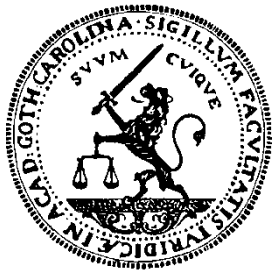

FACULTY OF LAW
Lund University

Filip Ryman

Resale Price Maintenance and Consumer Welfare

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Supervisor: Justin Pierce

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Content

Summary

Vertical restrictions and especially price restriction has generally been deemed anticompetitive during the years, both in the US as well as in the EU. Minimum resale price maintenance has a long history of being seen as anti-competitive. In the USA there has been a *per se* illegality regarding RPM for almost a hundred years under the Sherman Act section 2. However, in the last decades there has been a change in the attitude towards RPM, starting with prominent economists arguing that the per se illegality was without grounds. This development started in the 60s, with the Chicago School as the vanguard for this crusade. It has been an ongoing development which culminated in the removal of the per se illegality in Leegin, where the Supreme Court substituted it with the Rule of Reason.

In the European Union there has been a similar development. This however has not lead to a similar result. RPM, as a vertical restraint has always been seen as anticompetitive and even now after the development in the USA and a similar loosening of the snare around vertical restraint in the EU there is a quite harsh presumption of illegality.

This thesis investigates the relationship between resale price maintenance (RPM) and consumer welfare. The thesis shows that there is a solid role for consumer welfare within competition law. While it does not have the status that it has in the US antitrust system but is still very present, especially at a practical level.

The thesis continues to investigate different economic theories regarding the effects of minimum RPM and clearly shows an ambiguity regarding the theoretical effects. In lack of empirical evidence as well as theoretical support for a general presumption of illegality towards RPM this thesis concludes that the appropriate approach would be a removal of the status as a hard core restriction and said presumption and by moving towards the US Rule of Reason approach through a pure application of Article 101(3).

Sammanfattning

Vertikala restriktioner och särskilt sådana gällande pris har i allmänhet ansetts ha negativa effekter på konkurrens under en lång tid, både i USA och i EU. Prisgolv har en lång historia av att ses som konkurrensbegränsande. I USA har det setts som per se olagligt i nästan hundra år under Sherman Act avsnitt 2. Under de senaste decennierna har det dock skett en förändring i synen på prisgolv, som börjar med att framstående ekonomer argumenterade att olagligheten var grundlös. Denna utveckling startade på 60-talet, med Chicagoskolan som förtrupp för denna kampanj. Det har varit en pågående utveckling som kulminerade i fallet Leegin där högsta domstolen ersatte per se olagligheten den med en tillämpning av Rule of Reason doktrinen.

Inom EU har det skett en liknande utveckling. Detta har emellertid inte lett till ett liknande resultat. Prisgolv, som en vertikal restriktion har alltid setts som konkurrensbegränsande och även nu efter utvecklingen i USA och en liknande förändring åt att se mer positivt på vertikala restriktioner så finns fortfarande en stark presumtion om illegalitet gällande prisgolv.

Denna uppsats undersöker sambandet mellan prisgolv och konsumenternas välfärd. Avhandlingen visar konsumenternas välfärd har en stark plats i bedömningen inom konkurrensrätten. Även om den inte har den status som den har i den amerikanska konkurrensrätten, så är den fortfarande mycket närvarande, särskilt på en praktisk nivå.

Avhandlingen fortsätter att undersöka olika ekonomiska teorier om effekterna av prosgolv och tydligt visar en tvetydighet när det gäller dessa. I brist på empiriska bevis och teoretiskt stöd för en allmän presumtion om olaglighet mot prisgolv så finner denna avhandling att en lämplig metod skulle vara ett borttagande av statusen som en allvarlig restriktion och nämnda presumtion. Istället skall man röra sig mot en tillämpning av den Amerikanska Rule of Reason doktrinen genom en renare tillämpning av Artikel 101(3) TFEU.

Preface

This thesis is an original, unpublished, independent work by the author, Filip Ryman.

Abbreviations

ECJ	European Court of Justice.
EU	European Union.
RPM	Resale Price Maintenance .
TFEU	Treaty on the Functioning of the European Union.
USA	United States of America.
BER	Block Exemption Regulation

1 Introduction

1.1 Purpose

This thesis will investigate the relationship between resale price maintenance (RPM) and consumer welfare. This is a topic of great interest for the author and quite relevant in the development in European competition law. During the last decades consumer welfare has taken over as the sole purpose of antitrust law and it is this development and the American view of the relationship between consumer welfare and RPM that has inspired this thesis.

The purpose of this thesis is to uncover to what extent consumer welfare is regarded as a part of European competition law as well as investigating the effects of RPM on this aspect in a critical investigation of the status of RPM as a hard-core restriction. The question the Author seeks to answer is if the effects of the practice on consumer welfare really are as detrimental as the Commission and the courts would suggest and if, through this, the presumption of illegality regarding RPM is valid.

1.2 Method and Material

The subject of this thesis will be approached using a combination of dogmatic, comparative and economic methodology. Throughout the thesis, the author will look into the framework governing resale price maintenance as a whole in the European Union as well as a comparison with the US approach.

As case law is an integral part of the analysis of both the status of consumer welfare and the rules governing RPM, several cases regarding each topic will be referred to.

The main part of the thesis will be the economic analysis of RPM. Therefore, doctrine has become the largest source of reference in this thesis mainly because the economics needed to analyse the effects of RPM is not to be found in either case law, treaties or other official documents of the EU.

1.3 Delimitations

This thesis will cover consumer welfare in the competition law and antitrust law. The focus will then be the interplay between consumer welfare and RPM. There are more aspects of competition law, such as the protection of the internal market, which will not be dealt with. RPM is seen as a restriction of competition but the focus lies on the cartelization and price increase that are deemed to affect consumer welfare and competition as a process more than creating fragmentation in the market. The only issue of fragmentation that RPM creates is entry barriers for competitors which will be discussed in the economic theories.

There is a multitude of economists, theorizing regarding the effects of RPM. In this thesis, only a few of the most prominent names will be represented. The theories and their authors are regarded to be the dominating ones in this field of research. Furthermore, only one anticompetitive theory has been chosen. The purpose of this thesis is not to fully investigate the effects of RPM, but to cast a light on the procompetitive side of the practice as a critique of the presumption that RPM generally has a negative effect on competition.

1.4 Outline

Chapter two of this thesis will begin by examining the framework governing RPM in the European Union combined with a shorter account on the US approach to the practice. Here we will see the presumption of illegality of RPM which will be follow us through the rest of the thesis.

Chapter three continues to look into antitrust and competition law to discern what the purpose of competition and antitrust law is. Here we will see the place of consumer welfare in the two, followed by a chapter defining consumer welfare.

In chapter four, which is the focus of the thesis, we look into the economics of RPM. How it affects the market and the actors in it with a focus on consumer welfare leading up the conclusion regarding the questions that was put forth in the purpose.

2 Resale Price Maintenance

RPM is on the surface a simple and straightforward tool. A vertical restraint utilized by manufacturers and distributors to control the price of a product in the next level in the downstream market. A manufacturer can include in an agreement that a certain product must be sold at a certain price, not above a certain price, or lastly, that the product may not be sold under a certain price. Maximum resale price maintenance is not subject to this thesis since it is not included as a hard-core restriction in the Block Exemption Regulation and does generally not raise an issue in the European market unless it can be deemed to set a fixed price. This goes for recommended prices as well as it does not create a fixed price, at least in theory.

RPM has a long history of being seen as anti-competitive. In the USA there has been a per se illegality regarding RPM for almost a hundred years through the Sherman Act. However, the last decades there has been a change in the attitude towards RPM, starting with prominent economists arguing that the per se illegality was without grounds. This development started in the 60s, with the Chicago School as the vanguard for this crusade. It has been an ongoing development which culminated in the removal of the per se illegality in Leegin 2007, where the Supreme Court substituted it with the Rule of Reason.

In the European Union there has been a similar development. This however has not lead to a similar result as will be shown below. RPM, as a vertical restraint has always been seen as anticompetitive and even now after the development in the USA and a similar loosening of the snare around vertical restraint in the EU there is a quite harsh presumption of illegality.

2.1 The background of Vertical restraints in the EU Until today

Vertical restraints are provisions in an agreement, between two parties in a vertical relationship that aims to limit competition. Vertical restrictions have always been treated with suspicion and have been seen as limiting competition in the European as well as the market in the USA. In the USA there was a per se illegality connected with nearly all kinds of vertical restraints under the Sherman Act and it was not until the case of Leegin that the attitude towards vertical restraints started to shift for real.[1]

[1] *Leegin Creative Leather Products v. PSKS*, 127 S. Ct. 2705 (2007); *Continental TV v. GTE Sylvania*, 433 U.S. 36 (1978)

In the EU there has always been an interest in vertical restraints and the reason is quite simple. One main objective of the EU is the creation of a single market and this is where vertical restraints can become a hindrance by partitioning the market and affecting intra-brand as well as interbrand competition.

In 1966 the EU took its first decisive steps towards creating a framework regarding vertical restraints through the Consten Grundig case where the ECJ firmly established Article 85 (which now is article 101) was applicable to this kind of restraints. This was the start of was would become a quite extensive framework directed towards dealing with anticompetitive agreements such as these. In the EU, the Commission has been most prominent when it comes to loosening the snare around vertical restraints. As early as in the 1980s, the Commission started working on a block exemption regulation, which, as the name suggests, exempted some vertical restraints in certain situations. This was not the giant leap that the USA had taken with Leegin, which completely removed the per se illegality and replaced it with a Rule of Reason approach, but it was a step towards a more nuanced approach.

The development continued in 1997 with the Green Paper on Vertical Restraints. This was a more in depth look into vertical restraints and the effects they had on the market, and laid out an early guideline to dealing with them. The Green Paper however was lacking in several regards. The approach to vertical restraints was quite static. It was a form based assessment which lacked a more dynamic analysis of the situation. Furthermore it did not take into regard the market share and lacked a more economic perspective in the procedure. However, it was another step in the general direction of a more open mind regarding vertical restraints. The review that was the Green Paper resulted in several changes to competition law on an EU level. It led to a renewed framework with the 1999 Block Exemption Regulation and the guidelines a year later. It also led to more specialised BER as the motor vehicle in 2002 and the technology transfer BER in 2004. The general BER and the Commission guidelines were revised and the new version came out in 2011, these will be dealt with more in depth below.

2.2 Current Legal Status

As seen above, vertical restriction has always been treated with utmost care, almost with fear. Today, vertical restraints and RPM falls within the prohibition of Article 101(1) of the Treaty on the Functioning of the European Union (TFEU) with virtually no scope for meeting the strict conditions for exemption under Article 101(3). In 2011 there was a change with the new guidelines from the commission which loosened the snare around RPM, but not by much.

2.2.1 Article 101

As a vertical restraint, RPM falls under Article 101 in the TFEU which has the purpose of controlling agreements and undertakings that might have adverse effects on competition. The first part of the Article, 101(1), reads:

"1. The following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market, 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."[2]

2.2.1.1 The test

To establish a vertical restriction, it must be analyzed under Article 101 this analysis involves four steps.

- It should apply to bilateral or multilateral conducts (agreements, concerted practices) which do not include agency agreements.[3]

This jurisdictional point is a bit broader than it might seem at first glance. If an agreement falls under 101(1) a party cannot escape the scope of EU law even if its own contribution to the competition distorting parts of the agreement is insignificant.

[2] TFEU, Article 101.
[3] Guidelines, paragraphs 24-30

- It must have appreciable effects on competition and trade between Member States.[4]

- There have to be a restriction either in a) object, or b) effect.[5]

Regarding the effect this area is a bit trickier than it might seem at first. Rather than an agreement having adverse effects on competition, it is enough with the notion that it could have these effects. For instance, RPM as part of the hard core restriction is seen as something that would make an agreement capable of distorting competition "by its very nature".

- In the case that a restriction exists under Article 101(1), Article 101(3) can apply and then a balancing test of effects must be used.[6] This efficiency defense consists of four major points: efficiency gains; fair share for consumers; indispensability of the restrictions and no elimination of competition[7].

2.2.2 The Defense Under 101(3)

Especially the efficiency gain has been subject to investigation. The Commission and courts has elaborated on this part quite a bit. The purpose is for the parties to establish that even though there is a restriction to competition, this fact is outweighed by gains in efficiency. This could be cost reductions, quality improvement, or other improvements to the products given that there is a causal link between the economic activity stemming from the restrictive agreement and these improvements[8]. The burden of proof of the defendants is quite heavy regarding the efficiency gains. The defendants must show that the efficiency gains are linked to the specific agreement that are restricting competition, the nature of these efficiencies, the likelihood of them and the specific time and place that these efficiencies would manifest themselves.[9]

The definition of these efficiencies has been further developed during the years through case law. The most evident case is the case of *GlaxoSmithKline Services v. Commission*[10]. In this case the defendant (Glaxo) had an agreement that contained vertical restrictions in the form of territorial restrictions. The Commission was of the opinion that the agreement fell under article 101 because of this restraint, however, Glaxo made their defense under article 101(3). The arguments that Glaxo put forth

[4] *Bayer* appeal, paragraphs 47 and 174
[5] Regulation, Articles 4-5
[6] Case T-168/01 GlaxoSmithKline, paragraph 248 and 294; Guidelines, paragraph 122.
[7] http://europa.eu/legislation_summaries/competition/firms/l26114_en.htm
[8] Guidelines on Vertical Restraints, Para 45, 69-72
[9] Guidelines on Vertical Restraints, Para 51-59
[10] Case T-168/01 *GlaxoSmithKline Services v. Commission*,

was that these restraints were necessary since the interbrand competition on the market for pharmaceuticals is driven by innovation in contrary to other markets that is normally driven by price. These restrictions would increase upstream competition and lead to additional profit which would be put into research and development due to the strong pressure to innovate. In this case the General court and the ECJ supported Glaxo in their claims. The General Court even stated that Glaxo's defense was supported by Commission documents.[11] The ECJ made one strong statement that the Commission had failed to take the unique structure of the pharmaceutical market into account.

The Commissions definition of efficiency seems to be limited to economic factors, however supported by case law. There has been some debate regarding if this narrow view of efficiency gain should be expanded to a better fit with other public interests and EU policy. The Commission itself states in the Guidelines that other goals pursued by treaty provisions can be included in the process under Article 101(3).[12] The Commissions reliance on the ruling in Case T-17/93, *Matra Hachette SA v. Commission*[13], seems to signal that these other considerations are only to be used as a supplement to the economic analysis.[14] In practice however, this seems to be less prominent and quite inconsistent while looking at the case law.

In *Premier League Ltd v QC Leisure* and *Murphy v Media Protection Services Limited*[15] where broadcasters tried to protect their interests through limiting the competition by territorial restrictions and use restrictions the broadcasters argued that it was in the public's interest through the protection of copyright and increasing attendance in the stadium during football matches. Here the Court of Justice dismissed these arguments and their defense under 101(3) but did however not state that these arguments were not relevant.[16]

This attitude can also be found in the Commissions reasoning. As an example one can look at the older case of *Ford/volkswagen*[17]. In this case Ford and Volkswagen were doing a joint venture in Portugal, building a factory. This agreement was seen as falling within the scope of Article 101 (then 85(1)) but was exempted under the clause that was then 85(3). It was exempted under the economic analysis but what is important here is to note that the Commission stated the fact that this venture would have a significant effect on the labour market, by directly and indirectly creating around 15 000 jobs was to be taken into account. The Commission clearly stated that these factors would not on their own justified an exemption[18] but one can sense a degree of importance placed on them.

11 Case T-168/01 *GlaxoSmithKline* Services *v. Commission*, Para 233-307
[12] EU Competition Law: Text, Cases And Materials, Alison Jones, supra note 278
[13] *Case T-17/93 Matra Hachette v Commission*
[14] EU Competition Law: Text, Cases And Materials, Alison Jones, supra note 279
[15] Joined Cases C-403/08 and C-429/08
[16] Cases 403 and 429/08
[17] Case IV/33.814 (93/49 EEC)
[18] Case IV/33.814 (93/49 EEC), Para 36

Despite the focus on the efficiency aspect, it has been established both by the Commission and the ECJ that these points of defense are cumulative.[19, 20]

The second condition to be fulfilled so that a restriction may be exempted under 101(3) is that the consumers must be the recipients of a fair share of the efficiencies that the restriction creates.[21] This is where one can start to see explicit references to consumer welfare. This is a concept that might seem clear and defined at first glance, but is one that we will go into more thoroughly below. This criterion can be said to be more depending on one of the other than the rest. This is because the Guidelines indicate that this criterion is to be investigated after the indispensability has been established since the fair share for consumers becomes superfluous if there is another, less restrictive way to create the efficiency gains in question.[22] To explain this criterion further one must first establish what is meant by "consumer" and fair share. By consumer it is not limited to final consumers but this word contains all consumers in regard to the agreement. This is quite a broad definition and includes almost anyone that will purchase a product or service without regards to it being on whole sale or end user level.[23] However, the consumer definition does not include anything on an individual level, rather it takes into regard the groups of consumers in the relevant market.

One question that has been under investigation regarding to this is how the placement of adverse and positive effects can be. Here there are some differences between the Guidelines and the case law. The Guidelines states that the positive effects must affect the consumers in the same market as the adverse effects do. In contrary to this, case law has shown a much broader view on how to weigh the effects, not limiting the analysis to the same market and even including future effects. This much broader approach seems to be a better fit also when comparing to the similar broad approach adopted under Article 102.[24]

The concept of fair share is also one that seems to need some clarification. The Commission defines it in the Guidelines as follows:

> *"The concept of "fair share" 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). In line with the overall objective of Article 81 to prevent anti-competitive agreements,*

[19] Case C-238/05, Asnef-Equifaxv. Asociación de Usuarios de Servicios Bancarios, , ¶ 65.
[20] Guidelines on Vertical Restraints, Para 123.
[21] Guidelines on Vertical Restraints, Para 126.
[22] Guidelines on Vertical Restraints, Para 126.
[23] EU Competition Law: Text, Cases And Materials, Alison Jones, p 259
[24] EU Competition Law: Text, Cases And Materials, Alison Jones, p 259

> *the net effect of the agreement must at least be neutral from the point of view of those consumers directly or likely affected by the agreement(80). If such consumers are worse off following the agreement, the second condition of Article 81(3) is not fulfilled. The positive effects of an agreement must be balanced against and compensate for its negative effects on consumers(81). When that is the case consumers are not harmed by the agreement. Moreover, society as a whole benefits where the efficiencies lead either to fewer resources being used to produce the output consumed or to the production of more valuable products and thus to a more efficient allocation of resources."*[25]

We can see here that it is not necessary for consumers to gain positive effects from each efficiency gain that the restriction creates but more in line with the broader approach mentioned above.

The third condition is the indispensability of the restriction. Basically it is the indispensability of the restriction to achieve the efficiency gains in question.[26] Here, there is yet another test to affirm this indispensability. First, one is to look at the restrictive agreement itself so see if it is reasonably necessary to create the efficiency gain and to follow this up, one looks at the separate restrictions that the agreement creates in competition to see if these also can be deemed necessary to achieve the efficiency gains.[27] This means that a restriction cannot be deemed to be indispensable if it can be achieved by other means.

Hardcore restrictions and restrictions that can be deemed as restriction in object have a presumption of being not indispensable in the Commissions eyes and among these we can find RPM.[28]

The last condition is one that will later lead us into the earlier mentioned definition of consumer welfare. It is the criteria that the agreement must not allow the parties the possibility of eliminating competition[29]. This can also be seen as the protection of the competitive process, or, competition itself, as the Commission states in the Guidelines for Article 101(3):

> *" Ultimately the protection of rivalry and the competitive process is given priority over*

[25] Commission Guidelines on Article 101(3). Para 85.
[26] European Law, T P Kennedy, 6.7.3, p 171
[27] European Law, T P Kennedy, 6.7.3, p 172
[28] EU Competition Law: Text, Cases And Materials, Alison Jones, p 262
[29] EU Competition Law: Text, Cases And Materials, Alison Jones, p 262

potentially pro-competitive efficiency gains which could result from restrictive agreements".[30]

This is not all that governs the area of vertical restrictions. There are also the block exemptions which will be explained below.

2.2.3 The Block Exemptions

The block exemptions (BER) are what the name entails, exemptions, and to be more specific, exemptions to Article 101. There are several BERs govern specific areas of the market such as the Technology Transfer Block Exemption and Regulation the Vehicle Block Exemption Regulation as well as more general BERs.

The BERs function is to create an exemption in which Article 101(1) does not apply. The BERs has direct applicability and can therefore be applied on a national level. There is a difference however in the applicability of the BERs regarding technology transfer and vertical agreements. As a general rule, the BERs has a rigid scope that only creates applicability when the agreement falls precisely within it. The difference in the BERs regarding technology transfer and vertical agreements is that they among other BERs separate different provisions in hard-core restrictions that will create an inapplicability of the BER and provisions that even if not covered by the BER, does not create inapplicability for the rest of the agreement.

The BERs are to be applied before an assessment under Article 101(1) is done and if exempted, the agreement is not hindered by this article. If not however, an assessment under 101(1) is to be conducted and if a restriction is deemed to exist, 101(3) comes into effect. However, the Commission states that it is unlikely for an agreement that contains a hard-core restriction to fulfil the requirements of 101(3).

The content of a BER is often different depending on which you are looking at but they share similar cornerstones. The basis for most BERs is the market share and this is the case for the BER regarding vertical restraints, which can only apply when the market share of the undertaking is below 30%. This is similar in the Technology Transfer Block Exemption and Regulation in which the market shares are 20% if the parties are competitors and 30% if that is not the case.

Regarding the earlier mentioned hard-core restrictions, which RPM is a part of, these are also contained in many of the BERs. As stated, these are restriction that, if included in an agreement, creates an inapplicability of the BER to the agreement. This is shows the Commissions stance on this type

[30] Guidelines on Vertical Restraints, Para 105

of restrictions and the Guidelines also states that these restrictions are unlikely to pass the test of 101(3).

This creates a presumption of illegality regarding RPM, which is, as the guidelines state, unlikely to be rebutted. In the US the approach is quite different following recent developments in case law which we will se in the following chapter, where they have removed the earlier per se illegality of RPM and created an even more effect based approach than the analysis under Article 101.

2.2.4 A Change in the USA - Leegin Leather Products

The per se illegality of vertical price restrictions was read into the Sherman act for many years but was formalized by the case Dr Miles in regards to RPM. However, this was over 100 years ago and through persons such as Bork and Posner who's theories will be explained below, the attitude shifted towards these kinds of restraints over the years.[31] This lead up to the change in 2007 with the case Leegin Leather products.

In this case, Leegin Creative Leather Products, Inc. v. PSKS, Inc[32], a retailer to Leegin marked down Leegin's priducts by 20%. Leegin took them to court claiming this to be against their pricing policy but was first denied all right to make a case of the procompetitive effects of RPM in the district court based on the per se illegality through the Dr Miles case. Leegin appealed causing the change from per se illegality to a Rule of Reason and an approach more focused on the economic analysis of each case. The works of scholars such as Robert Bork and Coase heavily influenced this path and had pressured the court for many years to make a change. This was followed by several judgments regarding vertical restrictions which lead to a solid foundation for the Rule of Reason in the US. This was seen as more in line with the purpose of antitrust law, which had moved to a consumer welfare standard opposed to the older view that it was to protect competitors and competition itself.

This view is shared by many countries around the world such as Australia, who has consumer welfare as the paramount goal and even China who has consumer welfare as a partial goal of competition law.

[31] Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).
[32] Leegin Creative Leather Products, Inc. v. PSKS, Inc., 551 U.S. 877 (2007)

2.3 An Effect Based Approach or an Effects Based Process?

As seen above, the economic analysis has been given a place in competition law but it is not ajour with the modern economics. Even though the per se illegality of RPM does not exist in the EU, it remains a hard-core restriction. This comes with a presumption of illegality, which might be hard to rebut.

The question regarding if there is a Rule of Reason in the case of restrictions under 101(3) is a complicated one. 101(3) opens up the possibility for a case-by-case analysis and defence of otherwise prohibited practices. The question is however, if this can be seen as an implementation of the Rule of Reason doctrine adapted in the US regarding vertical restrictions? This is a question that has been debated the last couple of years, with scholars advocating that the EU should move towards a more pure Rule of Reason.

There is a legal difference between the approach in the US and the EU. The legal basis for the economic analysis is section 2 in the Sherman act. In the EU there is a multi-step process through article 101 to conduct any sort of economic analysis as seen above. Even though 101(3) contains the elements of the Rule of Reason doctrine it is still a more rigid approach creating more legal certainty while sacrificing the possibility of a dynamic analysis. ¨

Alexander Italianer Director-General for Competition in the European Commission discussed this subject and said regarding Article 101 that:

"…under Article 101(1), no matter whether the restraint is by object or by effect, the contextual analysis never goes as far as balancing the anti- and pro-competitive effects. It only aims at gauging the negative consequences of the restraint for the process of competition, for which the Commission or plaintiff carries the burden of proof. In other words, the analysis under Article 101(1) deals exclusively with identifying competitive harm."[33]

So, this is one of the steps in the process which leads to the economic analysis in 101(3). However, regarding price restrictions he stated that:

"It is true that severe restrictions of competition – such as price fixing or limiting, controlling and sharing markets – are unlikely to meet the conditions for exemption under Article 101(3) as they rarely enhance efficiencies or benefit consumers and are rarely indispensable"[34]

[33]Alexander Italianer Director-General for Competition in the European Commission, 40th Annual Conference on International Antitrust Law and Policy, Fordham Competition Law Institute New York, 2013

[34] Alexander Italianer Director-General for Competition in the European Commission, 40th Annual Conference on International Antitrust Law and Policy, Fordham Competition Law Institute New York, 2013

This shows that even though there is an economic evaluation conducted case-by-case, there is still a quite harsh presumption of illegality regarding a practice such as RPM.

2.3.1 A European Rule of Reason

Discussions regarding an adoption of the Rule of Reason doctrine from the US has been discussed in Commission level as well in the Courts but dismissed with various arguments. The Rule of Reason doctrine originates from US case law, specifically the *Standard Oil* case.[35] The basis for the Rule of Reason is here stated to be that the Sherman Act is supposed to promote one of the most fundamental parts of the law governing a market, the right to conclude a contract and not hinder it. The Rule of Reason is a case-by-case method, analysing the nature of the agreement and all surrounding circumstances. It is similar to the approach under 101(3) but it is less bound by procedural requirements and the analysis is open to take into regard any arguments for and against the case in question.

The Commission brought up the topic in their White Paper[36]. In this they stated that an adoption of the Rule of Reason was unnecessary since article 101(3) contains all the elements of this doctrine already.[37] While it might be true that 101(3) do contain all the elements of a Rule of Reason, its effects based analysis is bound by different constraints than the US doctrine. While in the Rule of Reason doctrine, the burden of proof is on the one claiming a restriction of competition, under 101(3) the presumption of illegality turns this around. Here the defendant is seen as guilty until proven otherwise when dealing with RPM, quite a twisted version of the Rule of Reason.

Is there a reason for this system where one must prove the innocence of a practice, and what is the fear of RPM based upon? To examine this RPM we must first look into what the EU wants to achieve by this - what they are trying to protect from the alleged harm that comes with the practicing of RPM.

[35] Standard Oil Co. v. United States, 221 U.S

[36] Commission, White paper on modernization of the rules implementing articles 85 and 85 of the EC-Treaty, 1999

[37] Commission, 'White paper on modernization of the rules implementing articles 85 and 85 of the EC-Treaty, Para 57

3 The Purpose of Competition and Antitrust Law

When looking at competition law it can be hard to distinguish a clear goal in the law as well as competition policy. There are differences regarding the goal between different markets and there are even different interpretations of these goals. A good example of this is the debate in the US regarding their antitrust law. It started back in the 60s with the book "The Antitrust Paradox" by Judge Bork. In this article, he argued that the ultimate goal of antitrust law[38] was to promote efficiency, protect consumers and competition rather than creating protection for the other actors on the market. He has been criticized by e.g Brietzke who has called Borks view to narrow and even accused him of using the term consumer welfare as a "staking horse" for corporate welfare.[39]

First we must establish a difference between the European competition law and the US antitrust law. Antitrust law was created as a tool to deal with so called "trusts", a sort of cartel.[40] The European competition law originates in the very core of the European Union, the goal to create and maintain the internal market.[41] However, regarding article 101, competition law and antitrust law shares a common approach in that both base the analysis on an economic framework. Article 101 distinguishes itself from e.g. 102 in this regard. One can see through the many documents such as the guidelines for article 101, that the focus is more on the economic aspects.[42] It is in the light of this similarity in antitrust law and competition law that a comparison will be made and which creates the possibility of the later economic analysis of RPM.

In the EU as well as in the US, there has not been a quite as thorough debate regarding the specific goals of competition law and as many as five different definitions have been applied to competition.[43]First, there is the view that competition means "the absence of restraints". This does not mean just the absence of restraints as in the absence of rules on a national and supranational level but would require the abolition of all rules, even between parties in which commercial contracts would be included. This is a view that

[38] This was aimed solely at the American market at the time since it was regarding the Sherman Act but spoke of the purpose of competition law in general.
[39] Valparaiso University Law Review, Vol. 13, No. 2 [1979], Art. 7, Robert Bork, The Antitrust Paradox: A Policy at War with Itself Paul H. Brietzke, p. 418
[40] For a more detailed explanation, se footnote 84.
[41] Robert O'Donoghue and Jorge Padilla, The Law and Economics of Article 102 TFEU, p 62
[42] Robert O'Donoghue and Jorge Padilla, The Law and Economics of Article 102 TFEU, p 68
43 Eugene Buttigieg, Competition Law: Safeguarding the Consumer Interest : a Comparative Analysis, p3

is not very wide spread and has little ground in the USA as well as the EU but has seen the light of day in *Chicago Board of Trade*[44], in which one judge used this meaning. The Commission has also been seen using this definition under heavy critique.[45]

Secondly, there is the view as competition as a state of perfect competition. This definition, put forth by Stigler has been criticized by Bork, stating that even if it's a great economic model, it can never be used as a foundation for policy making. The basis is that the elasticity of supply that any buyer can encounter is limitless. Stigler has put forth four criteria for this to exist: perfect knowledge, product homogeneity, large numbers and divisibility of output.[46]

The third definition is one that competition needs a fragmented market. This means that the basis and purpose of competition is that all actors on the market is locally owned. This view was earlier a part of the American position but was attacked since it lead to a near abolition of all mergers in the same market.

The fourth definition is one that many would say that its being used in the EU. It is the thought that competition is a process in which the parties should enjoy freedom and protection without any hindering regulation, especially the medium and smaller competitors; this is known as the ordoliberal view.

At last, we have the definition that will be the basis of the rest of this thesis; competition as a process that is to be utilized to maximize consumer welfare. By many considered to be the "best" definition of competition, this definition was put forth by the Chicago School and judge Robert Bork and will be explained in chapter 3.2.1.

3.1 The EU Goals of Competition Law

The EU competition law framework does not strive towards one single goal. It is a multi-goal framework. As the Competition Commissioner Van Miert stated in 1993:

> *"The aims of the European Community's competition policy are economic, political and social. The policy is concerned not only with promoting efficient production but also achieving the aims of the European treaties: establishing a*

[44] *Chicago Board of Trade v. United States 246 US 231*
[45] Eugene Buttigieg, Competition Law: Safeguarding the Consumer Interest : a Comparative Analysis, , p 3
[46] Eugene Buttigieg, Competition Law: Safeguarding the Consumer Interest : a Comparative Analysis, , p 4

> *common market, approximating economic policies, promoting harmonious growth, raising living standards, bringing Member states closer together etc. To this must be added the need to safeguard a pluralistic democracy, which could not survive a strong concentration of economic power"*[47]

In this Chapter, a movement will be shown, in line with the development of antitrust in the USA in the thinking regarding Community competition law. This shift is subtle but still clear if one were to look a bit closer.

The establishing of a common market has long been considered the main goal of community competition law as seen in the Consten Grundig[48] case where the Court states that the prevention of market segregation is of utmost importance in the community. However, here we indirectly see a connection to consumer welfare in the line of thinking in this case since a part of this objective is to break down the barriers of choice for the consumer.[49] It is this goal of competition law that the author wishes to highlight here. Many have acknowledged the shift towards a consumer welfare standard in the EU. Some even stating that a total shift already has occurred as Devlin and Jacobs in "Antitrust Divergence and the Limits of Economics".[50] This however cannot be said to be the case.

Before diving deeper into the consumer welfare aspect of competition law, the author wishes to highlight that one of the primary goals of European competition law has been and is, the protection of the internal market. The prevention of fragmentation has always been one of the key components of the European Union and will probably continue to be. This area of competition law will not be dealt with in any depth, since the purpose of this thesis is to examine the consumer welfare aspect of competition law.

However, regarding the place of consumer welfare within the competition law and policy of the European union, there has been an increasing focus on the consumer when dealing with competition law throughout the years even if it has not been thoroughly discussed in case law. In the earlier years of the EU, the focus has been mainly on efficient competition, in which the actors on the market is protected and regulated between themselves[51]. Earlier than this, it was stated in Consten & Grundig that the goal of EU competition law was the integration of the internal market[52]. The Commission has stated that consumer welfare is the goal of EU competition law as see in the guidelines for article 81(3) and later 101(3)[53]. However, it was not until 2006 in

[47] Competition Law: Safeguarding the Consumer Interest, Eugéne Buttigieg, p 48
[48] Cases 56/84 and 58/64, Consten Grundig v Commission
[49] Competition Law: Safeguarding the Consumer Interest, Eugéne Buttigieg, p 50
[50] Antitrust Divergence and the Limits of Economics, supra note 160, p 266
[51] *European* Commission, XV Annual Report on Competition Policy 1985 *(1986).*
[52] *Consten & Grundig [1966] E.C.R. 299 at 340*.
[53] Guidelines on the application of Article 81(3) of the Treaty. 2004/C 101/08, Commission Regulation No 1217/2010 on the application of Article 101(3) of the Treaty on the

GlaxoSmithKline[54] that the General court confirmed what the commission has already had stated, that consumer welfare is the goal of EU competition law. In their judgement, they stated that:

> *"In effect, the objective assigned to that provision is to prevent undertakings, by restricting competition between themselves or with third parties, from reducing the welfare of the final consumer of the products in question."*[55]

This judgment was later appealed to the Court of Justice, which corrected the general by stating that consumer welfare was only one part of a larger analysis and that a large part of the goal of EU competition law was competition itself and the structure of the market.[56]

The Commission however, has shown the most progress towards creating a consumer welfare standard. It has shown itself very open to apply policies of the EU that does not have a direct legal correlation cases before them. A good example of this is the cases of *Metro (no 1)* and the case of *Ford/Volkswagen* where employment policy where used as a strong argument in their decision. Furthermore, they did the same regarding the Uniform Eurocheques decision where they took into regard, Community monetary policy in their argument.[57] This clearly shows that the Commission regards Community policies as having an influence over the process under article 101(3) and this can be said of the consumer protection policy as well. The Commission has earlier also clearly stated their belief that consumer welfare should practically be the sole goal of competition policy and law, ridding the assessment of non-efficiency goals. This could be seen when they published the White Paper on Modernisation of the Rules Implementing Articles 85 and 86 of the EC Treaty as well as the guidelines to Article 83(1).[58]

These statements was however not upheld by the courts, creating somewhat of a conflict on the purpose of competition law. It was only in GlaxoSmithKline that the ECJ acknowledged the existence of consumer welfare as a part of the assessment but dismissed the Commissions approach that it was the sole goal of EU competition law.

This would be the end of it if it were not for two facts. First the Commission's view is that consumer welfare is to be considered the only

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functioning of the European Union to categories of research and development agreementsOfficial Journal L 335, 18.12.2010, p. 36

[54] Case T-168/01 GlaxoSmithKline Services Unlimited v Commission of the European Communities.

55 case t-168/01 glaxosmithkline v. commission par. 10

56 Appeal GSK [2009] 4 C.M.L.R. 2 at [63] and (C-8/08) T-Mobile Netherlands BV v Road van bestuur van de Nederlandse Mededingingsautoriteit at 38–39.

57 Uniform *Eurocheques* [1985] *OJ L35/43*

[58] Commission White Paper on Modernisation of the Rules Implementing Articles 85 and 86 of the EC Treaty 1999 O.J. (C 132) 1, ¶ 57 and Article 81(3) Guidelines, supra note 182

goal of competition law, or at least a dominant part of it paying little attention to the non-efficiency arguments. Secondly, it is up to the Commission to investigate a conduct under article 101 and also decide whether or not it falls under the scope and if so, any further assessment if conducted by the Commission. Now, the Commission is not likely to oppose the court's interpretation of the treaties on a consistent basis, but the discussion leading up to a vote on a decision is deemed confidential.[59] It could very well be the case that the Commissioners would let their view of competition law influence their decision as has already been seen in *de Havilland.*[60] Monti stated that during this case commissioners wanted to approve a merger based on the non-efficiency arguments that the courts have established as the primary base. However the merger was prohibited since a commissioner named Leon Brittand argued heavily for the consumer welfare aspect.

Even today, the Director-General for Competition in the European Commission, Alexander Italianer stated that:

"In its quest to protect rivalry among firms and so the competitive process to promote consumer welfare, the Court takes a broad approach when it comes to concerted restraints on the competitive autonomy of firms that are liable to impede the competitive outcome".[61]

This shows that even if not visible at first, EUs shift towards a consumer welfare standard has been ongoing. It is not the definite path taken by our US counterparts but the place of consumer welfare is unsure yet strong, at least at a practical level. This leads us to the question, how to define consumer welfare?

3.2 The Consumer Welfare Standard

Consumer welfare is often regarded as an integral part of a competition law and policy around the world, but the term is often used wrong or misinterpreted.[62] To clearly establish the role of consumer welfare in the European competition law, a solid definition of the EU approach has to be made.

There are two major interpretations of the concept of consumer welfare, and both have a different focus. However, one must first differentiate the consumer welfare standard from the total welfare standard. The latter will

[59] Decision (EU), Rules of Procedure, 2010 O.J. (L 55) 60, art. 9.
[60] Aerospatiale-Alenia/De Havilland, Case IV/M.53
[61] Alexander Italianer Director-General for Competition in the European Commission, 40th Annual Conference on International Antitrust Law and Policy, Fordham Competition Law Institute, New York, 2013
[62] Brodley, JF, 'The economic goals of antitrust: efficiency, consumer welfare, and technological progress, p 1032.

not be dealt with in detail in this chapter since this standard moves the focus of competition law and policy to strive towards economic efficiency by prioritizing the gains for society as a whole rather than the consumer. This approach, mostly supported by the Chicago school, was discussed above.

The two different interpretations of consumer welfare are quite similar in all but one aspect, one focuses on the long term and one on the short term. An approach based on short term goals entails a focus on price reductions and other aspects that are directly measurable while the long term approach focuses more on increasing innovation and efficiency gains. The latter of these could be said to resemblance the total welfare standard more than a version of the consumer welfare standard, however, the simple difference is that in the long-term consumer welfare standard, the focus is still the consumer and how these innovations and efficiency gains can benefit him or her in contrast to the total welfare standard in which many more factors are in play to determine the welfare level.

The term consumer welfare has its origin in the US. It was put forth by Bork in the previously mentioned "The Antitrust Paradox" as the paramount goal of antitrust law. His consumer welfare theory has later dominated the interpretation of the Sherman act and to establish a definition of consumer welfare, one must look into his work.

3.2.1 Consumer Welfare Theory

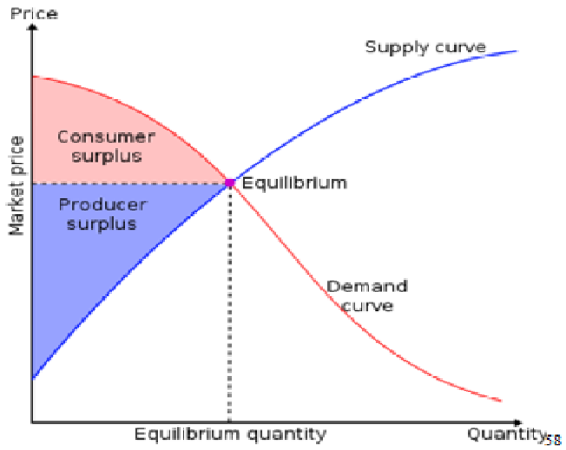
Robert Bork could be considered the main advocate for consumer welfare as the goal of competition and was also the one who started the main debate regarding the topic in the US in the 60s with a number of articles and could be said to have finished it with his book "the Antitrust Paradox". His take on consumer welfare's place in antitrust law created a paradigm shift in the purpose of antitrust in the US.[63] The reason for the impact of Bork's "The Antitrust Paradox" in contrast to Posner and other who had argued for a more economic analysis of law is probably since he lays down simple, yet eloquent rules on how to improve the approach in antitrust law as well as forming a single goal of this legislation, even if this goal contains more than only the words suggests as will be shown below. Bork argued that the law regarding vertical restraints should move from a per se illegality to an more nuanced approach as was created with Leegin. He stated that:

> *"...The whole task of antitrust can be summed up as the effort to improve allocative efficiency without impairing productive efficiency so greatly as to produce no gain or a net loss in consumer welfare"*[64]

63 Vivek Ghosal, Regime Shift in Antitrust Laws, Economics and Enforcement, 733
64 Katalin Judit Cseres, Competition Law and Consumer Protection, p 49

Borks theory was one of the Chicago School, advocating for an efficient market. The theory of the efficient market is not something that is easily applied to the European market since this is based on a less regulated American market, and even there it is a theory and not a practice. However, despite its roots in the Chicago School the consumer welfare theory does not incorporate the efficient market hypothesis but it is rather the other way around.

In economics, consumer welfare is equal to the well-being of the buyer. However, it is a concept that one who is a novice in the field of economics easily might mistake for another well-known economic term. One traditional way of looking at consumer welfare namely is that it is the same as consumer surplus. Consumer surplus is calculated through the Marshallian analysis of partial equilibrium. This analysis, named after the economist Alfred Marshall, defines consumer surplus and welfare as the difference between the price a consumer is willing to pay for a product and the actual price that they are paying.[65] This can be illustrated by the figure below. [66]



Here we can see the producer surplus represented as well. This is the difference in production cost and the price that the manufacturer sells the product for. This combined with the surplus for the consumer can be labelled as a total surplus. The notion that consumer welfare is equal to consumer surplus is flawed. This is because the benefit that the consumer receives in the calculation of consumer surplus is only based on the consumers own notion of what is beneficial to him or her. The economist Gregory Mankiw gives a good example of the difference between consumer welfare and surplus by mentioning heroin addicts. He means that it is in the addicts interest to procure heroin and his addiction creates a demand that, by looking at the figure above, would push the demand curve upwards. The addict is willing to pay a higher price because his demand of heroin is so

65 Alfred Marshall, Principles of Economics, 1890.
[66] http://en.wikipedia.org/wiki/File:Economic-surpluses.svg

great. However, from an outside perspective and from the view of society, this is not contributing to the welfare of the consumer.[67]

This shows the difference between the two concepts. Bork has received critique for his "misconception" of term consumer welfare[68], since in economics; the term consumer welfare has been equal to the concept of consumer surplus. Economists argue that Borks view of consumer welfare rather is allocative efficiencies, competition and wealth maximization bundled up.[69] This is where it, the authors view, becomes interesting. It is the Authors opinion that Bork did not misinterpret the concept of consumer surplus but his goal was to create an entirely new label. He himself explains the concept as follows:

"Consumer welfare is the greatest when society's economic resources are allocated so that consumers are able to satisfy their wants as fully as technological constraints permit. Consumer welfare, in this sense, is merely another term for the wealth of the nation…"[70]

This has received critique since this would equal what in economics is known as social welfare and therefore many see this as confusion in Borks reasoning.[71] The Author of this thesis however, does not. Social welfare and consumer welfare differs on one important aspect. Social welfare is in economics equal to the previously mentioned total surplus, an analysis excluding parts such as policy driven goals and the welfare of society as a whole. What Bork includes in his consumer welfare theory is policy and the needs for the society as a whole. This is a new concept and more suitable to apply in such a policy driven area such as antitrust law as well as European competition law.

Having established the place of consumer welfare in competition law and what this concept entails, this leads us to the next part of this thesis, the interplay between consumer welfare and RPM. Now that it has been shown above that consumer welfare is an integral part of competition law, we now need to look into the economics of RPM and how this interacts with this area of law.

[67] Gregory Mankiw, Principles of Economics, supra note 24

[68] Eg. Christopher Grandy, "Intent and the Sherman Antitrust Act: A Re-Examination of the Consumer-Welfare Hypothesis"

[69] Barak Y. Orbach, The Antitrust Consumer Welfare Paradox , p 14

[70] Robert Bork, The Antitrust Paradox, supra note 6.

[71] Eg. Barak Y. Orbach, The Antitrust Consumer Welfare Paradox, p 16

4 The Economic Theories Regarding Resale Price Maintenance

In the previous chapter, we have seen that consumer welfare has a strong presence in European competition law, at least at a practical level. When dealing with a restraint such as RPM, one must have in mind that it is an economic tool, used on a market with effects measurable only through economic analysis. The way of thought to strike a balance between restrictive effects and efficiency benefits is not a too old one. Looking at the US, which has been in the forefront of the development of competition law, it was not until the 1970s through the Chicago School that the procompetitive sides were aired with a degree of seriousness. It was attributed to prominent figures like Richard Posner and Robert Bork who started to publish works, arguing for the pro-competitive side of these restrictions.[72] These ideas were the start of a paradigm shift in the USA regarding antitrust creating a less interventionist and nuanced approach towards restrictions of competition.[73] The USA has always been an inspiration to the European countries and the EU regarding these issues but it took the EU several decades to accept this line of thinking and implement it themselves to some extent. Even so, a European scholar must approach the American economic theories with care.[74]

4.1 The Interplay Between Economics and Law

The relationship between economics and law is a complicated one. If you were to ask an economist you would probably get the answer that economics bears precedent over law and that the law is only there to regulate. However, if you were to ask a lawyer, the answer would probably not give such a high status to economics in relation to law. Especially in a field such as competition law, where the very area that is to be regulated is one of economics and finance, the two areas becomes so intertwined, that the interdependency is, in the author's view, already a fact.

[72] Robert Bork, The Antitrust Paradox: A Policy at War with Itself, p 39

[73] The influence of Borks "The Antitrust Paradox can be seen clearly, even cited in Reiter v Sono-tone Corporation 442 U.S. 330, showing the acceptance of the Chicago School – line of thought.

[74] S.Micossi, Regulation and Deregulation of Industrial Products in the Internal Market of the European Union: Finding the Right Balance, Forum for EU-US Legal-Economic Affairs.

The idea of an economic analysis of law began to take shape as a movement between 1958 and 1973. In 1958 the first number of the Journal of Law and Economics was published and the second date is when Posner published his book Economic Analysis of Law. Posner himself states that before the first date, the movement could not be said to exist, and after the second, its existence could not be denied.[75] Today the approach is evident in the USA and in the EU and is considered by many to be the single most significant development in the field of law since legal realism.[76]

One of the most prominent contributors in this field is Richard Posner Posner. He is more or less connected to the Chicago School, which is quite anticipated, considering his views on the matter. The Chicago School is the institute which has lead the development of the movement since the Journal of Law and Economics is published here and many of the most prominent scholars in the field is connected to the school such as Coase and Becker.

The theory put forth by Posner, that a Judge will act as a lawmaker and try to form the law to attain specific goals in policy and welfare and this can only be done through a rigorous economic analysis which can foresee the effects of the law. Posner summarizes his idea as such:

> *"As conceived in this book, economics is the science of rational choice in a world—our world—in which resources are limited in relation to human wants. The task of economics, so defined, is to explore the implications of assuming that man is a rational maximizer of his ends in life, his satisfactions—what we shall call his "self-interest."*[77]

Through this, one understands Posners view as economics as a tool of understanding the needs in society and the foundation of law. In an economic market, only economics can be used to foresee the effects of a rule and is therefore needed to create the most efficient rules to achieve wealth maximization

So to understand the effects and suitable approach to vertical restraints one must utilize an economic analysis. Posner also applies his approach to the price system with an example:

> *"No milk czar decides how much milk is needed when and by whom and then obtains the necessary inputs, which include dairy farms and farmers, milk-supply plants, refrigerated milk trucks,*

[75] Richard Posner, Benthams Influence on the Law and Economics Movement, , p 1
[76] Richard Posner , *Values and Consequences: An Introduction to Economic Analysis of Law.*
[77] Richard Posner, Economic Analysis of Law, , *supra* note 2, p 3-4.

packaging equipment and materials, accounting and other support activities, and the scheduling and provision of delivery to retail outlets."

With this example Posner wishes to show the static nature of the market, that everything is coordinated from within and from outside through the price system. Posner regards the world as being in equilibrium and that the main concern for a society is to strive towards social wealth through all its institutions, including law.[78]

4.1.1 The Criticism of the Economic Approach

Posners ideas are supported by many but equally so challenged by others. The most prominent one is Nobel Laureate in economics, Friedrich Hayek. Hayek has criticized a fundamental part in Posners theory, that if one assumes that the judge in question has implemented wealth maximization as a goal and that this judge possesses the ability to conduct an adequate economic analysis of the law in question, how can he be sure that this actually will be an improvement in the law?[79]

A Hayekian views society as a Darwinian views nature, what Hayek calls a "spontaneous order". With "spontaneous", Hayek means that it is a self-regulating entity with no real design and markets are a good example of this. Thus, he believes that putting too much power to regulate this in an administrative entity would endanger liberty and the rule of law. Hayek argues for a more dynamic view of the market and that a "sole goal" is to disturb this self-regulating society.[80]

In regards to European competition law, we have a market model more suited to the Posnerian view. The internal market, as seen above does not only consider social wealth maximization as the goal of competition law but this is an insignificant difference. The focus here lies in the view of the market as either dynamic and self-regulating, or something with equilibrium that should be regulated to strive towards a certain goal.

With this need of economic analysis of law, especially in a field such as competition we now turn to the theories regarding RPM.

[78] Posner, Hayek, Law, and Cognition, supra note 1, at 149.
[79] Friedrich Hayek, .Legislation an Liberty: Rules and Order 102.
[80] http://plato.stanford.edu/entries/friedrich-hayek/#PriSigSpoOrd

4.2 The Anticompetitive Side of RPM

There is really no dispute regarding the fact that RPM has the possibility to limit competition. Regarding consumer welfare the main concerns are the creating of monopoly pricing and that the efficiency gains is not allocated to the consumer but rather the manufacturers and perhaps the retailer. There are different schools of thought and they all focus on different possible situations. There are theories regarding collusion on the retailer level as well as the manufacturing level. The key component in all of them is that they aim to show a decrease in welfare, even though the definition of this exact concept may differ a lot if one were to look into it more closely as seen above.

To illustrate this side of RPM, the author has chosen to turn to the work done by Thibaud Vergé and Patrick Rey. The two authors have during the last decade published a number of articles and papers regarding the economy behind RPM. Their latest contribution, regarding the monopolizing effect of RPM was published in 2010 under the title, "Resale Price Maintenance and Interlocking Partnerships". Due to its complex mathematical nature, a shorter summary will be presented below.

4.3 Thibaud Vergé and Patrick Rey

The industry-cartelization argument has been the main justification for earlier per se illegality of RPM in the US and is the main concern in the EU as well[81]. Vergé and Rey explain that this facilitating practice has been developed by scholars such as Telser and later by Jullien, and Rey himself. With Jullien, Rey concluded that:

> *"by making retail prices less responsive to local shocks on retail cost or demand, RPM yields more uniform prices that facilitate tacit collusion – by making deviations easier to detect[82]."*

With Vergé, Rey examines the same practice but from another angle. The specific situation under examination is when multiple manufacturers collaborate with multiple retailers. In their article they state that when it comes to a retail monopoly, manufacturers can avoid interbrand competition by selling at cost and incorporate a fixed fee as exchange. This is based on the work of Bernheim and Whinston, and O'Brien and Shaffer, and Vergé and Rey summarize it as follows:

[81] Thibaud Vergé and Patrick Rey "Resale Price Maintenance and Interlocking Partnerships", Journal of Industrial Economics p. 929.
[82] Ibid, p. 930

> "*..since manufacturers internalize through fixed fees the impact of prices on the retailer's profit, eliminating the upstream margin on one brand transforms a rival manufacturer into a residual claimant on the sales of both brands. As a result, the rival manufacturer has an incentive to maintain retail prices at the monopoly level, which it can achieve precisely by supplying at cost. Simple two-part tariffs therefore suffice to maintain monopoly prices and profits."*[83]

When there are more than one retailer involved, the situation changes since the intra-brand competition has a clear effect on the retailer's margins. This is where we start to approach the core of Verge's and Rey's article. The industry always wants to maximize their profit and there are two large incentives for the manufacturers to consider: if they want to maximize their sales in this situation, they want to keep low upstream margins to avoid interbrand competition or but also keep the wholesale price up to maximize profit.[84]

Rey and Vergé shows that two-part tariffs no longer is sufficient to maintain monopoly prices but brings forth the new tool, two-part tariffs in combination with RPM. Through this, they show that manufacturers can give eachother incentives to keep retail prices high effectively eliminating both intra- and interbrand competition despite the fact that no multilateral agreement exists. They state that this mechanism has a unique effect that is unprecedented in other vertical restraints such as territorial restrictions. This is since restriction such as territorial ones may have adverse effects for the manufacturer due to retailors differentiation strategies. These specializations can make it undesirable for the manufacturer to exclude retailors on a territorial basis but this does not limit the positive effects of RPM which even with this in regard, would able manufacturers to eliminate intra-brand competition.[85]

4.4 RPM in Regard to Consumer Welfare – a Positive Side?

In contrast to the previous chapter, it must be said that despite the animosity often shown towards RPM, there are many who are advocating for its positive effects on competition, especially in regards to consumer welfare. Regardless how eloquent and solid a case Rey and Vergé makes against RPM, their theory still only shown a small part of the effects the utilization

[83] Ibid, p.930
[84] Ibid, p.930
[85] Ibid, p.930

of a tool such as RPM can have. There are an equal amount of theories regarding the positive aspects of RPM.

4.4.1 Borks Argument

The theory of welfare put forth by Bork, which is explained above, states that RPM has the possibility to be advantageous for competition since it can affect customer welfare positively. According to Bork, RPM can be used to increase welfare through increased services, innovations and other factors. This theory as well as the image theory are based on consumer interests and put this factor as the most important part in competition law. However, the theory presumes that producer interests and the interests of the consumer are the same, which has been criticized[86.] He continues to claim that there is an increase in competition through an increase services due to RPM, which then causes consumer demand to surge and, therefore, he concludes that RPM is *"highly pro-competitive and enhance[s] consumer welfare by stimulating inter-brand rivalry"*.[87]

Borks theory of welfare effects is based on an assumption that consumers make their choice also based on non-price aspects, for instance extra services – and with this he means that the more services a market entity can provide, the consumers will buy more or at least it will create an interest of buying the product – and that RPM is a good aid in to increase the availability of such aspects (services). Though, in reality, this does not motivate all potential buyers, many are still interested in such aspects as price and perhaps mainly this. Furthermore Bork states that consumer welfare is the only really important aspect to consider.

Borks argument is based upon that put forth by Telser and this will be explained below in chapter 4.4.4. Borks part in this is that he decisively connects RPM and Telsers service theory with consumer welfare as he interprets it.

4.4.2 Posners Argument

Posner was one of the advocates for a removal of the per se illegality of resale price maintenance in the US, before the change with Leegin. It was Posners view that a presumption of legality was the right path regarding the practice.[88] He counters the cartelization argument calling RPM an ambiguous sign of a cartel - what RPM shows is only that a manufacturer is seeking to further his own end by controlling the resale price. According to

[86] Pitofsky, "In Defense of Discounters" 1491
[87] R. H. Bork, "The Rule of Reason and the *Per Se* Concept: Price Fixing and Market Division"
[88] Richard A. Posner, Antitrust Law, Second Edition, p 4

Posner there is no empirical nor theoretical evidence that can declare RPM as generally anticompetitive as one could say the EU has done by labelling it as a hardcore restriction.[89]

4.4.3 Marvels Argument

Marvel argued for the procompetitive aspects of RPM during the 80s and 90s before the overturned per se illegality in Leegin. His most notable work and most suitable for this thesis is The Welfare Effects of Resale Price Maintenance in the *Journal of Law and Economics*. In this article, he compares the effects of per se illegality with per se legality to see which would prove least detrimental to consumer welfare. Even if the case in the EU is not a choice between per se legality or illegality, Marvels analysis and statements regarding the positive effects of RPM are still valid when discussing the presumption of illegality in the EU.[90]

Marvel concedes that RPM can facilitate collusion but in a vast majority of cases is a symptom rather than the cause. However, despite the fact that RPM can and has been used by monopolies and suspected monopolies, Marvel wishes to show us that the total effect on competition is positive, and that theorists such as Vergé and Rey are disproved by empirical evidence.

Marvel begins with the classical procompetitive argument put forth by Telser in the 60s, the theory of service, which also was incorporated in Borks argumentation on a positive effect on consumer welfare. This theory will be presented below along with Telsers other arguments for the procompetitive effects of RPM. Telser gives some empirical examples on which Marvel continues as a starting point of his article, namely the trusts in the factor system.[91] Through this Marvel wants to disprove the argument that resale price maintenance is used to induce retailer loyalty and through this create an entry barrier for new parties. Marvel presents a couple of examples of these trusts that used RPM and shows that no entry barriers were established. In all cases, a new company, even one taking up a very small part of the market, was able to penetrate the market successfully.[92] Marvel continues by stating that even if RPM is present and contributing to a cartel's stability, that itself does not constitute a reason to treat the practice itself with hostility. Furthermore, in Marvels view, one that is shared by the

[89] Richard A. Posner, Antitrust Law, Second Edition, p 189
[90] *Marvel*, "The Welfare Effects of Resale Price Maintenance", *Journal of Law and Economics, , p 367.*
[91] These "Trusts" created a system in which a wholesaler a sort of commission agent for the manufacturer. The difference from an ordinary agency was that the agent paid for the products as if they had been purchased and received at the end of the salesperiod a discount if the wares had been sold at the resale price specified by the Trust.
[92] *Marvel* , "The Welfare Effects of Resale Price Maintenance", *Journal of Law and Economics, , p 367.*

author, the presumption of illegality that exists in the EU with the possibility of rebuttal, is in practice very close to per se illegality due to the difficulties to prove such efficiency gains that are required. However, he also notes that it would prove equally difficult to have a reversed burden of proof, and this is because the existence of such anticompetitive effects that would be needed to be shown, is very rare. [93]

4.4.4 Telsers Argument

Telser was one of the Chicago School economists that during the 60s and 70s and is the creator of the "theory of services". Telser published in 1960 the article " Why Should Manufacturers Want Fair Trade?" in the Journal of Law and economics. In his article, Telser investigated resale price maintenance and the motivation for a manufacturer to utilize this tool. Telser begins by stating that the issue of RPM is one that has puzzled economists for quite some time. Why would a manufacturer want to eliminate price competition from the equation? Do not the manufacturers have most to gain through a maximized number of sales?[94]

Telsers put forth the service theory, which was later used and developed by economists such as Bork and Marvel. This theory is based on the notion that the manufacturer strives to create intra-brand competition by creating an increase of service surrounding the product. He illustrates this way of maintaining sales quantity with an increased retail price through the figure below. D_0 represents the demand with no increase in service present and D_1 represents the demand while extra service, made possible through RPM, is available. Through the increase in service, Telser concludes that an increase in service creates an increase in demand and therefore creates the shift from D_0 to D_1. An increase in demand makes the sales quantity less sensitive to an [95] increase in price as shown below.[96]

[93] Howard Marvel, "Resale Price Maintenance and the Rule of Reason", p 2
[94] Lester G. Telser, "Why Should Manufacturers Want Fair Trade?" *Journal of Law and Economics*, Vol. 3, (Oct., 1960), pp. 86-87
[95] Ibid, p 90
[96] Ibid, p 89

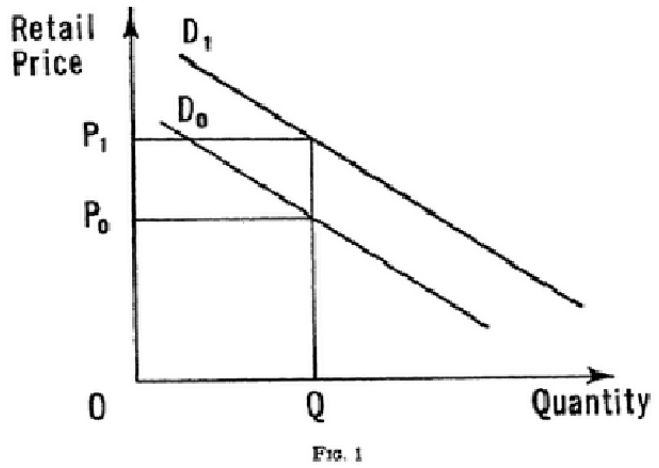


FIG. 1

Through this, Telser shows that the service argument is valid as a reason for a manufacturer to use RPM to increase retail prices. The service theory is based on the notion, previously mentioned by Bork, that consumers take other factors than price into account when making a purchase. The manufacturer might want to make the product appealing to a certain group of consumers and can do so by encouraging an increase in service. The problem with moving intra-brand competition from price to service is that the manufacturer needs a method of control. Otherwise one retailer could lower retail prices and be what is known as a "free rider" on the other retailers marketing and services.[97] This is where RPM could be used to control the retailers and create an incentive to compete on other areas than price.

Telser concedes that RPM indeed can be used to sustain a cartel and that the use of this practice by a cartel presents problems.[98] However, as we will see below, new research shows that the cartelization argument might be flawed.

4.4.5 The Anti-Collusive Effect of Resale Price Maintenance

In recent years, economists have even begun to theorize and experiment with the fact that RPM might even have an anti-collusive effect. Economists Martin Dufwenberg, Uri Gneezy, Jacob Goeree and Rosemarie Nagel carried out an experiment in which they tested the effects of implementing a price floor in regard to the joint profits. They found that rather than having the traditional thought that minimum RPM created higher joint profits for competitors, the answer was the opposite – a price floor actually reduced the joint profits for competitors showing that in theory, RPM might be a tool to facilitate collusion but in practice, it has an adverse effect on the joint competitors.[99] An excerpt from their abstract can be found in footnote 72.[100]

[97] Lester G. Telser, "Why Should Manufacturers Want Fair Trade?" *Journal of Law and Economics*, Vol. 3, (Oct., 1960), p 91
[98] Ibid, p 98
[99] *"A potential source of instability of many economic models is that agents have little incentive to stick with the equilibrium. We show experimentally that this may matter with price competition. The control variable is a price floor, which increases the cost of Deviating from equilibrium. Theoretically the floor allows competitors to obtain higher*

Regarding to pricing, they also conclude that:

"From the viewpoint of traditional theory, the introduction of price floors in Bertrand models protect competitors from making low or zero profits, and should thus be anti-competitive. With our experiment we have shown that the opposite can be true: the presence of a price floor fostered competition and can lead to more competitive pricing."[101]

This contradicts the traditional viewpoint, that RPM is beneficial for a cartel. This might be hard to comprehend for one not too experienced in economics and it is this notion in combination with the theories above that will lead us to the conclusions of this thesis.

4.5 Curing the Disease by Attacking the Sypmtoms

As Rey and Vergé stated, the cartelization argument has been the go to excuse for the negative attitude towards RPM in the EU. When used by cartels even advocates for the procompetitive side of RPM such as Marvel concedes that it has a negative effect on welfare.[102] However, there seems to be a consensus in the economic literature regarding the positive side of RPM that even though RPM is a practise that can maintain a cartel, by itself, it does not create a cartel. Despite this, there seems to be a fear of RPM regarding this very aspect. Looking at the different theories one can discern that the existence of RPM can be a sign of a cartel, but this is not so conclusive that it can be established as a rule. As shown above, RPM can be used in non-cartel circumstances and even provide positive effects on competition. What one must realize is that RPM is a symptom of a cartel and not the opposite. Cartelization is the main problem that the regulators want to attack and they do so by restricting anything with a correlation to cartels rather than going after the main issue itself.

That cartelization is a problem and not something that can be easily defended regarding its effects on competition is something most economists

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profits, as low prices are excluded. However, behaviorally the opposite is observed; with a floor competitors receive lower joint profits. An error model (logit equilibrium) captures some but not all the important features of the data. We provide statistical support for a complementary explanation, which refers to how "threatening" an equilibrium is. We discuss the economic import of these findings, concerning matters like resale price maintenance and auction design.", Price Floors and Competition, Martin Dufwenberg, Uri Gneezy, Jacob K. Goeree, and Rosemarie Nagel, 2002, Abstract

[100] Price Floors and Competition, Martin Dufwenberg, Uri Gneezy, Jacob K. Goeree, and Rosemarie Nagel, 2002, p1.

[101] Ibid, p 16.

[102] *Marvel,* "The Welfare Effects of Resale Price Maintenance", *Journal of Law and Economics, p 378*

and lawyers would agree upon. The question is if we really are to limit the market from potential tools that could be of benefit. The empirical evidence when it comes down to the effects of RPM is not abundant and one could argue that in the pursuit of cartels RPM has been unjustly swept along.

Throughout the thesis we have seen a side of RPM that might seem alien to a lawyer in the EU. As seen above, the European hostility towards the practice might have lessened during the last two decades but the view of RPM as detrimental to competition and consumer welfare still stands with the presumption of illegality. In the authors view, the lack of a strong economic advocate, similar to the Chicago school, has made the development much slower, in an economic sense, driven mainly by politicians and lawyers even though cooperation with economists has existed e.g. in the developments of the public documents surrounding Article 101.[103] To summarize, what one can discern from the theories above regarding RPM is that the role it plays in the market is quite ambiguous.

[103] Robert O'Donoghue and Jorge Padilla, The Law and Economics of Article 102 TFEU, p 62

5 Conclusion

The questions this thesis sought to answer was which status consumer welfare has in European competition law and how RPM interacts with it. Throughout the thesis the author has established a solid role for consumer welfare within competition law. It does not have the status that it has in the US antitrust system but is still very present, especially at a practical level.

Regarding the second posed question, the author has found is that the current legal framework surrounding RPM is not up to date with the economic theories in this area. Even though the analysis under 101(3) might contain elements of the balancing in the Rule of Reason doctrine the fact still stands that RPM is regarded as anticompetitive. Even if one can argue that the efficiency defense under 101(3) is enough to conduct a thorough economic analysis, we have seen above regarding consumer welfare, that in practice, the Commission conducts any discussion behind locked doors and can in these, apply their own opinions. While there might exist an equal amount of economists that argue for the anticompetitive effects of RPM it is the authors view that what one can derive from this is that the nature of RPM is truly ambiguous and this should motivate a more balanced approach toward the practice. The use of RPM can indeed be anticompetitive but in the authors view this does not, in any way validate a presumption of illegality. Therefore the status of RPM as a hard core restriction should be removed and thereby create more equal burden of proof.

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