



**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS  
COMPETITION COMMITTEE**

**ROUNDTABLE ON RESALE PRICE MAINTENANCE**

**-- Note by the European Commission --**

*This note is submitted by the European Commission to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 21-23 October 2008.*

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## Introduction

1. In EC law resale price maintenance (hereinafter "*RPM*") refers to agreements or concerted practices having as their direct or indirect object the establishment of a fixed or minimum price or a fixed or minimum price level to be observed by the buyer. In the case of contractual provisions that directly establish the resale price, the restriction is clear cut. However, RPM can also be achieved through indirect means such as, for instance, fixing the distribution margin or the maximum level of discount the distributor can grant from a prescribed price level<sup>1</sup>.

2. This submission explains the current treatment of RPM in the EU (I) and the *rationale* for such treatment (II). Finally, some leading cases on RPM are also briefly discussed (III).

### 1. The Current Treatment of RPM in the EU

#### 1.1 *RPM in the framework of the Commission's effects based approach*

3. The current EU block exemption regulation applicable to vertical agreements (hereinafter "*the Regulation*")<sup>2</sup> forms a package with the guidelines on vertical restraints (hereinafter "*the Guidelines*"). This package was the first of a new generation of block exemption regulations and guidelines inspired by a more economic and effects-based approach. The Regulation and the Guidelines are based on the idea that for a proper assessment of a vertical agreement it is necessary to analyse its likely effects on the market, both negative and positive. In general, an effects-based approach implies that likely effects have to be assessed both for the application of Article 81(1) EC, where the Commission must show that the agreement in question has actual or likely negative effects, and for the application of Article 81(3) EC, where the firm must show that the agreement causes actual or likely positive effects, which then have to be weighed against the negative effects.

4. In addition to such an individual effects-based assessment of a specific agreement there is the particular European technique of the block exemption. For vertical agreements the Regulation provides for a "safe harbour" (block exemption) on condition that the market share of the supplier does not exceed 30%. Below this threshold it is presumed that vertical agreements will either not have negative effects or, if they do, that the net balance will be positive. However, the Commission can withdraw the benefit of the block exemption regulation for the future if the negative effects resulting from a particular agreement are not outweighed by its positive effects, but below the market share threshold such a negative balance is considered unlikely and withdrawal decisions are thus rarely taken in practice<sup>3</sup>.

5. The benefit of the block exemption does not, however, extend to agreements containing a so called "*hardcore restriction*", and RPM is one of the hardcore restrictions listed in Article 4 of the Regulation. To be precise, an agreement as a whole cannot benefit from the block exemption if it requires the buyer to fix, or prevents the buyer from reducing, its resale price. It can, however, benefit from the

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<sup>1</sup> For more examples of practices treated as RPM by the Commission see Commission Notice Guidelines on Vertical Restraints [2000] OJ C 291, 1–44, point 47

<sup>2</sup> Commission Regulation (EC) 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices [1999] OJ L 336, 21–25.

<sup>3</sup> See the Guidelines Section IV "Withdrawal of the block exemption and disapplication of the block exemption regulation", points 71-87

block exemption where a maximum resale price is imposed on the buyer or where a particular resale price is only recommended, provided that the maximum or recommended price does not amount to a fixed price as a result of pressure from or incentives provided by the supplier or buyer<sup>4</sup>.

## 1.2 *Consequences of including RPM in an agreement*

6. As referred to above, the direct consequence of including RPM in an agreement is that the agreement cannot benefit from the block exemption. In addition, the Commission will presume that the agreement as a whole will have actual or likely negative effects. It is also considered that RPM is unlikely to have positive effects or that, where efficiencies are likely to result, these will not be passed on to consumers and/or that RPM is not indispensable for creating these efficiencies. In other words, in addition to the presumption of negative effects, there is also a presumption that the agreement will not fulfil the conditions of Article 81(3) EC<sup>5</sup>. Moreover, if the agreement does not fulfil the conditions of Article 81(3) EC, it is in principle void and unenforceable under Article 81(2) EC<sup>6</sup>. Lastly, there is a considerable chance that the Commission will impose a fine.<sup>7</sup>

7. However, the above does not mean that there is a "*per se*" prohibition of RPM. Article 81(3) EC can in principle apply to an agreement containing RPM. This means that it is always possible for the firm in question to come forward with substantiated claims that the RPM will bring about efficiencies. The moment that the firm brings forward convincing evidence of efficiencies, the Commission, in order to apply the hardcore rule, will be forced not only to investigate the claimed efficiencies, but also to show the likely or actual negative effects. If the efficiencies outweigh the negative effects, and the other conditions of Article 81(3), such as the indispensability test, are also fulfilled, the agreement is not prohibited<sup>8</sup>.

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<sup>4</sup> The text of Art 4 of the BER concerning RPM reads: "*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 . . .*"

<sup>5</sup> See the Guidelines, point 46

<sup>6</sup> See ECJ, 11/09/2008, *CEPSA Estaciones de Servicio SA v. LV Tobar e Hijos SL*, case C-279/06; points 75 and 78-79. The ECJ has held that an RPM clause cannot be block exempted and individual exemption under article 81(3) EC is "unlikely". It was for the national court to decide whether the conditions for an individual exemption are fulfilled. If those conditions are not fulfilled, the agreement is automatically void under article 81(2) EC. Furthermore, it is a matter of national law of the EU Member States to ascertain whether the RPM clause can be amended by unilateral authorisation of the supplier and whether a contract which is automatically void may become valid following an amendment of that contractual clause which has the effect of bringing that clause into line with Article 81(1) EC. Moreover, the ECJ has stated that the automatic nullity of an agreement applies only to those parts of the agreement which are affected by the prohibition laid down in Article 81(1) EC or to the agreement as a whole if it appears that those parts are not severable from the agreement itself. If those parts are severable from the agreement, it is not a matter of Community law to decide on the consequences of the nullity for the remaining parts of the agreement.

<sup>7</sup> See Section III of this submission dealing with the leading cases on RPM

<sup>8</sup> See the Communication from the Commission Notice—Guidelines on the Application of Article 81(3) of the Treaty [2004] OJ C 101, 97–118, points 17–27 and 40–47

## **2. Rationale for current treatment of RPM in the EU**

8. The EU hardcore approach is based on two rebuttable presumptions, as described before, which, at the time the Regulation was adopted in 1999, were considered to ensure an efficient enforcement policy towards RPM under Article 81 EC. This approach can be justified to the extent that it was thought that - on the balance of probabilities - RPM leads very often to negative effects in the market.

### **2.1 Rationale for presumption of negative effects under Article 81(1) EC**

9. RPM leads or can lead in general to the following negative effects: prevention of a direct price decrease (1); collusion between suppliers and/or buyers (2); lower pressure on the margin of the manufacturer (3).

10. First, RPM generally leads to a reduction in intra brand price competition<sup>9</sup>. The immediate effect of RPM will be that for a particular brand all or certain distributors are prevented from lowering their sales price. In other words, the direct effect of RPM is a price increase. If this were not the case, the agreement would be ineffective. Moreover, by preventing price competition between different distributors, RPM may hinder new retailers from entering the market with low prices. It may for instance hinder the entry of distribution formats based on low prices, such as price discounters. This may reduce dynamism and innovation at the distribution level.

11. Secondly, RPM generally leads also to an increased transparency on prices<sup>10</sup>. Therefore, RPM may facilitate collusion between suppliers by enhancing price transparency in the market, thereby making it easier to detect whether a supplier deviates from the collusive equilibrium by cutting its price. RPM may also undermine the incentive for the supplier to cut its price to its distributors, as the fixed resale price will prevent it from benefiting from expanded sales. It will in general be necessary for the plausibility of such a scenario of collusion that the suppliers form a tight oligopoly and that RPM is applied by all or many of them.

12. By eliminating intra-brand price competition, RPM may also facilitate collusion between the buyers, at the distribution level. Strong or well-organised distributors may be able to force/convince one or more suppliers to fix their resale price and thereby help them stabilise a collusive equilibrium. This loss of price competition seems especially problematic when the RPM is inspired by the buyers, whose collective horizontal interests can be expected to work out negatively for consumers.

13. Moreover, it is recognised that a manufacturer will normally have an interest in ensuring that its distributors compete fiercely, thereby lowering their costs and margins and increasing the sales of the manufacturer. However, the manufacturer generally prefers this competition not to be so fierce that it also starts to put pressure on its own margins. In other words, fierce downstream competition may mean that important buyers will demand lower purchase prices. Such pressure may be more effective where the manufacturer has a commitment problem, (i.e. where the supplier has an interest in lowering the price charged to subsequent distributors). In such a situation, the manufacturer may prefer to agree to RPM, so as to reduce the pressure on its own margin and help it to commit to not lowering the price for subsequent distributors.

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<sup>9</sup> See the Guidelines, point 112

<sup>10</sup> See the Guidelines, point 112

## 2.2 *Rationale for unlikelihood of exemption under Article 81(3) EC*

14. It is often argued that RPM can lead to the following positive effects: RPM allows distributors to increase promotion (1) and helps entry into new markets (2).

15. The first efficiency argument often mentioned in favour of RPM is based on the idea that, in a market with competing distributors, a “free rider” problem may reduce the incentive of distributors to promote the manufacturer’s product. Each distributor fears that its promotion efforts will not just benefit its own sales, but also the sales of its rivals. As a result, the distributors collectively invest at a sub-optimal level in the promotion of the manufacturer’s brand. It is argued that RPM could solve the problem by ensuring the distributors a better margin and by taking away the risk of price cutting by rivals, thereby enabling them to make sufficient funds available for promotion.

16. RPM may indeed provide the distributors with the necessary extra profits to invest in promotion, as reflected by the resulting higher resale price, but it does not provide the incentive to actually spend this extra profit on promotion. RPM does not take away the underlying “free rider” problem. Instead of using the extra margin for promotion, a distributor will in practice prefer to invest in other means of attracting customers such as offering lower-priced after-sales services or lowered prices achieved through bundling. Since RPM may not lead to extra promotion, or will do so only to a limited extent, it is not an efficient instrument for obtaining the desired efficiency. Other vertical restraints, such as providing exclusive territories, will often be much better equipped to solve the free riding problem. If, for instance, exclusive distribution is combined with imposing a maximum resale price, the efficiencies may be obtained without leading to unnecessary price increases<sup>11</sup>.

17. The second efficiency argument often mentioned in favour of RPM is that it may help a manufacturer to introduce a new brand or enter a new market. Where the introduction of a brand requires specific investments by the first distributor to develop the market and make the brand known, other distributors which start distributing this brand later may free ride on the initial investments of the first distributor. In that context, it is argued that by introducing a price floor, RPM may prevent later distributors from decreasing their price and so make it possible for the first distributor to recover its costs related to the introduction of specific investments.

18. This argument could indeed justify deviating from the hardcore approach for the launching of a new brand or for entry into a new market. This rationale has been recognised in the Guidelines on Vertical Restraints<sup>12</sup> and also in the Block Exemption Regulation for Technology Transfer Agreements for entry into a new market<sup>13</sup>, where certain restrictions on passive sales (in this case sales to customers located in

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<sup>11</sup> As a side remark, it can be questioned whether the extra promotion would be in the overall interest of consumers. Even in the case of a genuine “free rider” problem, it may be only the marginal (new) consumers which benefit from the extra promotion, but not the possibly larger group of infra-marginal (experienced) consumers which already know what they prefer, which do not benefit from the extra promotion and for which the extra outlays and the RPM only result in a price increase. However, this point is not exclusively linked to RPM but holds also for other vertical restraints.

<sup>12</sup> See the Guidelines on Vertical Restraints, Section 1.3 on the “General rules for the evaluation of vertical restraints”, point 119, and in particular 10) thereof

<sup>13</sup> Commission Regulation (EC) 772/2004 of 27 April 2004 on the application of Article 81(3) of the Treaty to categories of technology transfer agreements [2004] OJ L 123, 11–17, in particular Art 4(2)(b)(ii). See also Commission Notice—Guidelines on the application of Article 81 of the EC Treaty to technology transfer agreements [2004] OJ C 101, 2–42, in particular point 101

the new exclusive territory by distributors located in other territories), which are normally considered a hardcore restriction, fall within a "safe harbour" for the first two years after entry into the market. However, this is not a justification to allow hardcore restrictions for a long period, or more in general for existing markets and for established brands. Lastly, it can be questioned whether RPM is an efficient instrument for addressing this specific potential "free rider" problem. Instead of preventing price competition between all distributors, it may be more beneficial for the consumers, if the manufacturer rewards the investments made by the first distributor through a lump sum payment or by selling the product temporarily at a lower price to this distributor than to the other distributors. In this way, entry can be stimulated without limiting price competition at the distribution level.

### 3. Leading cases on RPM

19. Since the entry into force of the Regulation in 1999 the Commission has adopted 5 decisions on RPM. In all of these cases it was decided that RPM clauses could not benefit from the block exemption and/or the individual exemption under Article 81(3) EC.

20. In 2000, the Commission adopted a decision concluding that JC Bamford (JCB) violated Article 81 EC by entering into restrictive distribution agreements for construction and earthmoving equipment<sup>14</sup>. The restrictions consisted of limiting cross border parallel trade and fixing minimum resale prices at the wholesale level. JCB either occasionally set retail prices of its distributors or agreed with its distributors on the principle of uniform discounts granted to their retailers. The Commission considered the JCB's infringements as "very serious" and imposed a fine of 39,6 MEUR. In its ruling the Court of First Instance (hereinafter "*the CFI*") annulled in 2004 the Commission's findings in relation to RPM, and partially those in relation to restrictions on parallel trade. The CFI ruled that the retail sale price scales, although strongly indicative, were none the less not binding. This is because JCB's efforts to influence dealers in their fixing of resale prices involved a too low level of coercion<sup>15</sup>. JCB has appealed the CFI judgment, but the Commission has not cross appealed the findings of the CFI in relation to RPM<sup>16</sup>.

21. In 2000, the Commission adopted a decision concluding that the French company Editions Nathan violated Article 81 EC by entering into restrictive distribution agreements concerning educational material for young children in several Member States<sup>17</sup>. Nathan Editions prevented its exclusive distributors located in Italy, Sweden and Belgium from marketing Nathan products outside their own exclusive territories (more particularly in France) and restricted their freedom to set prices by preventing those distributors from granting larger discounts than those granted by Nathan Editions to its distributors in France. Given that the implementation of the infringement was not systematic, it was considered to be only as "minor". A 60000 EUR fine has been imposed on Nathan Editions.

22. In 2001, the Commission adopted a decision concluding that Volkswagen violated Article 81 EC by sending several circular letters to its German dealers, urging the dealers not to sell the new "Passat" car model at a price considerably below the recommended resale price and/or to limit or not to grant discounts to customers<sup>18</sup>. The infringement was considered as "serious" and not as "very serious" since some dealers

<sup>14</sup> Case COMP.F.1/35.918 *JCB*, 21/12/2000 (OJ L69/01; 12/03/02)

<sup>15</sup> CFI, 13/01/2004, *JCB Service v. Commission*, Case T-67/01, points 121-133

<sup>16</sup> ECJ, 21/09/2006, *JCB Services v. Commission*, Case C-167/04 P

<sup>17</sup> Case COMP.F.1/36.516 *Nathan-Bricolux*, 05/07/2000 (OJ L54/01; 23/02/2001)

<sup>18</sup> Case COMP/F-2/36.693 *Volkswagen*, 26/06/2001 (OJ L262/14, 02/10/2001)

did not follow the instructions of Volkswagen. The Commission imposed a 30,95 MEUR fine on Volkswagen. Subsequently, the Commission's decision has been annulled by the CFI on the grounds that it did not establish the existence of an explicit or tacit acquiescence by the dealers of the supplier's policy, in order to prove an antitrust agreement<sup>19</sup>.

23. In 2000, B&W Loudspeakers notified<sup>20</sup> a selective distribution network for its products requesting clearance under Article 81 EC<sup>21</sup>. The Commission found that the notified agreements contained several hardcore restrictions of competition, namely RPM disguised as a prohibition on "bait pricing"<sup>22</sup>; restrictions on cross supplies between authorised dealers and a prohibition on sales over the Internet. The Commission issued a comfort letter in 2002 only when the company agreed to delete those hardcore provisions, including the one on RPM.

24. In 2003 the Commission adopted a decision concluding that Yamaha violated Article 81 EC by entering into distribution agreements aimed at partitioning the markets for the provision of traditional and electronic musical instruments and equipment in Europe<sup>23</sup>. The restrictions implemented by Yamaha consisted of preventing parallel imports and fixing minimum resale prices for some of those distributors who engaged in parallel imports. The territorial and price restrictions had the common denominator of insulating national markets and ensuring different price levels within the EU. However, those restrictions were included in a limited number of agreements and were sometimes applied to only a limited number of dealers. Moreover, it appeared that those restrictions had not been implemented in full and the Commission had no evidence of their substantial effects. Therefore, the infringement committed by Yamaha was considered as "serious" and not as "very serious". A 2.56 MEUR fine was imposed on Yamaha.

25. The decisional practice of the Commission is supported by the jurisprudence of the European courts even though the CFI annulled in two cases (i.e. JCB and Volkswagen) the Commission's findings in relation to RPM. In those cases the Commission was sanctioned for not adducing sufficient evidence to show an RPM agreement rather than for unlawful competitive assessment of RPM.

26. As far as the competitive assessment is concerned, it is well established case law that RPM amounts to a restriction of competition by object (i.e. a hardcore restriction)<sup>24</sup>. Furthermore, in two recent preliminary rulings under Article 234 EC the ECJ has stated that the application of the block exemption is precluded if the contract concluded between two undertakings (in these cases an exclusive purchasing

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<sup>19</sup> CFI, 03/12/2003, Volkswagen AG v. Commission, Case T-208/01 confirmed by ECJ, 13/07/2006, Commission v. Volkswagen AG, Case C-74/04 P

<sup>20</sup> The first Regulation implementing articles 81 and 82 of the Treaty (Regulation 17/62 OJ [1962] 13/204) created a notification and authorisation system whereby undertakings had to notify agreements to the Commission in order to benefit from the exemption under Article 81(3) EC. The second Regulation implementing Articles 81 and 82 of the EC Treaty (Regulation 1/2003 OJ [2003] L1/1) abolished this system in 2004.

<sup>21</sup> Case IV/C-3/37.709 *B&W Loudspeakers Ltd*, 24/06/2002 (press release); IP/00/1418

<sup>22</sup> "Bait pricing" relates to the practice of offering certain products at a very attractive price with the aim of attracting customers to the sales outlet

<sup>23</sup> COMP/37.975 *PO/Yamaha*, 16/07/2003, not published

<sup>24</sup> See ECJ, 03/07/1986, *SA Binon & Cie v. SA Agence et Messagerie de la presse*, Case 243/83, point 44

agreement for petroleum products between a service-station operator and an oil company) contains a clause providing for the fixing of the retail price by the supplier<sup>25</sup>.

#### **4. Conclusion**

27. Current case law and practice in the EU towards RPM can only be understood from the perspective of application of the hardcore approach based on two rebuttable presumptions (i.e. of likely negative effects of RPM and unlikelihood of individual exemption). The current treatment of RPM in the EU can be explained by the assumption that the efficiency arguments mentioned in support of RPM are not very strong and that RPM is not an efficient instrument for bringing about efficiencies. However, this was the view of the Commission at the time it adopted the Regulation and Guidelines and does not preclude that further analysis may be needed to achieve again a balanced opinion, useful for policy formulation towards RPM. The review of the Regulation and Guidelines, necessitated by the expiry of the Regulation on 31 May 2010, has recently started. It will be an open process, taking into account new developments of the case law, the enforcement practice and economic theory and will offer ample opportunity for all parties to comment on the current rules and practice, in general and in relation to RPM.

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<sup>25</sup> See ECJ, 11/09/2008, *CEPSA Estaciones de Servicio SA v. LV Tobar e Hijos SL* quoted in footnote 5 above, point 64 and ECJ, 14/12/2006, *Confederation Espanola de Empresarios de Estaciones de Servicio v Compañía Española de Petróleos SA*, Case C-217/05, point 64