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Minimum Resale Price Maintenance Agreements - and the Dilemma Continues

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Economics, as an important tool of interpreting competition law principles gained momentum by the emergence of Chicago School economics in 1960-70's. It not only led to over-ruling of age-old established principles of competition law but elevated the 'efficiency' criterion as the chief decisive factor in evaluating anti-competitive effects of any conduct. The treatment accorded to vertical restraints underwent a major change during this phase and their ability to enhance consumer welfare started attracting appreciation. However, in spite of many countries (especially US) following this more liberalized approach towards vertical restraints, some countries continued to remain in dilemma and adopted strict penalization approach instead. The paper analyses one such case of vertical restraint—Minimum Resale Price Maintenance (RPM)—and inquires whether the strict penalization of such conduct by various countries is well deserved. The paper illustrates how EU, on one hand moved towards a 'more economic approach' by adoption of the guideline on the TFEU (Treaty on the Functioning of the European Union), but on the other hand retains its stand of treating some vertical restraints as hard core restraints without any exemption or exception available. RPM agreements are (and were) considered anti-competitive as it is an established position, both in law and economics, that they destroy 'intra-brand price competition'. This paper, however, proclaims that 'intra-brand price competition' at the distributor's level is neither required nor is welfare enhancing. Rather, the minimum RPM agreement actually fosters the real competition among retailers/distributors by shifting their focus from illusionary price competition to the competition based on 'services' (pre/post sale). The paper elucidates how, at times, the non-price competition can be more welfare enhancing than the price competition. The paper concludes that in case of some goods, 'Experience Goods' at least, minimum RPM can be welfare enhancing.

> 'A major source of objection to a free economy is precisely that it gives people what they want instead of what a particular group thinks they ought to want. Underlying most arguments against the free market is a lack of belief in freedom itself.'[1]

INTRODUCTION

The importance of applying economics in interpreting the principles entrenched in competition law has become inevitable in the last few decades. The emergence of the Chicago School of economics in the 1960s-70s led to jurisprudence which encouraged economics as the basic premise of antitrust decisions in the US. Quite interestingly,

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[1] Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962), pp. 7-17.

during that period the US courts expressly overruled some of its earlier celebrated decisions where economics principles were thrown out of the courts in pursuit of achieving 'other' ends of antitrust law. One of the major reasons why economics was often ignored in competition law in the US and Europe until the 1970s was a belief that other goals, apart from economics, were more important. The goals that were considered more important were, among others, promoting and protecting small business, promoting competitive processes where everyone had a 'fair go', distributional goals, and promoting economic integration (especially in the EU).[2] It is reasonable and understandable that each jurisdiction adopts an optimum mix of regulation and competition after gauging its socio-economic growth and devises the best national competition policy to guarantee the best rights and lives to its citizens. Indian Competition Law[3] also strives to attain the basic economic objective of efficiency by blending it with distributive social objectives as has been laid down in the Directive Principles of State Policy (DPSP) of the Constitution of India. Article 39 of the Constitution specifically talks about ensuring social justice with economic growth and regulating concentration of economic power to the common detriment.[4]

This, however, becomes problematic when the assessment by the policy makers or the understanding of market functions is ill premised. Sometimes the pursuit of protecting consumers and over-regulating market forces does more harm than good. The advocates of free markets argue that these free market forces are capable of correcting almost all defaults which regulation seeks to cure. The concept of 'invisible hands' proposed by Adam Smith in his famous writings also re-enforced this view in following words:

> 'By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for society that it was no part of it. By pursuing his own interest [an individual] frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the [common] good.'[5]

The evolving literature on the Chicago School of economics provided the much awaited and desired momentum to the importance of economic principles in understanding the market behaviour. The Chicago School economists emphasized that whatever exists in the marketplace exists because it is efficient unless it has been put

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[2] Dr Robert Ian McEwin, Competition Law and Economics, power point series for class lectures.

[3] Indian Competition Act, 2002, available at http://cci.gov.in/images/media/competition_act/act2002.pdf?phpMyAdmin=QuqXb-8V2yTtoq617iR6-k2VA8d

[4] Amitabh Kumar, 'The Evolution of Competition Law in India', in Vinod Dhall (ed), *Competition Law Today—Concepts, Issues and the Law in Practice* (New Delhi: Oxford University Press, 2007), pp 480-81.

[5] Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, (London: Methuen and Co., Ltd., 1904. Edwin Cannan, ed. First published 1776).

there by government fiat.[6] They argued that allocative efficiency and consumer welfare should be the only goal of competition law and also believed that markets are self-correcting because chiselling erodes cartels, and entry erodes monopoly, quickly, unless the government intervenes to create barriers to entry and the expansion of fringe firms.[7]

The strongest legitimate explanation for the growing importance of economics in interpreting competition law, by most countries in the world, is its basic objective. Competition law seeks to govern ethical behaviour in the market where, ideally, producer of goods and services compete with each other. The primary economic rationale of competition law is efficiency creation that results in price reduction and thereby enhances consumer welfare. It is understood competition between the actors of production ensures that a firm has an incentive to find newer and better ways of reducing cost; otherwise, someone else will reduce their cost of production and take the market away from them. Therefore, this unending struggle between the competing producers ensures that prices of the products/services will not cross its justiciable limit. However, a general misconception regarding the role of 'price' in ensuring consumer welfare often drives the competition authorities to view every price fixation with a suspicious eye. Undoubtedly, a lower price leads to higher consumer welfare but price is not, and ideally should not, be the only criteria to measure and judge consumer welfare. There can be situations where some non-price factors, that might push the price a little above the competitive price but, result in higher consumer welfare. The author, in this paper, attempts to take up one such case where a control over the price of the product can be beneficial for all actors in the market - the producers, the consumers and the retailers.

The paper will analyse in detail minimum resale price maintenance agreements (a kind of vertical price restraint) and how they are held as anti-competitive in most parts of the world, both developed and developing. By gauging the prospective benefits of such agreements in ensuring consumer welfare against the prevailing subjugation; this paper will propose recommendations on this issue.

The dilemma of policy makers whether to penalize or legalize minimum resale price maintenance agreements is evident from the difference in approaches employed by different countries and also from the inconsistent approach followed by some countries over time.[8] 'Resale Price Maintenance (RPM) Agreements' are not just held to be anti-competitive but also treated to be illegal per se in many jurisdictions. It is an established position, both in law and economics, that RPMs destroy 'intra-brand price competition'. This paper basically proclaims that 'intra-brand price competition' at the distributor's level is neither required nor is welfare enhancing. Rather, the minimum

[6] FM Scherer, *Some Principles for Post-Chicago Antitrust Analysis, Antitrust: New Economy*, New Regime: Second Annual Symposium of the American Antitrust Institute, 52 Case W. Res. L. Rev. 5 (2001-2002).

[7] Ibid.

[8] US is a good example in this context where RPM was *per se* anticompetitive for as many as 96 years before it was held to be worthy of evaluation under the *rule of reason* approach.

RPM agreement actually fosters the real competition among retailers/dealers[9] by shifting their focus from illusionary price competition to competition based on 'services' (pre/post sale). The paper illustrates why minimum RPM is welfare enhancing and, therefore, needs a revisit for further consideration.

RESALE PRICE MAINTENANCE AGREEMENTS

A resale price maintenance (RPM)[10] agreement is a contract in which a manufacturer and a downstream distributor agree to a minimum or maximum price that the retailer will charge its customers.[11] This is often termed as a vertical price restraint as the manufacturer and downstream distributor are not operating at the same level of production cycle. Most jurisdictions treat such vertical price restraint as anti-competitive. Section 3(4) of the Indian Competition Act, 2002, enlists 'Resale Price Maintenance' agreement as a vertical anti-competitive agreement, though not subject to the 'shall presume' rule[12] which means that it is equivalent to the 'rule of reason' approach used in the US.[13] For decades, the position in US was not the same as it stands today. The venerable *Dr Miles Medical* case[14] condemned *per se* the resale price maintenance (RPM) agreements. Although, the *Dr Miles* decision was attacked by the *Colgate* Doctrine[15] and several legislative amendments,[16] the subsequent developments[17] reinstated the *Dr Miles* dicta as good law till 2007. It was only after *Leegin*[18] when the US Supreme Court reversed *Dr Miles* dicta and held that RPM is no longer condemned *per se* but is instead to be treated under the rule of reason.[19] However, the mass opprobrium to the *Leegin* decision speaks volume of the perception of legal practitioners and academicians regarding the effects of RPMs in destroying consumer

[9] Retailers and Dealers will be used interchangeably in this article and for the sake of simplicity intended to mean the same.

[10] For the purpose of this article RPM, wherever not mentioned specifically, will mean minimum retail price mechanism.

[11] KG Elzinga and DE Mills, 'The Economics of Resale Price Maintenance', in KG Elzinga & DE Mills (eds), *Issues In Competition Law And Policy* (3-Volume Set), ABA Section of Antitrust Law, 2008. Available at SSRN: http://ssrn.com/abstract=926072.

[12] The horizontal agreements like cartels, horizontal price arrangements, bid rigging etc. are presumed to be anti-competitive as per Sec 3(3) of the Indian Competition Act, 2002.

[13] Vinod Dhall, 'The Indian Competition Act, 2002' , in Vinod Dhall (ed.)*, Competition Law Today—Concepts, Issues and the Law in Practice* (New Delhi: Oxford University Press, 2007), pp. 509-511.

[14] *Dr. Miles Medical Co. v. John D. Park,* 220 U.S. 373 (1911).

[15] *United States v. Colgate Co.*, 250 U.S. 300 (1919). In that case the Supreme Court allowed the manufacturer to unilaterally suggest the RPM for it products and refuse to deal with suppliers/distributors that do not sell at the suggested price.

[16] In 1937 and 1953, the Miller-Tydings Act and McGuire Act were passed, entailing state exceptions for RPM agreements.

[17] The enactment of Consumer Goods Pricing Act in 1975 repealed the legislative enactments of 1937 and 1953 (Miller-Tydings Act and McGuire Act).

[18] *Leegin Creative Leather Products, Inc., v. PSKS, Inc.*, 127 S.Ct. 2705 (2007)

[19] Kenneth G. Elzinga and David E. Mills, 'Leegin and Procompetitive Resale Price Maintenance', (2010) 55(2) The Antitrust Bulletin pp 349.

welfare. Where on the one hand States like New York, New Jersey and California already have state antitrust laws that specifically ban RPM agreements, on the other hand there is the State of Maryland which passed a '*Leegin* repealer' (in 2009) that effectively reaffirmed the *per se* illegality rule against RPM under state antitrust law.[20]

Unlike the US, EU competition law consistently has considered RPMs as a hard core restriction. It almost comes across as an irony of policy decision where on one hand the guideline on the TFEU (Treaty on the Functioning of the European Union) envisages an analysis that reflects consumer welfare economics, connecting the concept of a 'restriction of competition' with (likely) price and output effects of a particular restraint, but on the other hand retains its stand of treating some vertical restraints as hard core restraints without any exemption or exception available. Surprisingly, despite the 'more economic approach', there is a condemnation of minimum RPM as a hardcore restriction. The courts and Commission in the EU have consistently opined that such agreements by definition restrict competition and, therefore, do not require further analysis to establish that they fall under Art 101(1) TFEU.[21] And since these agreements are hardcore restrictions, block exemption is not available. The 'New EU Vertical Restraint Regulations'[22] have further made it clear that resale price maintenance is a hardcore restriction and the exemptions and safe harbour provisions introduced in other vertical restraint agreements will not apply to vertical agreements that establish a fixed or minimum resale price. Therefore, strict rules against RPM were grandfathered, even while Europe moved toward a more consumer-welfare oriented competition regime.

The guidelines, however, avoid explaining how frequent the scenarios are in which RPM might have harmful effects compared to scenarios where the effects would be benign or procompetitive, and also conveniently ignores any attempt to quantify the harmful effects of RPM. It is arguable that the guidelines cannot rely on any case law experience that would support the proposed rules as no Commission or court decision appears to have ever included factual findings on the harmful effects of RPM.[23] This is because the EU law has always prohibited RPMs as hardcore restrictions without ever going into the question of their economic or commercial justification.

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[20] Lao, Marina L., 'Resale Price Maintenance: A Reassessment of its Competitive Harms and Benefits' (2009). To appear in Josef Drexl et al. (eds), *More Common Ground For International Competition Law?*, Edward Elgar, forthcoming. Available at SSRN: http://ssrn.com/abstract=1434984.

[21] Frederik Van Door, Resale Price Maintenance in EC Competition Law, Utrecht University School of Law (Master Thesis), July 2009.

[22] Commission Regulation (EU) No 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices (OJ 2010 L 102, p. 1), replacing Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices (OJ 1999, L336/21). The New Guidelines can be found at: http://ec.europa.eu/competition/antitrust/legislation/guidelines_vertical_en.pdf.

[23] Andreas P Reindl, 'Resale Price Maintenance and Article 101', (2011) 33(4) Fordham International Law Journal 1300.

The guidelines rather justify the categorization of RPM as a hardcore restriction in the block exemption regulation by stating that RPM leads to higher prices and therefore is presumably unlawful. This price justification provided in the guidelines is not only wrong in theory (because RPM may not always lead to a higher price),[24] but is also unsupported by case law. RPM in the EU competition law, resultantly, is presumed unlawful unless the RPM proponent shows the restriction is indispensable to promoting technical or economic progress or improving the production or distribution of goods, and that consumers receive a fair share of the resulting benefits under Art. 101(3).[25]

Canada and Australia[26] also impose a *per se* prohibition on resale price maintenance agreements.

A quick look on the legal provisions relating to RPM in various jurisdictions makes it clear that the confusion persists to cloud the legitimacy and acceptability of RPM as an efficiency enhancing tool. The dichotomy, if any, has existed primarily only to the extent of whether the RPMs be evaluated under '*per se*' or 'rule of reason' approach, thereby ruling out all possibilities of guarantying a safe legal status to RPMs as 'generally efficiency enhancing'. Singapore, commendably, differs in its approach while dealing with the vertical agreements. The Third Schedule very specifically states that the Section 34 prohibition shall not apply to any vertical agreement,[27] other than such vertical agreement as the Minister may by order specify. Singapore follows 'allowed unless specifically prohibited by order' approach as opposed to the 'prohibited'[28] or 'prohibited unless allowed because of efficiency consideration'[29] approach.

Having discussed the cross country approach on minimum RPMs, it will be interesting to analyse the arguments proffered by different competition authorities for taking up a hostile approach against the RPMs.

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[24] *Ibid.* at 1319.

[25] *Supra* note 22 at 17.

[26] In Australia, RPM agreements are per se illegal for both goods and services but can be authorized on public benefit grounds. In UK, though, the conduct must have 'appreciable effect' – implicitly requires some market power. Singapore also follows that direction because vertical restraints are not prohibited unless the abuse of dominant position can be proved. The probable explanation for such a stand is that rule of analysis is quite a costly exercise and lack of information to analyse any such agreement might lead to false positives and false negatives. Therefore, Singapore's competition authority finds it better to focus on whether firms with considerable market power can engage in successful exclusionary practices rather than proscribe vertical conduct.

[27] Section 34 of the Singapore's Competition Act prohibits anti-competitive agreements. See, Clause 4.1 of the CCS Guidelines on the Section 34 Prohibition, available at http://app.ccs.gov.sg/cms/user_documents/main/pdf/S34_Jul07FINAL.pdf. Also see Third Schedule to the Competition Act 2004 available at http://statutes.agc.gov.sg/non_version/cgi-bin/cgi_legdisp.pl?actno=2004-ACT-46-N&doctitle=COMPETITION%20ACT%202004.

[28] '*Per se*' approach followed in Canada, Australia and EU.

[29] Rule of reason approach followed in US (after *Leegin's* case decided in 2007) and India.

The reason why resale price maintenance agreements have often been subjected to this strict evaluation is its ability to destroy the intra-brand price competition among the retailers. It is argued that by fixing the minimum floor price that can be charged to the ultimate consumer, it removes the possibility of a potential price reduction at the retailers' level. The prime reasons for adopting a hostile approach towards minimum RPMs is their ability to facilitate collusion upstream among producers or downstream among retailers. It is generally understood that price transparency (which is obvious in case of RPM agreements) can facilitate upstream collusion among manufacturers who might not otherwise be able to detect each other's cost of production and profit margins. Retailers can also act as enforcers under the RPM – informing manufacturers of potential breaches of the cartel. Research suggests this type of cartel enforcement is especially effective when there is an interlocking network of contracts between upstream manufacturers and downstream retailers.[30]

RPMs can be competition distortive or welfare diminishing particularly in two circumstances. In some cases, retailers may collectively (and collusively) induce the manufacturer to impose RPM agreements to prevent discount retailers from selling to the consumer. In yet another set of cases, the manufacturer might be a dominant player having enough power to set an unreasonably high minimum RPM. It is worthwhile to note that the two scenarios just explained - 'retailers colluding to induce the manufacturer to impose RPM' and 'manufacturing imposing RPMs because of its dominant position in the relevant market' can be dealt under horizontal agreements and abuse of dominant position, respectively. Because if the manufacturer imposes RPM pursuant to his own unilateral decision and he does not possess any dominant market power, he will be governed by the invisible hand of market forces which will govern his decision and which will stop him from fixing an unreasonable minimum RPM for his product. Each such manufacturer would like his product to be competitive in terms of price with that of the other competing brands available. That way the market forces and competition at the manufacturer level will keep the minimum RPM on the lower side.

It should also be noted that the argument that price competition at the retailers level ensure price competition among retailers, though seems to be a strong advocate of banning RPM, is flawed in its necessary assumption. The argument assumes that intra-brand price competition[31] at the retailers' level is welfare enhancing. The argument further assumes that such price competition is efficiency enhancing and required for consumer good. The next part of this paper goes on to explain how this assumption is deceptive and how intra-brand price competition diminishes consumer welfare and should, therefore, be discouraged.

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[30] OECD Policy Roundtables, 'Resale Price Maintenance', 2008, DAF/COMP(2008)37, available at http://www.oecd.org/dataoecd/35/7/1920261.pdf

[31] Intra-brand price competition is the competition among retailers for the price of the same product.

INTRA-BRAND PRICE COMPETITION: WHY RETAILERS SHOULD NOT COMPETE ON PRICE OF THE SAME PRODUCT?

Competition law aims at ensuring 'production efficiency'[32] and guaranteeing that a firm has the incentive to find newer and better ways of reducing cost. The European Commission stated that the purpose of competition law 'is the protection of competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources'.[33] This makes it undoubtedly clear that the protection of competition is only a means to meet the 'greater end' which is 'Consumer Welfare Maximization'. Two important observations here - firstly, competition law seeks to protect competition and not only 'price' competition and secondly, as long as the protection of competition is not leading to welfare maximization, there should be a room for deviation.

Production efficiency occurs when the firms seek to achieve the goal of producing goods at the minimum possible cost of production and they have an incentive to find newer ways to reduce costs as much as possible to earn maximum possible profits.[34] It is incontestable that manufacturers' sales and profits are inversely related to the price of the product,[35] i.e. lower the price at which the distributors resell the products to the consumers, the greater will be the demand for the product and the profits will be higher accordingly.[36] Therefore, the manufacturer's desire to eliminate the intra brand price competition by imposing a minimum RPM cannot be said to be without any purpose. Lester G Telser,[37] has beautifully explained why a manufacturer is motivated to impose minimum resale price when 'he' himself[38] will benefit the most if the price of the product is kept at a minimum.[39] This raises an important question—what is the role of retailers in the process of production of goods and why would the manufacturer want to regulate the retailers' activities?

Certainly, the retailer is not contributing towards the production of the goods in literal sense of the words. He comes into picture only when the goods are produced and are ready to be transferred to the final consumer through the commercial process.[40] The retailer is actually a producer of services (distribution) and facilitates the sale of goods produced by the manufacturer. However, in the absence of RPM, the retailer (who is

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[32] Also 'allocative efficiency and 'dynamic efficiency.

[33] Asian Development Bank Toolkit, Economic Foundations of Competition Law, available at http:/www.adb.org/Documents/others/OGC_Toolkits/Competition-Law/documents/Chap1.pdf.

[34] Ibid.

[35] For the purpose of this article, monopoly market model has not been considered; otherwise the results of situations considered will lead to variant consequences.

[36] Lester G Telser, 'Why Should Manufacturers Want Fair Trade?', (1960), Journal of Law and Economics, 86.

[37] An American Economist and Professor Emeritus in Economics at the University of Chicago.

[38] 'He', wherever used in this article, is intended to be a gender neutral term implying 'he/she'.

[39] *Supra* n 36.

[40] For the sake of simplicity the distributor is presumed to be the only linking pin between producer and final consumer, all other middlemen or multiple distributors are ignored.

not contributing in the production process as such but is only selling the product which is produced by the manufacturer) is competing on the price of the product when essentially he has no control over its cost of production at the manufacturer's level. So the reduction in price, at the retailer's level, which reaches the consumer is not because the retailer has become efficient or because the goods are procured at a lower cost, but because he has cut down on the services he was offering before. Although this might make the product more attractive in terms of price, it takes away the services which the consumer finds useful and for which the consumer is willing to pay.

The Chicago School[41] of thought rightly highlights that discounted dealers, who appear to benefit the consumer in the short run by providing products at cheaper prices, are in fact renegade free riders[42] who, if they remain unchecked, will destroy the manufacturer's place in the inter-brand market and ultimately decrease consumer choices.[43] Therefore, the prohibition on the minimum RPM under the competition law not only harms the manufacturers but also the consumers.[44] Telser, in 1960, provided the possible justification for imposing minimum resale price mechanism by emphasizing on the free riding problem. Telser argued that 'no frills distributors might 'free ride' on the promotional efforts of full service distributors, thereby undermining the incentives of full service dealers to expend resources on promotion.'[45] Thus, each person has an inducement to obligate others to bear the cost of providing pre-sale services and not personally contribute. The free rider problem occurs because one does not have an incentive to account for the global benefits of a private act.[46] In the absence of an RPM agreement, the motivation to provide pre-sale services, if not altogether missing, will be extremely minimal. If the retailers choose to provide pre-sale service like expert pre-sale assistance on the product information, trial usage of the product etc, the cost of such service will increase the cost of the product. This will make it difficult for such retailers (those who are providing pre-sale services) to provide heavy discounts to consumers. They cannot sell the product below the cost they are incurring on procurement and presale services, except at a loss. The problem arises when some retailers provide and some do not provide the important product specific pre-sale services. In such a scenario, the cost of the same product will be different for the two sets of retailers - for those providing pre-sale services and for those not providing pre-sale services. The consumer can go to the former retailer, see the product and avail all the pre-sale services which are free of cost and buy the product from the

41 See generally, Richard A. Posner, 'The Chicago School of Antitrust Analysis', (1979), 127(4) University of Pennsylvania Law Review, 925.

42 Free Rider is a situation commonly arising in public goods context in which players may benefit from the actions of others without contributing (they may free ride).

43 Jean Wegman Burns, 'Challenging the Chicago School on Vertical Restraints', (2006), Utah Law Review, 913, available at http://privateweb.law.utah.edu/_webfiles/ULRarticles/69/69.pdf.

44 This is explained in the later part of the paper.

45 *Supra* n 36.

46 Shor, Mikhael, 'Free Rider', Dictionary of Game Theory Terms, Game Theory.net, http://www.gametheory.net/dictionary/FreeRiderProblem.html, Web accessed: 24 September, 2010.

latter retailer at a discounted price. The latter retailer can give heavy discount because he is not incurring any cost on providing pre-sale services. Minimum RPM can solve this free riding problem by making retail prices uniform, so that customers no longer have a reason to shop from one store and buy from another. Apart from dealing with the free rider problem, the minimum RPM also has another added advantage. It shifts the focus of the retailers from intra-brand price competition to intra-brand non-price competition. With no possibility to compete with each other on the basis of price, retailers that operate under RPM conditions will focus on non-price factors, i.e., services.[47]

It might be argued in some instances that consumers do not require pre-sale services and, therefore, should not be charged for it. However, the problem arises in the cases where consumer needs some pre-sale services before making an informed decision for buying a product. This is true at least in case of some goods.[48] The kind of product market a consumer is facing today, presenting a wide array of differentiated products with specialized features and functions of every product, information regarding the functions and usage of the particular product becomes very important. A consumer buying an automobile will like to have a test drive and a consumer buying cosmetics will like to have a free application test. There are various other product categories falling in this category, namely perfumes, electronic items, mobile phones etc. In such product markets, demand is the function of product features and quality as well as the price of the product.[49] Therefore, to know those product specific features, consumers need pre-sale services. But the problem is that, in the absence of minimum RPM, the retailers compete with each other on the price at which they offer the products to the final consumer. In the effort of attracting consumer, the retailers may bring down the price further and further to make 'their' product seemingly more economical. The dilemma here is that whether such a price war at the retailers' level is welfare maximizing and should it be allowed? Whether 'intra-brand price competition' should be motivated?

The author is of the opinion that such intra-brand price competition is not only illusory but is also welfare diminishing because it might disincentivise the full service retailer to offer the important retail services that he was offering before. It will not only adversely affect the manufacturer but also the consumer. On the one hand, the manufacturer will be harmed because the product will not be able to capture the demand (at least that part of the demand which is directly proportional to the pre-sale services) in the absence of pre-sale services. On the other hand, the consumer will make less informed choices and they might end up making a wrong decision, thereby resulting in

[47] *Supra* n 36.

[48] Here a distinction can be made between experience goods and search goods, as the latter will not require much of pre-sale service while the former will. An example of search good can be cotton, pencils, pens etc where consumer does not require much information or pre-sale service to make a right choice. This, however, is not the case with experience goods where the absence of pre-sale services can lead the consumer to make a wrong choice.

[49] *Supra* n 36.

diminished consumer welfare. However, by imposing minimum resale price restraint, a manufacturer can eliminate the unnecessary intra-brand price competition which in turn encourages retailers to invest in tangible or intangible services or promotional efforts that aid the manufacturer's position as against rival manufacturers.[50]

This can be well explained with the help of an example. Suppose the manufacturer deals in product 'x' which is an experience[51] good e.g. a perfume. He sells the product to the retailers at a price of $100. It is quite obvious for a rational consumer to first experience such product (perfume) before making a decision whether to buy or not to buy the product. Assume that the cost to provide such pre-sale application test service is $5. Now consider the following two contrasting situations and their probable outcomes.

Scenario 1

RPM is illegal and therefore, not imposed: in the absence of RPM, the dealers can charge any price equal to or above $100. In the short run, some retailers might be willing to provide the pre-sale application test service but certainly most of them do not find it profitable to do so. As long as some of them are providing such services, the remaining retailers have enough incentive to free ride on them. The former cannot sell below $105, while the latter category of retailers can charge the price as low as $101 or may be even $100 to capture consumer demand. In order to avoid losses and to compete with the latter category of retailers, even the former will withdraw the pre-sale service. In the short run, free riding (as explained above) will take place and, in the long run, all retailers might stop providing pre-sale service. This mimic behaviour if not obvious, is very likely. The result will be two fold - the consumers will be bereft of necessary information to make an informed decision and the demand for manufacturers' product will be adversely affected. Now let us analyse the other situation.

Scenario 2

RPM is not illegal and therefore, is imposed: in the presence of minimum RPM imposed by the manufacturer (suppose $105 is the minimum resale price), the dealer cannot compete now on price as all will be selling at either $105 or above. In such a situation the only way they can capture consumer demand is by providing useful services. The margin of $5 is available with every dealer to utilize it as efficiently as possible. This will motivate the dealer to produce the services efficiently to bring down the cost of producing services and thereby increase his profit from that margin. It will not only take away the intra-brand price competition but also instigate intra-brand non-price competition, which is the required outcome.

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[50] *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007), available at http://scotusblog.files.wordpress.com/2007/06/06-480.pdf

[51] An experience good is a product or service where product characteristics such as quality or price are difficult to observe in advance, but these characteristics can be ascertained upon consumption. See Wikipedia at http://en.wikipedia.org/wiki/Experience_good

Some scholars argue that minimum RPM provides too much liberty to the manufacturer to impose the minimum price at which the product should be sold and thereby deprives the consumers of the benefits of price competition among retailers. This argument doesn't stand good, unless the manufacturer is a dominant player in the market and he is abusing his dominant position to dictate the product's price. And if that is the case, then there is an altogether different provision in competition law of all jurisdictions to deal with such a situation - abuse of a dominant position.[52]

It should be noted here that the minimum RPM of $105 cannot be an arbitrary figure because every manufacturer is incentivised to keep the price as low as possible. *Ceteris paribus,*[53] the minimum the price, the more will be the demand for his product. Therefore, the minimum resale price decided by the manufacturer will keep in consideration the optimum amount of pre-sale services required to build and maintain the demand for his particular product and the price of other competitive products in the market. Therefore inter-brand price competition will ensure that the manufacturer is not keeping the RPM towards the higher side to exploit the consumers. Inevitably, these opposite forces will keep a check on the minimum RPM fixed by the manufacturer.

SINGLE ECONOMIC ENTITY JUSTIFICATION

Another important justification for minimum RPM flows from the legal immunity endowed to vertical restraints such as RPM in case of 'single economic entities'. Subsidiaries may be independent legal entities but for the purpose of competition law, they are viewed as part of the parent company and are considered not to have any independent market power to guide their actions.[54] Therefore, any agreement between a parent company and a subsidiary company is immune from the clutches of competition law, as they are regarded as the single economic entity which cannot theoretically contract or collude with itself. Obviously, it is a question of fact, to be decided by the ruling court, whether the entities are part of the single economic entity or not but such difference of approach in dealing with 'agreement between manufacturer and retailer' formed between independent undertakings and those formed between related undertakings incentivizes the manufacturer to set up or acquire the vertical chain. Because that is the only way where he can impose minimum RPMs (for ensuring provision of pre-sale services and controlling free rider problem) and escape the competition authority's strictures. It is interesting to note that EU law does not apply the Art 101 TFEU prohibition to agreements between entities that form a single economic entity.[55] Also, in the US, the Act does not apply to action by people within a single enterprise. The Supreme Court has held that a parent and a fully-owned

[52] In the US, the term used for this provision is 'monopolization'.

[53] Ceteris Paribus is a latin phrase that literally means 'others things being constant'

[54] D Chalmers, G Davies, G Monti, *European Union Law: Cases and Materials* (Cambridge University Press, 2010), pp 964-965.

[55] R Whish, *Competition Law* (Oxford University Press, New York, 2009), p 91.

subsidiary are not legally capable of conspiring in violation to the Sherman Act.[56] India also follows the similar approach as the definition of enterprise includes all entities forming part of the single economic entity.[57]

Considering the prevailing legal rules that allow the manufacturer to fix the price for the retailer, only when they are part of the same economic entity, it is clear that the manufacturer has huge incentive to own the distribution system and then impose minimum resale price. Such a situation has the tendency to destroy intra-brand competition, both price and non-price. If the manufacturer knows that he can regulate the behaviour of the retailer down in the chain by establishing holding-subsidiary relation or exclusive agency relation, he will aim at doing so. There are real examples of such strategic behaviour. In the EU, Parker Pen embarked on the same strategy and owned all its distributors and the Court of Justice held that it was not caught by Article 101, being a single economic entity.[58] The strategy was in response to an earlier decision[59] whereby the Court penalised Parker Pen for indulging in anti-competitive behaviour. In the long run, if every manufacturer thinks in similar fashion, the retailers who are not related to the upstream distributor will be thrown out of the market and there will be an unprecedented parallel distribution chains between every manufacturer-retailer (of one economic unit) competing with manufacturer-retailer (of other economic unit) and so on. This is a kind of exclusionary conduct that destroys intra-brand price and non-price competition between the retailers. It therefore, might be more welfare enhancing to allow the manufacturer to impose RPM. Anyways the 'Invisible hand'[60] of the competition law in the form of free unregulated market will correct the abuse, if any, intended by the market actors and will restore low prices and optimum output.

CONCLUSION

This paper highlights the discourse and developments in the treatment of retail price maintenance agreements in various parts of the world. The paper argues in favour of 'Resale Price Maintenance' agreements and explains how the myth of RPM being anti-competitive is wrongly founded and premised. The above analysis argues that minimum RPM agreements, though traditionally held to be anti-competitive, actually lead to higher consumer welfare. It is quite apparent that a ban on resale price maintenance agreements not only allows the burgeoning of illusory intra brand price competition

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[56] *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984), available at http://caselaw.lp.findlaw.com/scripts/getcase.pl?navby=search&court=US&case=/us/467/752.html.

[57] *See* Indian Competition Act, Section 2(h).

[58] D Chalmers, G Davies, G Monti, *European Union Law: Cases and Materials* (Cambridge University Press, 2010), pp 964-965.

[59] Commission Decision 92/426/EEC of 15 July 1992 relating to a proceeding under Article 85 of the EEC Treaty (Case IV/32.725 - *Viho/Parker Pen*), available at http://eur-lex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexplus!prod!CELEXnumdoc&numdoc=392D0426&lg=en

[60] Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, (London: Methuen and Co., Ltd., 1904. Edwin Cannan, ed. First published 1776).

among the retailers but also demotivates the manufacturer to produce innovative products which can enhance consumer utility and surplus. Besides creating an artificial demand-supply mismatch in the market, it might also limit consumer choices, thereby prompting the consumer to take an ill informed decision which will further result in a welfare loss. By lifting the ban from minimum resale price maintenance agreements, the regulators can actually motivate the retailers to provide product specific services. Such services help in building the demand for certain products and are of vital value not only to the consumers but also to the manufacturer. The elimination of intra-brand price competition not only stimulates intra-brand non-price competition but also inspires inter-brand price competition. The paper in a way also elucidates a broader view - how price competition is not, and ideally should not, be the only aim of competition law. 'Competition is not an end in itself but a process that advances goals of economic well-being, ultimately for consumers'.[61] And if consumer welfare requires a deviation from price competition, the competition law and policy should not hesitate to allow such deviation.

[61] Sir John Vickers, the former Chairman of the Office of Fair Trading, *Competition is for Consumers*, a speech given to the Social Market Foundation, available at http://www.oft.gov.uk/shared_oft/speeches/spe0102.pdf.