RESALE PRICE MAINTENANCE IN EC COMPETITION LAW

A LAW & ECONOMICS PERSPECTIVE

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"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?

Economic discussion, such as the studies the Court relies upon, can help provide answers to these questions, and in doing so, economics can, and should, inform antitrust law. But antitrust law cannot, and should not, precisely replicate economists' (sometimes conflicting) views."[1]

[1] Justice Breyer, dissenting in *Leegin Creative Leather Products, Inc.* v. *PSKS, Inc.*, 127 S. Ct. 2705 (2007) at 2729.

1. Introduction

One of the fields where lawyers and economists appear unable to agree is the question on what to do with the instrument of resale price maintenance (RPM). Not only within, but also between competition policy regimes, there has continuously been disagreement as to whether, or when, RPM should be allowed. This paper combines the academic disciplines of law and economics and tries to clear up the uncertainty that has been created during the debate.

Recent developments have stirred the debate in the European Community (EC) as to the treatment of its so-called 'hardcore restrictions' within competition law. More specifically, the current treatment of the instrument of resale price maintenance, where a manufacturer is able to influence the retail price, may be under fire for two reasons. First, there is a noticeable trend in EC competition law in which business conduct's conformity with competition law is to a lesser extent determined using rules, and more on effects. Judging from recent developments in the European Courts' case law, this so-called 'more economic approach' may have caused not only a shift towards a more effects-based policy when dealing with agreements that have as their effect the restriction of competition, but may ultimately also affect the treatment of hardcore restrictions. Secondly, inputs for a possible policy change may also be derived from the debate on the other side of the Atlantic, where the treatment of RPM has also been controversial, to say the least. Pursuant to the recent *Leegin* judgement, where the Supreme Court has overruled a long-standing precedent regarding the treatment of minimum and fixed RPM, all forms of resale price maintenance are subject to a rule of reason rather than a per se prohibition. Both these policy changes were largely driven by increasing importance of economics in competition policy. The developments therefore raise the question whether the current treatment of resale price maintenance in EC competition law is satisfactory while taking into account new insights of economic theory. This paper tries to find an answer to the question whether the current treatment of resale price maintenance corresponds with the current objective of EC competition law, or that perhaps an 'even more economic approach' is desirable.

In answering this question, this research will look into the instrument defined in the Commission's Guidelines on Vertical Restraints as the 'Resale Price Maintenance group', which comprises the direct or indirect imposition of minimum, fixed, maximum and recommended resale prices. That is, resale price maintenance is defined in this paper as those agreements whose main element is that the buyer is obliged or induced to resell not below a certain price, at a certain price or not above a certain price. In order to provide a complete picture for answering the rather complex question phrased above, the paper consists of three separate, though inherently connected, analyses. First, the current treatment in EC competition law vis á vis resale price maintenance is analysed from a legal perspective. Here, the basic elements of the prohibition that is laid down in Article 81(1) EC, as well as the legal exception that is provided for in Article 81(3) EC, will be subsequently discussed. The legal analysis also entails a concise overview of the developments in the United States where some focus will be placed on the *Leegin* judgement by the Supreme Court, and how this relates to the approach in the European Community. Secondly, as economic theory stood at the basis of both the ‘more economic approach’ and the *Leegin* judgement, a research on the desirability of an ‘even more economic approach’ can not do without an analysis of the effects of resale price maintenance, and how these relate to the objective of EC competition law. The economic analysis therefore surveys the economic literature on the pro- and anti-competitive effects of resale price maintenance. Finally, in order to derive policy implications, a multidisciplinary approach is introduced where legal doctrines and economic insights are combined. This law & economics approach will prove a vital instrument for policy-makers in order to decide upon the most desirable way of treating RPM within competition law.

In sum, this paper has the aim to find whether the current regime of EC competition policy is treating resale price maintenance in a way that is consistent with the objectives of competition law. In the end, a conclusion will be derived as to whether the current approach towards RPM is satisfactory or that it requires changes. Regardless of the outcome, this paper aims to demonstrate the importance of multidisciplinary analysis in questions of competition law.

2. The law of resale price maintenance

This chapter will outline the current legal framework concerning resale price maintenance (RPM). In this, I will firstly survey the basic elements of the prohibition of Article 81(1) EC and reflect on how they relate to resale price maintenance. Secondly, I will consider the assessment of RPM under Article 81(3) EC, which provides for a legal exception to Article 81(1) if certain conditions are satisfied. Thirdly, I will briefly compare the treatment of RPM in EC competition law with that in U.S. antitrust law. This chapter will conclude with a summary of its main findings.

2.1 Article 81(1) EC

Resale price maintenance is dealt with within the framework of Article 81(1) EC, because it generally concerns multilateral behaviour by undertakings. Article 81(1) states the following.

> **Article 81(1) EC**
> The following shall be prohibited as incompatible with the common 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 common market, and in particular those which:
> (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
> (b) limit or control production, markets, technical development, or investment;
> (c) share markets or sources of supply;
> (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
> (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

Although it can easily be seen that Article 81(1)(a) refers to the concept of RPM, it is vital to look at the entire legal context of the prohibition. Judging from the wordings of the Article itself and from the case law on the matter, it is generally accepted that there are five distinct conditions to be satisfied in order for an agreement (or concerted practice) to fall within the prohibition of Article 81(1). Below, I will subsequently deal with these five elements, but they will – for analytical convenience – be discussed in the following order. The first condition for the Commission to satisfy in order to establish applicability of Article 81(1) is that there needs to be an effect on trade between Member States of the Community. Secondly, Article 81 EC only deals with undertakings, not with purely governmental activities. Thirdly, there needs to be some kind of collusion, i.e. an agreement, a decision by an association of undertakings or a concerted practice. Fourthly, this collusive form should have as its object or its effect the restriction of competition. Finally, this effect on competition should be appreciable.

2.1.1 The effect on trade between Member States

For an agreement to fall within the prohibition of Article 81(1) EC it must satisfy the criterion of having an appreciable effect on trade between Member States. In short, the condition stipulates that only agreements that may, with a sufficient degree of probability, directly or indirectly, actually or potentially, influence the pattern of trade between Member States, fall within Article 81(1).[2] It is convenient to start with this criterion for two reasons. First, if there is no appreciable effect on trade between Member States, the Commission does not have to look into the other elements, hence a thorough market analysis is not required. Secondly, from a historical perspective, it is appropriate to start with this element, as this question was a central one in the early case law on the application of EC competition law on RPM and distribution agreements in general. Therefore, this section's objective is twofold: on the one hand it will outline the historic development of the legality of resale price maintenance, whereas on the other hand the current state of affairs on this matter will be discussed. However, as the application of this condition is not substantially different when assessing RPM within the framework of Article 81(1) than other (vertical) agreements, I will refrain from lengthy discussions.

It is interesting to note that resale price maintenance has not always been unlawful in European law, and the instrument has been extensively used throughout the Member States.[3] Moreover, Community action in the field of resale price maintenance was absent, as it was claimed that maintenance of resale prices, or distribution agreements in general, in a single state could not affect inter-state trade, and its legality should therefore be left to the Member States to determine.[4] However, a trend for narrowing the scope of RPM gradually emerged. Interestingly, however, this trend did not emerge because it would better protect consumers or competition, but because it would contribute to single market integration.[5] In the case law, this new path was initiated by the Court in *Grundig/Consten*,[6] which is outlined below.[7]

Grundig/Consten: vertical restraints and the effect on trade between Member States

Grundig signed a distribution agreement with Consten which, in short, entailed the appointment of Consten as an exclusive agent for Grundig's sales in France. Accordingly, Consten agreed inter alia

[2] As a result, if this condition is not met, the behaviour may fall within national competition policy.
[3] An example of this is Germany, which allowed RPM until 1973. A conflict emerged, however, when Metro bought records from Deutsche Grammophon in France, and decided to sell them below the price at which the German distributors were allowed to sell (see Case 78/70, *Deutsche Grammophon Gesellschaft mbH* v. *Metro-SB-Großmärkte GmbH & Co. KG.* [1971] ECR 487).
[4] See Gogeshvili 2002, pp. 301 ff.
[5] See also infra paragraph 3.1.
[6] Cases 56/64 and 58/64, *Etablissements Consten SA & Grundig-Verkaufs-GmbH* v. *Commission* [1966] ECR 299.
[7] See in this context also Alese 2007.

not to market competing products. In return, Grundig agreed not to deliver to other distributors to France, and obstructed parallel trade. As a result of the distribution agreement, Consten enjoyed absolute territorial protection. The parties argued that, because the agreement did not entail one between competitors, it would not be caught by Article 81(1) EC, as, so they argued, this applied only to horizontal agreements. Moreover, specifically because the case entails a vertical agreement, it was said that it would be unable to affect trade between Member States. The Court, however, refused these arguments and related the illegality of the distribution agreement to the single market objective of competition law.

"Neither the wording of article [81] nor that of article [82] gives any ground for holding that distinct areas of application are to be assigned to each of the two articles according to the level in the economy at which the contracting parties operate. Article [81] refers in a general way to all agreements which distort competition within the common market and does not lay down any distinction between those agreements based on whether they are made between competitors operating at the same level in the economic process or between non-competing persons operating at different levels. In principle, no distinction can be made where the treaty does not make any distinction.
Furthermore, the possible application of article [81] to a sole distributorship contract cannot be excluded merely because the grantor and the concessionnaire are not competitors inter se and not on a footing of equality. Competition may be distorted within the meaning of article [81(1)] not only by agreements which limit it as between the parties, but also by agreements which prevent or restrict the competition which might take place between one of them and third parties. For this purpose, it is irrelevant whether the parties to the agreement are or are not on a footing of equality as regards their position and function in the economy. This applies all the more, since, by such an agreement, the parties might seek, by preventing or limiting the competition of third parties in respect of the products, to create or guarantee for their benefit an unjustified advantage at the expense of the consumer or user, contrary to the general aims of article [81]. […]
Finally, an agreement between producer and distributor which might tend to restore the national divisions in trade between Member States might be such as to frustrate the most fundamental objections of the Community. The Treaty, whose preamble and content aim at abolishing the barriers between States, and which in several provisions gives evidence of a stern attitude with regard to their reappearance, could not allow undertakings to reconstruct such barriers. Article [81(1)] is designed to pursue this aim, even in the case of agreements between undertakings placed at different levels in the economic process."[8]

This case is relevant for the subject of resale price maintenance for (at least) two reasons. First, in *Grundig/Consten*, the Court of Justice held that Article 81(1) EC applies not only to horizontal but also to vertical agreements.[9] Secondly, the Court makes clear that distribution contracts made between a producer and a distributor do not necessarily, as such, fall under the prohibition of article 81(1) EC, as they might primarily be limited to national fronts.[10] However, an agreement which might tend to restore the national divisions in trade between Member States might be such as to frustrate the most

[8] Cases 56/64 and 58/64, *Etablissements Consten SA & Grundig-Verkaufs-GmbH* v. *Commission* [1966] ECR 299, pp. 339-340.
[9] See infra paragraph 2.1.3.
[10] Alese 2007, p. 525.

fundamental objectives of the Community, i.e. single market integration. This view on distribution agreements in general appears to have been similarly applied to resale price maintenance when assessing its restrictive object or effect.[11] Allowing manufacturers to fix retail prices, even if limited to national fronts, would also obstruct parallel trade and thereby frustrate the single market integration objective, as prices could equalise across the Community.

Accordingly, both in the Court's jurisprudence and in the Commission's decision-making practice, the question whether an RPM agreement was capable of affecting trade between Member States appreciably was a central one on multiple occasions.[12] Although, as will be explained below, current EC competition policy puts less emphasis on the single market integration objective,[13] an agreement will still fall outside the scope of Article 81(1) EC if it is incapable of affecting trade between Member States. In this, the Commission stresses that the concept of 'trade' is not limited to traditional exchanges of goods and services across borders, but that it is a wider concept, covering all cross-border economic activity including establishment.[14] Moreover, the requirement is currently seen as a mere jurisdictional criterion.[15] Accordingly, it is accepted that the Community has no jurisdiction over cases in which the effects of an agreement are confined to one Member State.[16] The introduction of Regulation 1/2003 and the Guidelines on the effect on trade concept contained in Articles 81 and 82 of the Treaty shed more light on the question when an agreement is to be considered to have an appreciable effect on the effect on trade between Member States.[17] In the Guidelines, the Commission takes stock of the existing case law for the test for assessing whether there is an effect on trade.[18] The test requires the Commission to show that, firstly, there is a sufficient degree of probability on the basis of a set of objective factors of law or fact, secondly, there is an influence on the pattern of trade between Member States, and finally, there is a direct or indirect, actual or potential, influence on the pattern of trade.[19] In order to enhance the ease of establishing an appreciable effect on trade between

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[11] See also Alese 2007, p. 525, and Case 78/70, *Deutsche Grammophon Gesellschaft mbH* v. *Metro-SB-Großmärkte GmbH & Co. KG.* [1971] ECR 487.
[12] See Case 78/70, *Deutsche Grammophon Gesellschaft mbH* v. *Metro-SB-Großmärkte GmbH & Co. KG.* [1971] ECR 487, Case 27/87, *SPRL Louis Erauw-Jacquery* v. *La Hesbignonne SC* [1988] ECR 1919 and Commission decisions in *GERO-fabriek* [1977] OJ L16/8 and *Hennesey-Henkell* [1981] OJ L383/11.
[13] See infra paragraph 3.1.1.
[14] Commission Notice – Guidelines on the effect on trade concept contained in Articles 81 and 82 of the Treaty (hereafter Guidelines on the effect on trade concept), [2004] OJ C101/81, par. 19..
[15] Jones and Sufrin 2008, p. 191.
[16] Case 22/78, *Hugin Kassaregister AB and Hugin Cash Registers Ltd* v. *Commission* [1979] ECR 1869, par. 15 ff. See also the *Sammelrevers* case, where the Commission stated that a RPM regime covering only national books does not have an appreciable effect on trade between Member States (Notice pursuant to Article 19(3) of Council Regulation No 17(1) concerning an application for negative clearance or exemption under Article 81(3) of the EC Treaty (Sammelrevers and Einzelreverse), [2000] OJ C162/25). For the peculiarities of the treatment of RPM in the market for books, see infra paragraph 3.1.2.
[17] Council Regulation 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty (hereafter Regulation 1/2003), [2004] OJ L1/1; Guidelines on the effect on trade concept, [2004] OJ C101/81. See also Wijckmans et al. 2006, pp. 54 ff.
[18] Case 56/65, *Société la Technique Minière Ulm* v. *Maschinenbau* [1966] ECR 235, see Guidelines on the effect on trade concept, [2004] OJ C101/81, par. 24-43.
[19] See to this extent, for example, Case C-234/89, *Stergios Delimitis* v. *Henninger Bräu AG.* [1991] ECR I-935; Case C-306/96, *Javico International and Javico AG* v. *Yves Saint Laurent Parfums SA* [1998] ECR I-1983.

Member States, the Commission has recently introduced an attempt to quantify the concept of appreciability.[20]

2.1.2 Undertakings (or association of undertakings)

Article 81 (as well as Article 82) EC merely deals with undertakings and associations of undertakings. The basic definition of an undertaking has been given by the Court of Justice in the landmark case *Höfner*, in which it stated that "the concept of an undertaking encompasses every entity engaged in an economic activity, regardless of the legal status of the entity and the way in which it is financed".[21] From these wordings, it is clear that government bodies can be an undertaking within the meaning of Article 81 EC, but that it depends on the extent to which they are engaged in an economic activity whether any collusive measures are caught by Article 81(1).[22] Economic activity, in turn, is defined as the offering of goods or services on a given market.[23] This framework is not different in its application in assessing the competitive effects of resale price maintenance. Therefore, I will refrain from a more thorough analysis on this element and merely refer to the basic literature on this matter.[24]

2.1.3 Collusion

The third element of Article 81(1) EC that is to be discussed is the existence of an 'agreement', a 'decision' or of 'concerted practice'. That is, the third element of Article 81 EC entails the question whether the parties concerned have engaged in collusion (or coordination).[25] For proving the existence of a decision of an association of undertakings, the point of discussion can be whether it has been a decision,[26] but also whether the decision-making organ is an association of undertakings within the meaning of Article 81 EC, in which the question whether the members are engaged in an economic activity is raised again.[27] More ambiguous is, however, the term of a concerted practice, which is said to be designed to provide a safety-net catching relatively loose forms of collusion.[28]

Probably the most relevant (and tangible) form of collusion for RPM, however, is the agreement. It is clear from the case law that, for the Commission to prove that there has been an agreement, it is

[20] See Guidelines on the effect on trade concept, [2004] OJ C101/81, par. 50 ff.
[21] Case C-41/90, *Klaus Höfner and Fritz Elser* v. *Macrotron GmbH* [1991] ECR I-1979, par. 21.
[22] For the distinction between economic and non-economic activities, see for example, Case C-41/90, *Klaus Höfner and Fritz Elser* v. *Macrotron GmbH* [1991] ECR I-1979, Case C-343/95, *Diego Calì & Figli Srl* v. *Servizi ecologici porto di Genova SpA* [1997] ECR I-1547, and Case C-205/03, *Federación Española de Empresa de Tecnología Sanitaria (FENIN)* v. *Commission* [2006] ECR I-6295.
[23] Case C-35/96, *Commission* v. *Italy* [1998] ECR I-3851, par. 36.
[24] See e.g. Faull and Nikpay 2007, pp. 188-195; Jones and Sufrin 2008, pp. 128-147; Whish 2009, pp. 82-97.
[25] Case C-49/92 P, *Commission* v. *Anic Partecipazioni* [1999] ECR I-4125, par. 112.
[26] See e.g. Case 96/82, *IAZ* [1983] ECR 3369 in which the question came whether a recommendation made by an association of undertakings was to be considered as a decision, which the Court answered positively.
[27] See for example the landmark cases C-309/99, *J. C. J. Wouters, J. W. Savelbergh and Price Waterhouse Belastingadviseurs BV* v. *Algemene Raad van de Nederlandse Orde van Advocaten* [2002] ECR I-1577, T-193/02, *Laurent Piau* v. *Commission* [2005] ECR II-209 and C-519/04 P, *David Meca-Medina and Igor Majcen* v. *Commission* [2006] ECR I-6991.
[28] Jones and Sufrin 2008, pp. 173-174. For an explicit example of the treatment of concerted practice, see Case C-7/95 P, *John Deere Ltd* v. *Commission* [1998] ECR I-3111.

sufficient that the undertakings in question have expressed their joint intention to conduct themselves on the market in a specific way.[29] That is, "the concept of an agreement within the meaning of Article [81(1)] of the Treaty, as interpreted by the case-law, centres around 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".[30] Concurrence of wills can therefore be established regardless of they are legally binding and whether they are in writing or oral.[31] Moreover, and especially relevant for resale price maintenance, has been the ruling of the ECJ in the *Grundig/Consten* case in which it ruled that Article 81 also applies to vertical agreements.[32] This also includes when the upstream undertaking imposes terms and conditions on the downstream undertaking. In this, the Court distinguishes between situations in which an undertaking has adopted a apparent unilateral measure,[33] and those in which this unilateral character is actually genuine. The former category is especially relevant for vertical restraints such as RPM as it covers those agreements which appear to be adopted unilaterally, but nevertheless receive at least tacit acquiescence from the other parties.[34] An example of a situation in which this issue may rise is when an upstream manufacturer implements terms and conditions in which it is stated that retailers may not charge prices below a certain threshold (i.e. minimum resale prices), and announces that he will not deal with those not adhering to this contract. Jones and Sufrin argue that the Commission, in such a situation, takes a broad view of agreement, and has on multiple occasions been prepared to infer the existence of an agreement in cases of apparent unilateral behaviour.[35] However, the Court of Justice has made clear that an agreement cannot be presumed to exist in absence of a concurrence of wills, consisting at the very least of a tacit acquiescence.[36] This can be illustrated by the *Volkswagen* case.[37]

The Volkswagen case and the concept of agreement within 81(1) EC

In *Volkswagen*, a complaint was issued that Volkswagen was fixing the selling price of its Volkswagen Passat model in Germany. Although Volkswagen argued that its pricing policy was to be regarded as non-binding price recommendations, the Commission considered it to be "aimed at setting resale prices and hence at eliminating an essential factor of competition, namely the scope for granting price discounts".[38] Moreover, the Commission held that the admission to the distribution network implied that the contracting parties explicitly or implicitly accept the distribution policy of the manufacturer,

[29] Case 41/69, *ACF Chemiefarma* v. *Commission* [1970] ECR 661, par. 112; Joined Cases 209/78 to 215/78 and 218/78 *Van Landewyck and Others* v. *Commission* [1980] ECR 3125, par. 86; Case T-7/89 *Hercules Chemicals* v. *Commission* [1991] ECR II-1711, par. 256).
[30] Case T-41/96, *Bayer AG* v. *Commission* [2000] ECR II-3383, par. 69. This was confirmed on appeal in Cases C-2/01 P and C-3/01 P, *Bundesverband der Arzneimittel-Importeure eV and Commission* v. *Bayer AG* [2004] ECR I-23.
[31] See Jones and Sufrin 2008, p. 149 and Whish 2009, pp. 97-98 and the references to the case law therein.
[32] Cases 56/64 and 58/64, *Etablissements Consten SA & Grundig-Verkaufs-GmbH* v. *Commission* [1966] ECR 299.
[33] See, for example, Joined Cases 32/78, 36/78 to 82/78, *BMW Belgium and others* v. *Commission* and, more recently, Case T-325/01, *DaimlerChrysler AG* v. *Commission*
[34] See Wijckmans et al. 2006, pp. 65 ff. and Case T-41/96, *Bayer AG* v. *Commission* [2000], ECR II-3383, par. 70-71.
[35] Jones and Sufrin 2008, p. 156.
[36] See for example Case 107/82, *AEG-Telefunken* v. Commission [1983] ECR 3151, par. 38 and Case C-338/00 P, *Volkswagen AG* v. *Commission* [2003] ECR I-9189, par. 67.
[37] *Volkswagen*, [2001] OJ L262/14; Case T-208/01, *Volkswagen AG* v. *Commission* [2003] ECR II-5141; Case C-74/04 P, *Commission* v. *Volkswagen AG* [2006] ECR I-6585.
[38] *Volkswagen*, [2001] OJ L262/14, par. 76.

and that the warnings to ensure compliance with the pricing policies that were subsequently issued were part of the agreements between Volkswagen AG and the dealers.[39] Consequently, the Commission imposed a fine of EUR 30.96 million on Volkswagen AG.

On appeal, the Court of First Instance (CFI) repeated earlier case law by stating that the answer to the question as to whether there is an agreement depends on the existence of a concurrence of wills, regardless of its form, but that where a manufacturer's decision constitutes genuinely unilateral conduct, it escapes the prohibition in Article 81(1).[40] The CFI disagreed with the Commission that the dealers' tacit acquiescence could be established merely in the attitude adopted by the manufacturer (i.e. sending warnings to ensure compliance with the pricing policies).[41] Further, the Court held, contrary to the Commission, that the dealers' had by signing a lawful distribution agreement accepted a unlawful contract variation in advance. As a result, the Court of First Instance considered that the Commission had not proven the existence of an agreement, and annulled the Commission's decision.

The Commission appealed to the European Court of Justice (ECJ). The ECJ found that the CFI had made an error of law by automatically excluding the possibility that the issuing of warnings might have been authorised by seemingly neutral clauses in the contract. It ruled that by signing a dealership agreement, the dealers were said to have given their prior consent to all measures adopted by Volkswagen AG within the context of that contractual relationship, and that the CFI, therefore, should have examined whether the warnings were part of the agreement.[42] However, the ECJ stated that not "any call by a motor vehicle manufacturer to dealers constitutes an agreement within the meaning of Article 81(1) EC"[43] and that, in this case, the clauses in the contract could not have been regarded as having authorised Volkswagen to issue binding recommendations regarding the price of new vehicles.[44] The appeal was therefore dismissed.

The *Volkswagen* case illustrates that the Commission has a relatively high burden to discharge before it can establish that a concurrence of wills regarding RPM-clauses, or vertical restraints in general,[45] is present.

2.1.4 The object or effect the restriction of competition

As mentioned above, *Grundig/Consten* is often seen as a turning point in the analysis of vertical agreements in EC competition law for two reasons. First, the Court ruled that vertical agreements might also be caught by Article 81(1) EC. Secondly, although it was often held, especially in early case law, that distribution agreements would have no effect on trade between Member States, the Court was of the opinion that such agreements may nevertheless frustrate the objective of single market integration by contributing to the partitioning of the common market. Although it is defendable

[39] [2001] OJ L262/14, par. 57-58.
[40] Case T-208/01, *Volkswagen AG* v. *Commission* [2003] ECR II-5141, par. 30-32.
[41] Case T-208/01, *Volkswagen AG* v. *Commission* [2003] ECR II-5141, par. 36.
[42] Case C-74/04 P, *Commission* v. *Volkswagen AG* [2006] ECR I-6585, par. 34 and 39-48.
[43] Case C-74/04 P, *Commission* v. *Volkswagen AG* [2006] ECR I-6585, par. 36.
[44] Case C-74/04 P, *Commission* v. *Volkswagen AG* [2006] ECR I-6585, par. 52-54.
[45] See Wijckmans et al. 2006, pp. 66-71 and Lianos 2008 for a discussion on tacit acquiescence in the context of vertical restraints.

that there has been a shift in the objectives of competition law towards the mere promotion of consumer welfare,[46] vertical agreements, and especially those arranging RPM, have continuously been subject to strict application of EC competition law. The reason for this strict approach regarding resale price maintenance is that the instrument – at least when prescribing minimum or fixed resale prices – is categorised as one that has as its object the restriction of competition, i.e. a hardcore restriction. This section will illustrate the consequences of this categorisation as a hardcore restriction regarding Article 81(1) EC, but at the same time show that there has been a tendency to apply EC competition law less rigidly to certain (vertical) agreements, including to hardcore restrictions. Therefore, this section will firstly briefly review the early, rather interventionist, approach by the Commission vis á vis vertical restraints and RPM and show that there has been a development towards a 'more economic approach' (i.e. effects-based). Secondly, I will outline the current approach on RPM as an instrument that has as its object (or – depending on its form – effect) the restriction of competition. Finally, this section will briefly introduce the discussion regarding a possible policy change towards an effects-based policy even when dealing with hardcore restrictions.

As is clear from the wordings of Article 81(1) EC, competition law prohibits agreements which have as their object *or* its effect the restriction of competition. In *Société Technique Minière*, the Court has made clear that the phrase 'object or effect' is to be read disjunctively,[47] which' corollary is explained in *Grundig/Consten*: once it is established that an agreement has as its object the restriction of competition, there is no need to take account of its concrete effects.[48] However, neither from the wordings of the prohibition itself, nor from the illustrative list provided for in Article 81(1)(a)-(e) EC, is it clear what should be considered an agreement that has as its object the restriction of competition. From the case law, however, it has become clear that the word 'object' in this context does not mean the subjective intention of the parties when entering into the agreement, but rather the objective meaning and purpose of the agreement considered in the economic context in which it is applied.[49] In *European Night Services* v. *Commission*, the Court of First Instance elaborated on the concept of such an object, or hardcore, restriction and ruled that this kind of agreements contains "obvious restrictions of competition such as price-fixing, market-sharing or the control of outlets".[50] However, in this case, the Court referred to the concept of horizontal, rather than vertical price-fixing (RPM). Nevertheless, in line with the judgement in *Grundig/Consten*, vertical price-fixing has been judged to be in breach

[46] See infra paragraph 3.1.1.
[47] Case 56/65, *Société Technique Minière* v. *Maschinenbau Ulm GmbH* [1966] ECR 235, p. 249.
[48] Cases 56/64 and 58/64, *Etablissements Consten SA & Grundig-Verkaufs-GmbH* v. *Commission* [1966] ECR 299, p. 342.
[49] See Whish 2009, p. 116, and Case 29/83 and 30/83, *Compagnie Royale Asturienne des Mines SA and Rheinzink GmbH v Commission* [1984] ECR 1679, par. 26.
[50] Joined Cases T-374/94, T-375/94, T-384/94 and T-388/94, *European Night Services* v. *Commission* [1998] ECR II-3141, par. 136.

with Article 81(1) EC on numerous occasions, both in the Commission's decision-making practice and in the Court's jurisprudence.[51]

It is without a doubt, however, that the early – that is, before 1995[52] – approach of the Commission vis á vis vertical restraints has been extremely controversial. This criticism on its approach has ultimately caused the Commission to reform its rather interventionist approach on distribution agreements in general.

> **The reform in the Commission's policy regarding vertical restraints**
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> The criticism on the Commission's application of Article 81(1) EC to vertical restraints can be summarised in five arguments. First, the Commission's approach to distribution agreements was often said to be flawed because it refused to recognise the distribution efficiencies that may result from vertical restraints.[53] Secondly, the Commission has been blamed for using an overly broad application of Article 81(1),[54] which ultimately leads to legal uncertainty. In this context, Hawk, for example, has argued that the Commission's "stubborn adherence" to the definition of a restriction on competition as a restriction on the 'economic freedom' of operators in the market place fails to provide operable criteria to determine which agreements actually restrict competition.[55] Thirdly, and related to the second argument, the Commission's policy was said to be flawed because it pursued not only the goal of undistorted competition, but also that of market integration, which led to a "two way tug on policy-makers", in which they had to deal with the discrepancy that certain vertical agreements ought be allowed under the first, but would be contrary to the second objective.[56] Fourthly, the Commission was accused of shifting the analysis from Article 81(1) to 81(3) where the Commission had exclusive competence (i.e. the national courts were not competent to apply Article 81(3) prior to Regulation 1/2003).[57] Finally, both in Article 81(1) and 81(3), the Commission was said to have adopted a too formalistic approach, therefore being unable to cope with the economic reality.[58]

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[51] Examples of the Commission's decision-making practice condemning RPM are *Deutsche Philips* [1973] OJ L293/40; *SABA* [1976] OJ L28/19; *GERO-fabriek* [1976] OJ L16/8; *Hennesey-Henkell* [1980] OJ L383/11; *VBBB/VBVB* [1982] OJ L54/36; *Hasselblad* [1982] OJ L161/18; *Vimpoltu* [1983] OJ L200/44; *Polistil/Arbois* [1984] OJ L136/9; *Pronuptia* [1987] OJ L13/39; *Yves Rocher* [1987] OJ L8/49; *Computerland* [1987] OJ L222/12; *ServiceMaster* [1988] OJ L332/38; *Novaillance/Systemform* [1997] OJ L47/11; *JCB* [2002] OJ L69/1; *Nathan-Bricolux* [2001] OJ L54/1; *Volkswagen* [2001] OJ L262/14; *Mercedez-Benz* [2002] OJ L257/1; *Yamaha*, not yet published. For the case law, see e.g. Case 107/82, *Allgemeine Elektrizitäts-Gesellschaft AEG-Telefunken AG* v. *Commission* [1983] ECR 3151; 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; Case 243/83, *SA Binon & Cie* v. *SA Agence et messageries de la presse* [1985] ECR 2015; Case 161/84, *Pronuptia de Paris GmbH* v. *Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 353; Case 27/87, *SPRL Louis Erauw-Jacquery* v. *La Hesbignonne SC* [1988] ECR 1919. In the literature, see for example Jones and Sufrin 2008, pp. 236, 716-718; Korah 2006, pp. 540-542; Whish 2009, pp. 637-638; Wijckmans et al. 2006, pp. 156-164.

[52] See for example Korah and Rothnie 1992 and Gambardella and Salerno 2007, pp. 183-189 for a description of the Commission's early interventionist approach.

[53] See e.g. Hawk 1988 and Hawk 1995. Regarding distribution efficiencies, see also infra paragraph 3.2.

[54] See Hawk 1988, p. 65; Bright 1995; Deacon 1995.

[55] Hawk 1995, pp. 977-979.

[56] Deacon 1995, par. 9. See also Reich 1997, who notes that also the prevention of competition from being distorted to the detriment of the public interest, and the protection of individual undertakings are objectives of competition law, but that this results in a system with inherent conflicts.

[57] Hawk 1995, pp. 977-979. See paragraph 2.2 for a discussion on Article 81(3) EC.

[58] Hawk 1995.

> This stream of criticism was responded to by the Commission by issuing its Green Paper on Vertical Restraints in 1996, in which it was acknowledged that its policy needed revision.[59] Barely two years later, the Commission already introduced legislative changes with Regulation 2790/1999,[60] whereas approximately one half year later this legislative piece was accompanied by the Commission's Guidelines on Vertical Restraints.[61] In 2004, the Commission issued its Guidelines on the application of Article 81(3) of the Treaty,[62] which also has some relevance for Article 81(1) EC.[63] The gradual, though fundamental reorientation of substantive EC competition law has come to be referred to as the 'more economic approach',[64] which can be defined as a development pursuant to which the assessment of each specific case will not be undertaken on the basis of the form or the intrinsic nature of a particular practice (form-based approach) but rather will be based on the assessment of its anti- and pro-competitive effects (effects-based approach).[65]

In general, this reform towards a 'more economic approach' to vertical agreements has inter alia caused that many vertical agreements suddenly do not infringe Article 81(1) EC at all, or if they do, may find that the criteria of the exemption provided for in Article 81(3) EC are to be applied more flexibly.[66] This modernisation of competition law has also had consequences for the application of Article 81(1) EC to resale price maintenance.

Under the 'old' system, *fixed*, *minimum* and *maximum* resale price clauses were considered hardcore restrictions and therefore by definition an infringement of Article 81(1) EC. Moreover, judging from the case law, the Commission argued that "it will not as a rule qualify for exemption" in Article 81(3) EC.[67] In this regime, the Commission only allowed pricing practices whereby the supplier provides the dealer with lists of *recommended* prices, provided these are not followed up with instructions or other binding measures.[68] This view has been taken by both the Court,[69] and the Commission.[70] Under the

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[59] Green Paper on Vertical Restraints in EU Competition Policy (hereafter Green Paper on Vertical Restraints), COM(96) 721.
[60] Commission Regulation No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices (hereafter Verticals Regulation), [1999] OJ L336/21. See infra paragraph 2.2.2.
[61] Commission Notice – Guidelines on Vertical Restraints (hereafter Guidelines on Vertical Restraints), [2000] OJ C291/1.
[62] Commission Notice – Guidelines on the application of Article 81(3) of the Treaty (hereafter Guidelines on the application of Article 81(3)), [2004] OJ C101/97.
[63] Regulation 2790/1999 and the Guidelines on the application of Article 81(3) will be discussed in more detail in paragraph 2.2.
[64] See e.g. Gerber 2008.
[65] Schmidtchen 2007, p. 1; Gerber 2008. The 'more economic approach' extends to other competition policy fields as well, such as abuse of a dominant position and EC merger control.
[66] Jones and Sufrin 2008, p. 709. For Article 81(3) EC, see paragraph 2.2.
[67] Green Paper on Vertical Restraints in EU Competition Policy (hereafter Green Paper on Vertical Restraints), COM(96) 721, par. 157.
[68] Green Paper on Vertical Restraints in EU Competition Policy (hereafter Green Paper on Vertical Restraints), COM(96) 721, par. 157.
[69] See Case 107/82, *Allgemeine Elektrizitäts-Gesellschaft AEG-Telefunken AG* v. *Commission* [1983] ECR 3151, par. 123 in which the Court argued that "it would no doubt be going too far to take the view that a reference in an informal conversation to a price which [AEG] regarded as chargeable for a given type of equipment is in itself tantamount to bringing an unlawful influence to bear on prices. Also in Case 161/84, *Pronuptia de Paris GmbH* v. *Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 353, par. 25, regarding a franchising agreement, the Court has explicitly stated that "although provisions which impair the franchisee's freedom to determine his own prices are restrictive of competition, that is not the case where the franchisor simply provides franchisees with price guidelines, so long as there is no concerted practice between the franchisor and the franchisees or between the franchisees themselves for the actual application of such prices".

'new system', however, comprising of the Guidelines on Vertical Restraints and of Regulation 2790/1999, only "agreements or concerted practices having as their direct or indirect object the establishment of a *fixed* or *minimum* resale price" form hardcore restrictions.[71] Both *maximum* and *recommended* resale prices are, however, not considered hardcore restrictions, though they may still lead to a restriction of competition by effect.[72] That is, pursuant to the Guidelines on Vertical Restraints, the Commission has switched from categorising clauses containing the prescription of maximum resale prices as restrictions which have as their object the restriction of competition to a policy in which these are thought to be capable of restricting competition by effect.

Therefore, as to the current approach vis á vis resale price maintenance – the second point to address in this section – the state of affairs is as follows. On the one hand, minimum and fixed resale price maintenance, are considered to be hardcore restrictions,[73] hence they are said to "have such a high potential of negative effects of competition that it is unnecessary for the purposes of applying Article 81(1) to demonstrate any actual effects on the market".[74] As a result, minimum and fixed resale price maintenance form by definition an infringement of Article 81(1), unless exempted through Article 81(3).[75] Agreements entailing minimum or fixed RPM can take various forms, i.e. they can fix resale prices directly or indirectly. The most straightforward application of minimum or fixed RPM is the *direct* imposition of prices by means of a contractual provision (or concerted practice).[76] In that case, the Commission is of the opinion that, in such a case, the restriction is "clear cut".[77] Direct vertical-price-fixing can be implemented in the case where a single supplier agrees with its purchasers that they will not sell below a certain price,[78] but also when groups of suppliers agree to impose resale prices on their purchasers, i.e. collective resale price maintenance.[79] However, it is generally accepted that resale price maintenance can also be achieved through *indirect* means.[80] Examples of indirect price-fixing in a vertical relation are fixing the distribution margin,[81] fixing the maximum level of discount the distributor can grant from a prescribed price level,[82] making the grant of rebates or

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70 See for example *Pronuptia* [1987] OJ L13/39, par. 39; *Yves Rocher* [1987] OJ L8/49, par. 49; *Computerland* [1987] OJ L222/12, par. 12; *ServiceMaster* [1988] OJ L332/38, par. 20. See Wijckmans et al. 2006, pp. 162-164
71 Guidelines on Vertical Restraints, [2000] OJ C291/1, par. 47.
72 Guidelines on Vertical Restraints, [2000] OJ C291/1, par. 111. See *Nathan-Bricolux* [2001] OJ L54/1 (outlined below).
73 Guidelines on Vertical Restraints, [2000] OJ C291/1, par. 47. See also Regulation 2790/1999 in which both fixed and minimum RPM are black-listed in the sense that they are not eligible for exemption, see infra paragraph 2.2.2.
74 Guidelines on the application of Article 81(3), [2004] OJ C101/97, par. 21.
75 See infra paragraph 2.2.
76 See also Wijckmans et al. 2006, p. 159.
77 Guidelines on Vertical Restraints, [2000] OJ C291/1, par. 47.
78 See for example *Deutsche Philips GmbH* [1973] OJ L293/40; *Novalliance/Systemform* [1997] OJ L47/11; *Nathan-Bricolux* [2001] OJ L54/1.
79 See e.g. *VBBB/VBVB* [1982] OJ L54/36 in the context of fixed book prices. See van Bael 2005, p. 227. See infra paragraph 3.1.2 for more information of RPM in the context of fixed book prices.
80 See the Guidelines on Vertical Restraints, [2000] OJ C291/1, par. 47, Wijckmans et al. 2006, pp. 159-162 and van Bael 2005, pp. 226-227.
81 See e.g. *Yamaha*, not yet published, par. 81-82 and 144.
82 See e.g. *Mercedes-Benz* [2002] OJ L257/1, par. 113; *Yamaha*, not yet published, par. 126; *Vimpoltu* [1983] OJ L200/44, par. 16-18.

reimbursement of promotional costs by the supplier subject to the observance of a given price level,[83] linking the prescribed resale price to the resale prices of competitors,[84] and threats, intimidation, warnings, penalties, delay or suspension of deliveries or contract terminations (i.e. sanctions) in relation to observance of a given price level.[85] Regardless of the form, the Commission holds that (direct or indirect) minimum or fixed RPM 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 who deviate from the standard price level.[86]

On the other hand, maximum and recommended resale price maintenance, are regarded as agreements that do not have as their object the restriction of competition. However, even though maximum or recommended RPM clauses are no hardcore restrictions, they may still have the effect of restricting competition.[87] Therefore, when the Commission is aware that an producer imposes maximum or recommended resale prices on its distributors, it has to examine whether this has restrictive effects on competition, by taking into account both actual and potential restrictive effects.[88] In this, the Commission needs to look into the legal and economic context in which the agreement was concluded by the parties.[89] This entails an extensive analysis of the effects of the agreements on the market, as the Court has held that "in order to examine whether it is caught by article [81(1)] an agreement cannot be examined in isolation from the above context, that is, from the factual or legal circumstances causing it to prevent, restrict or distort competition".[90] In its Guidelines on the application of Article 81(3), the Commission has outlined its policy regarding this analysis.[91] Moreover, pursuant to the judgement of the Court of First Instance in the *O2* case, it is necessary for the Commission to examine, first, what the competition situation would have been in the absence of the agreement, i.e. the Commission needs to establish a 'counter-factual',[92] and second, to sufficiently substantiate the negative impact of the agreement on competition.[93] As will be elaborated upon below, this extensive analysis of the effects on the market before deciding whether or not the maximum or recommended RPM falls within Article

[83] See e.g. Case 107/82, *Allgemeine Elektrizitäts-Gesellschaft AEG-Telefunken AG* v. *Commission* [1983] ECR 3151, par. 124-128.
[84] See e.g. Case 107/82, *Allgemeine Elektrizitäts-Gesellschaft AEG-Telefunken AG* v. *Commission* [1983] ECR 3151, par. 87-91.
[85] See e.g. the decision in *Volkswagen AG* [2001] OJ L262/14, par. 66 (supra paragraph 2.1.3), *Hasselblad* [1982] OJ L161/18, par. 36 ff. and Case 107/82, *Allgemeine Elektrizitäts-Gesellschaft AEG-Telefunken AG* v. *Commission* [1983] ECR 3151, par.129-130.
[86] Guidelines on Vertical Restraints, [2000] OJ C291/1, par. 47. See also Wijckmans et al. 2006, pp. 161-162.
[87] See Guidelines on Vertical Restraints, [2000] OJ C291/1, par. 111-112, 225-228. In the literature, see for example Jones and Sufrin 2008, pp. 236 ff. and Whish 2009, pp. 122 ff.
[88] Guidelines on the application of Article 81(3), [2004] OJ C101/97, par. 24, and Case C-7/95 P, *John Deere* [1998] ECR I-3111, par. 77.
[89] Cases 56/64 and 58/64, *Etablissements Consten SA & Grundig-Verkaufs-GmbH* v. *Commission* [1966] ECR 299, p. 343.
[90] Case 23/67, *SA Brasserie de Haecht* v. *Consorts Wilkin-Janssen* [1967] ECR 407, p. 40. In this context, see also Case C-234/89, *Stergios Delimitis* v. *Henninger Bräu AG* [1991] ECR I-935, par. 13 ff.
[91] Guidelines on the application of Article 81(3), [2004] OJ C101/97, par. 24 ff.
[92] Whish 2009, p. 124.
[93] Case T-328/03, *O2 GmbH & Co. OHG* v. *Commission* [2006] ECR II-1231, par. 73.

81(1) EC "does not amount to carrying out an assessment of the pro- and anti-competitive effects of the agreement and thus to applying a rule of reason".[94] That is, although there is some ambiguity as to the exact meaning of the term 'rule of reason' (even within the context of competition policy), the extensive analysis of the effects of an agreement on the market within Article 81(1) does not entail a balancing of pro- and anti-competitive effects, as both the Commission and the Court have stated that this would deprive Article 81(3) EC of its objective.[95]

As to the treatment of recommended prices, it has already been argued above that both the Court and the Commission take the view that this in itself does not amount to a restriction of competition.[96] As a result, producers are generally free – though depending on the outcome of the extensive analysis of the effects on the market as discussed above – to recommend prices for their distributors to charge.[97] Moreover, the fact that a producer relies on these recommended prices to establish his own sales prices does not alter this conclusion.[98] However, recommended resale prices can be regarded as minimum or fixed RPM when the producer attempts to influence its distributor in its pricing behaviour, e.g. by price monitoring or sanctioning non-compliance (so that it amounts to indirect price-fixing).[99] As a result, the distinction between minimum or fixed RPM and recommended RPM may be unclear, as is illustrated in the case outlined below.

> **JCB and the question of fixed or recommended resale price maintenance**
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> In *JCB*,[100] the Commission had imposed fines on JCB for various infringements of Article 81 EC, including RPM in the United Kingdom and France. According to JCB, it made use of recommended prices which, however, involved no assumption that its distributors would sell at the list price or otherwise guaranteed distributor margins. Accordingly, JCB stated "that recommended retail price lists were and always had been mere recommendations".[101] The Commission, however, was of the opinion that JCB's recommended prices amounted to price-fixing, as the recommendations were followed up by several documents expressing JCB's disappointment with the discount level used by its distributors.[102]

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[94] Case T-328/03, *O2 GmbH & Co. OHG* v. *Commission* [2006] ECR II-1231, par. 69.
[95] See *White paper on modernisation of the rules implementing Article 85 and 86 (now 81 and 82) of the EC Treaty*, [1999] OJ C132/1, par. 56; Case T-112/99, *Métropole télévision (M6)* v. *Commission* [2001] ECR II-2459, par. 74. The ambiguity concerning the concept stems from the fact that EC competition policy does allow public policy concerns to be taken into account, which is sometimes also referred to as a rule of reason (see infra paragraph 3.1.2).
[96] Case 107/82, *Allgemeine Elektrizitäts-Gesellschaft AEG-Telefunken AG* v. *Commission* [1983] ECR 3151, par. 123; Case 161/84, *Pronuptia de Paris GmbH* v. *Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 353, par. 25; *Pronuptia* [1987] OJ L13/39, par. 39; *Yves Rocher* [1987] OJ L8/49, par. 49; *Computerland* [1987] OJ L222/12, par. 12; *ServiceMaster* [1988] OJ L332/38, par. 20.
[97] Guidelines on Vertical Restraints, [2000] OJ C291/1, par. 47.
[98] Wijckmans et al. 2006, p. 162.
[99] Van Bael 2005, p. 228. For an example, see supra paragraph 2.1.3 for an outline of the *Volkswagen* case in which Volkswagen issued warnings to ensure compliance with the 'recommended' prices imposed by Volkswagen.
[100] *JCB* [2002] OJ L69/1; Case T-67/01, *JCB Service* v. *Commission* [2004] ECR II-49; Case C-167/04, *JCB Service* v. *Commission* [2006] ECR I-8935.
[101] *JCB* [2002] OJ L69/1, par. 132.
[102] *JCB* [2002] OJ L69/1, par. 129 and 133.

The Court of First Instance, however, disagreed with the Commission that the price recommendations by JCB amounted to price-fixing. The CFI stated that “some limitation in price competition is inherent in any selective distribution system”,[103] and agreed that “JCB Sales, by drawing up lists of recommended retail selling prices for its products and determining invoice prices internal to its network according to those expected retail prices, exercised an influence over the fixing of retail prices”[104]. However, so the Court continued, although the influence of JCB on retail prices was significant, and strongly indicative, they were none the less not binding.[105] As a result, the Commission’s decision was partly annulled. The case has also been brought before the ECJ, but the finding that JCB’s recommendations did not amount to price-fixing was not challenged.

Similarly, the imposition of maximum resale prices on a distributor is under the ‘new’ system no hardcore restriction and, therefore, does not necessarily infringe Article 81(1) EC. However, the imposition of maximum resale prices can also amount to fixed RPM when the supplier exerts influence upon the buyer not to sell below the maximum level.[106] Although the ECJ has never ruled on the imposition of maximum prices,[107] the Commission has explained its position on this matter in the *Nathan-Bricolux* case, outlined below.

Nathan-Bricolux and the demarcation between maximum and fixed RPM

In *Nathan-Bricolux,*[108] Nathan had signed an exclusive dealing agreements with its distributors, Bricolux in Belgium, Smartkids in Sweden and Borgione in Italy, whereas it was distributing its products in France itself. In these agreements, a maximum price was set in that it was agreed that the prices “shall not exceed the price at which Nathan sells the same products in France by more than 5 %”.[109] However, this provision concerning the maximum price was supplemented by another provision which stipulated that the distributors “will refrain from all commercial conduct (special offers, discounts, rebates, clearance sales, etc.) liable to damage the Nathan brand”,[110] i.e. a ban on e.g. discounts.

The Commission stated explicitly stated that it had changed its mind regarding the lawfulness of maximum RPM. The Commission stated that “[it] no longer believes that an obligation not to exceed a maximum resale price, in this case a multiplier of the price charged in France by Nathan for the same products […], in itself necessarily restricts competition […]. However, the maximum price imposed here serves as a ceiling for a range of resale prices, at the bottom end of which is the ban on promotional discounts. As a result, the agreements fix effectively a resale price level (after discounts and rebates), although the range is fairly broad”.[111] Moreover, although not all the distributors adhered to the maximum resale price stipulated in the agreement, the Commission was still convinced of Nathan’s attempt to fix prices and therefore imposed a fine on Nathan for infringing Article 81 EC.

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[103] Case T-67/01, *JCB Service* v. *Commission* [2004] ECR II-49, par. 131.
[104] Case T-67/01, *JCB Service* v. *Commission* [2004] ECR II-49, par. 126.
[105] Case T-67/01, *JCB Service* v. *Commission* [2004] ECR II-49, par. 130.
[106] See van Bael 2005, p. 228, who explains how imposing a ‘most favoured customer’ clause can result in a significant disincentive for the reseller to sell below the maximum resale price.
[107] Whish 2009, p. 653.
[108] *Nathan-Bricolux* [2001] OJ L54/1.
[109] *Nathan-Bricolux* [2001] OJ L54/1, par. 43.
[110] *Nathan-Bricolux* [2001] OJ L54/1, par. 44 and 50.
[111] *Nathan-Bricolux* [2001] OJ L54/1, par. 87.

As mentioned above, whether genuine maximum or recommended RPM clauses are allowed depends on the outcome of the Commission's (or NCA's) extensive analysis of the effects of the agreement while explicitly taking into account the factual, legal and economic circumstances of the market in question. In its assessment, the Commission is especially concerned that recommended (or maximum) price maintenance will, in practice, amount to fixed RPM and thereby work as a focal point for the resellers to facilitate collusion between suppliers.[112] Therefore, the Commission especially takes into account the market position of the supplier – as the stronger the market position of the supplier, the higher the risk that a maximum or recommended RPM will be adhered to uniformly by the resellers – and the market position of competitors, because especially in an oligopoly (where there are relatively little competitors) the imposition of maximum or recommended RPM may facilitate forming a cartel.[113]

The third and final point that is to be addressed in this section is that it should be pointed out that there may be a trend going on in which the Courts require the Commission to discharge a heavier burden for establishing an infringement of Article 81(1) EC, even in the case of a hardcore restriction. That is, recent developments indicate that a trend towards the application of effects-based policy, even within the context of hardcore restrictions such as minimum and fixed RPM. As mentioned before, the Commission's current position on hardcore restrictions is that once it is established that an agreement has as its object the restriction of competition (i.e. hardcore restriction), there is no need to take account of its concrete effects.[114] This view corresponds with that of the Court issued in most case law.[115] Especially with regard to vertical price-fixing, a hardcore restriction of competition, the Court has consistently held that "price competition is so important that it can never be eliminated",[116] that "provisions which fix the prices to be observed in contracts with third parties constitute, of themselves, a restriction on competition within the meaning of article [81(1)] EC",[117] and in a franchising context, "provisions which impair the franchisee's freedom to determine his own prices are restrictive of competition".[118] However, there are also examples in the case law of the Courts that indicate a less rigid stance towards a reduction (or even elimination) of price competition. In several cases concerning a selective distribution agreement, the Courts have held that "price competition […] does not constitute the only effective form of competition or that to which absolute priority must in all circumstances be accorded",[119] and that "a restriction of price competition must however be regarded

[112] Guidelines on Vertical Restraints, [2000] OJ C291/1, par. 226. See infra Chapter 3 for a thorough discussion on the economics of RPM.
[113] Guidelines on Vertical Restraints, [2000] OJ C291/1, par. 227-228.
[114] Guidelines on the application of Article 81(3), [2004] OJ C101/97, par. 21.
[115] See e.g. Cases 56/64 and 58/64, *Etablissements Consten SA & Grundig-Verkaufs-GmbH* v. *Commission* [1966] ECR 299, p. 342.
[116] Case 26-76, *Metro SB-Großmärkte GmbH & Co. KG* v. *Commission* [1977] ECR 1875, par. 21.
[117] Case 243/83, *SA Binon & Cie* v. *SA Agence et messageries de la presse Binon* [1985] ECR 2015, par. 44
[118] Case 161/84, *Pronuptia de Paris GmbH* v. *Pronuptia de Paris Irmgard Schillgallis*, par. 25.
[119] Case 26-76, *Metro SB-Großmärkte GmbH & Co. KG* v. *Commission* [1977] ECR 1875, par. 21. This statement was repeated in Case C-198/01, *Consorzio Industrie Fiammiferi (CIF)* v. *Autorità Garante della Concorrenza e del Mercato*

as being inherent in any selective distribution system [because] that restriction [might be] counterbalanced by competition as regards the quality of the services supplied to customers, which would not normally be possible".[120] These statements show that the European Courts might be more willing to allow a restriction of price competition than the Commission, as although vertical price fixing does eliminate intra-brand price competition, it does not eliminate intra-brand competition as a whole. By contrast, from its decision-making practice it might be concluded that the Commission is not prepared to accept a reduction of intra-brand competition to factors other than price, as it continuously emphasises the importance of price as a competitive factor.[121] In recent cases, the Commission referred to price competition as "one of the decisive factors when it comes to making a choice",[122] "an essential factor of competition",[123] and "[an instrument that] holds prices to the lowest possible level and encourages trade in goods between Member States, thereby making possible an optimal allocation of resources based on the adaptability of retailers and giving benefit to consumers".[124]

This possible discrepancy between the opinion of the Courts of the one hand, and the Commission on the other hand might ultimately reveal itself in the case law of the Court. In this context, the recent judgement by the Court of First Instance concerning the *GlaxoSmithKline* case should be mentioned.[125] Although it is not a case concerning resale price maintenance, its outcome might be very relevant for the treatment of RPM, and hardcore restrictions in general. In *GlaxoSmithKline*, the CFI held that an indirect export ban, though normally – and also in this case by the Commission – considered to be a hardcore restriction, was not to be held a restriction by object. The case is outlined below.

The GlaxoSmithKline judgement by the Court of First Instance concerning Article 81(1) EC

In *GlaxoSmithKline*,[126] the Commission had received complaints regarding GlaxoSmithKline's (GSK) general sales conditions. These conditions stipulated that wholesalers had to pay a higher price for products exported to other Member States than for those sold in Spain. More specifically, pursuant to Clause 4 of its general conditions, GSK would make a distinction between, on the one hand, the prices charged to wholesalers reselling its products to Spanish pharmacies or hospitals for (reimbursable) end-use in Spain and, on the other hand, prices charged to wholesalers exporting the products. Moreover, Clause 4 prevented Spanish wholesalers who export the drugs outside Spain from buying the drugs at the (lower) price which Spanish wholesalers had to pay when not exporting. It should be

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[2003] ECR I-8055, par. 68, and Case T-168/01, *GlaxoSmithKline Services Unlimited* v. *Commission* [2006] ECR II-2969, par. 109 (see below).

[120] Case 107/82, *Allgemeine Elektrizitäts-Gesellschaft AEG-Telefunken AG* v. *Commission* [1983] ECR 3151, par. 42, repeated by the Court of First Instance in Case T-67/01, *JCB Service* v. *Commission* [2004] ECR II-49, par. 131.

[121] Wijckmans et al. 2006, p. 157.

[122] *Mercedes-Benz* [2001] OJ L157/1, par. 181.

[123] *Volkswagen AG* [2001] OJ L262/14, par. 76.

[124] *Yamaha*, not yet published, par. 151.

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

[126] *Glaxo Wellcome* [2001] L302/1; Case T-168/01, *GlaxoSmithKline Services Unlimited* v. *Commission* [2006] ECR II-2969; Case C-501/06 P *GlaxoSmithKline Services Unlimited* v. *Commission*, not yet decided; Case C-513/06 P, *GlaxoSmithKline Services Unlimited* v. *Commission*, not yet decided. See also Ratliff 2007, pp. 38-39 and Eccles 2007.

noted that this practice concerns a limitation of parallel trade, by engaging in dual pricing, which had been condemned in earlier case law as a hardcore restriction.[127] GSK, on the one hand, argued that its general conditions did not infringe Article 81(1) as, due to the fact that it had to apply the maximum price that it had negotiated with the Spanish authorities, it was not free to set the domestic wholesale price.[128] Moreover, GSK argued that its general conditions merely compensated the distortion of competition created by the Spanish regulatory authorities, by regulating drug sales prices differently than national authorities in other Member States.[129] The Commission, on the other hand, stated that "[t]he Court of Justice (and Court of First Instance) have always qualified agreements containing export bans, dual-pricing systems or other limitations of parallel trade as restricting competition 'by object'. That is to say, prohibited by Article 81(1) without there being any need for an assessment of their actual effects. In principle they are not eligible for exemption pursuant to Article 81(3)".[130] However, the Commission stated that although it was not obliged to look into the legal and economic context of the agreement, because its 'hardcore' restriction was proven, it nevertheless had undertaken this analysis "for the sake of completeness".[131] The Commission found that the price levels that were charged in Spain were significantly below the level that GSK was able to negotiate under the regulatory system and that segmentation between Spanish domestic and export market prices did not result from national legislation. Finally, as the Commission was of the opinion that GSK's situation did not satisfy the conditions stipulated in Article 81(3), it concluded that GSK had infringed Article 81(1) EC.

Strikingly, the CFI, firstly, disagreed with the Commission that GSK's dual pricing policy had as its object the restriction of competition, even though the Commission had substantiated its position with case law on the matter. The CFI ruled that, in its case law,[132] "the Court of Justice, contrary to the Commission's contention in its written submissions, did not hold that an agreement intended to limit parallel trade must be considered by its nature, that is to say, independently of any competitive analysis, to have as its object the restriction of competition".[133] Similarly, the CFI argued that "the characterisation of a restriction of competition within the meaning of Article 81(1) EC must take account of the actual framework and, therefore, of the legal and economic context in which the agreement to which that restriction is imputed is deployed. Such an obligation is imposed for the purpose of ascertaining both the object and the effect of the agreement".[134] The Court took into account the "legal and economic context peculiar to the medicines sector", and found that "the application of Article 81(1) EC to the present case cannot depend solely on the fact that the agreement in question is intended to limit parallel trade in medicines or to partition the common market, which leads to the conclusion that it affects trade between Member States, but also requires an analysis designed to determine whether it has as its object or effect the prevention, restriction or distortion of competition on the relevant market, to the detriment of the final consumer."[135] However, the CFI agreed with the Commission that GSK's general conditions had the effect of restricting competition,

[127] See e.g. Cases 56/64 and 58/64, *Etablissements Consten SA & Grundig-Verkaufs-GmbH* v. *Commission* [1966] ECR 299.
[128] *Glaxo Wellcome* [2001] L302/1, par. 77 ff.
[129] *Glaxo Wellcome* [2001] L302/1, par. 80.
[130] *Glaxo Wellcome* [2001] L302/1, par. 124. The Commission referred to the following case law to illustrate its view: Joined Cases 96-102, 104, 105, 108, 110/82, *NV IAZ International Belgium and others* v. *Commission* [1983] ECR 3369, par. 24, 25 and 27; Case T-62/98, *Volkswagen AG* v. *Commission* [2000] ECR II-2707, par. 89 and 178.
[131] *Glaxo Wellcome* [2001] L302/1, par. 125.
[132] Cases 56/64 and 58/64, *Etablissements Consten SA & Grundig-Verkaufs-GmbH* v. *Commission* [1966] ECR 299, p. 343.
[133] Case T-168/01, *GlaxoSmithKline Services Unlimited* v. *Commission* [2006] ECR II-2969, par. 120.
[134] Case T-168/01, *GlaxoSmithKline Services Unlimited* v. *Commission* [2006] ECR II-2969, par. 110.
[135] Case T-168/01, *GlaxoSmithKline Services Unlimited* v. *Commission* [2006] ECR II-2969, par. 103 and 119.

> though made a remark that the Commission had reached this conclusion after a relatively brief examination. Similarly, in its assessment of Article 81(3), the Court found that the Commission had failed to carry out a proper examination of GSK's application for an exemption under Article 81(3) EC.[136] The Commission's decision was therefore annulled.

Although it remains to be seen what the ECJ decides in the *GlaxoSmithKline* case, it is nevertheless interesting to think about what implications the CFI judgement might have for the assessment of hardcore restrictions. It might come to mind that this judgement means that the Court requires the Commission to engage in an analysis of the market, i.e. assess an agreement's effects, even when it concerns a hardcore restraint, or more specifically, an export ban.[137] After all, the Court ruled that the Commission could not have concluded that the general conditions used by GSK, entailing a provision intended to limit parallel trade – even though considered to be a hardcore restriction –[138] has as its object the restriction of competition, independently of any competitive analysis.[139] This would suggest that the Court requires the Commission to expand the scope of its effects-based policy (as initiated by the 'more economic approach')[140] so to include hardcore restrictions, thereby affecting the treatment of minimum and fixed RPM.[141] However, the Court of First Instance has let its decision unambiguously been influenced by the specific characteristics of the market concerned; the market for medicines.[142] The Court acknowledged that the price of medicines is not determined as a result of a competitive process but is directly fixed following an administrative procedure in most Member States and indirectly controlled by the other Member States,[143] and blames the Commission for not taking into account the specific characteristics of the sector.[144] The interpretation that the Court has not shifted its view on export bans, or hardcore restrictions in general, is substantiated by recent judgements of both the CFI and the ECJ, in which an indirect ban on exports of cars from the Netherlands was unambiguously condemned as an agreement having as its object the restriction of competition.[145]

From the above, it can be concluded that it is not clear whether the *GlaxoSmithKline* judgement will initiate a shift in the Commission's approach towards hardcore restrictions. Some commentators have, however, interpreted the judgement in another way: the judgement resembles the shift in objectives pursued by EC competition law from pursuing both the protection of competition and the promotion of

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[136] See infra paragraph 2.2.1.
[137] See also Vickers 2007, pp. 13-14.
[138] Cases 56/64 and 58/64, *Etablissements Consten SA & Grundig-Verkaufs-GmbH* v. *Commission* [1966] ECR 299, p. 343.
[139] Case T-168/01, *GlaxoSmithKline Services Unlimited* v. *Commission* [2006] ECR II-2969, par. 120.
[140] See e.g. Schmidtchen et al. 2007, p. 1; Gerber 2008.
[141] See also Parret 2008.
[142] Case T-168/01, *GlaxoSmithKline Services Unlimited* v. *Commission* [2006] ECR II-2969, par. 122-147. See also Whish 2009, pp. 121-122.
[143] Case T-168/01, *GlaxoSmithKline Services Unlimited* v. *Commission* [2006] ECR II-2969, par. 125.
[144] Case T-168/01, *GlaxoSmithKline Services Unlimited* v. *Commission* [2006] ECR II-2969, par. 133-134. See e.g. Rey and Venit 2004; Holmes 2005 and Volkerink et al. 2007 for a discussion on the specifics of the pharmaceutical sector.
[145] Case T-368/00, *General Motors Nederland BV and Opel Nederland BV* v. *Commission* [2003] ECR II-4491, par. 102; Case C-551/03 P, *General Motors BV* v. *Commission* [2006] ECR I-3173, par. 67. See also Whish 2009, p. 122.

single market integration to merely the protection of consumer welfare.[146] Indeed, the Court explicitly referred to this latter objective by stating that the export ban in the pharmaceutical sector will not have the object of restricting competition contrary to Article 81(1) EC if there is no actual indication of consumer welfare detriment in the relevant provision.[147] However, as will be elaborated upon below, it is not entirely clear that the single market integration objective has downgraded in importance in favour of the objective of promoting consumer welfare.[148]

2.1.5 An appreciable effect on competition

The previous section has explained that the treatment of resale price maintenance differs depending on its form. As of yet, minimum and fixed RPM form hardcore restrictions and, therefore, it is not necessary to look at their effects. Maximum and recommended resale price maintenance clauses, on the other hand, require that the Commission engages in an extensive analysis of their effect on the market, before it can establish an infringement of Article 81(1) EC. The fifth and final condition of Article 81(1) EC stipulates, however, that both categories may fall outside the scope of Article 81(1) if their effect on competition is not 'appreciable'.

An interesting feature of the condition that the effect on competition needs to be appreciable is that it is not to be concluded from the text of Article 81(1) EC, but that it is a condition established in the jurisprudence of the Court of Justice. The condition, also called the de minimis doctrine, was first formulated by the ECJ in *Société Technique de Minière*, and elaborated upon in *Völk* v. *Vervaecke*.[149]

> **The jurisprudential de minimis doctrine**
> In *Société Technique de Minière*, the Court ruled that "where […] an analysis of the said clauses does not reveal the effect on competition to be sufficiently deleterious, the consequences of the agreement should then be considered and for it to be caught by the prohibition it is then necessary to find that those factors are present which show that competition has in fact been prevented or restricted or distorted to an appreciable extent".[150] Clearly, with this statement, the Court ruled that the effect on competition must not be merely theoretical, but identifiable in practice.
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> The Court's position became, however, less clear after the *Grundig/Consten* judgement, in which it has, after all, established that there is no need to take into account the effects of an agreement when it

[146] See e.g. Jones and Sufrin 2008, pp. 231-233 and Pera 2008, p. 154.
[147] That is, the CFI stated that "the application of Article 81(1) EC to the present case cannot depend solely on the fact that the agreement in question is intended to limit parallel trade in medicines or to partition the common market, which leads to the conclusion that it affects trade between Member States, but also requires an analysis designed to determine whether it has as its object or effect the prevention, restriction or distortion of competition on the relevant market, *to the detriment of the final consumer* [emphasis added]" (Case T-168/01, *GlaxoSmithKline Services Unlimited* v. *Commission* [2006] ECR II-2969, par. 119).
[148] See also Whish 2009, pp. 52-53, who argues that *GlaxoSmithKline* is the exception to the rule that "single market integration is likely to remain a key feature to competition policy". See infra paragraph 3.1.1 for a more detailed discussion on this (possible) shift in the objectives of competition law.
[149] Case 56-65 *Société Technique Minière* v. *Maschinenbau Ulm GmbH* [1966] ECR 235; Case 5-69 *Franz Völk* v. *S.P.R.L. Ets J. Vervaecke* [1969] ECR 295.
[150] Case 56-65 *Société Technique Minière* v. *Maschinenbau Ulm GmbH* [1966] ECR 235, p. 249.

> appears to have as its object the restriction of competition.[151] The ECJ elaborated on this point in *Völk* v. *Vervaecke* in which it had to deal with a hardcore restriction, i.e. absolute territorial protection. The Court ruled that "an agreement falls outside the prohibition in article [81] when it has only an insignificant effect on the markets, taking into account the weak position which the persons concerned have on the market of the product in question. Thus an exclusive dealing agreement, even with absolute territorial protection, may, having regard to the weak position of the persons concerned on the market in the products in question in the area covered by the absolute protection, escape the prohibition laid down in article [81(1)]".[152]

These cases indicate that EC competition law is not concerned with agreements, even those concerning hardcore restrictions, concluded between parties that hold a weak position on the market and which have an insignificant effect on competition.[153] That is, the de minimis doctrine consists of a quantitative (addressing the position of the parties on the market) and a qualitative component (which takes into account the seriousness of the restriction).[154]

The quantitative component is outlined in the Commission's 2001 De Minimis Notice, which makes use of market share thresholds to quantify when an appreciable effect on competition is expected not to be present.[155] In this, the Commission makes a distinction between agreements between competitors (horizontal agreements) on the one hand and agreements between non-competitors on the other hand (e.g. vertical agreements).[156] According to the De Minimis Notice, however, these thresholds do not apply to agreements containing hardcore restrictions.[157] Minimum and fixed RPM therefore always satisfy the quantitative component of the condition that the effect on competition needs to be appreciable. By contrast, maximum and recommended resale price maintenance do not have an appreciable effect on competition when the aggregate market share held by the parties concerned does not exceed 15 percent on any of the relevant markets affected by the agreement. The qualitative notion of the de minimis doctrine, on the other hand, does not address the question of appreciability on the basis of market shares and turnover, but considers the seriousness of the restriction. As a result, an agreement that restricts competition between parties having market shares above the thresholds stipulated in the De Minimis Notice may nevertheless fall outside the application of Article 81(1) if its restrictive effect remains limited, e.g. because it only concerns a minor aspect of their competitive

[151] Cases 56/64 and 58/64, *Etablissements Consten SA & Grundig-Verkaufs-GmbH* v. *Commission* [1966] ECR 299, p. 342. See also Verouden 2003, pp. 548-550.
[152] Case 5-69 *Franz Völk* v. *S.P.R.L. Ets J. Vervaecke* [1969] ECR 295.
[153] Jones and Sufrin 2008, p. 183.
[154] See e.g. De Vries 2006, pp. 186-189.
[155] 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) (hereafter De Minimis Notice), [2001] OJ C368/13.
[156] According to the De Minimis Notice, agreements do not appreciably restrict competition if the aggregate market share held by the parties to the agreement does not exceed 10 % on any of the relevant markets affected by the agreement when signed between competitors, and if the market share held by each of the parties to the agreement does not exceed 15% in the case of an agreements between non-competitors. In case of doubt, the Commission uses the 10% threshold. (De Minimis Notice, [2001] OJ C368/13, par. 7).
[157] De Minimis Notice, [2001] OJ C368/13, par. 11.

relation.[158] It is, however, to be expected that a stricter approach will be taken towards hardcore restrictions than towards agreements that have as their effect the restriction of competition.[159]

It can therefore be concluded that resale price maintenance may fall outside the scope of Article 81(1) EC if the position of the parties to the agreement is weak and the effect on competition is insignificant. It is likely, however, that minimum and fixed RPM, since they are considered hardcore restrictions, will more often meet the requirement that the effect on competition is appreciable than maximum and recommended RPM.

2.2 Article 81(3) EC

The previous section has discussed how the conditions which have to be satisfied for an agreement to fall within Article 81(1) EC relate to resale price maintenance. It has been shown that minimum and fixed RPM form hardcore restrictions and fall, therefore, by definition under Article 81(1). On the other hand, recommended – and due to the 'more economic approach' – maximum RPM may, depending on the legal and economic context of the agreement, fall within Article 81(1) EC. This section will outline the current treatment of RPM under Article 81(3) EC, which forms a legal exception to the prohibition laid down in Article 81(1) EC.

Pursuant to Article 2 of Regulation 1/2003, the burden of establishing that the conditions of Article 81(3) EC are satisfied rests on those claiming its benefit. Moreover, Regulation 1/2003 has realised that Article 81(3) EC is a directly applicable exception. As most of the cases that are discussed took place under the old regime, however, it is important to consider that prior to Regulation 1/2003 the procedure concerning Article 81(3) was substantially different.[160]

> **The application of Article 81(3) before and after Regulation 1/2003**
> The former enforcement regime concerning the application of Article 81 EC was formed by Regulation 17, which differs substantially from the current enforcement regime that is established by Regulation 1/2003, which came into force 1 May 2004.[161] Under Regulation 17, there were two ways to escape the prohibition of Article 81(1). First, parties could bring their agreement into conformity with a block exemption. Secondly, parties could apply for the 'individual exemption' provided for in Article 81(3). The granting of this individual exemption was, however, the exclusive competence of the Commission and could only take place after notification, which entailed an administrative procedure.

[158] See e.g. Joined Cases C-180/98 to C-184/98, *Pavel Pavlov and Others* v. *Stichting Pensioenfonds Medische Specialisten* [2000] ECR I-6451, par. 90-97.
[159] Jones and Sufrin 2008, p. 183; Whish 2009, p. 138.
[160] See also e.g. Faull and Nikpay 2007, pp. 88 ff. and Gerber 2008.
[161] See e.g. Verouden 2003, pp. 529 ff., Jones and Sufrin 2008, pp. 1139-1141 and Whish 2009, pp. 148-164.

> The enforcement regime under Regulation 17 suffered from several substantial flaws, giving the Commission considerable scope to adopt an almost 'regulatory approach' towards Article 81.[162] First, because the system did not allow agreements that had not been notified to the Commission, there was an overflow of applications of individual exemptions under Article 81(3).[163] The Commission, however, was unable to deal with the number of notifications, which had serious delays as its result and it prevented that the Commission would concentrate its resources on curbing the most serious infringements.[164] Secondly, due to the notification system, undertakings had to spend substantial time on administrative procedures which also imposed considerable costs on them. Moreover, as the Commission had to decide on the individual exemption of Article 81(3), undertakings were facing uncertainty concerning the legality of their agreement.[165]
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> This regime changed with the entry of Regulation 1/2003, which inter alia changed the application of Article 81(3).[166] Pursuant to Regulation 1/2003, undertakings must now be self-reliant and engage in their own assessment of whether the conditions of Article 81(3) are satisfied. Article 2 of Regulation 1/2003 stipulates that the burden of proving that the conditions of Article 81(3) are satisfied rests with the parties. Once factual arguments and evidence are submitted in order to establish that Article 81(3) is satisfied, however, it is for the Commission to establish that these criteria are not met.[167] Moreover, the Commission shares the competence to apply Article 81(3) EC with both the national competition authorities of the Member States and with the national courts.[168] As a guidance for the national competition authorities, national courts and undertakings concerned, the Commission has issued its Guidelines on the Application of Article 81(3).[169]

Currently, there are two ways to satisfy the conditions stipulated in Article 81(3) EC. First, an undertaking may explicitly satisfy all four (cumulative) conditions formulated in Article 81(3) EC. As mentioned above, the burden of proving that the conditions of Article 81(3) are satisfied rests with the undertakings themselves. Below, I will deal with these elements by shortly discussing their relevance regarding resale price maintenance. The second way of satisfying the criteria of Article 81(3) is to bring an agreement in line with a block exemption, thereby automatically escaping the prohibition of Article 81(1) EC.

2.2.1 The criteria of Article 81(3) EC

Article 81(3) EC states two positively and two negatively formulated conditions which all have to be satisfied in order to escape the prohibition of Article 81(1) EC. Article 81(3) states the following.

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[162] Verouden 2003, p. 532.
[163] Jones and Sufrin 2008, p. 1140.
[164] Recital 3, Regulation 1/2003, [2004] OJ C101/81.
[165] See also Whish 2009, p. 162.
[166] See e.g. Faull and Nikpay 2007, pp. 88 ff.; Jones and Sufrin 2008, pp. 1143 ff. for a discussion on the implications of Regulation 1/2003.
[167] See Jones and Sufrin 2008, p. 269 and, for example, Case T-168/01, *GlaxoSmithKline Services Unlimited* v. *Commission* [2006] ECR II-2969.
[168] Article 5 and 6 of Regulation 1/2003, [2004] OJ C101/81.
[169] Guidelines on the application of Article 81(3), [2004] OJ C101/97.

Article 81(3) EC

The provisions of paragraph 1 may, however, be declared inapplicable in the case of:
— any agreement or category of agreements between undertakings,
— any decision or category of decisions by associations of undertakings,
— any concerted practice or category of concerted practices,
which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:
(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

Clearly, Article 81(3) EC forms a legal exception to the prohibition of Article 81(1). If the conditions stipulated in Article 81(3) are satisfied, an agreement that falls within Article 81(1) is nevertheless considered to be legitimate, because it "enhances competition within the relevant market, because it leads the undertakings concerned to offer cheaper or better products to consumers, compensating the latter for the adverse effects of the restrictions of competition".[170] Below, the four conditions will be subsequently discussed, after which their application on agreements facilitating RPM will be analysed.

The first condition of Article 81(3) is that the agreement should contribute to improving the production or distribution of goods (or services) or to promoting technical or economic progress. This criterion refers to the existence of an efficiency gain resulting from the agreement.[171] This efficiency gain is to be assessed from an objective point of view in that the improvement must "in particular show appreciable objective advantages of such a character as to compensate for the disadvantages which they cause in the field of competition".[172] Article 81(3) lists several types of efficiencies which are intended to cover all economic efficiencies, including cost efficiencies and qualitative efficiencies.[173] Interestingly, judging from the Guidelines on Article 81(3), it seems that the Commission is only concerned with economic efficiency gains as – so it argues – "efficiencies 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".[174] However, it also argues that "[g]oals pursued by other Treaty provisions can be taken into account to the extent that they can be subsumed under the four conditions of Article 81(3)",[175] while relying on case law in which this has

[170] Guidelines on the application of Article 81(3), [2004] OJ C101/97, par. 34.
[171] Guidelines on the application of Article 81(3), [2004] OJ C101/97, par. 48 ff.
[172] Cases 56/64 and 58/64, *Etablissements Consten SA & Grundig-Verkaufs-GmbH* v. *Commission* [1966] ECR 299, p. 348.
[173] Guidelines on the application of Article 81(3), [2004] OJ C101/97, par. 59.
[174] Guidelines on the application of Article 81(3), [2004] OJ C101/97, par. 60.
[175] Guidelines on the application of Article 81(3), [2004] OJ C101/97, par. 42.

also been implicitly stated.[176] As a result, the efficiency gain condition of Article 81(3) is rather broadly interpreted in the sense that non-competition factors may also be used to supplement the economic benefits the agreement concerned generates.[177]

Secondly, for an agreement to be eligible for the legal exception provided for in Article 81(3) EC, it should allow consumers 'a fair share' of the benefits it creates. According to the Commission, the concept of consumers within the meaning of Article 81(3) refers to the customers of the parties to the agreement and subsequent purchasers.[178] The 'fair share' concept, on the other hand, "implies that the pass-on of benefits must at least compensate consumers for any actual or likely negative impact caused to them by the restriction of competition found under Article 81(1)".[179] That is, the requirement that consumers should receive a fair share of the benefits implies a balancing of pro-competitive and anti-competitive effects of the agreement,[180] whereas it should be remembered that the standard of welfare taken is that of consumers, not total welfare.[181] If an agreement has both substantial anti-competitive and substantial pro-competitive effects, the Commission engages in a careful balancing, where it is, however, assumed that the more substantial the impact of the agreement on competition, the more likely it is that consumers will suffer in the long run.[182]

The third condition of Article 81(3) EC entails that the agreement must not impose restrictions which are not indispensable to the creation of the efficiencies. The central question is here whether more efficiencies are produced with the agreement than in the absence of the agreement.[183] In fact, the third condition implies a proportionality test in the sense that restrictions are considered to be 'indispensable' if, firstly, the efficiencies can not also be generated by other economically practicable and less restrictive means, and, secondly, each individual restriction is necessary in order to produce the efficiencies.[184] With regard to this second part of the third requirement of Article 81(3), the Commission holds that hardcore restrictions are unlikely to be considered indispensable.[185]

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[176] Case T-17/93, *Matra Hachette SA* v. *Commission* [1994] ECR II-595, par. 139 and Case 26-76, *Metro SB-Großmärkte GmbH & Co. KG* v. *Commission* [1977] ECR 1875, par. 43.
[177] See, in the literature, Monti 2002, Faull and Nikpay 2007, pp. 294-296 and Jones and Sufrin 2008, pp. 273-277, in the case law the cases cited above, as well as Cases T-528, 542, 543 and 546/93, *Métropole Télévision S.A.* v. *Commission* [1996] ECR II-649, par. 118, and in the Commission's decision-making practice *Synthetic Fibres* [1984] OJ L207/17, par. 30-31 (allowing 'crisis cartels') and *European Council of Manufacturers of Domestic Appliances (CECED)* [2000] OJ L187/47, par. 47-57 (referring to the efficiency gain reduced energy consumption).
[178] Guidelines on the application of Article 81(3), [2004] OJ C101/97, par. 84.
[179] Guidelines on the application of Article 81(3), [2004] OJ C101/97, par. 85.
[180] See also Faull and Nikpay 2007, pp. 304-306.
[181] See also infra paragraph 3.1.1.
[182] See the Guidelines on the application of Article 81(3), [2004] OJ C101/97, par. 92-104 where the analytical framework for assessing the pass-on of efficiency gains to consumers is outlined.
[183] Guidelines on the application of Article 81(3), [2004] OJ C101/97, par. 74.
[184] Guidelines on the application of Article 81(3), [2004] OJ C101/97, par. 73-78.
[185] Guidelines on the application of Article 81(3), [2004] OJ C101/97, par. 79. In fact, the Commission refers to restrictions that are black-listed in block exemption regulations (see infra paragraph 2.2.2) or identified as hardcore restrictions in Commission guidelines and notices.

The fourth and final condition of Article 81(3) requires that the restrictive effect of the agreement is not such that it eliminates competition. The Commission is of the opinion that when competition is eliminated, the competitive process is brought to an end, which implies that any short-term efficiency gains are outweighed by the anti-competitive effects of the agreement in the long run.[186] In its analysis, the Commission takes into account the degree of competition prior to the agreement and the impact of the restrictive agreement in itself, both on actual and potential competition. Regarding the impact of the agreement, the Commission states that it takes into account "the various sources of competition in the market", but also argues that competition may be considered to be eliminated in the case of the mere elimination of price competition.[187] The fact that the Commission interprets the 'elimination of competition' rather wide in the sense that it does not require that there is actually no scope at all for any competition is also reflected in the examples it gives in its Guidelines on the application of Article 81(3) EC.[188]

In its application of Article 81(3) EC in cases concerning RPM agreements, the Commission has proven to be rather unsympathetic, to say the least. In its Guidelines on the application of Article 81(3), the Commission states that, although Article 81(3) EC does not exclude a priori certain types of agreement from its scope, hardcore restrictions (which includes minimum and fixed RPM)[189] "generally fail (at least) the two first conditions of Article 81(3)", because they "neither create objective economic benefits nor do they benefit consumers".[190] Moreover, as to the third condition, the Commission is of the opinion that hardcore restrictions are also unlikely to be considered indispensable.[191] As a result, the Commission has on multiple occasions refused to apply Article 81(3) in cases concerning minimum and fixed RPM.[192] In fact, the legal exception has never been explicitly applied within the context of these hardcore restrictions.

186 Guidelines on the application of Article 81(3), [2004] OJ C101/97, par. 105.
187 Guidelines on the application of Article 81(3), [2004] OJ C101/97, par. 107-110.
188 For example, in paragraph 116 of the Guidelines on the application of Article 81(3), the Commission illustrates its view with the following hypothetical example. "Shipping firms A, B, C, and D, holding collectively more than 70 % of the relevant market, conclude an agreement whereby they agree to coordinate their schedules and their tariffs. Following the implementation of the agreement prices rise between 30 % and 100 %. There are four other suppliers, the largest holding about 14 % of the relevant market. There has been no new entry in recent years and the parties to the agreement did not lose significant market share following the price increases. The existing competitors brought no significant new capacity to the market and no new entry occurred. In light of the market position of the parties and the absence of competitive response to their joint conduct it can reasonably be concluded that the parties to the agreement are not subject to *real* competitive pressures and that the agreement affords them the possibility of eliminating competition within the meaning of Article 81(3) [emphasis added]." See also Green Paper on Vertical Restraints, COM(96) 721, par. 226.
189 See Guidelines on Vertical Restraints, [2000] OJ C291/1, par. 47 (supra paragraph 2.1.4) and Article 4 of Regulation 2790/1999 (infra paragraph 2.2.2).
190 Guidelines on the application of Article 81(3), [2004] OJ C101/97, par. 46.
191 Guidelines on the application of Article 81(3), [2004] OJ C101/97, par. 79.
192 See *SABA* [1976] OJ L28/19, par. 22; *GERO-fabriek* [1977] OJ L16/8; *Hennessy-Henkell* [1980] OJ L383/11, par. 23 ff.; *VBBB/VBVB* [1982] OJ L54/36, par. 47 ff.; *Polistil/Arbois* [1984] OJ L136/9, par. 54 ff.; *Novalliance/Systemform* [1997] OJ L47/11, par. 68 ff.; *JCB* [2002] OJ L69/1, par. 207 ff.; *Nathan-Bricolux* [2001] OJ L54/1, par. 105 ff.; *Volkswagen* [2001] OJ L262/14, par. 94 ff.; *Mercedes-Benz* [2001] OJ L257/1, par. 215 ff. See also *Yamaha*, not yet published, par. 175 ff., where the Commission categorically stated that "[t]erritorial protection and resale price maintenance are hardcore restrictions that do not meet the cumulative conditions of Article 81(3) of the Treaty".

An example of the Commission's stance on the application of Article 81(3) regarding fixed resale price maintenance is outlined below. Interestingly, this decision has met a lot of criticism because many Member States supported the use of RPM in the market concerned, the market for books.[193]

VBBB/VBVB and the application of 81(3) to fixed RPM in the market for books

In *VBBB/VBVB*,[194] the Commission found that VBBB (Dutch Association for the Promotion of the Interests of the Book Trade) and the VBVB (Association for the Promotion of Flemish Books) had agreed that books could not be sold in Belgium or the Netherlands at a price below the fixed price set by the publishers (i.e. collective resale price maintenance), and the agreement therefore fell within Article 81(1) EC. Even though it acknowledged that it was unnecessary to consider all four conditions of Article 81(3), the Commission subsequently dealt with them. First, although the parties claimed that their RPM scheme contributed to improving the production and distribution of goods, since it allows subsidisation of less popular books, thereby enabling publishers to place a wide range of titles on the market, resulting in certain security necessary for maintaining a wide range of titles, the Commission disagreed. The Commission considered that "any objective advantages which might derive from the agreement are outweighed by its disadvantages from the viewpoint of competition".[195] Second, the parties claimed that the consumer received a fair share of the benefits for the production and distribution of books resulting from the RPM system as it would cause a broader range of titles to be available than without RPM. The Commission, however, disagreed as it was of the opinion that "there is no reason why booksellers should not be able to carry on a normal business without resale price maintenance" and that "this system denies the consumer the opportunity of deciding for himself whether to buy books at a price that includes a service charge or to take his custom to a bookseller who does not provide any services and from whom he can buy books more cheaply".[196] Contrary to the allegations of the parties, the Commission also did not agree that the third condition, the indispensable nature of the restriction of competition, was satisfied. It substantiated its view by arguing that "it is not for undertakings or associations of undertakings to conclude agreements on cultural questions", but that these are "principally a matter for government".[197] Finally, concerning the question of elimination of competition, the parties argued that the RPM regime did not eliminate competition as not all publishers took part in the collective system. The Commission, however, disagreed once more and argued that by far the largest proportion of books published and sold were governed by the RPM regime, and that "other forms of competition – stocking, specialization, service offered and ordering facilities – must be regarded as secondary to price competition, certainly from the point of view of the consumer who is often not particularly interested in highly specialized books".[198] Having rejected that all conditions of Article 81(3) were satisfied, the Commission refused an exemption from the prohibition in Article 81(1). As mentioned above, the decision met a lot of criticism, and it was also

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[193] See also Simons 1982, pp. 288-289. As to the rationale for the use of RPM in the book sector, see infra paragraph 3.1.2.
[194] *VBBB/VBVB* [1982] OJ L54/36, par. 47 ff.
[195] *VBBB/VBVB* [1982] OJ L54/36, par. 53.
[196] *VBBB/VBVB* [1982] OJ L54/36, par. 54. Moreover, the Commission argued that "the system of collective resale price maintenance for Dutch-language books is that the main group of consumers, which tends to favour the more popular books, is forced to contribute to the cost of publishing short-run titles, which are generally intended for a smaller part of the population. In assessing the relative advantages and disadvantages of any agreement such as that concerned in this case, it cannot be accepted that the advantages it involves for a small minority of the population outweigh the disadvantages for the majority of consumers" (par. 56).
[197] *VBBB/VBVB* [1982] OJ L54/36, par. 60.
[198] *VBBB/VBVB* [1982] OJ L54/36, par. 62.

appealed to the Court of Justice, who upheld the Commission decision, but argued that similar proceedings would not relate to purely national RPM systems.[199]

The strict Commission approach when applying the Article 81(3) criteria to resale price maintenance agreements has met some resistance by the European Courts. Although the Court has agreed on several occasions that the Commission was right to decide that an agreement establishing an RPM regime did not meet the criteria of Article 81(3),[200] it has indicated that even a hardcore restriction like RPM might, in exceptional cases, come into the scope for exemption.[201] In *Binon*, for example, the Court stated that "[i]f, in so far as the distribution of newspapers and periodicals is concerned, 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 […] constitutes the sole method by which a wide selection of newspapers and periodicals can be made available to readers, the Commission must take account of those factors when examining an agreement for the purposes of Article [81(3)]".[202] More generally, the Court of First Instance in *Matra Hachette* explicitly rejected reasoning presuming acceptance of the view that there are infringements which are inherently incapable of qualifying for an exemption under Article 81(3) EC. "On the contrary, the Court considers that, 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 [81(3)] of the Treaty are satisfied and the practice in question has been properly notified to the Commission."[203] An example of where the argumentation used by the Court collided somewhat with that of the Commission is discussed below.

Fixed book-prices revisited: Publishers Association v. Commission

In *Publishers Association - Net Book Agreements*,[204] the Commission had found an infringement of Article 81(1) as Publishers Association (PA), had concluded uniform standard conditions of sale of so-called 'net books', both for the domestic and foreign markets of the UK and Ireland. In this regime, a 'net book' is defined as a book, pamphlet, map or other similar printed matter published at a net price, whereas a 'net price' is defined as the price fixed from time to time by the publisher below which the net book shall not be sold to the public. That, is PA had engaged in minimum resale price maintenance, which therefore fell within Article 81(1). Regarding the legal exception, the Commission considered that at least one of the conditions of Article 81(3) was not satisfied, i.e. the condition that the agreements may not impose restrictions which are not indispensable to the attainment of the objectives of the agreements. The Commission referred to its earlier decision in *VBBB/VBVB* and argued that "in order to achieve an improvement in the publication and distribution of the books in question, a collective resale price maintenance scheme entailing the imposition of restrictions on

[199] Case 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, par. 58-59.
[200] See e.g. Case 107/82, *Allgemeine Elektrizitäts-Gesellschaft AEG-Telefunken AG* v. *Commission* [1983] ECR 3151.
[201] See also Wijckmans et al. 2006, p. 158.
[202] Case 243/83, *SA Binon & Cie* v. *SA Agence et messageries de la presse* [1985] ECR 2015, par. 46.
[203] Case T-17/93, *Matra Hachette SA* v. *Commission* [1994] ECR II-595, par. 85.
[204] *Publishers Association - Net Book Agreements* [1989] OJ L22/12.

competition in trade between Member States, such as contained in the agreements in question, is not indispensable".

The Court of First Instance agreed with the Commission that the 'net book agreements' fell within Article 81(1) and that, although there were strong arguments that there was an efficiency gain, it still entailed a restriction of competition which was not indispensable for this gain, while explicitly stating that "anti-competitive conduct confined to the territory of a single Member State is capable of having repercussions on patterns of trade and competition in the common market".[205] The Court of Justice, however, argued that the CFI had committed an error of law by stating that Article 81(3) "is subject to the condition that those benefits should occur only on the territory of the Member State or States in which the undertakings who are parties to the agreement are established and not in the territory of other Member States".[206] Therefore, the Court annulled the Commission's decision as it should also have analysed efficiencies gained outside the UK.[207]

In *The Publishers Association* v. *Commission*, the ECJ annulled the decision because the Commission had not adequately dealt with the evidence put forward by the parties. It should be noted, however, that this decision might have been influenced by the fact that RPM in the market for books is a sensitive subject in EC (competition) law, as it involves products carrying unique important cultural values.[208]

It can therefore be concluded that, generally, hardcore restrictions such as minimum and fixed RPM are not eligible for the legal exception provided for in Article 81(3), as it is considered that these instruments do not meet the cumulative requirements set out in this provision. Maximum and recommended RPM might, on the other hand, if it is found that they have as their effect the restriction of competition, be subject to a thorough analysis of weighing their pro- and anti-competitive effects. In this context, however, it should be mentioned that the Court of First Instance's idea of assessing hardcore restrictions within Article 81(3) might be different than, or diverging from, the Commission's approach. Similar to the analysis of Article 81(1) above, a reference ought to be made to the *GlaxoSmithKline* case, where the CFI appears to refute any suggestion that hardcore restrictions, in this case restrictions on parallel exports, are never eligible for exemption under Article 81(3).[209]

The GlaxoSmithKline judgement by the Court of First Instance concerning Article 81(3) EC

In this case, GlaxoSmithKline (GSK) stated that its dual-pricing regime under its general sales conditions contributed to efficiency by means of increased capacity for research and development (R&D) expenditure. The Commission, however, was unconvinced that the agreement led to this

[205] Case T-66/89, *Publishers Association* v. *Commission* [1992] ECR II-1995, par. 43-59.
[206] Case C-360/92 P, *The Publishers Association* v. *Commission* [1995] ECR I-23, par. 29. See also Mok et al. 1997, p. 96.
[207] See also De Vries 2001.
[208] See infra paragraph 3.1.2 as well as Goyder 1998, p. 139; Mortelmans 2001, p. 639; De Vries 2001; De Vries 2006, pp. 214-219.
[209] Case T-168/01, *GlaxoSmithKline Services Unlimited* v. *Commission* [2006] ECR II-2969; Case C-501/06 P *GlaxoSmithKline Services Unlimited* v. *Commission*, not yet decided; Case C-513/06 P, *GlaxoSmithKline Services Unlimited* v. *Commission*, not yet decided. See supra paragraph 2.1.4, as well as Eccles 2007, pp. 137 ff.; Ratliff 2007, pp. 38-39.

alleged increase in R&D investments, and therefore did not believe it to contribute to production or distribution of goods or to promoting technical or economic progress.[210] Therefore, it stated that there was no need for it to engage in a balancing of the positive and negative effects of the agreement.[211] As to its analysis concerning the second condition, the Commission stated that GSK's argumentation was "nothing but a reiteration of the arguments put forward […] to demonstrate any causal link between the restriction of competition and the objectives set out in the first condition".[212] Finally, the Commission did not pay much attention to the fulfilment of the third and fourth condition of Article 81(3), and concluded that the agreement was not eligible for an exemption.[213]

In short, the Court of First Instance ruled that the Commission's examination of GSK's arguments was insufficient to reach its conclusion.[214] According to the CFI, the Commission was found not to have examined the facts adequately, nor had it looked properly at the possible gains in efficiency arising from the agreement or carried out a proper balancing exercise of the loss of intra-brand competition as against gains in inter-brand competition.[215] As a result, the CFI explicitly rejected the Commission's conclusion that there was no need to carry out a balancing exercise, and concluded that the Commission could have not lawfully concluded that GSK had not demonstrated that existence of a contribution to the promotion of technical progress for the application of Article 81(3) EC was satisfied.[216]

The actual implications of the *GlaxoSmithKline* case remain to be seen, and will become (more) clear after the upcoming judgement by the Court of Justice.[217] However, even after the ECJ has taken a stance in the matter, it will probably remain unclear for the foreseeable future whether this judgement has any implications for the treatment of minimum or fixed RPM under Article 81(3) EC. Notwithstanding this uncertainty, however, it should be pointed out that the judgement might induce the Commission to intensify its effects-based policy within the context of Article 81(3) EC.

2.2.2 Block exemptions

The second way of satisfying the criteria of Article 81(3) EC, thereby preventing an infringement of Article 81(1), is to bring the agreement in line with a block exemption. This section will give a description of Regulation 2790/1999,[218] concerning vertical agreements in general, though it should be mentioned that a similar analysis holds for other block exemptions.[219]

[210] Glaxo Wellcome [2001] L302/1, par. 150-151.
[211] Glaxo Wellcome [2001] L302/1, par. 152.
[212] Glaxo Wellcome [2001] L302/1, par. 179.
[213] Glaxo Wellcome [2001] L302/1, par. 187-189.
[214] Case T-168/01, *GlaxoSmithKline Services Unlimited* v. *Commission* [2006] ECR II-2969, par. 262 ff.
[215] Case T-168/01, *GlaxoSmithKline Services Unlimited* v. *Commission* [2006] ECR II-2969, par. 265 ff.
[216] Case T-168/01, *GlaxoSmithKline Services Unlimited* v. *Commission* [2006] ECR II-2969, par. 307-308.
[217] Case C-501-06 P *GlaxoSmithKline Services Unlimited* v. *Commission*, not yet decided; Case C-513/06 P, *GlaxoSmithKline Services Unlimited* v. *Commission*, not yet decided.
[218] Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices (hereafter Regulation 2790/1999), OJ L336/21.
[219] For a more extensive analysis of Regulation 2790/1999 and Regulation 1400/2002 concerning vertical agreements in the motor vehicle sector, see Wijckmans et al. 2006, pp. 45-378.

Regulation 2790/1999 has come into force on 1 January 2000 and thereby replaced three old block exemptions.[220] Regulation 2790/1999 provides for a categorically defined set of exemptions for the prohibition of Article 81(1) EC. That is, Regulation 2790/1999 exempts those agreements of which the experience acquired over the years has led the Commission to presume that they normally satisfy the conditions laid down in Article 81(3).[221] According to its recital, Regulation 2790/1999 exempts certain vertical restraints because they "can improve economic efficiency within a chain of production or distribution by facilitating better coordination between the participating undertakings; in particular, they can lead to a reduction in the transaction and distribution costs of the parties and to an optimisation of their sales and investment levels".[222] The exemption itself is provided for in Article 2(1) of Regulation 2790/1999, whereas additional conditions are specified in inter alia Articles 3 and 4.

> **Article 2(1) of Regulation 2790/1999**
> Pursuant to Article 81(3) of the Treaty and subject to the provisions of this Regulation, it is hereby declared that Article 81(1) shall not apply to agreements or concerted practices entered into between two or more undertakings each of which operates, for the purposes of the agreement, at a different level of the production or distribution chain, and relating to the conditions under which the parties may purchase, sell or resell certain goods or services ('vertical agreements').
> This exemption shall apply to the extent that such agreements contain restrictions of competition falling within the scope of Article 81(1) ('vertical restraints').
>
> **Article 3 of Regulation 2790/1999**
> 1. Subject to paragraph 2 of this Article, the exemption provided for in Article 2 shall apply on condition that the market share held by the supplier does not exceed 30 % of the relevant market on which it sells the contract goods or services.
> 2. In the case of vertical agreements containing exclusive supply obligations, the exemption provided for in Article 2 shall apply on condition that the market share held by the buyer does not exceed 30 % of the relevant market on which it purchases the contract goods or services.
>
> **Article 4(a) of Regulation 2790/1999**
> The exemption provided for in Article 2 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, without prejudice to the possibility of the supplier's imposing a maximum sale price or recommending a sale price, provided that they do not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties […].

[220] Regulation 2790/1999, OJ L336/21, Article 13. The old block exemptions were Commission Regulation 1983/83 of 22 June 1983 on the application of Article 85 (3) of the Treaty to categories of exclusive distribution agreements, [1983] OJ L173/1, Commission Regulation 1984/83 of 22 June 1983 on the application of Article 85 (3) of the Treaty to categories of exclusive purchasing agreements, [1983] OJ L173/5, and Commission Regulation 4087/88 of 30 November 1988 on the application of Article 85 (3) of the Treaty to categories of franchise agreements, [1988] OJ L359/46.
[221] Regulation 2790/1999, OJ L336/21, par. 2.
[222] Regulation 2790/1999, OJ L336/21, par. 6.

As is clear from its wordings Article 2 of Regulation 2790/1999 provides for a safe harbour for, so it seems, all vertical agreements. However, Article 3 stipulates that this exemption only holds when the supplier's market share does not exceed 30 percent of the relevant market (or in the case of exclusive supply obligation, when the buyer's market share does not exceed 30 percent of the relevant market).[223] Another important exception to the exemption is provided for in Article 4, which black-lists certain types of (hardcore) agreements, including minimum and fixed resale price maintenance. The reason that Regulation 2790/1999 does not exempt these hardcore restrictions is that they are not considered to be indispensable to the attainment of the positive effects vertical agreements tend to generate. As a result, agreements containing minimum or fixed RPM can not benefit of the block exemption of Regulation 2790/1999, whereas agreements entailing maximum or recommended RPM will, given that the supplier's market share does not exceed 30 percent.

2.3 Differences between EC and U.S. approaches to RPM

Now that it has been established how resale price maintenance is generally assessed under EC competition law, it is interesting to look at its treatment on the other side of the Atlantic, and discuss the differences. This section therefore, firstly, discusses the application of U.S. antitrust law to resale price maintenance and, secondly, reflect on the differences between the EC and U.S. approaches.

2.3.1 The treatment of RPM in U.S. antitrust law

This section will concisely outline the legal developments concerning the treatment of RPM in U.S. antitrust law.[224] Some more focus, however, will be on the recent *Leegin* judgement, where the Supreme Court has overruled a long-standing precedent regarding the treatment of minimum and fixed RPM. As will be seen below, however, the *Leegin* judgement did not bring such dramatic changes as one might think on the first sight.

The relevant legislative framework in U.S. antitrust law is the Sherman Antitrust Act, which was established in 1890. Section 1 of the Sherman Antitrust Act provides the following.

> **Section 1 of the Sherman Antitrust Act**
> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding

[223] It goes beyond the scope of this paper to discuss the Commission's approach concerning the definition of the relevant market. It suffices to state that the Commission has published guidelines on this matter, see Commission Notice on the definition of relevant market for the purposes of Community competition law, [1997] OJ C372/5.
[224] For more extensive analyses, see e.g. Alese 2007; Broder 2007; Brunell 2007; Cavanagh 2008; Ghosh 2008; Graglia 2007; Paldor 2007; Lambert 2008; Martin 2008; Marvel 2008.

> $100,000,000 if a corporation, or, if any other person, $1,000,000, or by imprisonment not exceeding 10 years, or by both said punishments, in the discretion of the court.

In 1911, however, the Supreme Court made clear that this section is not to be interpreted literally, i.e. that *all* restraints of trade or commerce are illegal, but that this only holds for *unreasonable* restraints.[225] Similar, but not equal to Article 81(3) EC,[226] U.S. antitrust law therefore allows a balancing of pro- and anti-competitive effects of certain practices. However, there are also agreements that were, when they were assessed under a rule of reason, almost always found to fall within Section 1. As a result, it became generally accepted that it would be a waste of resources to continue the application of the rule of reason to each individual agreement, because the additional information acquired through such a process would not be worth its costs.[227] Therefore, the courts adopted per se rules according to which agreements are conclusively presumed to be unreasonable and therefore illegal without an elaborate inquiry into their legal and economic context.[228] Obviously, per se rules save substantial administrative costs, though may be criticised from a more ethical point of view.[229]

The rather controversial career of resale price maintenance in U.S. antitrust law started in 1911, when the Supreme Court ruled in *Dr. Miles*.[230] Here, although it was explicitly recognised that minimum resale price maintenance might have pro-competitive effects, it was judged to be per se illegal. As a result, once it was established that a manufacturer used RPM in its distribution agreement, illegality was established, and a fine was to be expected without further research. Only eight years later, however, the Court established the so-called 'Colgate-doctrine' which substantially limited the ruling in *Dr. Miles*.[231] Here, the Supreme Court allowed a manufacturer to unilaterally suggest the resale prices for its products and refuse to deal with retailers that do not sell the products at the suggested prices.[232] The Colgate-doctrine, however, was limited again in 1920, where it was argued that no explicit contract was needed in order to establish RPM.[233] Then, the Court's ruling in *Dr. Miles* was 'attacked' by legislative activities; in 1937 and 1953 the Miller-Tydings Act and McGuire Act were passed, entailing state exceptions for RPM agreements. However, in 1975, these exceptions were repealed by the enactment of the Consumer Goods Pricing Act in 1975, leaving *Dr. Miles* intact and as

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[225] *Standard Oil Co of New Jersey* v. *US*, 221 US 1 (1911).
[226] See infra paragraph 2.3.2.
[227] Black 1997, p. 149.
[228] Horizontal price-fixing, for example, is a per se illegal practice, see e.g. *US* v. *Trenton Potteriss Co*, 273 US 392 (1927).
[229] As Black puts it: "[a]n assessment of an individual arrangement under a rule of reason is analogous to the direct consequentialist approach in that the legality of the arrangement is taken to depend on the arrangement's actual or intended consequences for competition. The per se approach is analogous to indirect consequentialism in comprising two levels of assessment: an individual arrangement is judged to be illegal if it falls within an applicable per se rule, and the rule itself is justified by its consequences for competition, judicial efficiency and other matters […]." (Black 1997, p. 150).
[230] *Dr. Miles Medical Co.* v. *John D. Park & Sons Co.*, 220 US 373 (1911).
[231] Or, as Graglia puts it, the Court's ruling in *Colgate* "effectively overruled *Dr. Miles* in all but name" (Graglia 2007, p. 11). See *United States* v. *Colgate & Co.*, 250 US 300 (1919).
[232] Martin 2008, p. 587.
[233] See *United States* v. *A. Schrader's Son, Inc.*, 252 US 85 (1920) and *Frey & Son, Inc.* v. *Cudahy Packing Co.*, 256 US 208 (1921).

relevant as before. Meanwhile, the Court had even extended the per se prohibition established in *Dr. Miles* to non-price vertical restraints in *Schwinn*,[234] and to maximum RPM in *Albrecht*.[235]

However, this early hostility towards RPM, and vertical restraints in general, ended with the rise of the Chicago School of Economics, which is generally characterised as a school of thinking that has a strong faith in free markets and opposes to most forms of economic regulation.[236] The first step towards a more lenient approach towards vertical restraints was in *Sylvania*, where the Court repeatedly cited the works of renowned Chicago School economists Bork and Posner, and explicitly overruled *Schwinn* and revived the Colgate-doctrine.[237] Similarly, in *State Oil* v. *Khan*, the Supreme Court reversed *Albrecht*, as "there is insufficient economic justification for per se invalidation of maximum price fixing", though reaffirmed the per se ban on minimum RPM.[238] Meanwhile, however, the Court had begun chipping away the per se ban on minimum resale price maintenance.[239] In *Monsanto*, the Court established that an antitrust plaintiff raising a claim of price fixing conspiracy among manufacturer and distributors had to rule out the possibility that the defendants were acting independently.[240] Moreover, in *Business Electronics*, the Court limited the concept of an agreement, thereby weakening the *Dr. Miles* ruling on per se prohibition of minimum RPM.[241]

It is these legal, but certainly also economic developments that led the Supreme Court to its 2007 judgement in *Leegin*, where it was decided that not only for maximum resale price maintenance, but also for minimum (and fixed) RPM, a plaintiff claiming an infringement of antitrust law should show that the anti-competitive effects of the agreement outweigh its pro-competitive effects.[242] That is, the *Leegin* judgement ruled that in assessing minimum RPM in antitrust law, the rule of reason applies, thereby explicitly overruling precedent, and leading to the 'demise of *Dr. Miles*'.

> **The Supreme Court's Leegin judgement: RPM under a rule of reason**
>
> Leegin Creative Leather Products, Inc. (Leegin) designs, manufactures, and distributes leather goods and accessories, including belts under the brand name 'Brighton'. Leegin's marketing policy consisted inter alia of selling through small retailers only, which aimed to "treat customers better, provide

[234] *United States* v. *Arnold, Schwinn & Co.*, 388 US 365 (1967).
[235] *Albrecht* v. *Herald Co.*, 390 US 145 (1968).
[236] See e.g. Graglia 2007; Pera 2008. See also infra paragraph 3.1.1.
[237] *Continental T.V., Inc.* v. *GTE Sylvania Inc.*, 433 US 36 (1977). In this context, an interesting remark is made by Marvel when criticising the *Albrecht* decision, as too little was known about the competitive impact of non-price restraints to treat them as per se unlawful. He argues: "[a]pparently, however, this perceived lack of knowledge did not extend to those teaching at Harvard", thereby heavily criticising "young Harvard-trained lawyer" Posner, who – according to Marvel – later benefited from "remedial training at the University of Chicago [where he] soon came to see the errors of the Harvard view" (Marvel 2008, p. 3).
[238] See Cavanagh 2008, p. 12 summarising the ruling in *State Oil Co.* v. *Khan*, 522 US 3 (1997).
[239] See e.g. Graglia 2007 and Ghosh 2008.
[240] *Monsanto Co.* v. *Spray-Rite Service Corp.*, 465 US 752 (1984).
[241] *Bus. Elecs. Corp.* v. *Sharp Elecs. Corp.*, 485 US 717 (1988). Martin summarises: "[i]n *Business Electronics*, the Court held that the termination of a price-cutting retailer at the request of another retailer would not reflect an unlawful agreement unless the plaintiff could show that an actual agreement to fix prices existed between the parties" (Martin 2008, p. 588).
[242] *Leegin Creative Leather Products, Inc.* v. *PSKS, Inc.*, 127 S. Ct. 2705 (2007).

customers more services, and make their shopping experience more satisfactory than do larger, often impersonal retailers".[243] Among these smaller retailers was Kay's Kloset, a women's apparel store in Lewisville, Texas, subsidiary of PSKS, Inc. (PSKS). In 1997, Leegin announced its RPM policy on its Brighton belts, which, in effect, meant that Leegin would refuse to sell to retailers that discounted Brighton goods below suggested prices. Accordingly, when Kay's Kloset introduced a discount on Leegin's belts, it requested Kay's Kloset to cease discounting. Kay's Kloset, who refused the request, was excluded from Leegin's distribution channel after which it sued the latter for an infringement of Section 1 of the Sherman Act.

PSKS sued Leegin in the United States District Court for the Eastern District of Texas. Leegin, however, tried to introduce expert testimony describing the pro-competitive effects of its policy. The District Court, however, relied on *Dr. Miles*' per se rule and therefore excluded the testimony. Moreover, Leegin tried to rely on the Colgate-doctrine, arguing that it had established a (lawful) unilateral pricing policy, but the jury refused this argument and imposed a fine. On appeal, Leegin did not dispute any more that it had engaged in RPM, but argued that this should be subject to a rule of reason. The Court of Appeals for the Fifth Circuit refused, and affirmed that the district court was right to exclude the expert testimony, because *Dr Miles*' per se rule rendered any pro-competitive justifications of Leegin's RPM policy irrelevant. However, the Supreme Court reversed this decision and ruled that RPM should be subject to a rule of reason.

The Supreme Court started its argument by stating that per se rules should only be used when assessing restraints "that would always or almost always tend to restrict competition and decrease output".[244] Therefore, according to the Court, a per se rule is only appropriate when courts have had considerable experience with the restraint concerned, which has proven its 'manifestly anti-competitive' effects. The Court explained that when it decided *Dr. Miles* in 1911, it relied on a formalistic common-law rule against restraints on alienation, and decided that it was necessary to examine the economic effects of minimum RPM, and to determine whether the per se rule is appropriate.[245] In this, the Court referred extensively to the economic literature, thereby recognising several pro- and anti-competitive effects of RPM, and concluded that as the practice may have both these effects, the rule of reason, and not a per se rule of unlawfulness, would be the appropriate standard for minimum resale price maintenance.[246]

Besides the overwhelming attention to the economic literature in which both pro- and anti-competitive effects of RPM are discussed, the *Leegin* judgement is also interesting because of its judicial controversy. The Supreme Court delivered a judgement, but this was supported only by five out of nine judges. Consequently, there were four dissenting judges, whose opinion was authored by Justice Breyer.[247] In the dissenting opinion, Breyer expresses his scepticism towards the majority's rejection of the per se rule. As to the substantive part of his argumentation,[248] Breyer explicitly acknowledges that it is well-established that RPM can have both pro- and anti-competitive effects. However, he also

[243] *Leegin Creative Leather Products, Inc.* v. *PSKS, Inc.*, 127 S. Ct. 2705 (2007).
[244] See *Leegin Creative Leather Products, Inc.* v. *PSKS, Inc.*, 127 S. Ct. 2705, 2713 (2007), where the Court referred to *Bus. Elecs. Corp.* v. *Sharp Elecs. Corp.*, 485 US 717, 723 (1988).
[245] *Leegin Creative Leather Products, Inc.* v. *PSKS, Inc.*, 127 S. Ct. 2705, 2713-2714 (2007).
[246] The Supreme Court referred to influential works in the industrial organisation literature, e.g. Bork 1978; Easterbrook 1984a; Marvel and McCafferty 1984; Mathewson and Winter 1998; Posner 2001; Scherer and Ross 1990. See also Chapter 3.
[247] That is, the other three dissenting judges joined the opinion delivered by Justice Breyer.
[248] Breyer also focuses on the concept of *stare decisis*, see also Brunell 2007, pp. 482-494.

> argues that another aspect should be taken into account and that is how 'administrable' the system is.[249] In this context, the dissenting judges argue that there is hardly any empirical evidence as to how much free-riding actually occurs, thereby weakening the pro-competitive arguments. Secondly, the dissenting party points out that concentration has been increasing both at the manufacturer and at the retailer level, thereby making collusion more likely to occur.[250] In sum, the dissenting judges find the majority's decision flawed, because although there might be benefits to RPM, its anti-competitive effects are more likely to occur, whereas, taking into account administrative costs, this should have led the Court to keep *Dr. Miles* alive.

Pursuant to the 2007 decision by the United States Supreme Court in *Leegin*, all forms of resale price maintenance are now subject to a rule of reason rather than a per se rule. To some, this is an antitrust nightmare coming true,[251] whereas others may be of the opinion that the decision was inevitable.[252] Notwithstanding these arguments, RPM will be assessed under a rule of reason from now on, and the task is now to establish an appropriate form of the rule of reason as it is unlikely that the Court will reverse its decision soon.[253]

2.3.2 The rule of reason

It has been explained that both EC competition law and U.S. antitrust law currently provide, at least theoretically, for the possibility of balancing the pro- and anti-competitive effects of resale price maintenance, regardless of its form. This section elaborates on a distinctive feature between EC competition and U.S. antitrust law: the rule of reason. It is argued that EC competition law has no rule of reason concept as referred to in the controversial *Leegin* case. This statement, however, requires some explanation as to the meaning of the concept.

Obviously, the question whether EC competition law has a rule of reason depends on the definition given to this concept. European law in general does have the rule of reason concept ever since the ECJ's ruling in the landmark cases *Dassonville* and *Cassis de Dijon*,[254] though its implications differ substantially per policy area.[255] When applying the concept of the rule of reason to the policy field of competition law, a distinction between two different concepts ought to be made.[256]

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[249] Breyer explicitly states: "[b]ut 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?".
[250] See also infra paragraph 3.3.2.
[251] See e.g. Brunell 2007; Cavanagh 2008; Ghosh 2008; Martin 2008.
[252] See e.g. Graglia 2007; Marvel 2008.
[253] See Lambert 2008 who discusses seven different forms of the rule of reason in the context of RPM.
[254] Case 8-74, *Procureur du Roi* v. *Benoît and Gustave Dassonville* [1974] ECR 837; Case 120/78, *Rewe-Zentral AG* v. *Bundesmonopolverwaltung für Branntwein* [1979] ECR 649.
[255] See e.g. Schrauwen 2005 for an overview of the application of the rule of reason concept in various policy areas of European law.
[256] Van de Gronden 2005, p. 83.

On the one hand, there is the concept of the rule of reason from U.S. antitrust law which entails a balancing of pro- and anti-competitive effects of certain practices.. If applied to EC competition law, this 'competition law rule of reason' would hold that agreements which are pro-competitive on balance are not caught by Article 81 EC, whereas "[a]pplication of the exemption provided for in Article [81(3)] would then be restricted to those cases in which the need to ensure consistency between competition policy and other Community policies took precedence over the results of the competition analysis".[257] As the legal analysis has shown, however, the current situation is quite different. Hardcore restrictions such as minimum and fixed resale price maintenance fall, without much analysis, under Article 81(1) EC, whereas weighing of pro- and anti-competitive effects takes place within the specific framework of Article 81(3) EC. The Commission has explicitly taken the stance that Article 81(3) provides the appropriate forum for weighing the pro- and anti-competitive effects of agreements, and that the incorporation of this 'competition law rule of reason' that is used in the U.S. would "run the risk of diverting Article [81(3)] from its purpose, which is to provide a legal framework for the economic assessment of restrictive practices and not to allow application of the competition rules to be set aside because of political considerations".[258] The Commission's view on this matter has been endorsed by the Court in its case law. In *Métropole Télévision*, the Court of First Instance explained that "[i]t is only in the precise framework of [Article 81(1)] that the pro and anti-competitive aspects of a restriction may be weighed", and that "Article [81(3)] of the Treaty would lose much of its effectiveness if such an examination had to be carried out already under Article [81(1)] of the Treaty".[259] A 'competition law rule of reason' such as in the United States has therefore explicitly been rejected in Article 81(1) EC; the relevant framework of weighing pro- and anti-competitive effects of agreements is Article 81(3).[260]

On the other hand, there is the rule of reason concept as developed in the case law of the Court according to which, notwithstanding the general rule that competition may not be restricted, certain (national) public policy concerns may be upheld within the framework of Article 81(1) EC.[261] In *Wouters*, for example, it was established that a decision by the Bar of the Netherlands prohibiting lawyers from practising as members of the Bar in full partnerships with accountants was a restriction of competition.[262] However, the Court concluded that although competition was restricted, it was

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[257] *White paper on modernisation of the rules implementing Article 85 and 86 (now 81 and 82) of the EC Treaty*, [1999] OJ C132/1, par. 56.
[258] *White paper on modernisation of the rules implementing Article 85 and 86 (now 81 and 82) of the EC Treaty*, [1999] OJ C132/1, par. 56.
[259] Case T-112/99, *Métropole télévision (M6)* v. *Commission* [2001] ECR II-2459, par. 74.
[260] See also Joined Cases T-374/94, T-375/94, T-384/94 and T-388/94, *European Night Services* v. *Commission* [1998] ECR II-3141, par. 130-134.
[261] See e.g. Case 56/65, *Société Technique Minière* v. *Maschinenbau Ulm* [1966] ECR 235; Case C-250/92, *Gøttrup-Klim e.a. Grovvareforeninger* v. *Dansk Landbrugs Grovvareselskab* [1994] ECR I-5461; Case C-309/99, *J. C. J. Wouters, J. W. Savelbergh and Price Waterhouse Belastingadviseurs BV* v. *Algemene Raad van de Nederlandse Orde van Advocaten* [2002] ECR I-1577; Case C-519/04 P, *David Meca-Medina and Igor Majcen* v. *Commission* [2006] I-6991.
[262] Case C-309/99, *J. C. J. Wouters, J. W. Savelbergh and Price Waterhouse Belastingadviseurs BV* v. *Algemene Raad van de Nederlandse Orde van Advocaten* [2002] ECR I-1577.

nevertheless justified on the basis of public interest grounds, as these would be necessary for the proper practice of the legal profession.[263] Similarly, in *Meca-Medina*, regarding the implementation of anti-doping rules, the ECJ ruled that "even if the anti-doping rules at issue are to be regarded as a decision of an association of undertakings limiting the appellants' freedom of action, they do not, for all that, necessarily constitute a restriction of competition incompatible with the common market, within the meaning of Article 81 EC, since they are justified by a legitimate objective. Such a limitation is inherent in the organisation and proper conduct of competitive sport and its very purpose is to ensure healthy rivalry between athletes".[264] Although this 'European style rule of reason',[265] or 'inherent restrictions' or 'ancillary restraints' doctrine,[266] implies to some extent a weighing of positive and negative effects of restrictions on competition (and might therefore seem difficult to reconcile with the CFI's judgement in *Métropole Télévision*),[267] it does not amount to the 'competition law rule of reason' that is used in the U.S. as that is merely based on economic reasoning, and not public policy concerns.[268]

Although there are some exceptional cases where the Court has argued that public policy concerns should be taken into account when determining whether an agreement falls within Article 81(1) EC, EC competition law has no 'competition law rule of reason' such as in the U.S. The key distinctive feature of EC competition law is that there is, in principle, no weighing of pro- and anti-competitive effects of restrictions of competition within the framework of Article 81(1) but only under Article 81(3) EC. This has especially important implications for the assessment of hardcore restrictions such as minimum and fixed resale price maintenance. Minimum and fixed RPM fall by definition under Article 81(1), and can therefore only be justified when the parties themselves resort to Article 81(3) EC, thereby having the burden of proving that the conditions for this legal exception are met.

2.4 Conclusion

This chapter has outlined the application of EC competition law to the instrument of resale price maintenance. In this, the developments in the legal framework of Article 81 EC have been discussed. It has been shown that European competition policy has undergone dramatic changes, inspired by the Commission's move towards a 'more economic approach' in the application of Article 81 EC. As to resale price maintenance, this trend towards an effects-based application of Article 81 EC has led the Commission to exclude maximum RPM from the category of hardcore restrictions.

[263] See e.g. De Vries 2006, p. 194-196.
[264] Case C-519/04 P, *David Meca-Medina and Igor Majcen* v. *Commission* [2006] I-6991, par. 45.
[265] Monti 2002, p. 1088 ff.
[266] Jones and Sufrin 2008, p. 248 ff.
[267] See also Jones and Sufrin 2008, p. 267-269.
[268] De Vries 2006, p. 189.

Besides focusing on the dynamics of EC competition policy, the chapter has also focused on the status quo, and shown that there is a dichotomy in the treatment of resale price maintenance. On the one hand, despite the 'more economic approach', there is the condemnation of minimum and fixed RPM as hardcore restrictions. It has been shown that the Court and the Commission are of the opinion that these kind of agreements by definition restrict competition and that, therefore, no further analysis is necessary to establish that they fall within Article 81(1) EC. Moreover, as minimum and fixed RPM are black-listed, they are not eligible for exemption under a block regulation. In addition, as to the application of the conditions of Article 81(3), the Commission and national competition authorities will assume that such an agreement will have negative effects. That is, there is a presumption that minimum and fixed RPM agreements do not meet the criteria stipulated in Article 81(3) EC. Although both the Commission and the Court have made clear that Article 81(3) does not a priori exclude agreements from its scope, it is defendable that the current approach vis á vis minimum and fixed RPM amounts to a de facto per se prohibition.[269]

Much milder, however, is the Community approach towards (genuine) maximum and recommended RPM, which' treatment differs from that towards minimum and fixed RPM on three levels. First, the Commission (or a national competition authority) will have to prove that such an agreement restricts competition by effect, taking into account the legal and economic context in which the agreement was concluded. Second, maximum and recommended RPM are in principle eligible to benefit from a block exemption. Finally, there is no negative presumption towards the application of the conditions stipulated in Article 81(3) to maximum and recommended RPM.

It has, however, also been noted that there are recent developments that are capable of affecting the rather rigid treatment of minimum and fixed resale price maintenance in the framework of Article 81(1) EC. First, recent developments in the case law might justify a conclusion that the European Courts have embraced the Commission's move towards a 'more economic approach', and are even appearing to require the Commission to expand its effects-based policy when applying Article 81(1) and Article 81(3), perhaps even in the case of hardcore restrictions such as minimum and fixed RPM. Second, pursuant to the recent *Leegin* case, there is the shift from per se prohibition towards the application of the rule of reason in the treatment of minimum and fixed RPM in U.S. antitrust law. Although generally outside the scope of this paper, these recent developments in U.S. antitrust law are to a large extent following developments in economic theory. It is therefore interesting to consider whether the regime change on the other side of the Atlantic, but especially the developments in economic theory, should have any relevance for EC competition law.

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[269] A similar conclusion is reached by Rey and Vergé 2005; Kneepkens 2007; Julien and Rey 2007; Vergé 2008. See also infra paragraph 4.2.2.

3. The economics of resale price maintenance[270]

The previous chapter has outlined the current approach taken by the Commission concerning the application of Article 81 EC towards the instrument of resale price maintenance. It has become clear that this approach is twofold. Minimum and fixed RPM are considered hardcore restrictions and fall therefore by definition under Article 81(1) EC, are ineligible for a block exemption, and are unlikely to satisfy the conditions of Article 81(3) EC. By contrast, maximum and recommended RPM do not necessarily fall within Article 81(1), may benefit from a block exemption, and there is no negative presumption concerning the criteria of Article 81(3). As a result, some commentators are inclined to believe that the Commission's approach vis á vis minimum and fixed RPM amount to a de facto per se prohibition.[271] The Commission, on the other hand, disagrees with this stance, as it explicitly states that it does not exclude a priori certain types of agreement from its scope.[272] Notwithstanding this discussion, however, it can be concluded that the current EC approach is far from sympathetic towards minimum and fixed RPM, to say the least.

However, the previous chapter has also focused on the fact that EC competition law has been continuously changing. From a substantive point of view, two aspects are of great importance when analysing resale price maintenance. First, whereas the first cases concerning RPM were primarily brought under the attention of the Commission because the instrument would frustrate the single market integration objective of competition law,[273] the Commission has increasingly put more emphasis on other objectives, especially that of promoting consumer welfare. Second, EC competition law has unambiguously been subject to a substantive modernisation towards a 'more economic approach', meaning that competition law has become much less formalistic and more based on economic reasoning (i.e. effects-based). This development seems to follow developments in the U.S. where antitrust law traditionally places much more emphasis on economics and where, pursuant to the Supreme Court ruling in *Leegin*, all forms of RPM are now to be assessed using a rule of reason.[274]

In trying to answer the question which approach towards resale price maintenance is optimal for EC competition law it is obviously necessary to have a look at its objectives. Moreover, as a great deal of the input for the answer of this question depends from economic argumentation, much attention will also be paid to the economics of resale price maintenance. This chapter is therefore structured as follows. First, in order to establish the 'optimal approach' of assessing RPM in EC competition law, it

[270] Paragraphs 3.2.1, 3.2.2, 3.3.2 and 3.3.3 are inspired by Van Gorp et al. 2008.
[271] Rey and Vergé 2005; Kneepkens 2007; Julien and Rey 2007; Vergé 2008.
[272] Guidelines on the application of Article 81(3), [2004] OJ C101/97, par. 46. It has moreover been noted that this is also confirmed in the case law, see e.g. Case T-17/93, *Matra Hachette SA* v. *Commission* [1994] ECR II-595, par. 85. See supra paragraph 2.2.
[273] See supra paragraph 2.1.1.
[274] *Leegin Creative Leather Products, Inc.* v. *PSKS, Inc.*, 127 S. Ct. 2705 (2007). See supra paragraph 2.3.1.

must be determined in what normative frame of reference this optimality is to be found. That is, it must be established what the current objective of EC competition law is, and what policy implications this may have in practice. Secondly, after having outlined this objective, and thereby established what is to be considered a restriction of competition, substantial attention will be paid to the effects of RPM in relation to this objective. That is, the second section of this chapter will discuss the arguments that state that RPM's effects are in line with this objective (i.e. pro-competitive effects) and those claiming that RPM contrasts this objective (i.e. anti-competitive effects). The chapter concludes with a concise summary.

3.1 Objectives of EC competition law

Pursuant to Article 3(1)(g) EC, competition law is among the most fundamental objectives of the European Community. The provision stipulates that the activities of the Community include "a system ensuring that competition in the internal market is not distorted".[275] Similarly, in the case law it has been established that the rules on competition constitute fundamental provisions which are essential for the accomplishment of the tasks entrusted to the Community and, in particular, for the functioning of the internal market.[276] However, Article 3(1)(g) EC and the case law do not explain how 'competition in the internal market' should be protected, nor does it become exactly clear whether the focus should be on 'competition' or on 'the internal market'. This section aims to resolve two ambiguities as to the objective of EC competition law. First, it will be explained *whose* interest EC competition law aims to protect. Second, this section will outline *what* interests are to be safeguarded when applying competition policy.

3.1.1 The standard of welfare

Especially regarding the first matter, EC competition policy has been very dynamic. Since its very start, EC competition law has undergone three different phases in which a different (composition of) objectives was pursued.[277] The first phase has been elaborated on more thoroughly before, as in this era the focus was on two objectives: the 'competition objective' and that of single market integration.[278] It has been argued above that in this period in which competition law was said to be "serving two masters",[279] or creating a "two-way tug on policy-makers",[280] was subject to a lot of

[275] Article 3(1)(g) EC.
T[276] See e.g. Case C-126/97, *Eco Swiss China Time Ltd.* v. *Benetton International NV.* [1999] ECR I-3055, par. 36, and Case C-453/99, *Courage Ltd* v. *Bernard Crehan and Bernard Crehan* v. *Courage Ltd and Others* [2001] ECR I-6297, par. 20.
[277] See also Jones and Sufrin 2008, pp. 41 ff., and Weitbrecht 2008, who identifies the following periods: the period 1958 to 1969 in which EC competition law was mostly a motor of integration, the period 1970-1989 in which Article 81 EC was primarily seen as an instrument to protect the economic freedom of market players, and a third period from 1990 to 2004 in which the Commission, during a period of 'Americanisation' gradually adopted its own version of the consumer welfare approach.
[278] See supra paragraph 2.1.4, as well as the Commission's XXIXth Report on Competition Policy, par. 2-3.
[279] Jones and Sufrin 2008, p. 42.
[280] Deacon 1995, par. 9.

criticism, which ultimately led the Commission to change its rather formalistic view and to initiate the 'more economic approach'.[281] The second phase that can be distinguished partly overlaps the first phase, and is actually more a transition period between the first and the third phase (and roughly covers the implementation of the 'more economic approach').[282] This second phase consists of the gradual belief that the focus of EC competition policy should not longer be primarily on the objective of single market integration, but rather "to concentrate more on ensuring effective competition by detecting and stopping cross-border cartels and maintaining competitive market structures".[283] That is, after an early phase where competition law pursued both the protection of competition and single market integration as primary objectives, a new period was initiated in which the competitive market system itself was placed before other objectives.[284] This new approach was largely influenced by the 'ordoliberal' view on competition, according to which an unconstrained market economy would be able to ensure an efficient allocation of resources.[285] Central aspects in the ordoliberal view are the hostile stance towards monopoly power as well as the protection of the competitive process though the prohibition of any form of conduct which restrained autonomous economic behaviour. Direct influences of ordoliberalism have been noticeable both in legislation,[286] and in the case law of the Court.[287]

Pursuant to the modernisation of competition law, however, the focus appears to have shifted towards a third phase. The current focus of the Commission approach within EC competition law appears to be merely on the protection of consumer welfare.[288] The new focus on consumer welfare became apparent in the Guidelines on Vertical Restraints, where the Commission states that "[t]he protection of competition is the primary objective of EC competition policy, as this enhances consumer welfare and creates an efficient allocation of resources", indicating that competition is to be protected as a means of enhancing consumer welfare.[289] Moreover, statements from Commission officials – including former Commissioner Monti, and current Commissioner Kroes – make more clear that an actual shift has taken place.[290] More specifically, as recent as 2008, current Director General Philip Lowe stated that "[i]n the Commission's view, the ultimate objective of its intervention in the area of antitrust and

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281 See supra paragraph 2.1.4 as well as Hawk 1988; Hawk 1995; Bright 1995; Deacon 1995; Reich 1997.

282 For this reason, the distinction between the first and second phase is rather artificial, though helpful from an analytical point of view.

283 White Paper on modernisation of the rules implementing Articles 81 and 82 of the EC Treaty [1999] OJ C132/1, Executive Summary, par. 8.

284 See e.g. Jones and Sufrin 2008, pp. 41-43; Pera 2008; Weitbrecht 2008.

285 See e.g. Eucken 1952.

286 In this respect, it should be recalled that Article 81(3) EC only allows an exception to Article 81(1) if competition is not eliminated, which is a clear reference to the ordoliberal view on competition.

287 See e.g. Case 26/76, *Metro SB-Großmärkte GmbH & Co. KG* v. *Commission* [1977] ECR 1875, par. 20, where the Court refers to the concept of 'workable competition'.

288 See also Pera and Auricchio 2005; Gerber 2008; Jones and Sufrin 2008; Pera 2008.

289 Guidelines on Vertical Restraints, [2000] OJ C291/1, par. 7. See also Guidelines on the application of Article 81(3), [2004] OJ C101/97, par. 13 and 33 for similar statements.

290 See e.g. Jones and Sufrin 2008, pp. 47-48 for excerpts of several speeches.

merger control should be the promotion of consumer welfare".[291] Similar developments are noticeable in the case law of the Court of First Instance.[292] It can therefore be concluded that there has been substantial development concerning the objective of EC competition law, but that the current focus seems to be on protecting consumer welfare. It should be mentioned, however, that this position is far from undisputed.

Ambiguity as to the current objective of EC competition law

Despite several official statements of the Commission that consumer welfare is a primary aim of EC competition law, there is also some uncertainty. First, it is not exactly sure to what extent single market integration is no longer an objective of EC competition law. Whish, for example, argues that the recent judgement of the Court in *GlaxoSmithKline* – where it was specifically argued that the Commission should prove that a agreement restricts competition to the detriment of the final consumer – should be considered as an exception, and that single market integration is likely to remain a key feature in EC competition policy.[293] This argument may be reinforced by the uncertainty created following the developments concerning the reform of the EC (and EU) Treaty. As mentioned before, the current EC Treaty states that that the activities of the Community include "a system ensuring that competition in the internal market is not distorted". However, no such reference to the importance of competition law is to be found in the Lisbon Treaty, whereas there still is an explicit mentioning of the internal market among the fundamental objectives.[294]

Secondly, a recent judgement by the Court of Justice has created uncertainty concerning the shift in the 'competition objective' from the (ordoliberal) view that competition itself should be protected to the (current Commission) view that the effects on consumer welfare should be the primary focus. In her opinion, the Advocate General stated that Article 81 EC does not primarily aim to protect consumers but the competitive process itself, thereby indirectly protecting consumers.[295] The ECJ appears to have followed this opinion as it has stated that "Article 81 EC, like the other competition rules of the Treaty, is designed to protect not only the immediate interests of individual competitors or consumers but also to protect the structure of the market and thus competition as such".[296] As not much attention was paid to this statement, however, it remains to be seen whether the Court has indeed meant with this judgement to disagree with the current Commission approach, which has – as has just been discussed – stated that the protection of consumer welfare is the primary concern of EC competition law. Moreover, as discussed below, a shift back towards the ordoliberal view on competition would also imply that the objective of EC competition law is diverging from that of U.S. antitrust law.

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[291] Lowe 2008, p. 6.

[292] In Cases T-213/01 and 214/01, *Österreichische Postsparkasse AG and Bank für Arbeit und Wirtschaft AG* v. *Commission* [2006] ECR II-1601, the CFI stated that "the ultimate purpose of the rules that seek to ensure that competition is not distorted in the internal market is to increase the well-being of consumers" (par. 115), whereas in Case T-168/01, *GlaxoSmithKline Services Unlimited* v. *Commission* [2006] ECR II-2969, the Court similarly stated that "the objective assigned to Article 81(1) EC […]s 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" (par. 118).

[293] Whish 2009, p. 51-52. For the specifics of the *GlaxoSmithKline* case, see supra paragraphs 2.1.4 and 2.2.1. See also Motta 2004, p. 23; Van den Bergh and Camesasca 2006, p. 240-244.

[294] Although the Treaty on the Functioning of the Union does include competition among the policies for which the Union is exclusively competent, there still remains uncertainty as to the significance of this change (see Pera 2008; Weitbrecht 2008).

[295] Case C-8/08, *T-Mobile Netherlands BV, KPN Mobile NV, Orange Nederland NV and Vodafone Libertel NV* v. *Raad van bestuur van de Nederlandse Mededingingsautoriteit*, Opinion, par. 58.

[296] Case C-8/08, *T-Mobile Netherlands BV, KPN Mobile NV, Orange Nederland NV and Vodafone Libertel NV* v. *Raad van bestuur van de Nederlandse Mededingingsautoriteit* [2009] ECR 00000, par. 38.

Despite this ambiguity, this paper will presume that EC competition law is currently primarily concerned with the protection of consumer welfare, which is in line with the most recent official statements by the Commission and most of the literature.

As to the reason for the change towards a regime focusing on the protection of consumer welfare it has been mentioned that it follows the need for convergence with the approach followed in the United States.[297] Indeed, U.S. antitrust law has a similar focus on consumer welfare, thereby unambiguously being influenced by the Chicago School paradigm.[298] The Chicago School has been highly influential since the 1980s and delivered some heavy criticism on the earlier approach in U.S. antitrust law which was guided by the 'structuralism' paradigm, and on the ordoliberal view on competition in the EC. According to this structuralist approach, similar to the ordoliberal view on competition, arrangements which could reduce the autonomy of the firm in the market were generally considered as harmful to competition.[299] By contrast, according to the Chicago School view, the anti-competitiveness of a practice should be evaluated on the basis of its effects on prices and quantities and on the ensuing effect on welfare, whereas less attention should be paid to effects on the structure of the market.[300] As a result, the Chicago School view on competition has for a large part been responsible for the U.S.' gradual lenient view regarding vertical restraints, which are notorious for their ambiguous effects on consumer welfare. In this context, it should be mentioned, however, that the current approach in U.S. antitrust law towards resale price maintenance is not the same as the approach advocated by the Chicago School for at least two reasons. First, whereas RPM is currently subject to a rule of reason, the Chicago School has consistently argued that vertical restraints are generally welfare-improving, and that they should therefore be per se legal.

The Chicago School view on resale price maintenance

The Chicago School vision on resale price maintenance is summarised by Bork: "vertical price fixing (resale price maintenance), vertical market division (closed dealer territories), and, indeed all vertical restraints are beneficial to customers and should for that reason be completely lawful. Basic economic theory tells us that the manufacturer who imposes such restraints cannot intend to restrict output and must (except in the rare case of price discrimination, which the law should regard as neutral) intend to create efficiency. The most common efficiency is the inducement or purchase by the manufacturer of extra reseller sales, service, or promotional effort."[301] That is, according to the Chicago School, RPM is generally welfare-enhancing. In this, the Chicago School greatly relies on the free-riding thesis as

[297] Pera 2008.
[298] See Pera 2008.
[299] More specifically, the structuralist conception, or Harvard School's vision, emphasises the relationship between market power, business conduct, and market results (i.e. the structure-conduct-performance paradigm), see Van den Bergh and Camesasca 2006, pp. 67-78.
[300] See especially the contributions of Coase 1960; Posner 1972; Posner 1975; Williamson 1975; Bork 1978; Posner 1981.
[301] Bork 1978, p. 297.

stated by Telser.[302] As to the anti-competitive effects of RPM, Bork argues that "[t]he proposed legality of vertical restraints need not be questioned on the theory that it would enable successful and undetectable horizontal reseller cartels",[303] and that "resale price maintenance […] for the purpose of policing a manufacturer cartel […] will be so rare and the ease of detection so great that this objection should not stand in the way of the legality of truly vertical restraints".[304]

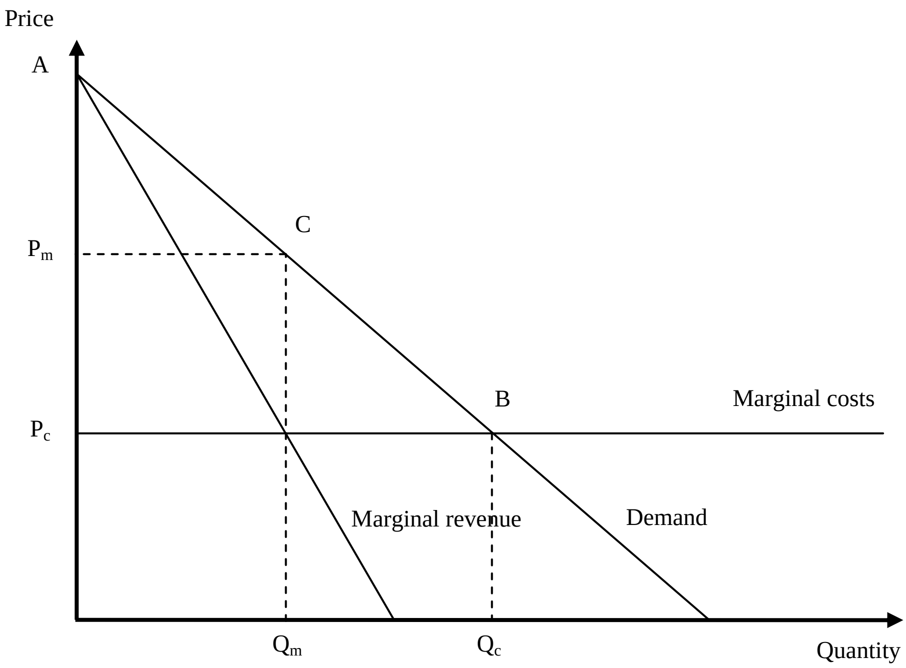
The Chicago School therefore acknowledges that resale price maintenance can have both pro- and anti-competitive effects, but argues that its pro-competitive effects are much greater in magnitude and frequency. Moreover, the Chicago School generally favours a rule of per se legality for RPM, and all vertical restraints in general, because choosing a rule of reason would provide judges too little or no guidance, making the balancing of pro- and anti-competitive effects a task that is "infeasible and unsound".[305]

A second difference between the approach advocated by the Chicago School and the approach currently taken in U.S. antitrust law, but also in the European Community, is that Chicago School has held that not *consumer* welfare, but *total* welfare should be the standard of welfare for competition policy. Indeed, especially from an economic point of view,[306] it seems rather odd to prioritise consumer's welfare higher than that of manufacturers, as this implies a value judgement which could have decisive influence on the outcome.[307] In fact, although the choice for a consumer welfare approach is in line with the 'more economic approach', a 'pure economic approach' would entail a regime focusing on total welfare (or so-called Kaldor-Hicks efficiency).[308] However, as a decrease in consumer welfare generally resembles a reduction in total welfare,[309] and because of administrative simplicity, a focus on consumer welfare is often advocated. The concept of consumer welfare is illustrated below.

The economic concept of consumer welfare

The rationale for the protection of consumer welfare can be illustrated by looking at a market where the seller faces constant marginal costs. In the case of perfect competition (or in the case where the competitors play Bertrand competition), prices equal marginal costs (i.e. P_c), and quantities are set at Q_c. As a result, consumer welfare is equal to the area P_cAB.

[302] See infra paragraph 3.2.2.
[303] Bork 1978, p. 293.
[304] Bork 1978, p. 295. As to both these arguments, see infra paragraph 3.3.2.
[305] Posner 1981, p. 8.
[306] See e.g. Bishop and Walker 2002, pp. 23-27.
[307] See also Verouden 2003; Jones and Sufrin 2008, p. 44-49.
[308] See Van den Bergh and Camesasca 2006, pp. 41-43 and Pera 2008. If competition policy would pursue Kaldor-Hicks efficiency, it would allow the (theoretical) situation where a certain instrument increases manufacturers' welfare by more than the losses of consumers. That is, Kaldor-Hicks efficiency is not concerned with the distribution of total welfare.
[309] See Posner 1975; Motta 2004, p. 20.



By contrast, in the case of a monopoly (or when all sellers perfectly collude), quantities will be set where marginal revenue equals marginal costs (i.e. Q_m), with the corresponding monopoly (or collusive) price P_m. Here, consumer welfare entails only the area between the points P_mAC, which is clearly smaller.

3.1.2 The scope of welfare

Now that it has been established that the standard of welfare in EC competition law is that of consumers, the question rises what this definition should include. The concept described above only allows for competition factors to change consumer welfare, either directly through a change in prices or quantities, or indirectly through a change in e.g. quality or service.[310] Economists are, however, often criticised for focusing too much on these values and not taking into account other factors that influence individuals' well-being (i.e. utility), which obviously encompasses a whole lot more than wealth. Although economists have tried to define social welfare as the sum of individuals' well-being which can include all kinds of variables,[311] these are mostly immeasurable or incomparable and not very helpful in practice. As a result, competition policy's limits are generally set so that it merely deals with competition factors, such as prices, quality, innovation, choice, service, etc.

This somewhat narrow conception of individuals' well-being, by including only competition factors, sometimes collides with other forms of government intervention in the market. As discussed above, the Commission has consistently opposed RPM agreements in the market for books, because it is of

[310] For the effects of a change in the level of service provided, see infra paragraph 3.2.2.
[311] One may think of factors such as health, fairness, but also elements such as legal certainty (see e.g. Kaplow and Shavell 2002; Cooter and Ulen 2004, pp. 310-313).

the opinion that these agreements do not create an efficiency in the sense of Article 81(3) EC.[312] However, as explained below, resale price maintenance is far from uncommon in the market for books.

Resale price maintenance in the market for books

Vertical price-fixing has been, and still is, extensively used in the market for books. The United Kingdom, for example, allowed RPM for books until 1997.[313] Germany and the Netherlands, however, still use RPM in these markets. Contrasting the traditional use of resale price maintenance, the situation in the market for books is a rather special case, as its regime is often set up by the legislator itself.

From a legal point of view, book producers and distributors will therefore generally not be caught by Article 81 EC because this provision requires the possibility of autonomous conduct by undertakings.[314] That is, Article 81 EC does not apply when the national legislator creates a legal framework which itself eliminates the possibility of competitive activity.[315] Nonetheless, even though RPM in the market for books may not be an infringement of competition law by undertakings, it might be by Member States, as Article 10 EC imposes a duty on Member States not to adopt or maintain in force any measure which could deprive Articles 81 and 82 EC of their effectiveness.[316] Another reason why RPM regimes, even set up by (associations of) undertakings, may fall outside the scope of Article 81 EC is that when it involves only national books, undertakings and consumers, the Commission assumes that this will not appreciably affect trade between Member States.[317]

Although the question whether Member States' legislation infringes the principle of loyal cooperation is beyond the scope of this paper, it remains interesting to see what arguments are used to justify fixed RPM from an economic point of view.[318] Governments who apply price-fixing in the book sector generally see books as a 'merit good' in the sense that they want to protect a dense network of well-stocked, high-quality bookshops and stimulate the publication of a large variety of books. The cultural value of books has also been acknowledged by the Council, who has invited the Commission "when applying competition rules and rules on the free movement of goods, to take account of the specific value of the book as a cultural object and the importance of books in promoting cultural diversity, and of the cross-border dimension of the book market [and] when examining national rules and agreements on fixed book prices, insofar as they affect trade between the Member States, to pay particular

[312] See supra paragraph 2.2.1.
[313] See Office of Fair Trade 2008.
[314] Holoubek et al. 2006, pp. 83-84.
[315] See Cases 40-48, 50, 54-56, 111, 113 and 114-73, *Coöperatieve Vereniging "Suiker Unie" UA and others* v. *Commission* [1975] ECR 1633, par. 71-72 and Cases C-359/95 P and C-379/95 P, *Commission of the European Communities and French Republic* v. *Ladbroke Racing Ltd* [1997] ECR I-6265, par. 32-34. If, on the other hand, the legislature merely encourages or approves undertakings to engage in RPM, Article 81 EC might still apply, see e.g. 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.
[316] Cases 209 to 213/84, *Criminal proceedings against Lucas Asjes and others* [1986] ECR 1425, par. 71-72. See also Case 13-77, *SA G.B.-INNO-B.M.* v. *Association des détaillants en tabac (ATAB)* [1977] ECR 2155.
[317] See Notice pursuant to Article 19(3) of Council Regulation No 17(1) concerning an application for negative clearance or exemption under Article 81(3) of the EC Treaty (Sammelrevers and Einzelreverse), [2000] OJ C162/25).
[318] See e.g. OECD 1997, p. 109 ff., Appelman and van den Broek 2002, Appelman and Canoy 2002 and Canoy et al. 2006 for (economic) assessments of the specifics of the market for books and a discussion on the arguments pro and contra RPM in the book sector.

> attention to […] questions relating to imports between countries practising fixed book-price systems”.[319]

It has been explained above that the national regimes of resale price maintenance in the market for books are different from the subject of this paper. First, as they are generally set up by the national legislatures themselves, or because they do not appreciably affect trade between Member States, these regimes do not fall within the scope of Article 81 EC. Secondly, the reason for government intervention in the market for books differs from the rationale of competition policy; the latter addresses a specific form of market failure (i.e. market power), whereas the former has a paternalistic motive because books are seen as a ‘merit good’. Resale price maintenance in the market for books is therefore an exception for both legal and economic reasons. The remainder of this paper will therefore assess resale price maintenance according to the traditional consumer welfare standard, thereby merely addressing competition values.

3.2 Pro-competitive effects of resale price maintenance

As has become clear from the previous chapter, the European Commission as well as many commentators are of the opinion that resale price maintenance can, by reducing or eliminating downstream price competition, substantially reduce consumer welfare. However, as has become clear inter alia from the discussion on the other side of the Atlantic, RPM can also have pro-competitive effects, and thereby increase consumer welfare. This section will outline the economic theory on the positive effects of resale price maintenance on consumer welfare, whereas the next section will discuss RPM’s potential welfare-reducing effects.

A discussion on the economic explanations for the use of resale price maintenance must begin with a determination of the playing field. In this respect, an important point is put forward by Mathewson and Winter in their influential article on RPM.[320] They argue that “if both the upstream (manufacturing) and downstream (retail) sectors were perfectly competitive, transacting in a functionless wholesale market, RPM (or any other restraint) would never be observed”.[321] A central assumption in this statement is that resale price maintenance – or vertical restraints in general – would be redundant if the upstream and downstream markets were in perfect competition.[322] Indeed, manufacturers would have

[319] Council resolution on the application of national fixed book-price systems, [2001] C 73/5.
[320] Mathewson and Winter 1998.
[321] Mathewson and Winter 1998, p. 64. See also Bishop and Walker 2002, p. 158.
[322] The theory of perfect competition assumes four cumulative conditions. The first condition is that economies of scale are small relative to the size of the market, meaning that average costs will rise rapidly if a firm increases output beyond a relatively small amount. Consequently, in a perfectly competitive market there will be a large number of sellers. Secondly, output is presumed to be homogeneous, i.e. consumers cannot distinguish between products produced by different firms as products are exactly the same. Thirdly, information is assumed to be perfect, hence consumers and undertakings are fully aware of their possibilities and their implications. Finally, in a perfectly competitive market there are no entry or exit barriers.

no incentive whatsoever to impose a restraint on its retailers, because in order for such a contract to be acceptable for the retailer, wholesale prices would have to be lower than marginal costs. That is, in a conventional market setting, both manufacturers and retailers will price their products equal to their marginal costs. As a result, both minimum and fixed RPM would not be accepted (or result in losses for the manufacturer), whereas maximum and recommended RPM would not be adhered to and therefore pointless. It can therefore be concluded that RPM can only be explained when resting the assumption of perfectly competitive markets.

3.2.1 Double marginalisation

The double marginalisation, or double mark-up, argument for resale price maintenance (and vertical mergers) is well-established in the economic literature.[323] In effect, the double marginalisation hypothesis entails a coordination problem which arises when both the manufacturer (or producer) and the retailer enjoy some market power.[324] Pursuant to this market power, both the upstream and downstream undertakings find it profitable to rise their price above their marginal costs.[325] As a result, final consumers of a product or service with a distribution chain with successive market power are confronted with a final price that is marked-up twice. However, this situation is not only detrimental to the consumer, but also to the manufacturer as he is confronted with reduced output. The underlying reason for this result is that neither the retailer nor the manufacturer takes into account the effect of its price on the other firm's profit. If, however, the upstream and the downstream undertaking would be placed under the same management, i.e. if the two firms would merge, there would be only one undertaking placing a mark-up on the product's marginal costs. This way, vertical integration, so to speak, internalises the externalities created by the retailer's pricing behaviour. Vertical integration is, however, by its nature rather costly, whereas operations on both levels of production generally impose very different, complex and conflicting problems on the management.[326] As the upstream firm merely prefers that the downstream firm does not add a mark-up to the product as well, another option for the manufacturer is to resort to RPM, which allows him to control the retailer's price, thereby preventing the retailer to charge a monopoly mark-up, and the corresponding loss in quantities sold. The argument is elaborated upon below.

As a result, new firms can easily enter the market, generally resulting in zero economic profits (see Church and Ware 2000, p. 21-22).

[323] See e.g. Scherer and Ross 1990, pp. 541-542; Mathewson and Winter 1998, pp. 75-78; Bishop and Walker 2002, pp. 157-159, pp. 217-218; Motta 2004, pp. 307-313; Rey and Vergé 2005, pp. 12-14; Van den Bergh and Camesasca 2006, pp. 209-210.

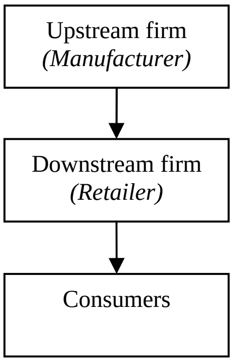
[324] The double marginalisation argument was first analysed by Spengler 1950.

[325] The ability of a firm to profitably raise price above marginal cost depends on the extent to which consumers can substitute to other suppliers. It is possible to distinguish between supply and demand substitution. Supply side substitution is relevant when products are homogeneous, whereas demand side substitution is applicable when products are differentiated (Church and Ware 2000, p. 29).

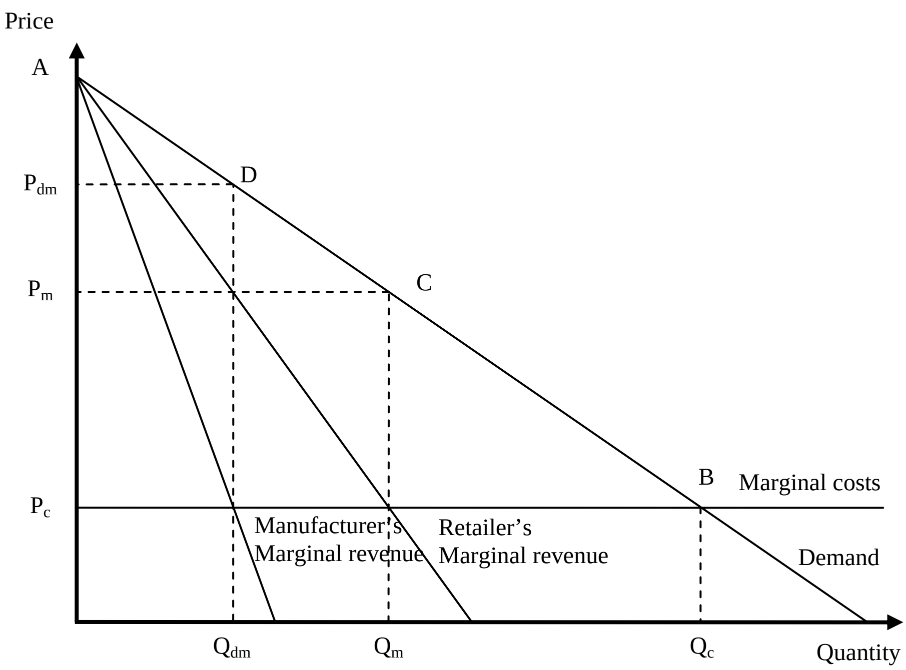
[326] See e.g. Scherer and Ross 1990, p. 542.

The double marginalisation hypothesis

In its most straightforward application, the double marginalisation hypothesis is set in a situation in which the distribution chain consists of successive monopolies. The distribution chain can therefore be depicted as follows.



In this scenario, the downstream firm takes the wholesale price as his marginal costs (assuming he has no marginal costs of his own). Following this marginal costs, and the industry demand curve, the retailer will add a monopoly mark-up to the price, thereby lowering the demand for the product. Consequently, the manufacturer is confronted with diminished demand (i.e. he faces a derived demand curve). The upstream firm, however, is also a monopolist and he will thus also add a monopoly mark-up to his marginal costs. In the end, because consumers are facing successive monopolies, they are confronted with two monopoly mark-ups, leaving them even worse off than in the case of a simple monopoly. The manufacturer, on the other hand, is also not pleased, as due to the decreased output, his profits are substantially lower. The problem is depicted below.



Due to the double marginalisation problem, two mark-ups are placed on the marginal costs instead of one. The retailer, who is directly confronted with consumer demand, sets a price equal to the level where industry demand is such that his marginal revenue equals marginal costs, thereby lowering

> consumer demand to Q_m. The manufacturer, however, determines his own price when facing his residual demand curve, which equals the retailer's marginal revenue curve. The end result is a price equal to P_{dm}, and a corresponding output of Q_{dm}. As a result, consumer welfare is diminished substantially; whereas under one monopoly this would be the area P_mAC, consumer welfare under a successive monopoly is only P_{dm}AD.[327] If, however, the manufacturer would be able to impose a fixed or maximum RPM on the retailer equal to his marginal costs (i.e. the wholesale price P_m), both manufacturer and consumer welfare would increase.[328]

It has been explained above that the imposition of fixed or maximum resale price maintenance in the case of successive monopolies can increase consumer (as well as producer and total) welfare. It should be noted, however, that this argument applies whenever both the upstream and the downstream undertaking enjoy some market power.

In this context, a remark considering the application of Article 81(3) EC to the double marginalisation hypothesis is in place. It has been explained that the third condition of Article 81(3) EC implies a proportionality test in the sense that restrictions are considered to be 'indispensable' if, firstly, the efficiencies can not also be generated by other economically practicable and less restrictive means, and, secondly, each individual restriction is necessary in order to produce the efficiencies.[329] Although it is beyond the scope of this paper to discuss their competitive effects, it should be mentioned that there are other means to solve the double marginalisation problem than vertical integration and the imposition of RPM. If the manufacturer could instead force the retailer to purchase a specific amount of his output, i.e. quantity forcing, the result would be similar to resale price maintenance.[330] Alternatively, the manufacturer could introduce a so-called two-part tariff,[331] where he sets his wholesale price equal to marginal costs, thereby giving the right incentives to the retailer, whereas a franchise fee can be used to share the accompanied profit.[332] An other, more straightforward, point that needs to be taken into account regarding the proportionality test of Article 81(3) EC is that whereas the double marginalisation problem can be solved by both fixed and maximum RPM, fixed RPM is generally more restrictive competition than maximum RPM. Obviously, fixed RPM does not allow the

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327 Note that under perfect competition consumer welfare would be represented by the area P_cAB.
328 The retailer, however, would be worse off, but – from a total welfare point of view – this decrease in retailer welfare will be compensated for by the increases in consumer and producer welfare.
329 See supra paragraph 2.2.1.
330 See Motta 2004, pp. 308-309; Rey and Vergé 2005, pp. 13-14. As to quantity forcing, see the Guidelines on Vertical Restraints, [2000] OJ C291/1, par. 152.
331 That is, a fixed (franchise) fee plus a variable component for each unit bought.
332 It should be mentioned, however, that the equivalence of quantity forcing and the imposition of a two-part tariff vanishes in the case of uncertainty in the market (either regarding final demand, or on the product's costs), and if the retailer is risk averse. When demand is uncertain, and a two-part tariff is introduced, the retailer will face substantial risk, which – being risk averse – he will only accept if the manufacturer's guarantees him a minimum profit. If, on the other hand, cost is uncertain, RPM is not the preferred instrument, as the retailer can not adjust his price following a price shock. That is, RPM is preferred to a two-part tariff when demand is uncertain, whereas two-part tariffs yield higher results than RPM when costs are uncertain (see Rey and Tirole 1986; Motta 2004, pp. 312-313).

retailer to set its prices below the price indicated by the manufacturer, which may cause that RPM results in anti-competitive effects as well.[333]

3.2.2 Solving non-price externalities

The double marginalisation paradigm described above discusses the situation where the retailer does not take into account the effect of its pricing behaviour on the upstream firm's profit. That is, because the retailer charges a monopoly price, consumer demand will diminish, thereby reducing total output and, correspondingly, the total vertical structure's profit. It has just been shown that the imposition of (fixed or) maximum RPM may solve for this problem. This tells nothing about the desirability of minimum and, to some extent, fixed resale price maintenance. The subject of this section is to outline the general explanation in the economic literature for the imposition of minimum and fixed RPM.[334] When analysing this subject matter, one should begin with asking himself the following question: given that a higher price, other things equal, diminishes total demand for the product (or service), why would a manufacturer impose a price floor on its retailers? The short answer to this question is that "other things are not equal".[335] The longer version of the answer entails the acknowledgement that demand for the manufacturer's product may, because of the higher retail prices, increase once the indirect effects of such a price change are taken into account. That is, manufacturers will generally want to 'purchase' additional investments to be made by the retailer.[336] Below, I will discuss six situations where minimum or fixed RPM may solve for such indirect effects: two of these situations concern horizontal externalities (i.e. between retailers), and four vertical externalities (i.e. between retailer and manufacturer). Then, the analysis will continue with a description of the welfare implications of the basic argument, which can be summarised by an outward shift of the demand curve.[337] However, the analysis is not complete without a discussion on the limitations of the basic argument, of which I will discuss four that are especially relevant when assessing the argument under Article 81(3) EC.

Probably the most commonly used argument in favour of resale price maintenance is the phenomenon that retailers can free-ride on their competitors' promotional activities, which has become known as the '*special services hypothesis*'.[338] The special services hypothesis considers that actual consumer demand depends to a large extent on pre-sale services that are provided by the retailer. These product-specific pre-sale services include advertising, information from knowledgeable salespeople (e.g. on how to use an appliance), displays of goods (e.g. retail showrooms), customer demonstrations (e.g. test

[333] See infra paragraph 3.3.
[334] See e.g. Scherer and Ross 1990, pp. 542-548; Mathewson and Winter 1998; Bishop and Walker 2002, pp. 161-162; Utton 2003, pp. 234-240; Motta 2004, pp. 313-338; Rey and Vergé 2005, pp. 14-18; Viscusi et al. 2005, pp. 283-284; Van den Bergh and Camesasca 2006, pp. 210-214.
[335] Mathewson and Winter 1998, p. 67.
[336] Marvel and McCafferty 1984, p. 346.
[337] Viscusi et al. 2005, p. 284.
[338] Telser 1960.

drives of car automobiles), and the like.[339] Naturally, such services require additional investments by the distributor and therefore add to the retail price. In such a scenario, a free-rider problem emerges, which stems from the fact that each retailer's promotion effort will not only benefit its own sales, but also the sales of its rivals. These competitors are, however, generally in a better position, as they are able to benefit from the increased demand arisen from the promotional activities, without having to spend equally. As a result, consumers are able to obtain the pre-sale services at one retailer, but then buy the product from another retailer who does not provide the special services and is consequently able to charge a lower price. This free-riding problem distorts the incentives of any retailer to provide the (for the manufacturer) optimal level of services. Consequently, when the special services hypothesis holds, the manufacturer is confronted with diminished output, because consumers, in turn, are not provided with an adequate level of pre-sale services, which lowers their demand. The manufacturer would therefore like to increase the retailers' level of services. An effective regime of minimum or fixed resale price maintenance, i.e. a regime in which a retailer who attempts to undercut the resale price will run the risk to having supplies cut off (or where the case is simply brought before court), will encourage the retailers to offer an optimal level of services. The intuition is that when all retailers have to charge the same (minimum) price that reflects the costs of providing the optimal level of services, they are forced to compete with each other on non-price terms. According to this argument, which is at the basis of Chicago School's enthusiasm towards RPM,[340] the imposition of minimum or fixed resale price maintenance, will lead to an increase in both producer and consumer welfare.

A second situation in which the imposition of RPM can solve a horizontal externality actually involves a broadening of Telser's original free-riding theory that has been just discussed.[341] Similar to the special services hypothesis, the '*quality certification hypothesis*' states that retailers can free-ride on each other's investments for developing a reputation for selling only high quality products.[342] These investments might include efforts for being a fashion trendsetter. Instead of making similar efforts to obtain such a reputation, retailers can free-ride on the reputation of such a high-reputation retailer by stocking the same products.[343] The quality certification hypothesis is a broadening of the special services theorem, because the latter, as will be discussed below, generally only explains RPM for complex goods such as electronic appliances, whereas the former entails an explanation for the use of RPM with goods which are not that complex, but which' quality can not be observed perfectly prior to purchase, e.g. clothing. In order to prevent such free-riding, which would again deteriorate output, a

[339] See Mathewson and Winter 1998, p. 67; Carlton and Chevalier 2001, p. 442; Van den Bergh and Camesasca 2006, p. 210-211; Blair 2008, p. 140.
[340] See e.g. Bork 1978, pp. 280-298; Posner 2007, pp. 307-310.
[341] Marvel and McCafferty 1984.
[342] See e.g. Van den Bergh and Camesasca 2006, pp. 212.
[343] See e.g. Motta 2004, pp. 334-335.

manufacturer can adopt minimum or fixed RPM in order to 'purchase' quality or style certification from its dealers.[344]

A third scenario in which resale price maintenance can solve a non-price externality involves, though related to the quality certification hypothesis, a vertical externality. The '*branding hypothesis*' states that minimum or fixed RPM may also add to prestige of the brand name by itself.[345] In this situation, consumers rely to some extent on the pricing of the product as an indication for quality. If, however, a retailer decides to use the image of the popular leading brand to attract customers to his own store, this luxury image might deteriorate. That is, the so-called practice of 'loss-leaders' might result in the fact that consumers feel that they often have to pay too high a price. As a result, manufacturers may very well be of the opinion that, if consumers frequently judge product by price, the widespread use of their products of 'loss leaders' will ultimately affect sales as customers lose confidence in the quality of the product.[346] A manufacturer may combat this 'loss-leading' practice by introducing minimum or fixed RPM.[347]

Fourthly, a vertical externality exists when a distributor does not take into account the effects of its after-sales services on the manufacturer's profits. The '*quality assurance theory*' – unlike the special services hypothesis, which concerns pre-sales services – states that distributors may also influence the manufacturer's profit by providing after-sales services.[348] According to this theory, retailers can influence the final quality of the good as received by the consumer by providing after-sales services (e.g. free post-sale maintenance of an electronic equipment or a car).[349] However, as interests between retailers and manufacturers may differ, a retailer may choose a level which is not equal to the level the manufacturer sees as optimal. Similar to the situation of underprovision of pre-sales services, a manufacturer may impose minimum or fixed RPM in order to increase retailer investments in after-sales services.

A fifth externality that may incentivise a manufacturer to impose minimum or fixed resale price maintenance on its retailers is the so-called '*outlets theory*'.[350] The outlets theory can apply in two scenarios.[351] First, intense competition between retailers may cause that, from the manufacturer's perspective, too few outlets may stock the manufacturer's product. Secondly, and more generally, as interests between retailers and manufacturers typically differ, retailers may choose to locate

[344] Marvel and McCafferty 1984.
[345] Marvel and McCafferty 1984.
[346] Utton 2003, p. 238.
[347] In this situation, the manufacturer does not require an actual investment to be made by the retailer, but merely demands a higher retail price. The analysis below is, however, equivalent.
[348] Klein and Murphy 1988.
[349] Van den Bergh and Camesasca 2006, p. 213.
[350] Gould and Preston 1965.
[351] Van den Bergh and Camesasca 2006, pp. 213-214.

themselves, in the eyes of the manufacturer, too distant from each other. In both scenarios, the manufacturer may use minimum or fixed RPM to contribute to the number of retail outlets or to an optimal density of the retail network willing to carry the product. In general, the theory states that the wider distribution of the product will increase demand, and thereby manufacturer (and consumer) welfare.[352]

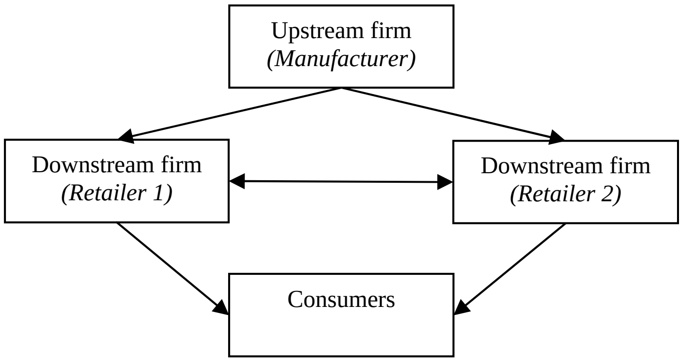
Finally, there is the situation in which minimum or fixed resale price maintenance may reduce the risk retailers face due to uncertain consumer demand.[353] The '*demand risk theory*' states that when consumer demand is uncertain, and retailers are risk averse, the latter may consequently keep an, from the perspective of the producer, inadequate level of inventories of the manufacturer's product.[354] The introduction of minimum or fixed RPM prevents the emergence of discount retailers, and shares the risk of uncertain consumer demand between the manufacturer and the retailer.[355] That is, by sharing the risk, resale price maintenance enables manufacturers to have their products sold by retailers in times of uncertain consumer demand.

So far, this section has outlined six different situations in which non-price externalities arise out of the principal-agent relation between a manufacturer and its retailers. In each scenario, the manufacturer wants to increase consumer demand either directly or indirectly by raising retail prices, thereby bringing the retailer's interests more in line with those of the manufacturer. That is, the introduction of RPM internalises the non-price externalities arising out of the retailer's behaviour. According to the basic arguments, this will not only lead to an increase in manufacturer welfare, but also in consumer (or total) welfare, because total demand increases. The welfare effects of this basic argument are illustrated below.[356]

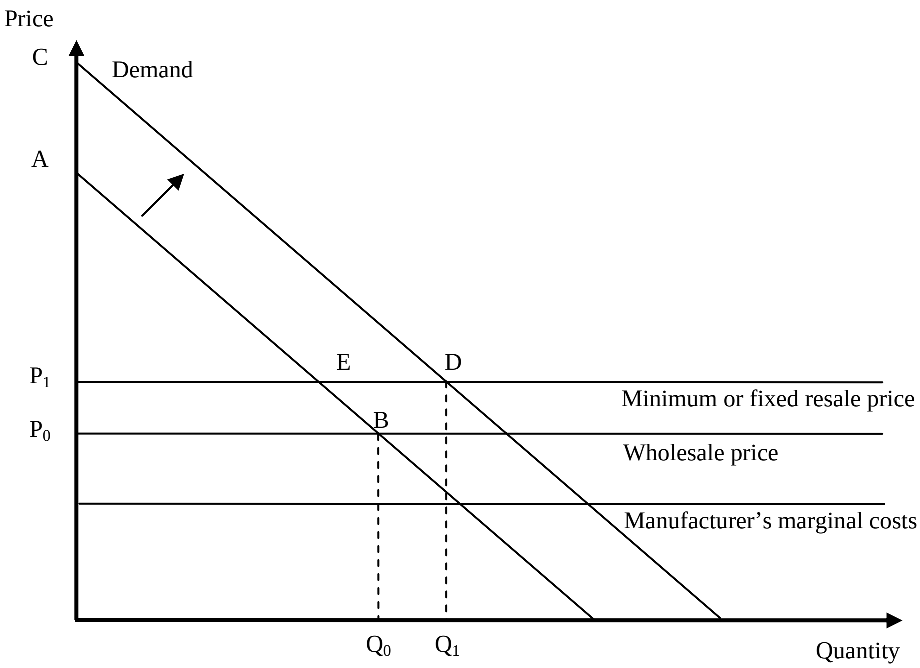
Welfare-enhancing effects of minimum or fixed RPM when solving non-price externalities

In order to outline the basic argument of using minimum or fixed RPM when it is used to solve for non-price externalities, it is useful to have in mind the following distribution chain, involving one manufacturer and two retailers, thereby introducing intra-brand competition (i.e. competition among retailers in the market for a certain brand).

[352] Mathewson and Winter 1998, p. 67.
[353] Rey and Tirole 1986.
[354] Deneckere et al. 1996.
[355] See Van den Bergh and Camesasca 2006, p. 214; Krishnan and Winter 2007.
[356] See also Scherer and Ross 1990, pp. 542-548; Utton 2003, pp. 235-238; Blair 2008, pp. 142-146.



Consider the situation where intra-brand competition is strong, so that both retailers charge a price equal to their marginal costs. Next, consider that the marginal costs of the retailers merely consist of the wholesale price. The wholesale price, in turn, is the sum of the manufacturer's marginal costs and his mark-up. As a result, the initial retail market outcome is that Q_0 products are sold at P_0. Consumer welfare is represented by the area P_0AB.



Now, assume that the manufacturer is displeased with the level of investment, e.g. the level of pre-sale services provided, and that he agrees with the retailers that they can only sell his product at (or above) P_1. Because of the highly competitive environment, retailers are induced to compete on non-price terms, e.g. on the level of pre-sale services. The increase in investment by the retailers can lead to an increase in consumer demand, which is illustrated by an outward shift of the demand curve. Pursuant to the introduction of RPM, the retail market outcome is now that the product concerned is sold at P_1, with a corresponding quantity of Q_1.

As is clear from the picture above, producer welfare has unambiguously increased. The introduction of resale price maintenance has generated additional demand for his product, whereas the wholesale price has not changed, thereby substantially increasing the manufacturer's profit. Secondly, retailer welfare has remained unchanged; both before and after RPM they sold their product at a price equal to their marginal costs. Finally, consumers appear to have gained as well, judging from a comparison of

> consumer welfare before and after the introduction of resale price maintenance. Whereas initially, consumer welfare was represented by the area P_0AB, the increase in pre-sale services has caused that consumer welfare is now P_1CD.[357]
>
> In this respect, it should be noted that the effect on consumer welfare depends on the relation between, on the one hand, the increase in retail price, and on the other hand, the increase in consumer demand. However, it should be kept in mind that a manufacturer will only impose minimum or fixed RPM if he can increase consumer demand (i.e. if he suspects that consumers will benefit from extra services). Therefore, according to the basic argument, resale price maintenance will generally increase total welfare.

The argumentation outlined above illustrates the Chicago School's sympathy towards minimum and fixed resale price maintenance; because output increases, there will also be a rise in consumer (and total) welfare.[358] However, modern literature in industrial organisation has put forward some rather convincing counter-arguments for the Chicago School stance. Below, I will consider four key limitations of the theory.

First, the application of some of the theories are limited in their scope. The special services hypothesis, for example, only holds for products where pre-sale services are relevant. In this context, one may think of goods such as cars, fragrances and refrigerators as goods for which consumers rely to a great extent on pre-sale services, either because they request try-outs, or explanation because of the complexity of the product.[359] The quality certification and branding hypotheses do have a somewhat wider applicability, though it remains uncontroversial that it does not fit in all markets.[360] The extent to which a theory applies on a market will, however, require a somewhat extensive analysis.

A second important limitation of the basic argument that RPM when used for correcting non-price externalities is generally welfare-enhancing is that it relies to a great extent on the premise that consumers benefit from an additional investment by the retailer equally.[361] However, it seems logical to assume that there are situations in which manufacturers' and consumers' interests conflict.[362] As a result, firms and consumers may, for example, disagree on the optimal amount of pre-sale services or, more specifically, on the right mix between retail services and prices.[363] The reason for this is that consumers generally differ as to their valuation of a product and, correspondingly, the need for additional effort made by the retailer. On the one hand, so-called marginal consumers are, without the

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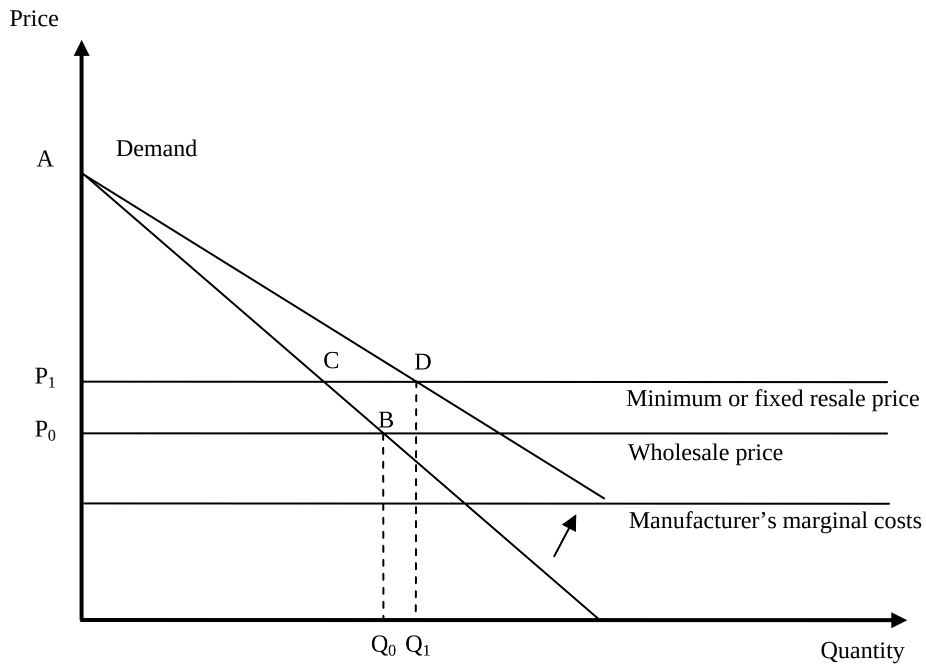
[357] The increase in consumer welfare is $ACDE - P_0P_1EB$.
[358] "Since vertical restraints are not means of creating restriction of output, we must assume that they are means of creating efficiencies, and it is perfectly clear that they are" (Bork 1978, p. 290).
[359] Carlton and Chevalier 2001.
[360] Marvel and McCafferty 1984.
[361] Or in the case of the branding hypothesis, from an increase in retail prices.
[362] See Comanor 1985.
[363] Van den Bergh and Camesasca 2006, p. 211.

RPM-induced increased effort, on the margin between buying and not buying a good.[364] An increase in, for example, the services provided by the retailer, might enhance the marginal consumer's valuation of the product, leading him to buy it, and thereby increase his welfare. On the other hand, so-called infra-marginal consumers have, by definition, already a rather high reservation price concerning the good at hand, and therefore do not value extra effort.[365] The infra-marginal consumer is therefore already willing to purchase the product concerned even without the additional effort. For example, when the effort concerned is the provision of pre-sale services, it seems plausible to assume that consumers with high pre-RPM reservation prices know enough about the product that they are eager to purchase it even without information provided by the retailer.[366] If minimum or fixed RPM would be introduced, however, also the infra-marginal consumers would have to pay a higher price, thereby reducing their welfare. This counter-argument is elaborated upon below.

Ambiguous welfare effects of minimum or fixed RPM when solving non-price externalities

The initial situation on the market in this counter-argument is the same as the situation explained above, concerning welfare-enhancing effects of minimum or fixed RPM. Therefore, Q_0 products are sold at P_0, whereas consumer welfare is represented by the area P_0AB. Consider, however, again the situation where the manufacturer introduced minimum or fixed RPM in order to increase the level of pre-sale services provided, and thereby to attract the marginal consumer to his product. That is, the manufacturer imposes a minimum or fixed retail price of P_1, leading the retailers to increase their level of services. This time, however, because infra-marginal consumers do not, but marginal consumers do value extra effort, there is no parallel shift of the demand curve, but a rotation (or iso-elastic shift) of the demand curve.



[364] Utton 2003, pp. 237-238.
[365] Motta 2004, p. 316.
[366] Scherer and Ross 1990, p. 548.

As the figure above shows, intra-brand competition results in a total demand of Q_1 at a price of P_1. Post-RPM, consumer welfare is represented by the area of P_1AD, which is, in this case, lower than consumer welfare before the introduction of RPM.[367] It becomes clear that when differences between consumers and firms are taken into account, consumer surplus may decline, even though RPM is being used for promotional purposes and total output increases.[368]

By contrast, the welfare effects for manufacturers and retailers remain similar. Manufacturers, on the one hand, achieve a higher output at a higher price, hence their profit increases. Retailers, on the other hand, still operate at a price equal to their marginal costs. The only effect that is ambiguous is the effect of RPM on consumer welfare. The exact welfare effects of an introduction of RPM depend on the movement of the demand curve, which, in turn, depends on the distribution of consumer's valuation of an increased investment. In general, it can be presumed that when the introduction of minimum or fixed RPM leads to a parallel shift of the demand curve, consumer (and total) welfare will increase. If, however, RPM leads the demand curve to rotate, the effects on consumer welfare are ambiguous. In an important contribution, Scherer and Ross stress that such a rotation (or iso-elastic shift) is more realistic than a parallel shift, because of the differences between marginal and infra-marginal consumers. For example, a higher level of service or larger stock of inventories is less likely to contribute to the infra-marginal consumer's welfare, because he already knows a lot about the product, or is willing to incur some costs of back-order delay or additional shop visits.[369]

It should be noted, however, that the counter-argument described above relies to a great extent on the assumption that there is little (or, as in the illustration, no) inter-brand competition.[370] If infra-marginal consumers, who do not value extra effort, suddenly have to pay more for (in their eyes) the same product, they might switch to a competitor that does not incorporate such effort. That is, if consumers have alternative solutions, an increase in the price is unlikely to harm the consumers as they would then be able to switch to an alternative product.[371] It is therefore generally accepted in modern economic literature that the divergence between the preferences of the marginal consumers and the infra-marginal ones is likely to be important when the vertical structure enjoys a substantial market power.[372]

A third limitation that is to be discussed is, again, especially a limitation of the special services hypothesis, and concerns inter alia the indispensability requirement of Article 81(3) EC. The core of this argument is that the pre-sale services are necessarily linked to the product concerned.[373] The free-

[367] The reduction in consumer welfare is equal to P_0P_1CB – ADC.
[368] Blair 2008, p. 145. Or, as Van den Bergh and Camesasca put it: "[i]f marginal consumers are willing to pay more to benefit from additional services whereas infra-marginal consumers would prefer to have lower services and prices, then it may be in the interest of the vertical structure to increase the level of effort and the retail price, even though it hurts the majority of consumers and decreases total welfare" (Van den Bergh and Camesasca 2006, pp. 211-212).
[369] Scherer and Ross conclude that "under plausible conditions, a tendency toward welfare reductions seems more likely than the opposite. The Chicago dogma that *all* profitable vertical restraints are welfare-increasing is false" (Scherer and Ross 1990, p. 548).
[370] Motta 2004, p. 316.
[371] Rey and Tirole 2005, p. 18.
[372] Motta 2004, p. 316; Van den Bergh and Camesasca 2006, p. 212.
[373] Utton 2003, p. 235.

riding problem does not arise when distributors can sell the goods and pre-sale services separately.[374] In this context, it should be mentioned that the assumption that the services are necessarily linked to the product is less plausible to hold for newer forms of retailing concepts.[375] On one hand, manufacturers might introduce a program of promotional allowances that pay for the particular services the manufacturer desires. This way, the manufacturer can ensure that the desired service is provided without introducing RPM. On the other hand, a manufacturer can agree contractually with its distributors to provide well-trained sales personnel and services as a condition for supplying the dealer with its product line.[376] Alternate to these contractual arrangements, a manufacturer may moreover decide to provide the desired services himself.[377] For example, the manufacturer may decide to open concept stores or corners which are specifically designed to offer the consumer the service he desires. Another way in which manufacturers may internalise the externality themselves is to provide information on their own websites.[378]

Finally, it should be taken into account to what extent the introduction of minimum or fixed RPM is proportional to the desired result. The question is whether the efficiencies generated by minimum and fixed RPM can not also be generated by other economically practicable and less restrictive means.[379] In this context, it is generally recognised that resale price maintenance is not the only instrument that can correct the non-price externalities discussed above.[380] First, as to the special services hypothesis, free-riding on pre-sale services might also be prevented or at least diminished by selective distribution, i.e. selectively distributing a product through outlets that offer pre-sale services.[381] However, in a situation where there is also inter-brand competition, if a manufacturer invests in training the retail staff, not only his product, but also that of its competitors may benefit from his investment. Another instrument that might be used (in combination with selective distribution) is exclusive territories.[382] That way, the manufacturer may divide its geographic market into different areas, and appoint an exclusive distributor in each area. As a result, it will be more costly for consumers to obtain the pre-sale services at one retailer, but then buy the product from another retailer (i.e. to shop around).[383] Second, the quality certification hypothesis, which states that retailers can free-ride on each other's investments for developing a reputation for selling only high quality products, can also be solved by selective distribution.[384] That is, by contractually arranging that its distributors must have certain

[374] Van den Bergh and Camesasca 2006, p. 211.
[375] Steiner 1997.
[376] Steiner 1997, pp. 427-429.
[377] See e.g. Steiner 1997, p. 425.
[378] See Carlton and Chevalier 2001, p. 443, as well as infra paragraph 3.3.3.
[379] See supra paragraph 2.2.1.
[380] See also Peeperkorn 2008, where it is argued that "the efficiency arguments in support of RPM are not very strong and that RPM is not an efficient instrument for bringing about these efficiencies" (Peeperkorn 2008, p. 212).
[381] See e.g. Bishop and Walker 2002, p. 161.
[382] See Church and Ware 2000, p. 693; Bishop and Walker 2002, p. 161; Motta 2004, p. 315; Rey and Tirole 2005, p. 17; Peeperkorn 2008, p. 209.
[383] Motta 2004, p. 315.
[384] Motta 2004, p. 334.

characteristics, a manufacturer can prevent that its luxury image collapses through free-riding.[385] Third, as the branding hypothesis simply states that a higher price itself adds to prestige of the brand, because consumers rely on the pricing of the product as an indication for quality, this problem can be overcome by introducing wholesale price discrimination.[386] By charging retailers who intend to use the product as loss-leader a higher price, manufacturers can ensure or at least make it less likely,[387] that customers do not lose confidence in the quality of the product that way. Next, as mentioned before, instead of imposing resale price maintenance, manufacturers can often also provide after-sales services themselves, thereby weakening the quality assurance hypothesis concerning RPM. Fifthly, concerning the case where, according to the outlets theory, retailers choose to locate themselves (in the eyes of the manufacturer) too distant from each other, location clauses might be used alternatively to RPM.[388] Finally, while the demand risk theory states that when consumer demand is uncertain and retailers risk averse, the latter may keep an (from the perspective of the producer) inadequate level of inventories of the manufacturer's product, this issue may also be solved by the instrument of quantity forcing.[389] Here, the retailer is contractually obliged to buy a certain amount of units from the manufacturer, who can hence ensure that his products are sufficiently stocked by its distributors. In sum, all of the non-price externalities discussed above may be solved through other instruments. It should be stressed, however, that this does not say anything about the restrictive nature or feasibility of these alternatives; it could very well be that these instruments are, in practice, more restrictive of competition than RPM.[390]

3.3 Anti-competitive effects of resale price maintenance

Now that it has become clear what the potential welfare-enhancing effects of the instrument resale price maintenance are, it is time to look at its anti-competitive effects. It has been explained that this concept of the restriction of competition, or the objective of Article 81 EC in general, circles around the central question as to the effects on consumer welfare.[391] It has also been discussed that the Commission seems rather convinced that minimum and fixed RPM have a negative effect on

[385] According to Article 1(d) of Regulation 2790/1999, OJ L336/21, 'Selective distribution system' means a distribution system where the supplier undertakes to sell the contract goods or services, either directly or indirectly, only to distributors selected on the basis of specified criteria and where these distributors undertake not to sell such goods or services to unauthorised distributors.
[386] See e.g. Aiura 2007.
[387] That is, distributors may still charge a price that is too low in the eyes of the manufacturer, but this will increase their own losses.
[388] Van den Bergh and Camesasca 2006, p. 215.
[389] Bishop and Walker 2002, p. 162.
[390] For example, assigning exclusive territories may create a monopoly, whereas minimum or fixed RPM merely eliminates intra-brand price competition.
[391] See supra paragraph 3.1.1.

consumer welfare.[392] In its Guidelines on Vertical Restraints, the Commission explains its position on resale price maintenance.[393]

> **The resale price maintenance group in the Guidelines on Vertical Restraints**
> 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. A maximum or recommended price may work as a focal point for resellers, leading to a more or less uniform application of that price level. Increased 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.

From this excerpt, it can be concluded that the Commission acknowledges that minimum and fixed resale price maintenance (and to a lesser extent with maximum and recommended RPM) facilitate manufacturer cartels, as well as cartels between retailers. The Commission's main concern is the reduction, or elimination, of intra-brand price competition, which leads to a greater transparency on prices. Besides the manufacturer and retailer cartel arguments, economic theory recognises some other anti-competitive effects of resale price maintenance. This section will subsequently deal with three arguments stipulating that RPM can have welfare-reducing effects.

3.3.1 The commitment problem

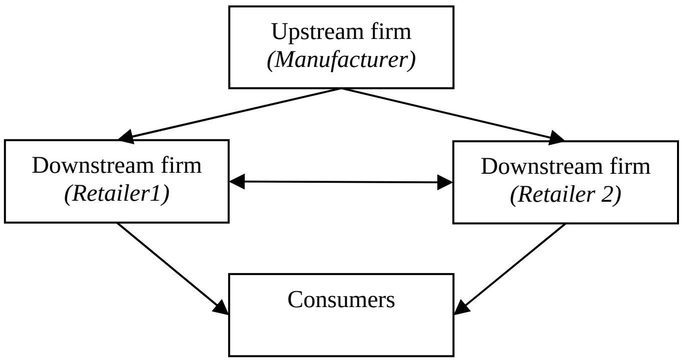
Unlike the others, the first argument according to which resale price maintenance is undesirable from a consumer welfare perspective takes place within a setting of mere intra-brand competition.[394] According to the commitment problem, resale price maintenance can have an adverse effect on welfare when it helps a manufacturer to keep his prices high, whereas without it he would not have been able to commit to high prices.[395] The theory states that a manufacturer will face a commitment problem, i.e. is unable to appropriate his market power, when his retailers anticipate on his (potential) opportunistic behaviour. In short, the commitment problem concerns the situations where the manufacturer contracts with competing retailers sequentially, simultaneously but secretly, or where he has the ability to (secretly) renegotiate his contracts with the retailers. In these situations, it can be shown that the manufacturer has an incentive to free-ride on the competing retailers.[396] If, however, the manufacturer has to deal with rather important buyers who, although they are in fierce competition, are

[392] See supra paragraph 2.1.4.
[393] Guidelines on Vertical Restraints, [2000] OJ C291/1, par. 112.
[394] See e.g. Bishop and Walker 2002, pp. 163-164; Motta 2004, pp. 338-343; Rey and Vergé 2005, pp. 20-22; Peeperkorn 2008, pp. 207-208.
[395] Motta 2004, p. 338. The foundations of the commitment problem are laid down in Hart and Tirole 1990 and O'Brien and Shaffer 1992.
[396] Rey and Vergé 2005, p. 21.

able to demand lower purchases, he might want to commit himself in a credible way not to engage in opportunistic behaviour.[397] Minimum or fixed RPM contributes to the good functioning of the (upstream) monopoly by distorting the manufacturer's incentives to engage in opportunistic behaviour. The situation where RPM allows a manufacturer to appropriate its market power is elaborated upon below.[398]

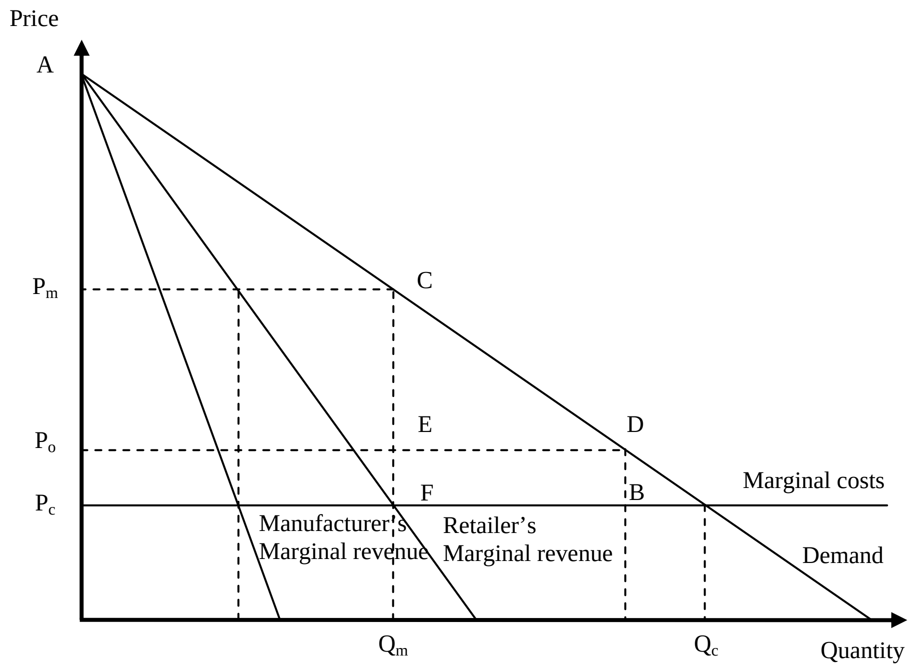
The commitment problem

Consider the situation of an upstream monopolist that faces little demand uncertainty and is able to choose from several, e.g. two, possible retailers that are ready to sell his brand (i.e. there is downstream competition). The distribution chain can therefore be depicted as follows.



Suppose, however, that the manufacturer promised to give exclusivity (for a certain region) to one retailer, and that this promise would be believed, he would sell his product at a monopoly wholesale price to the retailer, i.e. P_m. The situation is depicted below, where it is again assumed that the retailer does not have other per-unit costs than the wholesale price, and – for simplicity – that the retailer prices at his marginal costs. Having signed this contract, however, the manufacturer realises that he can increase his output, hence its profits, if he reduces his price somewhat and sell additional units by signing a contract with another retailer. That is, by charging a lower, opportunistic price (P_o), the monopolist manufacturer would be able to earn a supra-monopoly profit by increasing his original monopoly profit, P_cP_mCF, with additional rents of FEDB.

[397] Peeperkorn 2008, p. 207.
[398] See also Bishop and Walker 2002, p. 164; Motta 2004, pp. 338-339; Rey and Vergé 2005, p. 21.



However, because the initial retailer, i.e. he who signed first with the manufacturer, will have to compete with lower-priced units as sold by the second retailer, the additional contract creates a loss for him. Knowing the manufacturers possibilities, and having sufficient power to do something about it, the initial retailer will therefore not agree with the contract offered to him. That is, because everyone knows that the manufacturer is likely to renege on the promise, causing a loss for his contractors, this lack of commitment power will result in the situation where retailers only buy the manufacturer's product at a very low wholesale price.[399] Obviously, this scenario leaves the manufacturer with much less than the monopoly profit. This stimulates the manufacturer to impose a minimum or fixed retail price to increase his credibility as to not undercut the first contractor. That is, in this scenario, RPM leaves no incentive for the manufacturer to engage in opportunistic behaviour by secretly cutting the wholesale price as this would not increase his profit because the retailers' ability to sell at a discount price is eliminated. As a result, the manufacturer is able to earn a monopoly profit, which is clearly detrimental to consumer welfare compared to the alternative, a competitive outcome.[400]

As has just been explained, minimum or fixed resale price maintenance can restore a manufacturer's credibility in a rather general context when he faces a commitment problem. A more specific scenario in which the commitment problem can arise is in a franchising context. Here, the manufacturer will be unable to sign a (monopoly) initial franchise fee, because the retailers will envisage that he will have an incentive to engage in opportunistic behaviour and offer a cheaper contract to a competitor.[401] In all of these situations, however, minimum or fixed RPM is detrimental to consumer welfare.

399 Motta 2004, p. 339.
400 See supra paragraph 3.1.1.
401 See e.g. Motta 2004, pp. 339-343; Rey and Vergé, pp. 20-22.

3.3.2 Facilitating a manufacturer or retailer cartel

Unlike the commitment problem, the second potential welfare-reducing effect of RPM that is to be discussed in this section is explicitly recognised by the Commission in its Guidelines on Vertical Restraints: by eliminating retail price variation, a cartel among manufacturers or retailers is facilitated.[402] Both the retailer and manufacturer cartel hypotheses acknowledge that RPM not only affects intra-brand (i.e. competition among retailers in the market for a certain brand), but also inter-brand competition (i.e. competition between brands). Indeed, it can safely be presumed that by modifying the choices made by a vertical chain, vertical restraints will generally have an impact on the competition between a vertical chain and rival ones.[403] That is, the terms of the contracts accepted by the distributors affect the nature of competition between these retailers on the downstream market, thereby indirectly affecting the behaviour of rival manufacturers when they set the terms of the contracts with their own distributors.[404] This section will show that, when taking into account inter-brand competition, the effect of RPM can be to facilitate a cartel, either on the upstream (manufacturer) or on the downstream (retailer) level. In this, the manufacturer and retailer cartel hypotheses will be subsequently discussed. Then, because of many similarities, some attention will be paid to the welfare effects of manufacturer and retailer cartels.

The manufacturer cartel hypothesis states that, by enhancing price transparency in the market, especially minimum and fixed RPM makes a cartel between producers easier to sustain. The argument firstly assumes that when manufacturers want to collude, in order to earn a supra-normal profit, they face the problem that a cartel generally is no self-enforcing Nash-equilibrium.[405] That is, depending on several conditions in the market, a manufacturer might find it more profitable to deviate from the cartel, e.g. by offering a lower wholesale price, and increase his output.[406] A concise overview of factors affecting the stability of a cartel is given below.

Factors affecting the stability of a cartel

It is generally recognised in the economic literature that the stability of cartels depends to a large extent on the differences between collusive and 'ordinary' profits as well as on the magnitude and likelihood of retaliation when one cartel member decides to deviate.[407] In turn, these factors generally depend on the characteristics of the market concerned. In a study for the European Commission, Ivaldi et al. show the relevance of the following factors:

- a higher number of competitors hinders collusion;

[402] Guidelines on Vertical Restraints, [2000] OJ C291/1, par. 112. See also Scherer and Ross 1990, p. 550; Mathewson and Winter 1998, pp. 65-66; Carlton and Perloff 2000, p. 409; Bishop and Walker 2002, pp. 163-165; Utton 2003, pp. 239-240; Motta 2004, pp. 158, 359-362; Rey and Vergé 2005, pp. 27-28; Van den Bergh and Camesasca 2006, pp. 208-209; Peeperkorn 2008, pp. 206-207; Viscusi et al. 2005, pp. 284-286; Julien and Rey 2007.
[403] Motta 2004, p. 348.
[404] Rey and Vergé 2005, p. 23.
[405] In game theory, a Nash equilibrium is a strategy profile such that every player's strategy is a best response to the strategies of all the other players, see e.g. Church and Ware 2000, pp. 220-222; 305 ff.
[406] See e.g. Ivaldi et al. 2003.
[407] See e.g. Ivaldi et al. 2003; Motta 2004, pp. 142-185.

- asymmetry in the competitors' market shares makes collusion more difficult to sustain;
- entry barriers facilitate collusion;
- frequent interaction and frequent price adjustments facilitate collusion;
- market transparency (e.g. on prices and sales) facilitates collusion;
- collusion is easier to sustain in growing markets;
- demand fluctuations hinder collusion;
- collusion is more difficult to sustain in innovative markets;
- cost asymmetries between competitors hinder collusion;
- asymmetries in capacity constraints hinder collusion;
- higher differentiation in quality provided between competitors makes collusion more difficult;
- multi-market contact between competitors facilitates collusion.[408]

Because of the possibility of cheating cartel members, a group of manufacturer will want to check for compliance with the cartel, e.g. on whether all manufacturers charge the same wholesale price. However, because it is generally difficult to monitor a wholesale price, the colluding group of manufacturers might want to resort to checking retail prices, which are generally easier observed.[409] A problem with monitoring retail prices for checking on cheating cartel members is that absent RPM, when shocks in the retail market occur (e.g. on retailer cost or consumer demand), final prices will tend to change.[410] As a result, the colluding group of manufacturers will find it difficult to distinguish between retail price changes caused by different retail conditions from retail price changes due to cheating from one of the manufacturers. That is, observing retail prices does not allow the manufacturers to perfectly infer the wholesale prices and deviations from the collusive agreement cannot be easily identified.[411] If, however, the group of colluding manufacturers could agree on the imposition of (minimum or) fixed RPM, variations in retail prices would be eliminated (or, in the case of minimum RPM, diminished). Consequently, because RPM is used to set retail prices to reflect the collusive wholesale price, RPM prevents cheating because, firstly, retail price cuts are easier to detect, and secondly, wholesale price cuts are less desirable, since it does not lead to an increase in the manufacturer's output.[412] By eliminating retail price variation, resale price maintenance therefore greatly improves market transparency, and thereby makes it easier for a manufacturer cartel to sustain.

The manufacturer cartel hypothesis has recently been formalised by Julien and Rey.[413] They show that when deciding whether or not to impose RPM in order to collude through retail prices, manufacturers generally face a trade-off. On the one hand, fixing retail prices allows them to sustain a cartel, and thereby grants them a higher collusive profit. On the other hand, RPM makes it impossible for retailers

[408] Ivaldi et al. 2003.
[409] Mathewson and Winter 1998, p. 65; Carlton and Perloff 2000, p. 409.
[410] Motta 2004, p. 359; Rey and Vergé 2005, p. 28; Julien and Rey 2007.
[411] Rey and Vergé 2005, p. 28.
[412] Van den Bergh and Camesasca 2006, pp. 208-209.
[413] Julien and Rey 2007.

to adequately respond to cost or demand shocks, which makes price uniformity generally inefficient.[414] Julien and Rey show that when shocks affect retail costs RPM is clearly undesirable because prices are unable to respond to costs, whereas when shocks affect demand, consumers and society favour price rigidity. However, Julien and Rey conclude that manufacturers will tend to adopt RPM and thereby increase average prices by so much that consumer and total welfare will generally decrease.[415]

Economic theory also recognises that resale price maintenance can be used to facilitate a cartel among retailers. The retailer cartel hypothesis, in short, states that a group of retailers that want to collude might persuade a manufacturer to impose RPM in order to facilitate their cartel. Similar to the manufacturer cartel hypothesis, the situation where retailers want to form a cartel imposes two problems on them. First, like in any cartel, without special safeguards, a collusive agreement between retailers is endangered by cheating. Secondly, cartels are very likely to meet resistance by either the Commission or national competition authorities as these form the most straightforward example of a hardcore restriction. These problems might, to some extent, be resolved by persuading a manufacturer to impose resale price maintenance. The reason is that, firstly, the danger of cheating cartel members is diminished because all retailers would have to sell at the price that is set, on pain of having supplies withdrawn if they attempt a price reduction.[416] That is, by persuading the manufacturer to impose RPM, the retailers can establish a mechanism that allows for punishing the price-cutting retailer.[417] Secondly, if the manufacturer introduces RPM, this enables the retailers to circumvent having to engage in an explicit horizontal price-fixing agreement.[418] As a result, by eliminating intra-brand price competition, RPM allows and facilitates collusion between retailers.

There are, however, three important limitations to the retailer cartel hypothesis. First, it is rather doubtful that a manufacturer will voluntarily impose RPM, as this is generally not in his best interest.[419] More specifically, because the dealer cartel necessarily decreases his output, a manufacturer will generally be stimulated to report the cartel to the competition authority. Next, it is generally recognised that the retailer cartel hypothesis can only hold when the retailers concerned have substantial buyer power in that the manufacturer can not reasonably run the risk of not being boycotted by these retailers as this would lead him to lose his business.[420] Similarly, a manufacturer is also unlikely to agree with a dealer cartel when he faces substantial inter-brand competition, as this would give him a competitive disadvantage which can also force him out of the market.[421] Finally, if a group of retailers would be able to succeed and persuade a manufacturer to impose RPM, this would yield

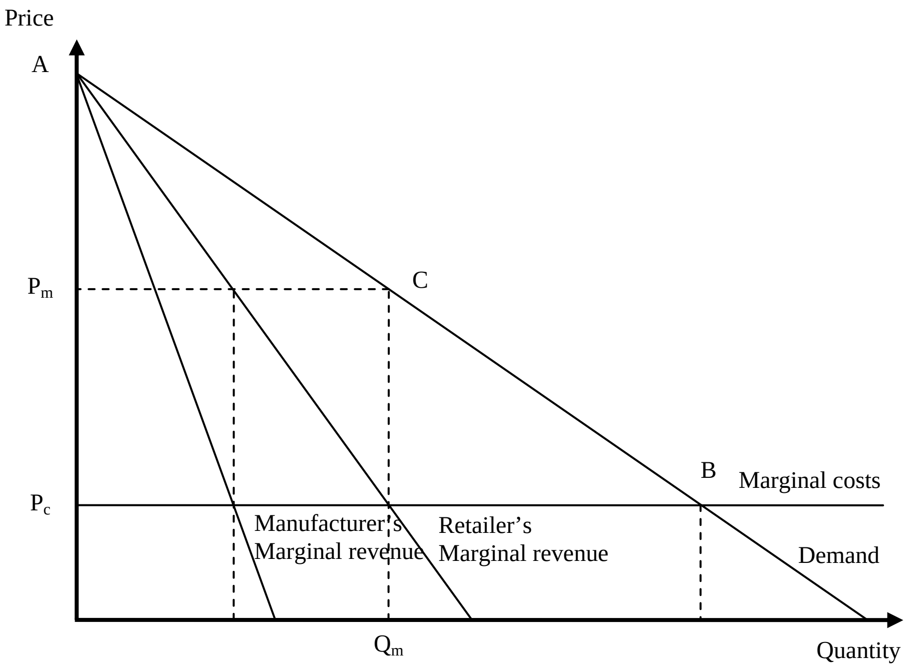
[414] Rey and Vergé 2005, p. 28.
[415] Julien and Rey 2007, p. 985.
[416] Utton 2003, p. 239.
[417] Van den Bergh and Camesasca 2006, p. 209.
[418] Mathewson and Winter 1998, pp. 65-66.
[419] See e.g. Scherer and Ross 1990, p. 550; Utton 2003, p. 239; Viscusi et al. 2005, p. 284. See however infra paragraph 3.3.3.
[420] See e.g. Peeperkorn 2008, p. 206.
[421] Viscusi et al. 2005, p. 284.

supra-normal retailer profit. It seems likely, however, that this would attract new entrants to the market, who – when competing for sales – might erode the incumbent retailers' profit in the long run.[422] Consequently, depending on market characteristics such as entry barriers on the market,[423] a retailer cartel might lose its appeal in the long run, as profits might be eroded by new entrants. It can therefore be concluded that the retailer cartel hypothesis is more likely to hold when the group of retailers that wants to collude has substantial buyer power, when there is relatively little inter-brand competition, and when entry barriers are high.

The welfare effects of the retailer and manufacturer cartel hypotheses are similar. Whether this is upstream or downstream, when a group of undertakings is able to form a cartel, consumer welfare generally suffers. The situation is illustrated below.

The welfare effects of an upstream or downstream cartel

The welfare effects of either a manufacturer or a retailer cartel are rather straightforward and therefore do not need a lot of attention. The illustration below considers the situations of a perfect manufacturer cartel and that of a perfect retailer cartel (where the cartel behaves like a single monopolist), and compares that with the competitive counterfactual (where prices equal marginal costs).



Both when concerning an upstream cartel and when it involves a downstream cartel, the cartel will generate an output where their joint marginal revenue equals their marginal costs. Assuming that, in

[422] Utton 2003, pp. 239-240; Van den Bergh and Camesasca 2006, p. 209.
[423] See Ivaldi et al. 2003, pp. 16-19.

the case of a manufacturer cartel, the retailers are engaged in perfect competition, and vice versa, consumer welfare will, as a result of the cartel, decrease from P_cAB to P_mAC.[424]

It can therefore easily be concluded that when RPM is used to facilitate either a manufacturer or a retailer cartel, this will happen to the detriment of consumer welfare.

3.3.3 Resale price maintenance as an entry barrier

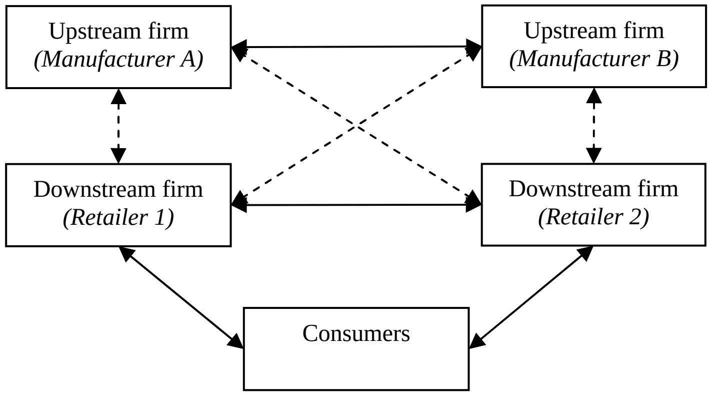
The previous two sections have considered potential anti-competitive effects of resale price maintenance in a setting of mere intra-brand competition, and when there is both intra- and inter-brand competition. The retailer cartel hypothesis outlined above already mentioned that influential retailers might convince a manufacturer to impose RPM to their benefit. It has been discussed, however, that the retailer cartel hypothesis has some important limitations as to its feasibility. Probably the most important counter-argument for the scenario that RPM can be used to facilitate a cartel among retailers is that a manufacturer generally is not willing to cooperate, as this would be contrary to his own interests. This section will, however, show that when also taking into (explicit) account a third type of competition, i.e. vertical competition between retailers and manufacturers, it might be in the best – albeit short-term – interest of a manufacturer to voluntarily impose (minimum or fixed) RPM on the retailers in order to foreclose new, innovative forms of retailing.[425]

The argument generally stems from analyses of manufacturer-retailer relationships, where competition at both stages is present, but imperfect, because there is differentiation both amongst manufacturers and amongst retailers. Although perhaps counterintuitive, it has been recognised that in such a scenario of so-called bilateral oligopoly, it might be in the manufacturers and retailers joint interest to maintain an effective alliance with their established partners in order to prevent new entry.[426]

RPM in a bilateral oligopoly

The most straightforward example of a bilateral oligopoly is a vertical structure where both upstream and downstream two undertakings operate, i.e. a bilateral duopoly. The distribution chain is depicted below.

[424] When both upstream or downstream there is a perfect cartel, or when a group of dominant retailers manage to persuade a monopolist manufacturer to facilitate their cartel, the double marginalisation problem occurs (see supra paragraph 3.2.1).
[425] See e.g. Steiner 1997.
[426] See e.g. Steiner 1997; Comanor and Rey 2000; Rey and Vergé 2004; Rey and Vergé 2005, pp. 30-33; Dobson and Waterson 2007; Vergé 2008.



Judging from this picture, three kinds of relations need to be taken into account aside from consumer demand. First, inter-brand competition, i.e. competition between brands, takes place on both the upstream and the downstream level. Second, infra-brand competition, i.e. competition among retailers in the market for a certain brand, takes place on the downstream level. Thirdly, there is also 'vertical competition' between retailers on one hand, and manufacturers on the other hand, in the form of negotiations (e.g. on the franchise fee).

In such a scenario of bilateral oligopoly, the end result of these negotiations and ultimately the outcome of the market depend crucially on the degree of differentiation between the firms at each vertical level and their relative bargaining power.[427] In this, a distinction is made between market power and bargaining power. The degree of differentiation between firms on both levels reflects to what extent the products or services are substitutable (in the eyes of the consumer), and is therefore an important input for market power. If the goods or services offered on both sides of the market are differentiated the players on both sides of the market may be able to earn significant profits. As discussed before, this situation would give rise to the double marginalisation problem. This issue might, however, be solved during the negotiations between manufacturers and retailers ('vertical competition'), where through franchise fees a 'somewhat competitive' outcome can be expected.[428]

The peculiarity of the bilateral oligopoly situation is that it can give rise to specific strategic behaviour with considerable effect on consumer welfare. For example, Rey and Vergé show that minimum or fixed RPM can be used to eliminate both upstream and downstream competition, in order to allow firms to sustain an (integrated) monopoly price, and – depending on bargaining (or buyer) power – share the profits.[429] A somewhat different result is obtained by Dobson and Waterson who argue that in a similar situation inter-brand competition is not eliminated and might even give rise to positive welfare effects. Nevertheless, they conclude that when inter-brand rivalry is weak or retailers dominate negotiations, retail prices will tend towards the (integrated) monopoly level under RPM.[430] An important implication of their conclusion is that RPM can prevent socially beneficial countervailing power arising both through eliminating intra-brand competition at the retail level and dampening vertical competition. The intuition of the argument is elaborated upon below.

[427] Rey and Vergé 2004; Dobson and Waterson 2007.
[428] Rey and Vergé 2004.
[429] In this scenario, manufacturers can, first, set retail prices to the monopoly level, second, in order to overcome the double marginalisation problem charge wholesale prices equal to their marginal costs, and third, use franchise fees to recover the resulting profits (See Rey and Vergé 2004). See also Björnerstedt and Stennek 2007 who obtain similar results outside a context of franchising fees.
[430] Dobson and Waterson 2007.

Without resorting to a scrutiny of these rather complex models of bilateral oligopoly, it is within the scope of this paper better to focus on a more intuitive approach of the argument.[431] As has just been explained it might be in the best interest of manufacturers and retailers to agree upon RPM in order to be able to reap (shared) monopoly profits. It is also conceivable, however, that a manufacturer might be confronted with price-cutting by new, low-cost retailers. This increased inter-brand competition between the traditional and new (i.e. low-cost and high-cost) retailers may cause that most of the manufacturer's original distributors can not operate profitably. As a result, if these high-cost retailers have a substantial market share, it will be in the best (at least short-term) interest of the manufacturer to protect the high-cost retailers. Either on request (as it is also in the best interest of the traditional retailers) or on his own initiative, a manufacturer might therefore impose minimum or fixed resale price maintenance in order to prevent price-cutting and to remain able to have its product sold by (a sufficient number of) retailers. In such a scenario, the new low-cost retailers are prevented from establishing their business model, and possibly from developing a profitable retailing concept. Although this new retailing concept may be in the best interest of a manufacturer (and society as a whole) in the long run, he may nevertheless choose to impose RPM if this is in his short-term interest.[432] That is, the low-cost retailers' welfare decreases, whereas (short-term) manufacturer welfare increases (though possibly resulting in lower profits in the long run). Obviously, however, the traditional, high-cost retailers' welfare increases, when compared with the counterfactual where they are driven out of the market. Finally, the imposition of RPM merely to prevent low-cost retailers from entering the market generally distorts the welfare of consumers. More specifically, consumers are faced with the following welfare-reducing effects.[433] First, costs in distribution will be higher because less efficient stores continue to retain a relatively large share of the market (whereas otherwise they would have been driven out of the market or forced to innovate), leading to higher prices. Second, consumers are faced with lower quality and less choice because innovation is discouraged. Finally, industry output as a whole will be lower because new and successful retailing concepts could have boosted consumer demand.

The theory outlined above does, however, not imply that every time when low-cost retailers are unable to enter the market (or to operate profitably) due to RPM, consumer welfare is necessarily hurt. As mentioned before, economic theory recognises that consumers are not merely interested in a product's price and its quality, but also on the services a retailer provides. More specifically, the actual effects on consumer welfare depend inter alia on the reason *why* the low-cost retailer is able to charge lower prices than the traditional retailer. If, for example, the low-cost retailer offers the same or equivalent

[431] See e.g. Steiner 1997.
[432] In fact, the manufacturer's choice will be largely influenced by his discount factor, i.e. his valuation of future profits. In this context, Steiner mentions some examples where short-run private efficiency and long-run social welfare differ, and mentions some example where growth of more efficient new retailing forms have been seriously retarded by their inability to obtain well-known manufacturer brands (see Steiner 1997, pp. 424-425 and the references therein).
[433] Steiner 1997, pp. 439-440.

level of services as the high-cost retailer but is, due to innovation, able to do this for a lower price, RPM is likely to distort consumer welfare. By contrast, if the low-cost retailer does not offer (similar or equivalent) services but is merely able to undercut the high-cost retailer by free-riding on the latter's effort, RPM might solve for a non-price externality and thereby enhance consumer welfare.[434] As illustrated below, the contrasting theories that RPM might solve for a non-price externalities and that it might foreclose low-cost retailers have proven especially relevant in the debate on the application of competition policy in the context of traditional, so-called 'brick-and-mortar' retailers, competing with internet retailers.[435]

> **RPM case study: brick-and-mortar versus internet retailers**
> It is without a doubt that internet retailing has been increasing substantially in the recent years. On one hand, this increase has been attributed to the fact that internet retailers generally have lower costs which allows them to charge lower prices.[436] Moreover, increased accessibility, ease of use, reliability, and convenience are also said to contribute to the recent growth in internet retailing.[437] On the other hand, it is also clear that internet retailers are often, due to their business model, unable to provide the same services as the traditional retailers, which may cause them to free-ride.[438]
>
> It has been discussed that in such a scenario RPM may improve a manufacturer's welfare in two situations, but that this may have very different effects on consumer welfare. First, if it appears that the internet retailers can only charge lower prices because they are free-riding on the services that are provided by the brick-and-mortar retailers, not only manufacturer but also consumer welfare may improve when RPM is introduced.[439] By contrast, as has just been discussed, an other scenario in which RPM may benefit manufacturers, but where it may nevertheless hurt consumers is when the instrument is used to protect inefficient, high-cost brick-and-mortar retailers, thereby possibly abstaining consumers to benefit from lower prices, better quality, and more choice.
>
> It is conceivable, however, that none of these (rather extreme) scenarios, but an other setting arises.[440] A plausible example of a third scenario is where the internet retailer does provide services, but that these are different than those provided by brick-and-mortar retailers.[441] As in such a scenario it may not be so straightforward to what extent consumers may judge these services as equivalent, the effects of RPM on consumer welfare will be (even more) unclear.

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[434] See supra paragraph 3.2.2.
[435] See e.g. Sewell and Bodkin 2009 as to the automobile market, and Office of Fair Trading 2008 for relevance within the market for books.
[436] See e.g. Bakos 1997; Brynjolfsson and Smith 2001; Bakos 2001; Chu and Kim 2006.
[437] See e.g. Wolfinbarger and Gilly 2001; Yang et al. 2003.
[438] See e.g. Carlton and Chevalier 2001; Spiegel and Yehezkel 2003; Hendershott and Zhiang 2006; Sewell and Bodkin 2009.
[439] See, however, the considerations placed when discussing the free-riding argumentation, supra paragraph 3.2.2. First, the theory that RPM may enhance consumer welfare as it solves for a non-price externality does not hold (equally) for all products. Second, the welfare effects of RPM are ambiguous when the difference between marginal and infra-marginal consumers are taken into account. Third, depending on the market concerned, a manufacturer might also solve free-riding by internet retailers by providing some of the desired services himself, e.g. through a concept store. Finally, in some circumstances it may be possible for a manufacturer to solve for non-price externality through different means, e.g. by using selective distribution, price discrimination or by refusing to deal with price-cutting internet retailers.
[440] Steiner, for example, mentions eight different scenarios (Steiner 1997, pp. 416-438).
[441] For example, internet retailers often provide extensive product information and customer reviews on their website (Carlton and Chevalier 2001, p. 443).

Accordingly, especially after the ruling of the Supreme Court in the *Leegin* case, where it was decided that the legitimacy of all forms of RPM should be judged under a rule of reason,[442] the economic debate has been increasingly concerned with competition between traditional distribution and internet retailing.[443] The question whether RPM should be allowed in the context of competition between traditional and internet retailers has, however, proven to be very difficult, because, firstly, the welfare effects largely depend on the producer's motive, and secondly, even when the motive is known, actual consumer welfare effects may still be rather ambiguous.[444]

3.4 Conclusion

This chapter has outlined the economic debate on the desirability of resale price maintenance from the point of view of competition policy. Before directly diving into the discussion on pro- and anti-competitive effects of RPM, this chapter has firstly paid attention to the question what should be understood by the term of a 'restriction of competition' under Article 81(1) EC. It has been shown that there is some discussion on this matter, but that the mainstream opinion is that EC competition law has as its primary objective the protection of consumer welfare.

A primary objective of this chapter was to show that, contrary to what might be concluded from the unsympathetic stance from the Commission, resale price maintenance can substantially improve consumer welfare. The analysis has shown that RPM may benefit consumers in two ways: by correcting for externalities arising from firms' pricing behaviour and by solving non-price externalities. In situations where there is successive market power in the distribution chain, maximum resale price maintenance has the ability to prevent the problem of so-called double marginalisation, thereby preventing consumers to be confronted with a price that is marked-up twice. On the other hand, minimum and fixed RPM can be helpful for a manufacturer to create an incentive for his retailers to compete on other competition factors than price, and thereby boost consumer demand. However, it has also been shown that the argument that RPM may be welfare-enhancing because it solves non-price externalities has several limitations. Counter-arguments that not all consumers will benefit equally from the RPM-induced increased retailer effort and that similar efficiencies might be derived from other vertical restraints are very relevant when assessing minimum and fixed resale price maintenance within the framework of Article 81(3) EC.

Besides outlining the potential welfare-enhancing effects of resale price maintenance, the chapter has confirmed the Commission's statement that especially minimum and fixed RPM can prove to be vital

[442] See supra paragraph 2.3.1.
[443] See e.g. Fabricus 2007; Martin 2008.
[444] See supra paragraph 3.2.2.

instruments for anti-competitive behaviour. First, both instruments can help commit a manufacturer in a credible way not to engage in opportunistic behaviour, thereby allowing him to enjoy his monopoly. Second, as especially minimum and fixed resale price maintenance greatly enhance the market transparency and create a mechanism deterring price-cutting at the downstream level, a cartel between both manufacturers and retailers is facilitated. However, it has also been acknowledged that these potential anti-competitive effects of RPM are also subject to significant limitations as they greatly simplify the reality in the distribution chain. Therefore, the more recent contributions in the economic literature pay more attention to the specifics of manufacturer-retailer relationships, thereby providing most valuable insights on welfare effects, but necessarily making the picture more complex. Notwithstanding this complexity, however, a third potential anti-competitive effect of RPM has been derived from the literature: minimum or fixed vertical price-fixing can seriously distort innovation by imposing barriers to entry for innovative retailing concepts for which price-cutting is essential.

In sum, this chapter has shown that resale price maintenance may have both pro- and anti-competitive effects but that the potential welfare-reducing effects seem to be more convincing when dealing with minimum and fixed RPM. By contrast, maximum resale price maintenance appears to be generally welfare-enhancing, whereas imposing recommended RPM may be regarded as pointless. In this context, however, it should be mentioned that economic theory generally makes use of (sometimes unrealistic) assumptions and simplifications, abstracting from the fact that both maximum and recommended RPM may, in practice, amount to fixed resale price maintenance.[445] Notwithstanding this remark, the different treatment of minimum and fixed resale price maintenance on one hand, and (genuine) maximum and recommended RPM on the other hand, seems therefore justified.[446] Similar to the discussion in the United States, the debate in the EC is therefore mostly directed at the ‘hardcore’ types of RPM: minimum and fixed RPM. For them, though outweighed by anti-competitive effects in general, it is without a doubt that they have the ability to improve consumer welfare. A competition policy that aims to maximise consumer welfare should therefore not prohibit RPM when it is used for correcting either price or non-price externalities. This chapter therefore suggests that the current approach of the Commission vis á vis the hardcore restrictions minimum and fixed resale price maintenance is too strict. A possible development in EC competition law towards an effects-based approach also when dealing with minimum and fixed RPM can therefore, on the basis of this analysis, only be applauded.

[445] Moreover, it should be noted that it is often extremely difficult, if not impossible, to find evidence that prices were imposed rather than recommended (see supra paragraph 2.1.4).
[446] Similar conclusions are reached by e.g. Rey and Vergé 2004 and Vergé 2008.

4. The law & economics of resale price maintenance

The previous chapter has surveyed the discussion on the desirability of the instrument of resale price maintenance in the light of EC competition law, which' primary focus is to protect consumer welfare. It has been shown that the imposition of maximum RPM is generally welfare-enhancing, and that even minimum and fixed RPM, though considered hardcore restrictions, can have pro-competitive effects. Correspondingly, the economic analysis has therefore established that the Commission's initiative towards a 'more economic approach' – which has inter alia resulted in a more lenient treatment of maximum RPM – is a step towards the right direction. However, the economic discussion has also suggested that, as also minimum and fixed RPM can enhance consumer welfare, their compliance with Article 81 EC should also be assessed using an effects-based policy. As of yet, the analysis has therefore supported a possible change in competition law concerning the hardcore restrictions minimum and fixed RPM pursuant to which the Commission would have to engage in more case-specific analysis in order to determine the legality of these instruments. That is, corresponding with the Supreme Court's finding in *Leegin*, it has been established that as minimum and fixed RPM may have both pro- and anti-competitive effects, a per se prohibition, either de jure or de facto, is inappropriate.

This chapter will, however, add another dimension to the analysis on the desired legal regime on minimum and fixed RPM. It will be explained that, from a societal point of view, competition policy should not only be concerned with the objective of competition law, but also with the administrability of the system. That is, EC competition policy should not merely look at how to prevent restrictions of competition detrimental to consumer welfare, but should also take into account at what cost this objective is pursued. This chapter will use a law and economics approach to analyse, firstly, the limits of the increased use of economics in EC competition law, and secondly, the allocation of the burden of proof under Article 81(3) EC. It will be subsequently shown that when the administrability of the system is taken into account, this will have implications for the strictness of the Commission approach and the allocation of the burden of proof.

4.1 Optimising EC competition policy on RPM

A change suggested in the previous chapter, and also in the literature, would entail an extension of the 'more economic approach' of EC competition law so that also minimum and fixed resale price maintenance are to be assessed using an effects-based policy (i.e. an 'even more economic approach'). This would correspond with the trend that can be observed, both in the U.S. and in the European Community, where (vertical) restraints are more often evaluated using economic analysis rather than relying on rules.[447] This increased use of economics, or effects-based policy, in competition policy has, as of yet, been an considerable improvement, as it has substantially increased competition authorities' capacity to separate between business behaviour with positive and with negative welfare effects.

This section will, however, show that competition policy should not only take these error costs, i.e. costs associated with a competition authority making the wrong decision, but also regulation costs into account, which encompass all kinds of direct and indirect costs caused by the formulation and application of competition rules.[448] Or, as Christiansen and Kerber put it: "[…] the main task of a 'more economic approach' is to use economics for the formulation of appropriate competition rules".[449] As elaborated upon below, this perspective has consequences for the current strictness of the approach towards minimum and fixed RPM, i.e. the condemnation as a hardcore restriction and the negative presumption concerning the application of Article 81(3) EC.

4.1.1 Limits to effects-based policy

The increased use of economics in competition policy (i.e. effects-based policy) causes diminished error costs. That is, by increased differentiation, i.e. the number and complexity of distinction incorporated in the set of rules, the Commission has been able to reduce the risks of so-called 'type I errors' – in which an undertaking's welfare-reducing behaviour is wrongly allowed (i.e. a 'false positive') – and 'type II errors' – in which pro-competitive behaviour is found to be an infringement of Article 81 EC (i.e. a 'false negative').[450] This differentiation occurs on two levels. First, by increasing the complexity or differentiation of rules, e.g. distinguishing horizontal from vertical agreements, the Commission can reduce the risks of not prohibiting anti-competitive behaviour (type I error) and of prohibiting pro-competitive behaviour (type II error). Secondly, and similarly, more case-specific analysis also has the advantage of reducing the risk of either a type I or type II error occurring. Applied to the context of EC competition policy, increased differentiation can be illustrated by looking at the history of the treatment of maximum RPM.

> **Increased differentiation in EC competition policy: maximum RPM**
>
> As has already been discussed, in early EC competition law, similar to minimum and fixed resale price maintenance, a manufacturer prescribing a maximum retail price would also engage in a hardcore restriction. Pursuant to the 'more economic approach', however, the Commission has excluded maximum RPM from this category by increasing the complexity or precision of the competition rules.[451]

[447] See supra Chapter 2, as well as Parret 2008; Pera 2008.
[448] See also Joskow 2002; Christiansen and Kerber 2006.
[449] Christiansen and Kerber 2006, p. 215.
[450] See e.g. Polinsky and Shavell 1989, p. 99; Christiansen and Kerber 2006, p. 225.
[451] See supra paragraph 2.1.4.

> Secondly, especially after the *O2* case, the Court's case law has made clear that in order to establish whether an agreement has as its effect the restriction of competition, the Commission has to engage in a rather extensive analysis of the market in which it needs to examine, first, what the competition situation would have been in the absence of the agreement, i.e. establish a 'counter-factual', and second, to sufficiently substantiate the negative impact of the agreement on competition.[452]

The central question in this section is whether EC competition policy should increase its degree of differentiation (i.e. move towards a more complex and case-specific analysis) when dealing with minimum and fixed resale price maintenance. That is, should the current approach change so that also minimum and fixed RPM will also be assessed by an effects-based policy, instead of the current strict approach? In answering this question, the findings of the previous chapters will be taken into account. The economic analysis has, in sum, shown that by increasing the degree of differentiation, the decision costs of committing type I or II errors will reduce. That is, effects-based policy increases the Commission's ability to separate between pro- and anti-competitive use of RPM. It is, however, rather common in the law and economics literature to also take into account the costs associated with implementing and applying the legal regime itself, and not only to focus on its effects.[453] An increase in the degree of differentiation of EC competition policy on minimum and fixed RPM will generally cause an increase of four types of 'regulation costs': the set-up costs of the rules, monitoring and compliance costs, legal uncertainty, and the costs of judicial review.[454]

First, in order to require the Commission (and national competition authorities when applying Article 81 EC), to engage in analysis of the effects on the market several competition rules, both binding (e.g. Regulation 2790/1999) and non-binding (e.g. the Guidelines on Vertical Restraints and the Guidelines on the application of Article 81(3)), would have to be amended.[455] Obviously, these changes would be associated with additional costs, where it should be noted that the more differentiated (i.e. complex or precise), these rules are, the higher the *set-up costs* can be expected to be.[456]

A second category of regulation costs that can be expected to increase due to a more effects-based treatment of minimum and fixed RPM is that of *monitoring and compliance costs*. On one hand, firms bear compliance costs when dealing with competition law, for example by obtaining legal advice but also by bringing their behaviour in line with EC competition law. On the other hand, competition authorities face costs associated with their operation, including costs incurred when monitoring the

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452 Case T-328/03, *O2 GmbH & Co. OHG* v. *Commission* [2006] ECR II-1231, par. 73. See supra paragraph 2.1.4.
453 See e.g. Ehrlich and Posner 1974; Easterbrook 1984b; Besanko and Spulber 1989; Polinsky and Shavell 1989; Kaplow 1995; Kaplow 2000; Joskow 2002; Christiansen and Kerber 2006.
454 Christiansen and Kerber 2006, p. 231-233.
455 Regulation 2790/1999, OJ L336/21; Guidelines on Vertical Restraints, [2000] OJ C291/1; Guidelines on the application of Article 81(3), [2004] OJ C101/97. See supra paragraph 2.2.
456 Christiansen and Kerber 2006. It should be noted, however, that Regulation 2790/1999 is currently already being reviewed due to its expiry on 31 May 2010.

market.[457] It is likely that both compliance and monitoring costs will be increasing as the degree of differentiation of competition policy is increasing.[458] As illustrated below, a requirement for the Commission to engage in an extensive analysis of the market in order to determine the net welfare effects of RPM would be accompanied with a substantial increase in monitoring costs.

Monitoring costs of effects-based policy when dealing with minimum and fixed RPM

The economic analysis has made clear that RPM may have both pro- and anti-competitive effects. However, it has also been shown that whether a specific agreement containing minimum and fixed resale price maintenance results in a net positive or negative effect on consumer welfare is rather unclear. In order for the Commission to obtain a clear picture of the market, it would not only have to take into account the kind of RPM at hand, but often also consider the status quo of intra-brand competition, inter-brand competition, vertical competition between manufacturers and retailers, and consumer perception of the product or service concerned.[459]

For example, in the situation where it is unclear whether RPM has been used to combat free-riding on pre-sale services (which is welfare-enhancing), or to foreclose low-cost retailers (in which case RPM is welfare-reducing), a competition authority would have to obtain a substantial amount of information just to determine whether the *motivation* for the imposition of RPM was pro-competitive.[460] In this scenario, a competition authority would, first, have to obtain the market shares of the high-cost retailers and the low-cost retailers, because manufacturers will be more susceptible to support the high-cost retailers if these have a substantial market share.[461] Secondly, in order to effectively separate between these pro- and anti-competitive motivations for RPM, the competition authority would have to determine the relative strength of the manufacturer's brand compared to his competitors. The reason for this is that manufacturers are less likely to foreclose price-cutting retailers when their brand is relatively strong, as the traditional retailers will have more difficulty to inducing consumers to switch to a competitor's brand.[462] Thirdly, information should be acquired on certain attributes of the manufacturer's brand in order to determine whether any of the hypotheses justifying the use of RPM to solve non-price externalities applies (e.g. information on whether the branding hypothesis holds). Finally, the competition authority would have to analyse the underlying reason why certain retailers can profitably undersell others, i.e. is it due to free-riding or because they are simply more efficient.[463]

If this analysis would lead the competition authority to conclude that RPM was introduced to solve a non-price externality (e.g. the special services hypothesis holds), it would still have to engage an analysis as to the *welfare effects* of RPM. When discussing the use of RPM to solve a non-price externality, it was shown that even then the welfare effects are ambiguous, because, for example, differences between marginal and infra-marginal consumers' perception of the increased effort ought to be taken into account.[464]

[457] See for example Niels and van Dijk 2008, p. 354.
[458] See e.g. Kaplow 1995.
[459] See supra Chapter 3.
[460] See supra paragraph 3.3.3, where the context of competition between traditional brick-and-mortar and internet retailers is discussed, as well as Steiner 1997, pp. 414-416.
[461] Steiner 1997.
[462] Steiner 1997, p. 415.
[463] Steiner 1997, p. 415.
[464] See supra paragraph 3.2.2.

Thirdly, an extension of the 'more economic approach' so that its effects-based policy covers also minimum and fixed resale price maintenance generates *legal uncertainty*. If minimum and fixed RPM would also be subject to an effects-based approach, firms previously able to rely on the fact that RPM would almost always be prohibited, would then face uncertainty, possibly hampering their innovative strategies. Similarly, in the U.S. debate on what to do with RPM, it has also been recognised that a move towards a rule of reason generates uncertainty for those who have relied upon the prior rule, and that legal confusion generates costs.[465] In a European context, Roth notes that the rule of law, and most notably the notion of legal certainty, requires rules to be devised in such a way that they give at least some information to the economic actors about what conduct is allowed or prohibited. He continues: "Accordingly, the 'rule of law' approach should be rather critical of a case-by-case approach based on the evaluation of all the facts in each case; it rather opts for abstract rules that are able to inform the addressees how they have to behave on the market (predictability) and that take notice of the potential difficulties of proof that may endanger the effectiveness of the rule".[466] Consequently, from a rule of law – or legal certainty – point of view, one may conclude that a somewhat form-based approach might be desirable.[467]

Finally, it is conceivable that an effects-based approach vis á vis minimum and fixed RPM would increase the *costs of judicial review* by the European Courts because of increased technicality of the cases. Commission decisions in which it is, for example, found that there has been an infringement of Article 81 EC can be challenged by the addressee under Article 230 EC, the action for annulment.[468] Similarly, decisions by national competition authorities who, pursuant to Regulation 1/2003,[469] have applied Article 81 EC, can also be appealed, though in the national law system.[470] As to the action for annulment, Article 230 EC stipulates that a Commission decision might be challenged on grounds of lack of competence, infringement of an essential procedural requirement, infringement of the EC Treaty or of any rule relating to its application, or misuse of powers. As to the substantive review, the third ground, infringement of the Treaty or any rule relating to its application, is most relevant. As shortly elaborated upon below, it has become clear from the Courts' case law that although the Commission has a discretionary power as to the application of Article 81 EC, the test whether the Commission has kept within the bounds of its power and discretion and has observed the law is still rather extensive.[471]

[465] See e.g. Posner 1981; Black 1997, pp. 151-152; Brunell 2007, pp. 518-519; Breyer 2009, pp. 130-131.
[466] Roth 2007, p. 38.
[467] Or, in the context of an effects-based policy this could imply an approach looking at *likely* effects rather than *actual* effects (Roth 2007).
[468] See e.g. Jones and Sufrin 2008, pp. 1252-1269; Whish 2009, pp. 160-161.
[469] Article 3(1), Regulation 1/2003, [2004] OJ C101/81.
[470] Such a case can, however, come under the attention of the ECJ if the national court decides to reference it for a preliminary ruling under Article 234 EC.
[471] See Jones and Sufrin 2008, pp. 1259-1263; Ottow and Doing-Bierens 2008, pp. 182-184; Whish 2009, pp. 160-161.

The standard of review applied by the Courts when assessing a Commission decision

Addressees of a Commission decision may, as they are directly and individually concerned, challenge this decision under an action for annulment (Article 230(4) EC) before the CFI and (on point of law) before the ECJ.[472] In early case law, the ECJ has stated that "the exercise of the Commission's powers necessarily implies complex evaluations on economic matters. A judicial review of these evaluations must take account of their nature by confining itself to an examination of the relevance of the facts and of the legal consequences which the Commission deduces therefrom".[473] Both Community Courts appeared to have maintained this approach as it is recognised that judicial review should not have the function of the Court to substitute its own judgement for that of the Commission but to ensure that the Commission keeps within the bounds of its powers and discretion and observes the law.[474] In this context, the Courts often emphasise the Commission's 'margin of discretion'.[475] The Court will therefore only annul a decision if the Commission has misinterpreted the law (or if it has failed to abide by general principles of law).

Nevertheless, although it is clear that the Courts' review does not entail a rehearing, it has also become clear that the review whether the Commission misinterpreted or misapplied the law is rather elaborate.[476] That is, in *Tetra Laval*, the ECJ ruled that "[w]hilst the Court recognises that the Commission has a margin of discretion with regard to economic matters, that does not mean that the Community Courts must refrain from reviewing the Commission's interpretation of information of an economic nature. Not only must the Community Courts, inter alia, establish whether the evidence relied on is factually accurate, reliable and consistent but also whether that evidence contains all the information which must be taken into account in order to assess a complex situation and whether it is capable of substantiating the conclusions drawn from it".[477]

It can therefore be concluded that when a Commission decision is challenged under Article 230 EC, the Court does look at the facts as it should establish not only whether the evidence relied on is factually accurate, reliable and consistent, but also whether it contains all the information which must be taken into account for the purpose of assessing a complex situation and whether it is capable of substantiating the conclusions drawn from it.[478]

A move towards an effects-based approach when dealing with minimum and fixed RPM would therefore cause both European and national courts to deal with rather complex economic analyses such as those referred to in the previous chapter. In this context, it should be noted that the amount of economics explicitly discussed in U.S. case law is astonishing.[479] Similar to the *Leegin* case, European

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[472] This regime applies since 1989, i.e. when the Court of First Instance was created.
[473] Cases 56/64 and 58/64, *Etablissements Consten SA & Grundig-Verkaufs-GmbH* v. *Commission* [1966] ECR 299, p. 347.
[474] Jones and Sufrin 2008, p. 1252.
[475] See e.g. Case 26-76, *Metro SB-Großmärkte GmbH & Co. KG* v. *Commission* [1977] ECR 1875, par. 45.
[476] Jones and Sufrin 2008, p. 1259.
[477] Case C-12/03 P, *Commission* v. *Tetra Laval BV* [2005] ECR I-987, par. 39.
[478] See e.g. Case T-168/01, *GlaxoSmithKline Services Unlimited* v. *Commission* [2006] ECR II-2969, par. 242; Case T-210/01, *General Electric* v. *Commission* [2005] ECR II-5575, par. 62-63.
[479] As noted before, many economic arguments – both pro-competitive and anti-competitive – were discussed in the *Leegin* case, see supra paragraph 2.3.1.

Courts could invite experts in order to report on the economic situation,[480] or train its judges. Nevertheless, it is plausible that an increase in the degree of differentiation when dealing with minimum and fixed RPM would result in a substantial rise in the costs of judicial review.[481]

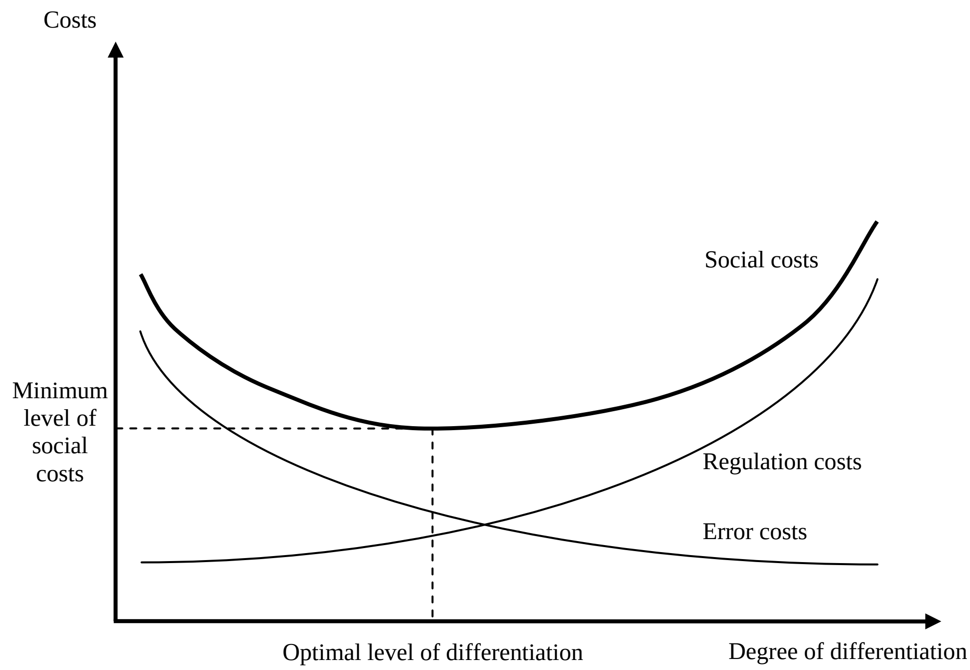
4.1.2 Optimally differentiating EC competition policy for minimum and fixed RPM

It has therefore been established that increasing the level of differentiation, i.e. engage in a more effects-based approach towards minimum and fixed RPM, would have two opposing effects. On one hand, increasing the complexity or engaging in more case-specific analysis has as its advantage that the Commission is more successful in separating anti-competitive behaviour from pro-competitive conduct. On the other hand, as has just been discussed, a higher level of differentiation will increase regulation costs. If competition policy would not only take the *effects* but also its *costs* into account, one will come to the acknowledgement that competition policy is always imperfect. That is, “the test of a good legal rule is not primarily whether it leads to the correct decision in a particular case, but rather whether it does a good job deterring anti-competitive behaviour throughout the economy given all the relevant costs, benefits, and uncertainties associated with diagnosis and remedies”.[482] In order to derive a (theoretical) solution, a law and economics model is introduced below, where the basic idea is that competition policy should minimise the sum of welfare costs caused by decision errors of type I and II, as well as the costs of the application of the rules.[483]

The optimal level of differentiation of competition policy

Increasing the level of differentiation of competition policy has two opposing effects on social welfare: decreased error costs and increased regulation costs. On one hand, case-by-case analysis, for example, decreases the probability that the Commission makes an error, either of type I or type II. It is conceivable, however, that the higher initial level of differentiation, the lower this positive effect will be. As a result, the error cost curve in the figure below is downward sloping, though at a decreasing rate. On the other hand, as has been discussed, an effects-based policy will cause regulation costs to increase and at an increasing rate, because in some cases it will be extremely costly to engage in a full-scale market analysis and to determine the actual effects on welfare. The social costs of competition policy can therefore by defined by the sum of error and regulation costs. The optimal degree of differentiation corresponds with the level where social costs are minimised.

[480] In this context, Peeperkorn notes that a primary difference between the ‘EC hardcore’ and the ‘U.S. per se’ approach in competition policy is that under the EC approach an expert report might be taken into account, whereas this would be impossible in a per se regime (Peeperkorn 2008, pp.203-205).
[481] Christiansen and Kerber 2006, pp. 231-232. By contrast, it is also possible that due to an increased effects-based analysis, Commission decisions are of a higher quality and therefore challenged less often. This would, however, impose an additional assumption that better decision are challenged less often, which is not at all straightforward.
[482] Joskow 2002, pp. 99-100.
[483] Christiansen and Kerber 2006.



> In such a model it can be shown that the optimal level of differentiation is where the marginal costs of additional differentiation equal the marginal reduction of error costs.[484] In this context, it should be noted that the reduction in error costs due to more case-specific analysis will concern reductions in errors of type II occurring. In practice, this model therefore shows that a more effects-based policy on minimum and fixed RPM can only be recommended if, and only if, the reduction of error costs of type II is larger than the increase in error costs of type I and the additional regulation costs.[485]

The model shows that the optimal complexity of the approach in competition law vis á vis minimum and fixed resale price maintenance depends crucially on the (regulation) costs and benefits (i.e. the reduction in error costs) of such differentiation. This rather theoretical result implies that a more case-specific analysis of cases involving minimum and fixed RPM will be undesirable from a societal point of view if the reduction in the Commission's type II errors does not weigh up against the increase in regulation costs. The previous section has already discussed that increased differentiation will lead to higher regulation costs. However, the exact amount of this increase in regulation costs is generally immeasurable. Similarly, it is very difficult, if not impossible, to quantify the benefit, i.e. the reduction in error costs of type II. However, it is straightforward to assume that this figure crucially depends on the distribution of positive and negative welfare effects associated with minimum and fixed RPM.[486] Intuitively, a more differentiated approach will yield less benefits the more uneven the frequency distribution with regard to positive and negative welfare effects is. That is, a more complex policy on

[484] Christiansen and Kerber 2006, pp. 225-229.
[485] Christiansen and Kerber 2006, p. 228.
[486] Christiansen and Kerber 2006, pp. 229-231.

RPM is less likely to be desirable the smaller the share of cases where RPM is welfare-enhancing.[487] In this context, the economic analysis has already shown that minimum and fixed resale price maintenance may be welfare-enhancing but that this is in general outweighed by the, more convincing, anti-competitive effects. It can therefore be concluded that a move towards a more differentiated approach on minimum and fixed RPM is unlikely to yield substantial benefits, because the pro-competitive arguments are severely limited, whereas the costs associated with an effects-based policy on minimum and fixed RPM are substantial.[488]

In conclusion, when taking into account the accompanied regulation costs, a change towards an effects-based policy towards minimum and fixed resale price maintenance seems undesirable from a societal point of view. The current strictness of the approach of EC competition law towards these hardcore restrictions is therefore justified even though this might sometimes cause the Commission (or a national competition authority) to prohibit an RPM agreement with positive effects on welfare. Similarly, the fact that this rigid stance of the Commission will also often deter firms to impose welfare-enhancing resale price maintenance can be seen as a sacrifice for the greater good of lower regulation costs, most notably monitoring costs, legal uncertainty and costs of judicial review.

4.2 The burden of proof

The previous section has provided for a justification of the negative stance, or strictness, of the Commission towards the hardcore restrictions minimum and fixed RPM: the administrability of the system. However, the analysis above fails to take into account one final peculiarity of EC competition law: the allocation of the burden of proof under Article 81(3) EC. The legal analysis has shown that Article 81(3) EC, in principle, should leave room for an exception to the prohibition of Article 81(1) EC as both the Commission and the Court have made clear that Article 81(3) EC does not a priori exclude agreements from its scope.[489] Therefore, notwithstanding the strictness, parties are allowed to challenge the Commission and argue that their instance of RPM is promoting consumer welfare. This section analyses this choice of placing the burden of proof into the hands of those claiming to benefit from Article 81(3) EC from a law and economics perspective.

4.2.1 Proving RPM's pro-competitive effect

First, however, it should be considered what kind of burden we are talking about in the case where a pro-competitive agreement entailing minimum or fixed RPM comes under the Commission's

[487] Or, as dissenting Justice Breyer points out in *Leegin*: "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?" (*Leegin Creative Leather Products, Inc.* v. *PSKS, Inc.*, 127 S. Ct. 2705 (2007) at 2729).
[488] See also Peeperkorn 2008.
[489] See supra paragraph 2.2.1.

attention. As mentioned before, Article 81(3) EC stipulates that an agreement that falls within Article 81(1) EC should nevertheless be considered legitimate if, firstly, the agreement gives rise to an efficiency gain, secondly, it allows consumers a fair share of it, thirdly, it is indispensable for achieving this efficiency, and finally, does not eliminate competition.[490]

As to the efficiency gain, the fair share of it for consumers and, to some extent, the fact that competition is not eliminated, the economic analysis has established that a party seeking to justify minimum or fixed RPM should resort to proving that the instrument solves a non-price externality.[491] That is, the first part of the burden consists of proving that there is a non-price externality in the market, and that RPM solves the problem, thereby enhancing consumer welfare. It is, however, rather difficult to prove that RPM has improved consumer welfare because, generally, the only information available is the pre-RPM price and output and the RPM-induced price and corresponding output. In this context, it should be noted that a price test – where prices before and after RPM are compared – is not helpful as the very objective of minimum or fixed RPM, whether pro- or anti-competitive, is to raise the price.[492] For example, when RPM is used to induce retailers to engage in a higher level of pre-sales services, the retail price is set at the level equal to the costs of providing the optimal level of services. By contrast, if RPM is used for anti-competitive motives, e.g. to establish a retailer cartel, prices are set at a high (or monopoly) level in order to maximise the retailers' joint profit. A quantity test, on the other hand, might prove more helpful.[493] Such an analysis on the effects on total output might show that minimum or fixed RPM is not used for the anti-competitive motives of the commitment problem, forming a cartel, or to foreclose low-cost retailers, as these tend to reduce total output.[494] However, as the economic analysis has shown, even when used to solve a non-price externality, RPM may have ambiguous results on consumer welfare even though total output increases.[495] That is, when differences between marginal and infra-marginal consumers, i.e. the differences in consumer valuation of the RPM-induced increased effort (or price), are taken into account, the effect on consumer welfare can go either way. A quantity test should therefore be accompanied with a convincing argument (or market survey) that consumers indeed (more or less) equally value the additional effort (or increase in price).

Then, if it has been proven that a non-price externality is present and that RPM offers a solution, the argument must be subjected to the test whether it meets the indispensability requirement of Article 81(3) EC. As already discussed, this condition implies a proportionality test in the sense that

[490] See supra paragraph 2.2.1.
[491] See supra paragraph 3.2.2 for an explanation of the special services, quality certification, branding hypotheses and the quality assurance, outlets, and demand risk theories.
[492] See also Blair 2008, pp. 146-147.
[493] See also Breyer 2009.
[494] See supra paragraph 3.3.
[495] See also Blair 2008, p. 148.

restrictions are considered to be 'indispensable' if, firstly, the efficiencies can not also be generated by other economically practicable and less restrictive means, and, secondly, each individual restriction is necessary in order to produce the efficiencies. That is, the party in whose hands the burden of proof is placed should demonstrate that the efficiency gain could not have been obtained in a less restrictive fashion. In this context, it should be remembered that each of the non-price externalities that have been discussed might, in theory, also be solved with other instruments.[496] It is, however, beyond the scope of this paper to derive conclusions as to whether these alternatives are generally less restrictive than resale price maintenance.[497] Nevertheless, it seems fair to conclude that the analysis as to the indispensability requirement of Article 81(3) EC is rather extensive and imposes substantial research costs on the party in whose hands the burden of proof is placed.

Obviously, the burden of proving that all the criteria of Article 81(3) EC are met in the case of minimum and fixed RPM is rather heavy. This, combined with the presumption that RPM is in most instances welfare-reducing, has important implications for the optimal allocation of the burden of proof.

4.2.2 The allocation of the burden of proof

Article 2 of Regulation 1/2003 states that the undertaking or association of undertakings claiming the benefit of Article 81(3) EC shall bear the burden of proving that its conditions are satisfied. This section claims that this allocation is preferable to its alternative, i.e. allocation to the Commission (and the national competition authorities), for two reasons. In this, it is assumed that it does not matter for the result of the analysis which party has the burden outlined above.[498]

The first reason why the burden of proof should be allocated as it is, i.e. to the parties claiming the benefit of Article 81(3) EC, is that it prevents unnecessary research.[499] Consider the situation where the burden of proving that the conditions of Article 81(3) EC are satisfied would be placed in the hands of the Commission. In this scenario, each time a case involving minimum or fixed resale price maintenance comes under the attention of the Commission, it would have to conduct the research outlined above. That is, regardless of whether RPM was imposed from a pro-or anti-competitive

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[496] That is, the special services and quality certification hypotheses might also be countered with selective distribution and/or exclusive territories. The branding hypothesis might be reacted to by wholesale price discrimination, whereas the quality assurance hypothesis does not hold when manufacturers can provide after-sales services themselves. Finally, the outlets and demand risk theories might also be solved by using location clauses and quantity forcing, respectively (see supra paragraph 3.2.2).

[497] This would require an integral analysis of the economics of vertical restraints, not only of agreements falling under Article 81 EC, but also of restraints that are generally covered by Article 82 EC (e.g. wholesale price discrimination and refusal to deal).

[498] This seems plausible as in both scenarios the Commission remains the decision-maker, or – to put it differently – if the Commission contests the proof put forward by the parties, the (evidential) burden of proof shifts to the Commission so it can establish that at least one condition is not satisfied (Parret, pp. 182-190).

[499] In this context, it should be remembered that one of the reasons to adopt Regulation 1/2003 was to relieve some of the Commission's workload, see supra paragraph 2.2.

motive, the Commission would have to analyse whether there is a non-price externality in the market, whether RPM solves the problem, whether this enhances consumer welfare, and if there is no less restrictive alternative for achieving this efficiency.

By contrast, if the burden would be, as it currently is, allocated to the parties claiming the benefit of the exception of Article 81(3) EC, the (full) analysis would only be conducted if the parties would think this would be worthwhile.[500] As will be discussed below, the parties' incentives to initiate an analysis on the four conditions of Article 81(3) EC are formed by the parties estimated chance of success, the amount at stake, and the costs of the analysis.

> **Parties' incentives to extensively analyse the criteria of Article 81(3)**
>
> As has become clear from the economic analysis, the welfare effects of resale price maintenance can be very uncertain, thereby making the result of the analysis as to the conditions of Article 81(3) similarly uncertain. It is, however, rather common in the law and economics literature to model the incentives of parties under such uncertainty in order to provide valuable insights. Cooter and Ulen explain: "[t]he basic idea is that rational decision-makers proceed in four steps: first, they determine the probability of each possible state; next, they multiply the probabilities by the utilities to give the expected utility; and finally, they choose the action that maximizes the expected utility".[501] Applied to the context of this paragraph, parties will engage in a serious analysis to show that their RPM contract is welfare-enhancing if, and only if, the following condition holds:[502]
>
> $$\textit{Parties' estimated chance of success} \times \textit{Amount at stake} > \textit{Parties' cost of presenting evidence.}$$

Obviously, the parties themselves are well aware of the reason they have imposed RPM. As a result, it is likely that they will not engage in an extensive analysis of the pro-competitive effects of Article 81(3) EC when they know that RPM was merely imposed, for example, to facilitate their cartel, as their chance of success would be zero. Allocating the burden of proof to the parties therefore saves substantial research costs when compared to the allocation to the Commission, which would conduct the analysis regardless of the motive of RPM.

The second reason why the burden of proving that the criteria of Article 81(3) EC are satisfied should rests with the parties to the agreement is that, if the analysis is conducted, it is likely that it will be much cheaper. That is, allocating the burden of proof to those claiming the benefit of the legal exception not only saves research costs, it seems also plausible that the parties themselves can easier obtain the information needed to build a case. Moreover, if the analysis is performed, it seems

[500] That is, the analysis will only be conducted if the parties think that their claim has merit (see in a somewhat different context Hay 1997; Cooter and Ulen 2004, pp. 388-444).
[501] Cooter and Ulen 2004, p. 431. It should be mentioned, however, that this approach assumes risk neutrality.
[502] Hay 1997, p. 661.

plausible that it will only focus on one, perhaps two, of the non-price externalities discussed in the economic analysis, whereas the Commission would have to put each possible non-price externality to the test. The underlying reason for this argument is that the parties have better (and cheaper) access to the information needed for proving that any of the non-price externalities applies.

The allocation of the burden of proof to the parties claiming the benefit of the exception of Article 81(3) EC therefore saves substantial research costs because, firstly, research is less often conducted, and secondly, if it is conducted, research is less costly. Admittedly, however, this conclusion will very likely lead to the deterrence of most, if not all, instances of RPM, because parties' estimated chance of success are rather slim, whereas the research costs are substantial. Pursuant to the economic analysis, however, it is likely that most instances of minimum and fixed RPM are welfare-reducing, or create efficiencies that could also have been obtained using other instruments. The situation therefore reflects the current state of the discussion on resale price maintenance among economists; it remains to be seen whether RPM can truly offer the best solution for solving a specific non-price externality, and whether the undertakings concerned see it as worthwhile to bring this case before the Commission, or the Court.

4.3 Conclusion

Competition policy should not merely be concerned with the objective of competition law but should also take into account the administrability of the system. It has been shown that when the costs of the legal regime are taken into account, one will derive seriously different conclusions than in the previous chapter. Whereas the previous chapter suggested that an 'even more economic approach' should be implemented so that also minimum and fixed resale price maintenance would be subject to an effects-based analysis, this chapter reached very different conclusions. Justifications for the current approach in EC competition law have been found on two levels: the strictness of the approach and the allocation of the burden of proof.

As to the strictness of the current approach, it has been discussed that there are limits to effects-based policy that are especially relevant for RPM. Obviously, the increased use of economics and case-specific analysis allows the Commission to separate between business conducts that are and that are not in line with EC competition law. However, an 'even more economic approach' concerning minimum and fixed RPM is also accompanied with considerably higher regulation costs, most notably monitoring costs, legal uncertainty and costs of judicial review. Because minimum and fixed RPM are, in most instances, detrimental to consumer welfare, it can therefore be concluded that a more lenient, effects-based approach towards these instruments is undesirable.

However, pursuant to Article 81(3) EC, EC competition law does allow undertakings to prove that their instance of RPM has a positive effect on welfare. The allocation of the burden of proving that the conditions of Article 81(3) EC are satisfied towards those claiming its benefit is justified because it saves substantial research costs. However, both because the chance of a successful claim on Article 81(3) is very small and because the research needed is rather costly, it is likely that most parties will refrain from making much effort to justify minimum and fixed resale price maintenance, thereby possibly explaining the statements concerning a de facto per se prohibition.

5. Conclusion

Despite all uncertainty created by recent developments in both EC competition law and U.S. antitrust law, the analysis in this paper has led to the conclusion that the current treatment of resale price maintenance in EC competition law is satisfactory. Corresponding with the economic analysis and the recent developments in U.S. antitrust law, but contrary to what might be concluded from the European Courts' case law and the Commission's decision-making practice, RPM can indeed have pro-competitive effects. I have argued, however, that the current strict approach is justifiable in order to keep the competition policy regime administrable, as an 'even more economic approach' would substantially increase regulation costs, whereas its benefits, a decrease in error costs, would be limited.

Before reaching such a conclusion, however, this paper has touched upon several aspects that made the question whether the current competition policy concerning RPM matches the objective of EC competition law rather complex. One of these matters involved a rather straightforward question which nevertheless needed answering before engaging in any actual analysis: what is the objective of EC competition law? Answering this question has proven to be rather difficult, as the answer is time-dependent and touches upon sensitive matters. On one hand, it has been shown that early EC competition law focused on two objectives: the 'competition objective' and that of single market integration. Pursuant to the 'more economic approach', however, a gradual shift has taken place in which the single market integration objective appears to have lost much of its importance as a primary objective in favour of the 'competition objective'. On the other hand, the question on the objective of EC competition law is very sensitive, as it deals with legal, economic and political issues, making it not straightforward what should be included in this 'competition objective'. It has been shown that especially after the implementation of the 'more economic approach', the 'competition objective' has been increasingly interpreted so that EC competition law should focus on protecting consumer welfare. However, recent case law has again created uncertainty on this matter, but it remains to be seen whether the Court has explicitly meant to disagree with the current tendency to assess business conduct from a consumer welfare perspective rather than from an ordoliberal perspective. Despite this uncertainty, I have taken the point of view in this paper that the conformity of resale price maintenance with EC competition law should be judged from a consumer welfare standard, thereby merely addressing competition values.

These developments concerning the objective of EC competition law have to a large extent been caused by another aspect that adds to the complexity of the subject matter. By its very nature, competition law deals with multidisciplinary questions, which creates a need for input from both economists and lawyers. Economics and law are, however, very different academic disciplines and the analysis has therefore encountered several tensions between economists and lawyers. First, an important input for the Commission's 'more economic approach' was the criticism expressed by economists that the early approach, especially with regard to vertical restraints, was too formalistic and did not correspond with economic reality. Pursuant to this criticism, the Commission has engaged in more economic analysis of the effects of business conduct on the market, and specifically on consumer welfare. For resale price maintenance, the 'more economic approach' has specifically realised that maximum RPM is no longer seen as a hardcore restriction. Although it is a step towards convergence, the 'more economic approach' has not eliminated the tension between lawyers and economists, to say the least. Supported by developments in U.S. antitrust law, many economists have argued that also minimum and fixed RPM should be judged using more case-specific analysis, indicating a need for an 'even more economic approach' and emphasising the relevance of this research.

A second tension stemming from the multidisciplinary nature of competition law is the problem how to translate economic theory into workable and reliable legal rules and concepts. For example, the analysis has shown that maximum and recommended resale price maintenance, on one hand, and fixed RPM, on the other hand, have very different effects on consumer welfare. According to the economic theory discussed, recommended RPM has little or no effect on consumer welfare, whereas maximum RPM is generally welfare-enhancing. By contrast, fixed resale price maintenance can very well be used for anti-competitive motives, thereby having an adverse effect on consumer welfare. This distinction is often, however, not so straightforward in practice, as the circumstances of the case may be so that the 'harmless' instruments of maximum and recommended RPM may in practice amount to the more harmful instrument of fixed RPM. Another difficulty in translating economics into law was implicitly found in the choice to analyse resale price maintenance within the scope of Article 81 EC, and not within Article 82 EC. As shown, resale price maintenance is generally only harmful when the undertakings involved enjoy market power, whereas the legal regime of Article 81 EC does not explicitly take this into account. More specifically, the economic literature often treats most vertical restraints alike, including behaviour that is within the scope of Article 82 EC, e.g. wholesale price discrimination and refusal to deal. The finding that RPM is generally only harmful when the undertakings involved enjoy market power therefore raises the interesting question of whether the instrument should not be analysed under Article 82 EC instead, as it would also circumvent the difficult task of competition authorities to prove a concurrence of wills. It was, however, beyond the scope of this paper to also deal with this question.

Amidst this complex landscape of changing legal regimes and their corresponding objectives on one hand, and disagreeing economists and lawyers on the other hand, this paper has evaluated the current approach within EC competition law concerning resale price maintenance. An important finding has been that the Commission's 'more economic approach' has been an improvement. Pursuant to this initiative, maximum RPM will only fall within the prohibition of Article 81(1) EC when it is, judging from an extensive analysis on the legal and economic context of the agreement, found that it has as its effect a restriction of competition. This change in the legal regime has been an improvement because maximum RPM generally has welfare-enhancing effects, and may only be detrimental to consumer welfare when it amounts, in practice, to fixed resale price maintenance. Because a similar approach is taken towards the theoretically harmless instrument of recommended RPM, it has therefore been concluded that there is no tension between economics and the treatment of maximum and recommended RPM.

The opposite proved, however, true for the treatment of minimum and fixed resale price maintenance. Despite the trend of increased effects-based analysis, these instruments, according to which a buyer is obliged to resell not below or at a certain price, have been consistently held hardcore restrictions. As a result, minimum and fixed RPM fall by definition under Article 81(1) EC, are ineligible for block exemptions, and are presumed to be incapable of meeting the criteria of the legal exception of Article 81(3) EC. Moreover, as the analysis has found no example of a case where minimum or fixed RPM satisfied the criteria of Article 81(3) EC, statements referring to the current approach of the Commission as a de facto per se prohibition are far from unfounded. This conclusion is inconsistent with the economic analysis, which explicitly found that although minimum and fixed RPM are in most instances welfare-reducing, they can very well have welfare-enhancing effects.

The economic analysis has shown that minimum and fixed RPM can be welfare-enhancing when a manufacturer imposes either of them to create an incentive for his retailers to compete on other competition factors than price, and thereby boost consumer demand. It has also been shown, however, that this argument that RPM may be used to solve non-price externalities has several limitations, as not all consumers will benefit equally, whereas similar results may be achieved by other (though not necessarily less restrictive) instruments. On the other hand, it has been explained that minimum and fixed resale price maintenance have an adverse effect on consumer welfare when used to solve the so-called 'commitment problem'. This argument states that by removing a manufacturer's incentive to engage in opportunistic behaviour, resale price maintenance contributes to a good functioning of an upstream monopoly. Another instance in which minimum and fixed RPM are detrimental to consumer welfare is when they are used to establish a cartel. Because they greatly enhance market transparency and create a mechanism deterring price-cutting at the downstream level, minimum and fixed RPM may be used to form a cartel between either manufacturers or retailers. Finally, minimum and fixed resale price maintenance can also be used to create entry barriers for innovative retailing concepts for which price-cutting is essential, thereby possibly depriving consumers from lower prices, higher quality and more choice. The economic analysis has therefore shown that although outweighed by their welfare-reducing effects in general, also the hardcore restrictions of minimum and fixed RPM have shown to be capable of increasing consumer welfare. Similar to the *Leegin* ruling in U.S. antitrust law, this finding therefore supported the view that a per se prohibition, either de jure or de facto, is inappropriate, and an 'even more economic approach' therefore seemed desirable.

Inspired by recent contributions in the law & economics literature and the dissenting opinion in the *Leegin* judgement, the analysis continued to try and find an explanation for the paradox of an instrument that is in most – but certainly not in all – instances welfare-reducing, and a competition policy that is often described as a de facto per se prohibition. The analysis therefore took a third, law & economics perspective, which subsequently dealt with the strictness of the current Commission approach and the allocation of the burden of proof under Article 81(3) EC. As to the strictness of the current approach, I have considered the (more lenient) alternative of introducing an 'even more economic approach' for minimum and fixed RPM. This approach would, similar to U.S. antitrust law, involve an extensive weighing of pro- and anti-competitive effects before concluding anything on the legitimacy of minimum and fixed RPM. It has been explained that such a change towards more increased differentiation of competition policy would imply a trade-off between increased capability to separate pro- and anti-competitive instances of RPM and increased regulation costs. Obviously, more case-specific analysis of the welfare effects on consumer welfare reduces the costs associated with the Commission wrongly prohibiting a welfare-enhancing instance of RPM (a type II error). The benefits of such an 'even more economic approach' therefore consist of reduced error costs, but are not very likely to be substantial because minimum and fixed RPM are in most instances welfare-reducing. Moreover, I have argued that it should also be taken into account at what cost a competition authority tries to make the right decision. In this context, it has been shown that an 'even more economic approach' would likely cause a substantial increase in regulation costs, most notably monitoring costs, legal uncertainty and costs of judicial review. Having in mind this increase in regulation costs, while taking into account that the benefits of such a policy change would be severely limited, I have therefore concluded that the strictness in the current policy is justified.

Having found a justification for the strictness of the current Commission practice vis á vis minimum and fixed resale price maintenance, the analysis continued with the allocation of the burden of proof under Article 81(3) EC. An interesting feature of EC competition law is that minimum and fixed RPM can, as they are hardcore restrictions, only be justified using the legal exception of Article 81(3) EC, while the burden of proving that its conditions are satisfied rests with the parties claiming its benefit. It has been shown, however, that the costs of proving that an agreement involving minimum or fixed RPM satisfies all conditions of Article 81(3) EC are substantial. An advantage of the current allocation is that it saves research costs compared to the alternate allocation. That is, under the current regime the research is only fully conducted when the undertakings involved, who know why RPM was imposed and who can more easily obtain the information needed for the analysis, think it is worth their resources. However, because a proper analysis on the conditions of Article 81(3) EC is rather expensive, whereas the chances of success are very slim, the current allocation appears to have, as of yet, resulted in a de facto per se prohibition of minimum and fixed RPM.

In sum, the current treatment of resale price maintenance is in line with the objective of EC competition law, the protection of consumer welfare. An extension of effects-based analysis towards an ‘even more economic approach’ when dealing with minimum and fixed resale price maintenance is undesirable as it would result in a strong increase in regulation costs, whereas the benefits of such a policy change are severely limited. This conclusion entails the somewhat difficult acknowledgement that competition policy is by definition imperfect, because the current regime also deters welfare-enhancing instances of RPM. The fact that the current approach amounts in practice to a per se prohibition reflects the status quo in the debate among economists: it is not certain that minimum and fixed resale price maintenance generates benefits to consumers that can not be achieved by less restrictive measures. It remains an interesting question for the future whether an undertaking engaged in resale price maintenance will be able and willing to prove the Commission, the Court, and the bulk of economists wrong.

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