wholesaler. The defendant claimed *inter alia* that the price fixing scheme was in restraint of trade, and that *Elliman* was inconsistent with earlier case law.[6] The court, nevertheless, held that the crucial issue was whether there was indeed a contract that could be held to be binding upon the retailer, and focused instead on the conceptual distinction between agents and independent distributors. This was the main question to be answered, since '[i]f there was a breach of contract, the plaintiffs could no doubt sue'.[7]

Subsequently, in *Dunlop Pneumatic Tyre Co v New Garage and Motor Co,*[8] the enforceability of vertical price fixing agreements was confirmed. The question at issue in this case was whether the stipulated payment in case of breach of contract on the part of the dealer was a 'penalty' or 'liquidated damages'. The plaintiff was a manufacturer of tyres and had entered into an agreement with the defendant by virtue of which the latter would not sell Dunlop products to any private customers or co-operative society at prices lower that those stipulated by the manufacturer. In case the distributor failed to comply with this arrangement, it would be liable to pay liquidated damages to Dunlop for every unit sold in breach of the agreement. The Privy Council held that, due to the uncertain nature of the damage caused and the fact that it could not be accurately sustained, the payment was to be regarded as liquidated damages, having been stipulated as a 'pre-estimate of the appellants probable or possible injuries in due performance of the contract'.[9]

The tolerant approach taken under English common law to RPM continued in the late 1920s, at a time when the harsh treatment thereof under Section 1 of the Sherman Act was already established – and further refined, through the *Colgate* exception.[10] In 1928, in *Palmolive Company (of England), Limited v Freedman,*[11] the Court of Appeal reiterated that an agreement fixing the wholesale price of toilet soaps was not in general restraint of trade. Lord Hanworth MR, stressed the importance of a larger profit margin in view of 'the

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[6] Ibid, 357.
[7] Ibid, 358. See also decision of the Court of Appeal in *McGruther v Pitcher* [1904] 2 Ch 306, where the Court, based on *Taddy & Co v Sterious & Co* held that a condition as to the resale price cannot, in the absence of agreement, be imposed on a subsequent purchaser, even though he bought the goods with notice of the condition.
[8] [1915] AC 79.
[9] Ibid, 96.
[10] In *United States v Colgate & Co*, 250 US 300 (1919), the US Supreme Court held that Section 1 of the Sherman Act was not applicable in the case of a supplier who terminated a distributor in response to the latter's refusal to comply with resale prices fixed unilaterally by the supplier.
[11] [1928] Ch 264.

necessary expenses either of the wholesaler or the retailer in conducting business, especially in relation to an article that has still to establish itself firmly in the market'.[12] Besides, His Lordship continued, the product in question is 'only one of many proprietary soaps and ... in the keen competition between them ... to speak of extortion from the public with regard to it is a little better than absurdity'.[13]

Furthermore, Lawrence LJ, in his own concurring opinion, seemed to grasp the significance of market power in the finding of anti-competitive vertical price fixing, since, as he pointed out, 'it is not as if the plaintiffs had acquired control of the whole or of a substantial part of the output of some indispensable commodity ... and were endeavouring to force the members of the public to pay higher prices for goods which they were practically compelled to purchase'.[14] His Lordship further argued that it is generally not expected that parties to such agreements fix unreasonable prices, since this would be detrimental to their commercial interests in the context of a competitive market.[15] In light of these assumptions, the court found for the plaintiff and upheld the RPM arrangement.

The aforementioned cases show beyond any doubt that the main concern of English courts when applying the doctrine against restraints of trade was not the promotion of undistorted competition. It would instead be more accurate to conclude that, towards the end of the 19th and in the first decades of the 20th century, common law prioritised freedom of contract over freedom of trade. This was also confirmed most emphatically by Watson, LJ in the landmark *Nordenfelt* case: 'it must not be forgotten that the community has a material interest in maintaining the rules of fair dealing between man and man. It suffers far greater injury from the infraction of these rules than from contracts in restraint of trade'.[16]

This approach to restrictive covenants was in fact the result of a more general lack of interest in the protection of the competitive order, which characterised the British industry at the turn of the century. The way in which the courts construed the definition of 'reasonableness' and applied the rule of reason test proposed in *Nordenfelt*, which required that restraints on trade be reasonable with regard to the interest both of the contracting parties and the public, showed that competition was not regarded as a matter of public policy. The basic implication of this attitude was the rule that, unless they were obviously

[12] Ibid, 277.
[13] Ibid.
[14] Ibid, 282.
[15] Ibid.
[16] *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co* [1894] AC 535, 552.

illegal, all contracts were in principle enforceable.[17] At the same time however, it was clear that contract law could not be relied upon for the protection of effective competition: common law had adopted an extremely tolerant view towards not only RPM, but also even towards hardcore cartels, such as those upheld unanimously by the House of Lords in *Mogul Steamship*[18] and by the Privy Council in *Attorney-General of Australia v Adelaide Steamship Co*.[19]

1.2. The Common Law Tradition and US Antitrust Law

1.2.1. *Dr Miles* and the Per Se Ban on RPM

The examination of the development of the common law doctrine against restraints of trade in the previous paragraphs was deemed necessary for two main reasons. First, because the Sherman Act was promulgated as a common law statute, based on a set of established concepts and intended to be interpreted flexibly. Senator John Sherman himself, in a speech before the Senate, stated that the bill 'does not announce a new principle of law, but applies old and well-recognized principles of the common law to the complicated jurisdiction of our Senate and Federal Government'.[20] Second, because it demonstrates the extent to which the subsequent application of the Sherman Act to RPM agreements deviated from its legal background and moved towards a more economics-based approach.

Vertical price fixing initially encountered the permissive attitude of American courts.[21] Thorelli observes that, prior to the enactment of the Sherman Act in 1890, no such schemes had been held unlawful.[22] In *Fowle v Park*,[23] for example, a case decided the previous year, the US Supreme Court dealt with an exclusive distribution agreement concerning a patented medicine. The agreement provided that the parties shall enjoy a

[17] PS Atiyah, *The Rise and Fall of Freedom of Contract* (Clarendon 1979), p 697.
[18] *Mogul Steamship Co v McGregor, Gow & Co* [1892] App Cas 25, 36.
[19] [1913] AC 781.
[20] 21 March 1890, 21 *Congressional Record* 3: 2457, 2456.
[21] The first reported case dealing with an RPM agreement was *Clark v Frank*, 17 Mo App 602 (1885).
[22] HB Thorelli, *The Federal Antitrust Policy: Origination of an American Tradition* (Allen & Unwin 1955), p 48.
[23] 131 US 88 (1889).

monopoly of the sale of the medicine, each within a defined region in the United States, and stipulated a specific price below which the medicine should not be sold. In upholding the restrictive clauses, the Court confirmed that they were reasonable and, therefore, lawful:

> The vendors were entitled to sell to the best advantage, and in so doing to exercise the right to preclude themselves from entering into competition with those who purchased, and to prevent competition between purchasers, and the purchasers were entitled to such protection as was reasonably necessary for their benefit.[24]

The next RPM case that reached the Supreme Court, and the first under the new Act, was the seminal *Dr Miles Medical Co v Park & Sons Co*.[25] The plaintiff, a manufacturer of proprietary medicines prepared on the basis of secret processes, had established an extensive distribution network in the context of which it was fixing the resale prices of both its wholesalers and retailers. Dr Miles brought a lawsuit against a discount retail druggist, arguing that the latter's pricing strategy resulted in the medicines being sold as 'loss leaders': systematic price-cutting was injurious to its business, having an adverse impact on the reputation of and, ultimately, demand for the medicines. At issue was essentially the distributor's practice of seeking to obtain the medicines at discounted prices by inducing certain contracting parties to violate the restrictions imposed by the manufacturer. The lawsuit brought by Dr Miles was therefore alleging malicious interference with a contract between two parties,[26] and thus essentially concerned an infringement not of Section 1 of the Sherman Act, but of business tort law.[27] The plaintiff argued that, since a manufacturer was under no obligation either to produce or to sell its products, it followed that it should be free to stipulate the retail prices.

1.2.1.1. Majority Opinion

In rejecting the complainant's assertions, the US Supreme Court held that an agreement fixing the resale price of the products in question amounted to a restraint of trade, and was thus void and unenforceable both at common law and under Section 1 of the

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[24] Ibid, 97.
[25] 220 US 373 (1911).
[26] Ibid, 394.
[27] SE Lee, 'Price Fix Away?: Does the Supreme Court's Decision in *Leegin Creative Leather Products* Strengthen the Ability of Businesses to Engage in Vertical Price Restraints with Impunity?' [2008] 8 *Pitt J Tech L & Pol'y* 1, 24.

Sherman Act. In order to reach this conclusion, the Court's argumentation – 'an overstuffed cookbook of common-law recipes to mediate tensions between competition and property rhetorics' –[28] was essentially based on two elements: the common law doctrine against restraints on alienation, and the ability of RPM to bolster collusion in the downstream market.

The Court's starting point in deciding the case was, surprisingly, not the competition concerns raised by price fixing agreements, which only came into play later in the judgment. In fact, throughout the decision there is hardly any reference to the Sherman Act as the statutory framework.[29] Instead, the Court placed more emphasis on the issue of Dr Miles' property rights in the products concerned. Mr Justice Hughes, writing for the majority, took the view that that the imposition by the manufacturer of any sort of restrictions upon purchasers constituted an illegal restraint upon alienation. In essence, the Court's rationale was based on Judge Lurton's opinion in *John D Park & Sons v Hartman*,[30] an earlier RPM case in which the Court of Appeals for the Sixth Circuit delivered the first relevant decision 'to rest unabashedly upon alienation principles':[31]

> [t]he right of alienation is one of the essential incidents of a right of general property in movables, and restraints upon alienation have been generally regarded as obnoxious to public policy, which is best subserved by great freedom of traffic in such things as pass from hand to hand. General restraint in the alienation of articles, things, chattels, except when a very special kind of property is involved, such as a slave or an heirloom, have been generally held void. 'If a man', says Lord Coke, in Coke on Littleton, section 360, 'be possessed… of a horse or of any other chattel, real or personal, and give or sell his whole interest or property therein, upon condition that a donee or vendee shall not alien the same, the same is void, because the whole interest and property is out of him, so as he hath no possibility of a

[28] RJR Peritz, *Competition Policy in America: History, Rhetoric, Law* (rev edn, Oxford University Press 2001), p 53.
[29] In fact, the case at hand did not originate as an antitrust action and, naturally, Section 1 of the Sherman Act did not constitute the legal basis for Dr Miles' lawsuit. Instead, the plaintiff sought equitable relief by invoking the doctrine against malicious interference with a contract between two parties; 220 US 373, 394-395.
[30] 153 F 24 (6th Cir 1907).
[31] CP Rogers III, 'Restraints on Alienation in Antitrust Law: A Past with no Future' [1995-1996] 49 *SMU L Rev* 497, 503.

reverter, and it is against trade and traffic and bargaining and contracting between man and man.'.[32]

By invoking the doctrine against restraints on alienation, Justice Hughes' analysis was essentially premised on the assumption that vertical price fixing restricts competition insofar as it constitutes an unlawful interference with a third party's property rights. In other words, according to Hughes' interpretation, the restrictive nature of RPM derives from the act of determining the price of someone else's property. This is a right that nobody other than the property owner himself may exercise.[33]

Justice Hughes justified the Court's willingness to embrace Judge Lurton's opinion and prohibit the vertical price fixing agreement at hand based on the rule against restraints on alienation stating that '[w]ith respect to contracts in restraint of trade, the earlier doctrine of the common law has been substantially modified in adaptation to modern conditions'.[34] Inevitably, however, the Court's reliance on an ancient doctrine for the purposes of condemning a modern business practice led an American scholar to observe that '[i]t does seem possible that the nineteenth and twentieth centuries have contributed legal conceptions growing out of new types of business which make it inappropriate for Justices Lurton and Hughes to base their sweeping overthrow of contemporary commercial policies on judicial views of the reign of Queen Elizabeth'.[35] In other words, and contrary to Hughes' assertion, the Court's argumentation failed to consider that the evolution of commercial practices also requires the respective adjustment of the law to the needs of the contemporary business environment.[36]

Antitrust considerations came into play only after it was established that the manufacturer had retained no property rights in the medicines. The Court then cited the rule formulated by Lord McNaghten in the leading English case of *Nordenfelt v Maxim Nordenfelt Co*, according to which, in order for a restrain to be upheld, it must be found to

[32] 153 F 24, 39, quoted in 220 US 373, 404-405. By the time of the hearing of the *Dr Miles* appeal, Lurton had already been appointed to the Supreme Court. However, he did not participate in the consideration and decision of the case; ibid, 409.
[33] RJ Peritz, 'A Genealogy of Vertical Restraints Doctrine' [1988-1989] 40 *Hastings LJ* 511, 519.
[34] 220 US 373, 406.
[35] Z Chafee, 'Equitable Servitudes on Chattels' [1927-1928] 41 *Harv L Rev* 945, 983.
[36] In an English judgment delivered two years after *Dr. Miles*, Lord Philimore expressed the exact opposite opinion: '[p]rice maintenance agreements are modern things and are strange to those who have been brought up on the older lines, but they are in almost universal commercial use and it would be a scandal if they could not be enforced', *Dunlop Pneumatic Tyre Co v Selfridge & Co*, [1913] 29 TLR 270. It should be noted, however, that, although recognising the importance of the adaptation of the law to contemporary commercial trends, His Lordship's statement should also be rejected as equally formalistic.

be reasonable with regard to the interest of both the contracting parties and the public.[37] Mr Justice Hughes stressed the importance of the compatibility of a restrictive agreement with public policy when applying Lord McNaghten's test: 'agreements or combinations between dealers, having for their sole purpose the destruction of competition and the fixing of prices, are injurious to the public interest and void. They are not saved by the advantages which the participants expect to derive from the enhanced price to the consumer'.[38]

According to Justice Hughes, a vertical price fixing agreement imposed by the manufacturer upon its dealers is in no way different from a horizontal collusive arrangement in the downstream market. Besides, in both cases it is the dealers that benefit from an increase in the price of the products concerned, and not the manufacturer: 'the complainant can fare no better with its plan of identical contracts than could the dealers themselves if they formed a combination and endeavored to establish the same restrictions, and thus to achieve the same result, by agreement with each other'.[39] Any increased profits resulting from the downstream firms' compliance with the stipulated prices would only benefit them and not the manufacturer. But even if we assume, Hughes continued, that the agreement could be in any way beneficial also for the manufacturer, this still would not be sufficient to justify its detrimental effect upon consumers, namely the increase in the resale prices. Based on these considerations, the agreement was declared 'injurious to the public interest and void'.[40]

Professor Hay asserts that the Court's rationale in *Dr Miles* suggested a general rule which went beyond the mere condemnation of RPM, and proscribed any vertical restraints, irrespective of their form, which produce effects equivalent to those of horizontal collusion.[41] The horizontal collusion objection to RPM will be explored in more detail in Chapter 3.

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[37] *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co* [1894] AC 535.
[38] 220 US 373, 408.
[39] Ibid, 408.
[40] Ibid, 407-408.
[41] GA Hay, 'Vertical Restraints after *Monsanto*' [1984-1985] 70 *Cornell L Rev* 418, n 13. The Court's refusal to apply the per se rule to territorial and customer restrictions in its subsequent *White Motor* decision severely undermined this reasoning. Mr Justice Clark's dissenting opinion, however, was entirely consistent with the spirit of *Dr Miles*; see *White Motor Co v United States*, 372 US 253, 282 (1963).

1.2.1.2. Dissenting Opinion

In a powerful dissent, Mr Justice Holmes pointed out that the majority's primary mistake was that their conclusion was 'reached by extending a certain conception of public policy to a new sphere': assuming, for instance, that the right of an artist to impose a minimum resale price upon the purchaser of one of his creations would generally be accepted, it would be normal for a similar restraint on the alienation of a manufacturer's products to be upheld.[42] It would be wrong to suggest that the application of the doctrine is dependent upon the quantity of the articles that constitute the object of a certain contract.

The basic antitrust concern raised by the agreement was that it operated in the context of a network of similar arrangements which were perceived as having 'the object of fixing a general market price'. In Justice Holmes' view, however, the manufacturer could achieve the very same result merely by appointing the downstream firms as agents, rather than independent retailers, thus retaining title to the goods until they reached end users.[43] Having implicitly argued that a price-maintaining manufacturer should be considered as 'acting within his right', Holmes took the position that 'the most enlightened judicial policy is to let people manage their own business in their own way, unless the ground for interference is very clear'.[44] In his view, the contribution of intrabrand competition to the establishment of a 'fair price' had been exaggerated; instead what could ensure such a fair price was 'the competition of conflicting desires'[45] or, in microeconomic terms, the elasticity of demand.[46] In light of interbrand rivalry, the manufacturer was by assumption in a better position to determine its policy in the most efficient way possible; therefore '[w]e must assume its retail price to be reasonable'.[47]

The antitrust implications of the rule against inalienability reveal that in *Dr Miles* the Supreme Court, by placing more emphasis on form than substance, prioritised the protection of the dealer's freedom to compete with its rivals over the promotion of the competitive process; and in order for this freedom to be exercised effectively, the dealer's property rights must be left unrestricted following the transfer of title in the goods.[48] It is important to note at this point that this rule does not introduce an outright ban on all restraints on alienation. Its application presupposes a separate assessment of the

[42] 220 US 373, 411 (Justice Holmes, dissenting).
[43] Ibid, 411.
[44] Ibid.
[45] Ibid, 412.
[46] RJ Peritz, *supra* n 33, 526
[47] 220 US 373, 412.
[48] CP Rogers III, *supra* n 31, 498 and 506.

reasonableness of the restriction in question: the interests of the property owner should be balanced against the purpose for which the inalienability of that property was imposed.[49] It is, for example, common for courts to enforce restraints on the alienation of land, where these restraints are held reasonable with regard both to the contracting parties and to the public. One such case is the restriction imposed on the purchaser of land not to use it in a way that would impede the vendor's use of the adjoining land.[50]

In fact such restrictions constitute servitudes, namely limitations on the use of property which are imposed upon transfer of title and have been recognised and upheld at common law since the seminal *Tulk v Moxhay* case, in which restrictive covenants that run with the land were declared enforceable in equity.[51] In a study published in 1928, Professor Chafee examined whether similar servitudes may be created on chattels and argued that property law may have to be adapted to the complexities of present-day business, given that

> the strictly legal situation corresponds inadequately with the practical situation. Actually, the manufacturer by his advertising and other commercial devices has brought the consumers into a direct relation with himself. He is trying to make them buy *his* product, and they think of themselves as buying *his* product. Legally, it ceased to be owned by him some time before it reaches them, for he is separated from them by a succession of sales through wholesalers and retailers.[52]

According to Chafee, any transfers of title are incidental, and irrelevant to any loss in consumer welfare resulting from the elimination of price competition between dealers. Irrespective of the dealers' classification as either resellers or agents, any restrictions (servitudes) running with the goods along the distribution chain are designed to facilitate control over their transfer from the manufacturer to consumers. Chafee, therefore, questions the applicability of the inalienability rule to vertical relationships in general, where 'the alienation is seen to be of a limited character'.[53]

The rule against restraints on alienation was subsequently invoked by the Supreme Court in *Schwinn*, a case involving both territorial and customer restrictions.[54] In declaring

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[49] M Handler, 'The Twentieth Annual Antitrust Review – 1967' [1967] 53 *Va L Rev* 1667, 1684-1685.
[50] See PA Sayre, 'Maintenance of Resale Prices' [1926-1927] 6 *Or L Rev* 241, 244.
[51] [1848] 41 ER 1143.
[52] Z Chafee, *supra* n 35, 947 (emphasis in original).
[53] Ibid, 987-995. A more recent study on the interplay between the law of servitudes and public policy towards RPM can be found in GO Robinson, 'Personal Property Servitudes' [2004] 71 *U Chi L Rev* 1449.
[54] *United States v Arnold, Schwinn & Co*, 388 US 365 (1967).

the per se illegality of vertical non-price restraints, the Court reiterated its reliance on property law principles. The Court's opinion was delivered by Mr Justice Fortas who, citing *Dr Miles* as an authority, noted that

> it is unreasonable without more for a manufacturer to seek to restrict and confine areas or persons with whom an article may be traded after the manufacturer has parted with dominion over it… to allow this freedom… would violate the ancient rule against restraints on alienation and open the door to exclusivity of outlets and limitation of territory further than prudence permits.[55]

The Court, nevertheless, conceded that any territorial and customer restraints imposed by a manufacturer which retained ownership and risk were to be assessed under the rule of reason.[56]

The Supreme Court eventually severed the ties of antitrust enforcement with property logic in its *Sylvania* decision, which re-introduced the rule of reason analysis for vertical non-price restraints.[57] In overruling *Schwinn*, the Court endorsed Mr Justice Stewart's dissenting comment regarding the applicability of the inalienability rule to restrictive agreements: 'the state of the common law 400 or even 100 years ago is irrelevant to the issue before us: the effect of the antitrust laws upon vertical distributional restraints in the American economy today'.[58] Despite substantially undermining the *Dr Miles* rationale, the Court hesitated to extend the rule of reason standard to all types of vertical restraints, and approved the per se illegality of RPM arguing that there are 'significant differences that could easily justify different treatment'.[59] More specifically, the Court's attempt to draw a distinction between RPM and market division was based on two arguments: the ability of price restrictions to facilitate collusion, and the recent repeal of the Fair-Trade Acts by the Congress.[60]

[55] Ibid, 379-380.
[56] Ibid, 381-382.
[57] *Continental TV, Inc v GTE Sylvania, Inc*, 433 US 36 (1977).
[58] Ibid, fn 21, quoting 388 US 365, 392.
[59] Ibid, fn 18.
[60] Ibid. See also RA Posner, 'The Rule of Reason and the Economic Approach: Reflections on the *Sylvania* Decision' [1977-1978] 45 *U Chi L Rev* 1, 7-9, criticising the Court's argumentation.

1.2.2. Restraints of Trade and the Sherman Act: The Interpretation of an Old Rule and a New Statute

The interpretation of the Sherman Act and its links to the common law tradition presented a challenge for the American courts in the first years after the promulgation of the statute. More specifically, in the early Section 1 cases the courts focused on whether the Act constituted a mere codification of the common law doctrine against restraints of trade or whether it aimed, as its very wording dictated, at the prohibition of *every* restrictive arrangement. The latter was the interpretation favoured by the US Supreme Court in the *Trans-Missouri* case.[61] The period of antitrust 'literalism' initiated by Mr Justice Peckham's opinion in *Trans-Missouri* was brought to an end by the teleological construction later embraced by Judge William Howard Taft who, sitting on the Court of Appeals for the Sixth Circuit, reconsidered the influence of the common law tradition on the interpretation and application of the Sherman Act in the *Addyston Pipe* case.[62]

The case involved six manufacturers of cast-iron pipes who had formed an association with the purpose of rigging bids for the sale of pipes (mainly to municipalities) in various designated territories in the United States. Certain territories were assigned to a specific manufacturer which was protected from all competition from the others, whereas in other territories, a committee set up by the cartelists was awarding the bid to the manufacturer that agreed to pay the highest bonus to the treasury of the association. The Government filed a lawsuit against the manufacturers, but the district court found for the defendants holding that, although the arrangement at hand did in fact restrict competition, it did not violate Section 1 as it only had an indirect effect on interstate commerce.[63]

On appeal the decision was reversed. The defendants attempted to establish that the arrangement did not fall within the scope of the Sherman Act and not only claimed that the fixed prices were reasonable, but also produced affidavits whereby their customers essentially confirmed that these prices were in fact satisfactory. Judge Taft, however, rejected the defendants' assertions as to the reasonableness of the restraints in question and

[61] *United States v Trans-Missouri Freight Association*, 166 US 290 (1897).
[62] *United States v Addyston Pipe & Steel Co et al*, 85 Fed 271 (6th Cir 1898).
[63] *United States v Addyston Pipe & Steel Co et al*, 78 Fed 712 (CCED Tenn 1897). The trial court based its judgment on the Supreme Court's decision in *United States v EC Knight Co et al*, 156 US 1 (1895). In *Knight*, the first antitrust case to reach the Supreme Court after the passage of the Sherman Act, it was held that where a contract in restraint of trade was only limited to the manufacture of a commodity and not its sale, it would be held to affect interstate commerce only indirectly and would, thus, escape the application of the Sherman Act. It should be noted at this point that the trial court delivered the *Addyston Pipe* decision only a month before *Trans-Missouri Freight Association* was decided by the Supreme Court; it is, therefore, not surprising that the court relied on the interpretation that was prevailing at the time of the judgment.

delivered an acclaimed opinion which has been described as 'at least as important as some of the leading decisions of the Supreme Court'.[64] Firstly, he observed that all types of restraints which had been traditionally upheld under common law were merely ancillary to an otherwise legitimate contract, and were also necessary for the protection of the interests of the contracting parties.[65] As long as it was established that a restriction attached to a lawful contract was 'necessary to protect the covenantee in the enjoyment of the legitimate fruits of the contract, or to protect him from the dangers of an unjust use of those fruits by the other party', that restriction would be regarded by the courts as enforceable;[66] for the purpose of such clauses is not to reduce competition, but to secure 'the seller against an increase of competition of his own creating'.[67] Regarding the case at hand '[t]here is ... no main lawful purpose, to subserve which partial restraint is permitted, and by which its reasonableness is measured, but the sole object is to restrain trade in order to avoid the competition which it has always been the policy of the common law to foster'.[68] Eventually, Judge Taft overruled the district court's decision, and his reasoning was upheld unanimously by the Supreme Court.[69]

Judge Taft, therefore, re-established the links between the Sherman Act and the common law tradition and rejected Justice Peckham's opinion that Section 1 went beyond common law in that in prohibited *every* contract in restraint of trade. However, Taft's analysis undermines the Supreme Court's decision in *Dr Miles*. It was seen in the previous section that under English common law vertical price fixing was not only lawful, but also enforceable. The enforceability of RPM clauses was established in the *Elliman* case in 1901, whereas in *Dunlop v New Gara*ge it was only the nature of the stipulated payment for breach of contract that was disputed, and not the enforceability of the RPM clause itself. In was not until after the first half of the 20th century – and only through state legislation – that this rule was repealed in England.

Professor Bork approaches the interrelation between the two decisions through a different lens. It is noteworthy, he observes, that Justice Hughes 'failed to ask whether the manufacturer's interest in eliminating competition between its distributors could be related

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[64] HB Thorelli, *supra* n 22, p 468.
[65] 85 Fed 271, 280-282.
[66] Ibid, 282.
[67] Ibid, 281. Letwin suggests that Judge Taft's opinion regarding the enforceability of ancillary restraints at common law, should be read as rejecting the views of many scholars that common law prioritised freedom of contract over freedom of trade; in fact, common law defended equally both the transferability of property and the freedom to compete; W Letwin, *Law and Economic Policy in America: The Evolution of the Sherman Antitrust Act* (Edinburgh University Press 1967), pp 174-175.
[68] 85 Fed 271, 283.
[69] 175 US 211 (1899).

to a valid main purpose capable of legitimating the contracts'. In other words, Hughes ignored the 'ancillary restraints' doctrine formulated in *Addyston Pipe*, despite the clear indication that it was also applicable to vertical restraints.[70] At least in principle, there was room for an inquiry into the possible ancillary nature of the RPM scheme at issue, in view of the 'loss leadership' concerns put forward by Dr Miles. Peritz, on the other hand, maintains that the Court's focus on the question of property rights implied a tacit rejection of the applicability of the doctrine to the case at hand. Since the title in the goods had been transferred to the dealers, the manufacturer retained no property rights to which the restraint was attached; the restraint was, therefore, primary and not ancillary.[71] In essence, *Dr. Miles* introduced a much broader prohibition than the common law precedent, disputing the reasonableness of RPM schemes altogether, and effectively prohibiting *every* agreement fixing minimum resale prices.[72]

Of course, one cannot fail to observe that, when listing the restrictive provisions that had traditionally been upheld by English courts as ancillary to legitimate contracts, Judge Taft omitted to include RPM as one of them. Indeed, according to Taft's research,

> covenants in partial restraint of trade are generally upheld as valid when they are agreements (1) by the seller of property or business not to compete with the buyer in such a way as to derogate from the value of the property or business sold; (2) by a retiring partner not to compete with the firm; (3) by a partner pending the partnership not to do anything to interfere, by competition or otherwise, with the business of the firm; (4) by the buyer of property not to use the same in competition with the business retained by the seller; and (5) by an assistant, servant, or agent not to compete with his master or employer after the expiration of his time of service.[73]

The first thing to note is that Judge Taft himself admitted that the above list of permissible restraints was not exhaustive: '[i]t would be stating it too strongly to say that these five classes of covenants in restraint of trade include all of those upheld as valid at the common law'.[74] But in reality, the explanation for the exclusion of vertical price fixing from this list

[70] RH Bork, 'The Rule of Reason and the Per Se Concept: Price Fixing and Market Division' (Part I) [1964-1965] 74 *Yale LJ* 775, 810-811. See also RH Bork, *The Antitrust Paradox: A Policy at War with Itself* (Simon & Schuster 1993), pp 32-33.
[71] RJ Peritz, *supra* n 33, 524-525.
[72] Compare AM Kales, 'The Sherman Act' [1918] 31 *Harv L Rev* 412, 416.
[73] 85 Fed 271, 281.
[74] Ibid, 282.

is fairly simple: the leading *Elliman* case, in which RPM was upheld as lawful at common law was only decided three years after Taft delivered his opinion in *Addyston Pipe*.

This late appearance of RPM cases before English courts is by no means surprising. Vertical price fixing, by contrast to all other restrictive covenants dealt with at common law, is a fairly recent commercial practice. It was virtually unheard of prior to the last quarter of the 19th century, and it emerged in the context of a broader restructuring of the distributive patterns throughout the British industry. The new methods of distribution, which included the emergence of retail outlets suitable to stock large quantities of mass-produced goods, were introduced in response to the increased consumer demands and the overall improved living standards of the British society brought about by the wealth created by the Industrial Revolution.[75] It was a period of fierce price competition at the retail level, during which the newly established large-scale outlets were able to benefit from their cost advantages in order to offer more attractive prices to consumers. In addition to their substantial cost-savings as a result of economies of scale and scope, large retailers also relied on innovative methods of marketing, such as advertising and branding of merchandise: although mostly undertaken by manufacturers, these new techniques also simplified and facilitated retail trade by reducing the need for specialised personnel, whereas they also contributed to the further expansion of large outlets, which eventually were transformed into 'universal providers'. But as competition was driving prices lower, the smaller retailers' profit margins were getting tighter. It was therefore under these economic conditions that RPM appeared at the turn of the century; at the request of small-scale outlets, manufacturers – which were otherwise willing to grant discounts to large purchasers – began to stipulate the resale prices of their goods in order to improve the competitive position and ensure the survival of their less competitive rivals.[76] Consequently, the emergence and expansion of RPM schemes as a response to the needs of a very specific class of dealers who saw their interests threatened by the new trends in the distribution of goods in the wake of the consumer society explains the lack of any common law precedent on vertical price fixing prior to *Addyston Pipe*.

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[75] PS Atiyah, *supra* n 17, pp 572-574.

[76] On the economic developments in Britain in the late 19th and early 20th century that led to the adoption of vertical price fixing by various manufacturers, see BS Yamey, 'The Origins of Resale Price Maintenance: A Study of Three Branches of Retail Trade' [1952] 62 *Econ J* 522.

1.3. RPM under Section 1 of the Sherman Act – The 'Per Se' Era

1.3.1. General

The *Dr Miles* judgment[77] was in its essence the result of an unlikely combination of economic and non-economic considerations. While the contribution of ancient common law principles to the shaping of the public policy towards RPM in the US has probably been exaggerated by subsequent commentators – as the dealer cartel theory invoked by the Court reflected an exceptionally likely scenario –[78] there is no doubt that the freedom of contract was one of the two fundamental intellectual bases for the decision. As was discussed earlier, the Court's decision has been criticised for placing disproportionate emphasis on the non-competition effects of RPM – which is particularly evident in the property logic underpinning the judgment – on the basis that they do not provide a sound theoretical support for per se treatment.[79] As will be seen in Chapter 3, however, the rule of per se illegality against price floors is to be understood in light of its horizontal effects.

Nevertheless, the legacy of *Dr Miles* survived for almost a century, having been consistently confirmed by subsequent decisions, even though its application was restricted. It was not until 2007 in *Leegin*[80] that the Supreme Court adopted the rule of reason for the appraisal of RPM agreement overruling the per se ban established by *Dr Miles*. It also put an end to what has been described as a 'schizophrenic legal regime',[81] established by the latter decision in conjunction with the Court's subsequent ruling in *United States v Colgate & Co*.[82]

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[77] *Dr Miles Medical Co v John D Park & Sons Co,* 220 US 373 (1911).
[78] See *infra* ch 3.
[79] See, eg, RJ Peritz, *supra* n 33; TA Lambert, '*Dr. Miles* is Dead. Now What?: Structuring a Rule of Reason for Evaluating Minimum Resale Price Maintenance' [2008-2009] 50 *Wm & Mary L Rev* 1937, 1942, fn 13.
[80] 551 US 877 (2007).
[81] KG Elzinga and T Baker, 'The Belated but Welcome Demise of Dr. Miles: Why the Court's Decision on Vertical "Price Fixing" is Good Law, Good Economics, and Good for Consumers' [2008] 4 *Competition L Int'l* 4, 4.
[82] 250 US 300 (1919).

1.3.2. The 'Per Se' Era in the Aftermath of *Dr Miles* – From *Colgate* to *Business Electronics*

Consistent with the logic behind *Dr Miles*, in 1926 in *United States v General Electric Co*[83] the Supreme Court reiterated its adherence to the property logic underpinning its earlier decision. At issue in *General Electric*, according to Judge Taft, was 'the question whether the sales are by the company through its agents to the consumer, or are in fact by the company to the so-called agents at the time of consignment'.[84] In introducing the consignment exception, the Court held that the per se ban on RPM does not apply to agreements whereby the manufacturer, instead of transferring title in the goods to a reseller, merely disposes of its articles to consumers through agents. Satisfied that the manufacturer retained ownership of the goods concerned, the Court recognised the manufacturer's right to stipulate the prices to be charged by the consignees for its products holding that the antitrust laws had not been violated.[85]

However, the first significant erosion of *Dr Miles* had already been introduced seven years earlier in *United States v Colgate & Co*.[86] Colgate was alleged to have been coercing its distributors to adhere to fixed resale prices by threatening that it would cease supplying them if they failed to do so. Based on the district court's finding that there had been no agreement between the parties, and thus Section 1 had not been violated, the Supreme Court stated that

> [i]n the absence of any purpose to create or maintain a monopoly, the act does not restrict the long recognised right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to the parties with whom he will deal. And, of course, he may announce in advance the circumstances under which he will refuse to sell.[87]

In other words, the Court took the position that a manufacturer's refusal to deal with a price-cutter did not warrant antitrust intervention: it merely constituted an exercise of an individual economic actor's right independently to choose its customers. It has thus been argued that the rationale behind the *Colgate* doctrine was the recognition of an independent, substantive right by virtue of which the manufacturer was immune from

[83] 272 US 476 (1926).
[84] Ibid, 485.
[85] Ibid, 488.
[86] 250 US 300 (1919).
[87] Ibid, 306-307.

antitrust liability, even where the requirements set by the *Dr Miles* precedent were satisfied.[88] The Colgate doctrine was subsequently narrowed by a line of decisions, which resulted in a strong debate between commentators with regard to its applicability.[89]

In *United States v Parke, Davis & Co,*[90] the most notable of its decisions that limited the scope of the *Colgate* doctrine, the Supreme Court construed the concept of 'unlawful combination' broadly, holding that in order for a violation of Section 1 to be established, no showing of explicit or tacit contractual arrangement is required. Instead, the existence of such a combination may also be substantiated where 'the producer secures adherence to his suggested prices by means which go beyond his mere declination to sell to a customer who will not observe his announced policy.[91] On the basis of this assumption the Court established a test according to which 'when the manufacturer's actions … go beyond mere announcement of his policy and the simple refusal to deal, and he employs other means which effect adherence to his resale prices … he has put together a combination in violation of the Sherman Act'.[92] The main implication of *Parke, Davis & Co* is that manufacturers were prohibited from applying coercive means in order to enforce retailer compliance with RPM schemes. Four years later, in *Simpson*[93] – perhaps unfairly described as 'one of the most dishonest opinions of all time in a field with many serious contenders'[94] – the Court reinforced the per se ban on RPM by effectively overruling the consignment exception established in *General Electric* almost forty years earlier.[95]

The following two RPM cases, *Monsanto*[96] and *Business Electronics*,[97] were discussed in the aftermath of the Supreme Court's landmark decision in *Sylvania*[98] which established the rule of reason standard for the treatment of vertical territorial restraints, thus creating an artificial normative inconsistency corresponding to the price/non-price

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[88] TA Baker, 'Interconnected Problems of Doctrine and Economics in the Section One Labyrinth: Is *Sylvania* a Way Out?' [1981] 67 *Va L Rev* 1457, 1476-1477. The inconsistent treatment of RPM in these early cases has been criticised by Posner: 'It is hard to believe that *Colgate* and *General Electric* would have been decided the way they were if the Court had had a define opinion as to what is wrong (or right) with resale price maintenance'; RA Posner, 'Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions' [1975] 75 *Colum L Rev* 282, 288-289.
[89] See, eg, R Pitofski and KW Dam, 'Is the Colgate Doctrine Dead?' [1967-1968] 37 *Antitrust LJ* 772, 774; TA Baker, *supra* n 88, 1477-1478.
[90] 362 US 29 (1960).
[91] Ibid, 43.
[92] Ibid, 44.
[93] *Simpson v Union Oil Co of California*, 377 US 13 (1964).
[94] WF Baxter, 'The Viability of Vertical Restraints Doctrine' [1987] 75 *Ca L Rev* 933, 935.
[95] For a thorough analysis of the Supreme Court's decision in *Simpson*, see RJ Peritz, 'A Genealogy of Vertical Restraints Doctrine' [1988-1989] 40 *Hastings LJ* 511, 532-537.
[96] *Monsanto Co v Spray-Rite Service Corp*, 465 US 752 (1984).
[97] *Business Electronics Corp v Sharp Electronics Corp*, 485 US 717 (1988).
[98] *Continental TV, Inc v GTE Sylvania, Inc*, 433 US 36 (1977).

dichotomy.[99] Interestingly, the Department of Justice filed an *amicus curiae* brief inviting the *Monsanto* Court to reconsider the per se illegality of RPM.[100] At issue in *Monsanto* was whether an unlawful vertical price fixing conspiracy could be inferred from termination following competitor complaints. Mr Justice Powell, delivering the Court's unanimous opinion, acknowledged the efficiency-enhancing potential of vertical restraints, and took the position that, in order for a violation of Section 1 to be substantiated, 'there must be evidence that tends to exclude the possibility that the manufacturer and nonterminated distributors were acting independently'.[101] More specifically, the plaintiff should demonstrate that the manufacturer and its distributors 'had a conscious commitment to a common scheme designed to achieve an unlawful objective'.[102] In addition to reviving the *Colgate* doctrine, the Court's decision is noteworthy in that, despite confirming the per se treatment of RPM, it nonetheless recognised that the economic effects of all types of vertical restraints are 'in many, but not all, cases similar or identical'.[103] The scope of the per se rule was narrowed even further in *Business Electronics*, where the Court held that an arrangement between a manufacturer and a dealer to terminate a discounting retailer does not warrant per se treatment 'unless it includes some agreement on price and price levels'.[104] Acknowledging the potential of price floors to facilitate and enforce cartelisation, Mr Justice Scalia, who delivered the opinion of the Court, justified the majority's conclusion arguing that a cartel's inherent instability implied that, in the absence of such an agreement on specific prices, the cartelists retained their incentive to cheat.[105]

1.3.3. The Fair-Trade Acts

The legal framework shaped by *Dr Miles* was not unanimously well-received by industry. Two classes of economic actors, in particular, saw the ban on vertical price fixing as a direct threat to their commercial interests. On the one hand, RPM was valuable to manufacturers which, concerned with the impact of price-cutting on consumer demand for their products, sought either to maintain their brand image or to prevent low-cost dealers

[99] See *infra*, section 5.4.3.
[100] 465 US 752, 761, fn 7.
[101] Ibid, 764.
[102] Ibid, quoting Judge Aldisert's opinion in *Edward J Sweeney & Sons, Inc v Texaco, Inc*, 637 F2d 105, 111 (1980).
[103] 465 US 752, 762.
[104] 485 US 717, 735-736.
[105] Ibid, 727.

from taking a free ride on their full-service rivals' sales efforts. In addition, small independent retailers also favoured RPM schemes, which allowed them to compete more effectively against large-scale chain stores.[106] Rising concerns over the growth of large retail chains and discount outlets had inspired a 'rhetoric of fairness and competition on equal terms', which was further complemented by the theory on the potentially adverse effects of 'ruinous competition' on both business and consumers.[107]

In response to the industry's political pressure, in 1931 the state of California promulgated the first statute effectively legalising RPM agreements and, within the next five years, thirteen other states followed suit.[108] In the wake of the Supreme Court's *Old Dearborn* decision which upheld the constitutionality of the fair-trade acts,[109] their number increased to forty-two. Against this background, the Congress passed the Miller-Tydings Amendment to the Antitrust Laws in 1937.[110] Under the Miller-Tydings Amendment, the prescription of minimum prices for the resale of trademarked, branded or identified products was declared lawful when applied to intrastate transactions, on the condition that it was also authorised by the relevant laws of the state concerned. In the *Schwegmann* case,[111] the Supreme Court construed the exemption introduced by the Miller-Tydings Act as limited to RPM agreements entered into on a consensual basis,[112] and quashed a Louisiana statute which provided for the enforceability of the relevant clauses not only against parties to a contract, but also against non-signers. The Congress responded the following year by promulgating the McGuire Act, which amended Section 5(a) of the Federal Trade Commission Act, and extended the scope of the fair-trade exemption to cover both signer and non-signer clauses affecting interstate commerce.[113]

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[106] RC Schragger, 'The Anti-Chain Store Movement, Localist Ideology, and the Remnants of the Progressive Constitution, 1920-1940' [2004-2005] 90 *Iowa L Rev* 1011, 1064-1069. Peritz, on the other hand, notes that the Congressional intent behind the passage of the Miller-Tydings Act was to protect small manufacturers who lacked the financial resources necessary for the consignment of their products to retailers; see RJR Peritz, *Competition Policy in America: History, Rhetoric, Law* (rev edn, Oxford University Press 2001), pp 153-156.
[107] RC Schragger, *supra* n 106, 1065-1066.
[108] For a account of the history and judicial enforcement of the Fair-Trade Acts, see Notes, 'The Operation of Fair-Trade Programs' [1955-1956] 69 *Harv L Rev* 316; CH Fulda, 'Resale Price Maintenance' [1953-1954] 21 *U Chi L Rev* 175; TR Overstreet, *Resale Price Maintenance: Economic Theories and Empirical Evidence* (FTC Bureau of Economics Staff Report, Nov 1983).
[109] *Old Dearborn Distributing Co v Seagram-Distillers Corp*, 299 US 183 (1936).
[110] 50 Stat 693, 15 USC §1 (1937).
[111] *Schwegmann Bros v Calvert Distillers Corp*, 341 US 384 (1951).
[112] Ibid, 387-390.
[113] 66 Stat 631, 15 USC §45 (1952).

The Miller-Tydings and McGuire Acts were eventually repealed by the Consumer Goods Pricing Act of 1975,[114] by which time almost half of the states had already abolished fair trade.[115] However, for a period of almost four decades, the Fair-Trade Acts created a legal environment most favourable towards RPM, which provided valuable empirical evidence regarding the occurrence of the practice. On the basis of estimates by several researchers, Overstreet observed that, even in the fair-trade era, vertical price fixing schemes were scarce: 'no more than one percent of manufacturers, accounting for no more than ten percent of consumer goods purchases, ever employed RPM in any single year in the US'.[116] Overstreet's statement was subsequently quoted by Mr Justice Kennedy in *Leegin*, in support of the Supreme Court's decision to overrule the per se ban on RPM.[117]

1.3.4. The Turning Point – The Supreme Court's *Sylvania* Decision

The rule of reason standard for all vertical non-price restraints was finally established in *Continental TV, Inc v GTE Sylvania, Inc*,[118] arguably one of the landmark antitrust decisions of the US Supreme Court which overruled the short-lived per se treatment introduced in *Schwinn*.[119] Sylvania was a manufacturer of television sets with insignificant market power (no more than 2 percent). Initially, it was selling its products to wholesale distributors who, in turn, were reselling them to various retailers. In order to improve its market position following a decline in its market share to the aforementioned levels, Sylvania switched to a selective distribution system and began selling its television sets directly to a group of selected retailers, each of whom, according to the new marketing strategy, was required to sell only from a specified location. Eventually, the strategy bore fruit and, three years following its adoption, Sylvania's market share rose to 5 percent.

Even though Sylvania retained sole discretion to increase the number of retailers in a specific area – thus no exclusive territories were created – Continental, a very successful franchised retailer in San Francisco, objected to Sylvania's decision to appoint a second retailer in the same city. In addition, Sylvania rejected Continental's request to open a store in Sacramento, which was already served by the local dealers. After Continental cancelled a large order and placed it with one of Sylvania's competitors, Sylvania terminated the

[114] 89 Stat 801 (1975).
[115] TR Overstreet, *supra* n 108, p 5, fn 4.
[116] Ibid, p 169.
[117] *Leegin Creative Leather Products, Inc v PSKS, Inc*, 551 US 877, 907 (2007).
[118] 433 US 36 (1977).
[119] *United States v Arnold, Schwinn & Co*, 388 US 365 (1967).

franchise agreement and Continental filed a claim alleging that the manufacturer's policy was restricting intrabrand competition and was, therefore, violating Section 1 of the Sherman Act. The district court, interpreting *Schwinn* strictly, ruled in favour of the plaintiff; but the Court of Appeals for the Ninth Circuit reversed, holding that an analysis under the rule of reason would be more appropriate, since the restrictions imposed by Sylvania had limited potential for anti-competitive effects and, thus, the case was sufficiently distinguishable from *Schwinn*.

However, on appeal, the Supreme Court rejected this distinction, on the ground that both cases involved clauses which limited the ability of the retailer to dispose of the contract goods as he desired.[120] It then stressed the complex market impact of vertical restraints which is associated with 'their potential for a simultaneous reduction of intrabrand competition and stimulation of interbrand competition'.[121] In a famous – and fiercely criticised – footnote, however, the Court distinguished the antitrust response to vertical price restraints and justified the stringent treatment thereof on the basis of their ability to facilitate horizontal collusion, as well as on the recent repeal of the Fair Trade Acts by the Congress.[122]

The Court naturally acknowledged that the location clauses at issue restricted competition between retailers; at the same time, however, they presented significant 'redeeming virtues' capable of offsetting this reduction of intrabrand competition 'by allowing the manufacturer to achieve certain efficiencies in the distribution of his product'.[123] Among the efficiency-enhancing effects of vertical non-price restraints, as cited by Mr Justice Powell, were the facilitation of new entry, the provision of product-specific promotional services, and the elimination of the free rider problem.[124] In light of these assumptions, the Court overruled the per se rule established in *Schwinn*, relying on its famous dictum in the earlier *Northern Pacific* case:[125] 'there has been no showing in this case ... that vertical restrictions have or are likely to have a "pernicious effect on competition", or that they "lack ... any redeeming virtue"'.[126] Heralding the turn towards a more economic approach to restricted dealing, Justice Powell concluded by noting that any departure from the rule of reason, as the prevailing analytical standard under Section 1,

[120] 433 US 36, 45-46.
[121] Ibid, 51.
[122] Ibid, at fn 18.
[123] Ibid, 54.
[124] Ibid, 55.
[125] *Northern Pacific Railway Co v United States*, 356 US 1 (1958).
[126] 433 US 36, 57-58.

should be justifiable on the grounds of demonstrable economic effect and not the result of 'formalistic line drawing'.[127]

Undoubtedly, the most significant contribution of *Sylvania* was that, along with upholding a practice that generated substantial efficiencies, it signalled the Court's departure from the formalistic treatment of vertical non-price restrictions by introducing a genuine effect-based approach. However, the decision had more far-reaching implications, decisively influencing the development of antitrust jurisprudence in general. For example, the impact of Sylvania on the public policy towards RPM is apparent in the Supreme Court's subsequent decisions in *Monsanto* and *Business Electronics*, which substantially limited the scope of the per se prohibition. Notwithstanding the criticism as to the actual relevance of the *Sylvania* rhetoric to the adjudication of these cases,[128] there can be no misunderstanding that these judgments were delivered by Justices familiar with the pro-competitive justifications for restricted dealing, which are generally applicable both to price and non-price restraints. It is, however, noteworthy that in *Business Electronics*, Mr Justice Scalia, writing for the majority, relied on *Sylvania* in endorsing the cartel theory as providing support for the stricter normative response to RPM.[129]

It has been pointed out that the impact of *Sylvania* extended beyond the field of vertical restraints, influencing also the antitrust response to various types of horizontal arrangements. More specifically, the Supreme Court in *NCAA*[130] and *Indiana Federation of Dentists*[131] followed the rationale of *Sylvania* to establish that 'horizontal restraints may be deemed reasonable if they enable a consortium of producers to more effectively differentiate their product from those of others'.[132] As a general proposition, *Sylvania* is a turning point in antitrust adjudication under Section 1. Although not involving an RPM agreement, the decision undoubtedly paved the way – initially – for the gradual erosion of

[127] Ibid, 59.
[128] It needs to be reminded at this point that *Monsanto* and *Business Electronics* effectively heightened the evidentiary standard for proof on antitrust conspiracy in cases where price-cutting retailers are terminated following complaints by their rivals. Naturally, a discounter's termination may very well be a measure to ensure the viability of a downstream cartel. Against this background, the relevance of a purely vertical case as *Sylvania* is rather questionable. For a relevant discussion, see ME Roszkowski, 'The Sad Legacy of *GTE Sylvania* and Its "Rule of Reason": The Dealer Termination Cases and the Demise of Section 1 of the Sherman Act' [1989-1990] 22 *Conn L Rev* 129.
[129] *Business Electronics Corp v Sharp Electronics Corp*, 485 US 717, 725 (1988).
[130] *National Collegiate Athletic Association v Board of Regents of the University of Oklahoma*, 468 US 85 (1984).
[131] *FTC v Indiana Federation of Dentists*, 476 US 447 (1986).
[132] KN Hylton, *Antitrust Law: Economic Theory and Common Law Evolution* (Cambridge University Press 2003), pp 266-267. See also MM Blecher, 'The Impact of *GTE Sylvania* on Antitrust Jurisprudence' [1991-1992] 60 *Antitrust LJ* 17, 22-24 and IS Sacks and HR Silvera, 'A Return to Reason for Price Restraints' [1995-1996] 24 *Hofstra L Rev* 1069, 1090-1092.

the per se rule against vertical price fixing and – ultimately – for *Leegin*, which is premised both implicitly and explicitly upon the same intellectual basis.

1.3.5. Non-Economic Considerations in *Leegin*: *Stare Decisis* and the Rule of Reason

In *Leegin*,[133] the Supreme Court completed the economics revolution in antitrust jurisprudence by endorsing the rule of reason as the appropriate standard for the substantive assessment of all types of vertical restraints. Since the efficiency-enhancing potential of RPM was generally acknowledged in economic theory, the Court took the position that the 'doctrinal underpinnings' of *Dr Miles* had been undermined, thus warranting the abolition of the judicial precedent.[134]

That said, non-economic considerations played more than just a marginal part in the adjudication of *Leegin*. The disagreement between the opinion of the majority and that of the dissenting Justices in this five-to-four decision concentrated *inter alia* on the issue of *stare decisis*, namely the law of precedent. In the words of the Supreme Court, *stare decisis* 'promotes the evenhanded, predictable, and consistent development of legal principles, fosters reliance on judicial decisions, and contributes to the perceived integrity of the judicial process'.[135] In pursuit of judicial predictability, *stare decisis* may occasionally favour consistency over soundness, reflecting 'a policy judgment that in most matters it is more important that the applicable rule of law be settled that it be settled right'.[136]

As has already been seen earlier in this chapter,[137] the Sherman Act was not intended to go beyond the mere codification of well established common law principles. This was also evident in the early judicial practice following the promulgation of the Act. In introducing flexibility in the interpretation of the otherwise rigid language of Section 1, Judge Taft's celebrated opinion in *Addyston Pipe* relied exclusively on the scholarly examination of English common law precedent.[138] In that sense, the Sherman Act was by its very inception designed to evolve in parallel with common law, under the influence of

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[133] *Leegin Creative Leather Products, Inc v PSKS, Inc*, 551 US 877 (2007).
[134] Ibid, 900.
[135] *Kimble v Marvel Entertainment*, LLC, 576 US (2015), not yet reported.
[136] *State Oil Co v Khan*, 522 US 3, 20 (1997).
[137] See *supra* s 1.2.
[138] *United States v Addyston Pipe & Steel Co et al*, 85 Fed 271 (6th Cir 1898).

contemporary intellectual developments.[139] Delivering the opinion of the majority in *Leegin*, Mr Justice Kennedy acknowledged that antitrust law was not intended to be codified in a static statutory instrument:

> From the beginning the Court has treated the Sherman Act as a common-law statute. Just as the common law adapts to modern understanding and greater experience, so too does the Sherman Act's prohibition on 'restraint[s] of trade' evolve to meet the dynamics of present economic conditions. The case-by-case adjudication contemplated by the rule of reason has implemented this common-law approach.[140]

The dissenting opinion delivered by Mr Justice Breyer largely consisted in a critique of the majority's decision to depart from *stare decisis*. In Breyer's view, the majority's deviation for such a well established principle as the per se ban on vertical price fixing was unwarranted. The case at hand involved the interpretation of a statute, and *stare decisis* had typically been applied more rigidly in statutory than constitutional cases.[141] At the same time, while it was not uncommon for the Court to overrule an erroneous decision delivered 'only a reasonably short time ago', particularly if the dispute was of a constitutional nature, overruling a statutory case which had been decided almost a century ago and had been repeatedly reaffirmed ever since was unprecedented.[142] Even under antitrust law, similar previous cases, such as *State Oil Co v Khan* and *Sylvania*, which abolished the per se illegality of maximum RPM and vertical non-price restraints, respectively, overruled judicial precedents which stood for not nearly as long as *Dr Miles*.[143] Finally, Breyer noted that *Leegin* was in reality at odds with the typical common law 'gradualism': 'Common-law courts rarely overruled well-established earlier rules outright. Rather, they would over time issue decisions that gradually eroded the scope and effect of the rule in question, which might eventually lead the courts to put the rule to rest'.[144]

Despite Mr Justice Breyer's fervent dissent, the Court decided in favour of the departure from *stare decisis* by overruling *Dr Miles*. As a general proposition, the reason for the Court's traditional hesitation to apply the principle to statutory cases appears to be

[139] A Jones, 'Completion of the Revolution in Antitrust Doctrine on Restricted Distribution: *Leegin* and Its Implications for EC Competition Law' [2008] 53 *Antitrust Bull* 903, 919.
[140] 551 US 877, 899 (citations omitted).
[141] Ibid, 923-924.
[142] Ibid, 924.
[143] Ibid, 927-928.
[144] Ibid, 928.

the understanding that Congress is capable of exercising its legislative power in order to quash by statutory means any judicial interpretation of the law which is considered as erroneous.[145] So far, with regard to the lawmakers' response to *Leegin*, any such attempts have failed and the bills brought by Senator Herb Kohl proposing the statutory re-introduction of the per se ban on RPM through the promulgation of the Discount Pricing Consumer Protection Act have died in subcommittees.[146]

1.4. The Law against RPM in Europe – Origins, Legislation and Judicial Practice

1.4.1. Competition Law Crosses the Atlantic

If the per se illegality of RPM in the United States was a result of a broad interpretation of the common law rule against restraints on trade by the Supreme Court, the origins of the hostility against vertical price fixing in the European area are much more obscure. As was seen in the previous section, English common law traditionally upheld contracts fixing resale prices as lawful and enforceable. The British legislator initially hesitated to impose a general ban on RPM agreements and limited the scope of the prohibition under the Restrictive Trade Practices Act 1956 only to networks of agreements entered into between more than one competing suppliers and their dealers. Vertical price fixing agreements were eventually outlawed altogether by the Resale Prices Act 1964.

It was, however, in Germany where the first piece of legislation effectively introducing an outright prohibition on all RPM agreements was enacted. In the zones occupied by the allied forces following Germany's defeat in World War II, the Allied Decartelisation Laws of the American and British Zone of Control of 12 February 1947 constituted an attempt to protect free competition in a country under reconstruction.[147]

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[145] A Jones, *supra* n 139, 918.

[146] See *infra* s 5.2.1.

[147] In the American Zone, Article I of the Military Government Law No. 56 of 12 February 1947, on the Prohibition of Excessive Concentration of German Economic Power, provided that

> 1. [e]xcessive concentrations of German economic power, whether within or without Germany and whatever their form or character, insofar as such concentrations or any part or activity thereof are subject to the jurisdiction of Military government, are prohibited, their activities are declared illegal and they shall be eliminated…

Although not the first statute intended to protect the competitive process,[148] it was interpreted by the Bronson Memorandum of June 21, 1948 as declaring illegal all types of price fixing agreements, both horizontal and vertical. The influence of the US antitrust experience was obvious: the Americans 'simply transplanted' the per se ban on RPM already developed in *Dr. Miles* into the legal order of the occupied territories.[149] The American influence, nevertheless, went beyond the mere drafting of the statutes; in practice, German courts even invoked American authorities when construing and applying the decartelisation laws.[150]

At this point it should be noted that Gerber rejects the assumption that competition laws in continental Europe have been a blind imitation of the Sherman Act. On the contrary, he argues, European antitrust legislation has been a product of the insight of European economic and political thinkers – most notably the ordoliberals of the Freiburg School – and has been developed as a response to the challenges facing the economies of the industrialised European states throughout the late 19th and the first half of the 20th century.[151] Djelic, on the other hand, disagrees and regards the transfer of the American antitrust tradition to the European legal order as part of a broader plan of the United States,

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> 2. Cartels, combines, syndicates, trusts, associations or any other form of understanding or concerted undertaking between persons, which have the purpose or effect of restraining, or of fostering monopolistic control of domestic or international trade or other economic activity, or of restricting access to domestic or international markets are hereby declared to be excessive concentrations of economic power within the purview of this law.

Article V, para 9(c)(1) further stated that the scope of Article I(2) included '[t]he fixing of prices or the terms or conditions in the purchase or sale of any product or thing'; see Military Government Gazette Germany, United States Area of Control, Issue C of 1 April 1947, pp 2-6.
In the British Occupation Zone, the text of the Military Government Ordinance No. 78 of 12 February 1947 was identical; see Military Government Gazette Germany, British Zone of Control, Issue No. 16 of 1947. The respective legislation in force in the French Zone, Ordonnance No. 96, Prohibant Toute Concentration Excessive de la Puissance Économique Allemande, of 9 June 1947, although based on the same rationale, was more concise and merely contained a general prohibition (Article 1), without further clarifying what constitutes a 'restriction or regulation of competition'. Accoding to Article 5 of the Ordinance, '[s]eront soumises à examen de la part du Commandant en Chef ... toutes ententes commerciales, industrielles ou financières conclues entre des enterprises juridiquement indépendantes ou des groupements d' enterprises et ayant pour but de limiter ou règlementer la concurrence'; Journal Officiel du Commandement en Chef Français en Allemagne, No. 78 of 13 June 1947, pp 784-785. In France, at that time, in the absence of specific antitrust legislation, resale price maintenance was caught by Article 419 of the Penal Code. The illegality of RPM was confirmed five years later by Law No. 52-835 of 18 July 1952. For a more detailed discussion on the treatment of RPM in France, see *infra*, section 2.3.2.3.

[148] The first German antitrust statute – and, in fact, the first of its kind in Europe – was the, largely ineffective, Cartel Regulation of 1923 (Verordnung gegen Missbrauch Wirtschaftlicher Machtstellungen of November 2, 1923); see DJ Gerber, *Law and Competition in Twentieth Century Europe: Protecting Prometheus* (Oxford University Press 1998), pp 115-136, and H Kronstein and G Leighton, 'Cartel Control: A Record of Failure' [1945-1946] 55 *Yale LJ* 297.

[149] W Moeschel, 'Vertical Price Fixing: Myths and Loose Thinking' [2013] 34 *ECLR* 233, 233-234.

[150] PD Schapiro, 'The German Law against Restraints of Competition – Comparative and International Aspects, Part One' [1962] 62 *Colum L Rev* 1, 4.

[151] DJ Gerber, *supra* n 148, p 3. Specifically with regard to the evolution of German competition law, Gerber understates the influence of the decartelisation laws on the shaping of the German Law against Restraints of Competition of 27 July 1957; ibid, pp 269-270.

which had just come out of World War II in a position of geopolitical and economic superiority, to reshape the European industry and modernise the pattern of trade using the American model as a point of reference. In this context,

> [i]n the period following 1945, there were two main paths for the transfer to Europe of the American antitrust tradition and oligopolistic understanding of competition. One was through Germany and the American Military Occupation Government in that country played there a significant role. The other was through the emerging European institutions.[152]

Djelic further argues that it was under American pressure that the first competition rules with a cross-border dimension were introduced by the Treaty on the European Coal and Steel Community (hereinafter 'ECSC Treaty') in 1951.[153] Whether this is true or not, it is in any event not surprising that the founding members of the ECSC relied on a group of American experts for the drafting of the respective provisions. The most prominent among them was Robert Bowie, formerly a professor of antitrust law at Harvard, who was at the time working as a legal counsel to the US High Commission for Germany. Bowie, who had also been involved in the drafting of the German anti-cartel legislation, was assisted in this task by antitrust specialists based in Washington who, unofficially, reviewed and gave their feedback on the draft provisions. These deliberations culminated in the introduction of Articles 65[154] and 66 into the ECSC Treaty: the former outlawed collusive agreements, while the latter set the framework for merger control and prohibited the abuse by 'public or private enterprises' of their dominant position on the market. These provisions, in addition to their historical significance as the first step towards the creation of a European competition regime, also served as the basis for the drafting of Articles 85 and 86 of the Treaty of Rome establishing the European Economic Community.[155]

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[152] ML Djelic, 'Does Europe Mean Americanization? The Case of Competition' [2002] 6 *Competition & Change* 233, 243.
[153] Ibid, 244.
[154] Article 65(1) of the ECSC Treaty – which is of interest for the purposes of the present thesis – provided that:

> All agreements between undertakings, decisions by associations of undertakings and concerted practices tending directly or indirectly to prevent, restrict or distort normal competition within the common market shall be prohibited, and, in particular, those tending:
> (a) To fix or determine prices;
> (b) To restrict or control production, technical development or investment;
> (c) To share markets, products, customers or sources of supply.

[155] Following the Treaty of Amsterdam in 1997, Articles 85 and 86 became Articles 81 and 82 of the Treaty on the European Union and, subsequently, Articles 101 and 102 of the Treaty on the Functioning of the European Union, after the Lisbon Treaty in 2007.

1.4.2. The Antitrust Treatment of RPM in Europe – National Competition Laws prior to the Treaty of Rome

By the time of the enactment of the Treaty of Rome only half of the founding Member States – Germany, France and the Netherlands – had already adopted some form of antitrust legislation. Similarly, reasonably effective competition statutes had been introduced in the United Kingdom and Sweden. The following paragraphs will underline the remarkable differences in the normative response to vertical price fixing in these jurisdictions, and will reveal the absence of a consistent pattern in the treatment of the practice under national competition laws. A more thorough presentation and analysis of the antitrust treatment of RPM under the competition statutes of a number of European jurisdictions will be outlined in the Appendix of this thesis.

In Germany, the main legal instrument was the Law against Restraints of Competition of 27 July 1957 (hereinafter 'GWB'),[156] which remains, as amended, the normative framework for the legal treatment of anti-competitive conduct in Germany to the present day. Section 15 of the GWB, as originally enacted, declared void and unenforceable any agreements restricting a party's freedom to determine its own prices or terms in contracts concluded with third parties. The rigidity of the prohibition against RPM was nevertheless mitigated by Section 16 which, by way of derogation, excluded from the scope of the prohibition any agreements fixing the resale prices of branded goods, as well as RPM schemes in the book publishing sector. Section 16(4) stipulated that, in order for RPM agreements concerning branded goods to become effective, they should be registered with the newly-established competition authority, the *Bundeskartellamt* (Federal Cartel Office). It was not until 1973 that a blanket prohibition on RPM was introduced by a new law amending the GWB.[157]

The French Ordinance No. 45-1483 (hereinafter 'the Price Ordinance'),[158] as amended by Decree No. 53-704,[159] dealt with RPM in Article 37 thereof. Article 37(4) of the Price Ordinance prohibited price fixing agreements entered into by an individual manufacturer or distributor, as well as by professional associations, but also provided that

[156] Gesetz gegen Wettbewerbsbeschränkungen [1957] 41 *Bundesgesetzblatt I* 1081, 1081-1103

[157] Zweites Gesetz zur Änderung des Gesetzes gegen Wettbewerbsbeschränkungen vom 3. August 1973 [1973] 64 *Bundesgesetzblatt I* 917, 917-929. The favourable treatment of the publishing sector was nevertheless maintained under the new legislation.

[158] Ordonnance No. 45-1483 du 30 juin 1945 relative aux prix, *JORF* 8 juillet 1945, rectificatif *JORF* 21 juillet et 8 septembre 1945.

[159] Décret No. 53-704 du 9 août 1953 relatif au maintien ou au rétablissement de la libre concurrence industrielle et commercial, *JORF* 10 août 1953.

exemptions could be granted, for a limited period of time only, in the case of RPM agreements having as their subject matter innovative goods or services, or products exploited under the exclusive rights of patent, licence or registered design, or requiring specifications such as guarantee of quality, or an initial advertising campaign. Despite the availability of exemptions, the treatment of RPM effectively amounted to a 'per se' prohibition. It should be noted, however, that the rationale behind the stringent treatment of RPM under the Price Ordinance did not appear to be premised on efficiency considerations. Instead, the primary objectives of the French lawmakers were the protection of large-scale retailers, as well as the fight against inflationary pressures which were prevalent across Europe in the first post-war years.[160]

In the Netherlands, the Economic Competition Law of 1956[161] did not initially deal with vertical price fixing agreements. The ban on vertical price fixing was introduced for the first time in 1964, but it concerned exclusively collective RPM, namely agreements where 'the supplier of the products is not free to determine prices independently of third parties'.[162] Later that year, the prohibition was extended to individual RPM agreements involving durable consumer goods such as radios, television sets, cars, cameras and household appliances. A general prohibition on all vertical price fixing schemes was eventually adopted in 1991, in the context of broader reforms in the Dutch antitrust policy.

At the same time, two later entrants, the United Kingdom and Sweden, had also promulgated antitrust legislation which expressly addressed the issue of vertical price fixing. In the United Kingdom, the Restrictive Trade Practices Act, 1956 drew a distinction between individual RPM, on the one hand, and the collective enforcement of resale price conditions, on the other: while recognising the individual manufacturer's freedom to maintain and enforce the price at which its products were to be sold,[163] the 1956 Act declared unlawful any collaboration among two or more competing manufacturers regarding the enforcement of the fixed resale prices.[164] The general prohibition on vertical price fixing was introduced into the British legal order by the Resale Prices Act 1964, which accordingly abolished the distinction between individual and collective RPM.

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[160] For a discussion on the conditions that shaped the antitrust treatment of vertical restraints in France, see F Jenny, 'French Competition Policy in Perspective' in WS Comanor *et al* (eds), *Competition Policy in Europe and North America: Economic Issues and Institutions* (Harwood Academic Publishers, 1990), pp 154-156.
[161] Wet Economische Mededinging, of 28 June 1956 / 16 July 1958.
[162] J Sperling, 'Dutch Public Competition Law is Shaping Up' [1994] 22 *Int'l Bus Law* 405, 407.
[163] Restrictive Trade Practices Act, 1956, s 25(1).
[164] Ibid, s 24(1)

At the same time, the public policy towards vertical price fixing in Sweden was particularly harsh. Under the Swedish Law against Restraints of Competition of 1953, RPM, along with collusive tendering, were the only two restrictive practices which were expressly prohibited and treated as 'per se' illegal, while they were also subject to criminal sanctions. RPM was in fact treated as an ordinary crime and was prosecuted in the regular criminal courts by the public prosecutor, following a recommendation by the Competition Ombudsman.[165]

1.4.3. RPM and the 'Effect on Trade' Criterion of Article 101(1) TFEU

In order to be caught by Article 101(1), a restrictive agreement must be capable of having an appreciable effect on trade between Member States. The standard test developed by the CJEU requires that 'it must be possible to foresee with a sufficient degree of probability on the basis of a set of objective factors of law or of fact that the agreement in question may have an influence, direct or indirect, actual or potential, on the pattern of trade between Member States'.[166] According to the Commission, the effect on trade requirement is an autonomous, jurisdictional criterion which must be assessed separately in each case.[167] In *Hugin*, the CJEU held that this requirement is to be construed in light of the specific objectives pursued by EU law:

> The interpretation and application of the condition relating to effects on trade between Member States contained in Articles [101] and [102] of the Treaty must be based on the purpose of that condition which is to define, in the context of the law governing competition, the boundary between the areas respectively covered by Community law and the law of the Member States. Thus Community law covers any agreement or any practice which is capable of constituting a threat to freedom of trade between Member States in a manner which might harm the attainment of the objectives of a single market between the Member States, in particular by

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[165] Lag om motverkande i vissa fall av konkurrensbegränsning inom näringslivet, of 25 September 1953 (*SFS* 1953:603).
[166] Case 56/65, *Société Technique Minière v Maschinenbau Ulm* [1966] ECR 235, 249.
[167] Commission Notice – Guidelines on the effect on trade concept contained in Arts 81 and 82 of the Treaty [2004] OJ C101/81, para 12 (hereinafter 'Guidelines on the effect on trade concept').

partitioning the national markets or by affecting the structure of competition within the common market.[168]

Within the constitutional framework of the EU Treaties, in other words, the jurisdictional criterion is effectively reinforced with a substantive value. The ‘effect on trade’ criterion of Article 101(1) does not imply that only agreements which restrict trade between Member States fall within the scope of the provision. In *Consten and Grundig*, the CJEU held that ‘the fact that an agreement encourages an increase, even a large one, in the volume of trade between States is not sufficient to exclude the possibility that the agreement may “affect” such trade in the abovementioned manner’.[169]

In various cases involving vertical price fixing arrangements,[170] the Commission found that the RPM clauses under investigation affected inter-State trade by exercising influence on the patterns of trade flows between the Member States concerned. These findings were subsequently incorporated in the Commission’s Guidelines on the effect on trade concept.[171] The fact that the agreements under scrutiny frequently also provided for the prohibition of parallel imports lead the Commission to the conclusion that the combined restraints were intended to reinforce each other, thus contributing to the partitioning of the internal market.[172]

In an early study on EU competition law, Deringer drew attention to the likelihood that RPM agreements involving goods distributed in several Member States may indirectly affect inter-State trade by creating artificial barriers between the States concerned. This may be the result of price differentials between the affected States, namely in cases where ‘the resale price in these States is not fixed or is not fixed at the same (comparable) level’.[173] According to the Guidelines on the effect on trade concept, however, similar concerns are raised by agreements implemented in a single Member State:

> Agreements involving RPM may also affect patterns of trade in much the same way as horizontal cartels. To the extent that the price resulting from RPM is higher than

[168] Case 22/78, *Hugin Kassaregister AB and Hugin Cash Registers Ltd v. Commission* [1979] ECR 1869, para 17.
[169] Joined Cases 56 and 58/64, *Établissements Consten Sarl and Grundig-Verkaufs-GmbH v Commission* [1966] ECR 299, 341.
[170] See *infra*, ch 5.
[171] Paras 72 and 88.
[172] See, eg, *Gerofabriek* [1977] OJ L16/8; COMP/37.975 *PO/Yamaha*, decision of 16 July 2003, not published but available at the DG COMP website.
[173] Arved Deringer, *The Competition Law of the European Economic Community: A Commentary on the EEC Rules of Competition (Arts 85–90) Including the Implementing Regulations and Directives* (Commerce Clearing House, Inc. 1968), paras 145 and 151.

that prevailing in other Member States this price level is only sustainable if imports from other Member States can be controlled.[174]

That said, it should also be noted that neither version of the Commission's Vertical Guidelines reveals that RPM is in any way perceived as a potential – even indirect – threat to market integration. The lists of possible adverse effects of RPM, as laid down in paragraphs 112 and 224 of the Commission's 2000[175] and 2010 Guidelines on Vertical Restraints, respectively, make no reference to RPM as a means to achieve the fragmentation of the internal market. There is, however, no doubt that, in making the competitive assessment of vertical restraints under Article 101(1), the Commission will take into consideration not only their welfare effects, but also their compatibility with the 'single market imperative'. The current Vertical Guidelines reiterate the relevance of EU competition law – and particularly its application to vertical restraints – to market integration as a policy priority: '[a]ssessing vertical restraints is also important in the context of the wider objective of achieving an integrated internal market … Companies should not be allowed to recreate private barriers between Member States where State barriers have been successfully abolished'.[176] Paragraph 100 of the Guidelines further includes the 'creation of obstacles to market integration' in the list of the likely negative effects of vertical restraints.

This idea is also consistent with the objectives pursued under the constitutional framework outlined in the EU Treaties. The Treaty on the European Union ('TEU'), in Article 3(3), provides that the Union shall establish an internal market, based on a 'highly competitive social market economy'. Similarly, by virtue of Article 3(b) TFEU the Union reserves exclusive competence for the purposes of establishing 'the competition rules necessary for the functioning of the internal market'. These provisions underline the broad objectives that EU competition law is designed to pursue, its application being premised on

[174] Guidelines on the effect on trade concept, para 88. However, initially the Commission took the view that purely national RPM schemes did not generally affect trade between Member States. Insofar as the enforcement of price floors was confined within the territory of a single Member State and was not combined with export bans, the relevant RPM agreement would fall outside the reach of EU competition law, being considered as a matter of national competition policy; see European Commission, *Ist Report on Competition Policy* (Brussels – Luxembourg 1972), p 62. It can be safely assumed that the Commission's subsequent decision-making practice and its rigid approach to RPM clauses (some of which were in reality designed to reinforce clauses conferring absolute territorial protection; see *infra* s 5.1.1.1) has been the driving force behind the gradual harmonisation of the antitrust response to vertical price fixing under the national laws of the various European jurisdictions.

[175] Commission Notice – Guidelines on Vertical Restraints [2000] OJ C291/1.

[176] 2010 Vertical Guidelines, para 7. The same idea can be found in para 7 of the 2000 Vertical Guidelines, albeit formulated in a slightly different way.

the integration of both economic and non-economic considerations.[177] Naturally, this applies also to the substantive analysis of vertical restraints in general, including RPM.

1.5. Conclusion: Is Convergence Possible and How?

This chapter explored the origins of the prohibition against RPM both in the US and the EU and investigated the links of the per se treatment of RPM under Section 1 of the Sherman Act with the English common law tradition. It was shown that, although in *Dr Miles* the Supreme Court signalled the departure of US antitrust law from the English courts' tendency to prioritise freedom of contract over freedom of trade in the field of vertical restraints, it nonetheless partially relied on an obsolete common law principle, the doctrine against restraints on alienation, in order to prohibit a practice with ambivalent welfare consequences.

The previous paragraphs also attempted to explain the traditionally and consistently harsh treatment of vertical price fixing under Article 101 TFEU, the only obvious precedent of which were the legal traditions of the founding Member States. The review of the national laws with respect to RPM schemes as in force at the time of the enactment of the Treaty of Rome revealed an impressive inconsistency in the treatment of vertical price fixing, which ranged from unequivocal permissiveness to utter condemnation – this harsh approach having been endorsed by the French and Swedish legislators. But, more importantly, it demonstrated that the rationale behind the treatment of RPM was based on the different economic, social, and, occasionally, political conditions which were prevalent in each jurisdiction during the first post-war years. It thus confirmed Thorelli's observation that '[r]egulation of resale price maintenance, incidentally, is a marvellous example of how crucial it is to view the law in relation to its particular task environment instead of making the rather sterile formal comparisons which are all too usual in this field'.[178]

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[177] See generally I Lianos, 'Some Reflections on the Question of the Goals of EU Competition Law' (CLES Working Paper Series 3/2013, 1 January 2013), pp 37-41, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2235875 (last accessed on 10 November 2015).

[178] HB Thorelli, 'Antitrust in Europe: National Policies after 1945' [1958-1959] 26 *U Chi L Rev* 222, 233.

This analysis leads to the reasonable conclusion that the prohibition of vertical price fixing under Article 101 TFEU was not influenced by the legal traditions of the individual Member States. Instead, it is submitted here that the current normative approach to RPM was developed on the basis of two factors: the first factor is of constitutional nature; the second is economic – or at least relevant to the understanding of substantive economics by the authorities of a more mature antitrust jurisdiction. First, the prohibition against RPM appears to have been developed in response to the very specific challenges facing the newly-established European Economic Community. Artificial price differentials have the ability indirectly to compartmentalise the internal market by diverting the trade flows away from the channels of distribution that would be used in the absence of price restraints. As will be shown in Chapter 5 below, it is interesting that, in a number of cases, the Commission found that price floors and export bans had been combined with the purpose of reinforcing each other.

At the same time, one cannot help observing the decisive influence exercised by the American model of per se prohibition as suggested in *Dr. Miles*. The previous paragraphs demonstrated not only the intellectual interactions between European officials and American scholars during the drafting of the Treaty of Paris, but also presented the direct involvement of the American forces in transplanting US antitrust law and principles into the legal order of the occupied West Germany in the first post-war years. Which of the two factors, the single market imperative or the American influence and the legacy of *Dr Miles*, played a more decisive role in the shaping of the blanket prohibition against RPM under Article 101 TFEU is unclear, and any attempt to answer this question would enter the sphere of academic speculation.

The recent Vertical Guidelines, however, frustrate the above analysis and obscure the rationale behind the ban on RPM, at least with regard to the 'single market imperative'. In what essentially constitutes a step away from the Commission's rigid adherence to the single market imperative, paragraph 61 of the Guidelines concedes that a prohibition on passive sales may qualify as an ancillary restraint and escape the application of Article 101(1) altogether. In order for an agreement conferring absolute territorial protection to be eligible for the ancillary restraints defence, three conditions must be met. First, the beneficiary of the prohibition on both active and passive sales must be a distributor which is the first to sell a new brand or the first to sell an existing brand on a new market. Second, absolute territorial protection must be necessary for the distributor to recoup substantial sunk investments. Finally, the duration of the agreement must not exceed the first two years that the distributor is selling the contract good or services.

Since the Commission has been willing to relax, under certain circumstances, its stringent approach to absolute territorial protection, which axiomatically leads to market partitioning, it can be safely assumed that the influence of the single market imperative on the public policy towards vertical restraints which may only indirectly produce the same effect – such as RPM – is decreasing. In the aftermath of *Leegin*, Jones observed that, by contrast to US antitrust law, the evolution of which has been facilitated by the Sherman Act's link with the common law, in Europe 'it is not clear that there has been, or could be, such a fundamental shift in objectives', particularly in light of the broad goals pursued under EU competition law, which go beyond the mere promotion of consumer welfare.[179]

However, having been expressed prior to the publication of the revised Vertical Guidelines in 2010, Jones' opinion appears to be outdated. The Commission's departure from its rigid adherence to the single market imperative in cases where export bans may facilitate new entry demonstrates that this 'shift in objectives' may be less problematic than initially thought – in fact it has already occurred: the fact that RPM has been effectively singled out as the most harshly treated vertical restraint has obviously nothing to do with the single market imperative, but should rather be understood as the natural result of a presumption of net anti-competitive effects. This is of course not to be interpreted as suggesting that integrationist goals are now out of the picture. It does, however, reveal the Commission's intention to subject even agreements that demonstrably fragment the internal market to the intuitive proportionality test of Article 101(1), where their likely effect is to promote interbrand competition.

At the same time, it is unclear whether the Commission's view is also shared by the Court of Justice. In *GlaxoSmithKline v Commission*, the Court reaffirmed that the scope of Article 101 extends beyond the mere promotion of consumer welfare:

> First of all, there is nothing in that provision to indicate that only those agreements which deprive consumers of certain advantages may have an anti-competitive object. Secondly, it must be borne in mind that the Court has held that, like other competition rules laid down in the Treaty, Article [101 TFEU] aims to protect not only the interests of competitors or of consumers, but also the structure of the market and, in so doing, competition as such. Consequently, for a finding that an

[179] A Jones, *supra* n 139, 953-954.

> agreement has an anti-competitive object, it is not necessary that final consumers be deprived of the advantages of effective competition in terms of supply or price.[180]

However, and in sharp contrast with the Commission's approach, in *Pedro IV*, decided the same year as *GlaxoSmithKline,* and the last RPM case to have been dealt with by the CJEU so far, the Court also took the position that no presumptions against RPM exist under Article 101(1):

> although the fixing of a retail price constitutes a restriction of competition expressly provided for in Article [101(1)(a) TFEU], it causes that agreement to be caught by the prohibition set out in that provision only where *all the other conditions for applying that provision are met*, that is to say, that the object or effect of the agreement is perceptibly to restrict competition within the common market and that it is capable of affecting trade between Member States.[181]

This lack of any presumptions of illegality concerns not only the net competitive effects of the RPM scheme at issue, but by all means also its likely effect on trade between Member States. It should also be stressed that the CJEU requires that, in order for an agreement fixing minimum resale prices to fall within the scope of the prohibition, all conditions laid down in Article 101(1) must be satisfied. The Court's view thus stands for another, more important proposition: welfare-positive or at least welfare-neutral RPM – in any event RPM that does not have the object or effect of restricting competition perceptibly – will escape the prohibition *even if* it is capable of affecting trade between Member States, thus indirectly resulting in market partitioning. Naturally, this argument does not work *vice versa*: despite its substantive value, the 'effect on trade' requirement is first and foremost a jurisdictional criterion. This entails that, where the RPM agreement at issue is not shown to be capable of affecting trade between Member States, its object or effect will not be appraised under Article 101(1) since, in such a case, EU competition law will not be applicable.

It is important to note that the normative implications of the CJEU's decision in *Pedro IV* are still obscure, not only because the Court has not yet had the opportunity to apply these criteria to a subsequent RPM case, but also because the rationale behind the

[180] Joined Cases C-501/06P, C-513/06P, C-515/06P and C-519/06P, *GlaxoSmithKline Services Unlimited v. Commission* [2009] ECR I-9291, para 63.
[181] Case C-260/07, *Pedro IV Servicios SL v Total España SA* [2009] ECR I-2437, para 82 (emphasis added).

judgment has neither been incorporated in the Commission's 2010 Vertical Guidelines, nor has it been relied upon by national competition authorities and courts, which condemn vertical price fixing as a 'by-object' and hardcore restraint. The Court's position is, however, interesting to the extent that it appears to be favouring a more effects-based approach to RPM, while implicitly leaving the door open for the possibility that price floors may even escape the application of Article 101(1) altogether.

It follows from the foregoing analysis that both the Commission's stringent approach to RPM, as defined in the recent Vertical Guidelines, and the CJEU's more favourable treatment outlined in *Pedro IV*, although diametrically different in their essence, prioritise the net competitive effects of the practice over any integrationist concerns, thus having economic considerations as their common denominator. Accordingly, the thesis will proceed upon the assumption that the substantive assessment of vertical price fixing under the current regime, as outlined by the Vertical Block Exemption Regulation and the accompanying Vertical Guidelines, is based for the most part on economic considerations.

Given this – subtle but genuine – step away from the traditional adherence to the single market imperative, and insofar as a general consensus on the substantive economics can be assumed, it is submitted here that the convergence of the public policy towards vertical price fixing in the two jurisdictions is indeed feasible. One last issue to be resolved is how this convergence may occur. It is rather clear that the adoption of a rule of reason approach under EU competition law is both unwarranted and impossible. Unwarranted, because, as will be shown later in this thesis, the strong anti-competitive potential of price floors require a cautions treatment which would be better served by a – genuinely – rebuttable presumption of illegality.[182] Impossible, because the normative framework of EU competition law is notably different from that of the Sherman Act.

The analytical dichotomy between the rule of per se illegality and the rule of reason standard does not apply to Article 101 TFEU. In *Métropole*, the General Court

[182] That said, the truth is that the nature and form of the rule of reason and its application to RPM post-*Leegin* is still unclear. As Jones Harbour and Price note 'the rule of reason is not, in fact, a single rule'; P Jones Harbour and LA Price, 'RPM and the Rule of Reason: Ready or Not, Here We Come?' [2010] 55 *Antitrust Bull* 225, 238. Instead, it represents a continuum of analyses in the context of which the use of presumptions is imperative; ibid, 239. For a relevant discussion, see also A Kuenzler and P Marsden, 'Presumptions as Appropriate Means to Regulate Resale Price Maintenance: In Defence of Structuring the Rule of Reason' [2012] 8 *Eur Competition J* 497. Despite the guidance provided by Mr Justice Kennedy to lower courts, RPM litigation in the years following *Leegin* has been notably scarce and does not allow for specific conclusions to be drawn as to the analytical framework employed for the substantive assessment of the practice under the rule of reason standard; see *infra* s 5.4.

categorically rejected the existence of a rule of reason under EU competition law, and stressed that any substantive assessment consisting in the balancing of any alleged pro- and anti-competitive effects can be carried out only in the context of Article 101(3).[183] Furthermore, the same Court has noted in *Matra Hachette* that under EU competition law all types of restrictive arrangements are potentially eligible to benefit from an individual exemption: 'in principle, no anti-competitive practice can exist which, whatever the extent of its effects on a given market cannot be exempted, provided that all the conditions laid down in Article [101](3) of the Treaty are satisfied'.[184]

However, as Jones points out, the differences in the approach taken to RPM under EU competition law and US antitrust law prior to *Leegin* are merely theoretical, as in practice price floors are essentially subject to the same stringent rule.[185] Chapter 6 below will examine the current treatment of price floors under Article 101 TFEU and conclude that is premised on a conclusive presumption of allocative inefficiency. As has already been argued earlier in this chapter, this presumption may be attributed to the influence of the US experience, since the European Commission has not to date engaged in a full-blown assessment of the competitive effects of an RPM scheme under scrutiny. This influence is particularly evident in the Commission's earlier official documents, such as the explicit reference of the Green Paper on Vertical Restraints to 'per se' illegality of price floors under Article 101(1),[186] or the preceding Vertical Guidelines, which, in citing the theories of harm associated with vertical price fixing, focus exclusively on the horizontal collusion theory, partially in line with the rationale behind *Dr Miles*.[187] These similarities will be discussed in more detail in Chapter 3 below, in the context of the investigation into the relationship between the horizontal effects of RPM and the per se rule.[188] Also, the presumption against RPM could, until recently, be explained by the single market imperative underpinning a great many Commission decisions and being at the epicentre of the EU public policy towards vertical restraints, at least until the publication of the 2010 Vertical Guidelines.

Moreover, the evolution of EU competition law and policy is not bound by the doctrine of *stare decisis*, but is instead shaped freely under the guidance of the Court of

[183] Case T-112/99, *Métropole television (M6) and Others v Commission* [2001] ECR II-2459, para 107.
[184] Case T-17/93, *Matra Hachette SA v Commission* [1994] ECR II-595, para 85.
[185] A Jones, 'Resale Price Maintenance: A Debate about Competition Policy in Europe?' [2009] 5 *Eur Competition J 479*, 501.
[186] Vertical Restraint in EC Competition Policy COM (96) 721 final, 22 January 1997, para 39.
[187] Commission Notice – Guidelines on Vertical Restraints [2000] OJ C291/1, para 112.
[188] See *infra* s 3.1.2.

Justice or on the basis of the Commission's enforcement priorities as outlined in soft law instruments, such as the Vertical Guidelines.[189] The following chapters will argue in favour of a moderate reform of the policy towards RPM in the EU, through the adaptation of the *Leegin* rule to the European legal order: while retaining the 'by-object' and 'hardcore' status of the practice, it will be demonstrated that sound antitrust policy requires the adoption of a rebuttable presumption of illegality under Article 101(1).

[189] A Jones, *supra* n 185, 503

Chapter 2

The Economics of Distribution

2.1. The Economics of Minimum RPM

As a general proposition, a rational manufacturer would be more likely to encourage price competition between its dealers, rather than undermine it by means of RPM.[1] Fierce intrabrand competition will lead to a gradual reduction of distribution costs, namely of the difference between the price charged by the manufacturer to the dealer and that charged by the latter to the consumer. This reduction in distribution costs will in turn result in lower retail prices and, accordingly, in increased demand for the particular brand.

In light of this assumption, many different explanations have been suggested as to why a manufacturer would limit competition among its dealers by resorting to vertical price fixing. The following two paragraphs shall examine the justifications for RPM agreements as put forward by commentators and/or by the courts. First, the focus will be on RPM as a means of actually stimulating interbrand competition, and then will follow the presentation of the anti-competitive concerns raised by such agreements. For simplicity's sake, during the presentation of the different arguments a two-stage distribution system is assumed, in which the manufacturer sells its products directly to the retailer, which in turn will resell them to the end user.

2.1.1. Pro-competitive Effects of RPM

Ever since the 1960s, antitrust economists have been arguing that restrictions of intrabrand competition may be indispensible for the enhancement of interbrand competition. In the case of price restraints, it has been stated that 'by enhancing the pricing power of the retailer, the manufacturer induces the retailer to engage in activities that

[1] RA Posner, *Antitrust Law* (2nd edn, The University of Chicago Press 2001), pp 171-172. By selling the product to the dealer, the manufacturer reaps all the available profits from that transaction, irrespective of the resale price charged by the former.

stimulate demand'.[2] Commentators have put forward several arguments to justify the precompetitive effects of vertical price fixing.

2.1.1.1. The 'Free Rider' Argument

The most prominent justification for RPM is the 'free rider' argument suggested by Telser in a seminal article published in 1960.[3] Telser argued that sales at the retail level depend on both the product's price and the product-specific services provided by the retailer. Customers value the additional services, but, given the chance, they would rather buy the product at a lower price. In the absence of RPM, retailers offering those special services would inevitably charge more than those who do not, due to the higher costs that the former incur. As a result, it is highly likely that a customer will be convinced to purchase a certain product by taking advantage of the pre-sales services provided by one retailer, but will eventually buy the product at a lower price from a competing dealer that offers no such services. In that way, a dealer takes a free ride on the 'full-service' competitor's promotional efforts. Accordingly, fewer or no dealers will provide pre-sale services, which in turn will cause a reduction in the sales.

2.1.1.1.1. Objections to the Free Rider Argument

Notwithstanding the fact that the free rider explanation remains the main argument in favour of RPM it has been criticised, primarily on the basis of its limited applicability. Telser himself concedes that the provision of sales-specific services is essential only where consumers are unaware of the specific attributes of the product in question. In due course, consumers' valuation of services attached to established goods that are subject to repeated purchases decreases. Consequently distributors will refrain from providing those special services that are deemed redundant, but will continue to rely on RPM in order to realise supra-competitive profits, unless the manufacturer abandons its pricing policy.[4] Professors Klein and Murphy further argue that, in reality, RPM does not necessarily offer a solution to the 'free-rider' problem. The retailers' commitment to observe the fixed prices may not

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[2] FM Scherer, 'The Economics of Vertical Restraints' [1983] 52 *Antitrust LJ* 687, 692.
[3] LG Telser, 'Why Should Manufacturers Want Fair Trade?' [1960] 3 *JL & Econ* 86.
[4] Ibid, 92.

prevent aspiring free-riders from bundling the product with services valued by consumers, but not by the manufacturer, such as promotional offers of tied accessories.[5]

A third objection to the 'free rider' argument is based on the assumption that not all consumers place the same value on special services: the manufacturer's decision to fix the retail price of its goods depends on the importance attached to such services by the 'marginal' consumers, namely the consumers whose reservation prices are nearly the same as the product's original price, and are therefore more sensitive to any fluctuations thereof. However, in order to assess the restraint's overall effect on consumer welfare, one must also take into account the response of a separate class which consists of those customers who have a clear preference for a given manufacturer's product and are thus rather insensitive to price increases. Having all necessary information regarding the product in question, infra-marginal customers are unlikely to take advantage of the available product specific services due to the time cost associated with their consumption. As the provision of services is designed to reflect the preferences of only the marginal consumers, inefficient outcomes may arise where the level of services offered is either too low or too high by reference to the value attributed to them by *all customers*, both marginal and infra-marginal. On the basis of this analysis, Comanor rejects the Chicagoan assumption that vertical restraints serve the interests of both the manufacturer and consumers.[6]

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[5] B Klein and KM Murphy, 'Vertical Restraints as Contract Enforcement Mechanisms' [1988] 31 *JL & Econ* 265, 265-267. The authors use the example of a retailer who free rides by inducing its customers to obtain the presale services of a full-service competing retailer, whereas it sells both the product and lower priced accessories thereof as a bundle. For a reply, see HP Marvel, 'The Resale Price Maintenance Controversy: Beyond the Conventional Wisdom' [1994-1995] 63 *Antitrust LJ* 59, 63-65. See also R Pitofski, 'In Defense of Discounters: The No-Frills Case for a *Per Se* Rule Against Vertical Price Fixing' [1982-1983] 71 *Geo LJ* 1487, 1493; Pitofski suggests that the best option for a manufacturer wishing to ensure the availability of the right services would be to enter into a separate contractual agreement with each dealer.

[6] WS Comanor, 'The Two Economics of Vertical Restraints' [1992] 21 *Sw U L Rev* 1265, 1273-1274; WS Comanor, 'Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy' [1984-1985] 98 *Harv L Rev* 983, 990-992.

Nevertheless, Neven *et al* take the position that the same problem may occur under conditions of vertical integration, where the amount of sales-specific services is determined by administrative command instead of contract; D Neven, P Papandropoulos and P Seabright, *Trawling for Minnows: European Competition Policy and Agreements between Firms* (Centre for Economic Policy Research 1998), p 23.

Note also that the infra-marginal consumer theory is not uncontroversial. Marvel argues that the costs that are relevant to the provision of free-rideable services are fixed, and thus non-marginal: the retailer will incur those costs regardless of whether an additional unit is eventually sold. According to Marvel, the set profit margin is designed to compensate the retailer for any such fixed costs, as well as for the opportunity cost of its distribution activities. If however the maintained price is too high, the resulting drop in sales is likely to be met by a reduction in the retailer's returns, which may not be sufficient to offset the opportunity cost involved. Under these circumstances, the latter would simply refuse to carry the manufacturer's goods. The fixed retail price will thus be expected to increase proportionally to the ability of RPM to generate customer loyalty; HP Marvel, *supra* n 5, 67-69.

For a critical appraisal of Comanor's theory, see also D Boudreaux and RB Ekelund, Jr, 'Inframarginal Consumers and the Per Se Legality of Vertical Restraints' [1988-1989] 17 *Hofstra L Rev* 137.

Finally, a significant drawback of Telser's insight is that it appears to be applicable to a relatively limited range of goods; in certain markets there is practically no scope for the provision of special services. Professor Pitofski, a proponent of the per se ban on RPM, relying on empirical evidence from antitrust litigation before US courts, is wondering: 'think for a moment about the product areas in which resale price maintenance has appeared – boxed candy, pet foods, jeans, vitamins, hair shampoo, knit shirts, men's underwear. What are the services we are talking about in these cases?'.[7]

2.1.1.2. The 'Quality Certification' Argument

In an attempt to explain the application of fixed resale prices to categories of products that do not require specific *tangible* pre-sale services, Marvel and McCafferty have developed an alternative theory, according to which RPM may be justified by the manufacturer's desire to 'purchase' certification of the quality and style of its products.[8] By deciding to stock a particular product, a reputable retailer attests that this product meets certain qualitative standards which are in conformity with the retailer's own reputation. This kind of indirect 'quality certification' may also be subject to free riding. More specifically, given that product branding guarantees across-the-board consistency in the quality of branded goods, in the absence of RPM less established outlets will be able to expand their market shares through price cuts, to the detriment of their high-quality competitors. Consequently, not only will the level of quality certification decline, but also a number of high-quality retailers will be forced to exit the market.[9] It is important to note that the common characteristic of both the free rider rationale and the quality certification

[7] R Pitofski, 'Why Dr. Miles Was Right' [1984] 8 *Regulation* 27, 29. It is important to note that, as will be subsequently argued in more detail, the objections to the free rider argument have been gaining momentum in the last few years in the light of the expansion of e-commerce; see *infra* ch 3.
[8] HP Marvel and S McCafferty, 'Resale Price Maintenance and Quality Certification' [1984] 15 *Rand J Econ* 346. In an article published at roughly the same time, Goldberg offered a similar explanation for RPM, asserting that a retailer essentially rents out its brand name to the manufacturer. In order for the reputable retailer to be encouraged to endorse the manufacturer's products, the latter finds recourse to RPM as a means to compensate indirectly the dealer through the increased difference between the retail and the wholesale price; see VP Goldberg, 'The Free Rider Problem, Imperfect Pricing and the Economics of Retailing Services' [1984-1985] 79 *Nw U L Rev* 736, 744-745.
[9] HP Marvel and S McCafferty, *supra* n 8, 354-355. The authors concede, however, that RPM 'will be most likely for goods that are purchased sporadically or for those goods characterized by rapidly deteriorating quality information'; ibid, 355.

argument is that they are premised upon the fundamental assumption that it is not economically feasible for a manufacturer to contract on the services directly.[10]

2.1.1.3. RPM and Demand Uncertainty

An alternative theory has been subsequently suggested by Deneckere *et al*, who contend that a manufacturer may have an incentive to fix the retail prices for its products in the face of demand uncertainty.[11] More specifically, particularly where the goods concerned are perishable and are facing highly variable demand, in the absence of RPM discount retailers will be able to sell their stock even when demand is low. At the same time, their high price rivals, likely to incur the costs of unsold inventory, will be induced to limit their future orders for the manufacturer's products. Taking into account that, where price competition in the downstream market remains unrestrained retailers set their prices and purchase inventories prior to the arrival of consumers, when both high and low demand are equally likely, this assumption appears to be credible. Deneckere *et al* argue that a uniform pricing strategy will result in consumers choosing retailers 'so as to equate the ratio of sales to inventory across firms. That is, where there is excess supply, the probability of any unit being sold is the same for all firms'.[12] The authors thus assert that RPM will increase total welfare where it is designed to encourage additional inventory holding, and take the position that it could serve as an alternative to vertical integration.[13]

Moreover, an additional justification is that RPM facilitates resale density, especially with regard to relatively inexpensive goods, or goods which are frequently bought on impulse.[14] With regard to these categories of products, a manufacturer may find it profitable to ensure the widespread availability of its products sold not exclusively from large retail outlets, but also from easily accessible convenience stores. However, large-scale retailers are generally capable of undercutting their smaller rivals by fully exploiting the available economies of scale. Economic theory suggests that not all consumers have the same willingness to search more in order to spot the lower price. As a result, the

[10] J Lipczynski, JOS Wilson and J Goddard, *Industrial Organization: Competition, Strategy and Policy* (4th edn, Pearson 2013), p 606.
[11] R Deneckere, HP Marvel and J Peck, 'Demand Uncertainty, Inventories, and Resale Price Maintenance' [1996] 111 *QJ Econ* 885; see also HP Marvel, *supra* n 5, 73-77.
[12] R Deneckere, HP Marvel and J Peck, *supra* n 11 890-891.
[13] Ibid, 911.
[14] See H Hovenkamp, *Federal Antitrust Policy: The Law of Competition and its Practice*, (4th edn, West 2011), p 503; BS Yamey, *The Economics of Resale Price Maintenance* (Pitman 1954), pp 49-52; JR Gould and LE Preston, 'Resale Price Maintenance and Retail Outlets' [1965] 32 *Economica* 302.

convenience stores will lose those consumers who would travel longer in order to profit from a better price, and will find it unprofitable to stock the manufacturer's products. Thus, by fixing the resale price of such goods, the manufacturer can ensure a wider availability for its products. The same applies to products which are subject to impulse purchases, to the extent that the manufacturer's return on additional sales outweighs the loss in consumer welfare caused by the increase in retail prices.[15]

2.1.1.4. RPM and New Entry

Finally, RPM can be used as a very effective tool by a new firm which attempts to penetrate a market or by an existing player that seeks to launch a new product. It is generally not very likely that a retailer will take the risk to stock either the products of unknown brands or novel goods consumer demand for which is still uncertain. This uncertainty represents a distribution cost which may discourage the potential dealer from undertaking any relationship-specific investments associated with its decision to stock the product, unless it is afforded the possibility to recoup the relevant costs.[16] A larger profit margin, guaranteed by means of price floors, may serve as an inducement for the retailer to include in its inventory products the success of which is rather uncertain, or to concentrate its sales efforts 'during the introductory period of expanding demand'.[17]

2.1.2. Objections to RPM

Notwithstanding the aforementioned pro-competitive hypotheses, it must be recognised that the consistently stringent treatment of vertical price fixing under Article 101 TFEU and the almost century-long application of the per se rule under Section 1 of the Sherman Act,[18] are by no means arbitrary. In justifying the Commission's hostility towards the practice, the recent Guidelines on Vertical Restraints mention seven ways in which RPM may restrict competition. In particular, RPM may (i) facilitate collusion in the upstream market; (ii) facilitate collusion between dealers; (iii) generally soften competition between manufacturers and/or between retailers; (iv) bring about an increase in the price of

[15] BS Yamey, *supra* n 14, p 50.
[16] H Hovenkamp, *supra* n 14, p 503.
[17] Commission Notice – Guidelines on Vertical Restraints [2010] OJ C130/1 (hereinafter '2010 Vertical Guidelines' or 'Vertical Guidelines'), para 225.
[18] For a relevant discussion see *infra*, sections 1.2. and 1.3.

the products concerned; (v) prevent the manufacturer from lowering the price charged to subsequent distributors; (vi) result in the foreclosure of smaller rivals, when employed by a manufacturer with market power; and (vii) reduce dynamism and innovation at the distribution level.[19]

2.1.2.1. The Cartel Objection

In order for a cartel to be successful, three general conditions must be cumulatively met: first, the members must be able to reach an understanding and align their behaviour; second, they must monitor the other members' compliance with the rules of the cartel; and, finally, they must punish any deviations from the common policy.[20] The enforcement of the collusive agreement is of particular importance, as economic theory suggests that cartels are inherently unstable. Given that any deviations from the rules of the cartel are generally expected to be profitable for its members, all cartelists have the incentive to cheat by undercutting the fixed price, with the purpose of expanding their market share. The cartel members therefore need to be able to police each other's conduct, and RPM may be employed as a facilitating mechanism designed to prevent the erosion of the collusive equilibrium.

This assumption appears to be equally relevant to cartels operating on either stage of the production and distribution chain. The reason why colluding dealers would rather induce the supplier to impose a minimum or fixed resale price is that the latter is in a better position to enforce the cartel agreement. It is by all means easier for the supplier to supervise the dealers' conduct and observe any deviations from the agreed upon price, since the supplier deals with each one of them separately. It has been argued,[21] however, that vertical price fixing cannot be regarded as a dealer collusion facilitator for one very important reason: cartels in the downstream markets (and especially at the retailer level) are by their very nature unstable. Factors such as the large number of market participants, low barriers to entry, high levels of outlet differentiation, and strong non-price competition, all of which are inherent in the retail market irrespective of the existence of RPM, render retailer cartels particularly difficult to organise and police. Additionally, as the objective of a retailer cartel is the restriction of output, it is not clear why a

[19] Vertical Guidelines, para 224.
[20] See generally GJ Stigler, 'A Theory of Oligopoly' [1964] 72 *J Polit Econ* 44.
[21] SI Ornstein, 'Resale Price Maintenance and Cartels' [1985] 30 *Antitrust Bull* 401, 411-414.

manufacturer would acquiesce to the implementation of an agreement that is obviously contrary to its own interests, unless of course the colluding dealers possess an overwhelming degree of monopsony power. But even in that case, the cartel would likely induce the manufacturer to integrate vertically, encourage new entry in the downstream market, or simply report the unlawful agreements to the enforcement agencies.[22]

Similarly, in the case of a manufacturer cartel vertical price fixing may be aimed at discouraging the cartel members from undermining the success of the collusive agreement by charging discounted prices. By contrast to sales made to dealers, which are 'generally large, secret, and individually negotiated ... [r]etail prices ... are generally public, relatively standardised at particular locations, and individually small',[23] while any discounts are made known through advertising. In light of this assumption, price cuts in breach of the cartel agreement are expected to be passed on to consumers in the form of lower retail prices, which are generally highly visible. Where RPM is enforced collectively by all cartelists, so the argument runs, the price rigidity in the downstream market will prevent aspiring cheaters from offering secret discounts, since these will have no effect other than providing retailers with higher profit margins.

This objection to RPM, however, is not unambiguous either. First of all, the mere fact that the (uniform) prices are made public entails that, at the same time, it is easier for enforcement agencies to detect the collusion: an industry-wide pattern of pricing policy is likely also to attract close scrutiny by the competition authorities. Second, vertical price fixing appears to be redundant as a cartel facilitating mechanism where the goods concerned are sold through multi-brand outlets. The retailer can be expected to report immediately to the colluding manufacturers any secret price reductions offered by a cheating member, in an attempt to obtain matching discounts.[24] Third, the retailer may frustrate the RPM scheme by indirectly passing on to customers any price cuts in the form of special terms that have the same effect as discounts, such as more favourable credit terms or concessions on tied products. In other words, the cheating manufacturer may benefit from the provision of increased point-of-sale, product-specific services, which are more difficult to detect than lower retail prices.[25] Although the manufacturer cartel objection is not unfounded, it is clear from the foregoing analysis that, in defiance of RPM,

[22] See RH Bork, 'The Rule of Reason and the Per Se Concept: Price Fixing and Market Division' (Part II) [1965-1966] 75 *Yale LJ* 373, 405-410.
[23] SI Ornstein, *supra* n 21, 453.
[24] RH Bork, *The Antitrust Paradox: A Policy at War with Itself* (Simon & Schuster 1993), p 293.
[25] Ibid, 293-294; LG Telser, *supra* n 3, 97.

manufacturers appear to have both the incentive and the ability to engage in secret price cutting.

2.1.2.2. RPM and Tacit Collusion

Economic theory suggests that price floors may be enforced with the purpose to sustain a collusive equilibrium even in the absence of explicit concertation between competitors. Shaffer argues that RPM is likely to be employed by manufacturers competing for access to shelf space at the retail level.[26] He asserts, however, that the practice may also be implemented as a mechanism designed to facilitate oligopolistic coordination, in which case it may give rise to significant anti-competitive effects.[27] In particular, the impact of RPM on retail profit margins appears to be greater where only some of the available brands are price maintained: in a downstream duopoly the retailer that opts for the price maintained brand behaves as the price leader, while its uncommitted rival acts as a price follower. The result will be a Stackelberg game which will cause retail prices to increase and consumer welfare to decline.[28] It is noteworthy however that, in relation to a perfectly competitive downstream market, not only are the welfare effects brought about by the strategic use of RPM considerably less adverse compared to the loss in allocative efficiency generated by a retailer cartel, but also price floors appear to produce greater surplus than slotting allowances.[29] Interestingly, Shaffer suggests that where both retailers decide to carry price maintained brands, and in the absence of fixed fees, the outcome would be equivalent to a situation where neither RPM nor fixed fees were employed.[30]

The view that RPM may be implemented with the purpose of facilitating tacit collusion is also supported by Rey and Vergé, who argue that vertical price fixing is likely to soften or even eliminate interbrand competition in situations of ‘interlocking relationships’ – or ‘double common agency’ – namely where the same competing dealers carry the goods of more than one upstream rivals.[31] Rey and Vergé start from the proposition that, where the goods of competing manufacturers are carried by a downstream

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[26] G Shaffer. ‘Slotting Allowances and Resale Price Maintenance: A Comparison of Facilitating Practices’ [1991] 22 *Rand J Econ* 120.
[27] Ibid, 121-122.
[28] Ibid, 126-128.
[29] Ibid, 134-135.
[30] Ibid, 126-127.
[31] P Rey and T Vergé, ‘Resale Price Maintenance and Interlocking Relationships’ [2010] 58 *J Ind Econ* 928.

monopolist, the former may eliminate interbrand competition simply by selling at cost while charging a fixed fee, thus transforming 'a rival manufacturer into a residual claimant on the sales of both brands'.[32] In this case, both manufacturers will have an incentive to protect the retailer's monopoly rents. If, however, by hypothesis the manufacturers supply a competitive downstream market where retailer margins are squeezed as a result of intrabrand competition, the same outcome may be achieved through a combination of RPM with two-part tariffs. It is interesting to note that, according to the analysis, other types of vertical restraints do not replicate the same mechanism; accordingly, the authors favour the continuation of a more 'cautious' approach towards vertical price fixing in comparison to non-price restraints.[33]

2.1.2.3. RPM as an Exclusionary Mechanism

Despite arguably being the most oft-cited, the horizontal collusion theory is by all means not the only objection associated with the use of vertical price fixing. Both the Commission, in its recent Vertical Guidelines,[34] and the US Supreme Court in *Leegin*[35] have endorsed the possibility that RPM may be implemented by a manufacturer enjoying substantial market power with the purpose of foreclosing the access of smaller rivals to the downstream market, or in order to raise barriers to new entry. However, while being an intuitively compelling argument, it has received limited attention by antitrust scholars.[36] Bork deals with the foreclosure objection to RPM in nothing more than an extensive footnote. He argues that, insofar as entry into retailing is easy, vertical price fixing is not likely to result in the exclusion of manufacturers from the downstream market. Particularly problematic is the fact that, in order to foreclose their rivals, price-maintaining

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[32] Ibid, 930.

[33] Two-part tariffs (or non-linear pricing, or franchise fee) are defined as 'a contract which specifies a fixed amount independent of the number of units bought plus a variable component', and are designed to encourage distributors to buy more units of the contract good; M Motta, *Competition Policy: Theory and Practice* (Cambridge University Press 2004), p 303.

[34] Commission Notice – Guidelines on Vertical Restraints [2010] OJ C130/1, para 224:

> RPM may be implemented by a manufacturer with market power to foreclose smaller rivals. The increased margin that RPM may offer distributors, may entice the latter to favour the particular brand over rival brands when advising customers, even where such advice is not in the interest of these customers, or not to sell these rival brands at all.

[35] *Leegin Creative Leather Products, Inc v PSKS, Inc*, 551 US 877, 893-894 (2007) ('Resale price maintenance, furthermore, can be abused by a powerful manufacturer or retailer. … A manufacturer with market power … might use resale price maintenance to give retailers an incentive not to sell the products of smaller rivals or new entrants').

[36] See, eg, BS Yamey, *The Economics of Resale Price Maintenance* (Pitman 1954), pp 34-35; HP Marvel and S McCafferty, 'The Welfare Effects of Resale Price Maintenance' [1985] 28 *JL & Econ* 363, 366-368 (doubting, however, the effectiveness of the scheme at hand as an exclusionary practice).

manufacturers need to combine RPM with exclusive dealing clauses. As it can be safely assumed that a – smaller or larger – fraction of the total number of manufacturers will not be able to appoint all of the industry's retailers as exclusive dealers, and that RPM will make entry into retailing more attractive for discounting dealers the foreclosure theory of RPM loses much of its credibility.[37]

In a recent article, Paldor takes the position that a dominant manufacturer may indeed use RPM as a 'rent-shifting device', in an attempt to induce retailer exclusivity.[38] The upstream monopolist, so the argument runs, has the incentive to exclude any actual or potential competitors in order to avoid the erosion of any rents available in a given industry, which would be the obvious consequence of new entry. By affording retailers a greater profit margin by means of RPM, the manufacturer seeks to align its commercial interests with those of its dealers. While retailers would be expected to favour a competitive – and perhaps even more so a duopolistic – over a monopolistic upstream market, the existence of excess rents under conditions of monopoly, along with the prospect of sharing these rents with the manufacturer, is likely to sustain the former's interest in preserving the upstream monopoly.[39] That said, Paldor concedes that his analysis is applicable only to markets which are dominated by one incumbent player. In oligopolistic or competitive markets, coordination between manufacturers regarding the division of costs associated with rent-shifting will be rather problematic. At the same time, the greater the number of firms that are active in the upstream market, the smaller the loss in their share of the available rents caused by new entry.[40]

The idea that price floors may be implemented by an upstream incumbent as a rent-sharing mechanism for exclusionary purposes has been subsequently confirmed by Asker and Bar-Isaac, who present a formal equilibrium foundation in support of this theory.[41] The authors demonstrate that the incumbent manufacturer may prevent its retailers from accommodating a possible new entrant simply by charging a wholesale price equal to its

[37] RH Bork, 'The Rule of Reason and the Per Se Concept: Price Fixing and Market Division' (Part II) [1965-1966] 75 *Yale LJ* 373, 413-414, fn 80. Compare KG Elzinga and DE Mills, 'The Economics of Resale Price Maintenance' in WD Collins (ed), *Issues in Competition Law and Policy*, vol 3 (American Bar Association Antitrust Section 2008), 1847-1848. Although acknowledging that under certain circumstances RPM may indeed result in the foreclosure of new entrants in the upstream market, the authors nonetheless take the position that the per se ban on vertical price fixing could have a similar effect.
[38] I Paldor, 'RPM as An Exclusionary Practice' [2010] 55 *Antitrust Bull* 309, 314-315.
[39] Ibid, 316-318.
[40] Ibid, 319-320.
[41] J Asker and H Bar-Isaac, 'Raising Retailers' Profits: On Vertical Practices and the Exclusion of Rivals' [2014] 104 *Am Econ Rev* 672.

marginal cost and setting a retail price at the monopoly level. The retail margin afforded in this way will ensure the maximisation of the rent transfer.[42]

2.1.2.4. Anti-Competitive RPM through the Lens of Behavioural Economics

Finally, in an article published in the aftermath of the US Supreme Court's decision in *Leegin*, Tor and Rinner suggest an alternative explanation for RPM on the basis of the behavioural analysis of the practice.[43] In challenging the validity of the rationality assumption in neoclassical economics, the authors argue that real-world manufacturers are loss-averse, insofar as they demonstrate the tendency to find 'the pain associated with the negative prospect of a potential loss … far stronger than the pleasure of the positive prospect of a comparable gain'.[44] As boundedly rational decision makers, they are prone to favouring the preservation of the current status quo ('status quo bias'), thus overestimating the expected harm from price-cutting.[45] Consequently, even in the absence of any credible pro-competitive justifications, manufacturers may be inclined to use RPM excessively and inefficiently, as they perceive it as the most appropriate method for the prevention of price-cutting and the protection of their interests.[46] Based on Tor and Rinner's insight, Van den Bergh asserts that behavioural analysis may provide a legitimate theoretical justification for the stringent treatment of RPM under Article 101 TFEU. However, he dismisses exclusive reliance on behavioural economics for the substantive assessment of RPM, arguing that, unless combined with neoclassical theories, the behavioural approach may increase the likelihood of false positives by extending the scope of the prohibition even to efficiency-enhancing RPM schemes.[47]

2.2. Theories on the Nature of the Firm

[42] Ibid, 679.
[43] A Tor and WJ Rinner, 'Behavioral Antitrust: A New Approach to the Rule of Reason after *Leegin*' [2011] 2011 *U Ill L Rev* 805.
[44] Ibid, 829.
[45] Ibid, 822-829 and 830.
[46] Ibid, 833-834.
[47] R Van den Bergh, 'Behavioral Antitrust: Not Ready for the Main Stage' [2013] 9 *J Comp L & Econ* 203, 220-221.

2.2.1. Neoclassical Theory

Under the neoclassical theory, the firm was viewed as a profit-maximising production unit operating on the free market or under state regulation.[48] Neoclassical economists focus on the price system rather than on the nature of the firm as a distinct economic entity.[49] In this framework, a firm maximises its profits when its marginal revenue, namely the additional revenue obtained for every additional unit of output produced, equals its marginal cost, in other words the additional cost incurred for the production of one additional unit of output (MR=MC). This theory recognises three main reasons for the existence of the firm: a) relatively large number of specialised employees; b) wider use of capital goods; and c) economies of scale.[50]

Nevertheless, the neoclassical theory does not explore the internal organisation of production within a firm; it rather approaches the firm as a 'black box', the size and boundaries whereof are more or less obscure. Accordingly, it does not attempt to explain why firms merge, or why one firm decides to split itself into two smaller firms. Similarly, it does not take into account the conflicting interests between employers and employees. Despite its shortcomings, the neoclassical theory has survived for well over one hundred years.[51]

2.2.2. Coasian Theory

In his 1937 article 'The Nature of the Firm',[52] Ronald Coase suggested a different approach to the concept of the firm, through the introduction of the principles of

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[48] See R Flannigan, 'The Economic Structure of the Firm' [1995] 33 *Osgoode Hall LJ* 105, 110, and O Hart, 'An Economist's Perspective on the Theory of the Firm' [1989] 89 *Colum L Rev* 1757, 1758. For a summary of the neoclassical theory, see also L De Alessi, 'Property Rights, Transaction Costs, and X-Efficiency: An Essay in Economic Theory' [1983] 73 *Am Econ Rev* 64.

[49] This conception culminated in the model of perfect competition, but, according to Demsetz, '[w]hat parades as perfect competition has much to say about the price system, but little to say about competition or the organization of firms'. The implication of this theory, Demsetz points out, does not refer to competition but to decentralisation, as opposed to the centralised control of economy. In this sense, each actor maximises its profits irrespective of the others' conduct, see H Demsetz, 'The Theory of the Firm Revisited' [1988] 4 *JL Econ & Org* 141, 142. Accordingly, a neoclassical market is a market in which a single buyer and a single seller can conclude an individual transaction which does not affect any third parties. Transactions in such a market are Pareto optimal, ie there is no alternative option that can make someone better off without making someone else worse off, see H Hovenkamp, 'Bargaining in Coasian Markets: Servitudes and Alternative Land Use Controls' [2001-2001] 27 *J Corp L* 519, 520.

[50] TS Ulen, 'The Coasean Firm in Law and Economics' [1992-1993] 18 *J Corp L* 301, 305.

[51] For the reasons of the neoclassical theory's survival, see ibid, 306.

[52] RH Coase, 'The Nature of the Firm' [1937] 4 *Economica* 386.

transaction cost economics.[53] The importance of this seminal paper lies, in particular, in the fact that 'it offered an entirely different way of looking at the reasons for the existence of the firm as an economic entity, and for explaining the scope of what the firm does'.[54] Coase drew a clear distinction between the market and the firm, and regarded them as alternative methods of coordinating production.[55] According to Coase, firms emerge because the use of the price mechanism (namely the market)[56] is costly. More specifically, he identified three types of relevant marketing costs: a) cost for the discovery of the relevant prices, b) costs related to the negotiation and conclusion of transactions, and c) cost of concluding a long-term contract where it is difficult for the 'factor of production' to foresee the course of conduct that the other contracting party will follow in the future; thus, the respective costs raise because of the entrepreneur's need to provide for the various contingencies that are likely to emerge during the term of the contract, in which case information and bargaining costs have to be incurred repeatedly.[57]

Coase suggested that firms come into existence specifically in order for the aforementioned marketing costs to be saved: it is the internalisation of production in the context of a firm[58] that minimises the costs that would otherwise be required for the use of the market. In particular, the direction of resources by an authority, in other words the power relationship within a firm, is regarded as a substitute for the price mechanism, which is superseded.[59] Thus, instead of a certain number of contracts that would have to be concluded on the market, the factor of production will have to enter into only one, establishing a relationship of hierarchical control, and setting limits to the power of the

[53] Note that one of the basic assumptions of the neoclassical theory is that transaction costs are zero, see L De Alessi, *supra* n 48, 65.
[54] TS Ulen, *supra* n 50, 307. However, note the substantial similarities between Coase's work and the earlier work of Pigou with regard to transaction cost economics, as highlighted in H Hovenkamp, 'The Coase Theorem and Arthur Cecil Pigou' [2009] 51 *Ariz L Rev* 633, 636-640.
[55] RH Coase, *supra* n 52, 388 ('Outside the firm, price movements direct production, which is co-ordinated through a series of exchange transactions on the market. Within a firm, these market transactions are eliminated and in place of the complicated market structure with exchange transactions is substituted the entrepreneur-co-ordinator, who directs production').
[56] In the words of Flannigan, '[t]he price mechanism or market terminology is only shorthand for the process of exchange or negotiation where persons do the work of buying and selling (the allocation or coordination of resources)'; R Flannigan, *supra* n 48, 113.
[57] RH Coase, *supra* n 52, 390-392. See also the criticism in R Flannigan, *supra* n 48, 115-116.
[58] Citing Robertson, Coase regards firms as 'islands of conscious power in this ocean of unconscious co-operation', RH Coase, *supra* n 52, 388.
[59] Ibid, 392.

entrepreneur.[60] Put differently, the organisation of a firm is similar to the relationship between employer and employee.[61]

Apart from identifying the reasons for the emergence of firms, Coase's work has one additional implication: it suggested that the costs of bargaining may simultaneously explain the firm's size. Obviously, the more the transactions conducted within a firm, the larger that firm is. However, given that internal organisation is also costly[62], the firm will expand until the point where the costs of in-house transactions equal the costs of doing business on the open market. The definition of the boundaries of the firm is a major contribution of Coase's insight, since the issue had not been addressed previously by the neoclassical paradigm.[63]

Thirty-five years after the publication of 'The Nature of the Firm', Professors Alchian and Demsetz[64] challenged Coase's understanding of the firm as an entity completely distinct from the framework in which it operates. In fact, they considered the firm as having 'no power of fiat, no authority, no disciplinary action any different in the slightest degree from ordinary market contracting between any two people'.[65] Alchian and Demsetz compare the relationship between an employer and an employee to that between a grocer and his customer. The relationship between two independent contractors, such as the latter, is based not on a formal contract, but on the continuous repetition of similar transactions, nevertheless it cannot be claimed that the grocer is the customer's employee. Giving a specific order to an employee is, according to Alchian and Demsetz, in no way different from telling a grocer to sell one or the other good. In both cases, the sanctions for the employee or the grocer's failure to comply with the obligations that derive from the respective agreements are identical: they will be either fired or sued. The grocer, in particular, will be 'fired' in the sense that the customer will start shopping from another grocer.[66]

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[60] In fact, according to Coase, the limitation of the powers of the entrepreneur is the only purpose of such a contract; see ibid, 391.
[61] Ibid, 404.
[62] The costs of entrepreneurial control relate to: a) increasing costs of organising additional transactions within the firm; b) increased likelihood of error resulting to a waste of resources; and c) rising supply price as the firm expands its boundaries; RH Coase, *supra* n 52, 394-395.
[63] See O Hart, *supra* n 48, 1758. Ulen points out that '[t]his second implication of the theory in *The Nature of the Firm* is so obviously correct that it has become a staple part of the economic literature'; TS Ulen, *supra* n 50, 308.
[64] AA Alchian and H Demsetz, 'Production, Information Costs, and Economic Organization' [1972] 62 *Am Econ Rev* 777.
[65] Ibid, 777.
[66] Ibid.

Thus, after having concluded that '[l]ong-term contracts between employer and employee are not the essence of the organization we call a firm',[67] Alchian and Demsetz pointed out that internal organisation has instead been developed as a solution to the problem of *shirking*: given that the firm involves a team productive process, careful monitoring of each team member's performance is essential for the enhancement of productivity. However, since monitoring is itself costly, and since individualised market competition cannot exercise sufficient control, individual team members have the incentive to relax and shirk.[68] The appointment of a specialised monitor is, therefore, required. In order for the monitor to perform his tasks efficiently and not shirk himself, he will be granted residual claimant status. The rights assigned to the monitor also include the power to alter team membership, to renegotiate the terms of any contract individually, and to sell those rights, and they define the essence of the firm as 'a contractual structure subject to continuous renegotiation with the central agent',[69] as well as the monitor's role as the firm's owner.[70]

2.2.3. The 'Nexus-of-Contracts' Theory

The Alchian-Demsetz understanding of the firm as a structure both the internal and external relationships whereof are governed by contract was subsequently carried further by the 'nexus-of-contracts' theory on the nature of the firm, which drew a distinction between ownership and control. The nexus-of-contracts theory was initially formulated by Professors Jensen and Meckling,[71] who objected to the emphasis placed by Alchian and Demsetz on the concept of team production; in their view,

> [c]ontractual relations are the essence of the firm, not only with employees but with suppliers, customers, creditors, etc… [since the] private organization or firm is simply one form of *legal fiction which serves as a nexus for contracting relationships and which is also characterized by the existence of divisible residual*

[67] Ibid.
[68] Ibid, 778-781. Shirking results in higher agency costs, the concept whereof refers to 'the inevitable risks that agents will act for themselves rather than their principals'; see EW Orts, 'Shirking and Sharking: A Legal Theory of the Firm' [1997-1998] 16 *Yale L & Pol'y Rev* 265, 275. The financial loss incurred by the principal as a result of the agent's opportunistic behaviour is termed 'residual loss', see also MC Jensen and WH Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' [1976] 3 *J Fin Econ* 305, 308.
[69] AA Alchian and H Demsetz, *supra* n 64, 794. See also H Demsetz, *supra* n 49, 151-154, and H Demsetz, 'The Structure of Ownership and the Theory of the Firm' [1983] 26 *JL & Econ* 375.
[70] AA Alchian and H Demsetz, *supra* n 64, 783 and 794.
[71] MC Jensen and WH Meckling, *supra* n 68.

claims on the assets and cash flows of the organization which can generally be sold without permission of the other contracting individuals.[72]

The basic implication of Jensen and Meckling's insight is, therefore, that there is no actual distinction between the transactions carried out within a firm and those concluded on the market; instead, all these transactions form a single 'continuum of types of contractual relations'.[73] By contrast to Coase's theory, the nexus-of-contracts conception does not recognise management hierarchy as a significant feature of the notion of the firm. Subsequently, Eisenberg approached the nexus-of-contracts conception as meaning that 'the corporation is a nexus of reciprocal arrangements made within a framework of mandatory legal rules, just as many other reciprocal arrangements, like contracts, trusts, and marriages, are made within a framework of mandatory legal rules'.[74] This theory has proved to be very influential, but has, at the same time, been subject to fierce criticism, mainly due to its inability to explain the firm's size; in essence, its implication that contractual continuity frustrates the definition of the firm's boundaries is in contrast with the general perception of the firm's structure.[75]

2.2.4. The Transaction Cost Argument

The significance of transaction cost savings (first suggested by Coase) was further elaborated by Oliver Williamson.[76] By contrast to the neoclassical theory, Williamson

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[72] Ibid, 310-311 (emphasis in original). Two other prominent proponents of the nexus-of-contract theory are Judge Easterbrook and Professor Fischel. They contend that

> [a] series of short-term dealings in a market may be more useful for trading than for producing goods, however. The firm – an aggregation of people banded together for a longer period – permits greater use of specialization. People can organize as teams with the functions of each member identified, so that each member's specialization makes the team as a whole more productive than it would otherwise be;

FH Easterbrook and DR Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1996), p 8. Reflecting the Coasian theory, they also argue that the firm will expand until the costs of internal organisation of production – agency costs being a substantial part whereof – equal the costs of organising through market transactions; ibid, pp 8-9.

[73] See O Hart, *supra* n 48, 1764. Besides, in the context of this conception, the firm has also been defined as 'the nexus of contracts, written and unwritten, among owners of factors of production and customers', see EF Fama and MC Jensen, 'Separation of Ownership and Control' [1983] 26 *JL & Econ* 301, 302.

[74] MA Eisenberg, 'The Conception that the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm' [1998-1999] 24 *J Corp L* 819, 823-824.

[75] See, eg, R Flannigan, *supra* n 48, 120-121; O Hart, *supra* n 48, 1764-1765.

[76] According to Williamson himself, the theoretical gap between transaction cost economics and the contractarian theory presented in the previous subsection should not be overstated, since '[t]ransaction economics adopts a contractual approach to the study of economic organization'; OE Williamson, *Economic Organization: Firms, Markets and Policy Control* (New York University Press 1986), p 174.

regards the firm as a 'governance structure'[77] and not a production function. Accordingly, account should be taken of the firm's organisational features, in order for its boundaries to be defined.[78] Williamson further assumes that there are two behavioural factors[79] which urge a firm to select internal organisation over market transactions. The first is bounded rationality, namely the fact that individuals are '*intendedly rational, but only limited so*';[80] the actors' bounded rationality makes the drafting of complete contracts impossible.[81] Thus, the main advantage of the centralisation of information in the form of hierarchical control is that the collection of information as well as the decision-making process will be assigned to 'one or few individuals who have superior information processing capabilities and exceptional oratorical and decision-making skills'.[82] This will in turn result in both considerable cost savings and in the increased likelihood that the correct decision will be reached by the central coordinator.

The second behavioural assumption on which transaction cost economics places great emphasis is related to the concept of opportunism. Williamson defines opportunism as the 'deep condition of self-interest seeking that contemplates guile'.[83] Parties to a transaction may act opportunistically either *ex ante*, through the asymmetrical disclosure of information during the negotiations for the conclusion of an agreement, or *ex post*, during the execution or renewal of the contract.[84] Williamson, therefore, suggests that internal organisation can result in more effective productivity evaluations, as well as in a more sophisticated conflict resolution mechanism, since the firm has the ability to settle any internal conflicts without recourse to fiat (as opposed to intra-organisational settlements). The importance of this mechanism lies in the fact that it keeps the conduct of the various divisions of the corporate entity under control and, at the same time, sets the standards for

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[77] Orts points out that '[b]y "governance structure", [Williamson] means one version or another of an explicit or implicit contract'; EW Orts, *supra* n 68, 290. The author also criticises Williamson's insight for failing to exhibit a comprehensive understanding of the underlying legal principles.

[78] Neoclassical economists, on the other hand, took the firm's boundaries for granted, as determined by the 'technological economies of scale and scope'; see OE Williamson, 'Economics and Organization: A Primer' [1996] 38 *Cal Mgmt Rev* 131, 131-133.

[79] See OE Williamson, 'The Logic of Economic Organization' [1988] 4 *JL Econ & Organ* 65, 67-69.

[80] OE Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting* (The Free Press 1985), p 30, quoting Herbert A Simon (emphasis in original).

[81] R Flannigan, *supra* n 48, 122.

[82] OE Williamson, *Markets and Hierarchies: Analysis and Antitrust Implications* (The Free Press 1975), p 52.

[83] OE Williamson, *supra* n 79, 68. An alternative definition provided by Williamson is that '[o]pportunism is an effort to realize individual gains through a lack of candor or honesty in transactions'; OE Williamson, 'Markets and Hierarchies: Some Elementary Considerations' [1973] 63 *Am Econ Rev* 316, 317.

[84] OE Williamson, 'Markets and Hierarchies: Some Elementary Considerations', *supra* n 83, 317.

admission to the integrated firm. In that way, both *ex post* and *ex ante* opportunistic behaviour is prevented.[85]

2.2.5. The Property Rights Argument

An alternative theory suggested by Oliver Hart[86] is that the firm should be regarded as a set of property rights or, put differently, of the assets that it owns. Even though the starting point for Hart's approach is the transaction cost theory developed by Coase and Williamson, it focuses mainly on the firm's physical (non-human) assets. Hart criticises the Coasean approach to the organization of the firm as a relationship of hierarchical control (similar to an employer-employee relationship) in that it failed to establish the source of the employer's authority. In the absence of physical assets, Hart argues, it is difficult to define authority in the context of a firm. Instead it is the '*control over nonhuman assets [that] leads to control over human assets*'.[87]

According to Hart, the importance of the ownership of assets lies in the fact that it provides a solution to the problem of contract incompleteness: in the absence of contractual terms specifying any possible aspect of the usage of a physical asset, the owner of this asset has residual control rights over that asset, in the sense that he has the right to take decisions regarding all usages thereof.[88] Based on this assumption, Grossman and Hart define vertical integration as 'the purchase of the assets of a supplier (or of a purchaser) for the purpose of acquiring the residual rights of control'.[89]

2.3. The Competitive Effects of Vertical Integration

[85] OE Williamson, 'The Vertical Integration of Production: Market Failure Considerations' [1971] 61 *Am Econ Rev* 112, 113-114, and OE Williamson, *Markets and Hierarchies: Analysis and Antitrust Implications*, *supra* n 82, pp 53-54.
[86] See O Hart, *Firms, Contracts, and Financial Structure* (Clarendon Press 1995); O Hart, *supra* n 48; SJ Grossman and O Hart, 'The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration' (1986) 94 *J Polit Econ* 691; O Hart and J Moore, 'Property Rights and the Nature of the Firm' [1990] 98 *J Polit Econ* 1119.
[87] O Hart, *Firms, Contracts, and Financial Structure*, *supra* n 86, p 58.
[88] Ibid, pp 29-30.
[89] SJ Grossman and O Hart, *supra* n 86, 716.

2.3.1. Pro-Competitive Effects of Vertical Integration

2.3.1.1. Pro-Competitive Effects in Non-Competitive Markets

Every firm which enjoys market power has the tendency to restrict its output and thus raise its prices above the competitive level (namely above its marginal cost) and up to the point where its marginal revenue (MR)[90] equals the firm's marginal costs (MC). A monopolist, being the only seller in a specific market, has the ability to raise prices effectively, since its own output equals the market-wide output.[91] The result (the 'social cost' of monopoly) is the so-called 'deadweight loss': consumers who would be willing to buy product A at a competitive price, decide to switch to their second-best option, product B, as long as the latter is available in a competitive market. The inefficiency of this outcome lies in the fact that customers are urged to 'engage in an alternative transaction that produces less social value than would their first choice'.[92]

The aforementioned problem is aggravated in the cases of 'successive monopolies'. A successive monopoly occurs when firms operating in the successive stages of production and distribution both enjoy monopoly power.[93] This social welfare loss is aggravated, where a firm operating in a subsequent stage of the production chain has the power to further limit output and charge its own profit-maximizing price. This is the case where the downstream firm is itself a monopolist: the latter will inevitably attempt to charge its own profit-maximising price by equating its own marginal cost (namely the price charged by the manufacturer)[94] and marginal revenue. In addition to the problem of 'deadweight loss' however, this practice will entail losses for the upstream monopolist because of the further decreased demand for its products.[95] One solution to the 'double marginalisation' problem

[90] Marginal revenue (MR) is defined as 'the additional revenue that a monopolist obtains when it produces one additional unit of output'; H Hovenkamp, *Federal Antitrust Policy: The Law of Competition and its Practice*, (3rd edn, Thomson/West 2005), p 12.
[91] By contrast, any price increase by a firm operating in a perfectly competitive market will merely induce the consumers to switch to competing products.
[92] H Hovenkamp, *supra* n 90, p 20. The mere transfer of wealth from the consumers to the monopolist is indifferent from an economist's perspective.
[93] See RD Blair and JM Fesmire, 'Maximum Price Fixing and the Goals of Antitrust' [1986-1987] 37 *Syracuse L Rev* 43, 60.
[94] For simplicity's sake, we assume that the downstream firm does not incur any further costs other than the cost of purchasing the product.
[95] From the supplier's perspective, the successive monopoly problem is essentially a problem of conflicting interests, see ACM Chen and KN Hylton, 'Procompetitive Theories of Vertical Control' [1998-1999] 50 *Hastings LJ* 573, 597.

would be the internalisation of this externality[96] through a vertical merger: by integrating with the downstream monopolist, the manufacturer achieves both desirable results: it limits the social cost of monopoly and enhances allocative efficiency, while, simultaneously, avoiding any undesired reduction in the demand for its products.

2.3.1.2. Pro-Competitive Effects in Competitive Markets

2.3.1.2.1. The Principal-Agent Problem and the Problem of Adverse Selection

One of the basic features of a perfectly competitive market is that all participants, namely both buyers and sellers, enjoy unlimited access to all sorts of information about the market.[97] Nevertheless, even in markets which are close to the model of perfect competition, it is not always the case that the information available to the independent dealer is also available to its supplier. This informational asymmetry is termed in the jargon of microeconomics as the 'principal-agent problem'.[98] The principal-agent problem, being related to the notion of opportunism and the costs thereof, is inherent in virtually every vertical relationship and, more specifically, arises when the agent focuses on the attainment of goals other than those of the principal.[99]

The principal-agent problem is merely a form of moral hazard, the concept whereof refers to 'the form of postcontractual opportunism that arises because actions that have efficiency consequences are not freely observable and so the person taking them may choose to pursue his or her private interests at others' expense',[100] and may also emerge in the context of an agency relationship.[101] Originally, the term moral hazard derives from the insurance industry and it refers to any changes in the insured individual's behaviour that

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[96] 'A vertical externality is an effect enjoyed, without payment for the benefit (or, if the externality is negative, suffered, without compensation for the detriment), by one firm (eg a supplier) by reason of the operations of a firm or firms at a different level of trade (eg a distributor)'; S Neubauer and J Lever, 'Vertical Restraints, their Motivation and Justification' [2000] 21 ECLR 7, 17.
[97] See, eg, H Hovenkamp, *supra* n 90, p 3.
[98] Accordingly, Chen and Hylton refer to the principal-agent dilemma as the conflict between the supplier's need to develop a distribution network and the uncertainty caused by this informational asymmetry; ACM Chen and KN Hylton, *supra* n 95, 581.
[99] See RS Pindyck and DL Rubinfeld, *Microeconomics* (6th edn, Prentice Hall 2005), p 627.
[100] P Milgrom and J Roberts, *Economics, Organization and Management* (Prentice Hall 1992), p 167.
[101] Ibid, p 170. Pindyck and Rubinfeld define an agency relationship as an arrangement 'in which one person's welfare depends on what another person does'; RS Pindyck and DL Rubinfeld, *supra* n 99, p 627.

would give him the right to larger claims from the insurance company.[102] Essentially, moral hazard is caused because of one party's difficulty to monitor the other's compliance with its contractual obligations.

A second problem directly associated to the aforementioned information asymmetry is that of 'adverse selection'.[103] In the context of any given transaction, any of the parties can be better informed that the other. From the buyer's perspective, the example of the insurance industry can demonstrate this asymmetry.[104] In the case of medical insurance, the level of the premium does not usually correspond to the risk of each purchaser. Since it is not easy for the insurance company to distinguish between consumers who have a higher risk of getting sick and those with a lower risk, it cannot price-discriminate against these two different classes of consumers, based on their respective needs. Thus, the insurance company is only left with the option of charging a uniform average premium to all applicants. However, in the long run, consumers with a lower risk of getting sick will eventually realise that the premium they pay is rather high in proportion to their likelihood of getting sick; as a result, they will cease purchasing insurance. Simultaneously, the high-risk consumers will regard the premium as a bargain and will keep buying at the same lower price. Accordingly, the insurance company will be left only with high-risk consumers and less profits. Similarly, in the context of an agency relationship the principal may not be in a position to confirm the agent's ability and/or willingness to act in his own best interest, thus leaving space for opportunistic behaviour by the latter.[105]

Inversely, in certain cases the seller might be better informed about a product than the buyer, in which case the latter will be the one affected by adverse selection. In a seminal article published in 1970,[106] economist George Akerlof used the example of the market for used cars (also known as 'lemons') to illustrate informational asymmetry from the buyer's standpoint.[107] By contrast to the car dealer, who has all the information available about the car's condition, a potential buyer of a used car is not familiar with the car's quality at the moment of purchase; he thus assumes that he has fifty percent

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[102] P Milgrom and J Roberts, *supra* n 100, p 167.
[103] ACM Chen and KN Hylton, *supra* n 95, 581.
[104] See, eg, J Lipczynski, J Wilson and J Goddard, *Industrial Organization: Competition, Strategy, Policy* (2nd edn, Prentice Hall 2005), p 101; ACM Chen and KN Hylton, *supra* n 95, 582.
[105] See J Lipczynski, J Wilson and J Goddard, *supra* n 104, pp 101-102.
[106] GA Akerlof, 'The Market for "Lemons": Quality Uncertainty and the Market Mechanism' [1970] 84 *QJ Econ* 488.
[107] For the sake of simplicity, Akerlof assumed that there are only four types of cars: new and used cars on the one hand, and good and bad cars, on the other; ibid, 489.

possibility to buy a good used car or a bad one, or, alternatively, that the car is of average quality. As a result, the buyer would prefer to pay the average price and hope that he will get a good used car, rather than pay a higher price and end up with a 'lemon'. This tendency of the purchasers to overvalue the bad used cars will drive good cars out of the market and, once the consumers realise that, the overall price for used cars will be further lowered.

In the context of a distribution network, the problem of informational asymmetry can also lead to adverse selection by both parties to a distribution agreement, depending on which of them has direct access to essential information. The manufacturer, for example, cannot always predict the potential demand that a specific product could have in a new market. Unaware of the popularity of his product, the supplier will charge an average price for both high-demand and low-demand markets. Accordingly, dealers operating in a low-demand market will eventually drop out of the distribution network, which will in turn accommodate exclusively high-demand areas.

The problem of adverse selection could also be approached from the distributor's perspective. Assume that two competitors operating on the upstream market are bidding for a distributor of their products in a certain geographical area. Assume further that one of the manufacturers produces a product of higher quality than the other, and yet it is impossible for the dealer to distinguish between the two – since the relevant information is only available to the suppliers – until he becomes part of one or the other distribution network. In such a case, the average price that the distributor will be willing to pay will be too high for the low-quality merchandise and too low for the high-quality merchandise. As in the case of 'lemons', the market will eventually be dominated by the bad products.[108]

Instead, a firm integrated vertically in both stages of the distribution chain would have access to vital information which would allow it to organise its strategy more accurately. Through the centralisation of control, any such information will be disseminated to every stage of the production and distribution chain; at the same time, the previously conflicting interests will converge and adverse selection will be eliminated.

[108] See ACM Chen and KN Hylton, *supra* n 95, 584.

2.3.1.2.2. Post-Contractual Opportunism and the Hold-up Problem

It is often the case that, in the context of any relationship between firms operating at different stages of the distribution chain, either the upstream or the downstream firm might be required to make an investment which is specific to that particular contractual agreement. It is therefore likely that the firm which undertakes such an investment finds itself at a disadvantage, since the other party will have the ability to exploit its position by threatening to drop out of the agreement, unless a new arrangement, on more favourable terms, is concluded. The investing party's dependence upon the proper completion of the initial contract gives rise to the 'hold-up problem'.[109] The hold-up problem is a consequence of the problems of contractual incompleteness and *ex post* opportunism, and vertical integration has been suggested as a means to reduce the costs of monitoring the likely post-contractual opportunistic behaviour of the parties.

Two terms from microeconomic theory are relevant here: rents and quasi-rents. A rent is the difference between the extra profits made by a firm and the minimum amount which would induce that firm to enter into a particular contractual agreement. By contrast, the concept of quasi-rents refers to a firm's profits in excess of the minimum amount that would prevent the firm from dropping out of a contract.[110] It is the existence of positive quasi-rents that renders the transactor vulnerable to opportunism.[111]

According to Bishop *et al*, an investment must meet three requirements in order to lead to a hold-up problem. The investment (i) should be used for the exclusive purposes of the relationship in question; (ii) it should represent a sunk cost; and (iii) the prevention of opportunistic behaviour should be 'impossible or excessively expensive'. The hold-up problem is also more likely to emerge in the case of long-term investments, where recoupment requires more time, or where the investments undertaken by both parties are asymmetric, namely where the parties to the transaction are not equally dependent on each other.[112]

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[109] See B Klein, RG Crawford and AA Alchian, 'Vertical Integration, Appropriable Rents, and the Competitive Contracting Process' [1978] 21 *JL & Econ* 297.
[110] P Milgrom and J Roberts, *supra* n 100, p 269.
[111] ACM Chen and KN Hylton, *supra* n 95, 589.
[112] S Bishop, A Lofaro, F Rosati and J Young, *The Efficiency-Enhancing Effects of Non-Horizontal Mergers* (Report for DG Enterprise and Industry, European Commission 2005), available at file:///C:/Users/1000834a/Downloads/non_horizontal_mergers_413.pdf (last accessed on 12 March 2015), pp 69-70.

2.3.1.2.3. General Transaction Cost Savings

As Coase first pointed out, using the market is itself costly. A firm would, therefore, wish to internalise any transactions that would otherwise be concluded in the form of a contractual agreement, at a considerably higher cost, especially bearing in mind that all such agreements involve transaction costs, regardless of whether moral hazard occurs or not.[113] Milgrom and Roberts distinguish between two different types of transaction costs, on the basis of whether they are associated with the coordination or the motivation of the various divisions of the organisational structure. More specifically, coordination costs include the costs of transmitting information through the different stages of the production or distribution chain, as well as any costs of maladaptation resulting from the availability of insufficient information. Motivation costs, on the other hand, may arise either from informational asymmetries or from imperfect commitment.[114]

In light of these assumptions, vertical integration can, for example, minimise any costs related to the search for qualified contracting partners. In that case, any manufacturer who seeks to enter into a distribution agreement will not only incur the post-contractual costs for monitoring the dealer's compliance with the terms of the agreement, but also any costs required for investigating the qualifications of its prospective dealers in the first place.[115] In addition to 'search costs', any costs related to the drawing up of contracts, as well as to their enforcement through litigation could be saved through the centralisation of control in the form of a unified corporate entity. Finally, the free rider problem provides a typical example of motivation costs incurred by the manufacturer where its retailers have the incentive to provide a suboptimal amount of sales-specific services.[116] It goes without saying that this minimisation of transaction costs could lead to pricing efficiencies to the consumer's benefit, since it will reflect in 'lower marginal costs and/or lower fixed costs'.[117]

[113] Ibid, p 72.
[114] See P Milgrom and J Roberts, *supra* n 100, pp 29-30.
[115] ACM Chen and KN Hylton, *supra* n 95, 586-587.
[116] WK Viscusi, JE Harrington, Jr and JM Vernon, *Economics of Regulation and Antitrust* (4th edn, The MIT Press 2005), p 238.
[117] S Bishop, A Lofaro, F Rosati and J Young, *supra* n 112, p 72.

2.3.2. Anti-competitive Effects of Vertical Integration

Economic theory suggests that vertical mergers may also produce significant anti-competitive effects, which are typically classified as either ‘non-coordinated’ or ‘coordinated’. This assumption has also been endorsed by the European Commission and incorporated in its Non-Horizontal Merger Guidelines.[118] The following paragraphs will examine the relevant theories.

2.3.2.1. Non-Coordinated Effects – The Foreclosure Theory

The main objection to vertical mergers is related to the foreclosure of actual or potential competitors on either the upstream or the downstream market. More specifically, foreclosure occurs when the access of competitors to the market is restricted or eliminated as a result of a vertical merger.[119] Three main anti-competitive effects of foreclosure have been identified: (i) leveraging of monopoly power from the input to the output market, or vice versa; (ii) raising barriers to new entry; and (iii) facilitation of co-ordination in oligopolistic markets.[120] Nevertheless, in order for such foreclosure to raise competitive concerns, the main requirement is that, consequently, the price charged to consumers is increased. Absent an increase in the price of the output, the merger can be regarded as resulting in a mere ‘realignment of supply relationships’[121] among the relevant markets.[122] It should be stressed at this point that this price increase can occur only where one of the merging firms enjoys substantial market power (it is ‘a monopolist or something close’, according to Hovenkamp).[123] In any other case, the merged entity’s rival will merely have to enter into new contracts, restructuring the supply pattern in that particular industry.

[118] See the Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings [2008] OJ C265/6 (hereinafter ‘Non-Horizontal Merger Guidelines’).
[119] Non-Horizontal Merger Guidelines, para 18.
[120] See, eg, AA Fisher and R Sciacca, ‘An Economic Analysis of Vertical Merger Enforcement Policy’ [1984] 6 *Research in L & Econ* 1, 40-47.
[121] MH Riordan and SC Salop, ‘Evaluating Vertical Mergers: A Post-Chicago Approach’ [1994-1995] 63 *Antitrust LJ* 513, 532. The US Supreme Court was heavily criticised by commentators for disregarding this aspect of foreclosure in *Brown Shoe Co v United States*, 370 US 294 (1962); see, eg TG Krattenmaker and SC Salop, ‘Anticompetitive Exclusion: Raising Rivals’ Costs to Achieve Market Power’ [1986-1987] 96 *Yale LJ* 209, 221.
[122] This condition is also being stressed by the European Commission in the Non-Horizontal Merger Guidelines, paras 18 and 47. See also S Bishop and M Walker, *The Economics of EC Competition Law: Concepts, Application and Measurement* (3rd edn, Sweet & Maxwell 2010), pp 429-430.
[123] H Hovenkamp, *supra* n 90, p 388.

Foreclosure can be further distinguished in two more specific categories: input foreclosure and customer foreclosure. Input foreclosure refers to a situation whereby the upstream division of the merged entity restricts the access of downstream competitors to substantial inputs (products or services) that would be available to them absent the merger. Accordingly, a rival's costs are likely to rise. On the other hand, customer foreclosure is related to the refusal of the downstream branch of the merged entity to purchase from an upstream competitor, in which case the latter will find itself in competitive disadvantage, due to a reduction in its revenues.

2.3.2.1.1. Input foreclosure

Input foreclosure can appear in two forms and it occurs where the upstream branch of the post-merger firm either (i) ceases supplying its downstream competitors altogether, or (ii) does so at a higher price. It can thus be either 'complete' or 'partial', respectively.[124]

The main anti-competitive concern raised by input foreclosure is that, due to the restricted access of downstream rivals to products or services that used to be available prior to the merger, the rivals' costs are likely to rise, since it will be 'harder for them to obtain supplies of the input under similar prices and conditions as absent the merger'.[125] The higher costs incurred by the downstream rivals shall force them to reduce their own output and, accordingly, to raise the prices charged in this market. In such a case, the merged firm may have the opportunity to exploit its market power in the downstream market either unilaterally or by forcing its downstream rivals – who are already in a competitive disadvantage due to their higher costs – to coordinate their conduct on that market (coordinated effects of vertical mergers).[126] In addition, foreclosure may facilitate collusion through the reduction of the number of players in the relevant market.[127] A third potential adverse effect of input foreclosure is that it can be used to prevent new entry, enabling the upstream division of the post-merger firm to maintain its market power.[128]

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[124] J Church, *The Impact of Vertical and Conglomerate Mergers on Competition* (Report for the Directorate General for Competition, European Commission September 2004), available at http://bookshop.europa.eu/en/the-impact-of-vertical-and-conglomerate-mergers-on-competition-pbKD7105158/ (last accessed on 8 April 2015), p v.

[125] Non-Horizontal Merger Guidelines, para 31.

[126] MH Riordan and SC Salop, *supra* n 121, 528.

[127] Non-Horizontal Merger Guidelines, para 83.

[128] S Bishop and M Walker, *supra* n 122, p 434.

In order for a vertical merger to raise anti-competitive concerns, the upstream firm should enjoy market power in the relevant market.[129] In the absence of market power, the downstream rivals who are excluded from the supply of a specific input post-merger will realign their strategy by searching for alternative sources of supply, namely by entering into contractual relationships with competitors of the merged entity in the upstream market. In such a case, rivals' costs are not likely to rise, unless the competing suppliers 'do not have the ability or incentive to expand output at current prices and if alternative inputs are imperfect substitutes'.[130] Another factor which should also be taken into account is the structure of the market for inputs: even in the absence of a monopolist in the upstream market, input prices might increase in cases where the market is conducive to collusive conduct. A close scrutiny of the market in question is therefore required.

The merged entity can benefit from the foreclosure of its competitors in two ways. On the one hand, the additional sales to customers who were formerly being supplied by the now foreclosed rivals of the integrated firm will result in an increase in the firm's retail profit margin, which will be proportionate to the increase in the demand for its products. However, this exclusion of rivals is in itself insufficient to support a claim of competitive harm. On the other hand, the reduced competition in the downstream market might allow the market participants profitably to raise their prices, in which case the merger will give rise to competitive harm.[131]

2.3.2.1.2. Customer foreclosure

Customer foreclosure occurs when, as a result of a merger, the downstream branch of a vertically integrated firm is no longer accessible for competing input suppliers, the customer base of which is thus restricted.[132] Where the downstream division of the merged

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[129] According to Hovenkamp, it is the monopolist's large market share, and not its market power, that allows it to exploit foreclosure to the detriment of the consumers. To this purpose, he uses the example of a statutory monopolist in a price-regulated industry: vertical integration by such a monopolist and its subsequent refusal to allow its downstream competitors to have access to, eg, its telephone lines will foreclose the latter, it being irrelevant whether the monopolist has the power to raise its price above marginal cost; see H Hovenkamp, 'Vertical Integration by the Newspaper Monopolist' [1983-1984] 69 *Iowa L Rev* 451, 466.

[130] MH Riordan and SC Salop, *supra* n 121, 531.

[131] For a detailed analysis of the benefits of input foreclosure strategy for the integrated firm, see S Bishop and M Walker, *supra* n 122, pp 435-438.

[132] Put differently, 'Under the "customer foreclosure" hypothesis, the integrated firm no longer sources supply from upstream competitors, but continues to supply other downstream firms. Indeed the profitability of foreclosure depends on being able to supply competing downstream firms at higher prices post merger'; J Church, *The Impact of Vertical and Conglomerate Mergers on Competition* (Report for the Directorate General for Competition, European Commission, 2004), p 95.

entity is sufficiently large, the upstream rival may incur higher production costs and, due to its limited ability to compete, may eventually be forced to exit the market (especially where economies of scale and scope are important).[133] By contrast to input foreclosure, the main benefit of customer foreclosure for the merged firm is the reduction of rivals' revenues. Customer foreclosure can have a double negative effect on competition. First, the restriction of the number of players in the upstream market may give the excluding firm the opportunity to raise its prices above the competitive level, either unilaterally or through coordination with the remaining competitors. Second, prices in the market for outputs are also likely to rise accordingly.

In order for the foreclosure strategy to give rise to anti-competitive concerns, the input suppliers affected by it should account for a substantial part of the upstream industry. If the revenue decreases resulting from the vertical mergers affect only a small fraction of the suppliers, and simultaneously the non-foreclosed players are capable of expanding their output, then the competitive pressure exercised by the latter may prevent the increase of prices in the upstream market.

2.3.2.1.3. *Brown Shoe* and Chicago School Criticism of the Foreclosure Theory

The treatment of vertical mergers under US antitrust law has gone through various fluctuations throughout the years. At first, vertical mergers were not even considered as falling within the scope of Section 7 of the Clayton Act, the wording whereof implied that it was only applicable to mergers and acquisitions between direct competitors. As a result vertical integration was challenged in only a limited number of cases.[134] It was not until 1950 that the Clayton Act was amended in order to apply to vertical and conglomerate mergers as well. Subsequently, the US Supreme Court's decision in *Brown Shoe*,[135] which condemned the acquisition by a shoe manufacturer of a firm operating in the shoe retailing industry, gave rise to severe criticism particularly by Chicago School scholars. For the first time in *Brown Shoe* Section 7 was applied both to the horizontal and vertical aspects of a merger; nevertheless, it was the Court's approach to the vertical effects of the acquisition

[133] S Bishop and M Walker, *supra* n 122, p 444, fn 67 and accompanying text. However, even in the absence of economies of scale and scope, a restricted customer base may have a negative impact on suppliers with regard to non-price competition, and 'may reduce the incentives of the foreclosed firm to invest in cost reduction, product quality, or other nonprice product dimensions'. In this way, the foreclosed entity is likely to relax its competitive pressure on the excluding firm; MH Riordan and SC Salop, *supra* n 121, 555.

[134] See, eg, GE Hale, 'Vertical Integration: Impact of the Antitrust Laws upon Combinations of Successive Stages of Production and Distribution' [1949] 49 *Colum L Rev* 921, 923-927.

[135] *Brown Shoe Co v United States*, 370 US 294 (1962).

that attracted the attention of antitrust law scholars. The case concerned the merger between two already integrated firms, one of which was mostly active in the upstream market for the production of shoes, and the other in shoe retailing. The decision was met with severe scepticism as overly protectionist and received only limited support.[136]

The Brown Shoe Company, Inc was an already vertically integrated corporation, being the fourth largest manufacturer and the third largest retailer of shoes in the United States. In 1956, Brown Shoe acquired another already vertically integrated firm, GR Kinney Company, Inc, the country's twelfth largest shoe manufacturer with a market share of 0.5 percent, and, at the same time, seventh largest retailer, operating more than 350 retail outlets. At the time of the merger, Kinney, notwithstanding its small market share – which did not exceed 1.2 percent of total retail sales by dollar volume (or 1.6 percent of total pairage) – was the largest 'family-style' shoe store chain in the United States. Kinney's upstream branch supplied 20 percent of the shoes sold in Kinney's outlets, and, before the merger, Kinney did not purchase any shoes from Brown. This changed post-merger and, as a result, Brown eventually covered 7.9 percent of Kinney's requirements, becoming the largest outside supplier of shoes to Kinney's downstream operations.[137]

The Supreme Court affirmed the district court's finding that the merger infringed Section 7. As a matter of methodology, the Court relied on the examination of the legislative history of the Clayton Act and sought to investigate the objectives pursued through the enactment of the Celler-Kefauver Act by the Congress. Perhaps this was the reason why the Court practically disregarded any economic justifications and based its reasoning on facts related to the structure of the merging entities and – to a lesser extent – the structure of the affected markets.[138] Therefore, Chief Justice Warren pointed out that the main concern of the Congress when deciding on the amendment of Section 7 was the danger to the American economy resulting from 'the rising tide of economic concentration', which would accordingly, threaten the maintenance of local control over industry and the protection of small businesses.[139]

In arguing that the foreclosure of even a small percentage of the market could bring a vertical merger under the scope of Section 7, the Supreme Court reasoned that:

[136] See, eg, W Adams and JB Dirlam, 'Brown Shoe: In Step with Antitrust' [1963] 1963 *Wash ULQ* 158.
[137] Ibid, 304.
[138] See also IR Barnes, 'The Primacy of Competition and the Brown Shoe decision' [1962-1963] 51 *Geo LJ* 706, 709.
[139] 370 US 294, 315-316.

> [t]he primary vice of a vertical merger or other arrangement tying a customer to a supplier is that, by foreclosing the competitors of either party from a segment of the market otherwise open to them, the arrangement may act as a 'clog to competition' ... which deprive[s] ... rivals of a fair opportunity to compete.[140]

The Court further stated that, in cases like the one under consideration, where the portion of the market foreclosed to competitors amounted to neither monopoly nor *de minimis* proportions, other relevant factors should be taken into account. These factors were of a historical or economic nature, and included the examination of the nature and purpose of the arrangement,[141] as well as the possible existence of a trend toward concentration through vertical integration in the specific industry.[142] In the case of *Brown Shoe,* the Court acknowledged that there was indeed a recent trend toward concentration, as large shoe manufacturers had been acquiring retail outlets; in view of this recent tendency, it was assumed that Brown's objective was to force the sale of its shoes through Kinney's stores.[143] Arguably, the merger in question could not possibly have the result of creating a monopoly. The Court's main concern was rather a tendency toward oligopoly in the industry through increased consolidation; according to its reasoning, the merger seems to have been condemned 'on the ground that other businesses in the industry are also growing'.[144] In other words, by focusing on the trend toward concentration as the most important factor for the appraisal of a vertical merger, the Court essentially accepted that the examination of market shares is relevant only within the context of a specific industry: even mergers which would result in only limited foreclosure would be prohibited if they were part of a widespread consolidation.

Based on the Supreme Court's decision in *Brown Shoe,* the Court of Appeals for the 6th Circuit in a subsequent case identified the six factors to be considered when the compatibility of a vertical merger with Section 7 is being assessed:

> (1) foreclosing of the competitors of either party from a segment of the market otherwise open to them; (2) the 'nature and purpose' of the vertical arrangement; (3) actual and reasonable likely adverse effects upon local industries and small businesses; (4) the level and trend of concentration in the market shares of

[140] Ibid, 323-324.
[141] Ibid, 329.
[142] Ibid, 332.
[143] Ibid, 331-332.
[144] JR Fitzgerald, 'The Brown Shoe Company Case: A New "Substantiality" in Section 7 of the Clayton Act' [1963] 27 *Alb L Rev* 54, 61.

participating companies, including any trend towards domination by a few leaders; (5) the existence of a trend towards vertical integration and consolidation in previously independent industries; and (6) the ease with which potential entrants may readily overcome barriers to full entry and compete effectively with existing companies.[145]

The Court's decision was based on the foreclosure theory, and this approach was incorporated into the 1968 Merger Guidelines of the Department of Justice.[146] In addition, the decision introduced the 'incipiency doctrine' in the field of vertical mergers: even though the risk of foreclosure after a merger is low, the court may block the concentration if it maintains that evidence shows that a market-wide trend towards vertical integration might eventually result in high levels of concentration in the industry in question.[147] Nevertheless, prominent commentators objected to this, arguing that vertical integration is merely a means employed by firms to increase efficiency. A monopolist, they stressed, cannot exploit a vertical merger in order to leverage its market power into a separate level of the distribution chain. A vertically integrated firm which monopolises more than one levels shall have only a single monopoly profit, since it will be unable to charge a separate profit-maximizing for every single level separately. A rational hypothetical manufacturer who holds a monopoly in the upstream market shall not allow its downstream subsidiary to restrict output further, since then the resulting price will be higher than its own profit-maximising level.[148] It has thus been argued that a monopolist lacks the incentive to acquire an additional vertically related monopoly.

Bork is rather explicit: 'foreclosure theory is not merely wrong, it is irrelevant … Foreclosure theory is like a conjuring stick: it causes you to look at the wrong level of the industry'.[149] He argues that the problem with a firm's foreclosure strategy does not lie in the exclusion of its rivals at a vertically related level, but rather in the establishment of the monopoly; once the monopoly is established, the vertically integrated firm has no reason to foreclose any competitors. In a hypothetical example whereby a manufacturer acquires all firms operating at the retailing level, potential anti-competitive effects will be caused not

[145] *United States Steel Corp v FTC*, 426 F2d 592, 599 (6th Cir 1970).
[146] American Bar Association, *Mergers and Acquisitions: Understanding the Antitrust Issues*, (2nd edn, American Bar Association 2004), p 352.
[147] KN Hylton, *Antitrust Law: Economic Theory and Common Law Evolution* (Cambridge University Press 2003), p 339.
[148] See RH Bork, *The Antitrust Paradox: A Policy at War with Itself* (Simon & Schuster 1993), p 229.
[149] Ibid, p 237.

by the series of vertical mergers itself, but rather by the horizontal concentration of retailers under a common ownership.[150]

It has also been argued that the acquisition by an upstream monopolist of all its distributors is not always profitable. The barriers to new entry resulting from the former's foreclosure strategy will not prevent new firms from entering the upstream market, but will merely delay their entry. Provided that the only purpose of the excluding firm is to eliminate competition, this delay is likely to be costly for it, since not only will it eventually incur higher distribution costs, but also it is unlikely that it will benefit from any net economies of integration: if such economies existed the firm would have integrated already.[151] That is to say, a monopolist's decision to integrate only with the purpose of restricting competition at a vertically related level would simply be unreasonable.

2.3.2.2. Coordinated Effects

In addition to the foreclosure theory, vertical mergers may also give rise to coordinated effects by facilitating competitors in coordinating their conduct without having to enter into an agreement. In other words, a vertical merger may encourage tacit coordination in markets susceptible to collusive outcomes. Kokkoris and Shelanski regard coordinated effects as the necessary result of market foreclosure, as they are more likely to emerge where the vertical merger has brought about a high degree of concentration, which could sustain a collectively dominant position held by the remaining firms.[152]

Nocke and White identify two counteracting effects of vertical mergers which may influence the likelihood of coordination in the upstream market. The 'outlets effect' of vertical integration arises because the downstream division of an integrated firm will always prefer to purchase its input from the upstream branch at marginal cost, rather than from any other supplier that deviates from existing collusion and sells at a price which guarantees positive profits. Consequently, the reduced profitability of deviation is in turn expected to deter cheating. The 'punishment effect', on the other hand, ensures that a vertically integrated firm will have an increased incentive to deviate from the collusive agreement. The reason is that the merged entity's profits in the noncooperative equilibrium

[150] Ibid, p 237.
[151] RA Posner, *Antitrust Law* (2nd edn, University of Chicago Press 2001), pp 225-226.
[152] I Kokkoris and H Shelanski, *EU Merger Control: A Legal and Economic Analysis* (Oxford University Press 2014), pp 360-361.

at both stages are greater than the respective profits of a non-integrated upstream competitor. In the event of cheating, therefore, the integrated entity can be expected to suffer less from retaliation than the independent firm.[153] It follows that the merged entity's decision to coordinate or deviate will be taken on the basis of a balancing between the outlets and punishment effects.

Furthermore, it has been argued that vertical mergers may soften price competition by facilitating the exchange of sensitive commercial information between competing suppliers.[154] The downstream division of a vertically integrated firm is in a position to disclose to the upstream division accurate information on the prices offered by independent suppliers.[155] Coordination may also be facilitated where the merger consists in the acquisition of a 'maverick', namely a firm which has the incentive to compete aggressively in defiance of the coordinated outcome.

2.4. The Antitrust Response to Vertical Integration by Ownership: EU Merger Control

The statutory framework for the competitive assessment of mergers under EU competition law is provided by Regulation 139/2004.[156] The European Union Merger Regulation (hereinafter 'EUMR') is supplemented by the Implementing Regulation 802/2004,[157] as well as by various Commission Notices which provide clarifications and guidance with regard to the application of the EUMR.[158] The EUMR is applicable to any concentrations with a 'Community dimension',[159] namely to concentrations that give rise to structural changes the impact of which goes beyond the national borders of any one

[153] V Nocke and L White, 'Do Vertical Mergers Facilitate Upstream Collusion?' [2007] 97 *Am Econ Rev* 1321.

[154] MH Riordan and SC Salop, *supra* n 121, 557-560. This paradigm assumes that the vertical merger has not resulted in customer foreclosure.

[155] Ibid.

[156] Council Regulation (EC) 139/2004 on the control of concentrations between undertakings [2004] OJ L 24/1. It replaced the original Merger Control Regulation 4064/1989 on the control of concentrations between undertakings [1989] OJ L395/1.

[157] Commission Regulation 802/2004 implementing Council Regulation (EC) 139/2004 on the control of concentrations between undertakings [2004] OJ L133/1.

[158] The relevant Commission Notices are available at the DG COMP website, http://ec.europa.eu/competition/mergers/legislation/notices_on_substance.html (accessed on 4 April 2015).

[159] Article 1(1) of the EUMR.

Member State.[160] The Community dimension of a specific concentration is decided on the basis of the turnover of the merging parties.[161]

The European Commission is the institution entrusted with the enforcement of the EUMR. The Regulation stipulates that any concentration that falls within its scope be notified to the Commission prior to its implementation and following the conclusion of the agreement, the announcement of the bid, or the acquisition of a controlling interest.[162] In case the parties fail, either intentionally or negligently, to comply with the requirement for prior notification, Article 14(2)(a) confer to the Commission the power to impose fines not exceeding 10 percent of their aggregate turnover.

A merger can have horizontal, vertical, or conglomerate effects, and in all these cases the legality test applied by the Commission is set out in Article 2(3) of the EUMR: '[a] concentration which would significantly impede effective competition in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position, shall be declared incompatible with the common market'.[163] It is only vertical mergers, namely mergers between undertakings that operate at successive stages of the same production or distribution chain, that fall within the scope of this thesis. It should be noted however that it is extremely rare that a specific case will give rise exclusively to vertical concerns; on the contrary, vertical effects usually result from concentrations involving actual or potential competitors, in addition to the horizontal effects of such mergers. Finally, conglomerate mergers are unlikely to have any detrimental effects on competition, as they involve undertakings that are in a relationship which is neither horizontal nor vertical, and for this reason are rarely scrutinised by the Commission. It is only where the merging parties are active in closely related markets that the merger might raise anti-competitive concerns.[164]

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[160] Recital 8 of the EUMR.
[161] See Article 1(2) of the EUMR.
[162] Article 4(1) of the EUMR. Recital 11 of Regulation 802/2004 also provides the merging parties with the possibility of pre-notification contacts. Such contacts of the undertakings concerned with the Commission, although not mandatory, are encouraged by the latter as a means to provide guidance regarding issues that may arise or the information to be subsequently submitted by the notifying parties: 'in cases in which notifications have been declared incomplete, usually there were no or very limited pre-notification contacts'; DG Competition, *Best practices on the Conduct of EC Merger Control Proceedings*, available at http://ec.europa.eu/competition/mergers/legislation/proceedings.pdf (last accessed on 9 April 2015), para 7.
[163] Article 2(3) of the EUMR.
[164] Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings [2008] OJ C265/6 (hereinafter 'Non-Horizontal Merger Guidelines'), paras 91-92. On certain occasions, the Commission and the Courts have taken action against, and have in fact prohibited, mergers based on their conglomerate effects, see Case No COMP/M.2220, *General*

The Commission acknowledges that vertical (as well as conglomerate) mergers are essentially less likely to impede effective competition; non-horizontal mergers do not result in the restriction of direct competition between firms operating in the same relevant market, whereas, on the other hand, they also provide a wider scope for efficiencies in comparison to horizontal mergers, for example lower prices, increased output and lower transaction costs.[165] An impediment to effective competition could, nevertheless, arise from a vertical merger that results in non-coordinated (in the form of foreclosure) or coordinated effects (where the nature of competition is transformed as a result of the merger in such a way that it is easier for the undertakings to coordinate their conduct with the purpose of harming competition).[166]

According to the Non-Horizontal Merger Guidelines, it is only where the merged entity enjoys a significant degree of power in at least one of the markets that a non-horizontal merger can in fact impede effective competition. In assessing the merged entity's market power, the Commission relies on two factors: (i) market shares, and (ii) concentration levels, whether the concerns raised are of non-coordinated or coordinated nature. More specifically, the Commission is not likely to treat the merger as harmful where, in each of the affected markets, the market share of the merged entity is below 30 percent and the post-merger HHI[167] is below 2,000.[168]

However, even in cases where the market shares or the concentration levels are below these thresholds, the Commission might initiate an extensive investigation, provided that certain special circumstances are present: (i) the merger involves a company that is likely to expand significantly in the near future; (ii) there are significant cross-shareholdings or cross-directorships among the market participants; (iii) one of the merging parties is a so-called 'maverick' firm, namely an undertaking with a high

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Electric/Honeywell, decision of 3 July 2001; Case No COMP/M.2416, *Tetra Laval/Sidel*, decision of 30 January 2002, annulled on appeal Case T-5/02, *Tetra Laval BV v Commission* [2002] ECR II-4381.

[165] Non-Horizontal Merger Guidelines, paras 11-14.

[166] Ibid, paras 17-19.

[167] The Herfindahl-Hirschman Index (HHI) is a way of calculating the level of concentration in a given market. It is defined as the sum of the squared market shares of all the firms in the market under investigation. Markets with an HHI below 1,000 are generally considered as not concentrated, whereas where the HHI is between 1,000 and 1,800 the market shall be deemed as moderately concentrated. Highly concentrated – and, therefore, more susceptible to anti-competitive effects as a result of a merger – are those markets with an HHI above 1,800. As a matter of methodology, the antitrust authorities compare the pre-merger and post-merger HHI and assess the change in concentration levels brought about by the merger. This change, which is calculated by subtracting the pre-merger HHI from the post-merger HHI, is called 'delta'. Depending on whether the market is highly or moderately concentrated, a delta of 50 or 100 respectively may give rise to competitive concerns; see generally JS Gans, 'Concentration-Based Merger Tests and Vertical Market Structure' [2007] 50 *JL & Econ* 661.

[168] Non-Horizontal Merger Guidelines, paras 23-25.

likelihood of disrupting coordinated conduct; or (iv) there are indications of past or ongoing coordination or facilitating practices.[169]

2.5. Conclusion: Is There Room for a 'Unified' Framework for RPM and Vertical Mergers?

The foregoing analysis examined the pro- and anti-competitive effects of RPM and vertical integration as two alternative forms of vertical control, and presented the various economic justifications for the adoption of each. It was seen that both RPM implemented in the context of market transactions and hierarchical organisation may produce comparable efficiencies, by enhancing the manufacturer's control over distribution where they are designed as solutions to the problem of post-contractual opportunism or with the purpose to remedy any emerging externalities, such as free riding. It can thus be concluded that, from an organisational perspective, RPM may be employed as a strategic alternative – albeit imperfect – to complete vertical integration, where the latter is not economically feasible and the market mechanism appears to constitute a less costly vehicle for product distribution.

That said, there are admittedly two main obstacles to the adoption of a truly 'unified' framework for the analysis of vertical mergers and RPM. First, from an economic perspective, vertical mergers and RPM, although having similar pro-competitive justifications, representing alternative forms of vertical control, nonetheless give rise to different theories of harm – or, to be more precise, the same theories of harm do not apply with equal force to both cases. The Commission, in its Non-Horizontal Merger Guidelines, recognises that vertical mergers may bring about non-coordinated and coordinated anti-competitive effects. However, a review of merger decisions involving parties operating at successive stages of the production or distribution chain shows that the Commission has never so far expressed any concerns with regard to a potential collusive behaviour or tacit coordination between the players in a market that would be more concentrated as a result of a merger. This is evident in a series of vertical mergers which raised serious competition

[169] Ibid, para 26.

concerns, but were eventually cleared subject to conditions,[170] as well as in *RTL/Veronica/Endemol*,[171] so far the only vertical merger blocked by the Commission.

The fact that evidence of possible coordinated effects has not yet been relied upon by the Commission for the competitive appraisal of vertical mergers is not particularly surprising in light of the limited theoretical support for this argument. Contrary to the foreclosure theory, economic literature has not dealt extensively with the coordinated effects of vertical integration. Against this background, in a relatively recent study, Schwalbe and Zimmer downplay the contribution of vertical mergers to the creation or stabilisation of inter-firm coordination, and suggest that '[f]rom an economic point of view, it would seem advisable not to base the assessment of a vertical merger on possible coordinated effects, since they are extremely difficult to predict'.[172]

The foreclosure theory is also applicable to RPM. Vertical price fixing is likely to result in the foreclosure of smaller firms active in the downstream market when applied at the behest of a dominant retailer or a group of retailers who collectively possess substantial monopsony power with a purpose to exclude smaller price-cutting rivals. However, retailer foreclosure raises problems of inference, as it is equally consistent both with pro- and anti-competitive theories.[173] At the same time, the recent years have witnessed the evolution of a significant body of literature confirming the foreclosure effects of price floors in the

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[170] See Case No COMP/M.2050, *Vivendi/Canal+/Seagram*, decision of 13 October 2000; Case No COMP/M.4314, *Johnson & Johnson/Pfizer Consumer Healthcare*, decision of 11 December 2006; Case No COMP/M.4540, *Nestlé/Novartis (Medical Nutrition Business)*, decision of 29 June 2007.

[171] Case No IV/M.553, *RTL/Veronica/Endemol (HMG)*, decision of 20 September 1995. The purpose of the concentration in *RTL/Veronica/Endemol* was the creation of a joint venture, HMG, which would supply and broadcast television and radio programmes. The parent companies included a supplier and broadcaster of Dutch speaking TV and radio programmes (RTL), a public broadcasting organisation (Veronica), and the biggest Dutch independent producer of TV programmes (Endemol). It was this new structural link between Endemol and the joint venture that raised concerns as to the vertical effects of the merger on competition. More specifically, not only was Endemol clearly dominant in the market for TV production in the Netherlands, but also had entered into contracts with the most popular Dutch TV personalities, had its own agency for TV stars, and, generally, enjoyed a number of advantages that strengthened its already dominant market position vis-à-vis its rivals.

The Commission was mainly concerned with the fact that Endemol had entered into a 'Production Agreement' with HMG, by virtue of which the latter undertook the obligation to purchase a minimum amount of its programme requirements from Endemol, a benefit which at the time was not available to any other player in the upstream market. The Commission held that the vertical integration of Endemol would result in customer foreclosure, through the restriction of the upstream competitors' access to HMG, particularly given that the Commission was expecting the new joint venture to acquire a dominant position, at least in the TV advertising market. Due to its influence on HMG's general programming policy, Endemol was also expected to have the ability to enter new programme sectors (for example documentaries) in which it was not active at the time of the concentration, thus enhancing its market power to the further detriment of its competitors. Eventually, the Commission blocked the merger, declaring it incompatible with the internal market.

[172] U Schwalbe and D Zimmer, *Law and Economics in European Merger Control* (Oxford University Press 2009), p 375.

[173] See in that regard *infra* s 6.4.3.

upstream market, when employed by an incumbent manufacturer.[174] However, the horizontal collusion theory remains the most prominent objection to RPM, and was the reason for the adoption of the rule of per se illegality in *Dr Miles*. The ability of RPM to facilitate cartelisation in the upstream and downstream market and to soften price competition in general will be examined in more detail in the following chapter. Suffice it to say at this stage, however, that the horizontal collusion story is a particularly compelling theory of harm, which advocates a more cautious approach to RPM in general.

The second obstacle to a truly unified framework is of procedural nature. While the competitive appraisal of mergers in the EU is based on a system of *ex ante* control, following the enactment of Regulation 1/2003, the substantive assessment of agreements between undertakings – including, of course, RPM – is carried out exclusively *ex post*, taking the form of a retributive approach. There are, however, very good reasons advocating against change in the current regime. The Modernisation Regulation put an end to a system which provided for the possibility both of *ex ante* and of *ex post* scrutiny of inter-firm cooperation: according to Article 4(1) of Regulation 17/62, then in force, the parties to agreements falling within the scope of Article 101(1) were required to notify them to the Commission in order to benefit from an individual exemption under Article 101(3).

The preceding regime, however, was based on the illusion that members to a demonstrably anti-competitive agreement would have any incentive to notify it to the Commission. Plainly put, the prior notification system under Regulation 17/62 turned out to be a burden both for the Commission and for undertakings. In the first year of its application, more than 34,500 agreements[175] seeking negative clearance or exemption under Articles 2 and 4(1) of the said Regulation were notified,[176] and, unsurprisingly, most of them did not raise any particular concerns.[177] Consequently, Recital 3 of Regulation 1/2003 announces that the purpose of modernisation was essentially to replace a system which '[prevented] the Commission from concentrating its resources on curbing the most serious infringements'.

In addition to the futility of such a system of *ex ante* enforcement of Article 101 TFEU from a point of view of administrative efficiency, there are also substantial

[174] See *supra* s 2.1.2.3.
[175] However, the number of notifications substantially decreased in due course.
[176] CD Ehlermann, 'The Modernisation of EC Antitrust Policy: A Legal and Cultural Revolution' [2000] 37 *CMLRev* 537.
[177] See R Whish, *Competition Law* (6th edn, Oxford University Press 2009), p 248.

differences in the costs incurred by undertakings for the purposes of reversing a transaction that warrants antitrust intervention which also justify the different policies. By assumption, the transaction costs involved in the reversal of a concentration are disproportionately large compared to those incurred by undertakings switching from an anti-competitive agreement to a less restrictive alternative. It follows that, also from the parties' perspective, *ex ante* control is imperative in the case of a merger, but essentially meaningless in the case of restrictive agreements.

Regardless of the difficulties in shaping a genuinely 'unified' analytical framework for the competitive appraisal of RPM and vertical mergers, however, it is submitted here that there is still the need for a more consistent antitrust response to the different methods of distribution. On the basis of Ronald Coase's pioneering scholarship, developed further by subsequent studies on new institutional economics, it has been demonstrated that the boundaries of a firm are determined in light of potential transaction cost savings. However, these boundaries are not as sharp as Coase appears to suggest: new institutional economics suggest that markets and hierarchies are the polar extremes of an organisational continuum, in the middle of which are hybrid forms of organisation, frequently referred to as 'networks'. Networks are organisational mechanisms governing inter-firm transactions, in the context of which long-term coordination is facilitated through relational norms implicit in the interactions between the parties.

On the basis of these assumptions, from an economic perspective, contract and ownership may be regarded as two alternative forms of vertical integration, as the requirements of stability and flexibility in contemporary commercial practice obscure the boundaries of the firm. Building on the foregoing analysis, it is submitted that manufacturer-imposed RPM, along with other forms of vertical restraints, may be implemented with the purpose of ensuring the sustainability of a long-term relational contract by enhancing control over distribution. More specifically, price floors may enhance the self-enforcing range of contractual relations. Thus, in light of the principle of organisational neutrality, a relative consistency in the treatment of RPM and vertical mergers under EU competition law is warranted.

Unlike the neoclassical economic theory, which views the firm as a production function, its purpose under new institutional economics is that of a governance structure. In this sense, the firm is only one of a number of alternative ways of organising relationships among economic units which are aimed at taking advantage of the division of labour, economising on bounded rationality and providing safeguards against contractual hazards.[178] It follows that the concept of organisational neutrality is associated with new institutional economics, which regards vertical integration as merely a 'paradigm': an organisational framework applicable with equal force to situations where a firm owns or contracts with a successive stage of the distribution chain.[179]

In view of the adverse effects of the practice, however, the steps taken to this direction must be cautious, and not go beyond the availability of a burden-shifting analytical framework. Accordingly, it will be argued that the optimal means for the attainment of this consistency will be a careful reform of the current regime, to the extent that it affords parties to a *prima facie* anti-competitive RPM agreement the opportunity to rebut the presumption of illegality associated with their classification as 'by-object' restrictions under Article 101(1) TFEU.

[178] C Ménard, 'A New Institutional Approach to Organization' in C Ménard and M Shirley (eds), *Handbook of New Institutional Economics* (Springer 2005), p 282.
[179] OE Williamson, 'Transaction Cost Economics' in C Ménard and M Shirley (eds), *Handbook of New Institutional Economics* (Springer 2005), pp 52-54.

Chapter 3

Resale Price Maintenance and Horizontal Collusion: Price Rigidity in the Offline and Online Context

3.1. RPM as a Collusion Facilitating Mechanism

The links between the public policy towards RPM and the English common law tradition were outlined in a previous chapter.[1] It was seen that the rationale behind the US Supreme Court's hostility towards the maintenance of minimum retail price levels, as demonstrated by the per se treatment established in *Dr Miles*[2] was partly – yet disproportionately so – premised on the ancient doctrine against restraints on alienation. The following analysis will concentrate on economic considerations behind the *Dr Miles* dictum, and in particular in the contribution of RPM to the facilitation of horizontal collusion in both the upstream and the downstream market.

The horizontal collusion objection to vertical price fixing has been traditionally the most oft-cited theory of harm associated with price floors. Although, as was seen in the previous chapter, the theory is generally applicable both to the upstream and the downstream market, in *Dr Miles* the Supreme Court found that the RPM scheme at issue was designed to reinforce a dealer cartel. In reaching this conclusion, the Court noted that the only parties that could possibly benefit from the maintained retail prices were the dealers themselves. The reason put forward by the manufacturer for the implementation of this policy was to prevent department stores from marketing its products as 'loss leaders': announcements of sales at cut prices adversely affected the reputation of the medicines and discouraged retail druggists to stock them. In essence, therefore, Dr Miles argued that the price floors were intended to increase the density of its distribution network by inducing otherwise unwilling druggists to carry its products.[3] However, Mr Justice Hughes was not convinced that a manufacturer would be interested in affording enlarged profits to retailers. Unable to understand how Dr Miles could possibly benefit from this policy, Hughes

[1] See *supra* ch 1.
[2] *Dr Miles Medical Co v John D Park & Sons Co*, 220 US 373 (1911).
[3] Ibid, 375.

concluded that any advantage from the maintained prices was primarily enjoyed by the druggists.[4] And, in light of this assumption, he argued:

> If there be an advantage to the manufacturer in the maintenance of fixed retail prices, the question remains whether it is one which he is entitled to secure by agreements restricting the freedom of trade on the part of dealers who own what they sell. As to this, the complainant can fare no better with its plan of identical contracts than could the dealers themselves if they formed a combination and endeavored to establish the same restrictions, and thus to achieve the same result, by agreement with each other. If the immediate advantage they would thus obtain would not be sufficient to sustain such a direct agreement, the asserted ulterior benefit to the complainant cannot be regarded as sufficient to support its system. But agreements or combinations between dealers, having for their sole purpose the destruction of competition and the fixing of prices, are injurious to the public interest and void. They are not saved by the advantages which the participants expect to derive from the enhanced price to the consumer.[5]

It is true that very frequently RPM is not entirely consistent with the manufacturer's commercial interests, but is instead implemented at the behest of its distributors, who are occasionally likely to be adversely affected by aggressive competition in the downstream market.[6] Traditionally, small-scale retailers have been among the most prominent adversaries of the prohibition against vertical price fixing. As was seen in Chapter 1, for example, the Fair Trade Acts were promulgated as a result of the lobbying activities of small independent retailers who saw their mark-ups being squeezed by the competitive pressure exercised by cost-effective retail chains and discount houses.

At the turn of the 20th century, the American drug industry was heavily cartelised at the retail level, and the operation of the cartel was dependent upon an extensive network of RPM schemes designed to enforce the respective agreements. Against this background, Hovenkamp observes that '[t]he druggists' cartel … accounts for a great deal of our current law of resale price maintenance'.[7] In addition to its function as a monitoring mechanism, the cartelists' reliance on RPM could also be interpreted as an attempt to circumvent the legal implications of entering into a horizontal collusive agreement, which would certainly

[4] Ibid, 407.
[5] Ibid, 407-408.
[6] WS Grimes, 'The Seven Myths of Vertical Price Fixing: The Politics and Economics of A Century-Long Debate' [1992] 21 *Sw U L Rev* 1285, 1297-1298.
[7] H Hovenkamp, *Enterprise and American Law, 1836-1937* (Harvard University Press 1991), p 342.

fall within the scope of Section 1 of the Sherman Act as a conspiracy in restraint of trade. Having been consistently upheld as lawful and enforceable at common law,[8] it is conceivable that a vertical price fixing scheme could be instigated by colluding dealers in an attempt indirectly to ensure the enforceability of what essentially was a naked horizontal price fixing agreement.[9]

3.1.1. RPM and the Rule of Per Se Illegality

An interesting aspect of *Dr Miles* is that, ostensibly, the decision had more far-reaching legal implications than the Court envisaged or even intended. Hovenkamp observes that:

> [i]n *Dr. Miles*, the Supreme Court never distinguished between unenforceability and affirmative illegality of RPM agreements ... [A]lthough *Dr. Miles* could be read for the proposition that RPM agreements are not enforceable among the parties, it was in fact read for the much broader proposition that such agreements are affirmatively illegal under the Sherman Act.[10]

In this sense, the *Dr Miles* dictum should be read and understood in conjunction with the Supreme Court's later judgment in *United States v Socony-Vacuum Oil Co*.[11] Although a horizontal case, *Socony-Vacuum* is a classic opinion and the first case in which the concept of 'per se illegality' was articulated. In the words of Mr Justice Douglas, '[u]nder the Sherman Act, a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity ... is illegal per se'.[12]

The per se rule is in its very essence an empirical rule. It has been developed inductively and applies to a limited category of restrictions of competition, which experience has shown to be so likely to produce adverse welfare consequences that a thorough competitive appraisal of their effects under the rule of reason would be redundant and, in fact, a waste of resources.[13] Put differently, it is not inconsistent with, but instead

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[8] See *supra* ch 1.
[9] H Hovenkamp, *supra* 7, 343-344.
[10] H Hovenkamp, *Federal Antitrust Policy: The Law of Competition and its Practice*, (3rd edn, Thomson/West 2005), p 472.
[11] 310 US 150 (1940).
[12] Ibid, 223.
[13] O Black, *Conceptual Foundations of Antitrust* (Cambridge University Press 2010), p 71.

derives from judicial practice and experience with the application of the rule of reason.[14] The rationale behind the rule of per se illegality has been encapsulated in the famous opinion in Northern Pacific Railway:

> there are certain agreements or practices which, because of their pernicious effect on competition and lack of any redeeming virtue, are conclusively presumed to be unreasonable, and therefore illegal, without elaborate inquiry as to the precise harm they have caused or the business excuse for their use. This principle of *per se* unreasonableness not only makes the type of restraints which are proscribed by the Sherman Act more certain to the benefit of everyone concerned, but it also avoids the necessity for an incredibly complicated and prolonged economic investigation into the entire history of the industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable – an inquiry so often wholly fruitless when undertaken.[15]

The main benefits of the per se rule lie in the increased deterrent effect emerging from its application, and the reduction in the administrative costs incurred for the adjudication of cases which, on the basis of experience, are generally not expected to be socially beneficial and are thus unlikely to give rise to Type I errors. Put differently, antitrust enforcement favours the application of the rule of per se illegality where the anti-competitive potential of a given restraint plus the administrative costs associated with the determination of the market context in which these effects are likely to arise 'far outweigh' any resulting benefits.[16]

According to Mr Justice Stevens, per se rules are essentially tantamount to statutory presumptions. In his opinion in *Superior Court Trial Lawyers*, Stevens argued that '[t]he per se rules are, of course, the product of judicial interpretations of the Sherman Act, but the rules nevertheless have the same force and effect as any other statutory commands'.[17] Put differently, the per se prohibition is not merely intended to facilitate administrative efficiency and convenience; it also reflects 'a long-standing judgment that the prohibited practices by their nature have "a substantial potential for impact on competition"'.[18]

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[14] See *United States v Topco Associates, Inc*, 405 US 596, 621 (1972) ('per se rules ... are complementary to, and in no way inconsistent with, the rule of reason').
[15] *Northern Pacific Railway Co v United States*, 356 US 1, 5 (1958).
[16] *United States v Container Corp*, 393 US 333, 341 (1969) (Mr Justice Marshall, dissenting)
[17] *FTC v Superior Ct Trial Lawyers Ass'n*, 493 US 411, 432 (1990).
[18] Ibid (citation omitted).

Since the notion of per se illegality represents the administration's experience with the – almost invariably – anti-competitive effects of certain types of cooperation between competitors, it constitutes a 'conclusive presumption of unreasonableness based on the character of the restraint'.[19] The conclusive character of the presumption is based on the idea that any thorough investigation into the legal and economic context in which the agreement operates is redundant, since 'no one has made a plausible argument that the action is competitive, and its anticompetitive potential seems fairly obvious'.[20]

It follows that the per se illegality of vertical price fixing – never explicitly established in *Dr Miles*, but interpreted as such by subsequent case law – should be understood in light of its effects on horizontal price competition between distributors. This assumption is important to the extent that it also contributes, at least in part, to our understanding of the ban on RPM in the European legal order. In Chapter 1 above, it was argued that the American precedent, along with integrationist considerations, shaped the prohibition against RPM under Article 101 TFEU. The European Commission and Courts have not developed significant experience with the practice, as the substantive assessment of any RPM cases brought before them has been – at best – superficial.[21] This fact is, of course, not sufficient in itself to prevent the development of analytical presumptions in the context of Article 101: the lack of domestic empirical evidence may be remedied by means of reliance on experience acquired through judicial practice in more mature foreign jurisdictions.[22] This is evident in the language of the 2000 Vertical Guidelines, the first type of soft law instrument designed to clarify the European Commission's enforcement priorities and specify the practical application of the EU competition rules with regard to vertical restraints.[23] The 2000 Guidelines, in addition to not addressing the issue of pro-competitive RPM, also focus exclusively on the horizontal effects of the practice disregarding any other theories of harm:

> There are two main negative effects of RPM on competition: (1) a reduction in intra-brand price competition, and (2) increased transparency on prices. In the case of fixed or minimum RPM, distributors can no longer compete on price for that brand, leading to a total elimination of intra-brand price competition. ... Increased

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[19] DH Marks and JM Jacobson, 'Price-Fixing: An Overview' [1985] 30 *Antitrust Bull* 199, 211-212.
[20] H Hovenkamp, 'Antitrust Policy, Restricted Distribution, and the Market for Exclusionary Rights' [1986-1987] 71 *Minn L Rev* 1293, 1294-1295, fn 8.
[21] See *infra* ch 5.
[22] D Bailey, 'Restrictions of Competition by Object under Article 101 TFEU' [2012] 49 *CML Rev* 559, 564-565.
[23] Commission Notice – Guidelines on Vertical Restraints [2000] OJ C291/1.

> transparency on price and responsibility for price changes makes horizontal collusion between manufacturers or distributors easier, at least in concentrated markets. The reduction in intra-brand competition may, as it leads to less downward pressure on the price for the particular goods, have as an indirect effect a reduction of inter-brand competition.[24]

Additionally, the Guidelines on the effect on trade concept reflect the idea that considerations related both to horizontal collusion and single market fragmentation are merged in the public policy towards vertical price fixing:

> Agreements involving RPM may also affect patterns of trade in much the same way as horizontal cartels. To the extent that the price resulting from RPM is higher than that prevailing in other Member States this price level is only sustainable if import from other Member States can be controlled.[25]

Naturally, EU competition law does not provide for an equivalent of the rule of per se illegality, which in essence means that the European legal order does not recognise the concept of conclusive presumptions.[26] Indeed, as the General Court confirmed in *Matra-Hachette*, 'in principle, no anti-competitive practice can exist which, whatever the extent of its effects on a given market, cannot be exempted, provided that all the conditions laid down in Article [101](3) of the Treaty are satisfied'.[27] Article 101(3) is therefore to be understood as providing a second line of defence for parties to an agreement which has been found to have as its object or effect the restriction of competition. Even in the context of the bifurcated Article 101 TFEU, however, the presumption against RPM is so strong, both in theory and in practice, and the potential for it to be rebutted so limited (in fact non-existent), that the relevant prohibition is to be understood as amounting *mutatis mutandis* to a rule of 'per se' prohibition.[28]

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[24] Ibid, para 112.
[25] Commission Notice – Guidelines on the effect on trade concept contained in Arts 81 and 82 of the Treaty [2004] OJ C101/81, para 88.
[26] Interestingly, however, the term 'per se' has been used in official documents of the European Commission with regard to forms of restricted dealing which are typically classified as 'by-object' and 'hardcore' restrictions of competition. According to the Green Paper on Vertical Restraints, which preceded Regulation 2790/1999 and the 2000 Vertical Guidelines, 'absolute territorial protection and Resale Price Maintenance (RPM) which may affect trade between Member States will not only continue to fall *per se* within Article [101](1) but are unlikely to be exempted'; Green Paper on Vertical Restraints in EC Competition Policy, COM (96) 721 final, 22 January 1997, para 39 (emphasis in original).
[27] Case T-17/93, *Matra-Hachette SA v Commission* [1994] ECR II-595, para 85.
[28] See *infra* ch 6.

3.1.2. Collusion in the Downstream Market – The Relevance of the Source of the Restraint

Any objections associated with downstream cartels are applicable to RPM imposed at the behest of one or more dealers enjoying substantial monopsony power, irrespective of whether they are acting jointly or independently.[29] Professor Comanor asserts that the economic consequences of vertical restraints – and, accordingly, their implications for antirust policy – are largely contingent upon the source of the restraint.[30] Where the vertical restraint is implemented by the manufacturer in an attempt to induce its distributors to provide product-specific promotional services or to address possible free riding concerns (what Comanor refers to as the 'positive economics' of vertical restraints), it is likely to result in an expansion of output. Nevertheless, contrary to the Chicagoan assumption that output increases invariably promote consumer benefit, Comanor takes the position that manufacturer-imposed vertical restraints 'do not lead automatically to conclusions regarding economic efficiency' but should instead by assessed having regard to the context in which they are applied.[31]

Where, on the other hand, the restraint is imposed at the behest of powerful dealers with significant bargaining power (the 'second economics' of vertical restraints), the resulting profit margins will be higher than would normally be required to remedy any free rider problems. The effect of the restraint would thus be similar to that of a horizontal collusive agreement, and would emerge irrespective of the existence of a cartel in the downstream market.[32]

Comanor further critiques the proponents of the Chicago School on the basis of their tendency to perceive the retail market as invariably perfectly competitive. In his view, a retailer with the ability considerably to influence consumers' purchasing decisions, may also have a significant impact on the pattern of consumer demand for the product in question. Under these circumstances, and even in the absence of collusion, the retailer will be in a position to exploit its leverage for rent-seeking purposes.[33] Based on this analysis,

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[29] H Hovenkamp, *Federal Antitrust Policy: The Law of Competition and Its Practice* (4th edn, West 2011), p 494.
[30] WS Comanor, 'The Two Economics of Vertical Restraints' [1992] 21 *Sw U L Rev* 1265.
[31] Ibid, 1276. Comanor adds that '[a]lthough lower output levels indicate reduced consumer welfare, increased output has ambiguous normative results. … Increased output is consistent with reduced consumer welfare'; ibid, 1282.
[32] Ibid, 1281. The significance of the source of the restraint has also been stressed by Posner, who regards dealer-induced RPM as 'a garden-variety violation of the Sherman Act's prohibition against price-fixing agreements between competitors'; RA Posner, *Antitrust Law* (2nd edn, University of Chicago Press 2001), p 177.
[33] Ibid, 1278-1279. An important qualification for this assumption is that a certain degree of market power needs to be present at both stages of the production and distribution chain; ibid, 1280. Regarding the relative

Comanor asserts that '[t]he second economics of vertical restraints provides a more valid account' than the Chicagoan assumption, which is less consistent with real market conditions.[34]

Comanor's insight has also been endorsed by the US Supreme Court: in *Leegin*, Mr Justice Kennedy, writing for the majority, placed emphasis on the ability of retailer-induced RPM to produce inefficient outcomes, and stressed the relevance of the source of the restraint to its substantive assessment under the rule of reason standard.[35] A number of notable cases brought before American courts may indeed have been consistent with theories of harm associated with dealer coercion. In *Klor's*,[36] for example, a retailer of radios, television sets and other household appliances, brought a lawsuit for treble damages under Section 4 of the Clayton Act alleging a group boycott instigated by a considerably larger competing retailer. According to the applicant, its rival exploited its 'monopolistic' buyer power by coercing major manufacturers and wholesalers either to refrain from supplying Klor's or to do so at discriminatory prices and highly unfavourable terms.[37] Although the case did not involve a vertical price fixing scheme, it is nonetheless indicative of a downstream dominant firm's ability to exploit its leverage to the detriment of a smaller discounting rival.[38]

In *Business Electronics,*[39] the termination of a downstream discounter was the result of an ultimatum delivered by Hartwell, a competing Houston-based full-price retailer.[40] The Supreme Court relied on the absence of an agreement on prices or price levels that would constitute an unlawful conspiracy in restraint of trade in order to quash the application of the per se rule by the district court. However, Mr Justice Stevens, writing for the dissent, argued that the degree of market power held by Hartwell allowed it to

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bargaining power of retailers, see also RL Steiner, 'The Nature of Vertical Restraints' [1985] 30 *Antitrust Bull* 143, 157-158 ('If consumers are more disposed to switch brands within store than stores within brand, retailers dominate manufacturers. … As a concomitant, the upstream bargaining leverage that retailers can exert against manufacturers is negatively related to the brand's popularity').

[34] Ibid, 1283.

[35] *Leegin Creative Leather Products, Inc v PSKS, Inc*, 551 US 877, 897-898 (2007):

> The source of the restraint may also be an important consideration. If there is evidence retailers were the impetus for a vertical price restraint, there is greater likelihood that the restraint facilitates a retailer cartel or supports a dominant, inefficient retailer. If, by contrast, a manufacturer adopted the policy independent of retailer pressure, the restraint is less likely to promote anticompetitive conduct. (citations omitted)

[36] *Klor's, Inc v Broadway-Hale Stores, Inc, et al*, 359 US 207 (1959).

[37] Ibid, 209.

[38] Hovenkamp, however, considers the termination at issues as a legitimate response to credible free rider concerns raised by Klor's price-cutting activities, particularly in view of the fact that the provision of sales-specific services is frequently warranted in the affected product market; H Hovenkamp, *supra* n 29, p 241.

[39] *Business Electronics Corp v Sharp Electronics Corp*, 485 US 717 (1988).

[40] Ibid, 721.

exercise coercion of a magnitude equivalent to that effected by an ultimatum by a greater number of dealers acting in concert.[41] In his opinion, '[i]f two critical facts are present – a naked purpose to eliminate price competition as such and coercion of the manufacturer – the conflict with antitrust policy is manifest'.[42]

Similarly, in the earlier *Burlington* case,[43] the Court of Appeals for the Second Circuit dealt with the termination by Esprit of a no-frills clothing retailer, allegedly at the behest of a much larger high-end rival, Federated Department Stores. The termination occurred one month after a public announcement by Federated expressing its decision to stop dealing with manufacturers who would insist on selling current-season apparel to free riders. Esprit, on the other hand, argued that the maintenance of retail prices did not form part of its marketing strategy and that, in reality, it had retained discount retailers whose layouts met the specified standards, while having ceased to supply full-price outlets that failed to comply with these standards. The court, relying on *Monsanto*,[44] found that the plaintiff had failed to demonstrate the existence of an agreement between Federated and Esprit, and held that direct complaints were insufficient to substantiate a conspiracy for the purpose of the application of Section 1 of the Sherman Act.[45]

In a subsequent case brought by the Federal Trade Commission, Toys 'R' Us ('TRU'), by far the largest toy retailer in the United States also enjoying substantial monopsony power, was alleged to have exerted pressure on toy manufacturers in an attempt to force them to cease supplying discounting 'warehouse clubs'.[46] In response to the latter's success, TRU met individually with each of its suppliers and outlined a new policy of vertical agreements designed to eliminate the competitive threat posed by the warehouse clubs. The Court of Appeals for the Seventh Circuit upheld the Federal Trade Commission's finding of a horizontal conspiracy among the toy manufacturers organised by TRU, which was found to be running 'against their independent economic self-interest'.[47] This policy ultimately brought about a decline in the warehouse clubs' share of toy sales in the United States.[48] Judge Wood rejected the argument that the case at hand involved a series of separate vertical agreements:

[41] Ibid, 747-748.
[42] Ibid, 745-746 (footnotes omitted).
[43] *Burlington Coat Factory Warehouse Corp v Esprit De Corp*, 769 F2d 919 (2nd Cir 1985).
[44] *Monsanto Co v Spray-Rite Service Corp*, 465 US 752 (1984).
[45] 769 F2d 919, 922.
[46] *Toys 'R' Us, Inc v FTC*, 221 F3d 928 (7th Cir 2000).
[47] Ibid, 932.
[48] Ibid, 933.

> That is a horizontal agreement. … [I]t has nothing to do with enhancing efficiencies of distribution from the manufacturer's point of view. The typical story of a legitimate vertical transaction would have the manufacturer going to TRU and asking it to be the exclusive carrier of the manufacturer's goods; in exchange for that exclusivity, the manufacturer would hope to receive more effective promotion of its goods, and TRU would have a large enough profit margin to do the job well. But not all manufacturers think that exclusive dealing arrangements will maximize their profits. Some think, and are entitled to think, that using the greatest number of retailers possible is a better strategy. These manufacturers were in effect being asked by TRU to reduce their output (especially of the popular toys), and as is classically true in such cartels, they were willing to do so only if TRU could protect them against cheaters.[49]

The Court further dismissed the applicant's assertion that its policy was justifiable in light of free riding concerns raised by the commercial activities of warehouse clubs: there was nothing to support the allegation that toy manufacturers were in any way interested in appointing full-service retailers for their distribution network. On the contrary, Judge Wood found that '[t]he manufacturers wanted a business strategy under which they distributed their toys to as many different kinds of outlets as would accept them … this was the distribution strategy that each one believed would maximize its individual output and profits'.[50]

Finally, in a case decided in the aftermath of *Leegin*, a lower court in the US found that a powerful brick-and-mortar retailer of baby products had coerced various manufacturers into imposing minimum resale prices for their products, in an attempt to ensure immunity from Internet discounting.[51] At the same time, the higher prices did not appear to be justified by an increase in sales-specific promotional efforts, as any relevant services would have been provided by the dominant retailer even in the absence of RPM.[52] Under these circumstances, the RPM scheme was likely to bring about a decline in output levels and a loss in consumer welfare.[53]

[49] Ibid, 936.
[50] Ibid, 938.
[51] *McDonough v Toys 'R' Us, Inc*, 638 F Supp 2d 461, 488 (ED Pa 2009).
[52] Ibid, 489.
[53] For a commentary, see WS Comanor, '*Leegin* and Its Progeny: Implications for Internet Commerce' [2013] 58 *Antitrust Bull* 107.

3.1.2.1. The Effects of RPM as Collusion-Facilitating Mechanism in the Downstream Market – Empirical Evidence

An interesting analysis of the adverse effects of a possible industry-wide use of price floors, particularly if implemented in markets characterised by 'interlocking relationships', is provided by Biscourp *et al* on the basis of empirical evidence from the impact of the Galland Act (*Loi Galland*) on retail prices in France.[54] Wholesale contracts negotiated between manufacturers and retailers typically provide for two categories of rebates: unconditional rebates granted upon delivery; and unconditional rebates which are contingent upon the quantity of contract goods ordered by the retailers and, consequently, do not appear on the relevant invoices issued at the time of delivery.[55] Aimed at protecting small retailers' mark-ups from the downward pressure on prices exerted by large-scale outlets, the Galland Act, which entered into force on 1 January 1997, proscribed the resale at a price below that quoted in the invoice produced at the time of delivery. In other words, as a result of being prevented from passing on to consumers any conditional rebates granted by the manufacturer, the retailers were afforded a greater profit margin. Pursuant to the Galland Act, the invoice price was effectively treated as a lawful retail price floor, thus giving rise to efficiency considerations comparable to those associated with industry-wide RPM.

The empirical data collected by Biscourp *et al* are revealing. Before the promulgation of the Galland Act, prices were generally considerably lower in less concentrated areas. The Galland Act, however, resulted in a general softening of intrabrand competition, which is evidenced by a substantial reduction in the correlation between retail prices and market concentration. The decrease in the correlation coefficient was larger for hypermarkets, which are typically cost-effective and are accordingly expected to compete more aggressively than other types of stores.[56] Similarly, in the aftermath of the Act, price dispersion of branded goods across stores was weakened,[57] while an increased degree of price convergence was observed, which reflected the respective raise in the prices for branded products sold in formerly less expensive stores.[58]

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[54] P Biscourp, X Boutin and T Vergé, 'The Effects of Retail Regulations on Prices: Evidence from the *Loi Galland*' [2013] 123 *Econ J* 1279.
[55] Ibid, 1282.
[56] Ibid, 1290-1295.
[57] Ibid, 1295-1297.
[58] Ibid, 1297-1300. The authors concede, however, that, by contrast to the effect of the Galland Act, 'the implementation of full scale RPM may have been limited by the possibility for consumers to substitute across

3.1.3. Collusion in the Upstream Market

The manufacturer cartel objection to RPM has already been discussed in the previous chapter. It is based on the simple assumption that monitoring retail prices is less burdensome than policing the cartelists' wholesale prices. By observing the pattern of price fluctuations in the retail market, colluding manufacturers may be in a position to draw reasonably accurate inferences of adherence to or deviation from the common policy. Jullian and Rey confirm the conventional wisdom by assuming the occurrence of local shocks in retailing: in the absence of vertical price fixing, final prices are determined by the retailers' information, which can otherwise be expected to be unavailable to a price-maintaining manufacturer.[59]

Price rigidity associated with RPM is generally socially undesirable where local shocks affect retail costs; in the event of shocks on demand, on the other hand, price rigidity is more likely to produce ambivalent welfare effects. This is particularly important, given that vertical price fixing may in reality encourage deviations where it restricts retailers' ability to respond to local demand shocks. In such a case, the manufacturer would be rather inclined to abandon the restraint in an attempt to increase its profitability.[60] With that in mind, Jullien and Rey suggest that, in order for RPM to be implemented by a manufacturer cartel as a facilitating mechanism, two requirements must be met: not only must price rigidity enhance the detectability of cheating, but also its inefficiency must be outweighed by the expected gains from collusion.[61] The authors thus demonstrate that, in markets that are prone to cartelisation, RPM will reduce consumer welfare exactly because it will be adopted 'only if it leads to a price increase large enough to compensate [manufacturers] for the loss in price flexibility'.[62]

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brands, from branded products to store brands and away from the types of stores and products present in our sample'; ibid, 1300.

[59] B Jullien and P Rey, 'Resale Price Maintenance and Collusion' [2007] 38 *Rand J Econ* 983.

[60] Ibid, 991.

[61] Ibid, 985.

[62] Ibid, 995.

3.2. Chicago School Criticism

The premises of the cartel objection have been repudiated by the proponents of the Chicago School. In criticising the manufacturer cartel theory, Telser doubts the effectiveness of RPM as a facilitating mechanism where the colluding manufacturers' products are sold through common outlets. The presence of RPM will not necessarily prevent a manufacturer from engaging in secret price-cutting in breach of the collusive agreement. Given that the retail prices are fixed, the resulting higher profit margin will induce the multi-brand retailer to single out the products of the manufacturer who offers a lower wholesale price, and to increase its brand-specific sales efforts.[63] Bork alternatively suggests that the multi-brand retailer can be expected to report instantly any price cuts to the remaining cartelists in an attempt to obtain similar concessions.[64]

The manufacturer cartel theory is no less problematic where the cartelised goods are sold through exclusive outlets. A member of the cartel may frustrate the collusive arrangement by offering secret concessions designed to subsidise the provision of special terms and services by the retailer.[65] Additionally, the cartel may have to adopt rules prohibiting its members from competing for existing dealers, or to agree upon specific market shares in order to prevent them from offering secret price cuts designed to attract new dealers.[66] The combination of exclusive dealership with RPM may thus restrict, but not completely eliminate, a manufacturer's incentive to cheat. Where the only available evidence of cheating consists in increased brand-specific sales efforts, and not in easily detectable lower retail prices, the effectiveness of RPM in monitoring compliance with the cartel agreement is naturally limited.

It has also been suggested that RPM imposed in the absence of free-rideable services is too costly for a mechanism designed merely to discourage cheating. Given that different retail outlets incur different operational costs, an RPM scheme will set prices at a level which, for the sake of affording least efficient retailers a competitive return, will necessarily prevent their superior competitors from fully exploiting their efficiencies. In order for the loss in relative efficiency to be avoided, the manufacturers will have to not only impose different resale prices in an attempt to reconcile the diversity among retailers, but also to subject the stipulated prices to constant review in response to the changing

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[63] L Telser, 'Why Should Manufacturers Want Fair Trade?' [1960] 3 *JL & Econ* 86, 96-97.
[64] RH Bork, *The Antitrust Paradox: A Policy at War with Itself* (Simon & Schuster 1993), p 293.
[65] L Telser, *supra* n 63, 97.
[66] Ibid, 97-98.

marketing conditions. This process is particularly problematic in markets characterised by a degree of product differentiation. It can be reasonably assumed, therefore, that the cartelists would be reluctant to set up such a complicated device only to police their arrangement.[67]

Overstreet notes that '[t]he most popular, and historically possibly the most important, explanatory hypothesis for [RPM] is related to the existence of retailer collusion'.[68] That said, the dealer cartel argument is by no means immune from criticism. The primary objection is that dealer cartels, although possible, are in reality infrequent due to particular attributes of retail trade. As downstream markets generally comprise a large number of participants and are characterised by relatively low barriers to entry, their cartelisation is notoriously problematic.[69] Moreover, the dealers may enhance the effectiveness of their cartel only if they recruit 'all or almost all' manufacturers, in an attempt to prevent consumers from switching between different manufacturers' brands.[70] This, however, is attainable only upon condition that the upstream market is also prone to cartelisation.[71] Consequently, the inherent difficulties in organising and administering dealer collusion not only undermine their stability, but further make it susceptible to prompt detection by enforcement authorities.[72]

Partially distancing himself from the typical Chicagoan rubric which is premised on the assumption that cartelisation of the downstream market is inherently problematic, Posner takes the position that the essence of the problem with the dealer cartel objection to RPM is of an evidentiary nature: although the detection of dealer cooperation may indeed be easy, it is nonetheless difficult to determine whether the purpose of this cooperation is collusive or it constitutes legitimate concerted activity intended to overcome credible free

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[67] RH Bork, 'The Rule of Reason and the Per Se Concept: Price Fixing and Market Division' (Part II) [1965-1966] 75 *Yale LJ* 373, 413.

[68] TR Overstreet, *Resale Price Maintenance: Economic Theories and Empirical Evidence* (FTC Bureau of Economics Staff Report, Nov 1983), p 13.

[69] RA Posner, 'The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality' [1981] 48 *U Chi L Rev* 6, 23-24; FH Easterbrook, 'Vertical Arrangements and the Rule of Reason' [1984-1985] 53 *Antitrust LJ* 135, 141-143 ('retailing is about as close to an atomistic market as you can get').

[70] RH Bork, 'Vertical Restraints: Schwinn Overruled' [1977] 1977 *Sup Ct Rev* 171, 191; RA Posner, *Antitrust Law* (2nd edn, University of Chicago Press 2001), p 172.

[71] FH Easterbrook, *supra* n 69, 142.

[72] RH Bork, *supra* n 64, pp 292-293 ('Reseller cartels tend to be so visible that they are hard for an enforcement agency to miss'); RH Bork, *supra* n 67, 409. Posner disagrees with this assumption. He argues that, despite cooperation among dealers being indeed easily detectable, an enforcement agency may nevertheless face significant difficulties in determining whether the purpose of this cooperation is collusive or legitimate; RA Posner, 'The Rule of Reason and the Economic Approach: Reflections on the *Sylvania* Decision' [1977-1978] 45 *U Chi L Rev* 1, 19-20.

rider issues.[73] Accordingly, Posner suggests a three-prong test for the substantive assessment of restricted dealing under the rule of reason standard, applicable both to price and non-price vertical restraints:

> 1. Does the restriction embrace so large a fraction of the market as to make cartelization a plausible motivation for the restriction? If not, the restriction should be held lawful.
>
> 2. If the restriction does embrace a sufficiently large fraction of the market to make cartelization a possible motivation, do dealers in the product in question provide any presale services? If not, the restriction should be deemed unlawful (An alternative would shift the burden of justification to the defendant at this point).
>
> 3. If the answer to both of the previous questions is yes (large market share and presale services provided), did the manufacturer's output increase or decrease after imposing the restriction? If his output increased, the burden would shift to the government of showing that it increased for reasons unrelated to the restriction. If output fell after imposition of the restriction, the restriction would be deemed unlawful, unless perhaps the defendant could prove the he *intended* by adopting the restriction to increase his output.[74]

Nevertheless, recent trends in retailing undermine the typical Chicagoan assumption that the retail market is invariably competitive. As will be seen in the following section, online retailing, despite contributing to the promotion of consumer welfare in various ways, is frequently characterised by heavily concentrated markets, which may also be dominated by powerful outlets. Access to these markets is notoriously difficult, due to high entry costs, which are typically sunk. Following an investigation into the specific features of the e-marketplace, the implications of the emergence of Internet commerce for the antitrust response to price floors will be examined.

[73] RA Posner, 'The Rule of Reason and the Economic Approach: Reflections on the *Sylvania* Decision' [1977-1978] 45 *U Chi L Rev* 1, 20.
[74] Ibid, 19 (emphasis in original).

3.3. RPM and Online Retailing: Collusion in the Digital Environment

3.3.1. The Welfare-Enhancing Effects of E-Commerce

The constant expansion of the Internet as an alternative channel for the distribution of goods and services is the obvious consequence of its significant benefits for consumers. The first pro-competitive aspect of online commerce lies in the very fact that it represents a different retailing method: the e-marketplace operates parallel to the traditional brick-and-mortar outlets, thus exercising substantial competitive constraints upon the latter. Prior to the emergence of e-commerce consumers were to a large extent 'trapped' within a single distribution channel. Inevitably, the costs related to the making of a purchase decision prevented them from carrying out a thorough market research by engaging in multi-channel shopping.[75]

E-commerce further stimulates price competition in various ways. As a general proposition, the total costs incurred by online retailers tend to be lower than the costs incurred by conventional outlets. This is due to the fact that the former are for the most part fixed, as opposed to the largely variable costs incurred by brick-and-mortar shops for the provision of sales-specific services.[76] In the absence of collusion, these lower costs are expected to be passed on to consumers in the form of lower prices, thus making the Internet a more appealing option, especially for price sensitive consumers.[77] Additionally, the Internet makes price competition more prevalent by providing consumers with the opportunity to compare prices in an easier and effortless way. In the digital environment, distance between outlets is measured in mouse-clicks rather than kilometres, while access to these outlets is available 24/7, by contrast to the limited opening hours of traditional stores. Also, price comparison can be further facilitated by the various consumer-orientated websites which provide information about the best prices or the latest deals.

[75] See GT Gundlach, JP Cannon and KC Manning, 'Free Riding and Resale Price Maintenance: Insights from Marketing Research and Practice' [2010] 55 *Antitrust Bull* 381, 391-392.
[76] The costs of conventional shops are variable because they depend on the number of customers visiting them; see S van Baal and C Dach, 'Free Riding and Customer Retention across Retailers' Channels' [2005] 19 *JIM* 75, 77.
[77] According to an empirical study published in 2000, prices for books and CDs were indeed found to be up to 16 percent lower on the Internet than in traditional outlets, see E Brynjolfsson and MD Smith, 'Frictionless Commerce? A Comparison of Internet and Conventional Retailers' [2000] 46 *Mgmt Sci* 563.

More specifically, online retailing increases the dispersion of information, thus minimising the consumers' search costs.[78] When faced with an array of alternative options in differentiated markets, a rational consumer's choice is based on the perceived utility of each option. The decisive factor in the process of evaluating the utility of a potential purchase is the availability of information on the price and quality of each alternative, which may be acquired and compared only after the necessary search. Search, however, is costly and produces diminishing returns: a buyer will search until the marginal cost of search exceeds the marginal expected return.[79] Bakos observes that sellers in differentiated markets may exploit high search costs in order to extract monopolistic profits. Accordingly, he takes the position that, in addition to enhancing allocative efficiency, e-commerce is capable of preventing market breakdown and facilitating the emergence of new markets, in particular where search costs in the conventional brick-and-mortar framework would be prohibitively high.[80]

Furthermore, online trade facilitates the manufacturers' vertical integration into the downstream markets for the distribution of their products. More specifically, the Internet helps a manufacturer which seeks to put its goods in the marketplace minimise its transaction costs: by setting up a retail website, the manufacturer can save up on the costs it would otherwise incur if it wished either to enter into distribution agreements with third parties, or to integrate vertically through merger or internal expansion (namely through establishing its own subsidiaries or setting up its own physical outlets). Although disintermediation via the Internet is more likely to appeal to manufacturers possessing established brand names, it may also benefit small local manufacturers who do not have access to physical shelf space for their products.[81]

The growth and constant expansion of e-commerce is thus the most representative manifestation of the applicability of the Schumpeterian understanding of the competitive process to retail trade:

> in capitalist reality as distinguished from its textbook picture, it is not [price competition] which counts but the competition from the new commodity, the new

[78] Note, '*Leegin*'s Unexplored "Change in Circumstance"' [2007-2008] 121 *Harv L Rev* 1600, 1613.
[79] GJ Stigler, 'The Economics of Information' [1961] 69 *J Pol Econ* 213, 216.
[80] JY Bakos, 'Reducing Buyer Search Costs: Implications for Electronic Marketplaces' [1997] 43 *Manag Sci* 1676, 1678-1684; JY Bakos, 'A Strategic Analysis of Electronic Marketplaces' [1991] 15 *MIS Quart* 295, 301-302.
[81] J Alba, J Lynch, B Weitz, C Janiszewski, R Lutz, A Sawyer and S Wood, 'Interactive Home Shopping: Consumer, Retailer, and Manufacturer Incentives to Participate in Electronic Marketplaces' [1997] 61 *J Mark* 38, 49.

technology, the new source of supply, the new type of organization (the largest-scale unit of control for instance) – competition which commands a decisive cost or quality advantage and which strikes not at the margins of the profits and the outputs of the existing firms but at their foundations and their very lives. This kind of competition is as much more effective than the other as a bombardment is in comparison with forcing a door, and so much more important that it becomes a matter of comparative indifference whether competition in the ordinary sense functions more or less promptly; the powerful lever that in the long run expands output and brings down prices is in any case made of other stuff.[82]

Building on this theory of 'creative destruction', Palamountain applied Schumpeter's insight to the dynamic framework of competition between different methods of distribution by introducing the concept of 'intertype competition'.[83] Writing decades before the Internet revolution, Palamountain maintained that the ability of the then innovative channels of distribution to bring about an increase in consumer surplus went beyond their cost-effectiveness: supermarkets, chain stores, large-scale department stores and mail-order houses took advantage of substantial technological advances in various fields of human activity, such as transportation and communication, and drastically altered the structure of the downstream market effectively by eroding the territorial monopolies held by local merchants.[84] And while this first stage in the historical evolution of intertype competition had already transformed retailing into what Judge Easterbrook has described as being 'about as close to an atomistic market as you can get',[85] e-commerce has contributed to its further fragmentation by invigorating price competition in geographical territories which, due to their limited population, cannot sustain unconcentrated brick-and-mortar retail markets.[86]

3.3.2. RPM in the Online Context: Antitrust Implications

[82] JA Schumpeter, *Capitalism, Socialism and Democracy* (2nd edn, Harper and Brothers Publishers 1947), pp 84-85.
[83] JC Palamountain, Jr, *The Politics of Distribution* (Harvard University Press 1955), pp 38-48.
[84] Ibid, pp 39-40.
[85] FH Easterbrook, 'Vertical Arrangements and the Rule of Reason' [1984-1985] 53 *Antitrust LJ* 135, 141-143.
[86] M Lao, 'Resale Price Maintenance: The Internet Phenomenon and Free Rider Issues' [2010] 55 *Antitrust Bull* 473, 485; M Wolfinbarger and MC Gilly, 'Shopping Online for Freedom, Control, and Fun' [2001] 43 *Cal Mgmt Rev* 34, 41 (Table 4).

3.3.2.1. The Applicability of the Free Rider Argument in the E-Marketplace

In light of the constant expansion of e-commerce, enforcement agencies on both sides of the Atlantic are likely to be faced with a considerable analytical problem, associated with the ability of the e-marketplace to exacerbate the free rider problem. Online retailers have the potential to engage in free riding, as they almost always offer lower prices than brick-and-mortar shops, and any price differentials usually reflect the lower costs incurred by online outlets offering promotional services the quality of which may occasionally be questionable, or at least inconsistent. Nevertheless, in the years following *Leegin*, various commentators have put the validity of the free-rider argument into question, suggesting that the evolution of e-commerce makes it more likely for RPM to be employed for anti-competitive purposes.[87] It is not uncommon for consumers nowadays to visit a high street outlet in order to acquire the necessary information about a specific product, which they subsequently purchase online at a lower price. That said, it is obvious that the free rider rationale is applicable only in the case of products demand for which is contingent upon the provision of services that are deemed essential and are valued by consumers. Special pre-sales services such as technical support, elaborate showrooms or assistance by trained personnel is required for only a limited category of products. For a large number of consumer goods, however, physical access to the product is not a decisive factor for the purchase, as shoppers need only some basic information which may be readily available online.

In its recent Vertical Guidelines, the European Commission implicitly accepts that vertical price fixing may stifle intertype competition, thus depriving consumers of the benefits of e-commerce. More specifically, the Commission envisages that 'RPM may reduce dynamism and innovation at the distribution level. By preventing price competition between different distributors, RPM may prevent more efficient retailers from entering the market or acquiring sufficient scale with low prices'.[88] Resale price floors, in other words, may restrict or even eliminate the ability of cost-effective outlets or distribution formats to pass on any cost advantages to end users in the form of lower retail prices.

[87] See, eg, M Lao, *supra* n 86; Note, *supra* n 78; P Jones Harbour and LA Price, 'RPM and the Rule of Reason: Ready or Not, Here We Come?' [2010] 55 *Antitrust Bull* 225; GT Gundlach, JP Cannon and KC Manning, *supra* n 75; RD Blair and JS Haynes, 'The Plight of Online Retailers in the Aftermath of *Leegin*: An Economic Analysis' [2010] 55 *Antitrust Bull* 245.

[88] Vertical Guidelines, para 224. See also P Jones Harbour and LA Price, *supra* n 87, 228-229 ('A resurgence of aggressive RPM policies may, however, stifle the growth of the Internet as a key marketplace for goods, services, and information'). The authors thus take the position that the approach to RPM under EU competition law is more appropriate; ibid, 244.

In that regard, Lao argues that the significance of the free rider rationale has rather been overstated, since its applicability is limited to the fairly limited class of consumer goods 'for which sensory experience is important to generate sales'.[89] On the other hand, Lao continues, for many other products the Internet can in fact be a better source of pre-sales services, providing more credible information than a salesperson in a conventional outlet.[90] In these cases free riding may indeed occur, but in the opposite direction: it is in reality the traditional outlets that may take a free ride on the services provided by online retailers.[91] This in essence constitutes a practical manifestation of the synergistic interaction between different distribution channels, which has been labelled 'the research-shopper phenomenon'.[92] Furthermore, an additional consideration is that e-commerce may also frustrate the free rider argument by obscuring the line separating legitimate business behaviour from free riding. Assuming that online outlets offer lower prices than their full-service conventional competitors, there is no evidence that the former aim at expanding their market share by taking a free ride on the brick-and-mortar retailers' investments: they may merely be serving specific groups of customers who base their purchase habits on factors other than product price.[93] This argument is consistent with empirical evidence according to which the vast majority of online shoppers are 'goal-focused' and place a great value on attributes such as 'convenience and accessibility; selection; availability of information; and lack of sociality' offered by the Internet, in other words features which provide them with 'increased freedom and control'.[94]

3.3.2.2. Price Rigidity in the E-Marketplace: A Far Cry from 'Friction-Free Capitalism'

In the face of the preceding analysis, it is well established nowadays that the correlation between the invigoration of intertype competition brought about by the Internet

[89] M Lao, *supra* n 87, 488-489.
[90] Ibid, 489-490, where the author uses as an example the popularity of the Kindle e-reader, a product sold exclusively online and which, due to its nature, would normally fall within the category of goods for which pre-sales services would be essential.
[91] Ibid, 490. For an overview of the relevant empirical data confirming this assertion see GT Gundlach, JP Cannon and KC Manning, *supra* n 75, 394-395 and the articles cited therein. See also DW Carlton and JA Chevalier, 'Free Riding and Sales Strategies for the Internet' [2001] 49 *J Ind Econ* 441, 443. The authors argue however that free riding, when it occurs in the opposite direction, is less likely to constitute a threat for the manufacturer, who can remedy the problem readily through fixed fees designed to compensate online retailers for the provision of demand-stimulating information.
[92] PC Verhoef, SA Neslin and B Vroomen, 'Multichannel Customer Management: Understanding the Research-Shopper Phenomenon' [2007] 24 *Int J Res Mark* 129.
[93] DB Nixa, 'Internet Retailers and Intertype Competition: How the Supreme Court's Incomplete Analysis in *Leegin v. PSKS* Leaves Lower Courts Improperly Equipped to Consider Modern Resale Price Maintenance Agreements' [2008-2009] 11 *Vand J Ent & Tech* L 461, 486.
[94] M Wolfinbarger and MC Gilly, *supra* n 86, 35.

and its contribution both to intrabrand and interbrand competition can very easily be overstated. The Internet appears to be falling short of living up to the expectations of pioneers in information technology, who saw in the incipient online retailing the framework for a 'friction-free' version of capitalism.[95] Empirical studies show that the efficiency of the e-marketplace is to an extent restricted due to two factors. First, the consumers' price sensitivity has apparently been exaggerated: online shoppers appear to be '[p]rice rational but not price obsessive [and] they also have a strong inclination toward loyalty'.[96] Put differently, online shoppers place greater value on their convenience than on product price; they would rather do business with a retailer whom they trust, even if this trust comes at a higher price.[97] The second factor – which is in reality a consequence of the previous assumption – is that certain online markets present two very interesting attributes: they are highly concentrated and are dominated by a number of powerful retailers, which serve as the market leaders.[98] Additionally, and contrary to conventional wisdom, barriers to entry in the e-marketplace are particularly high: entry costs are for the most part sunk, while the Internet shoppers' attraction to reputation typically presents first movers with a substantial competitive advantage. The presence of strong virtual network effects may also increase market concentration and favour the creation of dominant positions.[99]

In light of these assumptions and in view of online retailers' ability to detect and respond immediately to any promotions offered by their competitors, the discounter's ability to benefit from an enlarged market share is substantially limited. Additionally, it has been suggested that Internet sellers tend to match their rivals' price changes in a way that their prices may also increase rather than only decrease, as would normally be expected in fiercely competitive markets.[100]

Finally, in challenging the conventional wisdom that the Internet invariably stimulates price competition, Lal and Sarvary suggest that, under certain circumstances, e-commerce may encourage monopoly pricing with regard to products the purchase of which

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[95] See, eg, B Gates, *The Road Ahead* (Viking 1995), ch 8.
[96] FF Reichheld and P Schefter, 'E-Loyalty: Your Secret Weapon on the Web' [2000] 78 *Harv Bus Rev* 105, 110.
[97] An example supporting this assumption is that prices for books on Amazon, the leading Internet-based outlet, tend to be higher than various online book retailers which are actually being outsold by Amazon; E Brynjolfsson and MD Smith, *supra* n 77, 577.
[98] Ibid, 576.
[99] Background Note in OECD, 'Policy Roundtables: Vertical Restraints for On-Line Sales' (Directorate for Financial and Enterprise Affairs, Competition Committee 2013), p 40, available at www.oecd.org/competition/VerticalRestraintsForOnlineSales2013.pdf (last accessed on 20 October 2015).
[100] RJ Kauffman and CA Wood, 'Follow the Leader: Price Change Timing in Internet-Based Selling' [2007] 28 *Manage Decis Econ* 679.

is largely contingent upon physical experience.[101] Product attributes, so the argument goes, may be distinguished in digital and non-digital. Digital are those attributes that can be effectively communicated online and are associated with the sensory inspection, whether visual or acoustic, of reasonably standardised products that are subject to repeated purchases. While digital attributes generally have a significant influence on consumer choice, certain items present additional characteristics 'that can only be evaluated through physical inspection of the products'.[102] In markets where non-digital product attributes are prevalent, e-commerce is likely to intensify brand loyalty. As search costs in these markets are higher, equalling the cost of taking the entire shopping trip,[103] risk averse online shoppers will be less inclined to abandon the brand which they currently own and whose non-digital attributes they trust. As a result, not only will there be an increase in the prices of the goods concerned – since brand loyalty tends to curtail price sensitivity – but also consumer search will be reduced.

3.3.2.3. A Modest Suggestion: The Effects of RPM Are Not Channel-Specific

As far as the policy reform introduced by *Leegin* is concerned, the Supreme Court's timing could not have been more unfortunate: in addition to the criticism that such a controversial decision would have received anyway, the evolution of e-commerce certainly increased the concerns of the proponents of the per se ban on RPM as to its possible efficiency consequences in the online context. With the passage of time, however, the initial, almost automatic hostility towards *Leegin*'s rule of reason[104] has been replaced by a more moderate approach. A recent report by the OECD on vertical restraints in the digital environment expressly downplays the contribution of price floors to the softening of interbrand competition on the basis of the very nature of e-commerce:

> regarding the classic arguments about RPM as a collusive mechanism, it is not clear that these would actually work in an on-line environment. There is already a lot of price transparency in this environment and thus vertical restraints cannot act as a

[101] R Lal and M Sarvary, 'When and How Is the Internet Likely to Decrease Price Competition?' [1999] 18 *Marketing Sci* 485.
[102] Ibid, 487-488.
[103] If the goods in question are only handled by traditional offline outlets, search costs equal the cost of visiting an *additional* store; ibid, 495.
[104] See *supra* n 87 and accompanying text.

way to make it easier to enforce the collusive output of a cartel. Therefore there should be fewer reasons for concerns from RPMs in an online environment.[105]

The argument is intuitive. The price transparency that is generally prevalent in the e-marketplace allows upstream and downstream cartelists to have an accurate overview of any fluctuations in retail prices, thus adequately monitoring compliance with the collusive agreement. Plainly put, in light of the severe channel-specific competitive risks associated with e-commerce – availability of information on products and prices, high degree of market concentration, easy accumulation of market power – the competitive conditions in the e-marketplace are already unfavourable, even in the absence of RPM. Against this background, the argument that RPM could be of any added value as a facilitating mechanism designed to ensure the enforcement of a collusive equilibrium in the digital environment loses much of its credibility.[106]

The recent judicial experience from the other side of the Atlantic provides valuable support for this approach. In *Jacobs v Tempur-Pedic*,[107] a case decided in the aftermath of *Leegin*, the Court of Appeals for the Eleventh Circuit dealt with an antitrust action brought by Mr and Mrs Jacobs against Tempur-Pedic North America ('TPX'), a manufacturer of foam mattresses which sold its products through independent distributors, as well as through its own website. TPX had adopted a policy of minimum retail prices, which both the distributors and itself were observing. The plaintiffs alleged *inter alia* that TPX, through its dual distribution system, had effectively established a horizontal price fixing conspiracy with its dealers, having engaged in tacit collusion with the purpose of maintaining retail prices above the competitive level. The court, applying the *Twombly* standard which requires an antitrust plaintiff's allegations to be plausible and not merely consistent with the conspiracy element of Section 1,[108] dismissed the claim. Acknowledging that the provision of pre-sales services was essential for the effective distribution of the products concerned, the court observed that 'TRX's direct-distribution website acts as an "enforcement mechanism" to prevent distributors from raising prices',

[105] OECD, 'Policy Roundtables: Vertical Restraints for On-Line Sales', *supra* n 99, p 6. With regard to the manufacturer cartel objection to RPM, Baye takes a similar approach, arguing that 'this reasoning is not particularly compelling in online markets where manufacturers can readily obtain information about prices without the need for RPM'; Note by M Baye, 'Vertical Restraints in Relation to Online Sales: Some Causes, Effects, and Cautionary Notes'; ibid, p 178. Perhaps even more importantly, according to another expert's submission, '[t]here is no clear evidence that agreements containing RPM clauses occur frequently in e-commerce'; Background Note; ibid, p 24.
[106] See also P Buccirossi, 'Vertical Restraints on E-Commerce and Selective Distribution' [2015] 11 *J Comp L & Econ* 747, 759.
[107] *Jacobs v Tempur-Pedic Int'l, Inc*, 626 F3d 1327 (11th Cir 2010).
[108] *Bell Atlantic Corp v Twombly*, 550 US 544 (2007).

and took the view that the parties' strict adherence to the set retail prices was equally consistent with rational independent economic activity.[109] Accordingly, citing *Matsushita*,[110] the court noted that Jacobs failed to provide evidence that tended to exclude the possibility that the defendants were acting independently, and found for the latter.[111] Besides, even if the allegations of tacit collusion were indeed plausible, pursuant to the Supreme Court's dictum in *Brooke Group*[112] the plaintiff would still be required to substantiate that 'TPX and its authorized distributors somehow signalled each other on how and when to maintain or adjust prices'.[113]

Another aspect of the e-marketplace to be considered is that is provides members of a cartel with new, technologically advanced policing mechanisms, which, if not substantially weaken, at least put into question the relevance of the dealer cartel objection to online commerce. In the first criminal prosecution brought by the Department of Justice involving a price fixing scheme in the digital environment, Mr David Topkins, a former executive of an online seller of posters, prints and framed art, was charged with having conspired to fix the prices of posters sold online through the Amazon marketplace.[114] More specifically, Mr Topkins had implemented pricing algorithms which allowed him and his co-conspirators to coordinate changes to their respective prices, while relying on an algorithm-based software to adhere to the agreed upon prices. Eventually, Mr Topkins entered into a plea bargain with the government.[115]

The case is by no means suitable for conclusive assumptions, but is instructive nonetheless. It involved a typical horizontal price fixing agreement entered into between competing retailers. In an attempt to police the cartel and consolidate the collusive equilibrium, the conspirators appointed an individual with reasonably advanced knowledge in computer science with the task to develop an algorithm which would notify them of any changes in their competitors' prices. Let us now consider any other alternative facilitating mechanisms available to the colluding retailers. According to the dealer cartel objection to RPM, they would have to approach each of their suppliers and request that the latter enforces across-the-board retail price floors. As was explained in the previous chapter,

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[109] 626 F3d 1327, 1342.
[110] *Matsushita Electric Industrial Co, Ltd v Zenith Radio Corp*, 475 US 574, 587 (1986).
[111] 626 F3d 1327, 1342-1343.
[112] *Brooke Group Ltd v Brown & Williamson Tobacco Corp*, 509 US 209.
[113] 626 F3d 1327, 1343.
[114] Department of Justice, Antitrust Division, 'Former E-Commerce Executive Charged with Price Fixing in the Antitrust Division's First Online Marketplace Prosecution', available at http://www.justice.gov/opa/pr/former-e-commerce-executive-charged-price-fixing-antitrust-divisions-first-online-marketplace (last accessed on 20 October 2015).
[115] *United States v David Topkins*, Plea Agreement No CR 15-00201 WHO (ND Cal, 30 April 2015).

however, it is highly likely that some of the manufacturers would find the prospect of a restriction of output associated with the downstream cartel unprofitable, in which case they would have the incentive – and the means – to undermine the collusion. It is thus hardly a surprise that the online retailers opted for the former option. More importantly, it is self-evident that such a monitoring device is potentially at the disposal of all aspiring cartelists, whether operating or merely advertising their products online: even assuming that the cartel theory was indeed plausible in the context of brick-and-mortar commerce, new technologies have effectively rendered RPM redundant as a facilitating mechanism.

3.3.2.3.1. RPM in the E-Marketplace – Empirical Evidence

According to recent empirical data from the former Office of Fair Trading ('OFT') in the United Kingdom, as compiled and analysed by Giovannetti and Magazzini, RPM may be used by vertically integrated incumbent retailers as an entry barrier against discounting online outlets.[116] The authors observe that all complaints submitted to the OFT between 2007 and 2009 alleging illegal vertical price fixing were lodged by Internet retailers, involved the sale of durable goods – which do not normally give rise to serious free riding concerns – and implicated, for the most part, vertically integrated incumbent retailers. It is important to note that the vast majority (almost 70%) of complaints alleged the existence of a network of similar agreements in the same industry, which increases the likelihood that RPM was implemented for anti-competitive purposes.[117] Following an initial warning letter by the OFT, just over half of the upstream firms cited a pro-competitive justification for the imposed price floors, such as free rider considerations or the protection of brand image. A non-negligible 42.5% of them, however, replied that they employed RPM following complaints by downstream rivals, a finding which can be interpreted as confirming the foreclosure theory.[118] The very low market shares of the allegedly price-maintaining upstream firms further strengthens the credibility of the assumption that the restraints were retailer-induced.[119]

[116] E Giovannetti and L Magazzini, 'Resale Price Maintenance: An Empirical Analysis of UK Firms' Compliance' [2013] 123 *Econ J* F582.
[117] Ibid, F589.
[118] Ibid, F589-F590.
[119] Ibid, F588. For the relevance of the source of the restraint to its competitive assessment, see *supra* s 3.1.2.

To summarise the foregoing analysis, e-commerce is a distribution format which may have a considerable contribution to the promotion of consumer welfare. This assumption, however, is not unambiguous: the Internet also presents significant channel-specific risks which should not be underestimated. Additionally, the high barriers to entry in the e-marketplace severely undermine the Chicagoan criticism of the cartel objection to RPM, which is based *inter alia* on the assumption that entry into the downstream market is invariably easy. In any event, RPM has an obvious potential to eliminate intertype competition, which does not support the argument for a lenient public policy towards the practice: vertical price fixing should remain subject to a presumption of illegality.

There are very good reasons, however, why this presumption should be rebuttable even in the digital era. It needs to be reminded that all pro-competitive justifications for RPM – whether they involve the solution of the free rider problem, the provision of non-free-rideable special services or the facilitation of new entry – are premised on the fundamental assumption that, on certain occasions, intrabrand price competition may be restricted, insofar as this restriction will result in an increase in welfare-enhancing non-price competition. The fact that cost-effective Internet retailers may drive prices lower does not imply that their exclusion or the restriction of their ability to offer discounted prices should invariably be raising concerns. Instead, the parties should remain free to demonstrate that the nature of the products at hand warrants the restriction of online retailers' pricing freedom. In cases where the requisite services may be provided more effectively by brick-and-mortar outlets, the presumption should be rebutted by a showing that RPM has been employed by the manufacturer as an indirect means of right-channeling consumers towards the distribution format that best serves the interests of both.

3.4. Alternative Means of Reinforcing Price Rigidity on the Internet: Minimum Advertising Prices, Dual Pricing and Most Favoured Nation Clauses

3.4.1. Types of 'RPM Facilitating Conduct'

In a recent report on vertical restraints in the digital environment, the International Competition Network ('ICN') placed particular emphasis on a separate category of restrictive practices, which were classified as 'RPM facilitating conduct'.[120] Among the types of RPM facilitating conduct, the ICN identified Internet minimum advertising prices ('iMAP') and dual pricing as raising substantial competition concerns.

3.4.1.1. Internet Minimum Advertised Prices ('iMAPs')

Manufacturers implementing iMAP policies effectively prohibit their distributors from advertising the contract goods below a specified minimum price. Irrespective of whether they are applied in the digital environment or in the context of traditional brick-and-mortar commerce, minimum advertised prices ('MAP') may present the enforcement agencies or courts with challenging analytical problems, as they generally 'fall in a gray area between typical RPM and non-price advertising restrictions'.[121] Despite acknowledging the ambivalent nature of MAP schemes, the ICN Report emphasises that the relevant clauses may indirectly amount to rigid price floors where consumers are unable individually to bargain for price discounts with the retailer.[122] It follows that the substantial competition concerns raised by the implementation of MAP policies in the online context are relevant to the fact that similar price negotiations hardly ever occur in the e-marketplace.[123]

In its recent Vertical Guidelines, the European Commission does not deal specifically with MAP schemes. However, the Guidelines do clarify that the treatment of RPM as a hardcore restraint within the meaning of Regulation 330/2010 covers not only clear-cut vertical price fixing, but also any indirect means whereby RPM may be

[120] International Competition Network, 'Online Vertical Restraints Special Project Report' (International Competition Network Annual Meeting 2015), available at www.icn2015.com.au/download/ICN2015-special-project-online-vertical-restraints.pdf (last accessed on 20 October 2015).

[121] JB Albert, 'Adding Uncertainty to the Virtual Shopping Cart: Antitrust Regulation of Internet Minimum Advertised Price Policies' [2011-2012] 80 *Fordham L Rev* 1679, 1696.

[122] International Competition Network, 'Online Vertical Restraints Special Project Report', *supra* n 120, p 81.

[123] On the other hand, in the context of traditional brick-and-mortar commerce, a combination of MAP policies with in-store discounts may give rise to substantial efficiencies by preventing free riding among retailers, while invigorating interbrand competition once the customer visits the store. Empirical evidence indeed suggests that an increase in the list price is not necessarily followed by a respective increase in the actual transaction price. However, the fact that consumers are generally familiar only with the advertised price and not with the (lower) transaction price may explain the significant decline in quantities sold following the implementation of MAP schemes, even where in-store discounts were available. In these cases, 'genuine' price floors may be less detrimental to consumer welfare than MAP policies, insofar as the increase in advertised prices outweighs any pro-competitive, demand-stimulating effects associated with the latter; see A MacKay and DA Smith, 'The Empirical Effects of Minimum Resale Price Maintenance' (Kilts Booth Marketing Series, Paper No 1-009, 16 June 2014), pp 21-22, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2513533&download=yes.

achieved.[124] In *Hasselblad*, the Commission found that a clause requiring distributors to cease any advertisements to which the manufacturer had notified its objections in writing was 'tantamount to a right of post publication censorship ... [which] enables Hasselblad (GB) to prevent actively competing and price-cutting dealers ... from advertising their activities'.[125] The Commission's reasoning, which was upheld on appeal by the CJEU,[126] is thus consistent with the understanding of restrictions in advertising as RPM facilitating mechanisms.

The first relevant case was decided under the Resale Prices Act 1964, which introduced the general ban on RPM in the British legal order. In *Comet Radiovision Services Ltd v Farnell-Tandberg Ltd and Others*,[127] the plaintiff, a discount retailer and wholesaler brought an action alleging that a number of suppliers of tape recorders and other hi-fi equipment had withheld their supplies in response to its decision to advertise its cut prices in the press. In rejecting the defendants' argument that the arrangements at hand restricted the exercise of 'pre-contractual practices' and not the retailer's freedom to determine the prices at which it negotiates its contracts, Goulding J took the position that any restraints on advertised prices were tantamount to unlawful vertical price fixing:

> 'The object of a dealer in advertising is to promote his sales, and to complain of advertising at cut prices is in my judgment complaint, though in a limited form, that the dealer is likely to sell at cut prices ... It follows that to withhold supplies on grounds of advertising at cut prices is one form of withholding supplies on the ground that the dealer is likely to sell at cut prices'.[128]

More recently, the former Office of Fair Trading ('OFT'), following an investigation into the mobility aids sector in the United Kingdom, adopted two infringement decisions under Chapter I of the Competition Act 1998. In the first of these cases, a manufacturer of mobility scooters, Roma Medical Aids Limited, was found to have entered into agreements with its network of retailers whereby the latter undertook to refrain from selling Roma-branded scooters online and advertising their prices online. As far as the prohibition of online price advertising was concerned, the OFT found that it had the 'obvious consequence' of restricting price competition: the ensuing reduction of price

[124] See Vertical Guidelines, para 48, listing a number of examples of conduct which may indirectly amount to unlawful RPM.
[125] *Hasselblad* [1982] OJ L161/18, para 60.
[126] Case 86/82, *Hasselblad (GB) Limited v Commission* [1984] ECR 883, para 49.
[127] [1971] 1 WLR 1287.
[128] Ibid, 1292.

transparency would inevitably limit the retailers' incentives to engage in aggressive intrabrand price competition and result, in turn, in an increase in retail prices.[129] Additionally, the OFT took the view that the price advertisement prohibition was essentially designed to reinforce the ban on Internet sales.[130]

The second infringement decision in the market for mobility scooters involved a genuine iMAP policy implemented by Pride Mobility Products Limited ('Pride'). More specifically, Pride had agreed with its dealers that any prices advertised online in respect of certain models of its scooters would not exceed the manufacturer's recommended retail prices. According to the OFT, the arrangements at hand restricted competition by object. The iMAP scheme restricted the ability of price-cutting retailers to take advantage of the Internet as an alternative marketing format, while increasing consumers' search costs by preventing them for shopping around for better deals.[131]

In the United States, the Federal Trade Commission ('FTC') applied Section 5 of the FTC Act to challenge the MAP agreements entered into individually by each of the five largest distributors of pre-recorded music, prohibiting retailers to advertise discounts in all advertising. The FTC decided that the MAP policies were to be assessed under the rule of reason standard, because the retailers retained their freedom to determine their own prices, insofar as they refrained from advertising any discounts, and price-cutting activities had indeed been observed. As there was insufficient evidence that the arrangements at hand contributed to the establishment of retail price floors, the Commissioners dismissed as inappropriate the per se rule which was applicable to RPM.[132] That said, the MAP policies were deemed unlawful under the rule of reason. After having scrutinised the policies both individually and collectively, the FTC concluded that they had the effect of stabilising retail prices by reducing retailer incentives to sell at cut prices. At the same time, the schemes were found to constitute facilitating practices which increased the risk of horizontal collusion.[133] These considerations were also premised on the structure of the relevant market, in which the aggregate market share of the distributors was approximately

[129] *Roma-Branded Mobility Scooters*, OFT decision of 5 August 2013, paras 3.179-3.181.
[130] Ibid, 3.183.
[131] *Mobility Scooters Supplied by Pride Mobility Products Limited*, OFT decision of 27 March 2014, paras 3.200- 3.201.
[132] See Statement of Chairman Robert Pitofski and Commissioners Sheila F Anthony, Mozelle W Thomson, Orson Swindle, and Thomas B Leary – Concerning the Market for Prerecorded Music in the United States, File No 971-0070 (FTC 10 May 2000), available at https://www.ftc.gov/public-statements/2000/05/statement-chairman-robert-pitofsky-commissioners-sheila-f-anthony-mozelle (last accessed on 22 October 2015).
[133] Federal Trade Commission, 'Record Companies Settle FTC Charges of Restraining Competition in CD Music Market' (10 May 2000), available at https://www.ftc.gov/news-events/press-releases/2000/05/record-companies-settle-ftc-charges-restraining-competition-cd (last accessed on 22 October 2015).

85 percent.[134] The companies concerned entered into separate settlement agreements with the FTC.[135]

Similarly, in *Campbell v Austin Air Systems*,[136] a lower court decided that an iMAP policy constituted a non-price restraint and, as such, had to be scrutinised under the rule of reason, pursuant to *Sylvania*.[137] Austin, a manufacturer of air cleaners, had required distributors active in the online context to observe its 'Advertising Price Schedule'. The court held that the iMAP agreement was not an unreasonable restraint of trade, insofar as the dealers were allowed to sell Austin air cleaners at any price. In *Kichler*, however, a case decided only a few months before *Leegin*, a federal district court in New York held that the iMAP scheme at hand, whereby distributors could not advertise the defendant's products online at a price lower than that stipulated by the latter, essentially constituted vertical price fixing.[138] Although ostensibly the retailers remained free to determine their prices, the court, relying on the fact that the plaintiff was a pure play Internet outlet, took the view that for Internet shoppers, who were unable to carry out a thorough market research, the advertised price was the actual retail price.[139]

It is interesting to observe that the most high-profile MAP policies in the United States were implemented during the last stage in the evolution of the per se ban on RPM, at a time when the public policy towards price floors was governed by the *Business Electronics* dictum.[140] *Business Electronics* made it particularly difficult for plaintiffs to establish the existence of per se illegal vertical price fixing relying on a price-cutting dealer's termination, unless they substantiated the existence of 'some agreement on price and price levels'.[141] Against this background, it would not be unreasonable to infer that MAP schemes not involving an agreement on actual resale prices may have been employed for anti-competitive purposes as a surrogate for RPM in an attempt to avoid the rule of per se illegality applicable to the latter.[142] It is also noteworthy that MAP policies may be one of the reasons that Maryland's '*Leegin* repealer', which restored the per se treatment of

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[134] Federal Trade Commission, 'Analysis to Aid Public Comment on the Proposed Consent Order', available at https://www.ftc.gov/system/files/documents/cases/000510minimumadprice-analysis.htm (last accessed on 22 October 2015).
[135] Ibid.
[136] *Campbell v Austin Air Systems, Ltd*, 423 F Supp 2d 61 (WDNY 2005).
[137] *Continental TV, Inc v GTE Sylvania, Inc*, 433 US 36 (1977).
[138] *Worldhomecenter.com, Inc v LD Kichler Co, Inc*, No 05-CV-3297, 2007 WL 936206 (EDNY 2007).
[139] Ibid, 5.
[140] *Business Electronics Corp v Sharp Electronics Corp*, 485 US 717 (1988).
[141] Ibid, 735-736.
[142] Having said that, there are also some indications that *Leegin* has encouraged a substantial increase in the use of MAP policies; see A MacKay and DA Smith, *supra* n 123, pp 21-22.

RPM under the state's Antitrust Act has not had the desired effect on prices.[143] On the basis of empirical evidence from the video game industry, in which the use of price floors is frequent, Bailey and Leonard show that the '*Leegin* repealer' has not exercised any downward pressure on prices, and suggest as a possible explanation that manufacturers have switched to alternative restrictions 'such as minimum advertised pricing policies, that result in the manufacturer achieving the same retail pricing as minimum RPM'.[144]

3.4.1.2. Dual Pricing

On the other hand, the understanding by the ICN of dual pricing as a price restraint is interesting, if not surprising. Dual pricing is the practice whereby a manufacturer sets a higher wholesale price for goods which are intended to be sold online. By contrast to iMAP schemes, the Commission's recent Vertical Guidelines deal with dual pricing in the online context, implicitly taking the position that it constitutes a non-price restraint. More specifically, the Commission considers that 'an agreement that the distributor shall pay a higher price for products intended to be resold by the distributor online than for products intended to be resold offline' constitutes a restriction of passive sales for the purposes of the application of Article 101 TFEU.[145] The idea that dual pricing is to be classified as a territorial restraint is also shared by the German Federal Cartel Office.[146] Even in the context of traditional brick-and-mortar commerce the European Commission and Courts have on various occasions treated dual pricing systems as restrictions of competition by object, taking the position that they are tantamount to export bans as they reduce the distributors' incentive to engage in parallel trade.[147]

While this approach is certainly consistent with the importance of e-commerce in the promotion of the single market imperative, it is nonetheless unclear why the ICN members chose to classify dual pricing as an RPM facilitating practice. Whether driven by an efficiency-enhancing objective or by an anti-competitive intent, all other vertical restraints have a – most frequently upward – effect on prices. In line with this conventional

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[143] Md Com Law Code Ann §§11-201—213(2005).
[144] EM Bailey and GK Leonard, 'Minimum Resale Price Maintenance: Some Empirical Evidence from Maryland' [2010] 10 *BEJ Econ Anal Policy* 1, 5-6.
[145] Vertical Guidelines, para 52(d).
[146] Bundeskartellamt, 'Vertical Restraints in the Internet Economy' (Meeting of the Working Group on Competition Law, 10 October 2013), p 20.
[147] See, eg, *The Distillers Co Ltd (Conditions of Sale and Price Terms)* [1978] OJ L50/16, upheld on appeal Case 30/78, *Distillers Company Limited v Commission* [1980] ECR 2229; Joined Cases C-501/06P, C-513/06P, C-515/06P and C-519/06P, *GlaxoSmithKline Services Unlimited v Commission* [2009] ECR I-9291.

wisdom, the purpose of dual pricing is to limit online retailers' ability to compete effectively by taking advantage of any cost-efficiencies associated with the specific distribution format. In this sense, however, dual pricing is as much an RPM facilitating conduct as any other vertical restraint. In other words, there can be no misunderstanding that competitive conditions conducive to RPM may be shaped by the allocation of exclusive territories, whereby the distributor is granted the status of a territorial brand monopolist, or selective distribution, which may result in the outright exclusion of pure play Internet retailers from the network.[148]

Generally, dual pricing is treated more favourably under the current Vertical Guidelines than RPM. As a form of indirect prohibition of passive sales, dual pricing may benefit from the ancillary restraints defence, insofar as the parties substantiate that it was designed to assist a distributor to recoup suck investments undertaken to facilitate new entry, pursuant to paragraph 61 of the Guidelines. However, even if these requirements are not satisfied and the agreement is found to violate Article 101(1), undertakings have the opportunity to plead an efficiency defence under Article 101(3). Although restrictions of passive sales are typically classified as hardcore restraints and, as such, cannot benefit from the Vertical Block Exemption Regulation,[149] under certain circumstances a dual pricing policy may nonetheless be found to satisfy the four requirements set out in Article 101(3) TFEU on an individual basis. According to the Vertical Guidelines, dual pricing may survive a substantive assessment under this provision where 'selling online leads to substantially higher costs for the manufacturer that offline sales'.[150] As an example of a relevant situation, the Guidelines refer to the availability of post-sale home installation by the retailer, which is likely to be limited to offline transactions.[151]

3.4.1.3. Most-Favoured-Nation ('MFN') Clauses and Across Platform Parity Agreements ('APPA')

A similar analysis is applicable to most favoured nation ('MFN') clauses in the online context. A manufacturer bound by an MFN clause undertakes to refrain from offering to third parties better terms than those agreed with the beneficiary. MFN clauses may produce substantial pro-competitive effects. They may provide a solution to the 'hold-

[148] See ibid, para 54.
[149] Regulation 330/2010, Article 4(b).
[150] Vertical Guidelines, para 64.
[151] Ibid.

up problem' by encouraging a reluctant downstream firm to undertake relationship-specific investments. Such investments might represent sunk costs and expose the buyer to ex post opportunistic behaviour on the part of the supplier. Against this background, MFN clauses guarantee that the buyer will benefit from the best trading terms and conditions available. In addition, MFNs may contribute to a reduction of transaction costs associated with repeated price negotiations and the relevant market research.[152] Finally, they may be designed to remedy demand uncertainty by preventing buyers from delaying their orders in anticipation of last-minute discounted prices.[153] However, MFN policies also have a significant anti-competitive potential. For example, MFN is likely to result in market foreclosure and price increases, as it is likely to be imposed at the behest of powerful buyers with the purpose of raising their rivals' costs. Additionally, MFN may facilitate tacit collusion in the upstream market by reducing each manufacturer's incentive to reduce its wholesale prices.[154]

As a general proposition, it must be noted that MFN clauses in and by themselves do not qualify as vertical price restraints and thus do not fall within the scope of Article 4(a) of the Vertical Block Exemption Regulation. The Vertical Guidelines, although not engaging in an in-depth analysis of MFN policies, identify them as a facilitating mechanism for the reinforcement of price floors: 'direct or indirect price fixing can be made more effective when combined with measures which may reduce the buyer's incentive to lower the resale price, such as ... the supplier obliging the buyer to apply a most-favoured-customer clause'.[155] However, the Guidelines clarify that any such supportive measures are not considered in themselves as being tantamount to RPM.[156] This approach is sound; like dual pricing, MFN clauses do not impose any restrictions on the dealer's ability to determine its own prices, despite the fact that their economic effect is to facilitate retail price rigidity.[157]

A specific type of MFN clauses which has emerged alongside the expansion of e-commerce has taken the form of the so-called 'across platform parity' agreements ('APPAs'), also referred to as 'retail MFN'. Under such an arrangement, a seller agrees with an online trade platform that the price charged on the latter will not exceed the prices

[152] See generally JP van der Veer, 'Antitrust Scrutiny of Most-Favoured-Customer Clauses: An Economic Analysis' [2013] 4 *JECL&P* 501.
[153] I Vandenborre and MJ Frese, 'Most Favoured Nation Clauses Revisited' [2014] 35 *ECLR* 588, 589.
[154] TE Cooper, 'Most-Favored-Customer Pricing and Tacit Collusion' [1986] 17 *Rand J Econ* 377.
[155] Vertical Guidelines, para 48.
[156] Ibid.
[157] See generally V Soyez, 'The Compatibility of MFN Clauses with EU Competition Law' [2015] 36 *ECLR* 107, 109.

charged on its competitors. Online platforms are typical examples of two-sided markets, serving as intermediaries between two distinct groups of consumers: the suppliers and the end-users.[158] In order to be granted access to the platform, sellers are usually required to pay either a one-off access fee or a commission on a per-transaction basis.[159] Thus, retail MFN clauses directly affect the final retail prices, and not the fee which is payable by the supplier. Against this background, APPAs are closer to vertical price fixing than the pure MFN clauses examined earlier in that they are designed to govern the transactions between one of parties (the supplier) and end users rather that the commercial relationship between the parties themselves. Unlike RPM, however, an APPA does not limit the seller's freedom to determine its prices, insofar as it refrains from making the contract goods available at lower prices on rival platforms.[160]

The competition concerns raised by APPAs are generally comparable to those associated with retail price floors. Retail MFN clauses may be implemented by a dominant online platform in an attempt to foreclose entry. An APPA would prevent a new entrant from charging lower fees in order to attract sellers, who could in turn pass any cost-saving on to end users in the form of lower retail prices. Furthermore, APPAs may soften competition between platforms, by reducing their incentive to compete on the level of the transaction fees charged to the sellers. The resulting increase in the fees will entail higher prices for buyers. Similarly, an APPA may facilitate collusion between platforms which have entered into an agreement fixing the fees charged to sellers, by preventing any secret reduction to be reflected in lower final prices.[161] According to a Report by the OECD, however, APPAs have greater anti-competitive potential than RPM, since the online platform may not only control the industry-wide minimum, but is also in a position to manipulate retail price levels by increasing its access fee or commission.[162] The two most notable APPA cases concerned the markets of hotel online bookings and e-books. They

[158] See L Filistrucchi, D Geradin and E van Damme, 'Identifying Two-Sided Markets' [2013] 36 *World Competition* 33.
[159] Office of Fair Trading, 'Can "Fair" Prices Be Unfair? A Review of Price Relationship Agreements' (Lear, September 2012), para 6.38, available at http://www.learlab.com/pdf/oft1438_1347291420.pdf (last accessed on 4 November 2015).
[160] Background Note in OECD, 'Policy Roundtables: Vertical Restraints for On-Line Sales', *supra* n 99, p 23.
[161] The possible effects of APPAs on competition have not yet been examined thoroughly in economic literature. For an overview of the pro- and anti-competitive potential of these arrangement, see JB Baker and JA Chevalier, 'The Competitive Consequences of Most-Favored-Nation Provisions' [2012-2013] 27 *Antitrust* 20; Background Note in OECD, 'Policy Roundtables: Vertical Restraints for On-Line Sales', *supra* n 99, p 24; Office of Fair Trading, 'Can "Fair" Prices Be Unfair? A Review of Price Relationship Agreements', *supra* n 159, pp 96-105; International Competition Network, 'Online Vertical Restraints Special Project Report' *supra* n 120, pp 66-67.
[162] OECD, 'Policy Roundtables: Vertical Restraints for On-Line Sales', *supra* n 99, p 197.

culminated in the adoption of an infringement decision by the German Federal Cartel Office,[163] and a commitments decision by the European Commission,[164] respectively.

3.4.1.4. The Nature of 'RPM Facilitating Conduct'

Unlike iMAP policies, which are generally – and correctly – treated as an indirect form of RPM, as they may reduce the incentive of online outlet to engage in aggressive price cutting thus serving as *de facto* price floors, from a strictly legal perspective neither dual pricing nor retail MFN clauses are considered as falling within the definition of RPM under EU competition law. In order for a restraint to be described as 'hardcore' within the meaning of Article 4(a) of Regulation 330/2010, it must involve 'the restriction of the buyer's ability to determine its sales price', and the mere fact that dual pricing and APPA have the economic effect of reinforcing price rigidity in the e-marketplace is not sufficient to justify the application of that provision. As far as dual pricing is concerned, it is questionable whether the policy interferes with the retailer's independent pricing strategy, which is a function of the wholesale price plus distribution costs. Even though the purpose of dual pricing is to limit the downward pressure exercised on retail prices by distribution cost savings thus enhancing price rigidity across distribution channels, the manipulation by the supplier of one of the variables (the wholesale price) – which is in any event out of the buyer's control – cannot be said to amount to a direct or indirect restriction of the retailer's independence, in accordance with the grammatical interpretation of Article 4(a). On the other hand, a broader teleological interpretation would be rather redundant since, as has already been seen, dual pricing is also considered as a hardcore restraint which falls within the scope of Article 4(b) of the Block Exemption Regulation. Accordingly, the normative implications of its classification as a price or non-price restraint are in any case trivial, and the relevant discussion is more an issue of semantics than public policy considerations.

A different analysis applies to APPAs. As a general proposition, an APPA policy does indeed restrict the retailer's freedom to determine its price to the extent that it allows the online platform, and not the retailer itself, to control the market-wide minimum price. That said, Article 4(a) specifically refers to the restriction of the '*buyer's*' ability to set retail prices. Article 1(1)(h) of the Block Exemption Regulation defines the buyer as 'an

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[163] *HRS – Hotel Reservation Service Robert Ragge GmbH*, B.9-66/10, English translation available at http://www.bundeskartellamt.de/SharedDocs/Entscheidung/EN/Entscheidungen/Kartellverbot/B9-66-10.pdf?__blob=publicationFile&v=2 (last accessed on 4 November 2015).
[164] Case COMP/AT.39847 – *E-Books*, decision of 12 December 2012.

undertaking which, under an agreement falling within Article 101(1) of the Treaty, sells goods or services on behalf of another undertaking'. Although the relationship between an online platform and a retailer is also a relationship between a seller and a buyer, it is apparent that it is not of the nature covered by Article 4(a).

In order for this point to be fully understood, it must be stressed that the commercial relationship between the platform and the seller does not involve transfer of title in the contract goods. Pursuant to the consignment exception introduced in the US Supreme Court's *General Electric* decision,[165] transfer of ownership was acknowledged as a constitutive element of unlawful RPM under Section 1 of the Sherman Act. Similarly, in the European legal order, ownership of the goods is recognised as one of the criteria to be taken into consideration by the enforcement agency, when determining the allocation of risks between the principal and the agent in order to establish antitrust liability under Article 101(1) in vertical cases.[166]

Against this backdrop, however, it is necessary to clarify that retail MFN is consistent neither with RPM nor with genuine agency. To the extent that these clauses are imposed at the behest of typically powerful online portals, which determine their conduct independently – and even in defiance – of the seller, it is clear that it is the former that influence the seller's commercial strategy and not vice versa. In this sense, the status of the platform may not be considered as analogous to that of an auxiliary organ. Consequently, retail MFN clauses may fall within the scope of Article 101(1), unlike restraints contained in genuine agency agreements.[167]

However, retail MFN may not be considered as tantamount to RPM not only from a legal, but also from an economic perspective. As a general proposition, the pro-competitive theories of vertical control by means of price floors concentrate on the ability of vertical price fixing to align the interests of the manufacturer with those of end users. This idea was also endorsed by the *Leegin* Court:

> In general, the interests of manufacturers and consumers are aligned with respect to retailer profit margins. The difference between the price a manufacturer charges retailers and the price retailers charge consumers represents part of the

[165] *United Stated v General Electric Co*, 272 US 476 (1926).

[166] Vertical Guidelines, para 16 ('For the purpose of applying Article 101(1), an agreement will thus generally be considered an agency agreement where property in the contract goods bought or sold does not vest in the agent').

[167] Note by the United Kingdom in OECD, 'Policy Roundtables: Vertical Restraints for On-Line Sales', *supra* n 99, p 150; see also *HRS – Hotel Reservation Service Robert Ragge GmbH*, paras 145-149.

> manufacturer's cost of distribution, which, like any other cost, the manufacturer usually desires to minimize. A manufacturer has no incentive to overcompensate retailers with unjustified margins. The retailers, not the manufacturer, gain from higher retail prices. The manufacturer often loses; interbrand competition reduces its competitiveness and market share because consumers will "substitute a different brand of the same product". As a general matter, therefore, a single manufacturer will desire to set minimum resale prices only if the 'increase in demand resulting from enhanced service ... will more than offset a negative impact on demand of a higher retail price'.[168]

Thus, once the economic incentives of the manufacturer are removed from the equation, a totally separate welfare analysis of the effects of APPA is appropriate, which, however, falls outside the scope of this thesis. Although retail MFN raises particularly interesting theoretical challenges, this thesis focuses exclusively on *sticto sensu* vertical price fixing agreements, whether direct or indirect. It is thus submitted here that, for the reasons outlined above, APPAs do not constitute RPM for the purposes of the application of EU competition law, despite their impact on reinforcing price rigidity in the online context.

3.5. Conclusion: A Compelling Theory, in Search for Empirical Support

This chapter examined the horizontal collusion theory of RPM both in the offline and the online context. The argument that vertical price fixing may facilitate a collusive agreement in either the upstream or the downstream market is undoubtedly the most oft-cited objection to vertical price fixing and has recently been reiterated in studies by Jullien and Rey[169] and Rey and Vergé.[170] These academic assertions, however, insightful though they may be, lack practical support from credible empirical evidence. This comes as no surprise; the controversy surrounding vertical price fixing would not be nearly as intense, I reckon, were it not for the remarkable inconsistency between theory and practice.

[168] See *Leegin Creative Leather Products, Inc v PSKS, Inc*, 551 US 877, 896 (2007) (citations omitted).
[169] B Jullien and P Rey, *supra* n 59.
[170] P Rey and T Vergé, 'Resale Price Maintenance and Interlocking Relationships' [2010] 58 *J Ind Econ* 928, discussed in the previous chapter.

To the manufacturer cartel objection, Scherer and Ross – whose work stands out as one of the most sober and holistic accounts of the economic effects of RPM – respond that

> '[a]lthough the logic is persuasive, there are few documented cases of the use of RPM to strengthen manufacturer cartels. Also, a quantitative analysis of U.S. manufacturing industries in which RPM was actively employed suggests that in most, concentration ratios were too low to believe that price-fixing conspiracies were likely to thrive'.[171]

In addition, it should be reminded that the formal model presented by Jullien and Rey in support of this theory does not lead to unequivocal normative conclusions.[172] The authors conclude that price floors do not always facilitate collusion; under specific circumstances they may even make it harder. More specifically, where the discount factor is too large, the manufacturers do not need RPM in order to sustain prices close to the monopoly level; inversely, where the discount factor is too low and RPM is implemented, the short-run gain from deviation will be higher and the long-run cost of defection lower.[173]

Another point to consider is that these theoretical models assume publicly observable wholesale contracts.[174] While full observability may indeed be possible in highly concentrated markets, it is still necessary to take into account the facts specific to the case at hand and the economic context in which the agreement operates in order to reach safe conclusions as to the impact of price floors on competition between manufacturers. It is, for example, conceivable that the commitment value of vertical restraints imposed to facilitate collusion, such as RPM, may be eliminated if manufacturers have the ability to draft non-linear wholesale contracts which are unobservable to rivals.[175]

As far as collusion in the downstream market is concerned, the only 'solid' empirical evidence used to demonstrate the anti-competitive potential of RPM is provided in the paper by Biscourp *et al*, in which the authors examine the impact of the Galland Act on retail prices in France. The Act effectively prohibited the resale of the contract goods to end users at a price lower than that quoted in the invoice produced at the time of delivery.

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[171] FM Scherer and D Ross, *Industrial Market Structure and Economic Performance* (3rd edn, Houghton Mifflin Company 1990), p 550.
[172] B Jullien and P Rey, *supra* n 59.
[173] Ibid, 992.
[174] See, eg, P Rey and T Vergé, *supra* n 170, 934.
[175] Note by the United States in OECD, 'Policy Roundtables: Vertical Restraints for On-Line Sales', *supra* n 99, p 158.

The paper essentially deals with a statute the effects of which *may* resemble those of industry-wide RPM *in the event that* all market participants *had the incentive* to impose price floors and, as such, is of exceptionally limited normative value: it only stands for the proposition that unequivocal legality of RPM is unwarranted. Other than this unambiguous assumption, I find it difficult to identify its contribution to the existing literature on vertical price fixing. The authors refrain from explaining why their findings are more consistent with the effects of RPM than, for example, those of an outright dealer cartel. Certainly collective enforcement of vertical price fixing is generally meaningful only as a facilitating mechanism for upstream or downstream cartels but, in equating an across-the-board statutory prohibition on rebates with the individual incentives of profit-maximising economic actors, the authors assume that competitors are both willing and able to collude under any circumstances, and that collusion is invariably profitable.

The industry-wide implementation of RPM policies assumed by Biscourp *et al* is severely undermined by empirical evidence from the 'Fair Trade' era, which demonstrates beyond any doubt that, even in the face of a general leniency towards vertical price fixing, the practice is used only marginally by only a fraction of manufacturers. Overstreet estimates that fraction as representing 'no more than one percent of manufacturers, accounting for no more than ten percent of consumer good purchases',[176] while Scherer and Ross, relying on a number of similar studies, note that, in their heyday, RPM policies covered a fraction of retail sales 'variously estimated at from 4 to 10 percent'.[177] Even nowadays, as will be argued later in this thesis,[178] the body of federal antitrust litigation in the US almost a decade after *Leegin* is so limited that it can be concluded with a reasonable degree of certainty that the abolition of the per se ban on vertical price fixing has not led to a dramatic increase in the use of the relevant clauses. To the extent that, on the basis of empirical data, a more permissive policy towards RPM cannot be expected to produce as far reaching welfare consequences as an outright statutory prohibition of discounts, the implications of the study by Biscourp *et al* should be regarded as limited to the effects of the Galland Act and its conclusions should not be extended to RPM.

There is another side to this however. The Galland Act was obviously an exogenous source of price floors and, as such, its effect cannot be fully consistent with the traditional pro-competitive theories of RPM, which are based on the assumption that price

[176] TR Overstreet, *Resale Price Maintenance: Economic Theories and Empirical Evidence* (FTC Bureau of Economics Staff Report, Nov 1983), p 169.
[177] FM Scherer and D Ross, *supra* n 171, p 549.
[178] See *infra* s 5.3.

floors are imposed (voluntarily) by an independent manufacturer in an attempt to align its interests with those of consumers, thus also making the latter better off. In a paper summarising and assessing the existing body of empirical evidence on vertical restraints in general, including RPM, Lafontaine and Slade[179] noted that price floors imposed voluntarily by manufacturers had a net positive effect on consumer welfare, thus confirming the traditional Chicagoan rubric that the interests of end users are congruent with manufacturer profits. What is indeed revealing about this study, however, is that vertical restraints imposed exogenously (namely through governmental intervention, as in the case of the Galland Act), the consumers were typically made worse off, as the consistent consequences of these exogenous restraints were 'higher prices, higher costs shorter hours of operation, and *lower consumption as well as lower upstream profits*'.[180]

To make this point even clearer, to the inconclusive and not particularly instructive assumptions of Biscourp *et al* one can juxtapose empirical evidence from *actual* RPM cases. In a paper published two years prior to the Supreme Court's *Leegin* decision, Cooper *et al* reviewed the empirical literature on vertical restraints – including, of course, RPM – and vertical integration published between 1984 and 2005, and concluded that, not only did most relevant studies demonstrate that vertical restraints and vertical integration in general had produced efficiency-enhancing effects, but also that there were hardly any cases where forms of vertical control were found to be 'unambiguously anticompetitive'.[181] In fact, despite any theoretical academic assertions to the contrary, 'virtually no studies can claim to have identified instances where vertical practices were likely to have harmed competition'.[182] The same conclusion is reached by O'Brien in a brief prepared for the Swedish Competition Authority: '[w]ith few exceptions, the literature does not support the view that these practices are used for anticompetitive reasons. The literature supports a fairly strong prior belief that these practices are unlikely to be anti-competitive in most cases'.[183]

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[179] F Lafontaine and M Slade, 'Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy' in P Buccirossi (ed), *Handbook of Antitrust Economics* (The MIT Press 2008), pp 405-408.
[180] Ibid, p 408 (emphasis added). The authors note that the same results were observed in situations where pressure for governmental intervention came not only from downstream firms, by also from consumers themselves.
[181] JC Cooper, LM Froeb, D O'Brien and MG Vita, 'Vertical Antitrust Policy as a Problem of Inference' [2005] 23 *Int'l J Indus Org* 639, 658.
[182] Ibid.
[183] DP O'Brien, 'The Antitrust Treatment of Vertical Restraints: Beyond the Possibility Theorems', in Report, *The Pros and Cons of Vertical Restraints* (Konkurrensverket – Swedish Competition Authority 2008), p 76, available at http://www.konkurrensverket.se/globalassets/english/research/report-the-pros-and-cons-of-vertical-restraints-18mb.pdf (last accessed on 14 November 2015).

Interestingly, even empirical evidence suggesting that a more relaxed normative approach to price floors may result in a *loss* in consumer welfare provides no support for the horizontal collusion story. In a recent study, MacKay and Smith, despite contending that 'a more favorable legal environment for RPM' is associated with net anti-competitive effects reflected in price increases and output decreases, nonetheless take the view that their analysis offers 'little evidence for the broad applicability of any particular theory', whether pro- or anti-competitive.[184] More specifically, according to the authors the available data do not support the manufacturer collusion theory, and provide only 'weak support' for the downstream collusion theory.[185]

At the same time, it appears that the price transparency which is prevalent in the e-marketplace further undermines the horizontal collusion objection to RPM. In accordance with the OECD's recent report on vertical restraints in the online context, and in light of the preceding analysis which demonstrated the existence of powerful Internet outlets which serve as market leaders, it is submitted here that that price rigidity in the digital environment is considerably more likely than initially thought, and in a number of markets it is conceivable that a possible implementation of specific price floors may be unlikely to be more effective in facilitating cartels or tacit coordination. Symmetrically to the reduction of consumer search costs, the Internet also contributes to a significant decrease in the cost of monitoring any deviations from the collusive agreement, thus essentially rendering RPM redundant as a policing mechanism.

Additionally, the pro-competitive justifications for vertical price fixing apply with equal force across all distribution channels. The fact that online retailers may offer considerably lower prices does not necessarily imply that the stimulation of intrabrand price competition makes consumers invariably better off. In markets where non-price competition is prominent, the emergence of e-commerce has obviously not reduced the need for tangible product-specific promotional services. While the horizontal collusion theory reliably supports the argument for a more cautious approach to RPM, it is submitted here that sound antitrust policy should be based on a rebuttable presumption of illegality.

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[184] A MacKay and DA Smith, *supra* n 123.
[185] Ibid, pp 18-19.

Chapter 4

The Agreement Element in Vertical Relationships: Vertical Integration by Ownership and Contract

Article 101(1) TFEU catches restrictive agreements between undertakings. On the basis of the ‘single economic entity’ doctrine, however, EU competition law is generally declared inapplicable to relations between legally distinct entities which form part of the same economic unit. The exclusion of intra-enterprise conspiracy from the ambit of antitrust has been traditionally attributed by the European Commission and Courts to the absence of an agreement between the constituent parts of an economic unit: in the context of a hierarchical form of organisation, any communication between these parts is regarded as an internal allocation of tasks.

As has already been seen in Chapter 2, from the perspective of new institutional economics, vertical integration is understood as an organisational framework which may emerge not only from the ownership of successive stages of the distribution chain, but also through the contractual mechanism. The legal intellectual basis of this assumption can be found in the pioneering studies of Ian Macneil, who analysed the contract law systems that govern various forms of contractual relationships ranging from the discrete market exchange to internal organisation. At the same time, it has been argued that some types of intra-enterprise relations, such as commercial agency, are exempted from the scope of antitrust in the absence of a significant anti-competitive effect.

This chapter will discuss the agreement element in vertical relationships. Following the examination of the ‘single economic entity’ doctrine and the analysis of the concept of vertical collusion in the EU and the US, this chapter will present Macneil’s influential tripartite classification of contract law systems in classical, neoclassical and relational contracting. Then, the analysis will follow the intellectual debate on the nature of commercial agency as a hierarchical or hybrid form of organisation. Finally, this chapter will look at two common forms of restricted dealing which are also tantamount to vertical integration by contract, but are treated more favourably than price floors under EU competition law: selective distribution and exclusive territories.

4.1. The 'Single Economic Entity' Doctrine

4.1.1. The Agreement Requirement of Article 101

The scope of Article 101 covers anti-competitive agreements, however loosely defined, entered into between independent economic actors. Unilateral action that restricts competition can be dealt with under Article 102, and only upon condition that the undertaking concerned enjoys a sufficient degree of market power. This dichotomy is, nevertheless, anything but watertight: it fails to take into account the welfare consequences of coordination within the context of a single vertically integrated undertaking which does not hold a dominant position in the marketplace. The case law of the European Courts, far from having attempted to remedy the resulting lacuna, has instead upheld it as an established principle of EU competition law, under the veil of the 'single economic entity' doctrine.

As defined by the CJEU in *Höfner and Elser*, the term 'undertaking' refers to 'every entity engaged in an economic activity, regardless of the legal status of the entity and the way in which it is financed'.[1] In its seminal *Consten and Grundig* decision, the CJEU had already stated that the applicability of Article 101 is limited to agreements between several undertakings; the coverage of the prohibition does not extend to the internal organisation of a single undertaking which integrates its own distribution network into its business structure.[2] As the Court subsequently clarified, the concept of an 'undertaking' may also refer to the grouping of several natural or legal persons into an economic unit for the purpose of the subject-matter of a certain agreement. The mere fact that these persons have integrated their economic activities in pursuit of their common interests entails that there is no competition among them to be restricted in the first place.[3] The Court has further held that the relationship between a parent company and its subsidiary does not fall within the ambit of the Article 101(1) prohibition, where the latter,

[1] Case C-41/90, *Klaus Höfner and Fritz Elser v Macrotron GmbH* [1991] ECR I-1979, para 21.
[2] Joined Cases 56 and 58/64, *Établissements Consten Sarl and Grundig-Verkaufs-GmbH v Commission* [1966] ECR 299, 340.
[3] Case 170/83, *Hydrotherm Gerätebau GmbH v Compact del Dott Ing Mario Andreoli & C Sas* [1984] ECR 2999, para 11.

despite having separate legal personality, does not enjoy real autonomy in determining its course of action in the market, and the agreement in effect merely constitutes an internal allocation of tasks within a single economic unit.[4]

The single economic entity doctrine was given its final shape in *Viho v Commission*.[5] Parker Pen was a manufacturer of writing utensils, whose distribution policy required its subsidiaries to refrain from selling its products outside their allocated territories. Taking into account the subsidiaries' lack of freedom of action vis-à-vis their parent, the General Court took the position that the market division scheme at hand escaped the prohibition of Article 101(1):

> where there is no agreement between economically independent entities, relations within an economic unit cannot amount to an agreement or concerted practice between undertakings which restricts competition within the meaning of Article [101](1) of the Treaty. Where, as in this case, the subsidiary, although having a separate legal personality, does not freely determine its conduct on the market but carries out the instructions given to it directly or indirectly by the parent company by which it is wholly controlled, Article [101](1) does not apply to the relationship between the subsidiary and the parent company with which it forms an economic unit.[6]

On appeal, the CJEU endorsed the General Court's rationale and upheld the decision.[7]

Roughly a decade earlier the US Supreme Court had held in *Copperweld* that a parent company and its wholly-owned subsidiary are incapable of conspiring in breach of Section 1 of the Sherman Act and that their coordinated activity 'must be viewed as that of a single enterprise'.[8] The Court reasoned that a parent and a wholly-owned subsidiary have a 'complete unity of interest', and that adherence to their common purpose can be ensured at any time by the parent's full control over the latter.[9] Hylton criticises this approach as artificial, arguing that the firm itself merely constitutes a potentially efficiency-enhancing

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[4] Case 48/69, *Imperial Chemical Industries Ltd v Commission* [1972] ECR 619, para 134; case 15/74, *Centrafarm BV v Sterling Drug Inc* [1974] ECR 1147, para 41.
[5] Case T-102/92, *Viho Europe BV v Commission* [1995] ECR II-17 and, on appeal, Case C-73/95P, *Viho Europe BV v Commission* [1996] ECR I-5457.
[6] Case T-102/92, *supra* n 5, para 51.
[7] Case C-73/95P, *supra* n 5, para 16.
[8] *Copperweld Corp v Independence Tube Corp*, 467 US 752, 771 (1984).
[9] Ibid, 771-772.

contract in restraint of trade, and justifies the *Copperweld* rule as an attempt by the Court to circumvent the rigidity of the per se prohibition.[10]

According to Advocate General Lenz, the rationale behind the application of the single economic entity doctrine to the relationship between a parent company and its subsidiary lies in the absence of 'an agreement between two or more participants'; the latter's distribution policy is determined unilaterally by the parent.[11] The coordination between the various constituent parts of a firm is not the result of the separate – although integrated – legal entities' joint intention to behave in the marketplace in a specific way, but is achieved instead through the exercise of control over human capital and tangible or intangible assets.[12]

This point was further clarified by Advocate General Mischo who, in his opinion in the *Stora* case, examined the relevant case law of the CJEU and contended that the application by the Court of the single economic entity doctrine to the relationship between separate legal persons within a corporate group had not been contingent on the issue of decisive control exerted by a parent company over its subsidiary; the Court's inquiry focused, instead, on whether an agreement between those entities was possible.[13] The Advocate General observed that in *Viho*, for example, 'there could be *no question of an agreement or concerted practice* between Parker Pen Limited and its subsidiaries'.[14] The existence of authority and control, features inherent in the nature of the firm, entails that the subsidiary enjoys limited legal capacity, the scope of which only covers compliance with the instructions issued by the parent company and thus does not extend to the conclusion of agreements with the latter.[15] The hierarchical power exercised within the framework of a firm accordingly falls outside the ambit of the prohibition exactly because it falls short of the 'agreement' element of Article 101(1), construed by the General Court

[10] KN Hylton, *Antitrust Law: Economic Theory and Common Law Evolution* (Cambridge University Press 2003), p 80, fns 27-28 and accompanying text.

[11] Case C-73/95P, *Viho Europe BV v Commission* [1996] ECR I-5457, Opinion of AG Lenz, para 66.

[12] WPJ Wils, 'The Undertaking as Subject of E.C. Competition Law and the Imputation of Infringements to Natural or Legal Persons' [2000] 25 *EL Rev* 99, 102-103; I Lianos, 'Commercial Agency Agreements, Vertical Restraints, and the Limits of Article 81(1) EC: Between Hierarchies and Networks' [2007] 3 *J Comp L & Econ* 625, 654-657.

[13] Case C-286/98P, *Stora Kopparbergs Bergslags AB v Commission* [2000] ECR I-9925, Opinion of AG Mischo, para 30.

[14] Ibid, para 36 (emphasis added).

[15] O Odudu and D Bailey, 'The Single Economic Entity Doctrine in EU Competition Law' [2014] 51 *CML Rev* 1721, 1739-1740.

in the *Bayer* case as requiring 'the existence of a concurrence of wills between at least two parties'.[16]

As pointed out by Advocate General Lenz in his opinion in *Viho v Commission*, 'Article [101] does not make the protection of competition an absolute requirement'. In order for a competitive restraint to fall within the ambit of the prohibition, it must be the result of collusive behaviour, which may take the form of 'agreements between undertakings, decisions by associations of undertakings and concerted practices'. In light of the very language of Article 101(1), a broad teleological interpretation of that provision is thus precluded.[17] It follows that any loss in allocative efficiency caused by the internal allocation of tasks in the context of a non-dominant corporate group does not constitute a restriction of competition within the meaning of Article 101(1). The reductionist construction of Article 101 by Advocate General Lenz is indicative of the substantial difference in the legal and the economic notions of collusion. Motta observes that

> [i]n economics, collusion is a situation where firms' prices are higher than some competitive benchmark. A slightly different definition would label collusion as a situation where firms set prices which are close enough to monopoly prices. In any case, in economics collusion coincides with an outcome (high-enough price), and not with the specific form through which that outcome is attained.[18]

The formalistic adherence to the agreement requirement of Article 101 appears, at first sight, to be in line with the CJEU's earlier ruling in *Suiker Unie*, where the protection of the undertakings' economic autonomy was recognised as a fundamental objective in light of which the notion of collusion is to be understood. According to the CJEU, the protection of competition is premised on the principle that 'each economic operator must determine independently the policy which he intends to adopt on the common market including the choice of persons and undertakings to which he makes offers or sells'.[19] Thus, by emphasising that the element of economic autonomy is of central importance to the application of Article 101, the Court in effect endorsed the ordoliberal understanding of competition as a process in which an economic actor's freedom of contract remains

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[16] Case T-41/96, *Bayer AG v Commission* [2000] ECR II-3383, para 69; confirmed on appeal, Joined Cases C-2 and 3/01P, *Bundesverband der Arzneimittel-Importeure eV and Commission v Bayer AG* [2004] ECR I-23.
[17] Case C-73/95P, *supra* n 5.
[18] M Motta, *Competition Policy: Theory and Practice* (Cambridge University Press 2004), p 138.
[19] Joined Cases 40-48, 50, 54-56, 111, 113 and 114/73, *Coöperatieve Vereniging 'Suiker Unie' UA et al v Commission* [1975] ECR 1663, para 173.

unrestricted.[20] The normative implication of this interplay between antitrust and private law, as conceived by the Ordoliberals and endorsed under EU competition law, is that any restriction of an undertaking's freedom of action, including its ability 'to define and structure its distribution policy on its own terms', constitutes a distortion of competition in breach of Article 101(1).[21]

However, the protection of the downstream undertaking's economic autonomy does not provide an adequate explanation for the applicability of this formalistic approach to vertical relationships. In *GlaxoSmithKline v Commission*, the General Court implicitly conceded that the principle enunciated by the CJEU in *Suiker Unie* is not compatible with the obviously binding, and thus restrictive, character of vertical agreements.[22] In emphasising the necessity for an effects-based treatment of vertical restraints, the Court took the position that a breach of Article 101(1) may be established only where an agreement entered into between undertakings operating at different stages of the production and distribution chain is, additionally, found to have an adverse impact on consumer welfare:

> as the objective of the Community competition rules is to prevent undertakings, by restricting competition between themselves or with third parties, from reducing the welfare of the final consumer of the products in question… it is still necessary to demonstrate that the limitation in question restricts competition, to the detriment of the final consumer.[23]

4.1.1.1. Vertical Collusion in the EU

The normative implications of the agreement element are further undermined by a series of early cases in which the CJEU inferred the existence of an anti-competitive

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[20] NI Pauer, *The Single Economic Entity Doctrine and Corporate Group Responsibility in European Antitrust Law* (Kluwer Law International 2014), p 162, fn 295 and accompanying text, and pp 165-166.

[21] Ibid, p 166. For a criticism of the public policy towards vertical restraints in the EU as developed under the influence of the Freiburg School, see BE Hawk, 'System Failure: Vertical Restraints and EC Competition Law' [1995] 32 *CML Rev* 973, 977-982.

[22] Case T-168/01, *GlaxoSmithKline Services Unlimited v Commission* [2006] ECR II-2969, para 171.

[23] Ibid.

vertical agreement from the mere fact of the ongoing business relationship between a manufacturer and its distributors.[24]

In *AEG-Telefunken*,[25] the CJEU rejected the argument that the exclusion of certain dealers from the selective distribution system operated by a manufacturer of consumer electronics constituted a unilateral act which fell outside the scope of Article 101(1). The dealers were excluded, despite satisfying the stipulated qualitative criteria, on the basis of their refusal to comply with the price maintenance scheme implemented by AEG. The Court held that the manufacturer's conduct formed part of the contractual relations between the undertakings concerned, by virtue of which admission to the selective distribution network was conditional upon the dealers' tacit or express acceptance of the pricing policy pursued by AEG.[26] A similar approach was taken by the Court of Justice in *Ford*, a case concerning an automobile manufacturer's refusal to supply right-hand-drive cars to its German distributors.[27] In holding that the agreement requirement of Article 101(1) had been met, the CJEU essentially took the position that the distributors' acquiescence could be inferred from the mere fact that they did not terminate their business relationship with Ford AG. In the Court's view, admission to Ford AG's selective distribution network amounted to an implicit approval of the manufacturer's future decisions.[28] Finally, in *Sandoz*, the Court held that a supplier's attempt to restrict parallel trade by systematically sending to its customers invoices bearing the words 'export prohibited' did not constitute unilateral conduct, but should instead be regarded as forming an integral part of the general commercial relations between Sandoz and its distributors, which were governed by a pre-existing agreement. According to the Court, the fact that the

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[24] I Lianos, 'Collusion in Vertical Relations under Article 81 EC' [2008] 45 *CML Rev* 1027, 1040. See also NI Pauer, *supra* n 20, pp 138-143, concluding that 'the fact of "agreements or concerted practices" is not a sufficient basis for a precise classification of an "economic entity"'; ibid, p 142.

[25] Case 107/82, *Allgemeine Elektrizitäts-Gesellschaft AEG-Telefunken AG v Commission* [1983] ECR 3151.

[26] Ibid, para 38.

[27] Joined Cases 25 and 26/84, *Ford-Werke AG and Ford of Europe Inc v Commission* [1985] ECR 2725, para 21.

[28] U Wickihalder, 'The Distinction between an "Agreement" within the Meaning of Article 81(1) of the EC Treaty and Unilateral Conduct' [2006] 2 *Eur Competition J* 87, 94. More specifically, the Court noted that

> agreements which constitute a selective distribution system and which… seek to maintain a specialized trade capable of providing specific services for high-technology products are normally concluded in order to govern the distribution of those products for a certain number of years. Because technological developments are not always foreseeable over such a period of time, those agreements necessarily have to leave certain matters to be decided later by the manufacturer;

Joined Cases 25 and 26/84, *supra* n 27, para 20.

For a criticism of the decision, see also PS Jakobsen and M Broberg, 'The Concept of Agreement in Article 81 EC: On the Manufacturer's Right to Prevent Parallel Trade within the European Community' [2002] 23 *ECLR* 127, 130.

distributors renewed their order placements without protest was sufficient for their acquiescence of the supplier's policy to be substantiated.[29]

In the landmark *Bayer* case, the General Court adopted a more restrictive approach to the concept of agreement, which was premised on the subjective element of the parties' 'joint intention to conduct themselves on the market in a specific way'.[30] As defined by the Court, an agreement within the meaning of Article 101 corresponds to 'the existence of a concurrence of wills between at least two parties, the form in which it is manifested being unimportant so long as it constitutes the faithful expression of the parties' intention'.[31] The Court further drew a distinction between genuinely unilateral measures, which lack the 'express or implied participation' of another undertaking and are therefore immune from liability under Article 101(1), and measures which, despite appearing as having been adopted unilaterally by the manufacturer, receive at least the tacit acquiescence of the distributors thus satisfying the agreement requirement.[32] On that basis, the Court maintained that the relevant case law precedents – which included the decisions of the Court of Justice in *AEG-Telefunken*, *Ford* and *Sandoz* – were sufficiently distinguishable from the case at hand, and confirmed accordingly that they fell within the latter category.[33] The decisive step towards the erosion of the principle established in these decisions was taken in *Volkswagen II*, where the General Court held that the existence of a concurrence of wills may be substantiated only by reference to a particular conduct, which has already been made known to the parties at the time of their acceptance.[34]

4.1.1.2. Vertical Collusion in the US – The Colgate *Doctrine*

Burns argues that, unlike horizontal collusion, 'the anticompetitive nature of the [vertical] arrangement is not linked to a finding of a common plan or unity of purpose between the firms. On the contrary ... an anticompetitive vertical arrangement is likely to

[29] Case C-277/87, *Sandoz Prodotti Farmaceutici SpA v Commission* [1990] ECR I-45, para 1 (summary publication). See also Case C-279/87, *Tipp-Ex GmbH & Co KG v Commission* [1990] ECR I-261. For a commentary on these decisions, see J Shaw, 'The Concept of an Agreement in Article 85 EEC' [1991] 16 *EL Rev* 258.
[30] Case T-41/96, *supra* n 16, para 67.
[31] Ibid, para 69. See O Black, 'Agreement: Concurrence of Wills, or Offer and Acceptance?' [2008] 4 *Eur Competition J* 103.
[32] Case T-41/96, *supra* n 16 para 71.
[33] Ibid, paras 158-171.
[34] Case T-208/01, *Volkswagen AG v Commission* [2003] ECR II-5141, para 56.

involve some coercion between the two levels of distribution'.[35] By contrast to agreements between competitors, whereby cartelists exploit their jointly held market power by determining their profit-maximising price in much the same way as a monopolist,[36] vertical arrangements do not create market power, but instead derive from the exercise of pre-existing market power at either level of the production and distribution chain.[37] It follows that the effects of vertical restraints, whether welfare-enhancing or welfare-reducing, are produced irrespective of the existence of an 'agreement' – as the subjective element which constitutes the manifestation of the parties' joint intention; *a fortiori*, the existence of an agreement, as opposed to unilateral action, is irrelevant to the characterisation of the vertical restraint at hand as either benign or harmful.[38] Therefore the lawfulness of a vertical arrangement should be determined not on the basis of its form, but in light of the objectives pursued by the antitrust laws.[39]

This fundamental teleological assumption also highlights the analytical problems associated with the *Colgate* doctrine, as encapsulated in the US Supreme Court's infamous opinion that

> '[i]n the absence of any purpose to create or maintain a monopoly, the act does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business freely to exercise his own independent discretion as to parties with whom he will deal, and, of course, he may announce in advance the circumstances under which he will refuse to sell'.[40]

Colgate stood for the proposition that a manufacturer's refusal to supply a dealer who failed to observe resale prices announced in advance was not sufficient to establish the

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[35] JW Burns, 'Rethinking the "Agreement" Element in Vertical Antitrust Restraints' [1990] 51 *Ohio St LJ* 1, 31.

[36] H Hovenkamp, *Federal Antitrust Policy: The Law of Competition and its Practice* (3rd edn, Thomson/West 2005), p 148. Just as a single-firm monopoly, horizontal collusion results in supra-competitive pricing, thus creating a deadweight loss. In addition, the social costs of cartelisation include *inter alia* the costs of forming and policing a cartel, as well as the possible loss in productive efficiency; see RJ Van den Bergh and PD Camesasca, *European Competition Law and Economics: A Comparative Perspective* (2nd edn, Sweet & Maxwell 2006), pp 155-156.

[37] GO Robinson, 'Explaining Vertical Agreements: The *Colgate* Puzzle and Antitrust Method' [1994] 80 *Va L Rev* 577, 598. See also D Neven, P Papandropoulos and P Seabright, *Trawling for Minnows: European Competition Policy and Agreements between Firms* (Centre for Economic Policy Research 1998), p 23 ('Any potentially inefficient properties of the vertical contract are more properly thought of as a symptom than a cause of the market power concerned'). For this reason Posner refers to vertical agreements as 'unilateral abuses of market power'; RA Posner, 'Vertical Restraints and Antitrust Policy' [2005] 72 *U Chi L Rev* 229, 229.

[38] GO Robinson, *supra* n 37, 598 ('a vertical agreement between a supplier and dealer neither enhances the amount of harm nor the risk of its occurring').

[39] JW Burns, *supra* n 35, 32.

[40] *United States v Colgate & Co*, 250 US 300, 307 (1919).

existence of a common scheme, which would otherwise bring the arrangement within the ambit of Section 1. Instead, it was acknowledged as constituting an exercise of the manufacturer's obvious right freely to select its distributors.[41] As the Supreme Court noted in a subsequent case, '[i]f real competition is to continue, the right of the individual to exercise reasonable discretion in respect to his own business methods must be preserved'.[42] In the years following *Colgate*, the Court substantially narrowed the scope of the doctrine holding that unlawful agreements need not be express, but could also be implied from the course of dealing,[43] and that a manufacturer could not go beyond the exercise of said right and undertake affirmative action in an attempt to enforce dealer compliance with the RPM policy.[44]

The Supreme Court's subsequent decision in *United States v Parke, Davis & Co* demonstrated the limits of the *Colgate* doctrine. In order to be eligible to benefit from the *Colgate* exception, the only enforcement mechanism available to a manufacturer that had adopted a 'unilateral' policy of price floors was the outright termination of non-complying dealers. As the Court noted

> an unlawful combination is not just such as arises from a price maintenance *agreement*, express or implied; such a combination is also organized if the producer secures adherence to his suggested prices by means which go beyond his mere declination to sell to a customer who will not observe his announced policy.[45]

In this case, the manufacturer 'went beyond' the exercise of its right to announce retail prices in advance and secure compliance by terminating discounters. Instead, a finding of illegal combination in violation of the Sherman Act was based on two elements: the involvement of wholesalers, who were threatened with termination if they continued to supply price-cutters, and the fact that renewal of supplies was contingent upon the prior provision of assurances on the part of the retailers that they would observe the stipulated prices.

[41] Over the years there have been numerous essays on the *Colgate* doctrine. See, eg, AM Winn, 'The Colgate Doctrine: Its Past and Present' [1974-1975] 12 *Hous L Rev* 409; EH Levi, 'The Parke, Davis – Colgate Doctrine: The Ban on Resale Price Maintenance' [1960] 1960 *Sup Ct Rev* 258; GO Robinson, *supra* n 37; TJ Campbell and CJ Ware, '*Russell Stover* and the Vertical Agreement Puzzle' [1983] 52 *Antitrust LJ* 83; RE Day, 'New Theories of Agreement and Combination' [1972-1973] 42 *Antitrust LJ* 287.

[42] *FTC v Gratz*, 253 US 421, 428-429 (1920).

[43] *United States v A Schrader's Son, Inc*, 252 US 85, 99 (1920).

[44] *FTC v Beech-Nut Packing Co*, 257 US 441, 452-453 (1922); *United States v Parke, Davis & Co*, 362 US 29, 47 (1960).

[45] 362 US 29, 43 (emphasis in original).

The most significant problem with the *Colgate* exception, noted by numerous antitrust scholars, was that the manufacturer's ostensibly 'unilateral' refusal to deal in reality presented all the characteristics of an agreement, as defined in contract law.[46] The prior announcement of the stipulated resale prices and their endorsement by the prospective distributors correspond to a typical example of offer and acceptance, as the constitutive elements of a legally enforceable contract. Inversely, the refusal to supply is clear evidence of the parties' failure to reach an agreement. More importantly, however, from a welfare perspective *Colgate* was demonstrably irreconcilable with the rationale behind the *Dr Miles* precedent, as the Supreme Court conceded in *United States v Parke, Davis & Co*:

> True, there results the same economic effect as is accomplished by a prohibited combination to suppress price competition if each customer, although induced to do so solely by a manufacturer's announced policy, independently decides to observe specified resale prices. So long as *Colgate* is not overruled, this result is tolerated ...[47]

This opinion reveals that the intellectual foundations of the *Colgate* doctrine were inherently problematic: the Court's underpinning concern was not the promotion of consumer welfare, but instead the protection of the dealer's freedom to determine independently its conduct in the marketplace.[48] In other words, a vertical price fixing scheme would be upheld insofar as the dealer, in complying with the manufacturer's prices, exercised its own discretion without being bound by a formal contract and the coercive enforcement mechanism which it entails.[49]

The problem with the *Colgate* doctrine was not only that it failed adequately to address any anti-competitive concerns raised by price floors, effectively ignoring the horizontal collusion theory on which *Dr Miles* was based,[50] but that it also limited the availability of efficiency-enhancing RPM to 'those situations where it [was] least

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[46] See, eg, DF Turner, 'The Definition of Agreement under the Sherman Act: Conscious Parallelism and Refusals to Deal' [1961-1962] 75 *Harv L Rev* 655, 686-691 ('Is it not a tacit agreement for a distributor to resell at a price suggested by the manufacturer when, but for the manufacturer's declaration of policy, he would sell for less?'); R Pitofski and KW Dam, 'Is the Colgate Doctrine Dead?' [1967-1968] 37 *Antitrust LJ* 772, 774-775 ('compliance by the distributors with previously announced conditions of the seller is an "agreement" in every meaningful sense of that word.'); GO Robinson, *supra* n 37, 586-588.
[47] 362 US 29, 44.
[48] 250 US 300, 307-308.
[49] 252 US 85, 97. See also AM Winn, *supra* n 41, 411.
[50] According to a commentator, *Colgate* 'elevated noneconomic goals embodied in the freedom to trade concept over the economic goals of the horizontal effect rationale'; DF Shores, 'Vertical Price-Fixing and the Contract Conundrum: Beyond Monsanto' [1985-1986] 54 *Fordham L Rev* 377, 388.

valuable'.[51] As will be argued later in this chapter, pro-competitive RPM may be employed by the manufacturer as a substitute for full-blown vertical integration where the latter is prohibitively costly. Price floors may therefore create a situation of a 'network' and enhance the self-enforcing range of long-term relational contracts. Networks, however, are characterised by three elements, power, influence and trust,[52] which necessarily imply an increased level of cooperation between the various stages of the distribution chain, as well as the exercise of a certain degree of coercion. *Colgate* instead upheld RPM only where the organisational setting was weak enough to resemble the classical conception of the contract as a discrete transaction.

In *Monsanto*, the case involved the termination of a discounting distributor following complaints by numerous other members of the distribution network regarding its failure to comply with the manufacturer's suggested prices.[53] Relying on *Colgate*, the Supreme Court reviewed a decision by the Court of Appeals for the Seventh Circuit which held that the existence of unlawful RPM had been sufficiently established,[54] noting that

> it is of considerable importance that independent action by the manufacturer, and concerted action on nonprice restrictions, be distinguished from price-fixing agreements, since under present law the latter are subject to per se treatment and treble damages ... If an inference of [an RPM] agreement may be drawn from highly ambiguous evidence, there is a considerable danger that the doctrines enunciated in Sylvania and Colgate will be seriously eroded.[55]

In the Court's view, termination in response to dealer complaints created an obvious problem of inference, since such complaints represent natural reactions to the activities of rivals. Instead, *Monsanto* stood for the proposition that, in order to establish an unlawful combination, the plaintiff was required to provide evidence that the manufacturer and the complaining distributors 'had a conscious commitment to a common scheme designed to achieve and unlawful objective'.[56] Under *Colgate* communications between manufacturers and distributors regarding retail prices were legitimate insofar as the parties were not prevented from making independent business decisions; consequently, despite the probative value of discount-related terminations, '[t]here must be evidence that tends to

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[51] H Hovenkamp, *Federal Antitrust Policy: The Law of Competition and Its Practice* (4th edn, West 2011), p 509.
[52] HB Thorelli, 'Networks: Between Markets and Hierarchies' [1986] 7 *Strategic Manage J* 37, 38.
[53] *Monsanto Co v Spray-Rite Service Corp*, 465 US 752 (1984).
[54] *Spray-Rite Service Corp v Monsanto Co*, 684 F2d 1226 (7th Cir 1982).
[55] 465 US 752, 762-763.
[56] Ibid, 764.

exclude the possibility that the manufacturer and nonterminated distributors were acting independently'.[57]

Furthermore, in a footnote the Court appeared to raise the standard of proof even higher, ostensibly requiring the express communication of the parties' commitment to the fixed prices:

> The concept of 'a meeting of minds' or a 'common scheme' in a distributor-termination case includes more than a showing that the distributor conformed to the suggested price. It means as well that evidence must be presented both that the distributor communicated its acquiescence or agreement, and that this was sought by the manufacturer.[58]

At the same time, it may be deduced from the above statement and the references to a 'meeting of minds' and a 'common scheme' that the *Monsanto* dictum did not acknowledge coercion as a constitutive element of a Section 1 violation in the case of RPM. Instead, *Monsanto* appears to suggest that the finding of an unlawful combination is contingent upon a showing of willing compliance rather that reluctant acquiescence following the implementation of coercive means. In this regard, the Court's approach was particularly controversial and clearly in tension with earlier decisions.[59]

The last decision in this series of cases in which the Supreme Court placed emphasis on the conspiracy doctrine for the adjudication of vertical price fixing was *Business Electronics*.[60] At issue in *Business Electronics* was the termination of a small-scale retailer following an ultimatum delivered to the manufacturer by Hartwell, a powerful full-service rival. Although Hartwell had complained in the past about the terminated retailer's price-cutting activities, there was nonetheless no evidence that the manufacturer ever attempted to enforce retail price floors. Accordingly, Justice Scalia, delivering the opinion of the majority, took the position that a 'vertical restraint is not illegal per se unless it includes some agreement on price or price levels'.[61] In other words, in the Court's view, in the absence of a specific provision designed to maintain specific price floors, the termination of a price-cutter would be considered as a non-price restraint

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[57] Ibid.
[58] Ibid, 810, fn 9.
[59] See CD Floyd, 'Vertical Antitrust Conspiracies after *Monsanto* and *Russell Stover*' [1984-1985] 33 *U Kan L Rev* 269, 300; JR McGibbon, 'Proof of a Vertical Conspiracy under *Monsanto*' [1985] 30 *Antitrust Bull* 11, 27-29.
[60] *Business Electronics Corp v Sharp Electronics Corp*, 485 US 717 (1988).
[61] Ibid, 735-736.

for the purposes of the application of Section 1, even if this termination is shown to be the result of an agreement between the manufacturer and a complaining distributor. This, according to Scalia, was consistent with the existence of a 'presumption in favour of a rule-of-reason standard'.[62] To the plaintiff's argument that in the past the Court had established the per se illegality of horizontal price fixing agreements without a showing that prices had been fixed, Scalia replied that there was no 'notion of equivalence between the scope of horizontal per se illegality and that of vertical per se illegality', as had already been demonstrated by the differentiated treatment of horizontal and vertical market sharing schemes.[63]

As Mr Justice Kennedy noted in his opinion in *Leegin*, even the strict standards established in *Monsanto* and *Business Electronics* did not fully guarantee that unilateral conduct would escape the Section 1 prohibition.[64] In his view, this framework could result in inefficient outcomes, by forcing manufacturers to take unnecessary – and costly – precautions when discussing its pricing policy with members of its distribution network. Similarly, it could result in the termination without explanation of long-standing business partners for engaging in minor violations. In both cases, any additional costs would be passed on to consumers in the form of higher retail prices.[65]

Although *Leegin* did not expressly overrule the *Colgate* doctrine, its relevance has been inevitably put into question. The two last seminal cases of the *Colgate* saga, *Monsanto* and *Business Electronics*, were decided in the aftermath of *Sylvania*,[66] which drew a clear normative distinction between vertical price and non-price restraints, holding that the rule of per se illegality was only applicable to the former. Faced with a severe problem of inference stemming from the similar effects of these two forms of restricted dealing and from the identical reactions on the part of the manufacturer and the diligent dealers to price-cutting activities regardless of the nature of the restraint, the post-*Sylvania* decisions were characterised by the Court's cautious effort to avoid subjecting non-price restrictions to an unwarranted per se prohibition. In the post-*Leegin* world, both price and non-price restraints are assessed under an ostensibly unified rule of reason standard. Until the nature of the reasonableness inquiry applicable to RPM has been clarified by lower

[62] Ibid, 726.
[63] Ibid, 734.
[64] *Leegin Creative Leather Products, Inc v PSKS, Inc*, 551 US 877, 902-903 (2007).
[65] Ibid, 903.
[66] *Continental TV, Inc v GTE Sylvania, Inc*, 433 US 36 (1977).

courts, the relevance of the *Colgate* doctrine, as refined by *Monsanto* and *Business Electronics*, will remain doubtful.[67]

4.1.2. The 'Unity of Interests' Criterion and the Boundaries of the Firm

Having rejected the relevance of the agreement element to the interpretation of the single economic entity doctrine, it is necessary to consider an alternative basis for the inapplicability of Article 101 to the relationship between a parent company and its subsidiaries, namely the impossibility of competition between the constituent parts of an economic unit. It is submitted that antitrust intervention is unwarranted where the various legal entities which compound a corporate group are unable to engage in competition *inter se*, thus exercising a single competitive force on the marketplace.[68] Building on the CJEU's earlier decision in *Hydrotherm*,[69] Advocate General Lenz opines that

> there can be no competition between the parent company and its subsidiaries. Independent, economic competitive measures by the subsidiaries are inconceivable where the parent company determines and controls their conduct completely, as it does here. Consequently, Article [101] is not applicable because *there is no competition* between the group companies *which needs to be protected*.[70]

This contention is, nevertheless, equally debatable. Steiner suggests that manufacturers and distributors compete not only horizontally, but also vertically: given that undertakings operating at successive levels of trade are essentially producers of complimentary goods or services and negative cross-elasticity of demand allows them to increase their market share only to each other's detriment, they should be regarded as engaging 'in a form of vertical intrabrand competition'.[71] Accordingly, the parties to a vertical agreement have the incentive to exert constraints on the exercise of each other's market power.[72] The main implication of the hierarchical control exercised within the framework of a firm, however, is the presumption that this incentive disappears as the

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[67] See in that regard JL Harrison, '*Dr. Miles*'s Orphans: Vertical Conspiracy and Consignment in the wake of *Leegin*' [2010] 45 *Wake Forest L Rev* 1125, 1144-1147.
[68] O Odudu and D Bailey, *supra* n 15, 1726-1727.
[69] Case 170/83, *supra* n 3, para 11.
[70] Case C-73/95P, *supra* n 5, para 67 (emphasis added).
[71] RL Steiner, 'Intrabrand Competition – Stepchild of Antitrust' [1991] 36 *Antitrust Bull* 155, 161-162.
[72] D Neven, P Papandropoulos and P Seabright, *supra* n 37, p 21.

separate legal entities concentrate their efforts on the maximisation of the economic unit's profits.[73]

However, there is nothing to suggest that the protection of vertical intrabrand competition, as defined by Steiner, forms part of the objectives of EU competition policy. In fact, it is doubtful whether the Commission even embraces this two-dimensional understanding of competition. Article 2(4) of Regulation 330/2010, for example, declares the inapplicability of the block exemption to 'vertical agreements entered into between competing undertakings'. From the language of this provision it can be inferred that the Commission perceives competition as an exclusively horizontal process. More importantly, according to the Non-Horizontal Merger Guidelines, unlike horizontal mergers, vertical (and conglomerate) mergers 'do not entail the loss of direct competition between the merging firms in the same relevant market'.[74] Additionally, vertical mergers have no impact on the concentration levels in either the upstream or the downstream markets, which entails that any competition concerns that warrant closer scrutiny – most notably non-coordinated effects, namely input and customer foreclosure – may arise only where the merging undertakings already possess substantial market power, or in markets where vertical integration or the use of vertical restraints are widespread.[75]

Finally, the categorical rejection of the possibility of competition between the constituent parts of a corporate group appears to be unfounded. In reality, a firm may encompass a variety of divergent economic interests, which reflect the different – and, occasionally, even conflicting – incentives of the individual legal entities and employees. Although hierarchical control undoubtedly reduces friction in the economic interactions between these divisions, the alleged unity of interests between a parent company and its subsidiary should not be used as a criterion for the definition of a firm's boundaries, as it is

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[73] See *American Needle, Inc v National Football League et al*, 560 US 183, 200 (2010). According to the Supreme Court, this presumption is rebuttable. In rare cases, agreements entered into between the constituent parts of a firm may be caught by Section 1 of the Sherman Act 'when the parties to an agreement act on interests separate from those of the firm itself, and the intrafirm agreements may simply be a formalistic shell for ongoing concerted action'; ibid, 200-201.

[74] Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings [2008] OJ C265/6 ('Non-Horizontal Merger Guidelines'), para 12. Compare Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings [2004] OJ C31/5 ('Horizontal Merger Guidelines'), paras 37-38, where the elimination of an important competitive force, particularly in markets which are already concentrated, is cited as one of the main non-coordinated anti-competitive effects of horizontal mergers.

[75] I Kokkoris and H Shelansky, *EU Merger Control: A Legal and Economic Analysis* (Oxford University Press 2014), p 108.

premised on the unrealistic assumption that these entities invariably have identical profit motives.[76]

4.2. The Inconsistent Treatment of Vertical Restraints and Vertical Integration – RPM in Long-Term Contractual Relationships

4.2.1. Vertical Integration as a Paradigm: Ownership and Contract

Manufacturers impose vertical restraints in an attempt to prevent their dealers from engaging in what Williamson refers to as 'subgoal pursuit', namely the independent concentration of efforts to the promotion of individual profitability, which, although being consistent with the perfect competition paradigm, it may nonetheless jeopardise the effectiveness of the distribution system.[77] In other words, restricted distribution is designed as a remedy for those very externalities that vertical integration seeks to internalise.[78] And, inversely, any horizontal externalities associated with the provision of suboptimal pre-sales services – arguably the most frequently cited pro-competitive theory of restricted dealing – could be effectively controlled by a firm's decision to integrate vertically.[79]

Stone and Wright take the position that '[i]t is insufficient for antitrust purposes ... to describe a firm by its legal boundaries; instead, contracts can be viewed as firms themselves'. They suggest, accordingly, that the Section 1 prohibition should be inapplicable to all contractual relationships designed to centralise control in order to minimise transaction costs.[80] The economic autonomy of successive stages of the production and distribution chain is irrelevant to transaction cost analysis, which applies

[76] See B Klein and AV Lerner, 'The Firm in Economics and Antitrust Law' in WD Collins (ed), *Issues in Competition Law and Policy*, vol 1 (American Bar Association Antitrust Section 2008), 268-271.
[77] OE Williamson, 'Assessing Vertical Market Restrictions: Antitrust Ramifications of the Transaction Cost Approach' [1978-1979] 127 *U Pa L Rev* 953, 955-956.
[78] See generally ACM Chen and KN Hylton, 'Procompetitive Theories of Vertical Control' [1998-1999] 50 *Hastings LJ* 573, 599 ff.
[79] M Motta, *Competition Policy: Theory and Practice* (Cambridge University Press 2004), pp 315 and 317-318. Motta, however, argues that, in order for RPM to reproduce the vertically integrated outcome, it must be combined with either a franchise fee or quantity forcing; ibid, 319-321.
[80] JE Stone and JD Wright, 'Antitrust Formalism Is Dead! Long Live Antitrust Formalism! Some Implications of *American Needle v NFL*' [2009-2010] 2009-2010 *Cato Sup Ct Rev* 369, 379-380.

equally to market transactions as well as to a firm's decision to integrate vertically.[81] However, it is important to note at this point that neither vertical mergers nor vertical restrictions of competition contribute to the complete elimination of transaction costs. Instead, it is the prospect of *minimising* the transaction costs incurred by a firm for the purchase or the development of a certain input that will influence its decision to either integrate vertically or use the contractual mechanism, respectively.[82]

That markets and hierarchies are interchangeable organisational structures may be further understood in light of the definition of vertical integration provided by the theory of new institutional economics. Williamson advances a broad understanding of the concept:

> Vertical integration turns out to be a paradigm. Thus although many of the empirical tests and public policy applications have reference to the make-or-buy decision and vertical market restrictions, this same conceptual framework has application to contracting more generally. Specifically, the contractual relation between the firm and its 'stakeholders' – customers, suppliers, and workers along with financial investors – turn out to be variations on the theme set out in the simple contractual schema.[83]

Interestingly, the Commission has already conceded that the centralisation of control by means of long-term contractual arrangements may amount to an acquisition of control within the meaning of the European Union Merger Regulation ('EUMR').[84] In its Consolidated Jurisdictional Notice on mergers, the Commission endorses a broad understanding of control, which goes beyond the formalistic reliance on the existence of property rights over shares or assets to encompass purely economic relationships between undertakings operating at successive stages of the production and distribution chain. 'In exceptional circumstances', the Commission notes, 'a situation of economic dependence may lead to control on a *de facto* basis where, for example, very important long-term

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[81] OE Williamson, *supra* n 77, 958. At the same time, it has been observed that '[t]he price theory that is our predominant model is notorious for its failure to define the boundaries of firms at all'; C Sagers, 'Why *Copperweld* Was Actually Kind of Dumb: Sound, Fury and the Once and Still Missing Antitrust Theory of the Firm' [2011] 18 *Vill Sports & Ent LJ* 377, 387.

[82] WK Viscusi, JE Harrington, Jr and JM Vernon, *Economics of Regulation and Antitrust* (4th edn, The MIT Press 2005), p 238.

[83] OE Williamson, 'Transaction Cost Economics' in C Ménard and M Shirley (eds), *Handbook of New Institutional Economics* (Springer 2005), p 52.

[84] Council Regulation (EC) 139/2004 on the control of concentrations between undertakings [2004] OJ L24/1. Article 3(2) of the EUMR defines control as the possibility of exercising decisive influence on an undertaking. Thus, the existence of control may be demonstrated by the right to use the assets of an undertaking, as well as by the ability to influence the composition, voting or decisions of its organs. See M Broberg, 'The Concept of Control in the Merger Control Regulation' [2004] 25 *ECLR* 741.

supply agreements or credits provided by suppliers or customers, coupled with structural links, confer decisive influence'.[85] It is submitted that *de facto* control within the meaning of the Jurisdictional Notice may be asserted where substantial relationship-specific investments undertaken by either party to a contractual relationship give rise to hold-up problems.[86]

As alternative methods of vertical integration, ownership and contract have cost-effectiveness as their common denominator. That said, they also present substantial differences. First, unlike integration by contract, ownership guarantees the maximisation of control over the successive stages of distribution without recourse to the traditional contract law remedies. On the other hand, the threat of termination of a contractual relationship may have similar effects as hierarchical control. Second, while integration by contract offers parties a greater degree of flexibility, allowing them to adapt more effectively to changing marketing conditions, arrangements between independent economic actors are generally more volatile than the rigid relationships developed within a corporate group. At the same time, however, vertical agreements have the advantage of providing the parties with the ability to reach a consensus on the desired degree of flexibility and stability that will best serve their commercial interests. Third, despite any advantages of an economic or even political nature which are usually attributable to large size, diseconomies of scale may decrease a firm's efficiency thus discouraging its expansion.[87]

Kessler and Stern note that, in spite of their differences, '[c]ontractual arrangements aimed at coordinating the supply of materials or disposal of output frequently affect the contracting firms, as well as the rest of the industry, in much the same way as ownership of suppliers or outlets does'.[88] Besides, Grossman and Hart take the position that both methods of vertical integration have a similar impact on the firm's ability to monitor any changes in the incentive structures of the various stages of the distribution

[85] Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings [2008] OJ C95/1, para 20. It follows that the parties' subjective intention is irrelevant to the finding of an acquisition of control; ibid, para 21.
[86] I Lianos, *supra* n 12, 655. For a discussion on the 'hold-up problem', see B Klein, 'Why Hold-Ups Occur: The Self-Enforcing Range of Contractual Relationships' [1996] 34 *Econ Inq* 444.
[87] F Kessler and RH Stern, 'Competition, Contract, and Vertical Integration' [1959-1960] 69 *Yale LJ* 1, 2-14. The authors further cite tax considerations and labour relations as additional factors which may influence a firm's decision to integrate vertically by ownership or by contract.
[88] Ibid, 2.

chain.[89] It follows that integration by contract should be regarded as nothing but an alternative form of vertical integration.

Furthermore, a relevant Commission Notice has introduced a simplified procedure for the appraisal of concentrations which 'do not raise competition concerns', and may thus be declared compatible with the common market following the adoption of a short-form decision by the Commission.[90] In order for a notified vertical merger to benefit from this presumption and trigger the application of the simplified procedure, two conditions must be cumulatively satisfied. First, where the concentration involves undertakings which are active in the same product and geographic market, their combined market share must be less than 20 percent; and second, the individual or combined market shares of all vertically-related parties to the concentration must be less than 30 percent.[91] The latter criterion is equivalent (albeit not similar) to the market share threshold set out by Article 3(1) of Regulation 330/2010. Given that vertical agreements containing any of the hardcore restrictions cited in Article 4 are explicitly excluded from the block exemption, suppliers who seek to benefit from the efficiency-enhancing effects of RPM can reasonably be expected to contemplate vertical integration as an alternative, in an attempt to avoid exposure to antitrust liability.[92] Interestingly, in the aftermath of the seminal judgment of the CJEU in *Consten and Grundig*, the parties responded to antitrust intervention by integrating vertically into the successive stages of the distribution chain.[93]

On various occasions, however, recourse to integration by ownership in lieu of RPM may give rise to inefficient outcomes, as was also acknowledged by the *Leegin* Court:

> depending on the type of product it sells, a manufacturer might be able to achieve the precompetitive benefits of resale price maintenance by integrating downstream and selling its products directly to consumers. *Dr. Miles* tilts the relative costs of vertical integration and vertical agreement by making the former more attractive based on the *per se* rule, not on real market conditions. This distortion might lead to

[89] SJ Grossman and OD Hart, 'The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration' [1986] 94 *J Polit Econ* 691, 695, fn 3 and accompanying text. Although describing this view as 'extreme', Katz nonetheless finds it more convincing than the opposite argument; ML Katz, 'Vertical Contractual Relations' in R Schmalensee and RD Willig (eds), *Handbook of Industrial Organization* (North-Holland 1989), p 660.

[90] Commission Notice on a simplified procedure for treatment of certain concentrations under Council Regulation (EC) No 139/2004 [2013] OJ C366/5, paras 1-2 and 26.

[91] Ibid, para 5(c). Compare the preceding Commission Notice on a simplified procedure for treatment of certain concentrations under Council Regulation (EC) No 139/2004 [2005] OJ C56/32, para 5(c).

[92] RJ Van den Bergh and PD Camesasca, *supra* n 36, p 232.

[93] Ibid, pp 224-225 (Box 6.1).

inefficient integration that would not otherwise take place, so that consumers must again suffer the consequences of the suboptimal distribution strategy. And integration, unlike vertical price restraints, eliminates all intrabrand competition.[94]

A manufacturer may find it more profitable to remain unintegrated and set up a restricted distribution system where the transaction costs associated with hierarchical control, or even with vertical integration itself, are high, or where independent distributors are likely to perform their assigned tasks more effectively than the downstream division of a vertically-integrated firm.[95] Where, for example, the price-maintained goods are sold at the retail stage and full exploitation of economies of scope is possible only for multi-brand retailers, it can be safely assumed that certain manufacturers will find it prohibitively costly to integrate vertically in order to ensure that end users are provided with the optimal amount of pre-sales services. Even in industries where the integration of production and distribution is indeed economically feasible, cost-effectiveness and the need for increased specialisation frequently require that manufacturer-owned outlets and independent retailers operate side-by-side in the downstream market, in the context of a dual distribution network.[96]

4.2.2. Vertical Integration as a Paradigm: Insights from Contract Law Theory

The fact that the ownership/contract dichotomy is not as sharp as assumed under EU competition law can be observed in many types of contemporary commercial transactions, and particularly in long-term distribution agreements. The obscure boundaries between markets and hierarchies have been the subject of intellectual scrutiny not only by economists, but also by contract law theorists. Prominent among the latter was Ian Macneil, whose insightful analysis was premised upon the distinction between discrete and

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[94] *Leegin Creative Leather Products, Inc v PSKS, Inc*, 551 US 877, 903 (2007)

[95] See RS Markovits, *Economics and the Interpretation and Application of U.S. and E.U. Antitrust Law: Volume II Economics-Based Legal Analyses of Mergers, Vertical Practices, and Joint Ventures* (Springer 2014), p 252. Milgrom and Roberts outline the problems associated with the management of an integrated firm:

> The challenges in efficiently designing and managing a divisionalized firm involve the same dimensions on which the form finds its strengths. First, divisions must be delineated, reporting relationships structured, and activities allocated among the divisions and between them and the head office so that coordination is facilitated. Second, information, decision, evaluation, and reward systems need to be structured to encourage the appropriate behavior. Third, the scope of activities that the firm is going to undertake must be chosen in the light of the costs and benefits;

P Milgrom and J Roberts, *Economics, Organization and Management* (Prentice Hall 1992), p 546.

[96] FM Scherer and D Ross, *Industrial Market Structure and Economic Performance* (3rd edn, Houghton Mifflin Company 1990), p 542. On the antitrust implications of dual distribution, see R Zwirb, 'Dual Distribution and Antitrust Law' [1987-1988] 21 *Loy LA L Rev* 1273.

relational transactions.[97] Macneil suggested a tripartite classification of contract law systems which reflects the respective stages in the evolution of the nature of contractual relationships.[98]

Classical contract law is based on the assumption that transactions are entirely discrete: they are the result of the almost accidental interaction between total strangers and are independent of any past and future contextual inferences. The classical model is therefore designed to facilitate and encourage participation in transactions by enhancing discreteness, as well as presentiation,[99] defined by Macneil as the 'recognition that the course of the future is bound by present events, *and* that by those events the future has for many purposes been brought effectively into the present'.[100] Classical contract law attempts to integrate discreteness and presentiation into transactions in various ways. More specifically, (i) classical contract law is indifferent to the identity of the parties to the transaction; (ii) it commodifies the subject matter of the contract; (iii) the substantive content of the transaction is inferred from a limited set of formal, rather than informal, elements; (iv) in the event of non-performance, the limited availability of remedies guarantees the predictability of any consequences brought about by the initial presentiation's failure to materialise; (v) under classical contract law, the boundaries of the transaction are carefully delineated on the basis of 'rigorous and precise' rules; and, (vi) participation of third parties in the contractual relationship is discouraged.[101]

Complete presentiation is, however, virtually impossible in the case of long-term contracts, which are inherently incomplete – and thus unstable – in response to the need for increased flexibility.[102] More specifically, as gaps in contract planning naturally reduce predictability, the fundamental objective of enhanced presentiation under classical contract law is incompatible with the introduction of flexibility in long-term contracting.[103] The neoclassical contract law system acknowledges the parties' interest in preventing possible termination of the contractual relationship even in the event of internal conflict. Accordingly, neoclassical contract law partially rectifies the relevant shortcoming of the classical approach by providing the necessary processes and remedies which allow for the

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[97] IR Macneil, 'The Many Futures of Contracts' [1973-1974] 47 *S Cal L Rev* 691 (hereinafter cited as 'Futures of Contracts').
[98] IR Macneil, 'Contracts: Adjustment of Long-Term Economic Relations under Classical, Neoclassical, and Relational Contract Law' [1977-1978] 72 *Nw U L Rev* 854 (hereinafter cited as 'Contracts').
[99] Ibid, 862.
[100] IR Macneil, 'Restatement (Second) of Contracts and Presentiation' [1974] 60 *Va L Rev* 589, 589 (emphasis in original).
[101] IR Macneil, 'Contracts', *supra* n 98, 863-864.
[102] Ibid, 865.
[103] Ibid, 870.

adjustment of existing contractual relations to any subsequent changes in circumstances.[104] Nevertheless, the neoclassical system merely relaxes the classical objectives of discreteness and presentiation without fully renouncing them. In that sense, it does not introduce a radical departure from the classical pattern insofar as it requires 'adherence to an overall structure founded on full consent at the time of initial contracting'.[105]

In light of this assumption, the applicability of the classical and neoclassical models to contemporary economic transactions appears to have weakened substantially. Macneil observes that contractual relationships are distinguishable from discrete contract transactions in that they involve 'whole person relations, relatively deep and extensive communication by a variety of modes, and significant elements of non-economic personal satisfaction'.[106] Although both neoclassical and relational contract law relax the requirement for discreteness and presentiation, the point of reference of the latter approach is the entire relation, which remains the framework for contractual performance, and not merely the original agreement.[107] In the context of ongoing, long-term commercial interactions, complexity and uncertainty prevent the parties from reaching agreements on specific performance standards. In other words, parties to a relational contract 'are incapable of reducing important terms of the arrangement to well-defined obligations'.[108]

While planning in discrete transactions focuses exclusively on the subject matter of the exchange, relational contracts differ to the extent that planning is at least equally concerned with the development of processes for conducting future exchanges and further planning.[109] Furthermore, by contrast to discrete transactions which are fully binding on both parties, the need for flexibility in contractual relations allows for subsequent amendments to the initial planning, which may be either mutually agreed upon or imposed unilaterally.[110] The recognition of the parties' interdependence is an additional distinctive feature of relational contracts. This increased degree of interdependence reflects the complex character of contractual relations and is associated with the expectation of solidarity in future cooperation, as a result of the existence of a similarity of interests.[111]

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[104] Ibid, 876-880.
[105] Ibid, 885.
[106] IR Macneil, 'Futures of Contracts', *supra* n 97, 723.
[107] IR Macneil, 'Contracts', *supra* n 98, 890.
[108] CJ Goetz and RE Scott, 'Principles of Relational Contracts' [1981] 67 *Va L Rev* 1089, 1091.
[109] IR Macneil, 'Economic Analysis of Contractual Relations: Its Shortfalls and the Need for a "Rich Classificatory Apparatus"' [1980-1981] 75 *Nw U L Rev* 1018, 1029-1030.
[110] Ibid, 1031.
[111] Ibid, 1032-1034.

In emphasising the role of interfirm relations as the focal point of contemporary exchange transactions, Macneil's insightful scholarship supplements the contribution of transaction cost economics to the understanding of the blurred boundaries between markets and hierarchies. On the basis of a weakened adherence to discreteness and presentiation, the relational approach downplays the significance of the exchange – which under traditional contract law constitutes the quintessential element of the market-firm dichotomy – as the point of reference of any adjustment mechanisms that may be triggered in the face of conflict.[112] Relational contract law thus provides the necessary legal theoretical framework for the mitigation of the conceptual tension between integration by contract and integration by ownership.[113]

4.2.3. The Boundaries of the Firm: Markets, Hierarchies and Networks

In a study on the economic implications of Macneil's scholarship, Baker *et al* offer an alternative theory on the boundaries of the firm, suggesting that firms adopt that form of integration (ownership or contract) that best serves the relationship between the different levels of the chain.[114] Professor William A Klein takes the relational theory a step forward: relying on the element of dependence between the two stages of the production and distribution chain, he suggests that, where either of the parties to a distributorship agreement is in practice 'heavily dependent' on the other, the two – otherwise separate – entities 'can be thought of as parts of a single organization and their relationship analogized to a partnership'.[115] Similarly, Orts uses the term 'relational firms' to refer to forms of organisation which, although superseding the traditional notion of market transactions, do not necessarily fit within the conventional boundaries of fully integrated entities.[116] Relational firms, according to Orts, are the result of the ongoing relationship

[112] HN Butler and BD Baysinger, 'Vertical Restraints of Trade as Contractual Integration: A Synthesis of Relational Contracting Theory, Transaction-Cost Economics, and Organization Theory' [1983] 32 *Emory LJ* 1009, 1040.
[113] Ibid ('relational notions supersede the simple market-firm dichotomy that is the basis of the classical and neoclassical systems').
[114] G Baker, R Gibbons and KJ Murphy, 'Relational Contracts and the Theory of the Firm' [2002] 117 *QJ Econ* 39. The authors' starting point is that relational contracts are concluded both within a single firm and between different firms.
[115] WA Klein, 'The Modern Business Organization: Bargaining under Constraints' [1981-1982] 91 *Yale LJ* 1521, 1532-1533.
[116] EW Orts, 'Shirking and Sharking: A Legal Theory of the Firm' [1997-1998] 16 *Yale L & Pol'y Rev* 265, 312-313.

between smaller firms which agree to act as a single entity and, as such, compete with each other in 'organizational metamarkets'.[117]

This understanding of contractual relationships corresponds to the notion of 'networks', namely organisational structures which, due to the intense cooperation between the interacting firms, are placed in the middle of a continuum whose polar extremes are markets and hierarchies.[118] According to Thorelli's eloquent description of these interactions,

> [r]elationships, such as standing contracts, comprise streams of transactions or exchanges, which may or may not be *directly* tied in with any specific delivery of goods. Indeed, in the manyfold of transactions it would often be difficult to say where one leaves off and the next begins. Building networks involves expenditure of money and executive talent over many periods of time. It follows that resources spent on all aspects of networking other than everyday maintenance are to be regarded as *strategic market investments*.[119]

Williamson, on the other hand, describes 'hybrid' organisational structures, in the context of which 'the requisite adaptations to disturbances are neither predominantly autonomous nor bilateral, but require a mixture of each'.[120] On the same intellectual basis, Areeda *et al* suggest the term 'vertical integration by dependency or by contract' to describe hybrid forms of organisational structure that combine features of both market contracting and hierarchical control:

> Sometimes it makes sense for firms to combine aspects of vertical integration and coordination by contract. The single firm might be organized into divisions where each division is a profit center responsible for maximizing its own profits and therefore dealing with other divisions at arm's length, almost as if they were separate firms. On the other side, entirely separate firms may have very disparate bargaining strength or deal with each other through long-term contracts that may,

[117] Ibid, 312.
[118] See generally HB Thorelli, *supra* n 52.
[119] Ibid, 41 (emphasis in original).
[120] OE Williamson, 'Comparative Economic Organization: The Analysis of Discrete Structural Alternatives' [1991] 36 *Admin Sci Quart* 269, 283.

for example, allocate important decision rights to one to one of the firms so that their dealings resemble those within the integrated firm.[121]

The most typical example of such a hybrid system is the franchise agreement, namely the agreement whereby a supplier ('franchisor') licenses to an independent downstream undertaking ('franchisee') intellectual property rights for the use and distribution of goods or services. The franchisee, who commonly pays royalties calculated on the basis of sales made, is also the recipient of commercial and technical assistance. The element that distinguishes franchising from other forms of distributorship agreements is the increased level of control exercised by the franchisor over the franchisee's business strategy.[122] In terms of their organisational structure, therefore, it could be argued that franchising is more closely related to vertical integration by ownership than other forms of distribution agreements. Under EU competition law, franchising is generally covered by the Vertical Block Exemption Regulation,[123] while the Court of Justice has held that certain restraints contained in a franchise agreement may even escape the application of Article 101(1) insofar as they are necessary for the protection of the franchisor's know-how and for the maintenance of the reputation of the network.[124] Nevertheless, clauses restricting the franchisee's freedom to determine its prices are subject to the usual prohibition.[125]

Rubin takes the position that the restrictions of competition imposed in the context of a franchise system do not warrant antitrust intervention. Even though franchising is associated with the use of the market mechanism, the high degree of integration into the franchisor's operation has as a consequence that the franchisee's economic independence is curtailed, to the extent that the latter's status resembles that of an employee.[126] More specifically, the emergence of franchise systems can be explained in light of the externalities attributed to the franchisees' post-contractual opportunistic behaviour. In an attempt to prevent shirking that could have an adverse impact on the reputation of its trademark, the franchisor increases control over the franchise in order to ensure that certain quality standards are observed. Ongoing performance in the form of active monitoring is

[121] P Areeda, L Kaplow and A Edlin, *Antitrust Analysis: Problems, Text, and Cases* (7th edn, Wolters Kluwer Law & Business 2013), pp 583-584.
[122] J Goyder and A Aalbors-Llorens, *Goyder's EC Competition Law* (5th edn, Oxford University Press 2009), p 251.
[123] Vertical Guidelines, para 190.
[124] Case 161/84, *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 353.
[125] Ibid, para 25.
[126] PH Rubin, 'The Theory of the Firm and the Structure of the Franchise Contract' [1978] 21 *JL & Econ* 223, 232.

desired not only by the franchisor, but also by diligent franchisees which also incur part of the costs in the event of quality deterioration caused by shirking.[127]

4.2.4. RPM through the Lens of New Institutional Economics

Insights from the theory of new institutional economics are central to our understanding of the economic function of price floors. The most prominent explanation for RPM, Telser's free rider argument, is – implicitly, yet inherently – premised on Coasean transaction cost analysis.[128] As free riding represents a typical manifestation of opportunistic behaviour, the intellectual cornerstone of the free rider rationale is nothing other than the assumption that the costs of monitoring and policing dealer performance may be disproportionately costly, thus reducing the manufacturer's incentive to contract directly on the requisite level of product-specific services.[129]

Subsequent studies have also relied on new institutional economics to justify the implementation of RPM in long-term vertical relationships, namely in the context of an organisational setting where the hierarchical structure has been superseded by the market mechanism. According to these theories, price floors employed in contractual relationships governed by relational norms may be designed to incentivise retailers to engage in the desired promotional activities, or as a remedy to market failures typically addressed by means of vertical integration.

4.2.4.1. RPM as Ex Ante *Incentive Alignment Mechanism*

Examined from a relational perspective, the manufacturer's inability to draft an enforceable contract specifying the desired pre-sales services may be remedied by means of a private enforcement mechanism, in the context of which the manufacturer adequately compensates performing dealers, on the one hand, while relying on the threat of

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[127] Ibid, 226-230.

[128] H Hovenkamp, 'Harvard, Chicago, and Transaction Cost Economics in Antitrust Analysis' [2010] 55 *Antitrust Bull* 613, 622-623. Although Telser did not expressly cite transaction cost economics as the intellectual foundation of the free rider rationale, his theory is in obvious tension with neoclassical economics which assumes that the costs of the acquisition and dissemination of information is negligible, while dismissing the prevalence of opportunistic behaviour; see AJ Meese, 'Property Rights and Intrabrand Restraints' [2003-2004] 89 *Cornell L Rev* 553, 561-565.

[129] LG Telser, 'Why Should Manufacturers Want Fair Trade?' [1960] 3 *JL & Econ* 86, 94 ('it is easier to police violations of minimum prices than to survey retailers to see that they do indeed provide the special services'.).

termination of shirking dealers, on the other. Professors Klein and Murphy, while endorsing the basic premise of Telser's argument – that promotional efforts may be subject to free riding – nevertheless criticise his theory on the basis of its failure to explain exactly *how* vertical restraints may induce the supply of the requisite level of product-specific services. In their view, the mere implementation of price floors does not reduce a retailer's incentive to free ride, by engaging in promotional activities valued by consumers, but not by the manufacturer.[130]

In addressing this shortcoming of Telser's theory, Klein and Murphy note that a manufacturer may employ RPM in order to ensure dealer compensation – and, thus, dealer performance – by creating on a per unit basis a quasi-rent stream[131] which exceeds any potential short-run shirking gains.[132] The result is an 'implicit contractual understanding' whereby the dealer is compensated for any pre-sales services on the basis of its output which, in the absence of vertical integration, appears to be the appropriate measure of services provided, assuming that the manufacturer is not in a position to monitor either the level of services or the state of demand.[133]

4.2.4.2. RPM and Double Moral Hazard

Similarly, Romano takes the position that RPM (either minimum or maximum, depending on the parameters) may remedy any vertical externalities emerging in the context of a vertical relationship, where the decisions of both parties are subject to moral hazard.[134] This is particularly the case where both the upstream and the downstream firms are in a position to affect demand by means of non-price choices, such as quality improvement and promotional activities, respectively. Double moral hazard may thus arise if these decisions are non-contractible, in which case they constitute variables chosen non-cooperatively by each of the parties at a later stage. Against this background, vertical externalities are created where the wholesale price exceeds the upstream firm's marginal cost, thus reducing the retailer's incentives, and the wholesale price is lower than the final

[130] B Klein and KM Murphy, 'Vertical Restraints as Contract Enforcement Mechanisms' [1988] 31 *JL & Econ* 265, 265-266.
[131] A quasi-rent is defined as 'the portion of earnings in excess of the minimum amount needed to prevent a worker from quitting his or her job or a producer from exiting its industry. Whereas rents are defined in terms of decisions to enter a job or an industry, quasi-rents are defined in terms of the decision to exit'; P Milgrom and J Roberts, *supra* n 95, p 269.
[132] B Klein and KM Murphy, *supra* n 130, 276.
[133] Ibid, 285. BF Blair and TR Lewis, 'Optimal Retail Contracts with Asymmetric Information and Moral Hazard' [1994] 25 *Rand J Econ* 284, 284.
[134] RE Romano, 'Double Moral Hazard and Resale Price Maintenance' [1994] 25 *Rand J Econ* 455.

price; in the latter situation it is the supplier's incentive that is affected. According to Romano, price floors may solve these vertical externalities where quality and promotion are strategic complements: the increased promotional efforts resulting from RPM will enhance the marginal productivity of quality, thus inducing the manufacturer to improve the quality of the supplied good.[135]

In light of the foregoing, RPM can be regarded as a strategic alternative to vertical integration by ownership, insofar as it is designed to encourage distributors to undertake relationship-specific investments for the provision of pre-sales services in the context of long-term distributorship agreements. Since it can be safely assumed that the disproportionately high costs associated with the measurement of dealer performance in court proceedings for breach of contractual obligations will prevent a manufacturer from drafting an initial distributorship contract explicitly requiring such investments, the subsequent addition of an RPM clause may be deemed appropriate as a means to induce dealers to engage in promotional activities that will stimulate demand for the manufacturer's products. Such an adjustment is fully consistent with the relational model, particularly where distributors are faced with the threat of termination in the event of failure to observe the manufacturer's pricing strategy.[136] Thus, according to Butler and Baysinger, an agreement fixing resale prices is merely 'a bilateral governance structure that should be interpreted through relational contracting law principles … RPM is a strategy through which a firm is able to expand its sphere of influence beyond its legal boundaries'.[137]

4.3. Commercial Agency

An agent is defined by the European Commission's Vertical Guidelines as a legal or physical person appointed by another person, usually referred to as 'the principal', with the power to negotiate and/or conclude contracts on behalf of the latter, which involve either the purchase of goods or services by the principal, or the sale of goods or services

[135] Ibid, 461-462.
[136] HN Butler and BD Baysinger, *supra* n 112, 1083.
[137] Ibid, 1084. Naturally, the same applies also to vertical territorial restraints.

supplied by it.[138] As remuneration for its services, the agent typically receives either a salary or a commission on the contracts concluded. For the purposes of the application of Article 101 TFEU, the functions performed by the agent are considered as forming part of the principal's activities, insofar as the agent

> does not bear any, or bears only insignificant, [financial or commercial] risks in relation to the contracts concluded and/or negotiated on behalf of the principal, in relation to market-specific investments for that field of activity, and in relation to other activities required by the principal to be undertaken on the same product market.[139]

Where this requirement is met, the prohibition of Article 101(1) will be declared inapplicable, even if the agreement at issue contains clauses that are typically classified as hardcore restraints, including export bans and vertical price restraints. In the context of commercial agency, such restraints are deemed essential in light of the risks assumed by the principal, who accordingly needs to be in a position to determine the appropriate commercial strategy.[140]

The origins of the public policy towards commercial agency can be traced in the US Supreme Court's decision in *General Electric*.[141] As was seen earlier,[142] the 'consignment exception' introduced in *General Electric* was effectively based on the property logic underpinning the earlier *Dr Miles* case. According to Mr Justice Taft, who delivered the opinion of the Court,

> there is nothing as a matter of principle or in the authorities which requires us to hold that genuine contracts of agency like those before us, however comprehensive as a mass or whole in their effect, are violations of the Anti-Trust Act. The owner of an article, patented or otherwise, is not violating the common law or the Anti-Trust Act by seeking to dispose of his articles directly to the consumer and fixing the price by which his agents transfer the title from him directly to such consumer.[143]

[138] Vertical Guidelines, para 12. Compare the distinction between 'genuine' and 'non-genuine' agency agreements under the preceding regime; Commission Notice – Guidelines on Vertical Restraints [2000] OJ C291/1, paras 13-15.
[139] Ibid, para 15.
[140] Vertical Guidelines, para 18.
[141] *United States v General Electric Co*, 272 US 476 (1926).
[142] See *supra* ch 1.
[143] 272 US 476, 488.

In *Simpson v Union Oil Co*, the Supreme Court limited the scope of the consignment exception by ruling that the determining factor when assessing the compatibility of a relevant agreement with Section 1 of the Sherman Act is the allocation of risks between the principal and the consignee.[144] The case concerned an agreement between an oil refiner and its gasoline retailer whereby the former retained title to the consigned goods, while fixing the retail price to be observed by Simpson. In condemning the RPM scheme at issue, the Court noted that the risk of loss was entirely on Simpson, who bore personal liability and property damage insurance by reason of the contract goods, while also being responsible for all losses in the consigned gasoline in his possession. Simpson thus essentially operated as an independent businessman and, in that sense, formalistic reliance on the transfer of ownership requirement would allow potentially harmful arrangements to escape the antitrust laws merely by means of a 'clever manipulation of words'.[145] The fact that the price-maintained gasoline was distributed through a vast and established distribution network was an additional consideration:[146] according to Mr Justice Douglas, for the purposes of the application of the Section 1 prohibition, a consignment agreement cannot amount to commercial agency where its ultimate effect is equivalent to a horizontal price fixing conspiracy.[147]

The European Commission outlined the public policy towards commercial agency for the first time in a relevant Notice published as early as 1962.[148] While neither the 1962 Notice nor the 2000 Vertical Guidelines[149] left any doubts as to the constituent elements of commercial agency, significant controversy nonetheless emerged in that regard from the Commission and European Courts' decision-making practice.[150] In *Pittsburgh Corning*, the Commission, citing the judgment of the CJEU in *Consten and Grundig*[151] as an authority,

[144] *Simpson v Union Oil Co of California*, 377 US 13 (1964).
[145] Ibid, 22.
[146] Ibid, 21-22. See, however, *Illinois Corporate Travel, Inc v American Airlines, Inc*, 806 F2d 722 (7th Cir 1986), where the Court of Appeals for the Seventh Circuit declared the exception applicable despite a travel agent's broad metwork.
[147] In that regard, Mr Justice Douglas made specific reference to the Court's earlier decision in *United States v Socony-Vacuum Oil Co*, 310 US 150 (1940).
[148] European Commission, Notice on exclusive dealing contracts with commercial agents [1962] OJ C139/2921.
[149] *Supra* n 138, paras 12-20. Note that the 1962 Notice cites the assumption of 'financial risks' as the determining factor, while the 2000 Vertical Guidelines make reference to 'the financial or commercial risk borne by the agent'.
[150] See generally I Lianos, 'Commercial Agency Agreements, Vertical Restraints, and the Limits of Article 81(1) EC: Between Hierarchies and Networks' [2007] 3 *J Comp L & Econ* 625, 631-635; F Wijckmans and F Tuytschaever, *Vertical Agreements in EU Competition Law* (2nd edn, Oxford University Press 2011), paras 6.104-6.106.
[151] Joined Cases 56 and 58/64, *supra* n 2, 340 ('The wording of Article [101] causes the prohibition to apply, provided that the other conditions are met, to an agreement between several undertakings. Thus it does not apply where a sole undertaking integrates its own distribution network into its business organization').

refrained from examining any possible allocation of risks between the parties involved in the agreement and relied solely on degree of the agent's economic dependence on the supplier. In that regard, the Commission took the position that the agent was not performing the functions of an auxiliary organ, nor was it integrated into the principal's distribution system. Instead, the agent was simultaneously the subsidiary of other powerful undertakings and enjoyed in itself a degree of market power sufficient to allow it to deviate from the principal's directions, while sales of its own products accounted for a substantial part of its turnover.[152] The 'integration criterion' was further clarified in *Vereniging Vlaamse Reisbureaus*, where the Court of Justice held that agreements whereby travel agents in Belgium were obliged to observe the prices of tours stipulated by tour operators could not benefit from the immunity from antitrust liability conferred on commercial agency. In holding that the price fixing schemes at hand fell within the scope of Article 101(1), the Court noted that travel agents could not qualify as auxiliary organs forming an integral part of a tour operator's undertaking in light of the network of relationships between the upstream and downstream firms: each travel agent 'sells travel organized by a large number of different tour operators and a tour operator sells travel through a very large number of agents'.[153]

In *Mercedes-Benz,* the Commission categorically rejected the assertion that the criterion of integration is relevant to the distinction between a commercial agent and an independent dealer.[154] On appeal, however, the General Court drew a clear analogy between commercial agency and the single economic entity doctrine:

> In so far as application of Article [101 TFEU] is concerned, the question whether a principal and its agent or 'commercial representative' form a single economic unit, the agent being an auxiliary body forming part of the principal's undertaking, is an important one for the purposes of establishing whether given conduct falls within the scope of that article.[155]

Effectively transplanting the analytical framework associated with the single economic entity doctrine into the public policy towards commercial agency, the Court pointed out that immunity from antitrust liability is contingent upon a showing that the agent does not

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[152] *Pittsburgh Corning Europe - Formica Belgium - Hertel* [1972] OJ L272/35. See also European Sugar Industry [1973] OJ L140/17, upheld on appeal by the CJEU in Joined Cases 40-48, 50, 54-56, 111, 113 and 114/73, *Coöperatieve Verenigning 'Suiker Unie' UA and Others v Commission* [1975] ECR-1663.
[153] Case 311/85, *ASBL Vereniging van Vlaamse Reisbureaus v ASBL Sociale Dienst van de Plaatselijke en Gewestelijke Overheidsdiensten* [1987] ECR 3801, para 20.
[154] *Mercedes-Benz* [2001] OJ L257/1, para 163.
[155] Case T-325/01, *DaimlerChrysler AG v Commission* [2005] ECR II-3319, para 86.

determine independently its own conduct in the marketplace, but merely complies with the instructions given to it by the principal.[156] The Court further emphasised that an additional relevant element is the exercise of authority over the agent's marketing strategy.[157]

Eventually, in both editions of its Vertical Guidelines, the Commission appears to have dismissed the integration criterion, citing two only relevant factors which delineate the concept of agency: the agent's function as an organ negotiating and/or concluding sale or purchase transactions on behalf of the principal, and the level of risks assumed by the agent in relation to the fulfilment of its duties. In effect, by conceding that it is irrelevant for the purposes of defining an agency agreement whether the agent acts for one or several principals,[158] the Commission distances itself from the CJEU's judgment in *Vereniging Vlaamse Reisbureaus* and implicitly rejects the criterion of economic dependence.[159]

In two subsequent decisions, however, the Court of Justice also embraced the criterion of risk allocation as the distinctive element of commercial agency. In *CEEES*, despite observing that the relationship between a principal and its agent may be indistinguishable from the interactions between the various constituent parts of an economic unit within the meaning of Article 101,[160] the Court conceded that agents may lose their character as independent traders where do not bear any of the risks associated with the negotiation of contracts on behalf of the principal:[161]

> It follows that the decisive factor for the purposes of determining whether a service station operator is an independent economic operator is to be found in the agreement concluded with the principal and, in particular, in the clauses of that agreement, implied or express, relating to the assumption of the financial and commercial risks linked to sales of goods to third parties. ... [T]he question of risk must be analysed on a case-by-case basis, taking account of the real economic situation rather than the legal classification of the contractual relationship in national law.[162]

[156] Ibid, para 88.
[157] Ibid, para 94.
[158] Vertical Guidelines, para 13; see also 2000 Vertical Guidelines, para 13.
[159] See I Lianos, *supra* n 150, 638.
[160] Case C-217/05, *Confederación Española de Empresarios de Estaciones de Servicio v Compañía Española de Petróleos SA* [2006] ECR I-11987, paras 39-42.
[161] Ibid, para 43.
[162] Ibid, para 46.

This approach was later re-iterated and confirmed by the Court in *CEPSA*.[163]

It is important to note that, unlike EU competition law, which is naturally concerned with the likely adverse effects of restricted dealing on trade between Member States, under US antitrust law the significance of the consignment-agency exception has been limited to the field of vertical price restraints.[164] Whether the distinction between independent distributorship agreements and commercial agency for antitrust purposes can be defended on efficiency grounds is questionable. Theories of harm associated with the implementation of RPM schemes, such as the facilitation of manufacturer or dealer cartels, are equally applicable to agency relationships. Posner observes that, if *Dr Miles* is to be interpreted as proscribing vertical restraints which have the same adverse competitive impact as horizontal collusion, then the consignment exception as applied in *General Electric* is in sharp contrast with this precedent. And, inversely, if the consignment exception, along with the *Colgate* doctrine, stand for the proposition that the manufacturer may, under certain circumstances, have legitimate reasons for imposing minimum resale prices, then the per se treatment of RPM is rather unwarranted.[165]

That said, the consignment exception is consistent with the idea that the risk bearer is in a better position to determine its own profit-maximising price.[166] Additionally, by fixing the agent's mark-up, which in this way serves as a commission on sales made, the principal may be seeking to incentivise the dealer to increase its sales efforts in the face of any fluctuations in the retail market price relative to the wholesale price paid at the time of consignment.[167] The lenient public policy towards commercial agency can also be explained in light of new institutional economics: Lianos sees agency as an organisational structure similar to a situation of hierarchy. The fact that the principal retains property rights over the contract goods makes it susceptible to possible post-contractual opportunistic behaviour on the part of its agents. Against this background, antitrust immunity is deemed necessary to encourage the supplier to incur the administrative costs of establishing the form of organisation that best serves its commercial interests.[168]

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[163] Case C-279/06, *CEPSA Estaciones de Servicio SA v LV Tobar e Hijos SL* [2008] ECR I-6681, paras 35-36.
[164] H Hovenkamp, *supra* n 51, p 520
[165] RA Posner, *Antitrust Law* (2nd edn, The University of Chicago Press 2001), pp 178-179. See also KN Hylton, *Antitrust Law: Economic Theory and Common Law Evolution* (Cambridge University Press 2003), p 268.
[166] LA Sullivan and WJ Grimes, *The Law of Antitrust: An Integrated Handbook* (2nd edn, West 2006), p 404.
[167] H Hovenkamp, *supra* n 51, p 519.
[168] I Lianos, *supra* n 150, 663-664.

As a general proposition, the economic notion of agency refers to an agreement whereby the principal delegates a specific task to a different party and, accordingly, it is considerably broader that the respective antitrust definition.[169] In other words, a member of a distribution network is automatically classified as an agent in the above sense, regardless of whether it assumes financial or commercial risks of any degree. As has already been explained, it is in the context of such relationships that information asymmetry gives rise to agency problems which may expose the principal to post-contractual opportunistic behavior on the part of the agent. In the face of a possible conflict of interests, the principal is presented with two options; it can either adopt a monitoring mechanism, by entering into a form of hierarchical relationship with the agent,[170] or align the parties' interests by creating outcome-based agent incentives.[171] An outcome-based contract, however, entails the transfer of risk to the agent, whose performance may be determined by a number of contingencies which are independent of its own efforts. Against this background, the greater the agent's risk aversion, the greater the likelihood that it will demand a premium for bearing compensation risk and, in turn, the greater the costs incurred by the principal for the conclusion of an outcome-based contract.[172]

Naturally, both polar extremes may be prohibitively costly for a manufacturer. Hierarchical organization, on the one hand, although maximising control over distribution, requires a significant commitment of resources and exposes the manufacturer to an unfamiliar business environment, while considerably limiting its flexibility.[173] At the same time, arm's length transactions may give rise to the problems of moral hazard and adverse selection.[174] On the basis of this analysis, and contrary to Lianos's assertion, Zhang[175] takes the view that commercial agency is a hybrid form of organisation, which essentially constitutes 'a middle ground between vertical integration and outsourced distribution'.[176]

Zhang further justifies the lenient approach taken to commercial agency as reflecting the authorities' lack of concern as to its effects on competition. While Zhang's argument that agency agreements may have practically no contribution to the facilitation of

[169] AH Zhang, 'Toward an Economic Approach to Agency Agreements' [2013] 9 *J Comp L & Econ* 553, 576-577.
[170] See EF Fama, 'Agency Problems and the Theory of the Firm' [1980] 88 *J Pol Econ* 288.
[171] MC Jensen and WH Meckling, 'Theory of the Firm: Managerial Bahavior, Agency Costs and Ownership Structure' [1976] 3 *J Fin Econ* 305.
[172] WM Lassar and JL Kerr, 'Strategy and Control in Supplier-Distributor Relationships: An Agency Perspective [1996] 17 *Strategic Mgmt* 613, 614-615.
[173] Ibid, 615.
[174] Ibid.
[175] Zhang, *supra* n 169, 577-580.
[176] Ibid, 579.

a downstream cartel is indeed convincing, as the manufacturer remains the residual control rights holder,[177] her comparative analysis of the possible impact of RPM and commercial agency on the stabilisation of upstream cartels should rather be dismissed:

> Of course, if multiple competing manufacturers appoint the same agent and use that agent as a conduit for exchanging price information, this amounts to horizontal price fixing, in violation of antitrust law. In such a case, however, it is not the vertical restraint that makes the cartel possible – the manufacturers in question are able to fix prices on their own in the first place. Resale price maintenance might have the effect of facilitating such a cartel, though, as the manufacturers would not be able to easily fix retail prices in the absence of restraints imposed on the downstream retailers.[178]

First of all, horizontal collusion is exactly that; horizontal. As will be argued in Chapter 6, whether the parties to a collusive arrangement implement a vertical restraint of any sort as a facilitating mechanism, the loss in allocative efficiency which will trigger the application of the antitrust laws will be caused by the horizontal coordination, not by the vertical restraint. Second, Zhang appears to be confusing the ability to collude with the ability to monitor compliance with the rules of the cartel. More specifically, whether upstream firms are indeed 'able to fix prices on their own' is an issue which has nothing to do with the vertical relationship, but with other factors such as the structure of the relevant market, the availability of sensitive information on prices and cost structures, or the degree of product differentiation, none of which is in any way affected by RPM. In other words, RPM may be designed to ensure compliance with the cartel, not to create it. There can be no misunderstanding that RPM may indeed facilitate the maintenance of the collusive equilibrium, but this does not entail, as Zhang appears to imply, that RPM is a necessary condition of successful cartelisation. The European Commission and Courts' decision-making practice is particularly instructive in that regard. In no cartel case brought by the Commission under Article 101 was there any evidence of a parallel implementation of price floors and, inversely, in no vertical price fixing case did the Commission rely on an individual RPM scheme in order to infer the existence of a cartel. If Zhang's assertion was correct and collusion was indeed difficult in the absence of RPM, then one would expect to encounter not only at least some, but in fact an overwhelming number of cases combining horizontal and vertical price fixing. In light of the foregoing, the facilitation of the

[177] Ibid, 575.
[178] Ibid, 574-575.

exchange of sensitive information on prices through a common agent, which Zhang quickly dismisses as a purely horizontal matter – and rightly so – could in reality be described as greater threat from a welfare perspective, since it is effectively a constitutive element of a cartel.[179]

4.4. RPM and Selective Distribution

The maintenance of price floors is not the only means whereby no-frills retailers may be prevented from taking a free ride on the promotional efforts of their full-service rivals. A manufacturer may insulate its distribution network from the activities of free riders by selecting its members on the basis of qualitative criteria and by prohibiting any sales to unauthorised dealers, namely to wholesalers and retailers which fail to satisfy the necessary requirements as specified by the manufacturer and dictated by the nature of the contract goods. Being a unilateral act, a non-dominant manufacturer's refusal to deal with a specific distributor – any distributor and for whatever reason – falls outside the ambit of Article 101 TFEU. The manufacturer, however, cannot effectively prevent unauthorised dealers from carrying its products unless it ensures that they will not have access to alternative sources of supply. The fundamental characteristic of selective distribution therefore consists in the manufacturer's right to allow the resale of its products only to approved dealers and end users.

Article 101(1) TFEU is generally not applicable to purely qualitative selective distribution. In order for such a system to escape the prohibition of Article 101(1) three conditions must be met. First, selective distribution must be necessary in light of the nature of the products concerned, a requirement typically satisfied by distribution networks in 'the sector covering the production of high quality and technically advanced consumer durables'.[180] Second, the selection of the authorised distributors must be based on a set of

[179] Note that the Vertical Guidelines expressly state that agency agreements found to facilitate horizontal collusion will be caught by Article 101(1), even if the principal bears all the relevant financial and commercial risks. As examples of commercial agency which may potentially give rise to collusive outcomes, the Guidelines refer to situations in which 'a number of principals use the same agents while collectively excluding others from using these agents, or when they use the agents to collude on marketing strategy or to exchange sensitive market information between the principals'; Vertical Guidelines, para 20.

[180] Case 26/76, *Metro SB-Großmärkte GmbH & Co KG v Commission (Metro I)* [1977] ECR 1875, para 20.

objective criteria of a qualitative nature, which are applicable to all potential dealers in a non discriminatory way. And third, these criteria must be proportional and not go beyond what is necessary for the effective distribution of the contract goods.[181] In addition to these three conditions outlined in the Vertical Guidelines, the European Courts further require that the result sought by the distribution system be capable of enhancing competition, thus counterbalancing the restriction of competition inherent in selective distribution.[182] However, even where these requirements are not met, qualitative – as well as quantitative – selective distribution systems fall within the scope of the Vertical Block Exemption Regulation insofar as the individual market shares of both the supplier and the buyer do not exceed 30 percent of the relevant markets.[183]

The early case law of the CJEU on selective distribution established that intrabrand price competition may be curtailed where demand for the goods in question is contingent upon the provision of product-specific services or the preservation of their high-quality image. Lying at the very heart of selective distribution, the free rider argument and its 'quality certification' variant have thus always been, whether explicitly or implicitly, integrated in the enforcement logic of Article 101 TFEU. In the landmark *Metro* case, the CJEU conceded that 'although price competition is so important that it can never be eliminated it does not constitute the only effective form of competition or that to which absolute priority must in all circumstances be accorded'.[184] Accordingly, the Court noted that the relative structural price rigidity observed in selective distribution networks does not amount to a restriction of competition within the meaning of Article 101(1), provided that the operation of similar systems in a given industry is not widespread.[185] In *AEG-Telefunken*, the Court of Justice further refined the concept of selective distribution:

> there are legitimate requirements, such as the maintenance of a specialist trade capable of providing specific services as regards high-quality and high-technology products, which may justify a reduction of price competition in favour of competition relating to factors other than price. Systems of selective distribution, in so far as they aim at the attainment of a legitimate goal capable of improving

[181] Vertical Guidelines, para 175.
[182] See Case T-19/92, *Groupement d'achat Edouard Leclerc v Commission* [1996] ECR II-1851, para 112.
[183] Vertical Guidelines, para 176.
[184] Case 26/76, *Metro I* [1977] ECR 1875, para 21.
[185] Ibid, para 22.

competition in relation to factors other than price, therefore constitute an element of competition which is in conformity with Article [101](1).[186]

In light of this assumption, a manufacturer who has set up a selective distribution network does not need to prohibit discounted retail sales of its products. In fact, the manufacturer has selected its distributors on the basis of their ability to provide the necessary product-specific services, and upon the understanding that they will not engage in aggressive price competition with each other. As a substitute for unlawful RPM, the very nature of selective distribution guarantees that the goods concerned will be carried by full-service, full-price outlets. If a retailer operating within the framework of such a network starts undercutting systematically its rivals in order to expand its market share, the manufacturer may assume that the maverick retailer has been taking a free ride on the other members' promotional efforts. Alternatively, it could be the case that it has adopted a different marketing strategy, having been transformed into a no-frills outlet whose reputation is not compatible with the offered goods. In any event, EU competition law recognises the manufacturer's right to punish any deviation from the system's operational framework by terminating the price-cutting retailer and excluding it from the network. Its authorisation to carry the contract goods having been withdrawn, the latter will consequently be unable to obtain supplies either from the manufacturer or from the remaining members of the network. Absent any additional clauses that raise antitrust concerns, courts and competition authorities would be expected to uphold the termination.

Put differently, there can be no misunderstanding that the price rigidity derives from the very purpose and nature of selective distribution, which is designed to restrict the availability of a given manufacturer's products through a limited number of non-differentiated retail outlets[187] characterised by similar cost structures. Thus, in citing the pro-competitive effects of vertical restraints, the Vertical Guidelines acknowledge that selective distribution may provide a solution to the archetypical free rider problem,[188] as well as prevent no-frills retailers from taking advantage of the quality certification associated with the endorsement of the product by reputable outlets.[189] The Guidelines

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[186] Case 107/82, *Allgemeine Elektrizitäts-Gesellschaft AEG-Telefunken AG v Commission* [1983] ECR 3151, para 33, recently reiterated in Case C-439/09, *Pierre Fabre Dermo-Cosmétique SAS v Président de l'Autorité de la concurrence* [2011] ECR I-9419, para 40.

[187] The idea that even a strictly qualitative selective distribution network is intrinsically limited in scope is based on the obvious assumption that '[t]o be meaningful, qualitative criteria must have a quantitative effect'; JS Chard, 'The Economics of the Application of Article 85 to Selective Distribution Systems' [1982] 7 *EL Rev* 83, 97.

[188] Vertical Guidelines, paras 107(a) and 185.

[189] Ibid, para 107(c).

further accept that selective distribution may be designed to remedy any positive or negative vertical externalities[190] or to facilitate the attainment of economies of scale in distribution.[191] Finally, this form of restricted dealing may contribute to the uniformity and quality standardisation of the distribution network.[192]

In light of the free rider rationale, therefore, vertical price fixing and selective distribution may be employed as alternative commercial methods in pursuit of the same objective, namely to ensure the provision of the necessary demand-stimulating services.[193] In *AEG-Telefunken v Commission*, the CJEU rejected AEG's assertion that the protection of its selective distributors' profit margin by means of RPM was indispensible for the viability of the specialist trade. The Court held instead that, by excluding from its distribution network all dealers who could not supply the requisite product-specific services to consumers, the manufacturer 'had at its disposal all the means necessary to enable it to ensure the effective application of the system'.[194] However, although ostensibly constituting interchangeable remedies to the free rider problem, RPM and selective distribution are nonetheless only imperfect substitutes. A manufacturer relying on qualitative selective distribution is likely to encounter two noteworthy problems that may undermine the system's successful operation.

First of all, no-frills retailers may still have the possibility to purchase the contract goods from members of the distribution network. While the manufacturer has the ability contractually to prevent the latter from selling the products concerned to unauthorised outlets, ensuring the admitted dealers' compliance with the agreed upon restriction is an entirely different issue. As the likelihood of sales to non-eligible dealers threatens selectivity with erosion and re-affirms the prospect of free riding, the manufacturer will have to incur the additional cost of policing the distribution network, which equals the cost of detecting and preventing any deviations.[195] Under these circumstances, the manufacturer may decide that its interests are better served by RPM. Given that the detection of systematic price-cutting is likely to be less burdensome than the active supervision of the approved dealers' conduct in the marketplace, the manufacturer may be inclined to adopt a

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[190] Ibid, para 107(f).
[191] Ibid, para 107(g). Subsequently, however, the Commission asserts that 'such an efficiency is usually only marginal in selective distribution systems'; ibid, para 185.
[192] Ibid, para 107(i).
[193] That selective distribution and RPM constitute interchangeable solutions to the free rider problem has also been acknowledged by Telser; see LG Telser, *supra* n 129, 94 ('The manufacturer has still another alternative to resale price maintenance. He may refuse to sell his product to any retailer who does not provide the requisite special services').
[194] Case 107/82, *AEG-Telefunken* [1983] ECR 3151, para 43.
[195] LG Telser, *supra* n 129, 94 at fn.7.

policy of minimum retail prices designed both as form of compensation to diligent dealers and as a monitoring mechanism.

The second problem derives from the nature of distribution agreements as long-term contractual relations which are extremely unlikely to include terms and clauses that provide for all possible future contingencies, as this could be prohibitively costly. In other words, as the drafting of an enforceable contract explicitly specifying the requisite services is frequently not practicable, the manufacturer may not be able to go beyond a general outline of its preferences and expectations. As has been argued earlier in this chapter, in light of Professor Klein and Murphy's insight, a fixed resale price could supplement a qualitative selective distribution system as a mechanism designed to enhance the self-enforcing range of the selectivity clauses. This argument will be further developed in Chapter 6, where it will be argued that, under certain circumstances, and particularly where the retailer is required to undertake sunk relationship-specific investments, selectivity clauses and price floors are not alternative, but complementary restrictions.[196]

On the basis of the preceding analysis, and in light of the assumption[197] that qualitative selective distribution constitutes 'a hybrid form of organization, falling between a hierarchy and the market',[198] the compelling conclusion is that RPM designed to enhance the manufacturer's control over its distribution system should also be approached as a form of network. In the first instance, the possible anti-competitive character of price floors is irrelevant; as a general proposition, there is nothing precluding a network from being considered as '*undesirable from a public point of view*',[199] thus warranting antitrust intervention.[200]

Besides, even qualitative selective distribution is in itself not immune from antitrust criticism. For instance, being premised on the correlation between the necessity of specific pre-sales services and the ensuing increase in retail prices, Professor Comanor's infra-marginal consumer theory[201] is equally applicable both to RPM and to selective distribution.[202] Additionally, the industry-wide implementation of qualitative selective distribution networks may result in a reduction in interbrand competition. According to the

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[196] See *infra* s 6.5.
[197] See I Lianos, *supra* n 150, 657-663.
[198] Ibid, 658.
[199] HB Thorelli, *supra* n 52, 46 (emphasis in original).
[200] Ibid.
[201] WS Comanor, 'Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy' [1984-1985] 98 *Harv L Rev* 983; See *supra* ch 2.
[202] See in that regard P Marsden and P Whelan, 'Selective Distribution in the Age of Online Retail' [2010] 31 *ECLR* 26, 31.

CJEU's ruling in *Metro II*, where this reduction is not offset by a corresponding stimulation of non-price competition, selective distribution is likely to trigger the application of Article 101(1). Selective distribution may also fall within the scope of the prohibition where the cumulative effect of multiple similar network established in the same market is the prevention of other 'forms of distribution based on a different type of competition policy'.[203]

Last, and most certainly not least, selective distribution may have comparable effects in facilitating collusion both in the upstream and in the downstream market insofar as it restricts intrabrand price competition and reduces 'the number of dimensions on which retailers compete'.[204] On the other hand, as has been discussed already, RPM is not invariably detrimental to competition and, at the same time, may on certain occasions produce more far-reaching transactional efficiencies than selective distribution.

It is important, however, to acknowledge that, subject to certain qualifications, RPM also has a place in the market-network-hierarchy continuum. This observation lies in the very heart of this thesis. Whether vertical price fixing is indeed intended to establish a situation of network can be determined on a case-by-case basis, in much the same way as qualitative selective distribution. The determining factor, in other words, should be the demand-stimulating effect of non-price competition or the prevalence of free rider concerns, having regard to the specific attributes of the goods. Due to the presumptively greater anti-competitive potential of RPM, however, closer analysis of the welfare consequences of the scheme at hand is warranted. The Vertical Guidelines have already stressed the relevance of the nature of the products concerned in the context of a substantive assessment under Article 101(3) where the parties rely on the free rider argument to plead an efficiency defence.[205] As will be argued in Chapter 6 below, it is unclear why the current analytical framework cannot be replaced by an intuitive proportionality test under Article 101(1).

[203] Case C-75/84, *Metro SB-Großmärkte GmbH & Co KG v Commission (Metro II)* [1986] ECR 3021, para 40.

[204] P Buccirossi, 'Vertical Restraints on E-Commerce and Selective Distribution' [2015] 11 *J Comp L & Econ* 474, 753.

[205] Vertical Guidelines, para 225 ('In some situations, the extra margin provided by RPM may allow retailers to provide (additional) pre-sales services, *in particular in case of experience or complex products*') (emphasis added).

4.5. RPM and Exclusive Territories

As has already been stated, RPM is currently the most stringently treated of all vertical restraints. A conclusive presumption of allocative inefficiency allows the substantive assessment of agreements fixing resale prices to be carried out only in the context of Article 101(3). At the same time, the recent Vertical Guidelines have adopted a more permissive approach to absolute territorial protection: by acknowledging the potential necessity of export bans to the attainment of a legitimate business purpose, the Guidelines leave the door open for the parties to plead an ancillarity defence and escape the prohibition altogether.

Proponents of the Chicago school have on various occasions attacked this differentiated attitude towards RPM, on the one hand, and territorial exclusivity, on the other, asserting that it cannot be justified from an economic perspective. They argue that it is doubtful whether the distinction between vertical price and non-price restraints is anything but artificial:[206] all restrictions of competition between dealers, even those which are territorial in scope, aim at influencing the level of prices in the downstream market. Vertical restraints are fundamentally pro-competitive when they are intended to incentivise the distributors to increase their sales efforts with respect to a certain manufacturer's products. It goes without saying that no incentive could be more effective that a higher profit margin. Whether this profit margin is guaranteed directly, by means of fixed resale prices, or indirectly, through the elimination of intrabrand competition within a given geographical territory, is immaterial. Instead, the pattern of the distribution network – and, accordingly, the nature of the restraint – will depend on whether the products in question are likely to be sold more effectively in that territory through multiple outlets or through a single outlet, respectively.[207]

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[206] In the words of Professor Hay, 'the price-nonprice distinction seems to be an exercise in semantics'; GA Hay, 'Vertical Restraints after *Monsanto*' [1984-1985] 70 *Cornel L Rev* 418, 434.

[207] There is plenty of literature on this issue, particularly in the aftermath of the *Sylvania* case. See eg RH Bork, 'Vertical Restraints: Schwinn Overruled' [1977] 1977 *Sup Ct Rev* 171, 179-182; FH Easterbrook, 'The Limits of Antitrust' [1984-1985] 63 *Tex L Rev* 1, 14; RA Posner, 'The Rule of Reason and the Economic Approach: Reflections on the *Sylvania* Decision' [1977-1978] 45 *U Chi L Rev* 1; FH Easterbrook, 'Vertical Arrangements and the Rule of Reason' [1984-1985] 53 *Antitrust LJ* 135, 155-157.
Comanor argues that, in reality, the adverse effect of territorial restraints on intrabrand competition may be even greater. Unlike RPM, territorial restraints affect not only price, but service competition as well; WS Comanor, 'Vertical Arrangements and Antitrust Analysis' [1987] 62 *NYUL Rev* 1153, 1157-1160. See also RA Posner, 'The Next Step in the Antitrust Treatment of Restricted Competition: Per Se Legality' [1981] 48 *U Chi L Rev* 6, 8-14.

The same conclusion will be drawn if the problem of distinguishing between vertical price and non-price restraints is addressed in light of the free rider rationale. A free rider is, by definition, a price cutter. He is capable of offering discounted prices at the expense of his full-service rivals by taking advantage of their sales efforts, thus impeding the recoupment of their investments. Vertical market division, like RPM, is intended to remedy the free rider problem by preventing price cutting and, inversely, price cutting frustrates equally both types of intrabrand restrictions.[208] It could therefore be argued that, by precluding the applicability of the ancillarity doctrine to vertical price fixing, the Commission draws an arbitrary line between two aspects of the same economic phenomenon.

Furthermore, the distinction between RPM and market division may be frustrated in practice by the commercial purpose pursued by the restraint. The case law of American courts categorically demonstrates that formalistic line drawing is unwarranted. In *Eastern Scientific Co v Wild Heerbrugg Instruments, Inc*,[209] a case decided in the wake of the Supreme Court's *Sylvania* judgment, at a time when RPM was still treated as per se illegal, the Court of Appeals for the First Circuit held that the agreement whereby an exclusive distributor undertook to sell the manufacturer's products out of its assigned area at no less than the stipulated price should be analysed under the rule of reason. The court held that the case at hand in essence involved a policy of territorial restriction enforced by price maintenance, and rejected the plaintiff's assertion that the price restrictions at issue required per se treatment. Although acknowledging that these restrictions were similar in form to an RPM agreement, the court pointed out that, to the extent that they were used to enforce the allocation of territories, they could not possibly have a greater anti-competitive effect than a pure policy of territorial restrictions.[210] Thus, the court reached the conclusion that

> the resale price restriction in the present case produces the same anti-competitive effect as pure territorial restrictions but to a lesser degree. If the Supreme Court holds that pure territorial restrictions should be analyzed under the rule of reason,

[208] WJ Liebeler, '1983 Economic Review of Antitrust Developments: The Distinction between Price and Nonprice Distribution Restrictions' [1983-1984] 31 *UCLA L Rev* 384, 388-391; H Hovenkamp, 'Vertical Restrictions and Monopoly Power' [1984] 64 *BU L Rev* 521, 526-527.
[209] 572 F2d 883 (1st Cir 1978), *cert denied*, 439 US 833 (1978).
[210] Ibid, 885-886.

> we can see no reason based on substantive economic effect why a similar but less anti-competitive scheme should be treated differently.[211]

However, in an interesting article reviewed earlier in this thesis, Rey and Vergé, analysing the argument that vertical price fixing may facilitate horizontal collusion when manufacturers distribute their products through the same competing retailers, dispute the Chicagoan rubric, noting that 'RPM allows manufacturers to avoid interbrand competition even when, due to retailers' differentiation strategies, meeting consumer demand makes it undesirable to grant exclusive territories and exclude some of the established retailers'.[212] The authors thus put forward an argument in favour of the more cautious treatment of price restraints, ostensibly challenging the view that RPM and territorial restrictions have similar effects to competition. However, and although the value of this insight cannot be overstated, the fact remains, as Rey and Vergé themselves concede, that

> it is not clear that RPM has a more negative impact on welfare than other vertical restraints that limit intrabrand competition. Instead, both price (e.g., RPM) and non-price restraints (e.g., exclusive territories) may have positive or negative effects on welfare, depending on the context in which they are used. ... Overall, a comparison of the welfare effects of exclusive territories, RPM and exclusive dealing does not clearly justify a more lenient attitude towards non-price restrictions.[213]

As a starting point, it should be noted that, naturally, arguing that RPM and exclusive territories generally produce similar welfare consequences is as arbitrary as accepting in the abstract that all RPM schemes, on the one hand, and all territorial exclusivity clauses, on the other, are equally welfare-enhancing or equally welfare-reducing. When a restraint is taken out of context, all one is presented with is a series of equally compelling analyses in support of one or the other normative point of view.

In fact, Patrick Rey himself, in an earlier article co-authored with Professor Stiglitz, demonstrated that under conditions of imperfect competition – arguably the most likely scenario in real-life markets, by contrast to the polar models of pure monopoly and perfect competition – exclusive territories may be exploited by manufacturers in an attempt to curtail interbrand competition, thus increasing the equilibrium price and, accordingly, their

[211] Ibid, 886.
[212] P Rey and T Vergé, 'Resale Price Maintenance and Interlocking Relationships' [2010] 58 *J Ind Econ* 928, 931.
[213] Ibid, 929 (citations omitted).

profits.[214] More specifically, Rey and Stiglitz argue that exclusive distribution systems may affect the manufacturer's perception of demand elasticity: believing that it is facing a less elastic demand curve, a manufacturer which has conferred territorial exclusivity upon its retailers is therefore likely to compete less aggressively, in which case both wholesale and retail prices are likely to increase. As far as the implications of their study for antitrust policy are concerned, the authors suggest that all vertical restraints be subject to a rebuttable presumption of illegality.[215]

On the same intellectual basis, Motta takes the position that exclusive territories can produce strategic effects that cannot be replicated by means of price floors.[216] This argument is premised on the fundamental assumption that retailers have access to valuable information which is not available to the manufacturer. As has already been seen, this informational asymmetry is the reason why problems of moral hazard and adverse selection emerge. However, it also implies that, where a principal is unable to perform a specific task, it has the incentive to delegate the relevant decision-making powers to the agent. The fundamental difference between territorial exclusivity clauses and RPM is that, in the context of an exclusive distribution network, the decision-making power with regard to prices has been delegated to the retailer, who is simultaneously a territorial brand monopolist. In the case of an upstream duopoly, if this arrangement is observable by the competing manufacturer, the allocation of an exclusive territory will be interpreted as signalling the former's intention to keep prices high and as an invitation to soften interbrand competition. Such an outcome cannot be replicated by RPM, simply because the retailer will be obliged to observe the prices stipulated by the upstream firm.

Of course, that is not to say that the argument for a less lenient approach to price restraints is not compelling. Even before Rey and Vergé, Jullien and Rey demonstrated that the fundamental contribution of RPM to facilitating tacit collusion in the upstream market consists in their ability to make retail prices less responsive to local shocks on demand or costs. By contrast, in the presence of similar local shocks, exclusive territories, as well as any other non-price restraints which do not eliminate the distributors' freedom in determining their pricing policies, are less likely to eliminate retail price variability, thus making tacit collusion harder.[217]

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[214] P Rey and J Stiglitz, 'The Role of Exclusive Territories in Producers' Competition' [1995] 26 *Rand J Econ* 431.
[215] Ibid, 446.
[216] M Motta, *Competition Policy: Theory and Practice* (Cambridge University Press 2004), pp 348-351.
[217] B Jullien and P Rey, 'Resale Price Maintenance and Collusion' [2007] 38 *Rand J Econ* 983, 996-997.

It is submitted that the case for a more consistent public policy towards vertical price and non-price restraints is indeed stronger with regard to their exclusionary effects, which appear to be directly comparable. In a recent article, Asker and Bar-Isaac demonstrate that a wide range of vertical restraints may be employed by an incumbent manufacturer in an attempt to prevent new entry in the upstream market.[218] The idea supported by the authors is that an upstream monopolist has the incentive to restrict or eliminate intrabrand competition by means of various vertical practices, including RPM and the allocation of exclusive territories, which may be implemented as rent-sharing mechanisms designed to prevent retailers from accommodating new entrants. More specifically, the manufacturer may create the exclusionary equilibrium by setting a wholesale price equal to its marginal cost, while allowing the downstream firm to charge a monopoly price. In such a case, the retail price may be set at the monopoly level either by the price-maintaining manufacturer or by the retailer itself which, having been assigned with an exclusive territory, has the ability to act as a territorial brand monopolist.[219] Advocating the adoption of a common normative framework for both price and territorial restraints, the authors note that '[e]ven [post-*Leegin*], the judicial approach to evaluating the harm arising from these different restraints is, at best, unclear. The framework developed in this article suggests that, at least as far as concerns about exclusion are concerned, a more consolidated approach is both feasible and supported by economic theory'.[220]

As a concluding remark, it should be stressed, however, that the conclusions drawn by Rey and Vergé, and Jullien and Rey, although consistent with a generally more lenient public policy towards territorial restraints, they are nevertheless of exceptionally limited relevance to the application of the indispensability requirement of Article 101(3) TFEU. The reason is intuitive: exclusive territories, even assuming that they are indeed less restrictive, they cannot possibly be regarded as a reasonable alternative to price floors. Territorial exclusivity is so largely contingent upon the very nature of the goods concerned, that a manufacturer cannot be expected to be faced with a dilemma as to which of these types of restricted dealing to apply to its distribution network. It can be safely assumed that, while market division would be more appropriate for the distribution of expensive commodities, the sale of which through a geographically dense network of retailers would not be economically feasible, fixed resale prices could induce dealers to increase their sales

[218] J Asker and H Bar-Isaac, 'Raising Retailers' Profits: On Vertical Practices and the Exclusion of Rivals' [2014] 104 *Am Econ Rev* 672.
[219] Ibid, 680.
[220] Ibid, 682.

efforts with regard to relatively inexpensive goods, for the purchase of which consumers are not willing to incur higher search costs.[221] Besides, it has to be reminded that one of the pro-competitive theories of RPM focuses on the ability of price floors to facilitate resale density, particularly with regard to a non-negligible category of consumer goods which are frequently bought on impulse.[222] This theory is axiomatically not applicable to exclusive territories, which are employed exactly where the distribution of the contract goods is more efficient when undertaken by scarcely located outlets.

4.6. Conclusion

The concept of economic activity represents – more frequently than not – the result of active cooperation between more than one economic actors. As has already been seen earlier in this thesis, new institutional economics is in principle indifferent to the institutional framework within which such cooperation takes place, and acknowledges markets and hierarchies as alternative organisational structures, the use of which is to be interpreted through the lens of transaction cost economics.

This assumption has far-reaching normative implications which extend to the field of antitrust. According to Lianos,[223] reliance on new institutional economics may justify not only the exclusion of intra-enterprise conspiracy and commercial agency from the scope of Article 101(1) TFEU, but also the applicability of the ancillary restraints doctrine to hybrid forms of organisation, such as franchising agreements and qualitative selective distribution. And while the legal approach to exclusive distribution under EU competition law is less straightforward, since the substantive assessment of the relevant clauses appears to be largely confined in the context of Article 101(3),[224] it will be argued later[225] that the

[221] RA Posner, 'Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions' [1975] 75 *Colum L Rev* 282, 293-294.
[222] BS Yamey, *The Economics of Resale Price Maintenance* (Pitman 1954), pp 49-52; JR Gould and LE Preston, 'Resale Price Maintenance and Retail Outlets' [1965] 32 *Economica* 302.
[223] I Lianos, *supra* n 150.
[224] See Vertical Guidelines, paras 151-164. This, of course, is without prejudice to the ability of exclusive distribution agreements to benefit from the relevant Block Exemption Regulation.
[225] See *infra* s 6.5.

lenient treatment under the recent Vertical Guidelines of export bans designed to facilitate new entry[226] can be explained on the basis of this analysis.

Against this backdrop and in light of the foregoing, the blanket prohibition of price floors under EU competition law appears to be inconsistent not only with economic principles, but also with the general normative stance towards restrictions of intrabrand competition: a careful examination of the European Commission and Courts' decision-making practice reveals that antitrust immunity is typically conferred upon forms of restricted dealing designed to generate transactional efficiencies where the hierarchical organisation has been superseded by the market mechanism, and long-term contractual partnerships governed by relational norms have been entered into as a cost-effective alternative to complete vertical integration by ownership. This point will be further elaborated in Chapter 6 below, and will form the intellectual basis for the recommendation of a more consistent analytical framework for the substantive assessment of vertical price fixing under Article 101 TFEU.

[226] Vertical Guidelines, paras 60-61.

Chapter 5

The Public Policy towards Resale Price Maintenance in the EU and the US

5.1. The Public Policy towards RPM in the EU

It is established case law of the CJEU[1] that clauses fixing minimum resale prices restrict competition by object.[2] As a result, any agreements containing such clauses are conclusively presumed to fall within the ambit of Article 101(1). Even price fixing agreements between manufacturers and distributors with only limited market power may be caught by Article 101(1), since the 2014 *De Minimis* Notice excludes agreements 'containing any of the restrictions that are listed as hardcore restrictions in any current or future Commission block exemption regulation' from the benefit of the safe harbour created by the market share thresholds provided in paragraph 8 thereof.[3] In addition, Article 4(a) of Regulation 330/2010 expressly classifies the direct or indirect[4] imposition of fixed or minimum resale prices as a hardcore restriction of competition. More

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[1] See, eg, Case 161/84, *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 353; Case 26/76, *Metro SB-Großmärkte GmbH & Co KG v Commission* [1977] ECR 1875; Case 234/83, *SA Binon & Cie v SA Agence et Messageries de la Presse* [1985] ECR 2015.

[2] See the Commission Guidelines on the Application of Article 81(3) [now Article 101(3)] of the Treaty [2004] OJ C101/97 (hereinafter 'Article 101(3) Guidelines'), para 23, where the Commission further states that '[r]estrictions that are black-listed in block exemptions or identified as hardcore restrictions in guidelines and notices are generally considered by the Commission to constitute restrictions by object'.

[3] Communication from the Commission – Notice on agreements of minor importance which do not appreciably restrict competition under Article 101(1) of the Treaty on the Functioning of the European Union (De Minimis Notice) [2014] OJ C291/1, para 13. The general reference to hardcore restraints merely implies that the treatment of minimum RPM under the recent *De Minimis* Notice has remained unaltered. Compare Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty establishing the European Community (*de minimis*) [2001] OJ C368/13, Article 11(2)(a), where the Commission explicitly states that the Notice does not cover 'the restriction of the buyer's ability to determine its sale price'.

[4] The 2010 Guidelines on Vertical Restraints provide examples of indirect vertical price fixing and relevant facilitating practices:

> RPM can also be achieved through indirect means. Examples of the latter are an agreement fixing the distribution margin, fixing the maximum level of discount the distributor can grant from a prescribed price level, making the grant of rebates or reimbursement of promotional costs by the supplier subject to the observance of a given price level, linking the prescribed resale price to the resale prices of competitors, threats, intimidation, warnings, penalties, delay or suspension of deliveries or contract terminations in relation to observance of a given price level;

Vertical Guidelines, para 48.

specifically, the Vertical Block Exemption Regulation provides that '[t]he exemption ... shall not apply to vertical agreements which, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object: (a) the restriction of the buyer's ability to determine its sale price'. Any inclusion of such 'black-listed' clauses means that not only the particular provisions, but the agreement as a whole shall be unable to benefit from the block exemption.

Notwithstanding the Commission's general hostility towards RPM schemes, undertakings may qualify for an exemption under Article 101(3), insofar as they are able to substantiate that the RPM scheme at hand may generate efficiencies,[5] even though the attainment of such pro-competitive effects by means of hardcore restraints is presumed to be unlikely.[6] Indeed, the Commission, in its 2010 Vertical Guidelines,[7] expressly concedes for the first time that vertical price fixing may also give rise to considerable efficiencies. More specifically, the higher profit margin afforded to the distributor may be designed as an incentive for the provision of essential promotional services, particularly with regard to newly-launched products. Furthermore, RPM may be used in the context of a distribution system applying a uniform distribution format, such as franchising, for the purposes of a short term low price campaign the duration of which does not exceed six weeks. Finally, the Guidelines acknowledge that vertical price fixing may be employed as a solution to the free rider problem; they set, nevertheless, a fairly high standard of proof for parties wishing to demonstrate the existence of free rider considerations in the market concerned.[8]

A critical and more detailed examination of the approach taken to RPM under EU competition law is the subject matter of a different chapter.[9] The following two sections will present the most notable Commission decisions involving RPM agreements, as well as all judgments of the Court of Justice following references for a preliminary ruling concerning vertical price fixing.

5.1.1. European Commission Decisions on RPM

As has already been argued, the recent Vertical Guidelines obscure, rather than clarify, the approach taken to RPM under EU competition law. The Guidelines, on the one

[5] Vertical Guidelines, para 47.
[6] Ibid.
[7] Vertical Guidelines, para 225.
[8] Ibid.
[9] See *infra*, ch 6.

hand, acknowledge the possible efficiency-enhancing effects of RPM, but, on the other, they reiterate the traditional view that it constitutes a ‘hardcore’ restraint for the purposes of the application of Article 101(1). One would, therefore, reasonably assume that the second best way to understand the rationale behind the European Commission’s hostility towards vertical price fixing would be, at least in theory, the review of the relevant case law. In practice, nevertheless, things are not that simple. To the best of the author’s knowledge, the Commission has dealt with a relatively limited number of vertical price fixing cases during these years, the last one being the *Yamaha* case, decided back in 2003.[10] And the examination of these cases generally reveals nothing more than the Commission’s strict adherence to the legal and economic principles already elaborated in the Vertical Guidelines.

As a preliminary remark it should be noted that, in most of these cases, the Commission launched an investigation following a notification by the parties under Article 4(1) of Regulation 17/62 then in force.[11] In the vast majority of the cases reviewed, the fixing of resale prices was not the sole object of the agreement under investigation, but instead it formed part of a broader restrictive arrangement, and was commonly imposed in the context of an exclusive or selective distribution network. In these cases, the removal of the RPM clause was a requirement in order for the agreement to receive the Commission’s clearance.[12]

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[10] COMP/37.975 *PO/Yamaha*, decision of 16 July 2003, not published but available at the DG COMP website.

[11] Under the notification system introduced by Article 4(1) of Regulation 17/62, undertakings wishing to enter into a restrictive agreement falling within the scope of Article 101(1) TFEU had to notify the agreement to the Commission in order to benefit from the exemption provided for by Article 101(3). The obligation for notification was abolished after the entry into force of Regulation 1/2004, on 1 May 2004. The new Regulation aimed at modernising the enforcement procedures and, in essence, replaced the *ex ante* appraisal of the likely effects of a specific agreement with a system of *ex post* competitive assessment following either an investigation launched by the Commission on its own initiative or a complaint by a third party.

[12] In *DuPont de Nemours Germany* [1973] OJ L194/27, a negative clearance was granted after the parties amended a selective distribution agreement and removed clauses imposing fixed resale prices as well as prohibiting exports without the manufacturer’s permission. Similarly, in *Junghans* [1977] OJ L30/10, a German manufacturer of clocks and watches operated an exclusive distribution system, in the context of which distributors in a number of Member States were prohibited from exporting the contractual goods to other EU countries. Junghans further reinforced the territorial protection of its dealers *inter alia* by allowing its German retailers to sell to customers in other Member States at fixed prices; the German retailers were also required to adhere to the fixed prices even when the products had been re-imported for resale from other EU countries. Simultaneously, the French and Dutch distributors were allowed to sell Junghans products only to German dealers who had entered into RPM agreements. The hardcore restrictions were eventually abandoned, and the notified agreements received negative clearance.
In *B&W Loudspeakers*, another selective distribution agreement was cleared after the elimination of provisions combining both RPM and non-price restraints. In this case the fixing of resale prices for top-quality loudspeakers took the form of a prohibition on ‘bait pricing’, namely the practice of offering a product at a low price with the aim of attracting more customers to the outlet; press release of 24 June 2002, IP/00/1418.

The RPM cases under review are distinguished in two categories, on the basis of the prevalence of vertical price fixing in a given industry. Classified under the heading 'individual' RPM are agreements whereby a single manufacturer stipulates the resale price for its own products. The second category consists of 'collective' RPM agreements and involves cases of widespread use of RPM schemes by various competing manufacturers, commonly within the framework of an association of undertakings. As was shown in Chapter 1, the distinction between individual and collective RPM was fairly common in European antitrust literature of the first post-war years, and had been incorporated into at least two national competition law regimes.[13] The individual/collective RPM dichotomy certainly is defensible. While an individual manufacturer's decision to enter into RPM agreements with its dealers may be explained on efficiency grounds, it is likely that the industry-wide implementation of fixed retail prices is designed to increase price transparency, thus giving rise to collusive outcomes. Despite its sound logic, this distinction has never been endorsed in the context of Article 101 TFEU, and appears to have largely been rendered obsolete as far as national legal orders are concerned.

5.1.1.1. Individual RPM Agreements

5.1.1.1.1. The Interplay between RPM and Absolute Territorial Protection

An interesting category of cases consists of those agreements whereby RPM was used as a means to support and reinforce absolute territorial protection. In *Deutsche Philips GmbH*,[14] the Commission adopted for the first time a decision finding that an individual RPM agreement violated Article 101(1). The German subsidiary of Philips had failed to notify to the Commission an agreement fixing the retail prices of various products, irrespective of whether they had been purchased from German or foreign suppliers. Vertical price fixing was at the time legal in Germany, but the agreement also covered the goods sold to consumers in other European countries. Similarly, German retailers were obliged to comply with the fixed prices when reselling goods which had been re-imported from other countries into Germany. In view of its effects on price competition, the

See also the early Commission decision granting negative clearance in *Omega* [1970] OJ L242/22.

[13] The early competition laws of the UK and the Netherlands treated collective RPM more harshly; see *infra* ch 2.

[14] [1973] OJ L293/40.

Commission held that the RPM agreement at issue amounted to restrictions on parallel imports: '[a]t any rate the competitive position at the retail stage – as regards the prices which were decisive for the consumer – would be the same as in the case of protection by means of export or reimport bans'.[15]

In *Gerofabriek*,[16] the Commission rejected the application for a negative clearance regarding a network of agreements entered into between a Dutch manufacturer of stainless-steel cutlery and its retailers in BENELUX. The agreements fixed the prices of the cutlery sold at the retail level and required the Dutch wholesalers to refrain from exporting the products without the manufacturer's consent. According to the Commission, price fixing restricted the freedom of retailers to set their own prices by reference to their own costs and business strategy, thus limiting their ability to pass on to consumers any benefits.[17] The Commission further held that, in the case at hand, RPM was likely to have the same effect as export bans: '[e]ven if the various export prohibitions were lifted, the system of retail prices imposed on dealers would be likely to influence trade between Member States by deflecting trade flows away from the channels which they would naturally have if prices were fixed freely'.[18] Consequently, the clauses were found to be contrary to Article 101(1) and also unable to meet the requirements of Article 101(3).

In *Hasselblad,*[19] the case involved an exclusive distribution network operated by Victor Hasselblad, a Swedish manufacturer and supplier of high-end photographic equipment with sales in virtually all EU Member States. Victor Hasselblad took steps to prevent its distributors from engaging in parallel imports and required them to provide one another with the price lists and terms of business (regarding rebates and bonuses) applicable in each Member State. Moreover, Hasselblad (GB), the exclusive distributor of Hasselblad equipment for the United Kingdom, established in turn a selective sales network, admission to which was conditional upon the signing of the standard Dealer Agreement. The Dealer Agreement contained *inter alia* clauses which prohibited exports, subjected advertisements to Hasselblad (GB)'s approval, and prohibited dealers from changing the geographical location of their premises. In the context of the implementation of the Dealer Agreement, Hasselblad (GB) would cease supplying certain price-cutting dealers and threatened that it would withdraw credit facilities from any dealers who did not

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[15] Ibid, II(2)(c).
[16] [1977] OJ L16/8.
[17] Ibid, II(a)(3)(c).
[18] Ibid, II(a)(4).
[19] [1982] OJ L161/18.

treat the prices quoted in the relevant retail price list as minimum resale prices. Hasselblad (GB) further terminated its agreement with Camera Care, a discount retailer of photographic equipment, and subsequently enforced a boycott against it in concert with the other authorised dealers.

The Commission held that the policy of market compartmentalisation implemented by Victor Hasselblad and its exclusive distributors amounted to a concerted practice within the meaning of Article 101(1).[20] In this context, the exchange of price lists and information on the distributors' discount policy between the latter and the manufacturer was found to constitute an ancillary mechanism designed to prevent or, at the very least, to discourage exports.[21] Furthermore, regarding the selective distribution system operated in the UK, Hasselblad (GB)'s Dealer Agreement was found to fall within the scope of Article 101(1) to the extent that it provided the authorised dealers with territorial protection which, in practice, was supplemented with the imposition of minimum resale prices. The Commission noted that, in the context of the Dealer Agreement, retailers were restricted as to their freedom to determine their prices and that Hasselblad (GB) used the threat of termination in order to enforce adherence to the chosen price-level at the retail stage.[22] In assessing the Dealer Agreement's effect on trade between Member States, the Commission took the position that the export bans and the RPM clause were 'closely interconnected', since both aimed at the maintenance of the price differentials between the UK and the other Member States.[23] The elimination of price competition between Hasselblad's authorised UK-based dealers essentially created an artificial barrier to trade between the UK and the other Member States, by preventing them from seeking alternative, less costly sources of supply. Thus, according to the Commission, 'the effects of Hasselblad (GB)'s resale price maintenance policy cannot be separated from the effects of the other infringements of Article [101](1)'.[24]

The Commission condemned a motor vehicle manufacturer for a number of restrictive clauses contained in its agreements with its European dealers in *Mercedes-Benz*.[25] More specifically, DaimlerChrysler was found to have imposed export bans on its German agents, by instructing them to refrain from selling vehicles from outside their territory. It further prevented its distributors in Germany and Spain from supplying leasing

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[20] Ibid, paras 42-51.
[21] Ibid, paras 49-51.
[22] Ibid, paras 65-66.
[23] Ibid, para 69.
[24] Ibid, para 70.
[25] [2002] OJ L257/1.

companies in cases where no specific lessee was provided for by the agency agreements. Finally, the subsidiary of DaimlerChrysler in Belgium was found to have agreed with its dealers on the fixing of the resale prices in that country. Under the agreement, the dealers were not allowed to grant discounts of more than three percent, and test purchases were agreed to be carried out by an external agency, in order for the level of discounts to be controlled. The Commission held that the RPM agreement had as its object the restriction of competition.[26] The agreement kept the prices for Mercedes-Benz vehicles in Belgium at artificially high levels and, at the same time, the Commission observed that a considerable number of new cars had been imported to Belgium from other Member States. This, according to the Commission, affected inter-state trade to an appreciable extent, since established case law of the CJEU had made it clear that 'trade between Member States is affected not only where a measure restricts interState trade or compartmentalises markets, but also where an agreement leads to an increase, even a large one, in the volume of trade between Member States'.[27] On appeal,[28] the Commission's finding that DaimlerChrysler and its Belgian dealers had engaged in price fixing in violation of Article 101(1) was confirmed, although the Commission decision was partially annulled on different grounds.

In *Yamaha*,[29] a Japanese manufacturer of traditional and electronic musical instruments had established a selective distribution network in the majority of the Member States for the purposes of the distribution of its products in the EU. The agreements with several dealers imposed upon the latter direct and indirect export bans, including *inter alia* their obligation sell Yamaha musical instruments only to end users, thus preventing cross supplies within the selective distribution network, and to notify a subsidiary of Yamaha before exporting via the Internet. Additionally, the contracts entered into between Yamaha and its Dutch, Italian and Austrian distributors contained clauses which either fixed the level of permissible discounts or obliged them to observe the prices indicated in the price lists circulated by Yamaha and its subsidiaries. Furthermore, the manufacturer fixed directly the Austrian distributor's profit margin, although subsequently stated that the clause was 'not binding'.

The Commission held that these agreements fell within the ambit of Article 101(1) to the extent that they restricted the distributors' ability to set their own prices freely. The

[26] Ibid, para 177.
[27] Ibid, para 197.
[28] Case T-325/01, *DaimlerChrysler AG v Commission* [2005] ECR II-3319.
[29] COMP/37.975 *PO/Yamaha*, decision of 16 July 2003, not published but available at the DG COMP website.

extent to which the relevant clauses had in fact been implemented was immaterial: the mere inclusion of the restrictive provisions in the contracts under investigation was likely to influence the distributors in the course of their business conduct by creating a 'visual and psychological effect'.[30] The inclusion of both export bans and vertical price fixing in the context of Yamaha's selective distribution network was likely to have the combined effect of appreciably affecting trade between Member States. On the one hand, prohibition of parallel imports artificially reinforced different price levels between national markets.[31] Simultaneously, RPM could contribute to the compartmentalisation of the internal market 'by increasing imports from other Member States and by decreasing exports from Member States where resale price maintenance has been implemented'. According to the Commission, vertical price fixing had influenced the pattern of trade flows between the Member States.[32] Both the vertical block exemption regulation and Article 101(3) were declared inapplicable and the Commission eventually imposed a relatively low fine of €2.56 million after Yamaha took the necessary steps to restructure its entire selective distribution network by removing the hardcore restrictions.

5.1.1.1.2. The *Spices* Case – RPM as an Exclusionary Mechanism

The *Spices* case[33] is unique in the sense that the vertical price fixing clauses under investigation were included in order to reinforce the manufacturer's exclusive distribution network to the detriment of its competitors. Liebig was a producer of packaged spices for domestic consumption and was selling its products in Belgium primarily through the three largest chains of foodstores in the country, but also through a number of smaller distributors. By virtue of the distribution agreements concluded with the main Belgian distributors, the latter undertook to sell only Liebig spices apart from their own brands and agreed to sell the spices at the prices fixed by the manufacturer and to display them in special illuminated display units. This clause on the display method for Liebig spices was expected to be advantageous for Liebig because, as the Commission observed, impulse buying accounted for a large proportion of consumer purchases; it was therefore essential that spices be displayed at spots where they were more likely to catch the customer's eye.[34] For the same reason, the dealers undertook to display their own branded spices in the

[30] Ibid, paras 127 and 141.
[31] Ibid, para 150.
[32] Ibid, paras 161-162.
[33] [1978] OJ L53/20.
[34] Ibid, para 9.

special units below Liebig products and to refrain from displaying the prices for Liebig spices where these were higher than those of their own brands. In return, in addition to fixing the resale prices for its products, Liebig also provided the foodstores with a 10 percent rebate on total spice purchases and sales incentive premiums as a reward for a possible annual increase in sales.

The Commission objected to the high profit margin afforded to the Belgian distributors as a result of the aforementioned financial benefits; it also found that its purpose was to reward the large distributors for excluding Liebig's rivals.[35] Since both Liebig and the dealers possessed substantial market shares, the agreement was held to foreclose the downstream market for competing manufacturers of spices and was, thus, condemned under Article 101(1), not being able to benefit from Regulation 67/67 – the block exemption regulation then in force. Specifically with regard to RPM, the Commission pointed out that it enhanced the already restrictive effect of the agreement on interbrand competition, as it also restrained price competition between Liebig products.[36] The Commission, following a thorough appraisal of the foreclosure effects of the exclusive distribution agreement, merely limited itself to finding that the RPM clause contained in the agreement constituted 'a restriction of competition which is not permitted by Regulation No. 67/67/EEC and therefore the application of this Regulation is excluded'.[37]

Liebig's high market share aside, the *Spices* case involved an RPM scheme which could be consistent with an alternative pro-competitive justification recently suggested by Benjamin Klein.[38] According to Klein, the standard free rider rationale is not applicable to all types of sales-specific services. Prominent display is a point-of-sale promotional service which, on the one hand, is not free-rideable, but may nonetheless contribute to the expansion of the manufacturer's market share, particularly where the products concerned are more susceptible to impulse purchases.[39] However, as Klein points out, retailers have an insufficient incentive to promote a given manufacturer's product, given that manufacturer-specific services, albeit capable of stimulating interbrand demand, have virtually no influence on consumers' choice of retail outlet ('inter-retailer demand'). Moreover, the net overall sales increase resulting from the provision of brand-specific point-of-sale services is likely to be both greater and more profitable for the manufacturer

[35] Ibid, para 17.
[36] Ibid, para 22.
[37] Ibid, para 25.
[38] B Klein, 'Competitive Resale Price Maintenance in the Absence of Free Riding' [2009-2010] 76 *Antitrust LJ* 431.
[39] Ibid, 441-442. The same applies to brand-specific point-of-sale promotional efforts.

than for multi-brand retailers. Consequently, RPM may be designed to remedy this ‘incentive incompatibility’ between the manufacturer and its retailers by compensating the latter for their promotional efforts which, in the case of prominent display, consist in the use of their retailing assets.[40]

5.1.1.1.3. RPM and the Indispensability Requirement of Article 101(3)

The *AEG-Telefunken* case,[41] in which the CJEU held that price floors were not indispensable for the maintenance of the specialist trade when implemented in the context of a selective distribution network has already been discussed earlier in this thesis.[42] In *Novalliance/Systemform*,[43] the Commission dealt with a complaint submitted by a French company active in the distribution of computer printing and post-handling systems alleging that Systemform, a German manufacturer of equipment for processing computer printouts, had violated EU competition law by imposing export bans on its dealers and thus partitioning the common market. In the course of the investigation the Commission discovered that the exclusive distribution agreements that Systemform had concluded with a number of dealers operating in various Member States also included clauses requiring the joint setting of the resale prices of the goods concerned. The Commission stressed that it was immaterial for the purposes of the application of Article 101(1) whether Systemform had taken any steps to enforce the RPM agreements or whether it had ever exercised any control in order to ensure that the fixed prices are being observed by the distributors. What was important was the very presence of the RPM clauses in the contracts, given their potential to ‘put pressure on Systemform’s distributors to align their pricing policy with the perceived wishes of Systemform’.[44] In addition, the Commission rejected with a laconic statement the applicability of Article 101(3) to vertical price fixing: ‘[c]ontrol over the prices charged by a distributor is not related in any way to the possible benefits of an exclusive distribution contract, so the question of these restrictions being in any way indispensable does not arise’.[45]

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[40] Ibid, 443-449.
[41] Case 107/82, *Allgemeine Elektrizitäts-Gesellschaft AEG-Telefunken AG v Commission* [1983] ECR 3151.
[42] See *supra* s 4.4.
[43] [1997] OJ L47/11.
[44] Ibid, para 61.
[45] Ibid, para 75.

5.1.1.1.4. 'Brand Image' as a Defence: *Hennessy/Henkel* and *Nathan/Bricolux*

Perhaps the most interesting RPM case was *Hennessy/Henkell*,[46] in the sense that it provides a clearer picture of the Commission's argumentation against vertical price fixing. Hennessy was one of the largest French cognac producers and was marketing its products in a number of European countries through the operation of a dual distribution system. Hennessy cognac was distributed in the EU mostly by independent distributors, with the exception of three Member States where the products in question were marketed by subsidiaries of Hennessy. Hennessy entered into an exclusive distribution agreement for Germany with Henkell, by virtue of which the latter was guaranteed a specific profit margin for the German market. According to Hennessy itself, the purpose of the clause 'was to protect [the] distributor against parallel imports or infiltration'.[47] Henkell was allowed to charge lower prices than those quoted in the relevant price list, but only temporarily and on the condition that Hennessy was notified without delay. Henkell was in fact the only one among Hennessy's distributors to be provided with a fixed profit margin since, as the Commission observed, similar agreements between Hennessy and its distributors in other Member States did not restrict the latter's freedom to set their own prices.

The Commission held that the RPM agreement between Hennessy and Henkell was caught by Article 101(1) TFEU, and was not eligible for an exemption either under Regulation 67/67/EEC (the relevant block exemption regulation then in force) or under Article 101(3). More specifically, the Commission rejected Hennessy's argument that for luxury products, such as cognac, the fixing of resale prices was necessary in order for their brand image to be preserved; the luxury character of a product was not in itself, according to the Commission, a sufficient justification for an exemption under Article 101(3) to be granted.[48] What was more interesting, however, was the Commission's second argument in rejecting the indispensability of the restriction: 'Hennessy's competitors, the other cognac merchants ... have not taken measures to restrict the freedom of their sole distributors to fix their prices or to protect their territories, notwithstanding that some of those contracts concern the German market'.[49]

[46] [1980] OJ L383/11.
[47] Ibid, para 8.
[48] Ibid, para 32.
[49] Ibid, para 33.

The first point to be made about this case is that it is one of only two cases concerning (almost) exclusively an RPM agreement. In the vast majority of relevant cases, the Commission dealt with agreements which restricted competition in a number of different ways – more commonly by prohibiting parallel imports – among which was the fixing of resale prices. Secondly, it was the first time that the undertaking under investigation put forward a legitimate economic argument in defence of an RPM scheme. It has been argued that a high price is a necessary attribute of prestige products and it is in the manufacturer's best interest to prevent any price-cutting by its retailers, as 'greater affordability brings with it the implication of lessened exclusivity'.[50] Finally, the Commission's argument that RPM was not indispensable for the protection of the product's luxury image in view of the fact that Hennessy was the only producer of cognac having fixed the resale price of its product implies at the same time – although unintentionally – that the RPM scheme at hand did not threaten to produce any 'horizontal' effects. Indeed, one of the Commission's most frequently used arguments against RPM is that it can be employed with the aim of facilitating collusive conduct between competitors in either the upstream or the downstream market.[51] In the case at hand this scenario was effectively ruled out, given that the implementation of vertical price fixing in the affected market was not extensive enough to raise any relevant concerns. It would therefore be reasonable to conclude that Hennessy fixed its distributor's profit margin driven by a legitimate business purpose.

The protection of a product's brand image was also the justification put forward by the parties to a network of RPM agreements in *Nathan/Bricolux*.[52] Nathan, a producer of various materials for educational purposes also responsible for the distribution of its products in France, entered into agreements with its distributors in Italy, Sweden and the French-speaking part of Belgium which provided for both export bans and fixing of resale prices (both minimum and maximum). With regard to minimum RPM in particular, the distribution contracts with the Italian and Swedish dealers provided that the latter

[50] GR Ackert, 'An Argument for Exempting Prestige Goods from the Per Se Ban on Resale Price Maintenance' [1994-1995] 73 *Tex L Rev* 1185.
[51] See, for example, the Commission's 2010 Vertical Guidelines and, in particular, para 224 thereof, where the application of RPM as a facilitating mechanism for cartels in the upstream market is cited first among the competition concerns raised by its use: 'RPM may restrict competition in a number of ways. Firstly, RPM may facilitate collusion between suppliers by enhancing price transparency on the market, thereby making it easier to detect whether a supplier deviates from the collusive equilibrium by cutting its price'.
[52] [2001] OJ L54/1.

undertook to ‘refrain from all commercial conduct (special offers, discounts, rebates, clearance sales, etc.) liable to damage the Nathan brand’.[53]

The Commission, although acknowledging that maximum price fixing is not necessarily restrictive of competition, held that, in this case, maximum and minimum RPM should be regarded as having the combined effect of fixing a specific – albeit broad – resale price level.[54] According to the Commission, the provisions fixing a resale price level and conferring absolute territorial protection upon Nathan’s dealers ‘reinforce each other’.[55] Specifically RPM restricted the dealers’ freedom to determine their own prices, which were eventually fixed at artificially high levels not corresponding to any market reality.[56] The Commission finally rejected Nathan’s argument that the prohibition of discounts was necessary in order for its brand image to be protected, and made a statement which could be characterised as ambiguous, to say the least: it suggested that Nathan was still free ‘to set the prices it charges its distributors at a level it regards as adequate in relation to objective costs and the positioning it seeks for its products on the market’, since this alternative would be less restrictive of the distributors’ freedom.[57] In other words, the Commission maintained that, in order for intrabrand competition to remain undistorted, suppliers who are conscious about their products’ brand image should act against their commercial interests and increase the prices at which they are selling their products to their distributors. The Commission thus seems to have disregarded the fact that price competition is equally important at *all* levels of the distribution chain; no rational manufacturer, unless enjoying a position of market power, would risk losing a distributor by not providing it with a satisfactory profit margin as an incentive to stock the goods in question.

5.1.1.1.5. Infringement Decisions Annulled by the General Court: *Volkswagen II* and *JCB*

Volkswagen II[58] was the first case where a fine imposed by the Commission for RPM was quashed by the General Court and, subsequently, by the CJEU. Volkswagen had been sending circulars to members of its distribution network in Germany urging them to refrain from selling the new Passat at prices below the recommended retail price. The

[53] Ibid, paras 44 and 50.
[54] Ibid, para 87.
[55] Ibid, para 90.
[56] Ibid, para 110.
[57] Ibid, para 111.
[58] [2001] OJ L262/14.

circulars reveal that the company's main concern when encouraging price discipline among its dealers was the protection of its brand image. The Commission found that this practice constituted a restriction of competition within the meaning of Article 101(1) TFEU. It rejected Volkswagen's argument that, in spite of the circulars, several dealers continued to grant discounts. The Commission stated instead that this was not material for the purpose of the application of Article 101(1) to vertical price fixing. Since RPM is a 'black-listed' clause, it is established case law that it suffices to show that the relevant measure 'has the object of restricting competition. It is not necessary to show that it actually produces any such restriction'.[59] Furthermore, the Commission held that the RPM scheme at hand hindered trade between Member States, since the level of price differences for Volkswagen cars was likely both to alter the flow of imports into Germany and to limit the exports from Germany – particularly regarding right-hand-drive vehicles sold to customers based in the United Kingdom.

The fine of €30.95 million imposed on Volkswagen was eventually annulled by the General Court, which held that the Commission failed adequately to establish the existence of a restrictive agreement between Volkswagen and its dealers.[60] The fact that the distributors signed an, initially, lawful contract did not mean that they provided in advance their acquiescence to future requests by the manufacturer intended to influence them in the performance of the contract in a way that restricted competition.[61] On appeal, the CJEU upheld the judgment of the General Court.[62]

In the *JCB* case, the Commission dealt with agreements combining both vertical price fixing and export bans.[63] JCB was a manufacturer of excavating, earthmoving and agricultural machinery and a vendor of relevant spare parts, and was marketing its products in several Member States both through subsidiaries and through independent dealers forming part of an exclusive distribution network. In addition to restricting parallel trade by preventing its distributors from selling JCB machines and spare parts outside their allotted territory, JCB was found to have engaged in vertical price fixing either by circulating retail price lists or by agreeing with its dealers on the application of uniform discounts. The Commission held, therefore, that the agreements under investigation infringed Article 101(1) and could not benefit from either the vertical block exemption

[59] Ibid, para 74
[60] Case T-208/01, *Volkswagen AG v Commission* [2003] ECR II-5141.
[61] Ibid, paras 57-58.
[62] Case C-74/04P, *Commission v Volkswagen AG* [2006] ECR I-6585.
[63] [2002] OJ L69/1.

regulation or from Article 101(3). On appeal, however, the General Court annulled the Commission's finding pertaining to RPM. The Court held that retail price lists, 'although strongly indicative, were none the less not binding'; there was also nothing to indicate that JCB attempted to influence the pricing strategy of its dealers in a coercive way.[64] It is submitted that, in *JCB*, the existence of coercion was dealt with by the General Court as a constitutive element of an Article 101(1) violation, at least as far as RPM is concerned.[65] This part of the Court's decision was not challenged before the CJEU.[66]

5.1.1.2. Collective RPM Agreements

This study has identified only three Commission decisions which concerned collective RPM schemes. In *ASPA*,[67] the case involved a non-profit association of Belgian-based producers and distributors of perfumes and toiletries, the *Association Syndicale Belge de la Parfumerie* ('ASPA'). ASPA notified its Articles of Association and General Regulation to the Commission, and applied for a negative clearance pursuant to Article 2 of the then applicable Regulation 17/62. Within the framework of the association, every manufacturer or importer was stipulating independently and individually the resale prices of its own products. Among the primary objectives of ASPA was to prevent any deviations from the fixed prices, as well as to ensure that these prices would be observed also by successive sellers. Furthermore, the rules of the association required all its members collectively to cease supplying any wholesalers or retailers that failed to comply with the obligations imposed on them, in particular: the obligation to obtain supplies exclusively from members of the association or from authorised dealers; the obligation to refrain from reselling the products to other wholesalers or retailers who have acted in breach of the regulation; and the obligation of retailers to sell the products in question only to end users and at the stipulated prices, and to hold back on any form of price-cutting behaviour, whether direct or indirect.

The Commission took the position that these clauses had the object or effect of appreciably restricting the possibilities for competition between branded goods imported in Belgium from other Member States.[68] Moreover, the restriction on the dealers' freedom to

[64] Case T-67/01, *JCB Service v Commission* [2004] ECR II-49, para 30.
[65] I Lianos, 'Collusion in Vertical Relations under Article 81 EC' [2008] 45 *CML Rev* 1027, 1049.
[66] Case C-167/04, *JCB Service v Commission* [2006] ECR I-8935.
[67] [1970] OJ L148/9.
[68] Ibid, para 8.

obtain supplies of ASPA products for resale in Belgium exclusively through the official distribution channels was found to be capable of affecting inter-State trade by hindering imports within the internal market.[69] The Commission accordingly held that the clauses in question were caught by Article 101(1), and were not eligible for an exemption under Article 101(3).[70] The negative clearance was eventually granted following the removal of the contested provisions.

In *VBBB/VBVB*,[71] a case noteworthy for the Commission's detailed – albeit not unambiguous – examination of the Article 101(3) criteria, the agreement at issue had been entered into between two associations of publishers, importers, distributors of books, and booksellers established in the Netherlands and Belgium, respectively. In addition to establishing a collective exclusive dealing system, the agreement provided that Dutch-language books could not be sold in these countries at a price below the retail price stipulated by the Dutch or Belgian publishers, while discounts could be permitted only to recognised booksellers and distributors. The Commission held that the collective RPM scheme had as its object and effect the restriction of competition and was, therefore, caught by Article 101(1).[72]

In assessing the eligibility of the agreement for an exemption pursuant to Article 101(3), the Commission rejected the parties' argument that the agreement improved the production and distribution of the goods concerned by enabling the subsidisation of less popular books, thus guaranteeing the availability of a wider range of titles on the market. According to the Commission, collective RPM was not a necessary prerequisite of cross-subsidisation, since any relevant decisions could be taken individually and independently by each publisher.[73] To the parties' contention that the agreement allowed a fair share of the benefits to be passed on to consumers in the form of an expanded range of titles and increased sales-specific services, the Commission replied respectively that, first, few publishers actually published both general-interest and less popular books and, second, that this system prevented consumers who did not wish to use the ancillary services from purchasing the books at lower prices.[74] Moreover, the Commission took the position that the agreement's cultural implications were irrelevant in the context of the indispensability criterion of Article 101(3), and noted that 'it is not for undertakings or associations of

[69] Ibid.
[70] Ibid, para 9.
[71] [1982] OJ L54/36.
[72] Ibid, para 42.
[73] Ibid, para 51.
[74] Ibid, para 54.

undertakings to conclude agreements on cultural questions, which are principally a matter for government'.[75] Finally, the Commission downplayed the importance of service competition between booksellers asserting that it is only 'secondary' to price competition, particularly where consumer demand for highly specialised products is limited.[76] On appeal, the decision was upheld by the CJEU.[77]

The Commission adhered to this reasoning when delivering its decision in *Publishers' Association – Net Book Agreements*,[78] a similar case involving agreements entered into between publishers established in the United Kingdom, which concerned the application of uniform sales conditions, including the stipulation of the retail prices at which the books were to be sold. Interestingly, the UK Restrictive Practices Court had already upheld the RPM schemes at hand on two occasions, finding that they were not contrary to the public interest.[79]

5.1.2. References for Preliminary Ruling Concerning RPM Agreements

In *SA Binon & Cie v SA Agence et Messageries de la Presse*,[80] the CJEU was asked to deliver a preliminary ruling under Article 267 TFEU, regarding the compatibility with EU competition law of a selective distribution system for newspapers and periodicals. In particular, one of the questions concerned the distributor's right to fix the resale prices of the products in question and to compel retailers to comply with the stipulated prices. The distribution agency, supported by the German government which submitted its observations, stressed that the fixing of retail prices in this case was necessary in view of the particularities of the market for the distribution of newspapers and periodicals. This market in particular presents three distinctive attributes: first, the relevant products have very limited shelf life and publishers are frequently obliged to take back any unsold copies; second, the elasticity of demand for the products is very limited, since, as a general proposition, every newspaper or periodical has its own body of customers; third, the fundamental right of the freedom of press and the relevant freedom to contribute to the formation of public opinion entail that the readers should be given access to a

[75] Ibid, para 60.
[76] Ibid, para 62.
[77] Joined cases 43/82 and 63/82, *Vereniging ter Bevordering van het Vlaamse Boekwezen, VBVB, and Vereniging ter Bevordering van de Belangen des Boekhandels, VBBB, v Commission* [1984] ECR 19.
[78] [1989] OJ L22/12.
[79] Ibid, para 43; See *Re Net Book Agreement* [1962] 3 All ER 751.
[80] Case 243/83, [1985] ECR 2015.

representative selection of all publications.[81] The Court accepted these arguments, but first pointed out that, as a matter of law, agreements fixing the prices to be observed in contracts with third parties violate Article 101(1) TFEU; RPM clauses may escape this prohibition only provided that they qualify for an exemption under Article 101(3).[82] Therefore, when assessing the applicability of Article 101(3) to an agreement concerning the distribution of newspapers and periodicals, the Commission must examine whether 'the fixing of the retail price by publishers constitutes the sole means of supporting the financial burden resulting from the taking back of unsold copies and if the latter practice constitutes the sole method by which a wide selection of newspapers and periodicals can be made available to readers'.[83]

In *Louis Erauw-Jacquery SPRL v La Hesbignonne*,[84] the Court was asked whether Article 101(1) was applicable to an agreement granting a licence to propagate and sell certain varieties of cereal seed protected by plant breeders' rights. Among the contested provisions was the obligation of the licensee not to sell any seeds below the minimum prices stipulated by the breeder. The breeder argued that the clause at issue concerned only sales in Belgium; Article 101(1) was therefore inapplicable, since the agreement could not affect trade between Member States. The CJEU first observed that the breeder had in fact entered into identical RPM agreements with all the growers of the protected varieties. The Court maintained that this network of agreements had 'the same effect as a price system fixed by a horizontal agreement' and, therefore, its object and effect was the restriction of competition.[85]

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[81] Ibid, paras 27 and 40-41.

[82] Ibid, paras 44-45.

[83] Ibid, para 47. It should be noted at this point that in a similar case involving a selective distribution network for the distribution of newspapers and magazines in Belgium, the Commission took the view that, as a matter of law, the clauses fixing the retail prices of the products in question fell within the scope of Article 101(1). It then examined the applicability of Article 101(3) to the case at hand by carrying out a two-stage analysis, focusing on i) whether distribution at news-stands could be organised differently; and ii) whether the clause imposing the price set by the publisher was indispensable in a sale-or-return system. The Commission pointed out that the mere fact that this method of distribution was used uniformly throughout the world constituted in itself evidence of lack of alternative solutions. The limited shelf life of newspapers further justified the sale-or-return system, as this could ensure the availability of a wider range of newspapers and periodicals. According to the Commission, in the context of a sale-or-return system without fixed retail prices the publisher would bear the economic risk for any unsold copies; it was therefore acceptable that the latter determines the resale price. As the Commission found that there were grounds for exemption of the RPM clause in question, it eventually provided the parties with a comfort letter. See European Commission, *XXIXth Report on Competition Policy* (Brussels – Luxembourg 2000), pp 161-162.

[84] Case 27/87, [1988] ECR 1919.

[85] Ibid, para 15. See also para 22 of the Opinion of AG Mischo:

> it is interesting to note that [Regulation 2349/84 on the application of Article 101(3) to certain categories of patent licensing agreements] does not exempt from the prohibition set out in Article [101](1) agreements where 'one party is restricted in the determination of prices, components of

The Court further pointed out the interaction between the clause imposing minimum resale prices and a provision preventing the grower from exporting seed for propagation. According to the CJEU, these two clauses could have the combined effect of affecting trade between Member States.[86] In assessing whether the effect of an agreement on inter-state trade is appreciable, the national court should take into account the economic and legal context of the agreement in question and, more specifically, 'whether it forms part of a cluster of similar agreements concluded between the breeder and other licensees, on the breeders market share in respect of the seed concerned and on the ability of the producers bound by those agreements to export that seed'.[87]

The following three judgments of the CJEU under Article 267 concern exclusive purchasing contracts entered into between producers of petroleum-based products and service station operators in Spain. The agreements at issue contained *inter alia* clauses fixing the retail prices at which the contract products were to be sold. In the *CEEES* case,[88] the first in this series of references for a preliminary ruling, the confederation of Spanish service station operators filed a complaint with the Spanish national competition authority, alleging that the contracts concluded between CEPSA and a number of retailers included provisions that restricted competition. The confederation's complaint was dismissed by the competition authority and, subsequently, by the appellate courts, on the grounds that the agreement did not violate the relevant national competition rules. Eventually, the *Tribunal Supremo* stayed the proceedings before it and referred the case to the CJEU, asking whether the block exemption provided by Regulation 1984/83 to exclusive purchasing agreements was applicable in the case at hand, which involved contracts nominally classified as agency agreements. The Court first reiterated that, in order for the contested contracts to be considered as agreements for the purposes of Article 101(1), account should be taken of the financial and commercial risks assumed by the retailers with regard to the sale of fuel to third parties.[89] If the national court were to find that, in light of the allocation of risks between the supplier and the service station operators, the latter constituted independent economic operators, then the contracts constituted agreements between undertakings within the meaning of Article 101. In that case, the CJEU held that the

prices or discounts for the licensed products' (Article 3(6)). The same applies *a fortiori* as regards networks of agreements.

[86] Ibid, para 16.

[87] Ibid, paras 18-19.

[88] Case C-217/05, *Confederación Española de Empresarios de Estaciones de Servicio v Compañía Española de Petróleos SA* [2006] ECR I-11987.

[89] Ibid, paras 34-60.

provisions requiring the retailers to observe the resale prices stipulated by CEPSA would not be covered by the exemption provided by Regulation 1984/83.[90]

The contract at issue in the *CEPSA* case[91] had been entered into between a supplier of petroleum products and a service station and concerned the 'use of brand name and image, technical and commercial assistance and supply on a commission-agent basis'. The service station operator undertook *inter alia* to purchase exclusively from CEPSA various petroleum products for resale at the retail prices stipulated by the supplier. In a subsequent letter, CEPSA authorised the service station operators to lower the sale prices of the contract products without affecting the supplier's receipts. Eventually, the service station operator brought an action for annulment of the exclusive purchasing agreement, alleging that it violated Article 101 TFEU due to the clause leaving the setting of the retail prices to the sole discretion of the supplier. The Court of First Instance annulled the agreement and, on appeal, the Provincial Court of Madrid submitted a reference for a preliminary ruling to the CJEU, asking whether the present agreement fell within the scope of Article 101(1) or whether it could benefit from the block exemption granted under Regulation 1984/83 to exclusive purchasing agreements.

In response, the Court pointed out that the fixing by the supplier of the retail price for petroleum products was not covered by the block exemption regulation.[92] Nevertheless, account should be taken of the fact that CEPSA authorised the retailer to lower its prices without affecting the supplier's receipts. In such a case, held the CJEU, it was for the national court to determine whether national law allows the unilateral amendment of the contested clause.[93] Furthermore, the national court had to examine this authorisation in view of the economic and legal context in which the whole contract operated, and to ascertain that CEPSA made it 'genuinely possible' for the retailer to lower its prices.[94] In other words, if the court established that the service station operator was not in reality indirectly required to charge fixed prices, but that instead it enjoyed the freedom to set its own prices, then the agreement at hand could benefit from the block exemption regulation. Finally, the CJEU stated that the issue whether a contract that was automatically void

[90] Ibid, paras 63-64, and 66.
[91] Case C-279/06, *CEPSA Estaciones de Servicio SA v LV Tobar e Hijos SL* [2008] ECR I-668.
[92] Ibid, para 65.
[93] Ibid, para 67.
[94] Ibid, para 71.

under Article 101(2) TFEU could become valid following the amendment of the clause imposing a hardcore restriction was to be deal with under national contract law.[95]

In *Pedro IV*,[96] an operator of a service station in Spain and a supplier of petroleum-based products entered into four contracts providing for the building of a service station and the general terms of its operation. Under one of the contracts, the service station operator undertook to purchase all its requirements in fuel from the supplier, while the latter agreed to determine the price of the fuel supplied to the service station on the most advantageous terms agreed by it with other service stations in Barcelona. The parties further agreed that the retail price would never be higher than the average of the prices fixed by other suppliers; an appropriate distribution margin for the service station operator would then be added to that price, and the aggregated amount would constitute the recommended retail price for the fuel sold at the service station.

In assessing the compatibility of the agreement with Article 101(1), the CJEU held that, provided that the price was merely recommended – and not imposed – by the supplier, the method applied for its calculation would be immaterial. What was important was that the reseller maintained the freedom to determine its own retail prices.[97] Moreover, it was for the national court to establish that it was genuinely possible for the retailer to reduce the recommended resale price. To this purpose, account must be taken of the overall agreement in its commercial and legal context, in order to ascertain that the recommended retail prices did not in reality constitute minimum or fixed prices.[98] Interestingly, the Court further pointed out that, although RPM is expressly prohibited by Article 101(1)(a) TFEU,

> it causes that agreement to be caught by the prohibition set out in that provision only where all the other conditions for applying that provision are met, that is to say, that the object or effect of the agreement is perceptibly to restrict competition within the common market and that it is capable of affecting trade between Member States.[99]

[95] Ibid, para 75.
[96] Case C-260/07, *Pedro IV Servicios SL v Total España SA* [2009] ECR I-2437.
[97] Ibid, para 78.
[98] Ibid, paras 79-80.
[99] Ibid, para 82.

5.2. The Treatment of RPM by the NCAs

In its 2010 Vertical Guidelines the European Commission acknowledged for the first time that minimum RPM may give rise to considerable efficiencies. However, this development does not seem to signal a change in the Commission's approach: vertical price fixing is still being classified as a restriction of competition by object under Article 101(1) and as a hardcore restraint under Article 101(3). On the contrary, recently the CJEU in *Pedro IV* adopted a more relaxed approach, holding that a vertical price fixing agreement under investigation will be caught by Article 101(1) only insofar as all the conditions set out in that provision are met.

Following a quick look at the Commission decisions on RPM, one could not help observing that the last relevant case was *Yamaha*, decided well over a decade ago. A logical, but superficial explanation would be that the Commission, having already accepted the efficiency justifications of vertical price fixing but hesitating to remove the practice from the object box, does not consider the prohibition of RPM an enforcement priority. It is submitted here that the reason for the Commission's apparent indifference towards RPM is merely that, on the basis of a cost/benefit analysis, it relies on national competition authorities and courts to carry out lengthy and costly procedures which are simultaneously very likely to lead to false positive errors.

Indeed, in the years following *Yamaha* and the enactment of Regulation 1/2003,[100] which has decentralised the application of EU competition law, there has been considerable enforcement activity by the national competition authorities ('NCAs') of the EU Member States. In Germany, anti-competitive agreements, both horizontal and vertical, are caught by §1 of the Act against Restraints of Competition ('GWB'), a provision modelled on Article 101(1) TFEU. The German Federal Cartel Office ('FCO') has recently issued infringement decisions and imposed fines for vertical price fixing on a number of occasions. The price-maintaining manufacturers fined by the enforcement agency we active in the markets for: cosmetic products;[101] high-quality power tools;[102] computer

[100] Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty [2003] OJ L 1/1.
[101] Press Release, Fine imposed on WALA Heilmittel GmbH for vertical price fixing practices involving Dr Hauschka cosmetics products, available at http://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2013/31_07_2013_Wala.html (last accessed on 6 November 2015).

software;[103] hearing aids;[104] and electrical household appliances.[105] It is noteworthy that the vast majority of these cases concerned RPM imposed in the context of a selective distribution system, implemented through the exercise of coercion on retailers to observe 'non-binding' price recommendations. In two further cases, *CIBA Vision*[106] and *Bayer Vital*,[107] the FCO condemned the RPM schemes at issue taking into consideration their ability to facilitate horizontal collusion.[108] More recently, however, the FCO adopted two separate infringement decisions against two mattress manufacturers who were found to have individually maintained minimum retail prices for their products. Despite the parallel implementation of price floors by the manufacturers, the agency conceded that there were no indications of anti-competitive horizontal collusion.[109]

In France, the *Autorité de la concurrence* (formerly *Conseil de la concurrence*) has been actively enforcing national competition law and Article 101 TFEU post-Modernisation. The stipulation of retail price floors by a manufacturer for the resale of its products is in violation of Article L410-2 of the French Commercial Code (*code de commerce*), which establishes the general principle that the prices of goods, products and services are freely determined by the competitive process. Vertical price fixing also falls within the scope of the more specific provision of Article of Article L420-1, which is the equivalent of Article 101(1) TFEU in the French legal order, catching collusive anti-competitive practices. Interestingly, a natural person having taken action to impose

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102 Press Release, Bundeskartellamt fines TTS Tooltechnic for vertical price fixing, available at http://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2012/20_08_2012_Festool.html (last accessed on 6 November 2015).

103 Press Release, Bundeskartellamt imposes fine against Microsoft, available at http://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2009/08_04_2009_Microsoft.html (last accessed on 6 November 2015).

104 Press Release, Bundeskartellamt imposes fine on hearing aid manufacturer Phonak GmbH, available at http://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2009/15_10_2009_Phonak.html (last accessed 6 November 2015).

105 Press Release, Bundeskartellamt imposes fines against manufacturers of electrical household devices, at http://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2007/30_04_2007_Groupe-SEB.html (last accessed on 6 November 2015).

106 Press Release, Bundeskartellamt imposes fine on CIBA Vision, available at http://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2009/25_09_2009_Ciba-Vision.html (last accessed on 6 November 2015).

107 Press Release, Bundeskartellamt imposes fine against Bayer Vital, available at http://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2008/28_05_2008_Bayer-Vital_Geldbu%C3%9Fe.html (last accessed on 6 November 2015).

108 U Zinsmeister and M Held, 'Under Pressure – When Do Legal "Recommended" Resale Prices Turn into Illegal "Fixed" and Binding Resale Prices: Resale Price Maintenance under Scrutiny in Germany' [2014] 35 *ECLR* 317, 320.

109 Press Release, First fine imposed for resale price maintenance in mattress case, available at http://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2014/22_08_2014_Matratzen.html;jsessionid=53203061B1A48D11B2BB2F396A84FB55.1_cid371?nn=3591568 (last accessed on 6 November 2015) and Press Release, Further fine imposed for resale price maintenance in mattress case, at http://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2015/06_02_2015_Matratze.html?nn=3599398 (last accessed on 6 November 2015).

minimum resale prices is facing a fine of 15,000 euro, pursuant to Article L442-5 of the Commercial Code.

The approach taken to RPM by the French authorities is particularly stringent, and it is frequently claimed that the legal status of the practice in France is that of 'per se' unlawfulness.[110] In the *Luxury Perfumes* case, the then *Conseil de concurrence* adopted an infringement decision against 13 manufacturers of luxury perfumes for having entered into RPM agreements with three national chains of selective distribution. In defence of the agreements at issue, the parties noted that the stipulated price floors were designed to protect the luxury image of the contract. Although acknowledging that it was not qualified to indicate the price level necessary for the maintenance of a product's exclusive character, the *Conseil* underlined the manufacturers' obligation to respect the distributors' freedom independently to determine their prices, and noted that 'in this case, the unlawful practices allowed the undertakings involved in the vertical agreements to reap the profits associated with the existence of an integrated distribution network without assuming the costs, which are very important'.[111] In the view of the *Conseil*, the limited degree of demand elasticity would allow both the manufacturer and the distributors to extract supra-competitive profits from brand-loyal consumers.[112] The manufacturer could have a share in the distributors' inflated profit margin simply by fixing its wholesale price.[113] The only purpose of the RPM schemes was, according to the *Conseil*, to prevent price-cutting retailers from jeopardising the vertical collusion.[114]

In *Video Cassettes*, the *Conseil de concurrence* defined the standard of proof required for the inference of vertical price fixing. First, there should be a discussion on retail prices in the context of the negotiations between the manufacturer and its dealers. Second, there should be indications that the retailers have observed the fixed resale prices so that the existence of an agreement can be substantiated. Third, the agreement should be supplemented by a monitoring mechanism designed to ensure the sustainability of the vertical collusion.[115] The *Conseil* stressed the relevance of the upstream firms' market power to the correlation between RPM and horizontal collusion: '[f]or example, if the manufacturer's market share is 100% and if all distributors are involved in the agreement,

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[110] See, eg, P Rey and T Vergé, 'Resale Price Maintenance and Interlocking Relationships' [2010] 58 *J Ind Econ* 928, 928.
[111] Decision 06-D-04 (Luxury Perfumes), para 779.
[112] Ibid, para 269.
[113] Ibid, para 780.
[114] Ibid, para 781.
[115] Decision 05-D-70 (Video Cassettes), para 179.

the potential effect of the practice is the same as that of an agreement between all the manufacturers'. Accordingly, in the case at hand, the *Conseil* relied on the dominant position held by Buena Vista Home Entertainment as an aggravating factor, since its conduct had the ability to influence the pattern of trade in the industry.[116]

More recently, the French Competition Authority dealt with distribution agreements entered into by three leading pet food manufacturers setting minimum retail prices, establishing exclusivity clauses and restricting parallel trade. The RPM clauses had been negotiated directly between the manufacturers and the purchasing centres of retail chains. These centres purchased their products from wholesalers who got their supplies from the price-maintaining manufacturers. As a result, the wholesalers did not have the ability to determine their prices, as the rate negotiated nationally for shops of the same retail chain was applied in the same way by all wholesalers.[117] Eventually, the Authority imposed fines in excess of 35 million euro.

5.3. A Rule of Reason Standard for RPM – *Leegin Creative Leather Products, Inc v PSKS, Inc*

The per se illegality of RPM was challenged, and eventually overruled, in *Leegin Creative Leather Products, Inc v PSKS, Inc*.[118] The defendant, Leegin, was a manufacturer and distributor of leather goods, some of which were marketed under the brand name 'Brighton'. The plaintiff, PSKS, was a retailer of women's apparel in Texas that had been selling 'Brighton' products since 1995. In 1997, Leegin announced a new pricing policy, according to which retailers were required not to sell the said products at a price below that suggested by the manufacturer; otherwise, the latter would refuse to sell to any discounters. Accordingly, when Leegin discovered that PSKS was discounting, and after the retailer's refusal to adhere to the suggested price, Leegin ceased supplying it with 'Brighton' goods. PSKS then sued under Section 1 of the Sherman Act and was awarded treble damages by the district court. The Court of Appeals for the Fifth Circuit, bound by the *Dr. Miles* precedent, upheld the decision.

[116] Ibid, para 270.
[117] Decision 12-D-10 (Pet Food Manufacturers), para 259.
[118] 551 US 877 (2007).

However, in a five-to-four decision, the Supreme Court reversed, introducing the rule of reason as the standard to be applied in the appraisal of vertical price fixing. The Court overruled *Dr Miles* on the basis of the pro-competitive justifications of RPM as put forward by the economic literature, taking into consideration all the relevant arguments: the 'free rider' rationale, the facilitation of market entry for new firms, and the general stimulation of interbrand competition.[119] As in *Monsanto* more than two decades earlier, the abolition of the per se ban was recommended by an *amicus curiae* brief filed by both US antitrust authorities, the Department of Justice and the Federal Trade Commission.[120]

5.2.1. Majority Opinion

Mr Justice Kennedy, delivering the opinion of the Court, started his analysis by pointing out that the rule of reason is by default the accepted standard applied in order to determine whether a given commercial practice restraints trade within the meaning of Section 1 of the Sherman Act.[121] By contrast, the application of the rule of per se illegality is generally limited to restraints which, on the basis of considerable experience, have been proven to be always or almost always anti-competitive; in other words, the per se rule is appropriate 'only if courts can predict with confidence that [the restraint] would be invalidated in all or almost all instances under the rule of reason'.[122]

Kennedy continued by rejecting the Court's formalistic reliance on the ancient doctrine against restraints on alienation in the adjudication of *Dr Miles*: not only was the rule in contrast with the requirement that antitrust cases be based on 'demonstrable economic effect', established in *Sylvania*, but also, even under common law, it has typically been associated with the transfer of title in real property and not chattels.[123] Then, Kennedy addressed the central issue in *Dr Miles*, namely the idea that vertical agreements between a manufacturer and its distributors produce effects comparable to those of a horizontal combination in the downstream market. In his opinion, contemporary antitrust principles are to be formulated 'in accordance with the appreciated differences in economic effect between vertical and horizontal agreements, differences the *Dr. Miles* Court failed to

[119] Ibid, 889-892.
[120] Ibid, 900.
[121] Ibid, 885-886.
[122] Ibid, 886-887.
[123] Ibid, 887-888.

consider'.[124] In that regard, Kennedy cited the various pro-competitive justifications for '*a manufacturer's* use of resale price maintenance',[125] and took the view that neither these nor the relevant empirical evidence support the application of the per se rule.

The Court did not rule out the possibility that anti-competitive effects can result from such a practice.[126] In particular, it acknowledged that historical examples, including the suspected druggists' cartel at issue in Dr Miles, suggested that retailer collusion raised legitimate concerns. However, it stated that the per se rule should only be limited to the horizontal aspects of an upstream or downstream cartel, as the rule of reason would provide an adequate analytical framework for the appraisal of RPM implemented as a facilitating mechanism.[127] However, the rule of per se illegality is only appropriate for restraints that always or almost always restrict competition, and the aforementioned justifications do not allow for such a conclusion to be drawn in the case of RPM.[128] In rejecting the respondent's argument, the majority further dismissed the relevance of the effect of price floors on retail prices: pricing effects are consistent with both pro- and anti-competitive theories, and thus cannot be relied upon as indication 'absent a further showing of anticompetitive conduct'.[129]

In providing guidance to lower courts, Justice Kennedy drew attention to the anti-competitive potential of price floors, and noted three factors that should be taken into consideration in the context of the substantive assessment of RPM schemes: first, the number of manufacturers that implement fixed resale prices; second, whether the price maintenance was decided independently by the manufacturer, or adopted at the behest of the retailers; and, finally, the degree of market power held by each of the parties to an RPM agreement.[130] However, he also pointed out that, in view of the increased potential of RPM to cause competitive harm, courts should be diligent in applying the rule of reason to vertical price restraints, in order to prevent economic actors from implementing them for anti-competitive purposes.[131] The majority then proceeded to the justification for its departure from *stare decisis*, which has been examined in detailed earlier in this thesis.[132]

[124] Ibid, 888.
[125] Ibid, 889 (emphasis added).
[126] Ibid, 892-894.
[127] Ibid, 893.
[128] Ibid, 894-899.
[129] Ibid, 895.
[130] Ibid, 897-898.
[131] Ibid, 897.
[132] See *supra* s 1.3.5.

5.2.2. Dissenting Opinion

In a powerful opinion, Justice Breyer, writing on behalf of the four dissenting Justices, opposed the adoption of the rule of reason standard for RPM. In his view, antitrust law should be informed by economics but, as an administrative system in which courts bring their own administrative judgment to bear, it should not go beyond that to replicate economists' views. Breyer did not dispute the pro-competitive potential of the practice; his main concern, however, was the lack of satisfactory evidence as to the frequency with which the alleged efficiency-enhancing effects of RPM are encountered in practice.[133] The same, in his opinion, applied to the oft-cited free rider argument: even assuming that free riding may indeed occur sometimes, it would still be difficult for the court to identify whether the benefits arising from RPM outweigh any potential detriment to competition, or even to determine the source of the restraint.[134]

Despite his scepticism, Breyer was not unequivocally for the preservation of the rigid per se treatment. Instead, he conceded that he 'might agree that the *per se* rule should be slightly modified to allow an exception for the more easily identifiable and temporary condition of "new entry"'.[135] However, he noted that the *Dr Miles* dictum constituted a well-established statutory precedent which could not be overruled in the absence of a substantial change in circumstances that would justify a change in policy: virtually none of the economic arguments put forward by the majority to justify its position was new, while in the course of the 20th century both the structure of the American economy and the levels of concentration in important industries remained unaltered.[136] In concluding, Justice Breyer pointed out that '[t]he only safe predictions to make about today's decision are that it will likely raise the price of goods at retail and it will create considerable legal turbulence as lower courts seek to develop workable principles'.[137]

[133] 551 US 877, 914 ('But before concluding that courts should consequently apply a rule of reason, I would ask such questions as, how often are harms or benefits likely to occur? How easy is it to separate the beneficial sheep from the antitrust goats?')
[134] Ibid, 916.
[135] Ibid, 917-918 (emphasis in original).
[136] Ibid, 920-923.
[137] Ibid, 929.

5.2.3. The Aftermath of *Leegin* – The State Antitrust Laws

Maryland was the first, and so far the only, State to introduce a '*Leegin* repealer' in its legal order. The Maryland Antitrust Act,[138] in §11-204(a)(1) thereof, generally proscribes contracts, combinations or conspiracies between two or more persons which 'unreasonably restrain trade or commerce'. In April 2009, Maryland's legislature, in amending the Act, expressly outlawed RPM by clarifying that 'a contract, combination, or conspiracy that establishes a minimum price below which a retailer, wholesaler, or distributor may not sell a commodity or service' also amounts to an unreasonable restraint of trade within the meaning of the prohibition.[139] The State legislature's initiative was in contrast with the general federal harmonisation tendencies of the state courts which, in the absence of the new provision, would be expected to integrate the US Supreme Court's rationale into the antitrust laws of Maryland.[140]

Following in Maryland's footsteps, in 2012 the Pennsylvania State Senator introduced in the General Assembly a bill proposing the adoption of an antitrust statute which would proscribe minimum RPM.[141] Eventually, however, the deliberations of the relevant committee did not bear fruit, and Pennsylvania remains to date the only US State without antitrust legislation.[142] At the same time, RPM remains per se illegal in under California's antitrust statute, the Cartwright Act, and unenforceable – but not illegal – in New York.[143]

In April 2013, the reaction of the Kansas legislature to the *Leegin* dictum was diametrically different, and consisted in the adoption of, also the first and only, statute reinstating the reasonableness standard established in *Leegin*. In its *O'Brien* judgment, decided in the aftermath of *Leegin*, the Supreme Court of Kansas explicitly rejected the

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[138] Md Com Law Code Ann §§11-201—213(2005).
[139] Ibid, §11-204(b).
[140] GT Gundlach, 'Overview and Contents of the Special Issue: Antitrust Analysis of Resale Price Maintenance after Leegin' [2010] 55 *Antitrust Bull* 1, 16.
[141] The bill, in §904 thereof, stipulated that '[t]he following acts are prohibited: ... (2) To contract, combine or conspire to establish a minimum price below which a retailer, wholesaler or distributor may not sell a commodity or service'; Senate Bill 1565, Gen Assembly, Reg Sess 2011-2012 (Pa 2012). The bill was re-introduced the following year; Senate Bill 848, Gen Assembly, Reg Sess 2013-2014 (Pa 2013).
[142] MA Lindsay, 'Repatching the Quilt: An Update on State RPM Laws', *The Antitrust Source* (February 2014), www.americanbar.org/content/dam/aba/publishing/antitrust_source/feb14_lindsay_2_20f.authcheckdam.pdf (last accessed on 20 September 2015).
[143] See ibid and MA Lindsay, 'Overview of State RPM', *The Antitrust Source* (October 2014), available at http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/lindsay_chart.authcheckdam.pdf (last accessed on 20 September 2015).

applicability of the rule of reason standard under the State antitrust statute.[144] According to the Court, 'federal precedents interpreting, construing, and applying federal statutes have little or no precedential weight when the task is interpretation and application of a clear and dissimilar Kansas statute'.[145] The Court held accordingly that, under the laws of Kansas, vertical price fixing remained subject to the 'simple, per se rule'.[146] Perhaps inevitably, the *O'Brien* case encouraged a number of potential plaintiffs in RPM-related litigation to consider Kansas as a preferred destination in the context of forum shopping.[147] In response to the concerns expressed by various distinct industries affected by the decision, and perhaps also due to its possible over-inclusive implications that created uncertainty as to the enforceability and lawfulness of a broad range of standard clauses,[148] the Kansas Restraint of Trade Act[149] was modified in a way that aligned State legislation with the developments in federal antitrust policy. Under the amended §50-163(b) of the Act, 'the Kansas restraint of trade act shall be construed in harmony with ruling judicial interpretations of federal antitrust law by the United States supreme court'. The Act further confirms the legality of reasonable restraints of trade or commerce; a restriction of competition may qualify as 'reasonable' insofar as it is not found to 'contravene public welfare' following an assessment on the basis of all the facts and circumstances of the particular case.[150]

It is important to note that relevant actions were also taken at a federal level. In 2007 and 2009, Senator Herb Kohl introduced a bill proposing the statutory re-introduction of the per se ban on RPM through the promulgation of the Discount Pricing Consumer Protection Act, the declared purpose of which was 'to restore the rule that agreements between manufacturers and retailers, distributors, or wholesalers to set the minimum price below which the manufacturer's product or service cannot be sold violates the Sherman Act'.[151] The proposed Act would effectively amend Section 1 of the Sherman Act by inserting after the first sentence the following addition: 'Any contract, combination, conspiracy or agreement setting a minimum price below which a product or service cannot

[144] *O'Brien v Leegin Creative Leather Products, Inc*, 277 P3d 1062 (Kan 2012)
[145] Ibid, 1079.
[146] Ibid, 1081.
[147] JA Ney, 'The Revised KRTA: *O'Brien* and the Legislative Response' [2013-2014] 53 *Washburn LJ* 265, 277.
[148] For a relevant discussion, see ibid 275-276.
[149] Kan Stat Ann §50-101ff.
[150] Ibid, 50-163(c).
[151] Discount Pricing Consumer Protection Act, S 2261, 110th Cong (1st Sess 2007); Discount Pricing Consumer Protection Act, S 148, 111th Cong (1st Sess 2009).

be sold by a retailer, wholesaler, or distributor shall violate this Act'.[152] In Senator Kohl's view, vertical price fixing would jeopardise the very existence of discount stores and online outlets, and would be responsible for an across-the-board increase in retail prices. The bill gained the support of no less that thirty-five State Attorneys General who, in a letter to Congress, underlined the disadvantages that the *Leegin* dictum could entail for consumers, and championed the adoption of the statute.[153] That said, on both occasions the bill died in subcommittees.

5.4. Critical Assessment of the Public Policy towards RPM in the EU and the US

It is noteworthy that the present study has retrieved only three Commission decisions involving collective RPM agreements, two of which concerned the culturally sensitive market of book publishing. The vast majority of the cases examined earlier in this chapter dealt with individual RPM agreements, but – with very few exceptions – the parties refrained from invoking any credible efficiency-enhancing justifications. Furthermore, on no occasion did the Commission rely on individual RPM in order to infer the existence of a cartel in the market concerned. In fact, a quick look at the nature of some of the price-maintained goods involved in the Commission decisions – cars, high-end cameras, electronic appliances, perfumes, brandy – shows that the markets affected by the RPM schemes at issue were characterised by a high degree of product differentiation that would undermine any attempts for effective cartelisation.

The foregoing review of cases decided by the European Commission, and the German and French competition authorities provides valuable empirical evidence regarding the prevalence and nature of RPM schemes in various industries. The most important conclusion to be drawn is that a substantial fraction of all relevant cases brought by the Commission and the German and French authorities involved price fixing schemes

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[152] Ibid.

[153] AM Barr, State Challenges to Vertical Price Fixing in the Post-*Leegin* World (Federal Trade Commission, FTC Hearings on Resale Price Maintenance 2009), p 2, < www.ftc.gov/sites/default/files/documents/publicevents/resale_price_maintenance_under_sherman_act_and_federal_trade_commission_act/abarr.pdf > (accessed on 20 September 2015).

implemented in the context of selective distribution systems.[154] As has already been argued,[155] the fact that selective distribution and RPM may be employed as interchangeable means for the stimulation of intrabrand non-price competition does not imply that they are perfect substitutes. Qualitative selective distribution constitutes a typical example of long-term relational contract and RPM may be employed with the purpose of enhancing its self-enforcement range in cases where the initial contractual arrangement cannot provide for all future contingencies. The fact that, in so many cases, manufacturers operating selective distribution networks coerced their dealers to observe the recommended retail prices can be interpreted as confirming the inadequacy of selectivity criteria in ensuring the centralisation of the manufacturer's control over distribution, in accordance with the justification put forward by Professors Klein and Murphy.[156]

The relatively frequent reinforcement of selectivity clauses with RPM is consistent with the special services argument, since, by assumption, products which are qualified for a selective distribution system by virtue of their nature warrant the supply of specific promotional services. At the same time, however, it is also consistent with empirical evidence from the other side of the Atlantic. Ippolito, based on a meta-analysis of empirical data from RPM cases brought before federal and state courts between 1976 and 1982, observes that approximately 65 percent of all relevant lawsuits brought by private plaintiffs involved goods falling within the categories to which the special services argument is typically applicable: complex products, infrequently purchased, fashion goods or newly launched. The respective figure of government cases which could be explained by Telser's theory was 68 percent.[157]

It is also noteworthy that selective distribution agreements are typically applicable to products characterised by a certain level of technical complexity or distinguished by their luxury nature. Products falling within these categories present specific attributes which make horizontal collusion notoriously difficult: different cost structures, a great degree of product differentiation, limited elasticity of demand, and extensive consumer

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[154] The relevant European Commission decisions include: *Omega* [1970] OJ L242/22; *DuPont de Nemours Germany* [1973] OJ L194/27; *Gerofabriek* [1977] OJ L16/8; *Junghans* [1977] OJ L30/10; *AEG-Telefunken* [1982] OJ L117/15; *Hasselblad* [1982] OJ L161/18; *B&W Loudspeakers*, Press Release IP/00/1418 of 24 June 2002; COMP/37.975 *PO/Yamaha*, decision of 16 July 2003, not published but available at the DG COMP website. The same applies to the reference for a preliminary ruling dealt with by the CJEU in Case 234/83, *SA Binon & Cie v SA Agence et Messageries de la Presse* [1985] ECR 2015.
[155] See *supra* s 4.4.
[156] B Klein and KM Murphy, 'Vertical Restraints as Contract Enforcement Mechanisms' [1988] 31 *JL & Econ* 265.
[157] PM Ippolito, 'Resale Price Maintenance: Empirical Evidence from Litigation' 34 *JL&Econ* 263, 283.

brand loyalty. It is indicative that, in a number of cases, the simultaneous implementation of RPM policies by multiple competing manufacturers did not give rise to horizontal theories of harm. In *Luxury Perfumes*, the fact that no less than 13 manufacturers of high-end cosmetic products maintained retail prices was not sufficient for the French Competition Authority to infer horizontal effects: the *Conseil de concurrence* noted that demand for the goods was particularly inelastic, so competition between the manufacturers was already weak even in the absence of RPM. Similarly, in *Recticel* and *Metzeler*, the FCO adopted infringement decisions against two mattress manufacturers, despite acknowledging the applicability of the special services argument and expressly dismissing the existence of upstream collusion. Finally, an investigation carried out by the former OFT in the mobility aids sector in the United Kingdom resulted in two manufacturers of mobility scooters being fined for imposing independently restrictions on online advertising, which are generally considered as a form of indirect vertical price fixing.[158] Once again, no evidence of horizontal collusion was submitted.

Additionally, there was in fact no evidence that the RPM policies involved in the above cases were in any way imposed by downstream firms. Certainly, on various occasions, the coercion exercised by the manufacturer on discount retailers to adhere to the fixed price floors was a result of complaints by full-service, full-price outlets, but this fact is in itself insufficient to substantiate collusion in the downstream market. The reason is simple: diligent retailers are as interested in combating free riding as the manufacturer itself: it is them who will be forced to exit the market if the horizontal externality is not duly remedied. It is thus apparent that they may have had the incentive to foreclose price-cutters, but this incentive is equally consistent with anti-competitive intent as with efficiency gains associated with the elimination of the free rider problem. But apart from these theoretical assumptions, the most important fact remains that in none of these cases did the enforcement agencies infer the existence of a dealer cartel. This finding is consistent with empirical studies from the other side of the Atlantic, according to which, as Scherer and Ross point out, 'only a minority, and perhaps a small minority, of the adoptions for particular products came as a primary consequence of organized dealer pressures'.[159]

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[158] *Roma-Branded Mobility Scooters*, OFT decision of 5 August 2013 and *Mobility Scooters Supplied by Pride Mobility Products Limited*, OFT decision of 27 March 2014. See generally *supra* s 3.4.1.1.

[159] FM Scherer and D Ross, *Industrial Market Structure and Economic Performance* (3rd edn, Houghton Mifflin Company 1990), p 550.

The above observations are in no way to be interpreted as suggesting that the enforcement agencies in the EU have not dealt with RPM schemes presenting demonstrable anti-competitive effects. Two cases decided by the FCO, *CIBA Vision* and *Bayer Vital*, raised specific horizontal collusion concerns. Furthermore, the European Commission's *Spices* decision and the French Competition Authority's judgment in *Video Cassettes* were obviously based on the price-maintaining manufacturers' degree of market power, which allowed them to foreclose the upstream market and influence the pattern of trade in the affected industry, respectively. These cases can be understood as confirming the theories of harm associated with price floors.

In the United States, the response of commentators, lawmakers and State Attorneys General to *Leegin* merely reflects the ambivalent effects of RPM. To date, two states, Maryland and California, have confirmed the per se illegality of vertical price fixing under the relevant state antitrust statutes, while New York has maintained the current hostile – but less stringent – approach to the practice. At the same time, in addition to Kansas, which has already enacted the first and so far only '*Leegin* reinstater', all other states appear to be relying on federal harmonisation clauses thus endorsing the dicta of the US Supreme Court as guidance.[160] The fact that three states have explicitly chosen to deviate from the *Leegin* dictum is certainly indicative of the controversy surrounding vertical price fixing, but does not by any means provide a basis for safe inferences as to what the optimal antitrust response to RPM should be. In reality, it would be much more surprising if all policy makers across the United States had slavishly endorsed the rule of reason standard overnight, turning their backs on a century-long precedent that had been an integral part of the American retail tradition for generations.

As far as the application of Section 1 of the Sherman Act to RPM agreements is concerned, the body of relevant cases decided by lower courts in the post-*Leegin* world does not allow for specific conclusions to be drawn as to the analytical framework employed for the substantive assessment under the rule of reason standard or its effectiveness, for that matter. The lack of extensive antitrust adjudication of RPM cases leads to the compelling conclusion that *Leegin* has not had the effect of encouraging manufacturers to implement vertical price fixing policies.[161]

[160] See generally MA Lindsay, 'Overview of State RPM', *supra* n 143.
[161] See Note by T Voorhees, Jr, 'Roundtable on the Role and Measurement of Quality in Competition Analysis' (OECD Directorate for Financial and Enterprise Affairs, 27 May 2013), para 26, available at http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/WD(2013)68&docLanguage=En (last accessed on 24 November 2015).

In *PSKS v Leegin*, the Court of Appeals for the Fifth Circuit on remand rejected the plaintiff's assertion that the RPM scheme at issue deprived consumers of intrabrand price competition, holding that the argument 'ignores interbrand competition, which forces Brighton retailers to offer a combination of price and service that attracts consumers away from competing products'.[162] Besides, in the court's view 'robust competition can exist even in the absence of price competition. Retailers may seek to attract customers with better service, more knowledgeable staff, more appealing stores, and other nonprice-oriented strategies'.[163] In addition, the court also dismissed the market definitions suggested by PSKS, Inc.[164] The plaintiffs' failure to define the relevant market affected by the agreement has also been the reason for the dismissal of their claims in other RPM cases brought in the aftermath of *Leegin*.[165] In *re Nine West Group Inc*, the FTC, despite rejecting the manufacturer's argument that price floors stimulated demand for its products thus promoting interbrand competition, nonetheless relied on *Leegin* to modify an existing consent decree. The FTC justified the modification by noting the manufacturer's 'modest market share', the absence of a dominant retailer, and the fact that the price floors were determined by the manufacturer itself, in an attempt to induce the supply of product-specific services by its distributors. Having already concluded that the RPM agreement was 'not likely to harm consumers at this time', the FTC did not rule out the possible future anti-competitive effects of the policy. For that reason, it required Nine West to provide periodic reports on the impact of its RPM clauses on price and output.[166]

There is, however, encouraging evidence that the adjudication of RPM cases is not based on a rule of reason that is tantamount to a 'euphemism for nonliability',[167] according to the Judge Posner's famous quote, but is instead able to provide a solid analytical framework under which RPM can be reliably appraised on the basis of its net competitive effects. In *Toledo Mack Sales & Service, Inc v Mac Trucks, Inc*, a lower court allowed the plaintiff's action to proceed, noting that the latter had 'presented sufficient evidence to allow a jury to conclude that the agreement ... produced anti-competitive effects', in particular that the RPM policy was imposed as a result of dealer pressure, and could thus have been designed to facilitate dealer collusion.[168] A similar position was taken in

[162] *PSKS, Inc v Leegin Creative Leather Products, Inc*, 615 F3d 412, 419 (5th Cir 2010).
[163] Ibid.
[164] Ibid, 417-419.
[165] See, eg, *Jacobs v Tempur-Pedic Int'l, Inc*, 626 F3d 1327 (11th Cir 2010).
[166] FTC No C-3937, 2008 WL 2061410 (6 May 2008).
[167] RA Posner, 'The Rule of Reason and the Economic Approach: Reflections on the *Sylvania* Decision' [1977-1978] 45 *U Chi L Rev* 1, 14.
[168] 530 F3d 208, 225-226 (3rd Cir 2008).

McDonough v Toys 'R' Us, a motion to dismiss was denied on the ground that the price floors were imposed at the behest of a powerful brick-and-mortar retailer with the purpose of excluding online discounters.[169]

As a general proposition, to date there have been no indications suggesting that the rule of reason standard does not provide a workable analytical framework for the substantive assessment of vertical price fixing under Section 1 of the Sherman Act. However, the absence of a sufficiently large body of RPM litigation entails that the *Leegin* rule has yet to be refined.

[169] 638 F Supp 2d 461, 488 (ED Pa 2009).

Chapter 6

Shaping a Workable Analytical Framework under Article 101 TFEU

6.1. General

Article 101(1) TFEU prohibits 'agreements between undertakings… which have as their *object or effect* the prevention, restriction or distortion of competition within the internal market'. As in the case of the ban on RPM, the object/effect dichotomy under Article 101 seems to have been shaped independently of any pre-existing national antitrust traditions of the Member States. Unable to trace its origins in either the German and French antitrust laws or Article 65 of the ECSC Treaty, Joliet underlines the analogy with the distinction between per se illegality and the rule of reason standard under Section 1 of the Sherman Act, stating that '[w]ithout asserting unequivocally that the origin of the test laid down by Article [101] is to be found in American antitrust law, I can at least point to the identity of standards'.[1]

Price fixing is cited in Article 101(1)(a) as an example of a restraint falling within the scope of the prohibition. The classification of RPM as a 'by-object' restriction was confirmed by the CJEU in *SA Binon & Cie v SA Agence et Messageries de la Presse*.[2] According to the Court, 'provisions which fix the prices to be observed in contracts with

[1] R Joliet, *The Rule of Reason in Antitrust Law: American, German and Common Market Laws in Comparative Perspective* (Martinus Nijhoff 1967), p 133. For a comparison with the German GWB, see also A Deringer, *The Competition Law of the European Economic Community: A Commentary on the EEC Rules of Competition (Articles 85 to 90) Including the Implementing Regulations and Directives* (Commerce Clearing House, Inc 1968), pp 17-18. Both authors use the term 'purpose' to refer to the object of an agreement.
Compare AD Chirita, 'A Legal-Historical Review of the EU Competition Rules' [2014] 63 *ICLQ* 281, 291-294. Chirita suggests that the language of Article 101(1) has been influenced in that regard by French civil law, according to which the validity and enforceability of a contract – in other words, its ability to produce *legal effects* – are conditional upon the legitimacy of its object and cause. The disjunctive inclusion of the 'effect' requirement, according to Chirita, is thus dictated by the broad concept of 'agreement' under Article 101 and is aimed at covering those types of arrangements which, albeit informal, 'might have the same effect as legally enforceable contracts'.
[2] Case 243/83, [1985] ECR 2015.

third parties constitute, of themselves, a restriction on competition within the meaning of Article [101](1)'.[3]

Additionally, Article 4(a) of Regulation 330/2010 identifies 'the restriction of the buyer's ability to determine its sale price' as a hardcore restraint, and excludes any vertical agreements containing such a clause from the application of the block exemption. Paragraph 23 of the Vertical Guidelines clarifies that the terms 'hardcore restrictions of competition' and 'restrictions of competition by object' are used interchangeably, and implies that the relevant provisions are exempted from the general presumption of legality for vertical agreements, which is introduced by the Vertical Block Exemption Regulation and is conditional upon the market share of the supplier and the buyer.

Goyder is critical of the Commission's use of 'hardcore' restraints as a synonym for 'restrictions by object' in the recent Vertical Guidelines. In stressing the conceptual differences between the two terms, she argues that 'hardcore' is merely a restraint which prevents an agreement from benefitting from a block exemption regulation. Since block exemptions are essentially the statutory means for the application of Article 101(3) to categories of agreements, the classification of a specific clause as 'hardcore' reflects nothing but the presumption that the agreement is not capable of satisfying the four requirements of Article 101(3) even where the market share thresholds for the application of the regulation are not exceeded. The concept of 'hardcore' restraint is therefore unrelated to Article 101(1) and does not introduce any presumption whatsoever pertaining to the compatibility of the agreement with Article 101(1) in the first place.[4] On the other hand, 'restrictions by object' constitute, according to Goyder, 'a category of agreements in respect of which a significantly lower burden of proof of infringement exists than for other agreements, and its boundaries are ultimately defined not by any Commission regulation ... but by the [CJEU]'.[5] Indeed in *Pierre Fabre*, the Cour d' Appel de Paris filed a reference for a preliminary ruling asking whether an outright ban on Internet sales in the context of a selective distribution system constitutes a 'hardcore' restriction of competition within the meaning of Article 101(1). The CJEU pointed out that, as there is no reference to the concept of 'hardcore restraints' neither in Article 101 TFEU nor in Regulation 2790/1999,[6]

[3] Ibid, para 44.
[4] J Goyder, '*Cet Obscur Objet*: Object Restrictions in Vertical Agreements' [2011] 2 *JECL&Pract* 327, 331.
[5] Ibid.
[6] The term 'hardcore restraints' was, eventually, introduced in Regulation 330/2010 and the accompanying Vertical Guidelines.

the question at hand should be understood as seeking to ascertain whether the contested clause constitutes a restriction of competition 'by object'.[7]

The rationale behind the classification of a restraint in the 'object' and/or the 'hardcore' box is based on presumptions which, whether conclusive (irrebuttable) or rebuttable, are used in various fields of law for the purposes of judicial economy. In light of the distinction between the two concepts as drawn by Goyder, the following paragraphs will analyse critically the Commission's approach to RPM both as a 'restriction by object' and as a 'hardcore' restraint. But before that, the necessary first step is to examine the importance of presumptions in the enforcement of EU competition law.

6.1.1. Presumptions in Article 101 Cases

Article 2 of Regulation 1/2003 provides that the burden of proving an infringement of Article 101 (or 102) TFEU is on the party or the authority alleging the infringement. On the other hand, any undertakings seeking to benefit from an exemption under Article 101(3) bear the burden of proving that their agreement satisfies the four requirements laid down in that paragraph. With regard to RPM cases in particular, paragraph 223 of the Vertical Guidelines states that

> Including RPM in an agreement gives rise to the presumption that the agreement restricts competition and thus falls within Article 101(1). It also gives rise to the presumption that the agreement is unlikely to fulfil the conditions of Article 101(3), for which reason the block exemption does not apply. However, undertakings have the possibility to plead an efficiency defence under Article 101(3) in an individual case. It is incumbent on the parties to substantiate that likely efficiencies result from including RPM in their agreement and demonstrate that all the conditions of Article 101(3) are fulfilled.[8]

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[7] Case C-439/09, *Pierre Fabre Dermo-Cosmétique SAS v Président de l'Autorité de la concurrence* [2011] ECR I-9419, paras 31-33.

[8] Para 225 of the Vertical Guidelines further provides for the evidentiary standard in RPM cases where the parties seek the application of Article 101(3) on the grounds of the free rider rationale:

> The parties will have to convincingly demonstrate that the RPM agreement can be expected to not only provide the means but also the incentive to overcome possible free riding between retailers on these services and that the pre-sales services overall benefit consumers as part of the demonstration that all the conditions of Article 101(3) are fulfilled.

The Guidelines thus confirm that the substantive assessment of RPM under Article 101 is essentially based on a presumption of negative welfare consequences. As the burden of proof shifts from the authority, which seeks to establish that the alleged violation has been committed, to the parties, whose objective is to defend the lawfulness of their agreement, legal presumptions are a form of legal reasoning employed with the purpose of facilitating the fact-finder's task. They constitute 'inferences of fact that courts will recognize to exist when the facts necessary to give rise to the presumption have been proven to exist'.[9] The adoption of legal presumptions may be necessary for reasons of public policy or procedural convenience or may simply be based on experience and the general understanding of an oft-recurring fact or conclusion as highly probable.[10]

Presumptions may be either rebuttable, in which case the relevant inference may be refuted should the other party manage to establish to the requisite evidentiary standard that it is not applicable to the case at hand, or conclusive (irrebuttable). Conclusive presumptions introduce inferences which cannot be rebutted, so any evidence to the contrary will not be accepted. As will be shown in the following analysis, there is a subtle but fundamental discrepancy in the treatment of vertical price fixing under paragraphs 1 and 3 of Article 101. This discrepancy derives from the fact that presumptions of a different nature are applied in the context of each provision, on the basis of the different (foreseeable) welfare effects of RPM on allocative and productive efficiency, respectively.

6.2. RPM as a Restriction of Competition by Object – Article 101(1) TFEU

6.2.1. What Constitutes a Restriction by Object

In *Société Technique Minière v Maschinenbau Ulm*, the CJEU held that the conjunction 'or' in the language of Article 101(1) indicates that the two requirements are to be read disjunctively.[11] It is thus first necessary to consider the precise purpose of the agreement, in the economic context in which it is to be applied. Where the object of the

[9] Notes, 'A Suggested Role for Rebuttable Presumptions in Antitrust Restraint of Trade Litigation' [1972] 1972 *Duke LJ* 595, 605.
[10] Ibid, and D Bailey 'Presumptions in EU Competition Law' [2010] 31 *ECLR* 362, 363.
[11] Case 56/65 [1966] ECR 235. This was, subsequently, reiterated categorically by the Court in case C-219/95P, *Ferriere Nord SpA v Commission* [1997] ECR I-4411, paras 14-15.

agreement is not the restriction of competition, an appreciable restrictive effect needs to be shown in order for the agreement to be caught by the prohibition.[12] This categorisation is of great significance because, once an agreement is found to have as its object the restriction of competition, there is no need for its effects to be considered.[13]

The Article 101(3) Guidelines define restrictions of competition by object as those which 'by their very nature have the potential of restricting competition'.[14] Experience has shown that such restrictions are so likely to have negative effects on the market and hinder the attainment of the objectives pursued under the Treaty, that they are presumed to fall within the scope of Article 101.[15] The Commission thus seems to endorse the rationale behind the CJEU's earlier ruling in *Miller v Commission* that the object requirement is to be interpreted as a presumption of necessary anti-competitive effect.[16] Advocate General Trstenjak subsequently took this assumption one step further, by suggesting that the strong anti-competitive prospects of object restrictions necessitated the adoption of some sort of 'precautionary principle', analogous to the criminal law concept of inchoate offences.[17]

It is often asserted that this presumption of necessary effect is a product of adequate experience with the competitive impact of a specific type of conduct. Of course, as Bailey correctly points out, it may occasionally be the case that this experience has not been acquired through the judicial practice of the Commission or the European Courts; empirical evidence from different jurisdictions, the US antitrust experience in particular, may also be used as a pointer.[18] But under Section 1 of the Sherman Act, the nature of the presumption which derives from the characterisation of an agreement as per se illegal is not disputed: the US Supreme Court has clarified that 'there are certain agreements or practices which because of their pernicious effect on competition and lack of any

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[12] Ibid, p 249.

[13] See the Commission Guidelines on the Application of Article 81(3) [now Article 101(3)] of the Treaty [2004] OJ C101/97 (hereinafter 'Article 101(3) Guidelines), para 20; Joined Cases 56 and 58/64, *Établissements Consten Sarl and Grundig-Verkaufs-GmbH v Commission* [1966] ECR 299, 242 and, more recently, Case C-8/08, *T-Mobile Netherlands BV v Raad van beestuur van de Nederlandse Mededingingsautoriteit* [2009] ECR I-4529, para 30.

[14] Article 101(3) Guidelines, para 21.

[15] Ibid.

[16] Case 19/77, *Miller International Schallplatten GmbH v Commission* [1978] ECR 131, para 7: 'by its very nature, a clause prohibiting exports constitutes a restriction on competition'; the definition of object restrictions as laid down in the 101(3) Guidelines effectively echoes the Court's language. See also O Odudu, 'Interpreting Article 81(1): Object as Subjective Intent' [2001] 26 *EL Rev* 60, 62-63.

[17] Case C-209/07, *The Competition Authority v Beef Industry Development Society Ltd and Barry Brothers (Carrigmore) Meats Ltd* [2008] ECR I-8637 (*BIDS*), Opinion of AG Trstenjak, para 46; D Bailey, 'Restrictions of Competition by Object under Article 101 TFEU' [2012] 49 *CML Rev* 559, 563-564.

[18] Bailey further lists the insights of industrial organisation and the various policy priorities as two additional external factors which may contribute to the classification of a specific restraint in the 'object box', irrespective of the domestic judicial experience; D Bailey, *supra* n 17, 564-565.

redeeming virtue are *conclusively presumed to be unreasonable and therefore illegal* without elaborate inquiry as to the precise harm they have caused or the business excuse for their use'.[19] In other words, the per se rule introduces a conclusive presumption, which 'permits categorical judgments with respect to certain business practices that have proved to be predominantly anti-competitive'.[20]

By contrast, the nature of the object requirement under Article 101(1) is rather obscure. In *Société Technique Minière*, Advocate General Roemer seemed to favour the application of a 'rule of reason' standard for the competitive assessment of all restrictive agreements; in his Opinion the AG maintained that

> it would be going too far to allow the least interference with competition to fall under the strict prohibition in Article [101](1), *whether it arose from an agreement having that object or from an agreement which simply had that effect,* and to grant exemptions for such infringements in the context of Article [101](3).[21]

The Court agreed and expressly refused to read any conclusive presumptions of illegality in the language of the provision: 'as Article [101](1) is based on an assessment of the effects of an agreement from two angles of economic evaluation, it cannot be interpreted as introducing any kind of advance judgment with regard to a category of agreements determined by their legal nature'. In *Consten and Grundig*, however, a case decided only a fortnight later, the CJEU adopted a stricter methodology and rejected the effects-based approach consistently suggested by AG Roemer.[22] In endorsing the conclusive character of the presumption, the Court, after having established that the agreement under scrutiny aimed at the insulation of national markets, stressed that

> [n]o further considerations, whether of economic data… or of the corrections of the criteria upon which the Commission relied in its comparisons between the situations of the French and German markets, and no possible favourable effects of

[19] *Northern Pacific Railway Co v United States*, 356 US 1, 5 (1958) (emphasis added).
[20] *Northwest Wholesale Stationers, Inc v Pacific Stationery & Printing Co*, 472 US 284, 289 (1985).
[21] Case 56/65, *Société Technique Minière v Maschinenbau Ulm* [1966] ECR 235, Opinion of AG Roemer, p 257 (emphasis added).
[22] Joined Cases 56 and 58/64, *Établissements Consten Sarl and Grundig-Verkaufs-GmbH v Commission* [1966] ECR 299, Opinion of AG Roemer, p 358; the AG again opined that 'it would be artificial to apply Article [101](1), on the basis of purely theoretical considerations, to situations which upon closer inspection would reveal no appreciable adverse effects on competition, in order then to grant exemption on the basis of Article [101](3)'.

> the agreement in other respects, can in any way lead, in the face of the abovementioned restrictions, to a different solution under Article [101](1).[23]

In *European Night Services*, the General Court reiterated that the presumption of illegality of object restrictions cannot be refuted in the context of Article 101(1). According to the Court, agreements containing 'obvious restrictions of competition' may escape the prohibition only following a balancing of pro- and anti-competitive effects under Article 101(3).[24] Furthermore, in *BIDS*, the CJEU stressed that this presumption constitutes the essence of the object/effect dichotomy. Echoing the language used by the Commission in its 101(3) Guidelines, the Court stated that '[t]he distinction between "infringements by object" and "infringements by effect" arises from the fact that certain forms of collusion between undertakings can be regarded, by their very nature, as being injurious to the proper functioning of normal competition'.[25]

These cases clearly demonstrate that the current position of the Commission and the Courts is that restrictions by object are conclusively presumed to be illegal for the purposes of Article 101(1).[26] Odudu asserts that the substantive assessment of collusive agreements under Article 101(1) concentrates on the issue of allocative efficiency – or 'contrived scarcity of output'; he thus perceives the concept of 'restriction of competition' as essentially tantamount to allocative inefficiency.[27] Allocative efficiency refers to the difference between the marginal cost of production and the price that consumers are willing to pay for an extra unit of output. It is only in perfectly competitive markets that allocative efficiency is achieved, for only under conditions of perfect competition is price equal to marginal cost.[28] In light of these assumptions, it follows that RPM, being classified as an object restriction, is presumed to cause allocative inefficiency. Later in this chapter, it will be argued that this presumption is conclusive.

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[23] Joined Cases 56 and 58/64, *Établissements Consten Sarl and Grundig-Verkaufs-GmbH v Commission* [1966] ECR 299, 343.
[24] Joined cases T-374/94, T-375/94, T-384/94 and T-388/94, *European Night Services Ltd (ENS) v Commission* [1998] ECR II-1533, para 136.
[25] Case C-209/07, *The Competition Authority v Beef Industry Development Society Ltd and Barry Brothers (Carrigmore) Meats Ltd* [2008] ECR I-8637, para 17.
[26] Compare A Jones, 'Left Behind by Modernisation? Restrictions by Object under Article 101(1)' [2010] 6 *Eur Competition J* 649, 660; Jones argues that there is no conclusive presumption against object restraints under Article 101 taken as a whole. She is, nevertheless, sceptical as to whether the possibility of rebutting the presumption is anything but theoretical; ibid, 663.
[27] O Odudu, *The Boundaries of EC Competition Law: The Scope of Article 81* (Oxford University Press 2006), pp 102-103.
[28] S Bishop and M Walker, *The Economics of EC Competition Law: Concepts, Application and Measurement* (3rd edn, Sweet & Maxwell 2010), pp 25-26.

This presumption of allocative inefficiency has two main implications for the antitrust treatment of RPM. First, an agreement fixing resale prices will not be subject to the appreciability test, which constitutes the quantitative criterion for the application of Article 101(1). Second, the only way for such an agreement to escape the prohibition is by qualifying for an exemption under Article 101(3).

6.2.2. Appreciability

In order for an agreement to be caught by Article 101(1), it is not sufficient that it has the object or effect of restricting competition; the restriction also needs to be *appreciable*. A general idea of what constitutes (or, more precisely, what does not constitute) an appreciable restriction of competition is given by the 2014 Commission Notice on agreements of minor importance.[29] The Notice provides for specific market share thresholds below which an agreement is not likely to restrict competition perceptibly. Although the Notice covers in general agreements entered into both between competitors and between non-competitors, it expressly excludes, in paragraph 13 thereof, hardcore restraints from the *de minimis* rule. Unlike the preceding framework,[30] however, the current Notice does not make specific reference to RPM as an excluded restraint.

Nevertheless, this outright exclusion of hardcore restraints is, if anything, confusing, particularly in view of the CJEU's judgement in *Völk v Vervaecke*.[31] It was in that case that the Court introduced the *de minimis* doctrine as the standard for the assessment of an agreement's restrictive effect and it applied it to an agreement containing a restriction typically classified as 'hardcore'. More specifically, the exclusive dealing agreement at issue had been entered into between a manufacturer of washing machines and its distributor for Belgium and Luxembourg. Both parties held very small market shares (0.08% and 0.6% respectively) and the CJEU held that, although the agreement included a provision conferring absolute territorial protection upon the dealer, it escaped the prohibition of Article 101(1) in view of the weak position of the undertakings concerned.

[29] Communication from the Commission – Notice on agreements of minor importance which do not appreciably restrict competition under Article 101(1) of the Treaty on the Functioning of the European Union (De Minimis Notice) [2014] OJ C291/1. In the Notice, the Commission states that an agreement does not appreciably restrict competition where: (a) it has been concluded between competitors the aggregate market share of whom does not exceed 10% of the relevant market, or (b) the parties to the agreement are non-competitors, each of whom holds a market share not exceeding 15% of the relevant market; ibid, para 8.

[30] Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty establishing the European Community [now Article 101(1) of the Treaty on the Functioning of the European Union] (*de minimis*) [2001] OJ C368/13, para 11(2)(a).

[31] Case 5/69, *Franz Völk v SPRL Ets J Vervaecke* [1969] ECR 295.

As was seen earlier, in *Pedro IV* the CJEU, in the context of its response to a reference for a preliminary ruling regarding an RPM agreement, seemed to endorse and confirm its previous judgment in *Völk*: the court held that, in order for a vertical price fixing scheme to be caught by Article 101(1), all the conditions laid down in that provision must be met, including the requirement that 'the object or effect of the agreement is *perceptibly* to restrict competition within the common market'.[32]

The resulting uncertainty was eventually rectified in the recent *Expedia* case,[33] where the CJEU overruled its previous judgments in *Völk* and *Pedro IV* and adopted a position more consistent with the Commission's *de minimis* Notice. The case concerned the creation of a joint venture by SNCF, the French State railway company, and Expedia, an internet-based tour operator, for the reservation and sale of train tickets over the Internet. The French competition authority found that the agreement constituted a restriction of competition by object and that, as such, was in breach of Article 101, and, accordingly, imposed fines on both parties. On appeal, the parties argued that their market shares had been overestimated, as in reality they were below the 10 percent threshold provided for by the *de minimis* Notice. The *Cour de Cassation* filed a reference for a preliminary ruling asking whether national competition authorities are bound by the Notice when applying Article 101(1) of the Treaty. In replying to the referral, the Court also dealt with the issue of appreciability of restrictions by object and put an end to the conflict between its previous case law and the Commission's stricter approach by holding that 'an agreement that may affect trade between Member States and that has an anti-competitive object constitutes, by its nature and independently of any concrete effect that it may have, an appreciable restriction of competition'.[34] By this statement, the Court thus seems to accept that restrictions by object are conclusively presumed to satisfy the appreciability requirement of Article 101(1) TFEU.[35]

[32] Case C-260/07, *Pedro IV Servicios SL v Total España SA* [2009] ECR I-2437, para 82 (emphasis added). For a brief presentation of the case, see *supra* ch 1.
[33] Case C-226/11, *Expedia Inc v Authorité de la Concurrence*, decision of 13 December 2012 (not yet published).
[34] Ibid, para 37.
[35] A Ortega González, 'Restrictions by Object and the Appreciability Test: The *Expedia* Case, a Surprising Judgment or a Simple Clarification?' [2013] 34 *ECLR* 457, 465.

6.3. The 'Ancillary Restraints' Doctrine

It was seen earlier that in *Addyston Pipe*, Judge Taft, on the basis of a meticulous review of English court decisions, held that restraints on trade are illegal, unless they are found to be merely ancillary to the main purpose of a lawful contract, as well as necessary for the protection of the parties' commercial interests.[36] According to Bork, the main contribution of Taft's insightful analysis lies in the fact that it 'offered the Sherman Act not content but form: a method of preserving socially valuable transactions by defining an exception to an otherwise inflexible prohibition of agreements eliminating competition, and a formula for confining the exception to the area of its reason for existence'.[37] For the purposes of the application of Section 1 of the Sherman Act, the 'ancillary restraints' doctrine allows restrictive clauses otherwise classified as per se illegal to be assessed on the basis of their reasonableness, taking into account their effects on the market and the subjective intention of the parties.[38] The CJEU has endorsed the concept of ancillarity and applied the doctrine on various occasions, most notably in *Remia*[39] and *Pronuptia*.[40] In these cases, non-compete obligations imposed upon the transfer of two undertakings and a franchising system, respectively, were upheld as compatible with Article 101(1).

The Commission deals with the issue of ancillary restraints in paragraphs 28-31 of the 101(3) Guidelines. According to the Guidelines, individual restrictive clauses may qualify as ancillary restraints and escape the prohibition provided that they are directly related and objectively necessary for the implementation of the main transaction, as well as proportionate to it.[41] It has been argued that the 'ancillary restraints' doctrine is a means to 'eliminate the tension between prohibition and exception'.[42] Indeed, both the General Court and, subsequently, the Commission have clarified that the requirement that an

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[36] *United States v Addyston Pipe & Steel Co et al*, 85 Fed 271, 282 (6th Cir 1898).

[37] RH Bork, 'The Rule of Reason and the Per Se Concept: Price Fixing and Market Division' (Part I) [1964-1965] 74 *Yale LJ* 775, 801.

[38] See eg RH Bork, 'Ancillary Restraints and the Sherman Act' [1959] 15 *ABA Antitrust Section* 211. Similarly, Odudu asserts that the subjective intention of the parties is sufficient to satisfy the object requirement of Article 101(1), and that '[c]ertain practices that restrict conduct, prima facie, show a subjective intention of restricting competition. However, it is open to the parties to rebut this presumption of subjective intention by showing a legitimate purpose'. Accordingly, he construes the ancillary restraints defence as 'part of the object and not the effect consideration'; O Odudu, 'Interpreting Article 81(1): Object as Subjective Intention' [2001] 26 *EL Rev* 60, 71-74.

[39] Case 42/84, *Remia BV and Verenigde Bedrijven Nutricia NV v Commission* [1985] ECR 2545.

[40] Case 161/84, *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 353.

[41] 101(3) Guidelines, para 29.

[42] G Hirsch, F Montag and FJ Säcker, *Competition Law: European Community Practice and Procedure, Article-by-Article Commentary* (Sweet & Maxwell 2007), p 614.

ancillary restraint be objectively necessary does not imply any balancing of pro- and anti-competitive effects. The appraisal of any alleged efficiency gains may be carried out only in the context of Article 101(3).[43] Although various commentators have suggested that the concept of ancillarity indicates that a quasi 'rule of reason' standard is applied under Article 101(1),[44] this assumption was rejected categorically by the General Court in *Métropole*.[45]

In *Pronuptia*, in response to a reference for a preliminary ruling regarding the applicability of Article 101(1) to a franchise agreement, the CJEU upheld a number of restrictive clauses as essential for the protection of the franchisor's know-how and the network's reputation, but drew the line at export bans and RPM.[46] Although eventually not endorsed by the Court, the opinion of Advocate General VerLoren van Themaat with regard to RPM is of particular interest. The Advocate General maintained that Article 101(1) is concerned with the horizontal effects of vertical agreements, namely their effects on interbrand competition, and opined that RPM clauses should be regarded as compatible with Article 101(1), unless the franchisor enjoys a position of market power or unless the implementation of RPM schemes in a given industry is widespread.[47]

The Commission, in the recent Vertical Guidelines, states that, in exceptional circumstances, even agreements which confer absolute territorial protection upon distributors by prohibiting both active and passive sales may escape the application of Article 101(1) altogether, where they are found to be objectively necessary for the implementation of the main operation, and limited in time.[48] The approach taken to vertical price fixing is stricter: the Guidelines do not acknowledge the potential ancillarity of RPM clauses, and implicitly confirm that the substantive assessment of agreements fixing resale prices is only possible in the context of Article 101(3).[49] The wording of para 225 is

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[43] Case T-112/99, *Métropole Télévision (M6) v Commission* [2001] ECR II-2459, para 107; 101(3) Guidelines, para 30.
[44] See, eg, I Forrester and C Norall, 'The Laicization of Community Law: Self-Help and the Rule of Reason: How Competition Law Is and Could Be Applied' [1984] 21 *CML Rev* 11, 25-28; R Whish and B Sufrin, 'Article 85 and the Rule of Reason' [1987] 7 *YEL* 1; V Korah, 'The Rise and Fall of Provisional Validity – The Need for a Rule of Reason in EEC Antitrust' [1981] 3 *Nw J Int'l L & Bus* 320; E Steindorff, 'Article 85 and the Rule of Reason' [1984] 21 *CML Rev* 639. Compare BE Hawk, 'The American (Anti-Trust) Revolution: Lessons for the EEC?' [1988] 9 *ECLR* 53, 64-73.
[45] Case T-112/99, *supra* n 43, para 72. See also case T-65/98, *Van den Bergh Foods Ltd v Commission* [2003] ECR II-463, para 106.
[46] Case 161/84, *supra* n 40, para 23.
[47] Case 161/84, *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 353, Opinion of AG VerLoren van Themaat, pp 369-370.
[48] 2010 Vertical Guidelines, paras 60-61.
[49] Ibid, paras 60 and 223-225.

interesting: under specific circumstances,[50] RPM may be considered as 'helpful' or 'necessary', terms which undoubtedly imply subsidiarity. Unlike the Commission, the CJEU has envisaged that RPM may escape the prohibition altogether: in *Pedro IV*, the Court maintained that, in order for an agreement fixing retail prices to trigger the application of Article 101(1), all the conditions laid down in that provision must be met.[51]

Despite the Commission and General Court's assertions to the contrary, there is broad consensus among scholars that an inquiry into an agreement's net effects, however limited, is nonetheless inherent in the concept of ancillary restraints.[52] That said, Article 101(1) does not specifically require the undertakings concerned to demonstrate a restrictive agreement's welfare-enhancing potential; as Verouden points out: 'For its part, the European "rule of reason" appears to be limited in scope, focusing primarily on the functioning of the producer's distribution system (regulating intrabrand competition), rather than on competition in the market as such (promoting interbrand competition)'.[53] Faull and Nikpay accordingly take the position that, in order for the ancillarity defence to be applicable to a specific case, the main agreement must be shown to be either pro-competitive or 'at least neutral in competitive terms'.[54] Green, based on the Court's judgment in *Pronuptia*, reaches the same conclusion.[55] Similarly, Nazzini argues that 'the consumer welfare objective of Article [101] necessarily implies that 'legitimate business

[50] The Guidelines recognise that an individual exemption on efficiency grounds may be granted, for example, to RPM aimed at inducing distributors to increase sales efforts in order to promote a new product, or for the purposes of a coordinated short term low price campaign (2 to 6 weeks) organised in the context of a distribution system applying a uniform distribution format (eg franchise system). In the latter case, it has been doubted whether the agreement would even meet the appreciability requirement of Article 101(1) in the first place; see F Wijckmans and F Tuytschaever, *Vertical Agreements in EU Competition Law* (2nd edn, Oxford University Press 2011), p 140.

[51] Case C-260/07, *supra* n 32, para 82.

[52] See eg J Faull and A Nikpay, *The EC Law of Competition* (2nd edn, Oxford University Press 2007), pp 252-254; A Jones and B Sufrin, *EU Competition Law: Text, Cases, and Materials* (4th edn, Oxford University Press 2011), pp 231-239; R Nazzini, 'Article 81 EC Between Time Present and Time Past: A Normative Critique of "Restriction of Competition" in EU Law' [2006] 43 *CML Rev* 497; O Odudu, 'Interpreting Article 81(1): Demonstrating Restrictive Effect' [2001] 26 *EL Rev* 261, 267-274; P Nicolaides, 'The Balancing Myth: The Economics of Article 81(1) & (3)' [2005] 32 *LIEI* 123, 131-134.
Monti, on the other hand, argues that, once it has been established that the agreement as a whole is lawful, the effects of the ancillary restraint on the market are not scrutinised. Instead, he asserts that the doctrine serves administrative convenience: it allows 'the Commission to focus on the principal effects of an agreement, but also to control minor aspects if the ancillary restraints are excessive in duration and scope'; G Monti, *EC Competition Law* (Cambridge University Press 2007), pp 33-36.

[53] V Verouden, 'Vertical Agreements and Article 81(1) EC: The Evolving Role of Economic Analysis' [2003-2004] 71 *Antitrust LJ* 525, 540.

[54] J Faull and A Nikpay, *supra* n 52, p 253.

[55] N Green, 'Article 85 in Perspective: Stretching Jurisdiction, Narrowing the Concept of a Restriction and Plugging a Few Gaps' [1988] 9 *ECLR* 190, 197.

purpose' under Article [101](1) … can have no other meaning than "welfare-enhancing" or "welfare-neutral"'.[56]

Thus, the inapplicability of the 'ancillary restraints' doctrine to RPM clauses has far-reaching consequences. While a mere showing that an agreement is not harmful to competition is sufficient for it to escape Article 101(1), a substantive assessment under Article 101(3) presents the parties with a greater challenge: they are required to demonstrate that the agreement brings about substantial efficiency gains capable of outweighing any detrimental effects. In the words of the CJEU, the first condition for exemption under Article 101(3) requires the attainment of 'appreciable objective advantages of such a character as to compensate for the disadvantages which [it causes] in the field of competition'.[57] In light of the preceding analysis, it is submitted here that RPM is subject to such a strong presumption of illegality under Article 101 TFEU that could be described as 'quasi conclusive'.

6.4. RPM under Article 101(1): Allocative Efficiency Considerations

6.4.1. Causation

Causation is a fundamental requirement of liability, both in tort and criminal law. On the basis of the 'but-for test' it must be shown that a certain loss or result, respectively, would not have occurred had it not been for the defendant's conduct.[58] The following paragraphs shall examine whether a causal link does in fact exist between RPM and a loss in allocative efficiency, and whether a conclusive presumption against the practice is warranted.

The relevance of causation to the substantive assessment of restrictions of competition under Article 101(3) has already been acknowledged. Parties seeking an

[56] R Nazzini, *supra* n 52, 511.
[57] Joined Cases 56 and 58/64, *Établissements Consten Sarl and Grundig-Verkaufs-GmbH v Commission* [1966] ECR 299, 348 and, more recently, Case T-168/01, *GlaxoSmithKline Services Unlimited v Commission* [2006] ECR II-2969, para 247.
[58] See, eg, BS Markesinis and SF Deakin, *Tort Law* (4th edn, Clarendon Press 1999), pp 174-202; A Ashworth and J Horder, *Principles of Criminal Law* (7th edn, Oxford University Press 2013), pp 102-116.

individual exemption on the basis of alleged efficiency gains are required to substantiate that there is a sufficient and direct causal link between the restrictive agreement and the claimed efficiencies.[59] Furthermore, with regard to the third condition for exemption laid down in that provision, in order for the indispensability criterion to be met the parties need to establish that both the agreement itself and the individual restrictions are 'reasonably necessary' for the attainment of the efficiencies.[60] Nicolaides asserts that the causal link 'must be demonstrated with a high degree of certainty'.[61]

In the recent Vertical Guidelines, the Commission takes the position that there is a direct causal relationship between RPM and price increase: 'the *immediate effect* of RPM will be that all or certain distributors are prevented from lowering their sales price for that particular brand. In other words, the *direct effect of RPM is a price increase*'.[62] As a preliminary remark, it should be noted that the hypothesis that RPM invariably exercises an upward pressure on prices, although certainly intuitive, is nonetheless not unambiguous. Where, for example, RPM is designed to compensate dealers for engaging in promotional activities which, otherwise, would have been undertaken by the manufacturer, the increase in retail margins will be offset by a respective reduction in wholesale prices. The presumption that these higher retail margins are always passed on to consumers in the form of higher prices is, therefore, unwarranted.[63] But even assuming, for the purposes of the present discussion, that the Commission's insight is correct, it is an unfortunate oversimplification nonetheless.

By contrast to price fixing between competitors, any increase in prices resulting from pro-competitive, manufacturer-induced RPM does not reflect a respective restriction of output. What changes is in fact the composition of the offered good. In the absence of collusion in either the upstream or the downstream market, the fixed resale prices induce distributors to increase their sales efforts. It is thus wrong to assume that RPM results in higher prices for an already existing product. Instead, the integration of the distributor's profit margin into the resale price corresponds to a new product altogether: a bundle consisting of the tangible good and any sales-specific services attached to it. Restricted in

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[59] 101(3) Guidelines, paras 51-54; see eg *Glaxo Wellcome* [2001] OJ L302.
[60] Ibid, paras 73-82.
[61] P Nicolaides, *supra* n 52, 138.
[62] 2010 Vertical Guidelines, para 224 (emphasis added).
[63] See PM Ippolito, 'RPM Myths that Muddy the Discussion' [2010] 55 *Antitrust Bull* 151, 154-156; HP Marvel, 'The Resale Price Maintenance Controversy: Beyond the Conventional Wisdom' [1994-1995] 63 *Antitrust LJ* 59, 69-71; WF Baxter, 'The Viability of Vertical Restraints Doctrine' [1987] 75 *Cal L Rev* 933, 945. More specifically, RPM does not affect retail prices where the costs incurred for the provision of product-specific services are fixed; HP Marvel and S McCafferty, 'The Political Economy of Resale Price Maintenance' [1986] 94 *J Polit Econ* 1074, 1078-1084.

their ability to determine the resale price, distributors will inevitably engage in non-price competition by providing additional services, up to the point where the marginal cost of distribution equals the fixed resale price, in which case their returns will not exceed the competitive level.[64]

A special category of products the nature of which frustrates the mainstream price theory and undermines the presumption that RPM produces inefficient outcomes is that of prestige goods. In the case of prestige goods, the high price is an essential attribute of the product itself: it contributes to the preservation of the product's brand image and creates an air of exclusivity valued by consumers. Price-cutting, therefore, is not likely to stimulate demand. In fact, quite the opposite is possible: price competition may actually damage the product's exclusive image and eventually lead to a *reduction* in sales volume.[65] Ackert observes that

> [t]here is no net welfare loss when one pays an artificially high price for a prestige good. In fact, there is a welfare gain because it is conspicuous consumption, brought about by a high price that consumers desire… Even if there were such a thing as an inframarginal consumer of prestige goods, he would suffer no welfare loss by paying a high price because he wants to pay a high price.[66]

The following diagram (Figure 1)[67] demonstrates that, where RPM is designed to invigorate demand for a certain manufacturer's products, the expected price increase will bring about a respective *increase* in output. More specifically, as the resale price is inflated from P to P_{RPM}, the availability of pre-sales services valued by consumers stimulates demand for the products in question (from D to D_{RPM}), causing in turn the manufacturer to

[64] RA Posner, 'Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions' [1975] 75 *Colum L Rev* 282, 283-284; RH Bork, 'The Rule of Reason and the Per Se Concept: Price Fixing and Market Division' (Part II) [1965-1966] 75 *Yale LJ* 373, 454-456; RH Bork, 'A Reply to Professors Gould and Yamey' [1966-1967] 76 *Yale LJ* 731, 732-734.

[65] See GR Ackert, 'An Argument for Exempting Prestige Goods from the Per Se Ban on Resale Price Maintenance' [1994-1995] 73 *Tex L Rev* 1185; R Pitofsky, 'In Defense of Discounters: The No-Frills Case for a *Per Se* Rule Against Vertical Price Fixing' [1982-1983] 71 *Geo LJ* 1487, 1494.

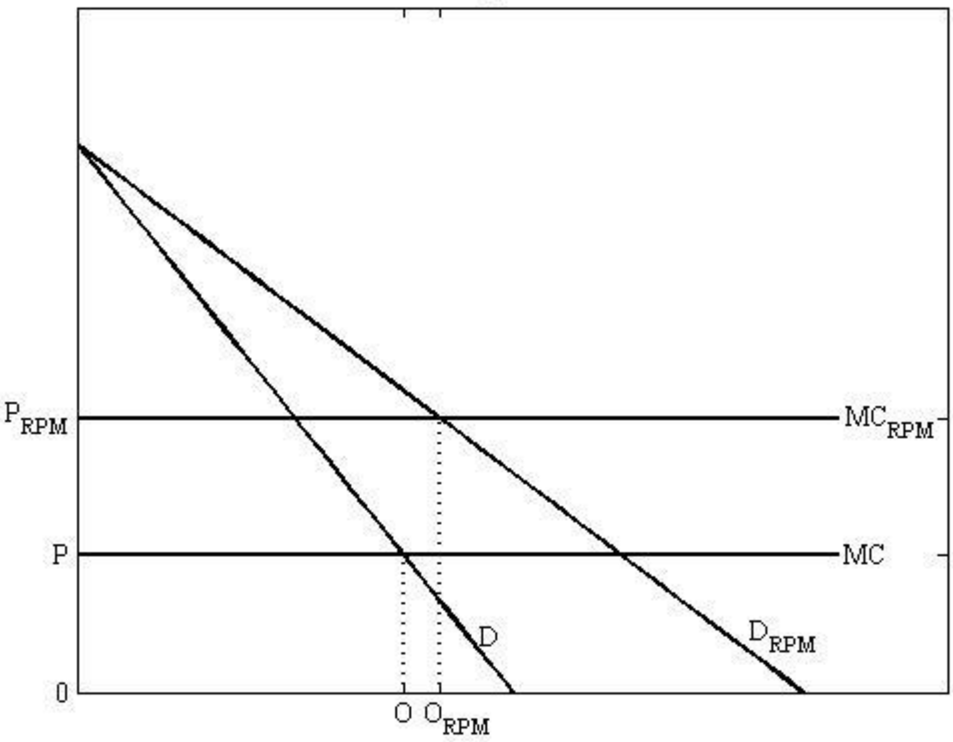
In a recent study, Ahlert and Schefer assert that brand care is essential for virtually all branded goods. Strong brands, they argue, are merely creations of the consumers' minds and can be undermined in the event of uncoordinated brand management. Price-cutting outlets do not necessarily promote consumer welfare, because in reality the notion of welfare refers to the 'diverse options facing consumers among various different supply concepts characterised by different prices'. If this diversity is restricted, consumer welfare is reduced accordingly. See D Ahlert and B Schefer, *Vertical Price Coordination and Brand Care: Interdisciplinary Perspectives on the Prohibition of Resale Price Maintenance* (Springer 2013), ch 2.

[66] GR Ackert, *supra* n 65, 1216. See also BY Orbach, 'Antitrust Vertical Myopia: The Allure of High Prices' [2008] 50 *Ariz L Rev* 261.

[67] ET Sullivan, H Hovenkamp and HA Shelanski, *Antitrust Law, Policy and Procedure: Cases, Materials, Problems* (6th edn, LexisNexis 2009), p 425.

expand its output from O to O_{RPM}. The greater profit margin allows the dealer to recoup any relationship-specific investments necessary for the provision of additional services, which entail the increased marginal cost MC_{RPM}.

Figure 1



It follows from the foregoing analysis that the conclusive presumption of allocative inefficiency, which, as was demonstrated earlier, constitutes the theoretical foundation of the public policy towards RPM agreements under Article 101(1), is unwarranted as there appears to be no *direct* causal link between vertical price fixing and a loss in consumer welfare. For the sake of completeness, however, it must be noted at this point that this view is not unambiguous. Based on the evaluation of manufacturers' share price responses to RPM antitrust challenges, Gilligan asserts that allocative distortions may sometimes be caused in both the upstream and the downstream markets where, as a result of marketing inertia, an RPM scheme initially designed to enhance productive efficiency outlives its purpose.[68]

A further caveat merits mention here. The assumption that RPM may lead to an increase in output is valid only where the restraint is instigated by the manufacturer and aims at compensating distributors for increased sales efforts that stimulate consumer demand. A *reduction* in output levels, on the other hand, is likely where RPM is imposed

[68] TW Gilligan, 'The Competitive Effects of Resale Price Maintenance' [1986] 17 *Rand J Econ* 544.

at the behest of a dominant retailer, or a group of retailers who collectively possess substantial monopsony power, in an attempt to foreclose the market to price-cutting rivals.[69]

More recent empirical evidence, which came to light in the aftermath of the *Leegin* decision, suggests that in jurisdictions which are more favourable to RPM consumers are more likely to witness a net loss in their welfare, which takes the form of both price increases and output decreases. In line with the anti-competitive theories of RPM – yet without conclusively providing support for any of them in specific – MacKay and Smith observe changes in the prices and quantities of a significant number of products (8.4 percent and 9.4 percent, respectively) as a result of *Leegin*, to the detriment of consumers.[70] However, the relevant study is controversial and has been criticised for its 'methodological and substantive deficiencies'.[71]

6.4.2. The Cartel Objection

Arguably the most frequently cited objection to RPM is its alleged ability to bolster collusion in either the upstream or the downstream market. It is submitted that the fixing of minimum retail prices may enable the members of a manufacturer or dealer cartel to monitor compliance with their arrangement by making a potential defector's price cutting activity readily visible. The Commission has endorsed the cartel theory in paragraph 224 of its Vertical Guidelines:

> Firstly, RPM may facilitate collusion between suppliers by enhancing price transparency on the market, thereby making it easier to detect whether a supplier deviates from the collusive equilibrium by cutting its price. RPM also undermines the incentive for the supplier to cut its price to itsdistributors, as the fixed resale price will prevent it from benefiting from expanded sales. Such a negative effect is particularly plausible where the market is prone to collusive outcomes, for instance if the manufacturers form a tight oligopoly, and a significant part of the market is

[69] WS Comanor, 'The Two Economics of Vertical Restraints' [1992] 21 *Sw U L Rev* 1265, 1276-1281; WS Comanor, 'Leegin and Its Progeny: Implications for Internet Commerce' [2013] 58 *Antitrust Bull* 107.

[70] See in this regard A MacKay and DA Smith, 'The Empirical Effects of Minimum Resale Price Maintenance' (Kilts Booth Marketing Series, Paper No 1-009, 16 June 2014), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2513533&download=yes.

[71] For a criticism of an earlier draft of the article by MacKay and Smith, see T Lambert and M Sykuta, 'Why the New Evidence on Minimum Resale Price Maintenance Does Not Justify a Per Se or "Quick Look" Approach' (November 2013) *CPI Antitrust Chronicle*, who dismiss the study as 'flawed'.

covered by RPM agreements. Second, by eliminating intra-brand price competition, RPM may also facilitate collusion between the buyers, that is, at the distribution level. Strong or well organised distributors may be able to force or convince one or more suppliers to fix their resale price above the competitive level and thereby help them to reach or stabilise a collusive equilibrium. The resulting loss of price competition seems especially problematic when the RPM is inspired by the buyers, whose collective horizontal interests can be expected to work out negatively for consumers.

The theoretical foundations of the cartel objection to RPM, however, are undermined by empirical evidence. Based on the examination of all reported RPM cases brought by the US Department of Justice and the Federal Trade Commission,[72] Ornstein draws a number of important conclusions regarding the interplay between vertical price fixing and horizontal collusion:

> the majority of RPM cases do not involve a cartel; the vast majority of cartel cases do not involve RPM; manufacturer-RPM cartels are far more likely than retailer- or wholesaler-RPM cartels; products requiring RPM protection from free riding on special services are rarely cartelized; and retailer cartels with RPM are unlikely without legal restrictions on entry and legal RPM programs.[73]

In a study published a few years later, Ippolito observes that only 13.1 percent of all RPM cases brought before federal and state courts between 1976 and 1982, either by the government or by private plaintiffs, also involved horizontal price fixing allegations.[74] In light of this evidence, Ippolito notes that 'noncollusive uses of RPM are far more common than collusive uses'.[75]

In any event, even assuming that the cartel objection is indeed plausible, it is nonetheless difficult to demonstrate the existence of a causal link, however subtle, between the vertical restraint and the loss in allocative efficiency, which would justify the application of Article 101(1) without an inquiry into the market context in which the agreement is implemented. There is, furthermore, no indication that the deterrent effect of

[72] SI Ornstein, 'Resale Price Maintenance and Cartels' [1985] 30 *Antitrust Bull* 401.
[73] Ibid, 425.
[74] PM Ippolito, 'Resale Price Maintenance: Empirical Evidence from Litigation' [1991] 34 *JL & Econ* 263, 281-282.
[75] Ibid, 282.

the public policy towards cartels in the EU would be in any way weakened were the Commission to relax its rigid approach to RPM.

6.4.3. RPM as an Exclusionary Mechanism

In addition to the horizontal collusion theory, it has been demonstrated that, on certain occasions, retail price floors may result in the exclusion of rivals either in the upstream or in the downstream market. Nevertheless, for analytical purposes it is important that a clear distinction is drawn between manufacturer and dealer foreclosure brought about by RPM.

It has been argued that, in the upstream market, price floors may serve as a rent-sharing mechanism, designed to reduce retailers' incentives to accommodate new entry.[76] In that case, however, the foreclosure theory is subject to a very restrictive qualification: essentially, it is credible only in the presence of a monopolist manufacturer. The level of rents available to retailers is inversely related to the number of manufacturers and, accordingly, retailers will be less interested in sustaining the status quo in the upstream market the greater that number is. It follows that no safe policy implications can be based on the manufacturer foreclosure theory, for the simple reason that the application of Article 101(1) to a relevant case should be primarily contingent upon a concrete market power inquiry and not on abstract theoretical speculations. Additionally, the relevant economic theories undermine the European Commission's rationale, according to which exclusion is a potential outcome of RPM implemented by 'a manufacturer with market power':[77] the likelihood of foreclosure diminishes as the structure of the relevant market moves away from the model of pure monopoly, and the requirement for the existence of market power in general appears to be theoretically unfounded and over-inclusive.

On the other hand, the retailer foreclosure theory is much more problematic in practice. This is because retailer foreclosure is consistent both with the welfare-enhancing and with the anti-competitive theories of RPM. For example, Telser's free rider justification obviously entails that retailers unable to contribute to the promotion of a given manufacturer's products will be necessarily left out of the distribution network. The special services argument necessarily implies exclusion, and full-service, full-price retailers are as

[76] See I Paldor, 'RPM as An Exclusionary Practice' [2010] 55 *Antitrust Bull* 309; J Asker and H Bar-Isaac, 'Raising Retailers' Profits: On Vertical Practices and the Exclusion of Rivals' [2014] 104 *Am Econ Rev* 672.
[77] Vertical Guidelines, para 224.

interested in combating free riding as the manufacturer itself. In other words, the mere fact that a price-cutter has been terminated at the behest of its rivals in no way suggests the existence of collusion in the downstream market, as lawful cooperation between retailers may be indistinguishable from anti-competitive coordination that would justify antitrust intervention. Professor Liebeler observes that '[t]he desire of the dealers to increase the efficiency of their distribution system will be manifested by behavior that will be in every respect identical to the behavior of dealers who desire to reduce competition among themselves in order to create or reinforce a dealer cartel'.[78]

The same logic applies to RPM in the e-marketplace. According to the Vertical Guidelines, 'RPM may reduce dynamism and innovation at the distribution level. By preventing price competition between different distributors, RPM may prevent more efficient retailers from entering the market or acquiring sufficient scale with low prices'.[79] By restricting the ability of cost-effective outlets or distribution formats to pass on any cost advantages to end users in the form of lower retail prices, the purpose and effect of RPM is essentially to exclude Internet-only retailers from the distribution network. It is unclear, however, why the indirect exclusion of pure-play online retailers is more harmful to competition than their direct exclusion in the context of a selective distribution system: in addressing the manufacturer's need to guarantee that its selective distribution system will not be compromised by the activities of online free riders, the Commission recognises the former's right to require the online outlet to comply with certain quality standards, or even to prevent retailers who are not simultaneously active in conventional brick-and-mortar commerce from carrying its products.[80]

If seen through the lens of the free rider rationale, this exception, in combination with the manufacturer's ability to restrict sales by its selective distributors to unauthorised dealers,[81] is designed to ensure the effective operation of a watertight selective distribution network, a result which may be equally attained by means of RPM. In other words, insofar as the provision of pre-sales services is required for the effective promotion of the product in question, the exclusion of online-only outlets, whether effected by means of selectivity criteria or by RPM, constitutes an indirect means of right-channeling consumers towards the distribution format that best serves both their and the manufacturer's interests. It is important to note that the exclusion of pure play Internet retailers from a selective

[78] WJ Liebeler, 'Intrabrand "Cartels" under *GTE Sylvania*' [1982-1983] 20 *UCLA L Rev* 1, 25.
[79] Vertical Guidelines, para 224.
[80] Vertical Guidelines, para 54.
[81] Regulation 330/2010, Article 4(b)(iii).

distribution network is likely to assert the structural price rigidity of selective distribution and have an effect on prices similar to that of RPM: marketing research shows that the prices of multi-channel retailers tend to be higher than those of distributors operating exclusively in the e-marketplace.[82]

6.5. RPM under Article 101(1): The Contribution of New Institutional Economics

The preceding section analysed the public policy towards RPM on the basis of Odudu's view that the application of Article 101(1) may be triggered by a showing that the restraint at hand has the potential to bring about negative welfare consequences, in the form of a loss in allocative efficiency. Professor Lianos, however, offers an alternative explanation for the bifurcation of Article 101.[83] On the basis of new institutional economics, he asserts that the antitrust intervention is contingent upon the organisational setting in which the transaction takes place:

> If there is no reason for the parties to the transaction to adopt an organizational framework that will take the form of a hierarchy or a network (specific investments, reputation externalities, free riding) and the transaction takes place in the context of an impersonal or immediate exchange, as is the case in a spot market, Article [101 TFEU] will intervene and will eventually prohibit these restrictive practices. The latter would not be considered a defensive strategic bahavior designed to protect investments from appropriability, thus maintaining ex ante incentives to incur the necessary investment costs, but would instead constitute an offensive strategic behavior that may harm consumers.[84]

Accordingly, when determining the compatibility of a restrictive clause with Article 101(1), the enforcement agencies should consider not only its effect on allocative efficiency, but also the organisational framework in which the transaction takes place. In Lianos' view, restrictions necessary for the creation of a network form of organisation fall

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[82] X Pan, BT Ratchford and V Shankar, 'Price Dispersion on the Internet: A Review and Directions for Future Research' [2004] 18 *J Interact Mark* 116, 122-126.
[83] I Lianos, 'Commercial Agency Agreements, Vertical Restraints, and the Limits of Article 81(1) EC: Between Hierarchies and Networks' [2007] 3 *J Comp L & Econ* 625, 668-672.
[84] Ibid, 668-669.

outside the scope of the prohibition, insofar as they satisfy the proportionality requirement of the ancillary restraints doctrine.[85] It is only where the restraint at issue is found to be unnecessary or disproportional to the objectives sought, following an intuitive balancing test, that the application of Article will be triggered, and the arrangement will be subjected to a full-blown substantive assessment under Article 101(3).

While this argument is particularly strong in the case of franchising, the antitrust response to qualitative selective distribution is in reality much more complex and needs to be examined thoroughly. Professor Lianos asserts that the process of selecting the members of a qualitative selective distribution network 'may show the existence of a relational contract'.[86] However, selectivity criteria in and by themselves are in reality as consistent with relational contracting as with discrete market transactions, both from a legal and from an economic perspective. In order to represent genuine relational norms, and not only abstract frameworks, selective distribution systems need to involve relationship-specific investments in assets owned by the parties.[87]

Additionally, while contract enforcement under the classical and neoclassical theories is entrusted on third parties (courts and arbiters, respectively),[88] relational contracts '*must* be self-enforcing: the value of the future relationship must be sufficiently large that neither party wishes to renege'.[89] In other words, the distinctive characteristic of relational contracts is their self-reliance in remedying 'consequential disturbances'. According to Telser, self-enforcing agreements are those which remain in force as long as each of the parties 'believes himself to be better off by continuing the agreement than he would be by ending it'. If one party acts in breach of its contractual obligations, the only recourse available to the other party is to terminate the contract; dispute resolution is not entrusted to third parties:[90]

> A party to a self-enforcing agreement calculates whether his gain from violating the agreement is greater or less than the loss of future net benefits that he would incur as a result of detection of his violation and the consequent termination of the agreement by the other party. If the violator gains more than he loses from the

[85] Ibid, 670.
[86] I Lianos, *supra* n 83, 661.
[87] C Ménard, 'Maladaptation of Regulation to Hybrid Organizational Forms' [1999] 18 *Int'l Rev L & Econ* 403 410; C Ménard, 'The Economics of Hybrid Organizations' [2004] 160 *J Inst Theor Econ* 345, 354-357.
[88] OE Williamson, 'Comparative Economic Organization: The Analysis of Discrete Structural Alternatives' [1991] 36 *Admin Sci Quart* 269, 272.
[89] G Baker, R Gibbons and KJ Murphy, 'Relational Contracts and the Theory of the Firm' [2002] 117 *QJ Econ* 39, 40 (emphasis added).
[90] LG Telser, 'A Theory of Self-Enforcing Agreements' [1980] 53 *J Bus* 27.

> violation, then he will violate the agreement. Hence both parties continue to adhere to an agreement if and only if each gains more from adherence to, than from violations of, its terms.[91]

Nevertheless, a system of 'unqualified' selective distribution, does not address either of these issues. In the absence of relationship-specific investments, the qualitative criteria merely represent a general framework, which essentially does not go beyond an agreement on shelf space. At the same time, they are entirely ineffective in the absence of a self-enforcing mechanism: in case of 'consequential disturbances' the partners will have to rely on third parties (courts or arbitration) for the resolution of their disputes. In other words, the antitrust concept of selective distribution is in principle vulnerable to such 'consequential disturbances' and thus fully consistent with traditional contract law theory. This description, however, does not correspond to a hybrid within the meaning of new institutional economics; instead, it represents a plain, autonomous market form of organisation, both from a legal and from an economic perspective.

By assumption, a distribution outlet has already been established prior to the conclusion of the selective distribution agreement. The retailer, in other words, has already undertaken investments which, by definition, are not transaction-specific, since they have preceded its selection by the manufacturer.[92] In reality, it is on the basis of these non-idiosyncratic investments that the retailer is chosen to be part of the distribution network. Any required investments that are specific to a given transaction, and which would be more consistent with relational norms, are considered as quantitative. In the *Grundig* case, for example, the Commission found that clauses by virtue of which admission to the network was restricted to dealers prepared to make specific commitments in terms of sales effort and provide particular services went beyond 'general technical and professional criteria' and were thus found to fall within the scope of the prohibition.[93]

The selection criteria which typically fall outside the scope of Article 101(1) are related to 'the technical qualifications of the reseller and his staff and the suitability of his

[91] Ibid, 28.
[92] See HN Butler and BD Baysinger. 'Vertical Restraints of Trade as Contractual Integration: A Synthesis of Relational Contracting Theory, Transaction-Cost Economics, and Organization Theory' [1983] 32 Emory LJ 1009, 1083 ('Because in the typical distribution contract the retail dealer is already established, the retailer's investment should not be characterized as idiosyncratic. Since the retailer's obligation does require some investments that are transaction-specific to the manufacturer (e.g., floor plans and local advertising), the investment should be characterized as mixed'). As has been noted, however, requirements for transaction-specific investments are typically described as quantitative and are caught by Article 101(1).
[93] [1985] OJ L233/1.

trading premises'.[94] The fact that selective distributors are not restricted in the ability to sell competing brands[95] makes it all the more likely that the investments which are conditions for their admission to the distribution system will not be transaction-specific. Simply put, a reseller would be the same as technically qualified if it had not stocked the new high-definition television set by Manufacturer A, and its premises would be the same as suitable even in the absence of an agreement for the distribution of luxury perfume B: the investments that made the outlet eligible have already been made. Idiosyncratic investments are instead typically associated with the provision of product-specific promotional services, such as local advertising, additional training of personnel in line with the product's specific features, or the design and implementation of a distribution 'quick response' system which will minimise the inventory that the retailer needs to have in stock, while at the same time limiting the possibility of stock-outs.[96] These investments, however, do not generally fall within the selective criteria which are exempted from Article 101(1).

In the context of selective distribution systems, such investments in physical and human assets are likely to be lower than those undertaken by franchisees. However, since they typically represent sunk costs which cannot be used for other activities – exactly because they are highly idiosyncratic – they may still give rise to *ex post* opportunistic behaviour and generate externalities.[97] Typical observable components designed as contractual safeguards, such as sales targets, are likely to be identified as quantitative criteria, and, as such, they will fall within the scope of the prohibition, but may be covered by the Vertical Block Exemption Regulation or benefit from an individual exemption under Article 101(3). However, such observable components are of limited significance if the retailer lacks the incentive to sustain the commercial relationship. On the other hand, specific incentive mechanisms, such as a guaranteed profit margin, which can create a quasi-rent stream, intended to enhance the agreement's self-enforcing range will almost certainly be condemned under the EU competition rules.

Or probably not: let us for a moment consider the applicability of the ancillary restraints defence to absolute territorial protection provided in order to facilitate new entry. This represents a typical relational contract, and the distributor's obligation to undertake

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[94] Case 27/76, *Metro I*, para 20.

[95] In fact, Article 5(1)(c) of the Regulation 330/2010 provides that 'any direct or indirect obligation causing the members of a selective distribution system not to sell the brands of particular competing suppliers' is excluded from the benefit of the block exemption.

[96] BA Weitz and SD Jap, 'Relationship Marketing and Distribution Channels' [1995] 23 *J Acad Market Sci* 305, 312.

[97] C Ménard, 'The Economics of Hybrid Organizations', *supra* n 87, 364.

sunk investments may very well be undermined by opportunistic behaviour. The distributor has few incentives to incur the necessary sunk costs in the absence of the guarantee that it will not be undercut by exclusive distributors established in other territories. Export bans will confer upon it the status of a territorial brand monopolist thus taking the form of a credible commitment: absolute territorial protection in this case will eliminate competing retailers' ability to appropriate part of the returns generated by the favoured distributor's promotional activities. Consequently the latter will accrue all the quasi-rents associated with the sale of the contract goods.

Price floors, along with all other vertical restraints, can be employed with the purpose of economising on transaction costs, in this case the cost of monitoring. In that sense, RPM is not exactly an alternative to selectivity criteria: shirking, free riding, *ex post* opportunism, types of behaviour that Oliver Williamson generally identifies as 'subgoal pursuit', namely 'efforts to promote local or individual goals to the possible detriment of global or system objectives',[98] are as likely to occur in the context of a qualitative selective distribution system as in open distribution. Selectivity clauses aside, it is still unclear why an approved distributor would have the incentive to engage in promotional activities of any kind with regard to a specific manufacturer's products, in the absence of an *ex ante* incentive alignment mechanism. The selection of trading partners does facilitate monitoring by reducing the relevant transaction costs, but in itself is not sufficient to constrain opportunism. Every time members of a selective distribution network complain to the manufacturer about an approved dealer's price cutting behaviour, enforcement agencies automatically assume that anti-competitive RPM is involved, designed to prevent selected distributors from taking advantage of possible cost efficiencies. However, nobody questions exactly how a retailer which forms part of a homogenous network of outlets with similar cost structures achieved that cost-effectiveness. *Ex post* opportunistic behaviour consisting in shirking on the required promotional activities could potentially provide a reasonable explanation.

It follows from the foregoing analysis that understanding of selective distribution as a less restrictive alternative to RPM for the provision of the necessary promotional services is based on a series of assumptions of questionable validity: approved dealers do not shirk; they invariably have the incentive to undertake relationship-specific investments; free riding *within* the selective distribution network never occurs; and, more importantly, the

[98] OE Williamson, 'Assessing Vertical Market Restrictions: Antitrust Ramifications of the Transaction Cost Approach' [1978-1979] 127 *U Pa L Rev* 953, 955, fn 13.

transaction costs incurred by the manufacturer for the monitoring of dealer compliance are trivial. The truth however is that the general selectivity criteria which are exempted from the application of Article 101(1) do not specifically address any of these issues.

This argument is intuitive: selectivity criteria are designed to restrict distribution of a given product only by authorised dealers. Post-contractual opportunistic behaviour, however, by definition is conceivable only if committed by the parties to the transaction, not by outsiders. 'Unqualified' selective distribution does not adequately address this problem and thus remains susceptible to opportunism.

Thus vertical price fixing and selective distribution – as defined under Article 101 TFEU – are not perfect substitutes and, accordingly, the idea that either of them may be a less restrictive alternative misses the point. Selectivity clauses provide the framework; a guaranteed retail profit margin voluntarily implemented by the manufacturer may serve as an *ex ante* incentive alignment mechanism. Under certain circumstances, therefore, RPM and selective distribution are complementary, not alternative restraints. In the words of Oliver Williamson, RPM, like all types of vertical restraints, has 'the purpose and effects of infusing order into a transaction where the interests of the system and the interests of the parts are otherwise in conflict'.[99] Against this background, Williamson takes the view that the use of vertical restraints to effect credible commitments is warranted 'in circumstances where market power is small, where simple market exchange ... would compromise the integrity of differentiated products, and where forward integration into distribution ... would be especially costly'.[100]

The fact that selectivity clauses alone are neither sufficient to eliminate opportunism nor able to serve as incentive alignment mechanisms is reflected in the German law concept of *lückenlösigkeit*, or 'imperviousness' of a selective distribution system. Under German legislation on unfair competition, actions for an injunction or damages can be brought against unauthorised third parties which, nevertheless, sell products distributed through a selective distribution network. The imperviousness doctrine, which is a constituent element of selective distribution under German law, is premised on the idea that unauthorised dealers can obtain the goods concerned only by participating in a breach by an admitted distributor of its contractual obligations.[101] The practical implication

[99] OE Williamson, 'Transaction Cost Economics' in C Ménard and M Shirley (eds), *Handbook of New Institutional Economics* (Springer 2005), p 55.
[100] Ibid.
[101] See, eg, Case C-376/92, *Metro-SB-Großmärkte GmbH v Cartier* [1994] ECR I-15, paras 20-21; Case C-41/96, *VAG-Händlerbeirat eV v SYD-Consult* [1997] ECR I-3123.

of ‘imperviousness’ is that it constitutes proof by the manufacturer that it is taking steps to enforce the system by taking action against such of his partners as are in breach of contract or against third parties who obtain the goods from dealers in breach of their contractual obligations.

In addition to being compelling from an economic standpoint, Lianos’ insight also enjoys robust jurisprudential support, as has already been shown in Chapter 4.[102] But under this interpretation, and in light of the preceding analysis, the outright prohibition of invariably all RPM schemes under Article 101(1) appears to be even less convincing. As has already been argued, price floors may be employed in the context of a long-term commercial relationship as a substitute, albeit imperfect, for full vertical integration. The main pro-competitive justifications for RPM concentrate on its contribution to the internalisation of vertical and horizontal externalities, the solution to the problem of double moral hazard or the assumption of specific investments for the penetration of a new market or the provision of demand-stimulating promotional services, even in the absence of specific free rider concerns. It is important to understand, however, that vertical price fixing and selective distribution do not constitute interchangeable restrictive practices for the establishment of a ‘network’, as understood in the context of new institutional economics. Even though both forms of restricted dealing are premised on the understanding that price competition is curtailed where demand for the products in question is contingent upon competition with respect to the supplied pre-sales services, they nonetheless do not serve the same purposes.

The preceding analysis built on Lianos’ insight and the pro-competitive theories of the practice in order to demonstrate that a *conclusive* presumption against RPM under Article 101(1) is mistaken. The first paragraph of the bifurcated Article 101 provides the right framework for the appraisal of price floors. However, in view of the increased potential of RPM to bring about a loss in allocative efficiency, the antitrust response should remain cautious: it is submitted here, therefore, that the conclusive presumption of illegality should be replaced by a presumption which can be rebutted insofar as the parties

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[102] On the issue of jurisprudential support, see, however, Case C-209/07, Opinion of AG Trstenjak, *supra* n 17, paras 56-57. According to the AG:

> *different aspects* of consumer welfare are taken into account under Article [101(1) TFEU] and under Article [101(3) TFEU]. Under Article [101(1) TFEU], agreements which restrict competition between market participants and thus its function of supplying consumers optimally with a product at the lowest possible price or with innovative products are prohibited in principle. Such agreements directly affect consumer welfare and as such are prohibited in principle. Nevertheless, Article [101(3) TFEU] recognises that agreements which restrict competition between market participants result in particular in a reduction in production costs, and the reduction in production costs can contribute indirectly to consumer welfare. (emphasis in original, citations omitted).

demonstrate convincingly that – to quote Professor Lianos – the price floors were implemented as 'a defensive strategic bahavior designed to protect investments from appropriability, thus maintaining *ex ante* incentives to incur the necessary investment costs'.[103] Once the presumption of anti-competitive object has been rebutted, the Commission, court or national competition authority may subject the RPM scheme at issue to the intuitive proportionality test of Article 101(1), and proceed to a full-blown monetised analysis of its effects under Article 101(3) only if the restraint has failed to qualify as 'ancillary'. Section 6.7 below will discuss whether EU competition law allows for the possibility of a presumption of anti-competitive object to be rebutted.

6.6. RPM as a Hardcore Restraint – Article 101(3) TFEU

As has already been explained, the notion of 'hardcore' restraints may be understood only in the context of Article 101(3) and the Block Exemptions Regulations. The mere fact that an agreement is found to violate Article 101(1) does not necessarily entail an automatic declaration of illegality. Article 101(3) declares the prohibition inapplicable to agreements which, despite falling within the scope of Article 101(1), fulfil all four requirements laid down in that paragraph. In order to benefit from the exemption, a restrictive agreement must, therefore, contribute to the improvement of the production or distribution of the goods concerned, while any resulting benefits must be passed on to consumers (positive conditions). Furthermore, the imposed restraints must neither go beyond what is necessary for the attainment of any efficiencies, nor result in a substantial elimination of competition (negative conditions).

In what could be described as the most notable difference between the two jurisdictions, at least with regard to the treatment of collusive agreements, EU competition law does not recognise the American concept of 'per se' illegal restraints. Instead, under Article 101 even the parties to an agreement that has as its object the restriction of competition are entitled to this second line of defence. The General Court in *Matra Hachette* held that 'in principle, no anti-competitive practice can exist which, whatever the

[103] See *supra* n 84, and accompanying text.

extent of its effects on a given market, cannot be exempted, provided that all the conditions laid down in Article [101](3) of the Treaty are satisfied'.[104] The Commission, in its 101(3) Guidelines, endorses this principle, but further acknowledges that severe restrictions are unlikely to fulfil the four requirements.[105]

Odudu maintains that exemptions under Article 101(3) are conditional upon a 'productive efficiency enquiry'.[106] Productive efficiency is achieved when the cost incurred for the production of a particular good or service is the lowest possible. Producers in perfectly competitive markets have an incentive to reduce their cost to the minimum in order to reap greater profits and, ultimately, in order to ensure their survival in the first place. Consequently, the optimal combination of resources will result in the maximisation of output.[107] Hovenkamp observes that '[m]any acts that arguably violate the antitrust laws are mechanisms by which firms increase their productive efficiencies. These include mergers, vertical integration, exclusive dealing or tying arrangements and even certain agreements among competitors'.[108]

The productive efficiency test as a condition for exemption is clearly the subject matter of the first requirement laid down in Article 101(3), namely that the agreement in question 'contributes to improving the production or distribution of goods or to promoting technical or economic progress'. The term 'productive efficiency' does not appear in the Commission's 101(3) Guidelines. Instead, the Commission refers to 'objective' efficiency gains, which 'stem from an integration of economic activities whereby undertakings combine their assets to achieve what they could not achieve as efficiently on their own or whereby they entrust another undertaking with tasks that can be performed more efficiently by that other undertaking'.[109] The Guidelines further draw a distinction between cost efficiencies and efficiencies of a qualitative nature; the latter category concerns technical and technological advances in the form of new or improved products, which would have been impossible had it not been for the restrictive agreement.[110] It is apparent that, in the

[104] Case T-17/93, *Matra Hachette SA v Commission* [1994] ECR II-595, para 85.
[105] 101(3) Guidelines, para 46.
[106] O Odudu, *supra* n 27, ch 6.
[107] S Bishop and M Walker, *supra* n 28, p 25; RJ Van den Bergh and PD Camesasca, *European Competition Law and Economics: A Comparative Perspective* (2nd edn, Sweet & Maxwell 2006), pp 29-30.
[108] H Hovenkamp, *Federal Antitrust Policy: The Law of Competition and its Practice* (3rd edn, Thomson/West 2005), p 75.
[109] 101(3) Guidelines, para 60.
[110] Ibid, paras 64-72.

context of the 101(3) Guidelines, the term 'qualitative efficiencies' is used by the Commission as equivalent to the concept of dynamic efficiency.[111]

Article 4 of Regulation 330/2010 excludes hardcore restraints from the benefit of the block exemption. This, according to the 2010 Vertical Guidelines, merely constitutes a presumption that an agreement containing any of the excluded clauses is unlikely to fulfil the conditions of Article 101(3).[112] This presumption is, however, rebuttable: the parties are given the opportunity to demonstrate possible efficiency-enhancing effects in the context of an individual assessment.[113] The Vertical Guidelines not only mention the possibility of pleading an efficiency defence in RPM cases, but further provide a list of examples of efficiency gains which could potentially satisfy the requirements of Article 101(3).[114] However, one cannot fail to notice that the methodology for the substantive assessment of hardcore restraints, as outlined in the Vertical Guidelines, is at least unorthodox:

> In case the undertakings substantiate that likely efficiencies result from including the hardcore restriction in the agreement and that in general all the conditions of Article 101(3) are fulfilled, this will require the Commission to effectively assess the likely negative impact on competition before making the ultimate assessment of whether the conditions of Article 101(3) are fulfilled.[115]

The Guidelines thus essentially suggest that the parties to an agreement containing a black-listed clause are required to demonstrate any efficiency gains before the Commission has confirmed whether the agreement is even likely to cause any competitive harm.

At the same time, the hurdle facing the parties seems insurmountable: it is doubtful whether the presumption against hardcore restraints – and RPM in particular – under

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[111] P Lugard and L Hancher, 'Honey, I Shrunk the Article! A Critical Assessment of the Commission's Notice on Article 81(3) of the EC Treaty' [2004] 25 *ECLR* 410, fn 51 and accompanying text. Odudu examines the dynamic effects of innovation and technological progress as a source of productive efficiency, although he recognises that these two types of efficiencies are rather distinct from each other; O Odudu, *supra* n 27, p 132, fn 30 and accompanying text.

[112] 2010 Vertical Guidelines, para 47. Compare Recital 5 of Regulation 330/2010, according to which the benefit of the BER is 'limited to vertical agreements for which it can be assumed with sufficient certainty that they satisfy the conditions of Article 101(3) of the Treaty'.

[113] 2010 Vertical Guidelines, para 47. In its 101(3) Guidelines (para 46), however, the Commission takes the position that hardcore restraints in general are presumed to fail at least the first two conditions for exemption and to be unsuccessful in satisfying the indispensability test.

[114] 2010 Vertical Guidelines, paras 223 and 225.

[115] Ibid, para 47.

Article 101(3) can be rebutted in practice.[116] Even if the undertakings manage to substantiate the efficiency-enhancing effects of a vertical price fixing scheme, it is still very likely that they will stumble upon the indispensability criterion. The Commission, in para 79 of the 101(3) Guidelines, indeed envisages that black-listed clauses will normally fail the indispensability test. It has been argued accordingly that the application of Article 101(3) to RPM agreements may be decisively undermined by a mere showing that any claimed efficiency gains may be achieved through other, less restrictive – but also less efficient – means.[117] The main implication of this quasi-conclusive presumption is that it virtually precludes a substantive assessment of the welfare effects of RPM under Article 101 in its entirety, making any relevant allegations purely speculative.

6.7. Recommendations for a Workable Analytical Framework

6.7.1. Rebuttable Presumptions and 'By-Object' Restrictions: The Case of RPM after *Cartes Bancaires*

The recent judgment of the CJEU in *Cartes Bancaires*[118] has been particularly enlightening in clarifying the notion of 'by-object' restrictions of competition within the meaning of Article 101(1). In favouring the strict interpretation of the concept, the Court of Justice took the position that the relevant conclusive presumption of anti-competitiveness is applicable only to restraints having *prima facie* adverse effects on the price, quantity and quality of the goods and services concerned. These forms of collusive behaviour essentially represent a well-defined class of restrictive agreements which reveal a sufficient degree of harm to the proper functioning of normal competition. In the Court's view, these types of coordination may be regarded as being 'by their very nature' restrictive of

[116] See A Jones, 'Resale Price Maintenance: A Debate about Competition Policy in Europe?' [2009] 5 *Eur Competition J* 479, 501, arguing that the current EU approach to RPM is more permissive than the US concept of per se illegality only in theory.
[117] On the issue of indispensability of RPM clauses, see M Velez, 'The Tenuous Evolution of Resale Price Maintenance' [2011] 32 *ECLR* 297, 299-300.
[118] Case C-67/13P, *Groupement des cartes bancaires (CB) v Commission*, not yet reported.

competition, in which case examination of their actual effects may be considered redundant.[119]

In other words, *Cartes Bancaires* stands for the proposition that classification as restrictions of competition by object should be reserved only for specific types of collusive behaviour the effects of which on consumer welfare are so likely to be detrimental, that demonstration of any actual anti-competitive impact is redundant.[120] Restraints so plainly anti-competitive that are lacking any credible efficiency-enhancing potential are commonly referred to as 'naked'. Hovenkamp defines naked restraints as those which are 'formed with the objectively intended purpose or likely effect of increasing price or decreasing output in the short run, with output measured by quantity or quality'.[121] Such restraints are meaningful only where the parties' aggregate market power allows them to affect industry-wide output and price,[122] and are presumed to reveal the 'sufficient degree of harm' required for the finding of a restriction of competition by object.

The term 'naked restraints' is not encountered under EU competition law, whether in the Commission's 101(3) Guidelines or in the European Courts' judicial practice. That said, it is clearly analogous to the General Court's conception of '*obvious* restrictions of competition such as price-fixing, market-sharing or the control of outlets'.[123] Echoing a relevant understanding of by-object restraints as facially anti-competitive practices, Advocate General Wahl took the position that '[o]nly conduct whose harmful nature is proven and *easily identifiable*, in the light of experience and economics, should … be regarded as a restriction of competition by object'.[124] It is only with regard to this type of conduct, in the Advocate General's view, that the formalist orthodox approach is appropriate, and not in the case of agreements the effects of which are ambivalent or ancillary for the attainment of a legitimate business purpose.[125] Ostensibly, therefore, the

[119] Ibid, paras 49-51.
[120] Ibid, para 51.
[121] H Hovenkamp, *Federal Antitrust Policy: The Law of Competition and Its Practice* (4th edn, West 2011), p 212. It has thus been suggested that, in per se cases, 'the economic concept of market power remains central even when no formal proof of market power is required to establish a technical violation'; ABA Section of Antitrust Law, *Market Power Handbook: Competition Law and Economic Foundations* (2nd edn, American Bar Association 2012) pp 14-15.
[122] H Hovenkamp, *supra* n 121, p 212.
[123] Joined Cases T-374/94, T-375/94, T-384/94 and T-388/94, *European Night Services Ltd and Others v Commission* [1998] ECR II-1533, para 136 (emphasis added).
[124] Case C-67/13P, *Groupement des cartes bancaires (CB) v Commission*, not yet reported, Opinion of AG Wahl, para 56 (emphasis added). See also P Ibanez Colomo, 'Market Failures, Transaction Costs and Article 101(1) TFEU Case Law' [2012] 37 *EL Rev* 541, 549.
[125] Case C-67/13P, Opinion of AG Wahl, *supra* n 124, paras 55-56.

Court re-affirmed the orthodox view, and conceded that a presumption of necessary effect is intrinsically associated with the notion of object.

On various occasions, however, it is conceivable that the anti-competitive object of the agreement may not be as conspicuous as that of a naked horizontal price-fixing agreement. With that in mind, the Court has emphasised that, in order to determine whether the agreement under investigation has an anti-competitive object, account should be taken of factors that go beyond its mere terms, and may include an inquiry into the aims pursued by the agreement in light of the economic and legal context in which it operates.[126] In this regard, the Court has already conceded that the fact that an agreement pursues other legitimate objectives does not preclude a *prima facie* finding of restrictive object.[127] In *BIDS*, the CJEU stressed that any alleged objective justifications may be considered only in the context of a substantive assessment under Article 101(3).[128]

That said, the recent case law of the Court has established that it is open to the parties to a facially restrictive agreement to rebut the presumption of necessary effect by demonstrating that the restraint at hand is 'objectively justified'. In *Pierre Fabre*, endorsing Advocate General Mazák's point of view,[129] the Court acknowledged that the existence of an objective justification could prevent a *prima facie* finding of anti-competitive object.[130] Accordingly, in *Cartes Bancaires* the CJEU took the position that, in determining whether the restriction at issue reveals a sufficient degree of harm, account should be taken of any legitimate objectives allegedly sought by the parties. Although reiterating that the mere fact that the agreement pursues a legitimate objective does not preclude a finding of anti-competitive object, the Court stressed that the restrictive object must nonetheless be substantiated.[131]

This is not to say, however, that *Cartes Bancaires* is at odds with the Court's judicial precedent. According to the CJEU, the presumption of competitive harm generated

[126] Case C-551/03P, *General Motors BV v Commission* [2006] ECR I-3137, para 66.
[127] Ibid, para 64.
[128] Case C-209/07, *supra* n 17, para 21.
[129] Case C-439/09, *Pierre Fabre Dermo-Cosmétique SAS v Président de l'Autorité de la concurrence* [2011] ECR I-9419, Opinion of AG Mazák, para 35. More specifically, the Advocate General took the position that restraints justified on the grounds of the pursuit of a legitimate objective 'may fall outside the scope of Article [101(1) TFEU] provided the limitations imposed are appropriate in the light of the legitimate objective sought and do not go beyond what is necessary in accordance with the principle of proportionality'. In his view, however, the alleged legitimate objective must be of a public law nature, and thus unrelated to the business and marketing strategy of the undertakings concerned.
[130] Case C-439/09, *Pierre Fabre Dermo-Cosmétique SAS v Président de l'Autorité de la concurrence* [2011] ECR I-9419, para 39.
[131] Case C-67/13P, *supra* n 118, para 70.

by the relevant practices is supported by experience, defined by AG Wahl in his Opinion as 'what can traditionally be seen to follow from economic analysis, as confirmed by the competition authorities and supported, if necessary, by case-law'.[132] In a number of cases, however, judicial experience may be inadequate, or even non-existent. This comes as no surprise; in the volatile environment of everyday commercial transactions, '[n]o two restraints are identical, and no two restraints are imposed within identical marketplace contexts'.[133] Besides, experience is acquired inductively, and a presumption of competitive harm cannot be established in the abstract, but only following a reasonably thorough examination of an agreement's likely effects.[134]

The Court's ruling in *Cartes Bancaires* stands for the proposition that the validity of any legitimate objectives pursued by the measures at issue is to be examined as part of an inquiry into the economic and legal context in which the coordination takes place. It is thus submitted here that *Cartes Bancaires* favours the implementation of an abridged effects analysis whereby any alleged objective justifications are considered on an *ad hoc* basis, 'having regard, in particular, to the nature of the services at issue, as well as the real conditions of the functioning and structure of the markets'.[135] Where, following the relevant analysis, the fact-finder fails to demonstrate to the requisite legal standard that the measures at hand have an anti-competitive object an elaborate examination of their actual or potential effects in the marketplace is appropriate.[136] Advocate General Wahl, citing the Court's earlier judgments in *Pronuptia*[137] and *Gøttrup-Klim*,[138] takes the view that failure adequately to establish the object of an agreement entails that 'it will be necessary to examine the anticompetitive effects and, in this framework, to assess the *necessity* and the *proportionality* of the measures in question having regard to the objective pursued'.[139]

[132] Case C-67/13P, Opinion of AG Wahl, *supra* n 124, para 79.
[133] JW Markham, Jr, 'Sailing a Sea of Doubt: A Critique of the Rule of Reason in U.S. Antitrust Law' [2012] 17 *Fordham J Corp & Fin L* 591, 598.
[134] O Odudu, *The Boundaries of EC Competition Law: The Scope of Article 81* (Oxford University Press 2006), p 115.
[135] Case C-67/13P, *supra* n 118, para 78.
[136] Ibid, paras 80-82. Compare the General Court's observation in Case T-168/01, *GlaxoSmithKline Services Unlimited v Commission* [2006] ECR II-2969, para 119 ('that analysis, which may be abridged when the clauses of the agreement reveal in themselves the existence of an alteration of competition … must, on the other hand, be supplemented, depending on the requirements of the case, where that is not so').
[137] Case 161/84, *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 353.
[138] Case C-250/92, *Gøttrup-Klim ea Grovvareforeninger v Dansk Landbrugs Grovvareselskab AmbA* [1994] ECR I-5641.
[139] Case C-67/13P, Opinion of AG Wahl, *supra* n 124, para 125 (emphasis added).

6.7.2. Truncated or 'Quick-Look' Rule of Reason under Section 1 of the Sherman Act

A similar abridged analysis is also applied in the context of Section 1 of the Sherman Act. In *BMI*, the defendant associations had organised systems of non-exclusive rights for the issuance of blanket licences to copyrighted musical compositions.[140] These performance licences granted to the licensees the right to perform all of the compositions in the portfolio at fees negotiated by the associations, which would then be distributed among the members of each association on the basis of the frequency of the use of their music. Mr Justice White, delivering the opinion of the majority, rejected the literalist application of the antitrust laws to price fixing agreements, and noted that per se treatment should be reserved for those practices which are '"plainly anticompetitive" and very likely without "redeeming virtue"'.[141] In the Court's view, various types of cooperation among competitors, such as horizontal mergers or joint ventures, entail the restriction, or even elimination, of price competition. Nevertheless, they are not treated as per se illegal, and are frequently upheld, where they have the potential to bring about transactional efficiencies that demonstrably outweigh any competitive harm. The blanket licensing arrangement at issue fell within exactly that category: in light of the fact that it constituted 'an acceptable mechanism for at least a large part of the market for the performing rights to copyrighted musical compositions', a thorough substantive assessment under the rule of reason would be more appropriate than an automatic declaration of illegality.[142] In his dissenting opinion, Mr Justice Stevens did not object to the inapplicability of the per se standard to the arrangement at hand, but rather disagreed with the majority's decision to remand the case.[143] In his view, the blanket licence would flunk the rule of reason test because there were other, less restrictive marketing policies which could attain comparable results, such as the negotiation of music-performing rights on a per-composition or per-unit basis.[144]

In any event, both the majority and the dissenting opinions in *BMI* stand for the proposition that there is no bright line distinguishing per se illegality from the rule of reason standard, which form an analytical continuum employed for methodological purposes, given that 'easy labels do not always supply ready answers'.[145] This approach

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[140] *Broadcast Music, Inc, et al v Columbia Broadcasting System, Inc, et al*, 441 US 1 (1979).
[141] Ibid, 8-9.
[142] Ibid, 23-24. The per se rule is instead warranted where 'the practice facially appears to be one that always or almost always tend to restrict competition and decrease output'; ibid, 19-20.
[143] Ibid, 26.
[144] Ibid, 33.
[145] Ibid, 8.

was subsequently confirmed in *NCAA*[146] and *California Dental*.[147] In *NCAA*, in introducing the 'quick-look' or 'truncated' rule of reason analysis, the Supreme Court conceded that '[*p*]*er se* rules may require considerable inquiry into market conditions before the evidence justifies a presumption of anticompetitive conduct'.[148] The plan at issue limited the number of games that any one college football team was allowed to televise. Despite effectively constituting a restriction of output, the Court decided that the agreement was to be assessed under the rule of reason, in light of the fact that horizontal cooperation of a certain degree between members was necessary if the product was to be made available at all. The Court, however, refused to engage in a more thorough analysis consisting in a market power inquiry: '[a]s a matter of law, the absence of proof of market power does not justify a naked decision on price or output'.[149]

In *California Dental*, in requiring that a restriction on advertising imposed on the members of an association of dental societies be assessed on the basis of a fuller rule of reason analysis, the Supreme Court outlined the rationale behind the application of a more truncated analytical framework:

> there is generally no categorical line to be drawn between restraints that give rise to an intuitively obvious inference of anticompetitive effect and those that call for more detailed treatment. What is required, rather, is an enquiry meet for the case, looking to the circumstances, details, and logic of a restraint. The object is to see whether the experience of the market has been so clear, or necessarily will be, that a confident conclusion about the principal tendency of a restriction will follow from a quick (or at least quicker) look, in place of a more sedulous one.[150]

It follows that the quick-look rule of reason is appropriate where the arrangement at issue is *prima facie* detrimental to competition, but lack of adequate experience prevents the fact-finder from drawing safe inferences with regard to its lawfulness. It is therefore on the parties to plead an efficiency defence and, failure to substantiate any gains to the requisite legal standard will result in the agreement being condemned where it is found, on the basis of 'a rudimentary understanding of economics', to give rise to anti-competitive effects.[151] Thus, the application by Court of the quick-look approach in *California Dental* can be

[146] *National Collegiate Athletic Association v Board of Regents of the University of Oklahoma et al*, 468 US 85 (1984).
[147] *California Dental Association v FTC*, 526 US 756 (1999).
[148] 468 US 85, 104, fn 26 (emphasis in original).
[149] Ibid, 109.
[150] 526 US 756, 780-781.
[151] Ibid, 770.

interpreted as introducing a third, separate evidentiary rule rather than an abbreviated analysis merely intended to designate the combination at hand in the per se category or subject it to a full-blown rule of reason analysis.[152]

6.7.3. Recommendations for a Workable Analytical Framework in RPM Cases

The methodology favoured by the CJEU in *Cartes Bancaires* is more compatible with the 'hybrid approach' to 'by-object' restrictions described by King, which is the middle ground between the orthodox view of object as necessary effect and the more analytical approach applied in *Société Technique Minière,*[153] rather than the formalistic concept of an 'object box', as suggested by Professor Whish.[154] Besides, as Whish and Bailey themselves concede, the 'object box' may be an oversimplification, as its boundaries cannot be defined with sufficient precision.[155] Where the effects of the agreement at issue are ambivalent and the lack of adequate experience prevents a conclusive inference of harmful object, the Court favours an abridged effects analysis concentrating on the content of the agreement's provisions, the objectives pursued by it and the economic and legal context of which it forms a part. At this stage, in determining whether the agreement under examination restricts competition by object, the enforcement agencies – the European Commission, the national competition authorities and courts – should take into consideration any legitimate objectives put forward by the parties in an attempt to justify the restrictive clauses. Insofar as the fact-finder is convinced that the alleged objective justification is indeed plausible, a finding of anti-competitive object is automatically precluded. In such a case, the assessment of any actual or potential harmful consequences is only relevant to the effect requirement of Article 101(1).

While the case law of the European Courts discussed above exclusively concerned agreements between competitors, the issues raised are of a methodological nature and thus there is nothing to preclude the applicability of this hybrid approach to vertical restraints, and RPM in particular. The purpose of this thesis is by all means not to advocate the unequivocal legality of RPM under Article 101 TFEU. Judge Posner's argument that

[152] MA Lemley and CR Leslie, 'Categorical Analysis in Antitrust Jurisprudence' [2007-2008] 93 *Iowa L Rev* 1207, 1215-1216; DA Crane, 'Rules Versus Standards in Antitrust Adjudication' [2007] 64 *Wash & Lee L Rev* 49, 61.

[153] S King, 'The Object Box: Law, Policy or Myth?' [2011] 7 *Eur Competition J* 269, 288-291

[154] See, eg, R Whish and D Bailey, *Competition Law* (7th edn, Oxford University Press 2012), p 124.

[155] Ibid.

purely vertical restraints should be per se *legal* is rather unwarranted.[156] Striking a balance between two opposing conclusive presumptions is indeed the greatest challenge facing the lower courts post-*Leegin*: as Posner himself had admitted in an earlier article, in practice the rule of reason 'is little more than a euphemism for nonliability'.[157] But for all the pro-competitive justifications, the effects of RPM remain ambivalent and require a thorough case-by-case analysis.

The first step towards the erosion of the Commission's formalism would be the formal distinction between individual and collective RPM. Only the latter should be subjected to a conclusive presumption of illegality under Article 101(1). This would be consistent with the horizontal theories of harm associated with RPM schemes implemented by multiple competing manufacturers in concentrated markets,[158] or at the behest of a number of retailers collectively possessing substantial monopsony power.[159] Even though few relevant cases have been reported,[160] there are credible reasons to believe that associations of undertakings, which frequently bring together firms operating at different stages of the production and distribution chain, may operate as a vehicle for the collective enforcement of RPM policies with the purpose of facilitating collusion between their members.

As far as individual RPM is concerned, the approach taken by the CJEU to 'by-object' restrictions is clearly at odds with the Commission's hesitation even to imply the possibility of an effects-based treatment of vertical price fixing, despite the fact that, as was seen in Chapter 1 above, the current analytical framework defined by the 2010 Vertical Guidelines has been largely influenced by welfare economics, having reduced the contribution of non-economic, integrationist objectives to our understanding of the public policy towards vertical restraints in the EU. In a move that was in sharp contrast with established case law, the Commission, in its recent Vertical Guidelines, conceded that

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[156] RA Posner, 'The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality' [1981] 48 *U Chi L Rev* 6.

[157] RA Posner, 'The Rule of Reason and the Economic Approach: Reflections on the *Sylvania* Decision' [1977-1978] 45 *U Chi L Rev* 1, 14. For a confirmation of Judge Posner's assertion on the basis of empirical data from the first decade of the 21st century, see MA Carrier, 'The Rule of Reason: An Empirical Update for the 21st Century' [2008-2009] 16 *Geo Mason L Rev* 827.

[158] See B Jullien and P Rey, 'Resale Price Maintenance and Collusion' [2007] 38 *Rand J Econ* 983; P Rey and T Vergé, 'Resale Price Maintenance and Interlocking Relationships' [2010] 58 *J Ind Econ* 928.

[159] See WS Comanor, 'The Two Economics of Vertical Restraints' [1992] 21 *Sw U L Rev* 1265.

[160] *ASPA* [1970] OJ L148/9; *VBBB/VBVB* [1982] OJ L54/36; *Publishers' Association – Net Book Agreements* [1989] OJ L22/12.

export bans may escape the application of Article 101(1) where they are designed to facilitate new entry.[161]

Although the outright removal of individual RPM from the 'object box' would probably not be advisable, as the anti-competitive potential of price floors necessitates a more cautious approach, a sound antitrust policy should at the very least provide parties to a vertical price fixing agreement with the opportunity to rebut the existing presumption of necessary effect. This presumption, associated with the classification of RPM as a restriction of competition by object, could be rebutted by a showing that the contested clause was 'objectively justified' by the manufacturer's need to maximise control over distribution in cases of long-term contractual relationships, where horizontal externalities and moral hazard are likely to arise. Such an approach would be fully consistent with the CJEU's recent judgement in *Cartes Bancaires*:

> The concept of restriction of competition 'by object' can be applied only to certain types of coordination between undertakings which reveal a sufficient degree of harm to competition that it may be found that there is no need to examine their effects, otherwise the Commission would be exempted from the obligation to prove the actual effects on the market of agreements which are in no way established to be, by their very nature, harmful to the proper functioning of normal competition.[162]

Following the successful showing of the existence of an objective justification, the Commission or national competition authority can proceed to a full-blown effects analysis. In the context of this analysis, the fact-finder will have to take into account factors such as the source of the restraint, the market power of the undertakings involved, and the levels of concentration in the affected market. In addition to these structural considerations, which may reveal a tendency towards horizontal collusion, the Commission should also investigate the nature of the products concerned and any free rider concerns arising in the industry. It is important at this point to stress the relevance of intertype competition. If online retailing is found to provide a credible alternative distribution format, having regard to the nature of the goods concerned, and given that Internet shoppers are more likely to be infra-marginal consumers who are sufficiently familiar with the specific attributes of a

[161] Vertical Guidelines, paras 60-61. See *supra* 5.4.3.
[162] Case C-67/13P, *Groupement des cartes bancaires (CB) v Commission*, not yet published, para 58.

given product and thus place little or no value to any promotional services, it is possible that the net effect of the price floors will be anti-competitive.[163]

It can generally be assumed that the case will be stronger for RPM agreements of limited duration imposed during the introductory period of expanding demand, since the sunk investments undertaken by distributors at that stage are expected to be higher, along with the need for a 'defensive mechanism'. Also, consumer valuation of promotional services tends to decrease with the passage of time, as they are becoming for familiar with the specific attributes of the goods.[164] It is interesting that even Mr Justice Breyer, in his powerful dissent in *Leegin*, conceded that he would be willing to consider an exception to the per se ban on price fixing 'for the more easily identifiable and temporary condition of "new entry"'.[165]

If the agreement at issue fails this effects-based test, then the parties have a leeway in the form of an efficiency defence under Article 101(3). Given that this thesis advocates against the removal of all types of RPM from the 'object box', there is also no reason why the 'hardcore' status of the practice should not be retained. It follows that any application for exemption may be appraised on an individual basis only. This effectively means that an RPM agreement which has already been found to infringe Article 101(1) is still likely to fail a substantive assessment under Article 101(3), in view of the indispensability requirement of that provision, given that it is always possible that its harmful competitive effects will be found to outweigh any alleged transactional efficiency gains.

In principle, however, this last statement does not contradict my previous argument regarding the complementary use of selectivity criteria and price floors: it goes without saying that I do not dispute the relevance of the 'less restrictive alternative' test under Article 101(3). To be more precise, if the parties to an RPM agreement have not managed to rebut the presumption of anti-competitive object, in accordance with my proposal, this means that the transaction did not involve any idiosyncratic investments that needed protection from appropriation or an incentive alignment mechanism. In such a case there is no credible threat of post-contractual opportunistic behaviour and the arrangement is more consistent with the traditional conception of a discrete exchange in a spot market, rather than a long-term contractual partnership governed by relational norms. In the context of

[163] See WS Comanor, 'Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy' [1984-1985] 98 *Harv L Rev* 983, discussed supra s 2.1.1. Note, '*Leegin*'s Unexplored "Change in Circumstance": The Internet and Resale Price Maintenance' [2007-2008] 121 *Harv L Rev* 1600, 1616-1617.
[164] See also Vertical Guidelines, para 108.
[165] 551 US 877, 917-918.

weak organisational settings, where the manufacturer merely ‘rents’ shelf space without imposing any transaction-specific obligations on the retailer, selective distribution is indeed less restrictive than RPM, always assuming that the nature of the products in question merits selective distribution in the first place.

If, on the other hand, the RPM policy is found to be caught by the prohibition because, despite having rebutted the presumption, it nonetheless failed the intuitive balancing test of Article 101(1), this implies that it has been found to be *disproportionately* detrimental to consumer welfare. Under these circumstances, the maintenance of the organisational form may be too cumbersome from a public policy perspective, so a less restrictive alternative may need to be sought.

6.7.4. Benefits of the Suggested Approach

The most significant advantage of the suggested approach is that it helps parties to a genuinely efficiency-enhancing RPM agreement to avoid the indispensability test of Article 101(3). The effects-based test carried out in the context of Article 101(1) does not involve a ‘less restrictive alternative’ requirement, which is inherently problematic in the first place. On the one hand, the suggested approach provides the parties with the opportunity to substantiate that their agreement has a net welfare-enhancing or at least welfare-neutral effect. Similarly, under the intuitive proportionality test of that provision, in order for a restraint to qualify as ancillary and escape the prohibition, it is sufficient that the parties substantiate that it is ‘directly related and necessary to the implementation of a main non-restrictive transaction and proportionate to it’.[166] In this context, the existence of less restrictive alternatives to the restraint at hand is not examined, as the relevant requirements may be satisfied if the parties merely demonstrate that ‘without the restriction the main non-restrictive transaction would be difficult or impossible to implement’.[167]

As has already been seen earlier in this thesis, other forms of restricted dealing are either not as effective as price floors in achieving the same efficiencies, or cannot even be regarded as alternatives in the first place. Selective distribution, for example, is in theory less restrictive, as it entails the reduction but not the elimination of intrabrand price competition, but at the same time it is not a perfect substitute for price floors, which can

[166] Communication from the Commission – Notice – Guidelines on the application of Article 81(3) [now 101(3)] of the Treaty, [2004] OJ C101/97, para 29.
[167] Ibid, para 31.

produce more far-reaching efficiencies.[168] It is indicative that in economic literature there are practically no studies in which even the staunchest critics of *Leegin*'s rule of reason seriously include selective distribution in the list a reliable less restrictive alternatives.[169] The allocation of exclusive territories, on the other hand, even assuming that it is less restrictive,[170] is frequently not a practicable alternative. Territorial exclusivity is largely, if not exclusively, contingent upon the nature of the contract goods, and it is not even economically feasible for a broad category of relatively inexpensive consumer goods which are typically subject to impulse purchases. If the various types of vertical restraints were as easily and readily interchangeable as the European Commission and Courts appear to believe, the public policy towards RPM on the other side of the Atlantic would be exhausted in just a few paragraphs of an antitrust handbook, instead of giving rise to the most heated intellectual debate on antitrust issues of the previous century.[171] According to a commentator:

> very few, if any, of the less restrictive alternatives identified by the Populists are equally effective as exclusive territories or resale price maintenance. Indeed, the assertion that less restrictive alternatives *will* produce the very same benefits as these restraints rests upon highly unrealistic assumptions – assumptions usually associated only with the perfect competition model.[172]

The point advocated in this thesis is simple. Vertical price fixing has ambivalent effects, which depend largely on the economic and legal context in which it is implemented. It may be pro-competitive; it may be anti-competitive. The rule of an antitrust enforcement agency is to uphold the pro-competitive commercial practices and to condemn the restraints that have a pernicious effect of competition. In any event, however, and regardless of one's understanding of the objectives of competition law, the role of antitrust is certainly not to transfer executive decision-making powers from an undertaking's board of directors to Brussels and Luxembourg. Nobody other than the parties themselves is in a position to judge what is indispensable and what is not, and the fact-finder's task is rather to examine whether what was deemed as indispensable

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[168] For the relevant discussion, see *supra* ss 4.4 and 6.5.

[169] The only such paper which I have come across is JB Kirkwood, 'Rethinking Antitrust Policy toward RPM' [2010] 55 *Antitrust Bull* 423.

[170] This is another assumption that cannot be made in the abstract, in light of the economic evidence discussed earlier in this thesis; see *supra* s 4.5.

[171] See, eg, GM Struve, 'The Less-Restrictive-Alternative Principle and Economic Due Process' [1966-1967] 80 *Harv L Rev* 1463, 1477-1478.

[172] AJ Meese, 'Price Theory and Vertical Restraints: A Misunderstood Relation' [1997-1998] 45 *UCLA L Rev* 143, 190-191 (emphasis in original).

commercial conduct by the parties is in line with consumer welfare. As Mr Justice Holmes noted in his dissenting opinion in *Dr Miles*, ‘I think that at least it is safe to say that the most enlightened judicial policy is to let people manage their own business in their own way, unless the ground for interference is very clear’.[173]

Besides, it makes no normative sense to read a ‘less restrictive alternative’ test into Article 101(1), as the indispensability requirement is meaningful only in the context of a substantive assessment under Article 101(3). Indeed, an inquiry into alternative forms of restricted dealing is sound only provided that an anti-competitive object or effect has already been established. Within the analytical framework of Article 101(1), the ‘less restrictive alternative’ test in the case of welfare-enhancing or even welfare-neutral clauses – generally clauses that do not fall within the scope of the prohibition – would result in agreements being condemned simply on the ground that they *fail to increase consumer surplus* as effectively as others. But that would constitute unacceptable *contra legem* interpretation of the provision, which expressly outlaws only those arrangements that are found to prevent, restrict or distort competition in the internal market.

The suggested approach has an additional advantage. While reducing the scope for false positives inevitably associated with a conclusive presumption of illegality, it also presents enforcement agencies and national courts with the opportunity to subject RPM agreements to a thorough substantive assessment, which would be impossible, were they to be covered by a block exemption. It is obvious that the normative effect of the Vertical Block Exemption Regulation is to benefit agreements falling within its scope with a status of ‘per se legality’: insofar as the market share thresholds set out in Article 3(1) of Regulation 330/2010 are met and provided that no hardcore restrictions are included, the agreement effectively enjoys immunity from antitrust liability. Such a development, however, would be undesirable in the case of RPM. Removal of vertical price fixing from the category of black-listed clauses would limit considerably the scope for competitive appraisal of the actual and potential impact of the relevant schemes on the market. Despite all pro-competitive justifications suggested by economists, the effects of RPM remain highly ambivalent, and reliance on the parties to carry out the relevant self-assessment would rather be unwarranted. Against this background, the extension of the block

[173] *Dr Miles Medical Co v John D Park & Sons Co*, 220 US 373, 411 (1911).

exemption to cover RPM would undermine severely the deterrent effect of the law, and should be dismissed as a policy consideration.[174]

Finally, a third option, that of a system of prior notification should be automatically rejected for practical reasons. For the purposes of the application of Article 101 TFEU, a relevant system was in force under Regulation 17/62: Article 4(1) provided that the parties to agreements falling within the scope of Article 101(1) were required to notify them to the Commission in order to benefit from an individual exemption under Article 101(3). The requirement for prior notification was abolished by Regulation 1/2003, which established a system of *ex post* substantive assessment, primarily for reasons of administrative efficiency.[175] A similar system of registration had been established in a number of national legal orders – such as Germany and the United Kingdom – prior to the promulgation of the Treaty of Rome, but was eventually abandoned.[176]

The reason for the dismissal of this alternative is that it is based on the unrealistic assumption that parties will invariably have the incentive to notify an RPM scheme. As has been repeatedly stated in this thesis, vertical price fixing has ambivalent effects and may be applied both for efficiency-enhancing and efficiency-reducing purposes. It is therefore almost certain that parties to a manifestly anti-competitive RPM agreement – for example, a network of collectively enforced price floors or RPM designed to result in market foreclosure – cannot be reasonably expected to make use of such a notification/registration

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[174] An alternative proposal put forward by Reindl would involve the future re-categorisation of RPM within the context of the Block Exemption Regulation; see AP Reindl, 'Resale Price Maintenance and Article 101: Developing a More Sensible Analytical Approach' [2009-2010] 33 *Fordham Int'l LJ* 1300, 1331-1333. More specifically, the argument runs, the removal of vertical price fixing from the category of hardcore restraints and its inclusion in the list of excluded restrictions outlined in Article 5 of the Regulation would open the door to an effects-based, case-by-case analysis.
However, it is submitted here that the practical implications of such an approach are highly questionable. First of all, there is in principle nothing precluding a hardcore restraint from benefitting from an exemption under Article 101(3) on an individual basis; see Vertical Guidelines, paras 47 and 60-64. In this sense, the normative approach to both categories of presumptively anti-competitive restraints is in effect identical, at least as far as the contested clause itself is concerned. The essential difference between hardcore and excluded restrictions lies in their legal effects on the contractual relationship: while the existence of a hardcore restraint entails that the vertical agreement as a whole loses the benefit of the Block Exemption Regulation, excluded restrictions are severable and thus do not affect the application of the block exemption to the rest of the agreement; see Vertical Guidelines, paras 70-71. Although there is no doubt that the severability of excluded restrictions reflects the Commission's view that they are relatively less suspicious, it does not nevertheless point to a perceived increased eligibility for a case-by-case substantive assessment, nor does it predetermine the outcome of a cost-benefit analysis under Article 101(3). That said, it must acknowledged that the symbolism of a possible re-categorisation of RPM under Article 5 and its impact both on enforcement agencies and on undertakings could be significant. With this in mind, Reindl's assertion that it would encourage a 'more honest assessment' of price floors is not necessarily unfounded.
[175] According to Recital 3 of Regulation 1/2003, 'the system of notification [established by Regulation 17/62] prevents the Commission from concentrating its resources on curbing the most serious infringements. It also imposes considerable costs on undertakings'.
[176] See the Appendix.

system. As has already been demonstrated by the application of a similar system under EU competition law, its operation would be disproportionately costly for all parties, and its deterrent effect practically negligible.

Conclusion

1. Summary

In the aftermath of the US Supreme Court's decision in *Leegin*,[1] which overruled the century-long per se ban on vertical price fixing, and the publication of the European Commission's 2010 Vertical Guidelines, which retained the classification of the practice as a restriction of competition by object under Article 101(1) and a hardcore restraint under Article 101(3), there exists a notable difference in the approach taken to RPM under the laws of the world's most mature antitrust jurisdictions. This difference is, of course, not absolute given that EU competition law does not recognise the concept of per se illegality: in principle, all types of restrictive agreements may benefit from an individual exemption under Article 101(3), insofar as the four requirements set out in that provision are satisfied.[2] In the case of RPM, however, this is only a theoretical possibility, as in practice it remains subject to a quasi-conclusive presumption of illegality, notwithstanding the fact that the Commission recently acknowledged for the first time the efficiency-enhancing potential of price floors.[3]

The purpose of this thesis was to examine whether a convergence of the two regimes is indeed plausible, through the introduction in the current framework of Article 101 TFEU of a more relaxed approach to vertical price fixing, influenced by *Leegin*'s rule of reason. As a starting point, it was demonstrated that the Commission, in its recent Vertical Guidelines, has shown its willingness to depart from the rigid adherence to the single market imperative, insofar as an agreement imposing export bans is limited in time and designed to facilitate new entry. Although RPM agreements have on many occasions been condemned *inter alia* on the basis of their ability to compartmentalise the internal market, the fact that price restraints have been singled out as the most harshly treated forms of restricted dealing may be understood primarily in light of economic, rather than integrationist considerations. Assuming, therefore, an agreement on the substantive

[1] *Leegin Creative Leather Products, Inc v PSKS, Inc*, 551 US 877 (2007).
[2] Case T-17/93, *Matra-Hachette SA v Commission* [1994] ECR II-595, para 85.
[3] Vertical Guidelines, para 225.

economics, it is submitted here that the pro-competitive justifications for vertical price fixing do not support the argument for a blanket prohibition, but instead favour a policy reform.

This reform, however, needs to be moderate and cannot go beyond the adoption of a – genuinely – rebuttable presumption of illegality. The theories of harm associated with RPM, in particular, but not exclusively, the horizontal collusion objection are compelling and have been recently confirmed by the economic literature, as discussed in Chapters 2 and 3. For these reasons, the outright removal of RPM from the lists of 'by-object' and 'hardcore' restraints would be unwarranted.

Building on insights from new institutional economics, it was argued that there is also a need for a more consistent approach to RPM and vertical mergers. In light of the principle of organisational neutrality, vertical integration is primarily to be understood as a paradigm, applicable both to hierarchical and to contractual relationships between economic units. It was also seen that vertical price fixing may serve as a substitute of full-blown vertical integration and produce comparable transactional efficiencies: price floors may be used to create a quasi-rent stream which, through its appropriation by retailers, may enhance the self-enforcing range of long-term relational contracts, while serving as *ex ante* incentive alignment mechanism designed to induce the latter to undertake the necessary relationship-specific investments. Such investments are typically sunk, and may be subjected to post-contractual opportunism even in the context of a selective distribution network.

Against this background, and on the basis of the assumption that the two paragraphs of the bifurcated Article 101 TFEU represent 'the two dominant concepts of the limits of the firm',[4] it has been argued that Article 101(1) provides the correct normative framework for the substantive assessment of price floors. Only if the presumption of anti-competitive object is not rebutted, or if it is rebutted but the agreement fails the intuitive proportionality test, is a full-blown, monetised cost-benefit analysis under Article 101(3) appropriate.

[4] I Lianos, 'Commercial Agency Agreements, Vertical Restraints, and the Limits of Article 81(1) EC: Between Hierarchies and Networks' [2007] 3 *J Comp L & Econ* 625, 671.

2. Limitations of this Study

The preceding analysis focused exclusively on *stricto sensu* RPM, or vertical price fixing, defined by Article 4(a) of the Vertical Block Exemption Regulation as the 'restriction of the buyer's ability to determine its sales price'. In that sense, it covers only agreements which are aimed, either directly or indirectly, at establishing a fixed or minimum price to be observed by the distributor. According to the Vertical Guidelines, examples of indirect RPM include:

> an agreement fixing the distribution margin, fixing the maximum level of discount the distributor can grant from a prescribed price level, making the grant of rebates or reimbursement of promotional costs by the supplier subject to the observance of a given price level, linking the prescribed resale price to the resale prices of competitors, threats, intimidation, warnings, penalties, delay or suspension of deliveries or contract terminations in relation to observance of a given price level. Direct or indirect means of achieving price fixing can be made more effective when combined with measures to identify price-cutting distributors, such as the implementation of a price monitoring system, or the obligation on retailers to report other members of the distribution network that deviate from the standard price level. Similarly, direct or indirect price fixing can be made more effective when combined with measures which may reduce the buyer's incentive to lower the resale price, such as the supplier printing a recommended resale price on the product or the supplier obliging the buyer to apply a most-favoured-customer clause.[5]

As was seen in Chapter 3,[6] policies imposing minimum advertised prices ('MAP'), especially in the online context (Internet minimum advertised prices, 'iMAP'), although not expressly mentioned in the Guidelines, should also be considered as tantamount to indirect price floors. By preventing retailers from advertising the contract goods below a specific price – or, in their most extreme form, by prohibiting price advertising altogether – such schemes have the effect of reducing the distributors' incentive to engage in aggressive intrabrand price competition. It follows that MAP policies, whether in the offline or the online context, should be subjected to the same antitrust treatment as vertical price fixing.

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[5] Commission Notice – Guidelines on Vertical Restraints [2010] OJ C130/1, para 48.
[6] See *supra* s 3.4.

It has been acknowledged in this thesis that the emergence and expansion of e-commerce has presented antitrust authorities with new challenges, *inter alia* in the field of vertical restraints. New types of restrictive clauses, specific to Internet retailing, such as dual pricing and retail most-favoured-nation clauses ('retail MFN'), also referred to as across platform parity agreements ('APPA'), are being implemented by undertakings for anti-competitive purposes and with the effect of restricting the competitive advantage of cost-effective online outlets.

Although raising challenging theoretical issues, and despite their comparable effects, these restraints do not constitute RPM, either directly or indirectly. Dual pricing, namely a requirement that the distributor pay a higher wholesale price for products intended to be sold online than for those which will be made available in brick-and-mortar outlets is already being treated under EU competition law as a territorial restraint. More specifically, the Vertical Guidelines indentify dual pricing as a form of indirect ban on passive sales and take the position that it constitutes a hardcore restraint unable to benefit from the block exemption.[7] Although dual pricing does have the effect of reinforcing price rigidity in the e-marketplace, the question as to whether it should be classified as a price or a non-price restraint is probably an exercise in semantics, which falls outside the scope of this thesis.

As far as retail MFN is concerned, this practice, whereby a seller agrees with an online trade platform that the price charged on the latter will not exceed the prices charged on its competitors, should also not be considered as RPM despite their theoretically comparable effects. Retail MFN does not fall within the legal definition of vertical price fixing, insofar as in does not involve a relationship between a supplier (the manufacturer) and a buyer (the distributor). Also, from an economic perspective, the practice merits a separate welfare analysis in view of the fact that the manufacturer is not involved in the arrangement. The typical pro-competitive justification for RPM is that, when it is employed voluntarily by the manufacturer, it makes both itself and consumers better off.

Another limitation of this research is that it has not managed to discuss more than a handful of RPM cases from national competition authorities ('NCAs'). Following the enactment of Regulation 1/2003, which decentralised the enforcement of EU competition law, on a number of occasions NCAs have applied the national competition laws, sometimes alongside Article 101 TFEU, to agreements fixing minimum resale prices.

[7] Ibid, para 52(d).

However, language barriers, along with the fact that such an endeavour would require considerable expenditure of resources, have prevented me from undertaking a more thorough investigation into the enforcement activities of NCAs with regard to RPM. I sincerely hope though that a future expanded version of this thesis will include a wider range of decisions by NCAs, in addition to the few German and French cases reviewed in Chapter 5.

Appendix

Resale Price Maintenance under National Antitrust Laws Prior to the Treaty of Rome

Prior to the enactment of the Treaty of Rome, the legal orders of half of the founding states – Germany, France and the Netherlands – already contained some form of legislation aimed at the protection of the competitive order, whereas Belgium introduced an antitrust statute three years later, in 1960.[1] As will be seen in the following paragraphs, the treatment of vertical price fixing by the various domestic legal orders was, at that time, anything but consistent, a finding which will be used to support the assumption that the severity towards RPM has been merely an import from American law.

In addition to these four founding Member States, account will be taken of the approach to RPM under British and Swedish competition law. Given that the accession of the United Kingdom and Sweden did not occur until considerably later – in 1973 and 1995, respectively – it is obviously unlikely that their domestic legal traditions exercised any direct influence on the competition rules of the Treaty. Nonetheless, without the review of their relevant national laws this study would be incomplete. In view of the level of

[1] At the time of the enactment of the Treaty of Rome, the other two founding members of the European Economic Community, Luxembourg and Italy, had not yet passed any specific legislation pertaining to the protection of the competitive process and relied mostly on some relevant provisions of their respective Penal Codes.
In Luxembourg, a general ban on resale price maintenance was introduced a few years later by Article 1 of the Grand Ducal Decree of 9 December 1965 (Règlement grand-ducal du 9 décembre 1965 portant réglementation des prix imposes et du refus de vente, *Mémorial du Grand-Duché de Luxembourg* du 15 décembre 1965). Additionally, Article 2 of the Decree provided that exemptions from the prohibition may be granted on certain occasions. Both provisions reflected the influence of Article 37(4) of the French Price Ordinance.
By contrast, the Italian legal order lacked any form of antitrust legislation until 1990 (Norme per la tutela della concorrenza e del mercato, *Gazzetta Ufficiale* del 13 ottobre 1990). During the period of time examined in the present chapter, there was no express prohibition on resale price maintenance. Regarding the validity of these agreements, this was generally accepted by scholars – particularly where they involved branded goods – but the legal basis for their enforceability was disputed. It was argued that RPM could fall within the scope either i) of Article 1379 of the Italian Civil Code, which stipulates that restraints on alienation are enforceable only with respect to the parties to the contract at hand, and only if they are limited in time and in accordance with the interests of one of the parties, or ii) of Article 2593, which requires that agreements restrictive of competition be in writing and provides that they are valid if they concern territorial restraints or restraints on certain activities, and their duration does not exceed five years. According to a third opinion, which was based on the general principles of Italian law, in order for RPM agreements to be upheld, they should not restrict the consumer's freedom of choice, while being in accordance with the interests of one of the parties. On the relevant intellectual debate, see L Focsaneanu, 'Les Prix Imposés dans la Communauté Economique Européenne' [1967] 3 *Revue Trimestrielle de Droit Européen* 173, 206-209.

industrialisation of these countries, along with the existence of reasonably effective antitrust legislation in both jurisdictions during that period of time, the examination of their national laws could provide a broader picture of the trends in the treatment of RPM in post-war Europe.

1. Germany

It was seen in the previous paragraph that the adoption of decartelisation laws by the American, British and French Military Governments of the respective Zones of Control formed part of the reconstruction of the German economy, following the country's defeat in World War II. In the context of these reforms, and on the basis of the US model, the legal framework for the prohibition of RPM was introduced in the German legal order. The occupation regime in the Federal Republic of Germany was eventually terminated on 5 May 1955 by the Bonn Conventions, which were signed between the three powers and the German government and conferred full sovereignty upon the latter. Specifically with regard to the Allied Decartelisation Laws, it was agreed that they should remain in force until repealed or replaced by the German legislature.[2]

Deliberations regarding the drafting of a cartel law, its basic principles and ideological foundations, started as early as 1949 and culminated in the enactment of the Law against Restraints of Competition of 27 July 1957 (hereinafter 'GWB').[3] The GWB became effective on 1 January 1958, the same day as the Treaty of Rome, and remains, as amended, the normative framework for the legal treatment of anti-competitive conduct in Germany to the present day. As originally enacted, the German law dealt with RPM in section 15, which declared void and unenforceable any agreements restricting a party's freedom to determine its own prices or terms in contracts concluded with third parties.[4] Additionally, the law provided that the parties to such agreements were liable for the

[2] IE Schwarz, 'Antitrust Legislation and Policy in Germany – A Comparative Study' [1956-1957] 105 *U Pa L Rev* 617, 646-648.

[3] Gesetz gegen Wettbewerbsbeschränkungen [1957] 41 *Bundesgesetzblatt I* 1081, 1081-1103. For details on the negotiations between the German government and industry representatives, which ultimately resulted in the adoption of the GWB, see DJ Gerber, *Law and Competition in Twentieth Century Europe: Protecting Prometheus* (Oxford University Press 1998), pp 270-276.

[4] Section 15 of the GWB provided that

> Verträge zwischen Unternehmen über Waren oder gewerbliche Leistungen, die sich auf Märkte innerhalb des Geltungsbereichs dieses Gesetzes beziehen, sind nichtig, soweit sie einen Vertragsbeteiligten in der Freiheit der Gestaltung von Preisen oder Geschäftsbedingungen bei solchen Verträgen beschränken, die er mit Dritten über die gelieferten Waren, über andere Waren oder über gewerbliche Leistungen schließt.

damages suffered by another party (§35), and that they would also be subject to an administrative fine (§38).

Section 16, however, introduced an important exception to this general rule: the invalidity would not extend to agreements fixing the resale prices of branded goods (*Markenwaren*) which were in price competition with similar goods of other manufacturers or dealers.[5] The rationale behind this exception was the conventional wisdom that branded goods meet certain quality standards valued by consumers;[6] a fixed resale price would thus serve as a guarantee for the product's quality, while the demand would, in turn, induce the manufacturer to maintain the high standards of production. In addition, the provision reflects the emphasis on the protection of the competitive process in the upstream market and the idea that restraints of intrabrand competition are generally less harmful or that they can even generate considerable efficiencies.[7] A second exemption concerned book publishers imposing the resale price of their products. Section 16(4) stipulated that, in order for RPM agreements concerning branded goods to become effective, they should be registered with the newly-established competition authority, the *Bundeskartellamt* (German Federal Cartel Office, hereinafter 'FCO'). The authority was, nevertheless, given the power to invalidate an already registered RPM agreement where, at any point in the future, it established that the agreement in question ceased to fulfil the requirements of section 16, or was being implemented in an abusive way, or was able, either by itself or in combination with other restrictions of competition, to result in an increase in the price of the goods concerned, to prevent any price reductions or to restrict output, in a way not justified with regard to the general economic conditions (§17(1)).

Furthermore, the GWB adopted a quite stringent approach to recommended resale prices. Section 38(2) outlawed any recommendations which would result in the violation, by means of uniform conduct, of any of the prohibitions laid down in the law.[8] Price

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[5] According to section 16(1),

§15 gilt nicht, soweit

1. ein Unternehmen die Abnehmer seiner Markenwaren, die mit gleichartigen Waren anderer Hersteller oder Händler in Preiswettbewerb stehen, oder
2. ein Verlagsunternehmen die Abnehmer seiner Verlagserzeugnisse

rechtlich oder wirtschaftlich bindet, bei der Weiterveräußerung bestimmte Preise zu vereinbaren oder ihren Abnehmer die gleiche Bindung bis zur Weiterveräußerung an den letzten Verbraucher aufzuerlegen.

[6] Indeed, section 16(2) of the GWB defined 'branded goods' as those, the provision of which at a given or improved quality is guaranteed by the price-fixing manufacturer.

[7] PD Schapiro, 'The German Law against Restraints of Competition – Comparative and International Aspects, Part Two' [1962] 62 *Colum L Rev* 201, 205.

[8] According to the second sentence of section 38(2) of the GWB, 'Wer Empfehlungen ausgesprochen hat, die eine Umgehung der in diesem Gesetz ausgesprochenen Verbote oder der von der Kartellbehörde auf Grund

recommendations also fell within the scope of this provision, but, according to a decision of the Federal Supreme Court, they could be exempted provided that they were not mandatory and fulfilled the requirements set out for the exemption of RPM agreements.[9] The FCO further opined that recommended prices should also be registered, without, however, this registration being a requirement for their validity.[10]

Following a broad amendment of the GWB in 1965,[11] para 6 of the modified section 16 authorised the Minister of Finance to issue a regulation regarding the establishment and administration of a register for vertical price fixing agreements (*Preisbindungsregister*), which would be kept by the FCO; the regulation was adopted at the beginning of the following year.[12] Under the new regime, registration was required only for RPM agreements concerning branded goods; agreements covering publications were not subject to any such requirement. An additional interesting aspect of the amendment was that it introduced a legal presumption for the appraisal of the conditions justifying the withdrawal of the exemption for registered agreements under section 17(1). According to the modified text of the provision, it would be presumed that the requirements of section 17(1)(3) were met where a considerable number of sales below the fixed prices had been observed, or where the products in question were being made available partly subject to an RPM scheme and partly without or under a different brand name, at prices substantially lower than the fixed prices.

In 1973, RPM was eventually outlawed by a new law amending the GWB.[13] The scope of section 16 was substantially limited by the abolition of the exemption of branded goods, which would now fall within the ambit of the general prohibition of section 15. Under the modified GWB, however, the favourable treatment of RPM in the publishing sector was maintained. It has been estimated that, by the time of the second amendment of the GWB, the resale prices of more than 175,000 'selling units' had been fixed by some 750 firms.[14] Naturally, the amendment also provided for the abolition of the

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dieses Gesetzes erlassenen Verfügungen durch gleichförmiges Verhalten bewirkt haben, macht sich ebenfalls einer Ordnungswidrigkeit schuldig'.

9 See KE Markert, 'The New German Antitrust Reform Law' [1974] 19 *Antitrust Bull* 135, 149.

10 PW Heil and G Vorbrugg, 'Anti-Trust Law in West Germany: Recent Developments in German and Common Market Regulation' [1974] 8 *Int'l L* 349, 357.

11 Gesetz zur Änderung des Gesetzes gegen Wettbewerbsbeschränkungen vom 15. September 1965 [1965] 53 *Bundesgesetzblatt I* 1349, 1363-1364; for the consolidated version of the GWB, as amended, see [1966] 2 *Bundesgesetzblatt I* 37, 37-59.

12 Verordnung über die Anlegung und Führung des Preisbindungsregisters vom 3. Januar 1966 [1966] 2 *Bundesgesetzblatt I* 37, 59-60.

13 Zweites Gesetz zur Änderung des Gesetzes gegen Wettbewerbsbeschränkungen vom 3. August 1973 [1973] 64 *Bundesgesetzblatt I* 917, 917-929.

14 KE Markert, *supra* n 9, 149.

Preisbindungsregister.[15] Moreover, para 1(12) of the amended section 38 maintained and expressly laid down the ban on resale price recommendations; but section 38(a)(1) exempted from the prohibition any non-binding price recommendations which were expected to be similar to the prices presumably charged by the majority of the dealers who were the addressees of these recommendations.

2. United Kingdom

The validity and enforceability of RPM agreements was generally upheld by English courts until the enactment of the Restrictive Trade Practices Act, 1956.[16] Prior to the passage of the Act, various committees had been appointed by the government with the task to examine the impact of RPM with regard to the public interest.[17] The most prominent among them was the Committee on Resale Price Maintenance (also referred to as 'the Lloyd Jacob Committee' after its Chairman, Sir George H Lloyd Jacob). In an influential Report submitted in 1948, the Lloyd Jacob Committee stressed the detrimental effects of the collective administration of RPM schemes and suggested that the necessary 'steps be taken to render illegal the application of sanctions which extend beyond the remedies open to an individual producer for any breach of resale price maintenance conditions'.[18]

In accordance with the recommendations of the Lloyd Jacob Committee, the 1956 Act recognised the individual manufacturer's freedom to maintain and enforce the price at which its products were to be sold,[19] and drew a distinction between that and the collective enforcement of resale price conditions. By contrast to individual vertical price fixing agreements, which were enforceable even against subsequent purchasers who had notice of the RPM clause, collaboration among two or more competing manufacturers regarding the

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[15] See Article 1(6) of the 1973 Law, amending sections 16 and 17 of the GWB.

[16] Lord Wilberforce, A Campbell and N Elles, *The Law of Restrictive Trade Practices and Monopolies* (2nd edn, Sweet & Maxwell 1966), pp 404-405.

[17] The reports of the early committees were generally favourable for RPM, but were followed by a gradual shift towards a more hostile attitude; for an account of the most notable committees and their findings, see H Mercer, *Constructing a Competitive Order: The Hidden History of British Antitrust Policies* (Cambridge University Press 1995), pp 150-153.

[18] Para 167 of the Report of the Committee on Resale Price Maintenance, as quoted in Lord Wilberforce *et al.*, *supra* n 16, pp 406-407.

[19] S 25(1) of the 1956 Act provided that

> [w]here goods are sold by a supplier subject to a condition as to the price at which those goods may be resold, either generally or by or to a specified class or person, that condition may, subject to the provisions of this section, be enforced by the supplier against any person not party to the sale who subsequently acquires the goods with notice of the condition as if he had been party thereto.

enforcement of the fixed resale prices was declared unlawful under s. 24(1) of the Act.[20] Additionally, s. 24(2) prohibited any arrangements between dealers the purpose of which was to induce their suppliers to impose resale price conditions or to enforce the stipulated prices. It is clear from the relevant provisions that the British legislator's primary concern with regard to RPM arrangements was not the resulting increase in prices, but the 'horizontal' effects of the widespread use of vertical price fixing, namely the possibility that RPM might be used as a means to reinforce a cartel agreement in either the upstream or the downstream market.

It should be stressed at this point that, under the 1956 Act, only collective agreements regarding the *enforcement* of RPM schemes were prohibited; not agreements between suppliers as to the maintenance of resale prices as such. In a Report published a year earlier, the Monopolies and Restrictive Practices Commission – the authority entrusted under the 1948 Act with the duties to investigate and report on monopolies and collusive agreements[21] – had stated:

> We express no views about the advantages or disadvantages of resale price maintenance itself, but we think that the disadvantages we have described arise to an important extent from the uniformity and rigidity of its application in many trades, and that this uniformity and rigidity result in the main from collective enforcement … We appreciate that some manufacturers may at times have good grounds for wishing to be able to check extreme forms of price competition among retailers in the distribution of their branded goods … We appreciate that distributors as well as manufacturers may be concerned at the possibility of marked and persistent loss-leader selling where resale prices are not effectively enforced. Whether or not changes in the law should be made to meet these difficulties must

[20] The text of s 24(1)(a) dealing with the collective enforcement of RPM read as follows:

> 24. Prohibition of agreements for collective enforcement of conditions as to resale prices.
>
> (1) Subject to the provisions of this section, it shall be unlawful for any two or more persons carrying on business in the United Kingdom as suppliers of any goods to make or carry out any agreement or arrangement by which they undertake –
>
> > (a) to withhold supplies of goods for delivery in the United Kingdom from dealers (whether party to the agreement or arrangement or not) who resell or have resold goods in breach of any condition as to the price at which those goods may be resold;
> >
> > (b) to refuse to supply goods for delivery in the United Kingdom to such dealers except on terms and conditions which are less favourable than those applicable in the case of other dealers carrying on business in similar circumstances…
>
> or any agreement or arrangement authorising the recovery of penalties (however described) by or on behalf of the parties to the agreement from dealers who resell or have resold goods in breach of any such condition as is described in paragraph (a) of this subsection, or the conduct of any domestic proceedings in connection therewith.

[21] Under s 28 of the Restrictive Trade Practices Act, 1956, the Monopolies and Restrictive Practices Commission would be replaced by the Monopolies Commission.

depend mainly on an assessment of the general effects of resale price maintenance … We are satisfied that collective enforcement arrangements of the kinds covered by our reference do not provide an answer which is consistent with the public interest.[22]

Thus, collective agreements whereby suppliers merely undertook to enter into price maintenance schemes with their dealers, without agreeing on the steps to be taken for their enforcement, did not fall within the scope of s. 24(1). That said, such agreements were required to be registered with the Registrar of Restrictive Trading Agreements, pursuant to ss. 9 and 6(1)(a) of the 1956 Act. Following its registration, a restrictive agreement would be subject to a reasonableness inquiry by the Restrictive Practices Court; a registered collective RPM scheme could, therefore, be declared void (s. 20), unless the Court was satisfied that it fulfilled the conditions set out in s. 21.[23]

The general prohibition on RPM was introduced into the British legal order by the Resale Prices Act 1964. The general leniency towards vertical price fixing had encouraged its widespread use to such an extent that, at the time of the promulgation of the Act, RPM in Britain reportedly accounted for ‘45 percent of consumer expenditure on goods’.[24] The Resale Prices Act, in section 1(1) thereof, declared void ‘any term or condition of a contract for the sale of goods by a supplier to a dealer ... in so far as it purports to establish or provide for the establishment of minimum prices to be charged on the resale of the goods in the United Kingdom’. Interestingly, RPM, albeit unlawful under the Act, was not treated as a ‘hardcore’ restraint.

According to section 5(2), an RPM agreement could escape the application of section 1(1), provided that it satisfied at least one of five conditions. These conditions for exemption were: (i) the quality of the goods available for sale, or the varieties of the goods so available, would be substantially reduced to the detriment of the public as consumers or users of those goods; or (ii) the number of establishments in which the goods are sold by retail would be substantially reduced to the detriment of the public as consumers or users; or (iii) the prices at which the goods are sold by retail would in general and in the long run be increased to the detriment of the public as such consumers or users; or (iv) the goods would be sold by retail under conditions likely to cause danger to health in consequence of

[22] Monopolies and Restrictive Prices Commission, *Collective Discrimination: A Report on Exclusive Dealing, Collective Boycotts, Aggregated Rebates and Other Discriminatory Trade Practices*, Cmd. 9504 (1955), paras 237-238.
[23] Lord Wilberforce *et al*., *supra* n 16, pp 408 and 414.
[24] Notes, ‘Resale Prices Act, 1964’ [1964] 30 *Arbitration* 71.

their misuse by the public as such consumers or users; or (v) any necessary services actually provided in connection with or after the sale of goods by retail would cease to be so provided or would be substantially reduced to the detriment of the public as such consumers or users.

It is interesting to note that the second and fifth conditions for exemption demonstrate beyond any doubt that the British legislator had already endorsed the 'free rider rationale' only four years after its formulation in Lester Telser's seminal article 'Why Should Manufacturers Want Fair Trade?'.[25] According to s. 6 of the Act, agreements which sought to qualify for an exemption were subject to a registration requirement. Following their registration, the Registrar would make a reference to the Restrictive Practices Court, which was authorised under s. 5 to issue exemption orders. The Resale Prices Act, 1964, was amended by the Resale Prices Act 1976. The latter defined the legal framework for the treatment of RPM until March 2000, when the Competition Act 1998 entered into force.

3. France

The foundations of the law against restrictive agreements in France were laid by Article 419 of the French Penal Code (*Code Pénal*) of 1810, drafted under the influence of the *laissez faire* ideology of the physiocratic school which was prevalent in the country in the years after the French Revolution. Article 419 provided for the criminal offence of coalition and penalised *inter alia* agreements concerning the sale at fixed prices, as well as the artificial increase or reduction in the price of goods 'above or below the price which the natural and free course of competition would determine'.[26] The language of the provision, which covered combinations between 'the principal holders of the same kind of merchandise or commodity', implied that the prohibition was not applicable to vertical agreements. The exclusion of vertical agreements from the scope of Article 419 was of no

[25] LG Telser, 'Why Should Manufacturers Want Fair Trade?' [1960] 3 *JL & Econ* 86.

[26] According to the original text of Article 419, as in force prior to its first amendment in 1926,

> Tous ceux qui, par des faits faux ou calomnieux semés à dessein dans le public, par des suroffres faites aux prix que demandaient les vendeurs eux-mêmes, par réunions ou coalitions entre les principaux détenteurs d'une même marchandise ou denrée, tendant à ne la pas vendre, ou à ne la vendre qu'à un certain prix, ou qui par des voies ou moyens frauduleux quelconques auront opéré la hausse ou la baisse du prix des denrées ou marchandises ou des papiers et effets publics au-dessus ou au-dessous des prix qu'aurait déterminés la concurrence naturelle et libre du commerce, seront punis d'un emprisonnement d'un mois au moins, d'un an au plus, et d'une amende de cinq cents francs à dix mille francs. Les coupables pourront de plus être mis, par l'arrêt ou le jugement, sous la surveillance de la haute police pendant deux ans au moins et cinq ans au plus.

particular significance at the time of its enactment, as it was not until World War I that a general trend towards vertical integration was first observed in the French industry.[27]

Vertical restraints were eventually brought within the ambit of Article 419 following its amendment in 1926.[28] The second paragraph of the modified provision outlawed any type of action or attempt to effect, either directly or through an intermediary, an artificial increase or reduction in the price of commodities or merchandise or of public or private securities. At the same time, the requirement that the parties to the unlawful coalition hold the same kind of merchandise or commodity was abolished.[29] Due to the strict interpretation of the provision, criminal prosecutions under Article 419 were infrequent and, occasionally, unsuccessful; that said, illegal combinations were generally declared void and unenforceable by civil courts.[30] The enforcement of the prohibition was eventually brought to an end in the 1930s. In France, as in most other economies affected by the crisis, the impact of the Great Depression resulted in an increased degree of state intervention in the market mechanism. In response to the need for economic stabilisation, the government encouraged and, occasionally, imposed cartelisation in various industries. During World War II the systematic central planning of industrial production was further enhanced by the Vichy regime. This policy of interventionism was not abandoned after the restoration of the country's sovereignty, as the state assumed the leading role in the struggle for economic restructuring. The return to economic stability was characterised by a wave of nationalisations in vital sectors of the economy and by the adoption of a system of extensive price control with the aim of preventing inflation.[31]

The legal framework for the control of prices was set out by Ordinance No. 45-1483 (hereinafter 'the Price Ordinance'), which was promulgated immediately after the

[27] See F Deák, 'Contracts and Combinations in Restraint of Trade in French Law – A Comparative Study' [1935-1936] 21 *Iowa L Rev* 397, 418, fn 48 and accompanying text.

[28] Loi du 3 décembre 1926 modifiant les articles 419, 420 et 421 du Code penal, *JORF* 4 décembre 1926.

[29] The amended text ofArticle 419 read as follows:

> Tous ceux:
> 1) qui, par des faits faux ou calomnieux semés sciemment dans le public, par des offres jetées sur le marché à dessein de troubler les cours, par des suroffres faites aux prix que demandaient les vendeurs eux-mêmes, par des voies ou moyens frauduleux quelconques;
> 2) ou qui, en exerçant ou tentant d'exercer, soit individuellement, soit par réunion ou coalition, une action sur le marché dans le but de se procurer un gain qui ne serait pas le résultat du jeu naturel de l'offre et de la demande;
> Auront, directement ou par personne interposée, opéré ou tenté d'opérer la hausse ou la baisse artificielle du prix des denrées ou marchandises ou des effets publics ou privés,
> Seront punis …

[30] For a detailed review of the enforcement of Article 419, see F Deák, *supra* n 27.

[31] SA Riesenfeld, 'The Legal Protection of Competition in France' [1960] 48 *Cal L Rev* 574, 578-583; A Kuenzler and L Warlouzet, 'National Traditions of Competition Law: A Belated Europeanization through Convergence?' in K Klaus Patel and H Schweitzer (eds), *The Historical Foundations of EU Competition Law* (Oxford University Press, 2013), pp 95 and 99.

end of the war.[32] As originally enacted, the Price Ordinance, in Article 37 thereof, provided *inter alia* for the prohibition of three types of restrictive agreements as 'illicit pricing practices' (*pratiques de prix illicites*). These blacklisted agreements, all of which were vertical in nature, were: refusals to supply and unjustified price discrimination (Article 37(1)(a)); and tying clauses (Article 37(1)(c)). In 1952, the ban on price fixing was introduced in the Price Ordinance, in the context of one of its several amendments. Law No. 52-835[33] inserted a third paragraph in Article 37, which declared unlawful all agreements entered into between multiple producers and/or distributors with the aim of fixing the minimum prices of goods and services. Only collective actions fell within the scope of the provision, but the type of association between the parties was irrelevant.[34] The law further provided that exemption from the prohibition could be granted by ministerial decision. According to the second subparagraph of Article 37(3), the prohibition was not applicable to prices imposed by an individual manufacturer for the resale of its goods throughout the different stages of the distribution chain.[35]

The lack of comprehensive anti-cartel legislation was – only partially – remedied the following year, by the promulgation of Decree No. 53-704.[36] The 1953 Decree, more of a reaction to inflationary pressures rather than a response to efficiency-enhancing considerations, is regarded as the first French antitrust statute, although in essence it constituted a complement to the Price Ordinance.[37] The cornerstone of the amendment was the general clause of Article 59 *bis*, which prohibited 'all concerted actions, conventions,

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[32] Ordonnance No. 45-1483 du 30 juin 1945 relative aux prix, *JORF* 8 juillet 1945, rectificatif *JORF* 21 juillet et 8 septembre 1945.

[33] Loi No. 52-835 du 18 juillet 1952 complétant l'article 37 de l'ordonnance 45-1483 du 30 juin 1945 relative aux prix, *JOFR* 19 juillet 1952.

[34] J Mazard, 'Prix Imposés et Prix d'Entente' [1953] 16 *Droit Social* 129, 131-132.

[35] The original text of Article 37(3), which would also be subsequently amended, read as follows:

> Est assimilé à la pratique des prix illicites le fait ...
>
> 3. Par toute personne, et sauf dérogation autorisée par arrêté du ou des ministres competent, de conférer, maintenir ou imposer un caractère minimum aux prix des produits et des prestations de service, soit au moyen de tarifs ou barèmes professionnels, soit en vertu d' ententes, quelle qu'en soit la nature ou la forme, intervenues entre producteurs, entre distributeurs, entre prestataires de services, ou entre les uns et les autres.
>
> Ces dispositions ne s'appliquent pas aux prix de marque qui feront l'objet d'une réglementation spéciale…

The term 'prix de marque', as used in the context of subparagraph 2, was broad and did not refer exclusively to branded goods; see J Mazard, *supra* n 34, 131.

[36] Décret No. 53-704 du 9 août 1953 relatif au maintien ou au rétablissement de la libre concurrence industrielle et commercial, *JORF* 10 août 1953.

[37] F Jenny, 'French Competition Policy in Perspective' in WS Comanor *et al* (eds), *Competition Policy in Europe and North America: Economic Issues and Institutions* (Harwood Academic Publishers, 1990), p 148. For a discussion on the problem of unconstitutionality of the 1953 Decree, which led to its partial annulment by the Conseil d'Etat and its re-enactment (and amendment) by Decree No 58-545 of 24 June 1958, see EE Goldstein, 'National and International Antitrust Policy in France: An Interview with M. Antoine Pinay, Minister of Economic Affairs and Finance' [1958-1959] 37 *Tex L Rev* 188, 193.

express or tacit agreements, or coalitions, irrespective of their form and cause, which have as their object or potential effect the restriction of the full exercise of competition by preventing the reduction of costs or prices or by facilitating an artificial increase in prices'. These agreements were also declared as void as a matter of civil law. The prohibition was, however, not applicable to agreements concluded in accordance with a statutory provision or where the parties could demonstrate that the agreement contributed to the improvement or expansion of production or resulted in the development of the economic progress through rationalisation and specialisation (Article 59 *ter*).

As far as the treatment of vertical restraints is concerned, the relevant legal framework was set by the more specific provision of Article 37, as amended by the 1953 Decree. Particularly with regard to RPM, the amendments introduced by the Decree were substantial. Firstly, the prohibition of – what was now – Article 37(4) was extended to cover price fixing agreements entered into by an individual manufacturer or distributor, as well as by professional associations.[38] The amendments further included the specification of the conditions for exemption from the general prohibition. According to the modified provision, exemptions could be granted, for a limited period of time only, in the case of RPM agreements having as their subject matter innovative goods or services, or products exploited under the exclusive rights of patent, licence or registered design, or requiring specifications such as guarantee of quality, or an initial advertising campaign.[39] In a circular issued in 1960, the government set the practical framework for the appraisal of these requirements.[40] Firstly, the circular clarified that the above list was non-exhaustive and that the parties to an RPM agreement could put forward any other reasons suitable to justify their request for exemption. It was further stressed that the derogation did not provide for the possibility of 'block exemptions': as it was meant to be granted in exceptional circumstances, a more generalised application of the exemption to agreements

[38] Circulaire du 31 mars 1960 relative à l'interdiction des pratiques commerciales restreignant la concurrence, *JORF* 2 avril 1960.

[39] According to the amended provision of Article 37(4):

> Est assimilé à la pratique des prix illicites le fait ...
>
> 4. Par toute personne de conférer, maintenir ou imposer un caractère minimum aux prix des produits des prestations et services ou des marges commerciales, soit au moyen de tarifs ou barèmes, soit en vertu d'ententes, quelle qu'en soit la nature ou la forme.
>
> Sont exclus de l' application du paragraphe 4 ci-dessus les cas où les produits ou les services auront fait l'objet d'une dérogation accordée par arête conjoint du ministre chargé des affaires économiques, du ministre chargé du commerce et du ministre intéressé. Cette dérogation qui, en tout état de cause, doit être limitée dans le temps, peut être donnée notamment en fonction de la nouveauté du produit ou du service de l'exclusivité consécutive á un brevet d'invention, à une licence d'exploitation ou au dépôt d'un modèle, ou des exigences d'un cahier des charges comportant garantie de qualité et spécification du conditionnement, ou d'une campagne publicitaire de lancement ...

[40] Circulaire du 31 mars 1960, *supra* n 38.

within a certain industry was precluded. In order for a vertical price fixing agreement to be considered eligible for the derogation, it should also not contribute to the parties enjoying an 'unjustified advantage' in the marketplace; in other words, it should neither result in 'excessive profits' for the manufacturer nor afford the distributor with a profit margin which is disproportionately large with regard to the significance of its intervention. Finally, the firms concerned should demonstrate that the products in question were distributed through the least expensive channel and that, ultimately, the prices charged to consumers were the lowest possible. According to the circular, this condition implied that firms with a certain degree of market power could not, as a general proposition, benefit from the derogation. Factors such as brand image or the luxury character of the product, or the uncertainty related to the launching of a new product, were also to be taken into consideration. In practice, such derogations were granted on a number of occasions.[41]

The 1953 Decree aimed solely at the prevention of artificial price increases by means of collusive agreements. A main downside of its formalistic application was that it failed to catch some types of combinations that had an indirect effect on prices.[42] The other side of the coin was that an effects-based approach to restraints was precluded. In spite of any exemptions granted by the competent Ministers, the treatment of RPM effectively amounted to a 'per se' prohibition. The rationale behind the prohibition was the protection of large-scale retailers, which had already made their appearance since the early 1950s, against traditional dealers which used the threat of boycott with the aim of forcing manufacturers to maintain resale prices. The fight against inflation was once again at the epicentre of the French government's economic policy, and the development of large discounters was falsely considered as an available remedy.[43] At this point it should be noted that the illegality under Article 37(4) concerned only minimum resale prices, and not maximum or recommended prices, provided that the latter were not binding.[44] A further point to be made is that French law provided manufacturers that wished to impose a minimum resale price for their products upon their distributors with a loophole, by not obliging them to disclose the reasons for terminating a certain dealer. Thus, the fact that downstream firms would bear the burden of establishing the unlawful basis for termination

[41] See eg SA Riesenfeld, 'The Anti-Trust Laws of the Common Market Countries' [1962] 56 *Am Soc'y Int'l L Proc* 27, 32; R Joliet, 'Resale Price Maintenance under EEC Antitrust Law' [1971] 16 *Antitrust Bull* 589, fn 2.

[42] F Jenny and AP Weber, 'French Antitrust Legislation: An Exercise in Futility?' [1975] 20 *Antitrust Bull* 597, 600-601.

[43] For a discussion on the conditions that shaped the antitrust treatment of vertical restraints in France, see F Jenny, *supra* n 37, pp 154-156.

[44] Circulaire du 31 mars 1960, *supra* n 38.

discouraged their price-cutting activities and, to some extent, prevented compliance with the law.[45] Article 37(4) of the Price Ordinance, as amended by the 1953 Decree, remained the legal instrument for the treatment of vertical price fixing until the abrogation of the statute by Ordinance No. 86-1243, which maintained the same stringent approach to RPM.[46]

4. The Netherlands

Antitrust legislation was effectively introduced in the Netherlands by the Economic Competition Law of 1956,[47] which entered into force two years later. The promulgation of the Economic Competition Law was a turning point in the Dutch government's policy towards cartels, as it put an end to a period of outright encouragement of coordination between economic operators. The Business Agreements Act (*Ondernemersovereenkomstenwet*) of 1935 had been enacted with the aim of contributing to the recovery of the Dutch economy from the disastrous effects of the Depression, and contained provisions which, not only allowed restrictive agreements, but further conferred upon the state the power to force cartel membership. A similar approach was adopted by the Nazi-imposed Cartel Decree of 1941, which, additionally, provided for the mandatory registration of cartels.[48]

The Law of 1956 retained the cartel register, as well as the power of the government to impose participation in cartel agreements; this power, nevertheless, was now subject to very specific limitations. A significant innovation of the new law was that it gave the Minister of Economic Affairs the power to take action against any restrictive agreements which would be found to be contrary to the public interest, and to declare them, in whole or in part, non-binding.[49] Vertical price fixing did not initially fall within the scope of the statute, but Article 10 thereof provided that, where the protection of the public interest necessitated it, a Royal Decree could be adopted, declaring the unenforceability of certain types of restrictive agreements.

[45] H De Richemont, 'The Regulation of Resale Price Maintenance under U.S., French, German, British, and EEC Law: A Comparative Analysis' [1973] 5 *Law & Pol'y Int'l Bus* 440, 489.
[46] F Jenny, *supra* n 37, p 162.
[47] Wet Economische Mededinging, of 28 June 1956 / 16 July 1958.
[48] W Asbeek Brusse and R Griffiths, 'Paradise Lost or Paradise Regained? Cartel Policy and Cartel Legislation in the Netherlands' in S Martin (ed), *Competition Policies in Europe* (Elsevier, 1998), pp 16-18.
[49] Ibid, 19.

By virtue of this clause, the ban on vertical price fixing was introduced for the first time in 1964, but it concerned exclusively collective RPM, namely agreements where 'the supplier of the products is not free to determine prices independently of third parties'.[50] This legal framework proved to be rather ineffective, due to the large number of exemptions granted by ministerial decree in response to relevant requests by producers.[51] Later that year, the prohibition was extended to individual RPM agreements involving durable consumer goods such as radios, television sets, cars, cameras and household appliances. A general prohibition on all vertical price fixing schemes was eventually adopted in 1991, in the context of broader reforms in the Dutch antitrust policy.

5. Belgium

Competition policy in Belgium was introduced by the Law against the Abuse of Economic Power of 1960,[52] which, at the time of its enactment, was 'by far the most general and indulgent' among the national antitrust laws of the EU Member States.[53] The central concept of the new statute was that of 'abuse of economic power' (*abus de la puissance économique*). Economic power was defined as the power possessed by any natural or legal persons, acting alone or in concert, which allows them to exercise preponderant influence on the supply of products or capital in the market, or on the price or quality of a specific product or service (Article 1). Article 2 further stated that, in order for an abuse to be established, the persons who enjoy economic power should 'harm the public interest through practices which distort or restrict the normal course of competition or which impede either the economic freedom of producers, distributors or consumers, or the development of production or trade'.[54] The Law further introduced a rather complex enforcement mechanism (Articles 3-17).

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[50] J Sperling, 'Dutch Public Competition Law is Shaping Up' [1994] 22 *Int'l Bus Law* 405, 407.

[51] W Asbeek Brusse and R Griffiths, *supra* n 48, p 21. Also, for brief reviews of Dutch court decisions confirming the enforceability of vertical price fixing agreements, see SA Riesenfeld, 'Antitrust Laws in the European Economic Community: A Sequel' [1962] 50 *Cal L Rev* 829, 839-840; and L Spier, 'Restrictive Business Practices and Competition in the European Economic Community' [1965] 53 *Cal L Rev* 1337, 1354.

[52] Loi du 27 Mai 1960 sur la protection contre l'abus de la puissance économique, *Moniteur Belge* 22 juin 1960. The Royal Decree No. 62 of 13 January 1935, which was still in force at the time of the passage of the Law of 1960, authorised the Minister of Economic Affairs to order the extension of cartel agreements for reasons of public interest; for more details on the Royal Decree and the issue of the conflicting nature of the two statutes, see LP Suetens, 'Belgian Antitrust Law "in Action"' [1965] 2 *CML Rev* 325, 334-335.

[53] SA Riesenfeld, *supra* n 41, 38.

[54] According to the original text of these provisions:

The approach taken to RPM agreements, both collective and individual, under the 1960 law was particularly lenient. Vertical price fixing schemes could, theoretically at least, fall within the scope of Articles 1 and 2 of the statute, as long as the requirements set out in these provisions were met. Besides, Article 2 expressly included the restriction of the distributor's commercial freedom in the list of practices which might constitute an abuse of economic power if determined to be detrimental to the public interest. In practice, however, RPM agreements were generally upheld and enforced.[55]

In 1964, Ministers Spinoy and De Clercq submitted for consultation to the Senate a draft bill which would have authorised the Minister of Economic Affairs to proscribe the imposition of minimum resale prices. The bill was eventually withdrawn as a result of the reaction of producers of branded goods to that provision.[56] Given that exports accounted for a substantial proportion of the country's gross domestic product, the government supported activities which would increase the Belgian companies' competitiveness, occasionally by encouraging restrictive agreements which would have such an effect. This led a commentator to claim that '[t]he "public interest" is generally synonymous to the producer's interest'.[57] That said, on certain occasions, the Belgian government disregarded the Law of 1960 and favoured the application of the legislative decree of 22 January 1945 concerning the repression of violations regarding national supply – probably because of the latter's more expedient enforcement procedures. Article 1(2) of the legislative decree outlawed the maintenance of abnormally high prices, and the government relied on that provision in order to disallow a number of RPM agreements, most notably in the chemical and pharmaceutical industries.[58]

Article 1. La puissance économique, au sens de la présente loi, est le pouvoir que possède une personne physique ou morale agissant isolément ou un groupe de ces personnes agissant de concert d'exercer sur le territoire du Royaume, par des activités industrielles, commerciales, agricoles ou financières, une influence prépondérante sur l'approvisionnement du marché de marchandises ou de capitaux, sur le prix ou la qualité d'une marchandise ou d'un service déterminé.

Article 2. Il y a abus, au sens de la présente loi, lorsqu'une ou plusieurs personnes, détentrices de puissance économique, portent atteinte à l'intérêt général par des pratiques qui faussent ou qui restreignent le jeu normal de la concurrence ou qui entravent soit la liberté économique des producteurs, des distributeurs ou des consommateurs, soit le développement de la production ou des échanges.

[55] R Joliet, *supra* n 41, 591-594.

[56] Ibid, 594.

[57] L Spier, *supra* n 51, 1373; on the concept of 'public interest' under the 1960 Law, see also C Del Marmol and M Fontaine, 'Protection against the Abuse of Economic Power in Belgium: The Law of May 27, 1960' [1960-1961] 109 *U Pa L Rev* 922, 932-933.

[58] L Focsaneanu, *supra* n 1, 211.

6. Sweden

The first post-war piece of legislation aimed at the protection of free competition in Sweden was promulgated in 1946.[59] Its purpose was to limit the detrimental effects of cartels, firstly, by providing for the registration of restrictive agreements in a Cartel Register kept by the Monopoly Investigation Bureau, a newly-established agency within the National Board of Trade, and, secondly, through a monitoring system under which the Bureau was authorised to carry out special investigations and inquiries. The Act did not, however, confer upon the Bureau the power to impose fines on firms which had engaged in collusive conduct, nor to require the termination of cartel agreements.[60] Although limited in scope, the legal framework under the Act of 1946 had a surprising deterrent effect: twelve years after the introduction of the Cartel Register, almost half of the notified restrictive agreements had been voluntarily terminated following their registration.[61]

A Report drafted in 1951 by the Committee of New Entry on the basis of evidence collected during investigations and data from the Cartel Register reflected the collusive tendencies in the Swedish industry and the ubiquity of vertical restraints. The fixing of minimum resale prices in particular was so widespread that, according to a commentator, 'it [was] probably in [the area of the distribution of products] that the use of explicit agreements to limit or even completely eliminate price competition went furthest'.[62] Vertical price fixing was largely imposed at the behest of powerful and organised retailers which threatened to boycott any manufacturers that would not comply. Additionally, price competition in the downstream market was further stifled by means of price lists circulated by retailers' associations fixing the prices of products not covered by RPM schemes.[63] The immediate result of these networks of vertical and horizontal price fixing agreements was an across-the-board increase in the prices of various goods.[64]

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[59] Lag om övervakning av konkurrensbegränsning inom näringslivet, of 29 June 1946 (*SFS* 1946:448).
[60] Y Bourdet, 'Policy toward Market Power and Restrictive Practices in Sweden' [1989] 34 *Antitrust Bull* 533, 537.
[61] HB Thorelli, 'Antitrust in Europe: National Policies after 1945' [1958-1959] 26 *U Chi L Rev* 222, 235. The Cartel Register was maintained by the Law against Restraints of Competition of 1953 and was eventually abolished in 1993.
[62] LG Sandberg, 'Antitrust Policy in Sweden' [1964] 9 *Antitrust Bull* 535, 538.
[63] Ibid, 539-540.
[64] Ibid, 539.

It was on the basis of the aforementioned Report that the first effective Swedish antitrust statute was enacted in 1953.[65] The 1953 Law Against Restraints of Competition contained a general provision according to which,

> [i]f a restraint of competition has a harmful effect within the country, the Market Court may ... adopt measures to prevent such an effect ... A harmful effect shall occur where, in a manner which is contrary to the public interest, the restraint of competition (1) unduly affects the formation of prices, (2) impairs efficiency in business, or (3) hinder or prevents the business activities of another.[66]

It can be deduced from the language of this clause that the law introduced an effects-based approach to the legal treatment of competitive restraints: only where a restriction of competition was found to be detrimental to the society as a whole, by meeting one of the three criteria set out in the provision, would it fall within the ambit of the provision. With the exception of only two types of collusive behaviour, no restrictive conduct was subject to an outright prohibition. Furthermore, the law did not confer any specific coercive powers upon the authorities. The enforcement of the 1953 Law, initially entrusted to two institutions, the Competition Ombudsman and the Market Court, was based on the method of negotiations and on the voluntary cooperation of the companies concerned; it thus provided the latter with the opportunity to eliminate any harmful effects of their actions on the basis of guidance provided by the authorities.[67]

In sharp contrast to this framework, under the 1953 Law RPM, along with collusive tendering, were the only two restrictive practices which were expressly prohibited and treated as ‘per se’ illegal, while they were also subject to criminal sanctions. RPM was in fact treated as an ordinary crime and was prosecuted in the regular criminal courts by the public prosecutor, following a recommendation by the Competition Ombudsman.[68] The harsh treatment of vertical price fixing was, however, to an extent mitigated by a clause authorising exemptions from the prohibition where special reasons, such as a benefit to consumers or the public in general, were present.[69] Such exemptions were granted in a

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[65] Lag om motverkande i vissa fall av konkurrensbegränsning inom näringslivet, of 25 September 1953 (*SFS* 1953:603).
[66] Section 5 of the 1953 Law as translated in DJ Gerber, *supra* n 3, p 197.
[67] A third authority, the National Price and Cartel Board, was established in 1956. For a presentation of the powers of these three institutions, see Y Bourdet, *supra* n 60, 541-543.
[68] DJ Gerber, ‘Antitrust Law and Economic Analysis: The Swedish Approach’ [1984-1985] 8 *Hastings Int’l & Comp L Rev* 1, 14-15.
[69] For the translation of the provision in English, see J Gillis Wetter, ‘Swedish Antitrust Law’ [1961] 10 *Am J Comp L* 19, 24.

limited number of cases, most notably to RPM agreements in the retail markets for books and published music; the relevant petitions were approved for cultural reasons.[70]

The treatment of RPM as 'per se' illegal under the 1953 Law essentially precluded any analysis by the courts of its likely effects on a case-by-case basis and revealed the legislator's distrust regarding its efficiency-enhancing potential. It is apparent that this approach was largely influenced by the findings of the Committee of New Entry, as outlined in its Report. More light on the rationale behind the prohibition was shed by the Minister of Commerce:

> The most serious disadvantage of the resale price maintenance system is that it deters rationalization and thus potential price reductions at the retail level. This is based primarily on the fact that in this system the sales price of a good is basically determined by the retail merchant with the highest costs. In distribution the incentive is lost which is provided by free price formation.[71]

Thus, as Gerber notes, the severity of the Swedish law was dictated by the danger of elimination of intrabrand competition and the need to promote 'efficiency and international competitiveness ... The government was concerned with the structure-preserving and thus inefficient effects of resale price maintenance'.[72] The attitude towards RPM following the 1982 legislative reform remained unaltered.

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[70] Ibid, 32-33.
[71] As translated in DJ Gerber, *supra* n 68, 29.
[72] Ibid.

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