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The Law of Vertical Territorial and Price Restraints in the EU and in the USA:
A Critical Analysis of Vertical Territorial and Price Restraints - an Argument against
Legalisation

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ABSTRACT

This PhD thesis critically surveys vertical territorial and price restraints in the EU and the USA not just from a legal angle, but also from comparative, economic, theoretical and historical perspectives. Different aspects of such comprehensive research assist with tackling the different issues that have occurred in the law of vertical territorial and price restraints while determining its correct approach.

This thesis argues against some existing competition policies and principles, such as the objective of the law of vertical territorial and price restraints. It shows that law of vertical territorial and price restraints should protect effective and free competition. Nevertheless, it follows that the object of effective competition is efficiency which is difficult to determine in situations when RPM or VTR is used. Furthermore, the complexity of vertical competition and vertical chains, including relationships, power and market structures, is surveyed. This thesis advocates the existence of vertical competition and further explains that it is bargaining power which should be assessed in RPM and VTR cases and not horizontal market power, which serves the purpose of horizontal rather than vertical competition.

The development of the laws of vertical territorial and price restraints including the analysis of relevant and significant cases both in the EU and the USA within a broader historical framework and relevant theories unveil some inconsistencies and uncertainties. This thesis criticises the formalistic approach within traditional anti-competitive theories and the demagogical approach within the majority of pro-competitive theories offering new suggestions and points of view.

Although vertical restraints have been part of US antitrust law and EU competition law almost since the beginning of their existence, this thesis reveals that their approaches have been unsettled and continue to develop with contradictory arguments on this issue across the legal, economical, empirical and theoretical scholarly works, which show lack of understanding of vertical competition. Unfortunately, vertical competition has not been acknowledged as the basic framework for vertical restraints in both the EU and US policies and their legislations. Therefore, this thesis concludes with legislative suggestions which better reflect the nature of vertical restraints.

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DECLARATION

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

Signature: _____

Printed name: Ms Barbora Jedličková

LIST OF ABBREVIATIONS

AMCHAM EU	American Chamber of Commerce to the European Union
CJEU	Court of Justice of the European Union
DOJ	Department of Justice
EC	European Community
ECSC	Treaty Establishing the European Coal and Steel Community
EEA	European Economic Area
EEC	European Economic Community
EFPIA	European Federation of Pharmaceutical Industries and Associations
EFTA	European Free Trade Area
EU	European Union
FTC	Federal Trade Commission (USA)
GSK	GlaxoSmithKline Services Unlimited
GW	Glaxo Wellcome, SA
ICC	International Chamber of Commerce
OECD	Organization for Economic Cooperation and Development
OJ	Official Journal
R&D	Research and Development
RPM	Resale Price Maintenance
SSNIP	Small but Significant Non-transitory Increase in Price
TFEU	Treaty on the Functioning of the European Union
UNIDROIT	International Institute for the Unification of Private Law
US	United States; United States of America
VTR	Vertical Territorial Restraints

Chapter 1: Introduction

*“Antitrust is an interdisciplinary field that is best served by acknowledging that a deeper understanding of the issues will result by addressing the subject from several points of view.”*¹ (Oliver Eaton Williamson)

1.1. Vertical Price and Territorial Restraints

Vertical restraints have the ability to restrict competition in a primarily vertical fashion. They involve arrangements on a vertical chain, such as bilateral conducts between a manufacturer and a distributor. In contrast with horizontal collusions, vertical relationships are common and essential in a market consisting of bilateral or even multilateral arrangements. Nevertheless, such arrangements can include restrictive aspects which can lessen competition. Vertical territorial and price restraints have the potential to be the most restrictive forms of vertical restraints. Vertical price restraints (“RPM”) restrict price competition, and vertical territorial restraints (“VTR”) have the potential to restrict any form of competition, not just price. RPM includes practices where a seller and its buyers agree or one party is forced to agree that the latter will sell the sold product at set price, or at or above a price floor, which is also known as “minimum resale price maintenance” or “minimum price fixing/setting”, or at or below price ceiling, which is also known as “maximum resale price maintenance” or “maximum price fixing/setting”. VTR includes any territorial restrictions based on arrangements between a seller and its buyers when a buyer is allowed to sell only within a certain, set territory.

Vertical price and territorial restraints are controversial topics in both economic and legal scholarly works. This is also reflected in the development of both US antitrust law and EU competition law. Despite the strong and stable positions of both of these legal systems, the approach and effects of vertical territorial and price restraints remain unsettled and tentative.²

¹ O.E. Williamson, *Antitrust Economics: Mergers, Contracting, and Strategic Behaviour*, (Basil Blackwell, New York, 1987) 158.

² See, e.g., G.T. Gundlach, “Overview and Contents of the Special Issue: Antitrust Analysis of Resale Price Maintenance after Leegin” (2010) 55 *Antitrust Bulletin* 4-7; A.I. Gavil, “Resale Price Maintenance in the Post-*Leegin* World: A Comparative Look at Recent Developments in the United States and European Union” (2010) 1 *CPI Antitrust Journal* 2-3; M. Bennett, A. Fletcher, E. Giovannetti, D. Stallibrass, “ Resale Price

The recent case of *Leegin*, which changed the approach to RPM in the US, opened a new and intensive debate on RPM not just in the US, but also in the EU.³ There have been numerous articles published discussing RPM in the US in the last 4 years, most notably in 2010.⁴ Scholars have managed to agree on one aspect of this area of competition law: change is inevitable. Nonetheless, this call for change has been ongoing since the creation of the *per-se* approach to RPM in 1911.⁵ Although the most notable, current scholarly stream is based on the idea of the application of a modern, restructured rule of reason, for instance in the form of a quick approach,⁶ it is argued in this thesis that the basic legislation should be changed to reflect the nature of vertical restraints, which is not captured in either the US Sherman Act or the Treaty on the Functioning of the European Union (“TFEU”).

Scholarly works reveal one paradox with regards to RPM: so much has been said recently regarding this issue but so little is known about it. Furthermore, the debate has frozen in terms of understanding VTR and almost nothing is known about the issue. The latest development of VTR shows the US approach to be very benevolent and different from the EU approach, which is considerably stricter. The obvious explanation for this difference would be the protection of free and internal markets as the main objective of the EU. However, another and more key explanation, although not as obvious, is inconsistency and lack of deep knowledge of the issue.

1.2. Objective, Novelty and Methodology of the Thesis

The lack of research studies in both areas of competition law has been frequently highlighted. Recent commentators have agreed that, with respect to vertical territorial and

Maintenance: Explaining the Controversy, and Small Steps Towards a More Nuanced Policy” (2010) MPRA Paper No. 21121, posted 4 March 2010/18:02, (at <http://mpa.ub.uni-muenchen.de/21121/>), p. 1; Brunell, R.M., “Overruling *Dr. Miles*: The Supreme Trade Commission in Action” (2007) 52 *Antitrust Bulletin* 528; T.R. Sass, D.S. Saurman, “Mandated Exclusive Territories and Economic Efficiency: An Empirical Analysis of the Malt-Beverage Industry” (1993) 36 *J.L. & Econ.* 153-154.

³ See, e.g. C. Callery, “Should the European Union Embrace or Exorcise *Leegin*’s ‘Rule of Reason’?” (2011) 32(1) *ECLR* 43; A. Jones, “Resale Price Maintenance: A Debate about Competition Policy in Europe?” (2009) 5(2) *European Competition Journal* 479; further See Chapter 4 “Development of the US Law of Vertical Territorial and Price Restraints”, Chapter 5 “Development of the EU Law of Vertical Territorial and Price Restraints”.

⁴ See, e.g., *Antitrust Bulletin*: Vol. 55 No. 2/Summer, No. 1/Spring – both issues are dedicated to RPM.

⁵ See Chapter 4 “Development of the US Law of Vertical Territorial and Price Restraints” and Chapter 6 “Theories of Pro-Competitiveness v. Anti-Competitiveness”; Williamson, *Antitrust Economics*, 143.

⁶ *Ibid.*

price restraints, comprehensive and empirical studies are missing.⁷ Ippolito summarises the necessity of filling this gap when she states that “detailed case studies, systematic statistical evidence, and in-depth legal investigations are all potentially important contributors to a clearer understanding of the uses of practice.”⁸

This lack of research studies is even more obvious in relation to vertical territorial restraints, the studies of which include only vague, if any, discussion and empirical, persuasive studies are almost non-existent. Therefore, how can US antitrust policy come to the final conclusion that vertical territorial restraints are not, or almost always not, anti-competitive? Or, in contrast, how can the EU states that such forms of vertical restraints are almost as anti-competitive as RPM?

This thesis aims to address to a significant extent the gap in the demand for comprehensive research in this area of law, with the principal aim of discovering the most appropriate approach to the law of vertical territorial and price restraints for developed countries.

Therefore, this thesis will answer this primary research question:

- what is the most appropriate approach to the law of vertical territorial and price restraints?

It will also attempt to answer related questions such as:

- are vertical territorial and price restraints generally pro-competitive or anti-competitive?
- Do entities use these restraints for anti-competitive or pro-competitive reasons and why?

⁷ See, e.g., F. Lafontaine, M.E. Slade, “Transaction Cost Economies and Vertical Market Restrictions – Evidence” (2010) 55 *Antitrust Bulletin* 608; B.Y. Orbach, “The Image Theory: RPM and the Allure of High Prices” (2010) 55 *Antitrust Bulletin* 278; P.J. Harbour, L.A. Price, “RPM and the Rule of Reason: Ready or Not, Here We Come?” (2010) 55 *Antitrust Bulletin* 227; P.M. Ippolito, “RPM Myths that Muddy the Discussion” (2010) 55 *Antitrust Bulletin* 151-165; W.S. Comanor, “Antitrust Policy Toward Resale Price Maintenance Following *Leegin*” (2010) 55 *Antitrust Bulletin* 78; A. Gavil, “Resale Price Maintenance in the Post-*Leegin* World: A Comparative Look at Recent Developments in the United States and European Union” (2010) 1 *The CPI Antitrust Journal* 1; R. Steiner, “Vertical Competition, Horizontal Competition and Market Power” (2008) 53 *Antitrust Bulletin* 252; M.P. Lynch, “Why Economists Are Wrong to Neglect Retailing and How Steiner’s Theory Provides an Explanation of Important Regularities” (2004) 49 *Antitrust Bulletin* 911-940; P.J. Harbour, “An Enforcement Perspective on the Work of Robert L. Steiner: Why Retailing and Vertical Relationships Matter” (2004) Winter *Antitrust Bulletin* 997; Brunell, “Overruling *Dr. Miles*” 528; Sass, Saurman, “Malt-Beverage Industry” 154; S. Comanor, “The Two Economics of Vertical Restraints” (1992) 21 *Sw.U.L. Rev.* 1277.

⁸ P.M. Ippolito, “RPM Myths that Muddy the Discussion” (2010) 55 *Antitrust Bulletin* 154.

- What is and what should be the objective of the law of vertical territorial and price restraints?
- Is current legislation rightly based to reflect the nature of VTR and RPM?
- What are the current frameworks of the EU and US laws of vertical territorial and price restraints and how have these changed since their inception and why?

The research questions require analysis of the issue from different perspectives, combining knowledge from law, economics and history. Thus, the qualitative methodology used in the thesis reflects this comprehensiveness and is based on doctrinal, comparative, legal-economic and historical methodologies.

Comparative methodology is a useful and even essential tool for the aim of the thesis as it must be determined whether differences in the systems mean that different principal approaches to the law of vertical territorial and price restraints should be introduced or whether it is possible to suggest one approach for both systems and, thus, whether there is a possibility for global harmonisation in this area of competition law in the future. Furthermore, the comparative approach allows the issue to be analysed from different perspectives, which thus enriches understanding of the topic.

This thesis compares the EU and US approaches to vertical territorial and price restraints because both EU competition law and US antitrust law are well-recognised and respected worldwide and appear to be well-developed and soundly-based. They belong to the major systems of competition law and competition/antitrust law plays an important role in the EU and the US.

Besides new arguments and legislative suggestions in this area of competition law, the novelty of this PhD thesis is also reflected in the comprehensiveness of its combined methodologies. As indicated above, existing research and literature in this area of competition law focuses only on one aspect or a few aspects of this issue and/or analyses vertical restraints from only one angle, generally using one or two methodologies or studying a specific market. Among others, a recent book dedicated to vertical restraints in the US and in the EU is a book written by Colino.⁹ Although this book contributes to our

⁹ S.M. Colino, *Vertical Agreements and Competition Law: A Comparative Study of the EU and US Regimes* (Hart Publishing, Oxford, 2010); also see D. Hildebrand, *Vertical Analyses of Vertical Agreements – A Self-Assessment* (Kluwer Law International, 2005), this book is based on previous, expired EC Block Exemption Regulation 2790/1999 and it focuses on economic analysis of vertical agreements which is only one aspect of

understanding of this issue, it does not focus specifically on RPM and VTR, but rather discusses vertical restraints in general. It is based on a general overview and a comparison of the current legal framework in both the EU and the US, and includes some economic theories and author's suggestions. In contrast, this thesis deeply and comprehensively analyses the two forms of vertical restraints that have the most anti-competitive potential. It does not only summarise some aspects of existing knowledge of vertical restraints while making suggestions and predictions for future development, but it tackles this area of vertical restraints from several angles, including analysis of cases and the development of this area of competition law, critical survey of available theories in English, analysis of its objective and economic discussion and analysis of the functioning of this issue. It is based on comprehensive research substantially analysing vertical territorial and price restraints and introduces new arguments and novel legislative suggestions.

1.3. Structure of the Thesis

The thesis is divided into seven chapters including Chapter 1 "Introduction" and Chapter 7 "Conclusion". Chapter 2 "Objective of the Law of Vertical Territorial and Price Restraints" determines the most appropriate objective for the law of vertical territorial and price restraints by discussing the nature of this issue from different perspectives, including US and EU legislation and different scholars' perspectives. The key parameter of this thesis is to set out and explain the most appropriate objective of this area of competition law, as this is necessary to determine aspects which must be analysed to survey the appropriateness of the law and theories and, finally, to assist with legislative and policy suggestions.

Chapter 3 "Vertical Competition and Structure" explains and analyses vertical chains and vertical territorial and price restrictions primarily from a macroeconomic perspective and within the framework of vertical relationships. It reveals their complexity and real functioning on the market, and discusses those aspects of the markets and competition that influence the use of both vertical territorial and price restrictions and their potential effects.

Chapter 4 "Development of the US Law of Vertical Territorial and Price Restraints" and Chapter 5 "Development of the EU Law of Vertical Territorial and Price Restraints"

the thesis and thus it substantially differs from the content and the aim of the thesis and its concentration on RPM and VTR.

critically survey the development of legislation, cases, policy and other aspects which have influenced the law of vertical territorial and price restraints to explain and make appropriate assumptions about the current situation in both systems.

Chapter 6 “Theories of Pro-Competitiveness v. Anti-Competitiveness” critically analyses theories, introduces new arguments and novel ideas and determines the similarities and differences of these theories in RPM and VTR. This chapter builds on the knowledge from previous chapters, most notably on the development of this area of antitrust/competition law, to reflect how these theories fit within reality and how they have influenced law, and finally to introduce new arguments based on the overall comprehensiveness of the thesis.

This thesis focuses purely on RPM and VTR within the vertical chain, which includes both upstream and downstream vertical arrangements, without discussing other aspects such as agencies and joint ventures. As this thesis concentrates on the most restrictive forms of VTR and RPM, the abbreviation VTR and its related meanings refer to exclusive and/or absolute vertical territorial restrictions, unless noted otherwise. Although maximum price fixing in general terms is also discussed, the focus is on the analysis of price fixing and minimum price fixing and it is these two forms of vertical price restraints that determine the meaning of the abbreviation RPM.

In this thesis the terms “manufacturer” and “supplier” are generally used synonymously to describe undertakings which constitute the first link in the supply chain for a particular product, unless noted otherwise. Buyers further down the supply chain are referred to as distributors, wholesalers or retailers. The term “distributor” is used in a general sense and includes wholesalers and retailers, unless otherwise differentiated in the text. Finally, within the terminology of EU competition law, the meaning of “restriction of competition” includes all forms of restrictions, such as prevention, restriction and distortion of competition.

This PhD thesis was finalised on the 31st of August 2011; therefore, the content reflects only those cases, literature and data available before this date.

Chapter 2: Objective of the Law of Vertical Territorial and Price Restraints

2.1. Introduction

The purpose of this thesis is to introduce the most appropriate approach to the law of vertical territorial and price restraints. Such research potentially requires, at its beginning, the determination of the right objective for this area of competition law and its comparison with the existing objectives to clarify against which principal objective the current approach is tested and on this and other bases to determine in following chapters whether the existing approach to vertical price and territorial restraints is rightly based. Therefore, this chapter analyses the possible goals of competition/antitrust law in a legal, economic and theoretical framework, and tries to determine the most genuine principal objective for the law of vertical territorial and price restraints.

2.2. Efficiency

The objective of competition law has not been soundly-based in either US antitrust law or EU competition law.¹ Nevertheless, economic efficiency has often been recognised as the exclusive goal of competition and competition law.² However, efficiency is not always considered as the only aspect of legality or illegality of vertical restraints. For example, Hovenkamp highlights that economic efficiency is not and has not been the only objective of US antitrust law, noting that current politics affect the decision of which “competing values” should be protected.³

Based on the significant usage of efficiency as the objective of competition law, this chapter proceeds on the assumption that efficiency is the objective of the law of vertical territorial restraints and, therefore, its meaning is analysed within the framework of

¹ See below; see chapters Chapter 4 “Development of the US Law of Vertical Territorial and Price Restraints” and Chapter 5 “Development of the EU Law of Vertical Territorial and Price Restraints”.

² Ibid; see e.g., B.J. Rodger, A. MacCulloch, *Competition Law and Policy in the EC and UK*, Fourth Edition (Routledge-Cavendish, 2009) 21; G. Monti, *EC Competition Law*, Reprinted (Cambridge Univ. Press, 2008) 8; F.M. Scherer, D. Ross, *Industrial Market Structure and Economic Performance*, Third Edition (Houghton Mifflin, 1990) 29-30; W.S. Comanor, “Vertical Price-Fixing-Vertical Market Restrictions, And the New Antitrust Policy” (1985) 98 *Harv.L.Rev.* 983; R. Pitofsky, “In Defense of Discounters: The No-Frills Case for a Per Se Rule against Vertical Price Fixing” (1983) 71 *Georgetown L.J.* 1487.

³ H. Hovenkamp, *Federal Antitrust Policy, The Law of Competition and Its Practice*, Third Edition (Thomson West, St. Paul, 2005) 71-72.

competition and competition law to determine whether it is efficiency or another goal that should be the genuine objective of the law of vertical territorial and price restraints.

2.2.1. Consumer Welfare as a Goal of Efficiency?

General understanding of the term “efficiency” differs. The Chicago School, along with other theorists including Comanor and Schmidt, believe that economic efficiency means consumer welfare, thus claiming that economic efficiency/consumer welfare should be the sole objective or at least the main objective of antitrust/competition law.⁴

Fox and Cann, however, expand the attributes of economic efficiency under the alternative banner of “consumer satisfaction” that includes not just consumer welfare, but also diversity, choice and innovation.⁵ Although they highlight other aspects of efficiency, it could be argued that consumer welfare and consumer satisfaction are no different because both terms focus on consumers and their interests.

Remarkably, Posner, who claimed that consumer welfare was the only objective of antitrust law, re-evaluated his position in 2001 after working as a judge in the Federal Court of Appeal in the United States. His new stance holds that economic efficiency includes multiple values and is much more than just consumer welfare, asserting that all of these values collectively create the objective of competition.⁶ Furthermore, the Harvard School argues that the aim of competition itself is good performance on a particular market, where that performance maintains and increases general material welfare without concentrating solely on consumer welfare.⁷

⁴ W.S. Comanor, “Antitrust Policy Toward Resale Price Maintenance Following *Leegin*” (2010) 55 *Antitrust Bulletin* 59, 76-77; I.L.O., Schmidt, “The Suitability of the More Economic Approach for Competition Policy: Dynamic vs. Static Efficiency” (2007) 28 (7) *ECLR* 408; Hovenkamp, *Federal Antitrust Policy*, 75-77; S. Bishop, M. Walker, *The Economics of EC Competition Law: Concepts, Application and Measurement*, Second Edition (Thomson, Sweet and Maxwell, 2002) 11-16; G. Amato, *Antitrust and the Bounds of Power* (Hart Publishing, Oxford, 1997) 21; F.H. Easterbrook, “Workable Antitrust Policy” (1986) 84 *Michigan Law Review*, 1703-1704; Comanor, “Vertical Price-Fixing” 983; R.H. Bork, *The Antitrust Paradox: A Policy at War with Itself* (The Free Press, New York, 1978) 7, 51; see also below.

⁵ W.A. Cann, “Vertical Restraints and the ‘Efficiency’ Influence – Does any Room Remain for More Traditional Antitrust Values and More Innovative Antitrust Policies?” 24 *Am. Bus. Lawyer* 46 (1986) 526-531; E.M. Fox, “The Modernization of Antitrust: A New Equilibrium” 66 *Cornell L. Rev.* (1981) 1153-1155, 1182-1161.

⁶ R.A. Posner, *Antitrust Law*, Second Edition (Chicago, 2001) 21.

⁷ J.S. Bain, *Industrial Organisation* Second Edition (Wiley, New York, 1968) 372; E.S. Mason, “The Current Status of the Monopoly Problem in the United States” (1949) 62 *Harvard Law Review* 1266-1267.

Kaysen and Turner from the Harvard School assume that competition policy can have four alternative objectives:

(1) Limitation of the power of big business; (2) performance (efficiency and progressiveness); (3) “fair dealing”; and (4) protection of competitive process by limiting market power.⁸

However, even though the authors recognise only performance as being part of efficiency, all four objectives have an impact on efficiency. Furthermore, there are other economic values apart from competitive prices which constitute efficiency and from which society can benefit, such as innovation. Therefore, progressiveness should not be separated from efficiency but should be considered as its part. Innovation, diversity and output can increase or decrease economic levels.

From a jurisprudential point of view, the term “competition” includes not just consumers but mainly competitors and the state as its subjects. The object of competition is not subjective but generally emphasises economic effect and benefit to the whole society and the state. Besides legal and theoretical analysis, such understanding of efficiency is also supported by economic disciplines. A basic economic model measuring efficiency is formed not only from consumer surplus but also from producer surplus and total welfare, and considers welfare on all markets and within the whole competition chain rather than just within consumer welfare.⁹ An older welfare model was based on Pareto optimality. It promoted consumer rather than total welfare as it argued that the transferring of wealth from consumers to producers was harmful.¹⁰ Later, total welfare was enriched by the concept of Kaldor-Hicks efficiency, which showed that the outcome was efficient not just if there were no losers, as in Pareto optimality, but also when the winners won more than the losers lost. Thus, winners can compensate for losers and still have an extra part of surplus left for them.¹¹ Therefore, total welfare is not based on the results from when consumers receive all the welfare, but rather when the most efficient participants receive the highest and thus equivalent profits. Such a situation is beneficial for the whole of society, including consumers.

⁸ C. Kaysen, and D.F. Turner, *Antitrust Policy, An Economic and Legal Analysis* (Harvard University Press, 1959) 44.

⁹ R.L. Steiner, “The *Leegin* Factors – a Mixed Bag” (Spring 2010) 55 *Antitrust Bulletin* 44-45, 51.

¹⁰ V. Pareto, *Manuale d'economia politico* (Milan, 1906).

¹¹ J. Hicks, “The Foundations of Welfare Economics” (1939) 49 *Economic Journal*, 696-712; N. Kaldor, “Welfare Propositions in Economics and Interpersonal Comparisons of Utility” (1939) 49 *Economic Journal* 549-552; also see Steiner, “The *Leegin* Factors” 44-45, 51.

2.2.2. Different Efficiencies

Generally, to understand the basics of efficiency, one can use Pareto optimality,¹² which states that “if everyone is made better off by the change (or no one is made worse off, and at least one person is made better off), then... the change is good”.¹³ However, reality usually includes cases where some parts of a society are better off and others are worse off, as is reflected in the Kaldor-Hicks model of efficiency.¹⁴ Positive and negative impacts must be measured and compared to determine whether particular behaviours are efficient or inefficient.

The issue is further complicated by the different kinds of efficiency that exist in reality. The basic differentiation is between allocative and productive efficiency. Productive efficiency concentrates on a particular competitor and their business strategy and coordination of sources; thus, efficiency where resources are used in different stages of the vertical chain, such as production or distribution.

Allocative efficiency refers to the market and the welfare of society; it considers available sources at various levels of production and industry.¹⁵ Understanding allocative efficiency is problematic because its definition differs as it is not possible to measure it in a precise and economic way. Nevertheless, Hovenkamp and Hammer contend that allocative efficiency is the economic efficiency that should play the main role in antitrust policy as it can determine total welfare.¹⁶

Although allocative efficiency reflects total welfare better than productive efficiency, which is focused on a particular entity, it does not involve all aspects of efficiency within competition. Leibenstein argues that the term “efficiency” is broader than the economic term “allocative efficiency” for the purposes of competition and competition law. He terms efficiency, which is not part of allocative efficiency, as “X-efficiency”. He claims that allocative efficiency has a trivial impact on the market and the economy because allocative

¹² Pareto, *Manuale d'economia politico*.

¹³ W.K. Viscusi, *Economics of Regulation and Antitrust*, Second Edition (The MIT Press, 1995) 74.

¹⁴ P.J. Hammer, “Antitrust beyond Competition: Market Failures, Total Welfare, and the Challenge of Intramarket Second-Best Tradeoffs” (2000) 98 *Michigan Law Review* 849-925; Viscusi, *Economics of Regulation*, 74.

¹⁵ See R.L. Steiner, “How Manufacturers Deal with the Price-Cutting Retailer: When Are Vertical Restraints Efficient?” (1997) 65 *Antitrust LJ* 445; J.F. Brodley, “The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress” (1987) 62 *NYULRev* 1020, 1025.

¹⁶ Hovenkamp, *Federal Antitrust Policy*, p. 72; Hammer, “Antitrust beyond Competition” 876-879.

efficiency is based only on the net marginal effects. This leads to the general assumption that every entity purchases and uses all of its inputs efficiently.¹⁷

X-efficiency also includes productive efficiency; Leibenstein recognises aspects such as management, employee motivation and knowledge, properly operated incentive plans, working conditions, invention and innovation as significant factors in efficiency.¹⁸ However, even this efficiency is not absolute as it has some gaps based on human imperfection. X-inefficiency includes, for example, non-absolute motivation and non-utilisation of labour, unknown production functions and imperfections in some inputs.¹⁹ This could also include Williamson's bounded rationality and opportunism, which can lead to entities making mistakes in efficiency.²⁰ Therefore, X-efficiency is impossible to measure precisely.²¹

From a legal point of view, competition law on its own cannot directly regulate whether a company will make an effective, low-cost business decision based on productive efficiency and also X-efficiency. It is necessary that entities have the freedom to legally manage their business and carry the responsibility for inefficient decisions. Ineffective entities will risk bankruptcy on the fair competitive market, which should be ensured by competition law. The more ineffective decisions made by an entity should increase the possibility that the entity will become bankrupt. Competition law, by directly influencing aspects of economy, guarantees the right competitive conditions for a particular market and provides internal (productive) and external (allocative) economic efficiency, which both include X-efficiency. Internal efficiency is maintained by governing external efficiency.

Efficiency can be also divided into the categories of dynamic and static. Dynamic efficiency is a process based on the idea that competing companies must focus on innovation and research to keep consumers interested and to remain in the market.²² Schmidt points out that what matters and what should be examined by competition authorities and the courts is dynamic efficiency and not static efficiency.²³ However,

¹⁷ H. Leibenstein, "Allocative Efficiency vs. 'X-Efficiency'" (1966) 56 *American Economic Review* 392-415.

¹⁸ *Ibid*, pp. 401-415.

¹⁹ *Ibid*, pp. 406-413.

²⁰ O.E. Williamson, *Antitrust Economics: Mergers, Contracting, and Strategic Behaviour*, (Basil Blackwell, New York, 1987), 126-127; for further discussion see Chapter 3 "Vertical Competition and Structure".

²¹ See also L. De Alessi, "Property Rights, Transaction Costs, and X-Efficiency: An Essay in Economic Theory" (1983) 73 (1) *American Economic Review* 70.

²² P.J. Harbour, L.A. Price, "RPM and the Rule of Reason: Ready or Not, Here We Come?" (2010) 55 *Antitrust Bulletin* 240-242.

²³ Schmidt, "The Suitability" 408-409.

dynamic efficiency is based on a changeable and ongoing process in the market and it is therefore difficult to measure precisely.²⁴

In reality, competition and thus its efficiency are not static. It is impossible to measure dynamic efficiency as complex, static moments. In other words, situations at the beginning of applying a restriction and at any time after its application is used can be compared with situations on a market without restrictions.²⁵ Hence, if the antitrust approach is based on economic analysis, authorities and the courts should survey the complexity of efficiency comparing situations with and without particular vertical restraints within an exact time slot. Nonetheless, as it follows from this subchapter, such an approach is technical, time-consuming and costly, and contains one certainty: it is impossible to consider and analyse all forms and aspects of efficiency.

2.3. The Objective of Competition Law: Effective Competition

Although economic efficiency can be recognised as the main objective of competition law, it is more precise to argue that the aim of the economic efficiency approach is to protect competition²⁶ and the objective of antitrust/competition law is the protection of markets and an assurance that they are competitive.²⁷ In other words, as Furse states, competition law must prevent free competition from being disturbed to protect the entire competitive process.²⁸ Similarly, the Ordoliberalist School believes that competition law should protect the process of competition as a means of protecting individual economic freedom. Therefore, competition should be free and best performing for the whole society, with competition law as a regulator of this process.²⁹ To summarise, the protection of

²⁴ D. Hildebrand, "The European School in EC Competition Law" (2002) 25 *World Competition* 3, 8-9; G., Stigler, "Perfect Competition, Historically Contemplated" (1957) 65 *The Journal of Political Economy* 1; J.M. Clark, "Toward a Concept of Workable Competition" (1940) 30 *The American Economic Review* 241; also see Harbour, Price, "RPM" 240-241.

²⁵ EU Courts have clarified that situations with and situations without a particular restriction should be compared to determine the effects on competition: See Case 56/65, *Société La Technique Minière v Maschinenbau Ulm GmbH* [1966] ECR 235, [1966] CMLR 357, CMR 8047.

²⁶ E.T. Sullivan, H. Hovenkamp, *Antitrust Law, Policy and Procedure: Cases, Materials, Problems*, Fifth Edition, (LexisNexis, Newark, 2004) 2.

²⁷ Hovenkamp, *Federal Antitrust Policy*, 3.

²⁸ M. Furse, M. *Competition Law of the EC and UK*, Sixth Edition (Oxford University Press, 2008) 1; also see M. Bennett, A. Fletcher, E. Giovannetti, D. Stallibrass, "Resale Price Maintenance: Explaining the Controversy, and Small Steps Towards a More Nuanced Policy" (2010) MPRA Paper No. 21121, posted 4 March 2010/18:02, (at <http://mpra.ub.uni-muenchen.de/21121/>), p. 5.

²⁹ W. Möschel, "Competition Policy from an Ordo Point of View" in Peacock, A.T., Willgerodt, H. (eds), *German Neo-Liberals and the Social Market Economy* (Macmillan, London, 1989); W. Eucken, *The Foundations of Economics, History and Theory in the Analysis of Economic Reality* (William Hodge, London, Edinburgh, Glasgow, 1950) 314.

competition, in other words, of a competitive process without anticompetitive restrictions ensures economic freedom for competing entities, total welfare and fair allocation of resources.

In the EU and in the USA, the competition authorities and the courts as the final instances set the objective of competition/antitrust law. However, most notably in the EU, the authorities and the courts interpret the existing legislation and therefore, the objective(s) set by them must reflect the words and meaning of the relevant provisions.

The courts have stated in several cases that the Sherman Act and Articles 101 and 102 of the TFEU protect competition, effective competition or economic efficiency and not just competitors, consumers or the common market as was contended in the earliest cases.³⁰ Recently, in 2009, the Court of Justice of the European Union (CJEU) stated that the aim of Article 101 TFEU was not only to protect consumers but mostly to protect effective competition, which includes the protection of the market structure.³¹

However, even though establishing the main goal of competition law seems to be essential, it has been neither consistent nor static. This is mainly true in the US. The US courts have used different policies as goals of US antitrust law since its existence; for instance, protection of small businesses,³² preserving small decentralised businesses rather than allowing them to merge or grow,³³ protection of mere interbrand competition,³⁴ protection of free choice for consumers³⁵ and protection of consumer welfare.³⁶

³⁰ See US: *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988), at 756 – Justice Stevens dissenting; *National Society of Professional Engineers v. United States*, 435 U.S. 679 (1978), at 691-695; *Northern Pacific Railway v. United States*, 356 U.S. 1 (1958), at 4; EU: C-501 P, C-513/06 P, C-515/06 P, C-519/06 P, *GlaxoSmithKline Services Unlimited v Commission of the EC* [2009] 4 CMLR 2, paragraphs 62-64; C-234/89, *Delimitis (Stergios) v. Henninger Bräu*, 28 February 1991, [1991] ECR I-935, [1992] 5 CMLR 210, [1992] 2 CEC 530; Case 56/65, *Société La Technique Minière v Maschinenbau Ulm GmbH* [1966] ECR 235, [1966] CMLR 357, CMR 8047, p. 249; cases T-374, 375, 384 and 388/94, *European Night Services v. Commission* [1998] ECR II-3141 [1998] 5 CMLR 718; Chapter 4 “Development of the US Law of Vertical Territorial and Price Restraints” and Chapter 5 “Development of the EU Law of Vertical Territorial and Price Restraints”.

³¹ C-501/06 P, C-513/06 P, C-515/06 P, C-519/06 P, *GlaxoSmithKline Services Unlimited v Commission of the EC* [2009] 4 CMLR 2, paragraph 63 (citing C-8/08 *T-Mobile Netherlands BV v Road van bestuur van de Nederlandse Mededingingsautoriteit* [2009] 5 CMLR 11, paragraphs 38-39).

³² See *United States v. Trans-Missouri Freight Association*, 166 U.S. 290 (1897), at 322-323.

³³ See *United States v. Von's Grocery Co.*, 384 U.S. 270 (1966), at 274-275; *United States v. Brown Shoe Co.*, 370 U.S. 294 (1962), at 344.

³⁴ *PSKS, Inc. v. Leegin Creative Leather Products, Inc.*, 615 F.3d 412 (5th Circuit 2010), at 419; *Leegin Creative Leather Products, Inc. v. PSKS, Inc., DBA Kay's Closet...Kays' Shoes*, 551 U.S. 877 (2007), at 906; *State Oil Co. v. Khan*, 522 U.S. 2 (1997), at 15.

³⁵ *Leegin Creative Leather Products, Inc. v. PSKS, Inc., DBA Kay's Closet...Kays' Shoes*, 551 U.S. 877 (2007), at 928 (Justice Breyer dissenting).

Most importantly, the objective of competition law being the protection of competition as a process is supported by collocations of words used in the Sherman Act and in the TFEU. Section 1 of the Sherman Act, as the main piece of legislation on US antitrust law, prohibits multilateral conducts, which are “in restraint of trade or commerce”; and Section 2 uses such words as “[e]very person who shall monopolize... any part of the trade or commerce...”. The Act is focused on the business affairs of the market when using words such as “trade” and “commerce” and also prohibits restrictions or monopolisation as forms of restrictions on competition. The Clayton Act prohibits any conduct that may substantially lessen competition under Section 7. This is in harmony with the protection of effective competition. Section 5 of the 1914 Federal Trade Commission (FTC) Act focuses on fairness rather than its effectiveness in competition when it condemns “unfair methods of competition”.³⁷ Thus, the FTC Act covers unfair competition law if the differentiation typical of the continental European legal system is used.

Protection of competition is even more obvious from the text in the TFEU. Article 101 prohibits multilateral conducts “... which have as their object or effect the prevention, restriction or distortion of competition ...”. Article 102 of the TFEU considers illegal “[a]ny abuse by one or more undertakings of a dominant position ... as it may affect trade between Member States”. It is reasonable to recognise abuse that affects trade as another form of restriction on competition. Article 101 directly quotes “restriction on competition” as illegal. Furthermore, Article 120 of the TFEU requires that the EU and the Member States act in accordance with the “principle of an open market economy with free competition”.

Therefore, antitrust/competition law, as its principal objective, protects and should protect competition and its process. Competition maintains primarily allocative efficiency and other objective efficiencies which have an impact on productive efficiency. Further, it must be specified what competition, and in which form, protects best the competitive process and thus maximises efficiency.

³⁶ See *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993); *Business Elec. Corp. v. Sharp Elec. Corp.*, 485 U.S. 717 (1988); *Broadcast Music, Inc. v. Columbia Broadcasting Sys.*, 441 U.S. 1 (1979); *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977); *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477 (1977).

³⁷ For further discussion see Hammer, “Antitrust beyond Competition” 906-914.

2.3.1. Effective Competition

In 1985, the European Commission focused its policy on effective competition, which protected the freedom of participants in the competitive process and free competition.³⁸ Additionally, recent developments in EU competition law have seen a notable use of the phrase “effective competition”³⁹ and “fully-effective internal market”.⁴⁰ Unfortunately, an official explanation of the meaning of the phrase “effective competition” has, to date, proven elusive.

Bishop and Walker explain “effective competition” as competition that increases consumer welfare.⁴¹ Buttigieg goes further to explain that competition law’s most important objective is that of the protection of consumer interest.⁴² However, as discussed previously, the protection of consumer interest should be an objective of consumer law and not that of competition law, as competition law has an objective and not subjective nature. Consumers are just one aspect and one subject of competition law. Overall efficiency determines total welfare, not just that of consumer welfare.

As argued by Vickers and Hay, it is more appropriate to recognise effective competition as achieving “a more efficient allocation of resources”.⁴³ Steiner refuses to focus merely on consumer welfare in antitrust law and also refuses the protection of one kind of competition, interbrand or intrabrand, as the objective of the law of vertical restraints. He believes that focus should be aimed at total social welfare measured by a total surplus, the sum of three surpluses (consumer, manufacturer and distributor), as it considers efficiency

³⁸ European Commission, XV Annual Report on Competition Policy 1985 (1986).

³⁹ See e.g. Case 85/76, *Hoffmann-La Roche & Co. AG. v. Commission* [1979] ECR 461, [1979] 3 CMLR 211, paragraph 38; Case 2/76, *United Brands v. Commission* [1978] ECR 207, [1978] 1 CMLR 429, paragraph 65; Communication from the Commission - Guidance on the Commission’s enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, C(2009)864, Art. 6, 10, 18, 27; Council Regulation 139/2004 [2004] OJ L124/1 (Merger Regulation), Art. 2 (3); Commission Evaluation Report on the Operation of Regulation No 1400/2002 Concerning Motor Vehicle Distribution and Services, p. 3; European Commission, Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, [2004] O.J. C31/5, paragraph 76; Competition Policy in Europe, The Competition Rules for Supply and Distribution Agreements, <http://europa.eu.int> [08/2008], p.5; Bishop, Walker, *The Economics of EC*, 11-12.

⁴⁰ The Treaty of Lisbon, Protocol 27.

⁴¹ Bishop, Walker, *The Economics of EC*, 16; see also Schmidt, “The Suitability” 411.

⁴² E. Buttigieg, *Competition Law: Safeguarding the Consumer Interest: A Comparative Analysis of US Antitrust Law and EC Competition Law* (Kluwer Law International, 2009), 1-3.

⁴³ D. Hay, J. Vickers, “The Economics of Market Dominance” in D. Hay, J. Vickers, (eds), *The Economics of Market Dominance* (Oxford University Press, 1987), 2.

and productivity in the market.⁴⁴ Therefore, the effectiveness of competition as the objective of the law of vertical restraints can be measured by a total surplus.

Even consumer associations have recognised that competition law should be focused on total welfare and should protect effective competition.⁴⁵ Moreover, legislation and some case law should pay attention to the protection of competition not the protection of an aspect of competition. Related efficiency is focused on other primarily objective aspects. Indeed, consumer welfare and its interests are protected and increased by effective competition as a secondary effect; in other words, as a consequence of the protection of competition. Similarly, Furse claims that consumers can benefit from the protection of competition, even though this is not the direct objective of competition law.⁴⁶ In general, when competition is effective the whole society should benefit.⁴⁷ Therefore, effective competition is competition protecting efficiency and thus maximising total welfare.

Although the European Commission uses the phrase “effective competition”, its most recent test is a test of the protection of consumers,⁴⁸ which might, and arguably does, narrow the aim of effective competition. However, understanding of the term “consumers” within the Commission’s tests is broad as it includes anybody who purchases from the undertaking concerned. Therefore, it also includes other undertakings at the vertical level.

Some illegal conducts, such as horizontal cartels, can sometimes harm just consumers; however, simultaneously, the competitive process is hindered. Nevertheless, a clear test of balancing the harm with the benefits of a conduct on all players in the market within competition, except for the benefit of restricting undertaking(s), would better reflect the genuine objective of competition law, which is effective competition. The CJEU recently criticised the Commission in this sense, stating that EU competition law protects not just

⁴⁴ Steiner, “The *Leegin* Factors” 44-45, 51; also see R.L. Steiner, “Sylvania Economics – A Critique” (1991) 60 *Antitrust L.J.* 41; also see Hammer, “Antitrust beyond Competition” 849-925.

⁴⁵ For instance, see Consumer Focus (the statutory organisation for consumers across England, Wales, Scotland and Northern Ireland) “Consumer Focus Response to Vertical Restraints Block Exemption Regulation” (September 2009) pp. 3, 4.

⁴⁶ Furse, *Competition Law*, 2.

⁴⁷ R.L. Steiner, “Exclusive Dealing + Resale Price Maintenance: A Powerful Anticompetitive Combination” (2004) 33 *Sw.U.L.Rev.* 476.

⁴⁸ See, e.g., European Commission, Guidelines on the application of article 81(3) [2004] O.J. C101/97, paragraph. 13; see Chapter 5 “Development of the EU Law of Vertical Territorial and Price Restraints”.

the welfare of consumers, but primarily competition itself, which includes the structure of the market, based on the text of the antitrust rules in the TFEU.⁴⁹

In the US, the Department of Justice (“DOJ”) very clearly highlights that antitrust law must protect competition as a process:

For over six decades, the mission of the Antitrust Division has been to promote and protect the competitive process — and the American economy — through the enforcement of the antitrust laws.⁵⁰

Furthermore, recently, the Antitrust Division has focused on other values that complement efficiency in competition: economic freedom and fairness.⁵¹ These values, already discussed above, ensure that competitors are free to compete, are not restricted by anticompetitive interests of other competitors and are therefore rewarded fairly for increasing efficiency in the form of procompetitive behaviour. Indeed, as this thesis will analyse further, primarily in Chapter 6 “Theories of Pro-Competitiveness v. Anti-Competitiveness”, economic freedom and fairness do not contradict but rather enhance the protection of effective competition.

2.3.2. The Term “Competition”

It is necessary to understand the meaning of the term “competition” to establish boundaries for effective competition. For example, Cann sets the meaning of the term “competition” within the terms of allocative and productive efficiencies which determine the level of consumer satisfaction, including interbrand as well as intrabrand relationships.⁵² Fox is more concerned about business itself when explaining the term “competition”, arguing that, aside from reflecting legislative intent, it should also consider business initiatives, decentralised decision-making and power diffusion.⁵³

These explanations of competition include several attributes of competition but are arguably not complete. The understanding of competition in accordance with both the

⁴⁹ See cases C-501/06 P, C-513/06 P, C-515/06 P, C-519/06 P, *GlaxoSmithKline Services Unlimited v Commission of the EC* [2009] 4 CMLR 2; C-8/08 *T-Mobile Netherlands BV v Raad van bestuur van de Nederlandse Mededingingsautoriteit* [2009] 5 CMLR 11.

⁵⁰ DOJ, Antitrust Division, “Overview” (Washington, DC, 29/09/2009), <http://www.usdoj.gov/atr/overview.html>.

⁵¹ DOJ, Ch.A. Varney, “Vigorously Enforcing the Antitrust Laws: Developments at the Division,” (Washington, DC, 24/6/2011, <http://www.justice.gov/atr/public/speeches/272536.pdf>), pp. 1, 15.

⁵² Cann, “Vertical Restraints” 526-528.

⁵³ Fox, “The Modernization of Antitrust” 1153-1155, 1182-1190.

Sherman Act and the TFEU is based on competition in the market considering the general and total impact of restrictions on the market, without concentrating on individual competitor's or only on consumers' interests.

Competition does not only exist among competitors offering similar products or services (interbrand competition), but also among competitors who sell one-brand products produced by one manufacturer (intra-brand competition). Steiner, Cann and Burns claim that not only interbrand competition should be discussed when making judgments about a particular vertical restraint, but also intra-brand competition, and that both, including vertical competition, should be protected by competition law.⁵⁴

Therefore, the term "competition" consists of the following aspects:

- *Competitors*: Competition must exist; this means that there are competitors competing in the market and also on the vertical chain.⁵⁵
- *Competitive Environment*: There should not be any restrictive, efficiency-hindering agreements or other artificial actions or boundaries which would prevent competitors from competing.
- *Market*: Each market and related vertical markets are specific because of the nature of the product, environment, competitors' and consumers' choice. Hence, different forms of competition are suitable for different markets.
- *Consumers*
- *Product (or Service) and its Substitutes*.

To summarise, competition is a state of affairs and allocation of resources among competitors, including vertical competitors, who are driven by rivalry and are influenced by consumers' choices and preferences, and thus maintain a competitive environment in the market concerned, as well as in vertically related markets.

2.4. Basic Models of Markets and Market Behaviour

Competition can be effective only when it respects the nature of the market concerned. Although, generally, perfect competition is an ideal situation, it is not always effective to

⁵⁴ Steiner, "The *Leegin* Factors" 32; J.W. Burns, "Vertical Restraints, Efficiency, and the Real World" (1993) 62 *Ford. L. Rev.* 597; Cann, "Vertical Restraints" 526-549; for further discussion see Chapter 3 "Vertical Competition and Structure".

⁵⁵ See Chapter 3 "Vertical Competition and Structure".

aim for such a situation if the nature of the market inclines to a different model. Hence, basic models and theories are briefly discussed here to assist with finding the appropriate systems for different markets, to explain the functions of competition and to understand differences in market structures.

2.4.1. Perfect Competition Model

The perfect competition theory, with its roots in Adam Smith's idea of the competitive market, supposes that a firm's objective is profitability and the only consumer choice is price, while the company's profit only covers its maintenance of investment in the industry.⁵⁶ Perfect competition is a situation where prices equal marginal costs; output is the highest possible and prices are the lowest possible.⁵⁷ The theory can apply when there is a competitive environment in a market that includes:

- An industry with a number of small firms with small outputs;
- The firms are producing identical, homogenous products;
- They have the same access to inputs and free and available information about the market and competitors;
- They are charging the same price; and
- Manufacturers and distributors compete and create perfect competition.⁵⁸

This theory is based on the relationship between supply and demand. To sell for the most competitive price, supply must cover the whole demand while making a profit high enough to cover companies' investments.⁵⁹ If the company tries to sell its product for a higher price it would not make any sales, and if it tries to sell under the market price it would lose the highest perfect competition profit. If new companies enter the market, the quantity supplied will exceed the quantity demanded and the price will therefore fall. If the price is too low, companies will leave the market or decrease their production to make an

⁵⁶ D. Besanko, ... [et al.], *Economics of Strategy*, Fifth Edition (John Wiley & Sons, 2010), p. 30; Hovenkamp, *Federal Antitrust Policy*, 3; Bishop, Walker, *The Economics of EC*", 17.

⁵⁷ H. Hovenkamp, *The Antitrust Enterprise: Principle and Execution* (Harvard University Press, London, 2005),16.

⁵⁸ Besanko, *Economics of Strategy*, 30-31; Hovenkamp, *Federal Antitrust Policy*, 3; P. Areeda, L. Kaplow, A. Edlin, *Antitrust Analysis: Problems, Text and Cases*, Sixth Edition (Aspen, 2004), 5; V. Korah, *An Introductory Guide to EC Competition Law and Practice* Ninth Edition (Hart Publishing, 2008), 13; Bishop, Walker, *The Economics of EC*", 17; Harrington, Vernon, Viscusi, *Economics of Regulation*, 73; R.B. Bouterse, *Competition and Integration – What Goals Count?* (Kluwer Law and Taxation Publishers, Deventer – Boston, 1994), 22-23.

⁵⁹ Hovenkamp, *Federal Antitrust Policy*, 3-4; Bishop, Walker, *The Economics of EC*", 17-19.

accounting profit but most likely without an economic profit. Hence, the price remains optimal for consumers and high enough for producing companies.⁶⁰

The model of perfect competition does not take into account any external factors, such as changes in consumer income, new inventions replacing old products, war and, most importantly, all of the factors aside from price that come from competing among competitors, such as quality, availability and promotion.⁶¹ Furthermore, the theory of contestable markets recognises perfect competition as competition in a market where there is no need for regulation by competition law because the market is perfectly contestable with absolutely free entry and an absolute costless exit.⁶² Nevertheless, competition law is necessary in contestable markets because without law there is no guarantee that barriers will not be created in the future.

2.4.2. Game Theory, Oligopoly

Game theory is based on the probability of the reactions of rivals which have an impact on market price, thus highlighting subjective business decisions. Companies try to predict how their rivals will react, particularly in a market with a small number of competitors, such as Boeing and Airbus in the aircraft-production market. The main factor of this theory is profit-making for the competing companies.⁶³ Part of game theory is Nash Equilibrium, which considers the strategies of other players while trying to find the best strategy for the player who “plays the game”, including not just profit maximisation, but also expansion of capacities and anything which is in their collective interest.⁶⁴ For example, if a company increases price this would lead to a higher profit only if the strategies of its competitors follow its example and increase their prices as well.

Game theory is typical of an oligopoly or oligopsony.⁶⁵ An oligopoly or oligopsony is natural for transparently-concentrated markets with homogenous products, significant barriers to entry and inelastic demand. Moreover, game theory can be used with regards to

⁶⁰ Besanko, *Economics of Strategy*, 30-35; Bishop, Walker, *The Economics of EC*”, 17-19.

⁶¹ Hovenkamp, *Federal Antitrust Policy*, 7.

⁶² W.J. Baumol, “Contestable Markets and Uprising in the Theory of Industry Structure” (1982) 72 *American Economic Review*, 1.

⁶³ Besanko, *Economics of Strategy*, 34-35.

⁶⁴ *Ibid.*, pp. 36-37; Hovenkamp, *Federal Antitrust Policy*, 162-165; Bishop, Walker, *The Economics of EC*”, 28-29.

⁶⁵ H. von Stackelberg, *Marktform und Gleichgewicht* (1934, Julius Springer, Berlin) in P. Dobson, M. Waterson, A. Chu, “The Welfare Consequences of Exercise of Buyer Power” 16 (Sept. 1998) Office of Fair Trading, Research Paper, p. 8.

artificial oligopolies, such as concerted practices or other cartels. However, in contrast to natural oligopoly, competitors are at risk of cheating in cartels.⁶⁶

The conflict between self and collective interests is referred to as the prisoners' dilemma⁶⁷ and is more typical of an artificial oligopoly. For instance, increasing production can increase a company's profit; however, in this case, it would be in other competitors' interests to increase their production, which would in turn decrease the first company's profit. Therefore, the collective interest is to keep production the same, giving all competitors the ability to obtain the best profit from their collective profits. However, in some situations,⁶⁸ when the company makes the first strategic move, it will increase its profit while other competitors can only accommodate their own strategies around the first company's strategy, not to lose but to keep their profits as high as possible.⁶⁹ This can also mean a risk for the leading entity, as it can lead to profit loss if, for instance, the leading company increases its prices and its competitors do not and consumers subsequently switch to competitors.

2.4.3. Monopoly Model and Social Cost

The ideal monopoly or monopsony includes markets which consist of one monopolist and significant barriers to entry. A monopolist with absolute power will set the price at the highest possible level to receive maximum profit. Each product has its natural price peak. If the price is higher than this price maximum limit, consumers will decrease their purchase in such an amount that the monopolist will lose its profit.⁷⁰ As Hovenkamp explains:

The monopolist will not be able to charge an infinite price for its product. Even the orthodontists may be unwilling to pay more than \$3000 per pound for steel; if the price goes higher they will change to silver or some other alternative.⁷¹

The scenario of an absolute monopolist earning the maximum profit includes social cost, which is a net loss that society suffers as a result of absolute monopolistic behaviour. The

⁶⁶ See, e.g. EU: C-89/85, 104/85, 114/85, etc. *Ahlström Oy v Commission* [1993] 4 CMLR 407; C-172/80, *Züchner v. Bayerische Vereinsbank* [1981] ECR 2021, [1982] 1 CMLR 313; US: *E.I. Du Pont De Nemours & Co v. FTC*, 729 F.2d 128 (1984, 2d Cir.).

⁶⁷ Besanko, *Economics of Strategy*, 27-28.

⁶⁸ Where demand is not inelastic or absolutely inelastic which is, again, not typical of a natural oligopoly.

⁶⁹ Besanko, *Economics of Strategy*, 36-38.

⁷⁰ Hovenkamp, *Federal Antitrust Policy*, 12-17; Areeda, Kaplow, Edlin, *Antitrust Analysis*, 10-14; Bishop, Walker, *The Economics of EC*, 21-23.

⁷¹ Hovenkamp, *Federal Antitrust Policy*, 12.

social cost is less if the monopoly has an efficient impact on society. For example, fairly created monopolies based on innovative, patented products can increase social benefits rather than decrease them when introducing such products into newly created markets.⁷² Moreover, the nature of some markets predicts that there can be space only for a limited number of companies, for instance, the railway market. A private company would probably introduce a maximum profit price if it is not regulated by the state.⁷³

2.4.4. Models and Real Markets

Although the perfect competition model assists with predictions as to whether a certain situation is efficient in the market, it cannot answer the question of whether other aspects or effects on competition should be considered and whether the market itself is suitable for this model.⁷⁴ Furthermore, such horizontal focus does not consider the effects of certain vertical conducts on related vertical markets.⁷⁵ The same can be said for all models; they are useful in understanding the nature of competition however the reality is generally more complicated.

Moreover, real competition is never based solely on price competition but on other ways of competing and other interests of competitors and consumers, such as services.⁷⁶ Cann argues that consumer choice can be made “upon geographic accessibility, product differentiation, misinformation and intensity to price quality adjustment”.⁷⁷

The perfect competition model assumes that production and distribution costs are the same. However, a new process could be developed by one company which decreases production costs and thus creates an advantage over its competitors and allows that company to increase its production and decrease its price.⁷⁸ Even in markets where society benefits from having a high number of competitors, competing products can be differentiated. This is not just the case for sophisticated and technical products, but basic goods such as fruit and metals can also be differentiated by competitors in terms of specific distribution,

⁷² Ibid., pp. 17-20; Areeda, Kaplow, Edlin, *Antitrust Analysis*, 25-27; see also Viscusi, *Economics of Regulation*, 84-87

⁷³ Hovenkamp, *Federal Antitrust Policy*, 31-34.

⁷⁴ Ibid, pp. 26-27, 71; Areeda, Kaplow, Edlin, *Antitrust Analysis*, 10.

⁷⁵ Further see Chapter 3 “Vertical Competition and Structure”.

⁷⁶ See Chapter 6 “Theories of Pro-Competitiveness v. Anti-Competitiveness”.

⁷⁷ Cann, “Vertical Restraints” 526-549.

⁷⁸ See Hovenkamp, *Federal Antitrust Policy*, 26-31.

country of origin, trademarks or specific packaging. For this reason, manufacturers and distributors can make different arrangements and introduce restrictions.⁷⁹

On the other hand, a market with products that are homogenous and not differentiated can establish a natural oligopoly. If there are a lot of competitors, an oligopoly has a lot of similarities with perfect competition with the exception that all competitors will try to pursue their own common interest: profit maximisation. The market with fewer competitors will tend to have higher prices than those markets similar to the perfect competition model.⁸⁰

Generally, different strategies and costs, such as distribution costs, must be considered.⁸¹ It is more efficient for some companies to distribute products themselves, while for other companies it may be cheaper to conduct business with independent distributors. Other typical attributes of real markets are research and development costs, patent systems, risks, such as defect products, and government regulation, all of which create barriers to entry.

In reality, different markets and different forms of competition exist. The right market with the right form of competition creates effective competition; different models are available to help and understand different markets. Industrial organisation theory determines this suitability and indicates whether a particular behaviour is or is not efficient in that market. For instance, trying to achieve the perfect competition model can result in an increase in efficiency in some markets while this might not be a suitable structure for other markets.⁸²

2.5. Conclusion

The genuine objective of competition law is to protect effective competition. The right type of competition for the right market increases its efficiency. Such an objective has not always been recognised and applied by the courts and competition authorities as the principal objective of competition law. If antitrust/competition law concentrates on values other than efficiency and protection of competition, for example on the protection of small businesses, then this will be at the expense of such factors as development and research. If effective competition is protected by competition/antitrust law and policy, then each aspect

⁷⁹ See *ibid.*, p. 37; Areeda, Kaplow, Edlin, *Antitrust Analysis*, pp. 18-20; see also Bouterse, *Competition and Integration*, 23-24.

⁸⁰ See Areeda, Kaplow, Edlin, *Antitrust Analysis*, 14, 235.

⁸¹ See Chapter 3 “Vertical Competition and Structure”.

⁸² Hovenkamp, *Federal Antitrust Policy*, 26-27.

of competition will be valued which will lead to fair allocation of resources and thus fair competition. For instance, small business will have its place in the market if the nature of a particular market structure allows it and if small businessmen make effective business decisions. Different groups and subjects of competition and factors creating total welfare in the market will be in harmony and will benefit in the right way.

Perfect competition does not occur in reality, even though the real market can be only a few steps away from perfect competition. Moreover, each market requires a different natural structure. For example, it is naturally impossible for the global aircraft producers' market to include more than a few competitors, and railways will usually only have one owner, making the railway market naturally restricted. Effective competition can be understood as the competition that is the most efficient for a particular market or a particular market model. All aspects of competition including the nature of the market must be considered, to determine the efficiency of competition and efficiency of certain conduct in the market, in other words, whether certain conduct such as RPM or VTR is anticompetitive or pro-competitive. This reflects total welfare, not just consumer welfare and this consideration is complicated due to its complexity.

Chapter 3: Vertical Competition and Structure

“For every seller there is a buyer.”¹

3.1. Introduction

The previous chapter, “Objective of the Law of Vertical Territorial and Price Restraints” explains that the principal objective of the law of vertical territorial and price restraints is the protection of effective competition enhancing efficiency. Along with the following chapters, it highlights that analysis and an understanding of the nature of competition, the market and its interactive aspects within the vertical chain is essential for studying RPM and VTR as this creates the basis for the determination of anti-competitiveness or pro-competitiveness of RPM and VTR, and thus their best legal approach. Such key elements including, among others, market structures, horizontal market power, bargaining power and their vertical interactions show whether RPM and/or VTR occurring in specific markets with specific vertical relationships hinder effective competition and if yes to what extent; or whether RPM and VTR have the potential to improve efficiency and hence to increase effective competition in certain markets. Therefore, this chapter critically surveys these key aspects. It studies the nature of vertical interactions between markets and between vertical relationships and thus it sets this market analysis within a framework of vertical chains and vertical competition revealing that bargaining power influences the existence of VTR and/or RPM and determines the intentions for their applications. The existence of vertical competition is also established and explained in this chapter.

3.2. Distribution and Its Forms

3.2.1. Vertical Integration and Its Aspects

Non-integrated companies cooperate with independent entities in order to specialise in one aspect of the vertical process, such as manufacturing or distribution. However, any entity has the option to be vertically integrated; therefore, to produce, distribute and sell its products/services on its own or with the assistance of agencies, thus being self-sufficient in

¹ R.D. Blair, J.L. Harrison, “Antitrust Policy and Monopsony” (1990-1991) 76 *Cornell L. Rev.* 298, 339.

areas where it could obtain assistance from another entity.² In 1925, Frank explained that vertical integration is “the functional coordination of one or more units in each of the several successive stages of production, so that they are all operated as a single, unified industrial process”.³

The basic principles of how the market and companies operate are explained in “the neoclassical model of economic welfare”, which has its roots in the theories of Adam Smith.⁴ John Bates Clark, William Jevons and Alfred Marshall introduced the marginal cost curve. They believed that strategic companies make their decisions based on the value and cost of the next choice, because they are concentrating on the future and not on an evaluation of past accounting costs.⁵

Indeed, it is not just the matter of capital but also that of efficiency which plays an important role when deciding whether an entity will be vertically integrated or not. Even the current markets of developed countries include both situations. This is determined by the nature of the market and by all of its aspects, including the nature of the product.

Any business decision and any part of the business process, including bargaining with non-integrated entities or taking responsibility for an integrated part of an entity, has its transaction costs. Consideration of this cost determines the structures of companies.⁶ In addition to this, companies make strategic decisions based on different transaction costs with their bounded rationality, which is based on limited information.⁷ Transaction costs and economies of scale offer explanations as to why some markets and/or producers are vertically integrated and others are not.⁸ For instance, Hovenkamp explains that a small pizza restaurant delivers its own pizzas rather than hires delivering companies because it is cheaper, quicker and probably more reliable and is, therefore, more efficient. By contrast, very large manufacturers such as Colgate-Palmolive or General Electric do not usually sell

² M. Ricketts, *The Economics of Business Enterprise: An Introduction to Economic Organization and the Theory of the Firm* (London, Edward Elgar 2002).

³ L.K. Frank, “The Significance of Industrial Integration” (1925) 33 *J.Pol.Econ.* 179.

⁴ H. Hovenkamp, *The Antitrust Enterprise: Principle and Execution* (Harvard University Press, London, 2005), 15.

⁵ A. Marshall, *Principles of Economics* (London: Macmillan, 1890); W.S. Jevons, *The Theory of Political Economy* 3rd Edition (London: Macmillan, 1888); J.B. Clark, *The Philosophy of Wealth* (Boston: Ginn, 1886).

⁶ R. Coase, “The Nature of the Firm” (1937) 4 *Economica* 386; also see H. Hovenkamp, “Harvard, Chicago, and Transaction Cost Economics in Antitrust Analysis” (2010) 55 *Antitrust Bulletin* 624-625, 628-630.

⁷ O.E. Williamson, *Antitrust Economics: Mergers, Contracting, and Strategic Behaviour*, (Basil Blackwell, New York, 1987), 24-38.

⁸ M.P. Lynch, “Why Economists Are Wrong to Neglect Retailing and How Steiner’s Theory Provides an Explanation of Important Regularities” (2004) 49 *Antitrust Bulletin* 922-925.

directly to the final customers but, rather, they sell to distributors, dealers or large retailers.⁹

According to Williamson, strategic decision-making based on transaction costs includes two aspects: bounded rationality and opportunism. Bounded rationality means that companies are not absolutely capable of making the most efficient decisions because there are simply too many aspects and too much information that they must consider. Opportunism means that it is wrong to presume that companies always tell the truth, rather if they recognise an opportunity they will do whatever they can not to miss it.¹⁰

Competition law and its policies play an essential role when companies make decisions as to whether they will be vertically integrated. This decision-making process includes other aspects such as innovation.¹¹ Companies judge different situations and make strategic decisions based on the consideration as to whether integration will be more profitable to them, taking into account transaction costs, while constantly evolving.¹² Williamson argues that “neither firms nor markets come in predetermined shapes”.¹³ Although this observation is highly valuable, it could also be argued that it has its limits, mainly in the nature of the markets concerned. Airway transport from Glasgow to Prague is not, and probably will not be, as competitive as the jeans market in Glasgow because of the nature of the market, including entry boundaries.

Ineffective competition policy and law could possibly lead to vertical integrations in markets where the nature of the market determines that market integration is not the most efficient way of distribution. It is arguable whether unlawful RPM and VTR lead to such situations. It also depends on the size of the market. For instance, a German producer of TV sets will not distribute and sell its products on its own in the whole of the EU. Moreover, EU competition law and US antitrust law incorporate stricter approaches regarding both forms of vertical restraints, most notably at the beginning of their existence. However, this has not led to a vertical-integration wave. On the other hand, tolerating the

⁹ Hovenkamp, *The Antitrust Enterprise*, 181-182.

¹⁰ Williamson, *Antitrust Economics*, 126-127; also see W.S. Grimes, “A Dynamic Analysis of Resale Price Maintenance: Inefficient Brand Promotion, Higher Margins, Distorted Choices, and Retarded Retailer Innovation” (2010) 55 *Antitrust Bulletin* 101-149.

¹¹ Hovenkamp, “Harvard, Chicago, and Transaction Cost” 625-626; P.E. Areeda, H. Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application*, (Volume VIII, Second Edition, Aspen Publishers, 2004), 109-113; Williamson, *Antitrust Economics*, 138-141.

¹² Williamson, *Antitrust Economics*, 124-125; also see Hovenkamp, “Harvard, Chicago, and Transaction Cost” 624-625.

¹³ Williamson, *Antitrust Economics*, 124.

existence of RPM and VTR has restricted and even eliminated the businesses of at least some distributors.¹⁴

It is important to note that the purpose and objectives of firms that are integrated or non-integrated differ. Yale economist, Irving Fisher, recognises in his “separation theorem” that a firm’s profit maximising goals differ from the goals of individual shareholders.¹⁵ Therefore, a vertically integrated company’s goal could serve the purpose of its mother firm contrary to the goal of an independent entity operating at the same level which will probably aim at maximising its profit.

Although, it is possible to agree with Easterbrook, that both cooperation across entities and cooperation within one entity are beneficial,¹⁶ it depends on the market structures and other aspects to determine which cooperation is more efficient and thus more beneficial. His further argument is moot as he argues that

[r]estricted dealing is a form of cooperation. One firm (the retailer) agrees to do things the way a manufacturer specifies, just as an employee does things within an integrated firm... Such contracts are the market at work.¹⁷

An independent entity cannot be compared to an employee, as the independent entity’s goal differs to that of an agency, an employee and his/her employer. Circumstances which pressure one party to agree and, thus, put itself in the position of an integrated rather than independent firm cannot be seen as the workings of a market at its most efficient.

3.2.1.1. Vertically Combined Systems

Aside from vertically integrated distribution and non-integrated distribution, a manufacturer can decide to co-distribute their products, thus establishing dual distribution.

¹⁴ The allowance of RPM and VTR in the US: *Toledo Mack Sales & Service, Inc. v. Mack Trucks, Inc.*, 530 F.3d 204 (2008); *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988); *Continental T.V. v. GTE-Sylvania*, 433 U.S. 36 (1977); *United States v. Colgate & Company*, 250 U.S. 300 (1919); it was ruled that vertical restraints in question restricted competition in the EU recent cases with the less stricter approach: Case C-501/06 P, C-513/06 P, C-515/06 P, C-519/06 P, *GlaxoSmithKline Services Unlimited v Commission of the EC* [2009] 4 CMLR 2; Commission Decision of 30 October 2002: COMP / 35.587 PO Video Games, COMP / 35.706 PO Nintendo Distribution and COMP / 36.321 Omega – Nintendo; 97/123/EC, IV / 35.679 – Novalliance / Systemform, Official Journal L 47, 18/02/1997; Case 107/82 *Allgemeine Elektrizitäts-Gesellschaft AEG-Telefunken AG v Commission of the EC* [1983] ECR 3151; and others; further see Chapter 4 “Development of the US Law of Vertical Territorial and Price Restraints” and Chapter 5 “Development of the EU Law of Vertical Territorial and Price Restraints”.

¹⁵ See *The Works of Irving Fisher*. edited by William J. Barber et al. 14 volumes (London : Pickering & Chatto, 1996).

¹⁶ F. H. Easterbrook, “Vertical Arrangements and the Rule of Reason”, (1984) 53 *Antitrust L.J.* 140.

¹⁷ *Ibid.*, p. 140.

Alternatively, retailers can decide to sell so-called “private labels”. The reasons behind and the results of such vertically combined systems are higher profits and stronger bargaining power on the side of the entity, which combines its specialisation with another stage on the vertical chain.

Areeda and Hovenkamp rightly argue that manufacturers of dual distribution systems, who are also distributors, do not have to introduce RPM to increase their own profit, although the opposite could seem to be reasonable at first glance. They are in a position where they can increase their profit by increasing wholesale prices. Moreover, their bargaining power should be stronger than in a situation where they were not distributing their own products.¹⁸ Therefore, the reasons for using RPM are equivalent to the reasons arising from independent distribution-production relationships rather than reasons arising from horizontal arrangements. For instance, RPM can occur if the manufacturer does not have sufficient bargaining power, despite the dual distribution, and is forced by its distributor(s) to use it. In contrast, in the case of territorial restraints, such manufacturers can be motivated by concentrating on and increasing their own distribution business and thus eliminating other distributors from certain territories.

In the second scenario, manufacturers producing products for retailers’ private labels are generally smaller companies with lower bargaining powers.¹⁹ Retailers selling private labels have stronger bargaining and market powers and thus the possibility that they would agree “horizontally” with a restriction of their own private labels is low and rather illogical.²⁰ On the other hand, they can still have the same reasons for using vertical restraints, such as RPM, in relation to branded products. It is also arguable whether any limitation upon private labels should be recognised as horizontal or vertical limitation in situations where a retailer does not produce such a product itself but only lends its name, label and packaging.

¹⁸ Hovenkamp, “Harvard, Chicago, and Transaction Cost” 641-642; Areeda, Hovenkamp, *Antitrust Law*, 68-81; compare with D. Gilo, “Private Labels, Dual Distribution, and Vertical Restraints – An Analysis of the Competitive Effects” in *Private Labels, Brands, and Competition Policy* (2009, Oxford University Press), 141-152.

¹⁹ H. Smith, J. Thanassoulis, “Bargaining between Retailers and Their Suppliers” in *Private Labels, Brands, and Competition Policy* (2009, Oxford University Press), 45-70.

²⁰ Compare with Gilo’s arguments which focus on the limitations of “horizontal” private labels: Gilo, “Private Labels” 141-152.

Private labels are used by large and powerful retailers.²¹ They are popular in Europe, with the exceptions of Italy and Russia, and have a long tradition in the UK in sectors such as food, drinks and household categories. This has driven away some smaller manufacturers' brands which have become "integrated" under private labels.²²

Nonetheless, private labels have positive rather than negative effects on competition. Firstly, it is more efficient for large retailers if they cover both manufacturers' brands and private labels. Therefore, private labels do not eliminate branded products, except for those products produced by less effective and smaller manufacturers. Secondly, manufacturers who have made the right business and strategic/marketing decisions are driven by private labels to improve their products and offer more and new options for consumers. In general, successful and thus efficient manufacturers concentrate on advertising and innovation, thus increasing and maintaining a high quality with a good reputation and value for money, and distinguishing their products.²³ Moreover, private labels have been used in practice to increase competition where a strong brand was significantly powerful.²⁴

3.2.2. Current Distribution Systems

Non-integrated vertical chains can have different forms of distribution, including selective systems and franchising systems. A basic distribution relationship is as follows: manufacturers supply wholesalers and wholesalers supply retailers. The European Commission notes that it would be almost impossible to analyse all forms of distribution systems separately.²⁵

The Commission distinguishes four types of distribution systems for analytical purposes:

- Exclusive selling (a producer sells only to one distributor in a particular territory)
- Exclusive buying (a distributor takes supplies only from one producer – this is typified by the beer and petrol markets)
- Franchising (a franchisee exploits the know-how and intellectual property rights of the franchiser and sells in a standardised format in an allocated territory)

²¹ R. Herbert, "Private Labels – What Drives Them Forward?" in *Private Labels, Brands, and Competition Policy* (2009, Oxford University Press), 4.

²² *Ibid.*, pp. 4-6.

²³ Herbert, "Private Labels" 21-46.

²⁴ Smith, Thanassoulis, "Bargaining" 68-69.

²⁵ Green Paper on Vertical Restraints in EC Competition Policy, Economic Analysis, COM (96) 721, points 4, 13.

- Selective distribution (distributors are chosen on the basis of objective criteria).²⁶

Indeed, there are a number of forms and types of distribution, some of them more complex than others. For example, franchising, in comparison to mere absolute territorial restrictions, ensures certain benefits such as services, quality and brand maintaining and protecting, disclosing and protecting know-how and other IP rights. It is a detailed promotional and business tool based on close cooperation between entities, such as the cooperation between a company and its agent.

However, distribution is not static and has been continually changing.²⁷ The most recent changes are due to developments in information technology and the creation of new distribution systems that have resulted in ongoing greater concentration and integration, and the decline of traditional distribution channels (manufacturers-wholesalers-retailers).²⁸ However, the situation differs in different sectors; for instance, wholesalers have a strong position in the pharmaceutical sector in the EU, whereas in other sectors, wholesale trade has become integrated with suppliers or buyers.²⁹

In general, the retail sector has become more concentrated and is expanding.³⁰ Distributive trades, including wholesaling and retailing, increased from roughly 20% in Denmark and Belgium to 40% in Greece in the EU in 1990s.³¹ In the US, a buyer's power has increased in retail, health care, manufacturing and the entertainment market.³²

New forms of competition have arisen, such as online shopping and new technologies, which influence changes in consumer shopping habits. Large retail stores have developed and have played an important role in the changes by increasing their bargaining power and becoming concentrated and vertically integrated, most notably in the food industry.

²⁶ Ibid., point 4.

²⁷ See below; Lynch, "Steiner's Theory" 912-913; Williamson, *Antitrust Economics*, 124; for historical development see H. Hovenkamp, "The Law of Vertical Integration and the Business Firm: 1880-1960" (2010) 95 *Iowa Law Review* 863-918.

²⁸ G.T. Gundlach, J.P. Cannon, K.C. Manning, "Free Riding and Resale Price Maintenance: Insights from Marketing Research and Practice" (2010) 55 *Antitrust Bulletin* 391-401, 403-410, 412-413; Green Paper on Vertical Restraints (96), points 20, 40, 41, 44.

²⁹ Green Paper on Vertical Restraints (96), point 24.

³⁰ Lynch, "Steiner's Theory" 912-913; Herbert, "Private Labels" 3-20; D. Bell, "The Business Model for Manufacturers' Brands" in *Private Labels, Brands, and Competition Policy* (2009, Oxford University Press), 21-46; Organisation for Economic Co-operation and Development., "Buying Power of Multiproduct Retailers" 7 OECD (Policy Roundtables), (1998) DAFPE/CLP(99)21, Introduction, pp. 15-18 at <http://www.oecd.org/dataoecd/1/18/2379299.pdf> (9/11/2009).

³¹ Green Paper on Vertical Restraints (96), point 15.

³² T.A. Piraino, "A Proposed Antitrust Approach to Buyers' Competitive Conduct" (2004-2005) 56 *Hastings L.J.* 1121-1122.

However, the structure and performance of the retail distribution market differs widely from one state to another.

In general, the retailing sector creates more than 10% of GDP.³³ Large retailers created over 50% of retail sales in most of northern Europe, with the exception of Sweden and Finland, with the retail sector being less concentrated in southern Europe in 1996.³⁴ The concentration of the world retail market, which should be recognised generally as bargaining power rather than a traditional monopsony, increased at the end of 20th century.³⁵

The Organisation for Economic Co-operation and Development's (OECD) report on buying power from 1998 shows that, in general, it cannot be concluded that buyers (retail) have been gaining power and manufacturers have been weakened in the recent developments. Although the retail market has become more concentrated and the market share of retailers has increased, profitability of large manufacturers has also increased.³⁶ There are two possible explanations for this. Firstly, this could mean that social welfare has been generally growing and the most efficient players have benefited the most from such situations. Secondly, players with bargaining power have "abused" their positions at the expense of weaker "vertical competitors" and, potentially, consumers.

It is possible that the type of product can influence the forms of distribution, as claimed by Gellhorn, Kovacic and Calkins. They argue that RPM is generally used for convenience goods, such as drugs, and vertical territories are involved in more complicated products which are usually sold on their own, such as cars and TV sets.³⁷ However, Chapter 4 "Development of the US Law of Vertical Territorial and Price Restraints" and Chapter 5 "Development of the EU Law of Vertical Territorial and Price Restraints" and Overstreet's study prove this claim to be rather elusive and definitely not an absolute rule.³⁸

³³ O. Boylaud, G. Niccoletti, "Regulatory Reform in Retail Distribution" (2001) 32 *OECD Economic Studies* 254-259; P. Dobson, M. Waterson, "Retailer Power: Recent Developments and Policy Implications" (1999) 28 *Economic Policy*, 135-166; OECD, "Buying Power" (1998).

³⁴ Green Paper on Vertical Restraints (96), points 25, 30.

³⁵ Organisation for Economic Co-operation and Development., *Buying Power of Multiproduct Retailers* 7 (1999) at <http://www.oecd.org/dataoecd/1/18/2379299.pdf>; also see A. Pozdnakova, "Buyer Power in the Retail Trading Sector: Evolving Latvian regulation" (2009) 30 *ECLR* 387; P. Dobson, "Exploiting Buyer Power: Lessons from the British Grocery Trade" (2005) 72 *Antitrust L.J.* 529.

³⁶ OECD, "Buying Power" (1998) Introduction, p. 17.

³⁷ Gellhorn, E., Kovacic, W.E., Calkins, S., *Antitrust Law and Economics* (Fifth Edition, Thomson West, St. Paul, 2004), 359-360.

³⁸ A.A. Fisher, T.R. Overstreet, "Resale Price Maintenance and Distributional Efficiency: Some Lessons from the Past" (1985) 3 *Contemp. Policy Issues* 43-58.

3.3. Vertical Competition

Competition process also takes place vertically. Entities are competitors when they can take sales or profit, margins and market share from each other.³⁹ Manufacturers compete among themselves, distributors compete among themselves, and manufacturers and distributors also compete among themselves at the vertical level. Distributors attempt to bargain down manufacturers' wholesale prices and decrease selling prices for retailers. There is not only a complementary, but also a competitive relationship between firms at different vertical stages.

In reality, horizontal and vertical competitions coexist in close relationship and are correlated; vertical competition influences horizontal social welfare. If a manufacturer increases its horizontal market power it will arguably gain a stronger bargaining power at the vertical level. Lower vertical bargaining power will potentially lead to lower horizontal power and a lower market share.⁴⁰ Moreover, decreasing supplier margins can also increase the manufacturer's market share and power.⁴¹

A manufacturer's bargaining power is also influenced by the horizontal market power of its distributors, as indicated previously. Generally, if the distributor and manufacturer simultaneously increase their market power, the manufacturer does not necessarily increase its bargaining power.

Economic analysis based on a single stage market is insufficient to make accurate assumptions about vertical restraints.⁴² Steiner recognises that margins at both stages are determined by three forms of competition: "interbrand competition among manufacturers, intrabrand competition among retailers and manufacturer/retailer bargaining".⁴³ It must be noted that interbrand competition among retailers is also important; this includes private labels' interbrand competition. However, as discussed below, when determining vertical

³⁹ R.L. Steiner, "Vertical Competition, Horizontal Competition and Market Power" (2008) 53 *Antitrust Bulletin* 254; also see F.A. Hayek, "The Meaning of Competition", in *Individualism and Economic Order* (Chicago: University of Chicago Press [1948] 1996), 96.

⁴⁰ Steiner, "Vertical Competition" 252, 257, 260, 268; R.L. Steiner, "The Leegin Factors – a Mixed Bag" (Spring 2010) 55 *Antitrust Bulletin* 35-36.

⁴¹ Steiner, "Vertical Competition" 269.

⁴² Steiner, "Vertical Competition" 254; Lynch, "Steiner's Theory" 911-940; P. Dobson, M. Waterson A. Chu, "The Welfare Consequences of Exercise of Buyer Power" 16 (Sept. 1998) Office of Fair Trading, Research Paper, p. 6; R.L. Steiner, "How Manufacturers Deal with the Price-Cutting Retailer: When Are Vertical Restraints Efficient?" (1997) 65 *Antitrust LJ* 409; Hayek, "The Meaning of Competition" 96.

⁴³ Steiner, "How Manufacturers Deal?" 409.

restraints, intrabrand competition among retailers can be more important than interbrand competition, as the lack of intrabrand competition increases retail margins.

Steiner argues that the vertical process is based on “dual-stages” factors or “triple stage effects”, rather than a horizontal single stage market.⁴⁴ Aside from consumer preferences and the demand curve, there are other aspects that influence such a process:

...(1) retail penetration – which measures the share of retail market held by dealers stocking the brand; (2) dealer support – which measures the additional demand due to display, local advertising, and other promotional efforts by the brand’s retailers; and (3) retail gross margin (RGM) – roughly the difference between the brand’s retail price and its factory price divided by the former.⁴⁵

Although Steiner has been advocating the existence of vertical competition through the entirety of his scholarly work, in a recent article he adds another aspect to the triple stage effect: “the vertical competition effect”, which highlights that an entity faces upstream and downstream competition.⁴⁶

Steiner is not the only scholar who promotes the existence of vertical competition and the complexity of vertical arrangements, including vertical restraints.⁴⁷ Already in 1968, Palamountain recognised three types of competition: horizontal competition, competing among different types of retailers and vertical competition, which he termed “vertical conflict”. He stated that the last type had been mostly ignored by antitrust policy and law.⁴⁸ Dobson, Waterson and Chu suggest that anti-competitive vertical practices should include a consideration of the market power of both buyers and sellers, followed by an analysis of market behaviour with regard to the nature of trading relationships, and finally an analysis of the underlying economic conditions in distribution, most notably cost in the buying process.⁴⁹

Unfortunately, both US and EU laws and policies have not properly acknowledged, and have not included, vertical competition as described above and have not considered the

⁴⁴ Steiner, “The Leegin Factors” 30-31; Steiner, “How Manufacturers Deal?” 409.

⁴⁵ Steiner, “How Manufacturers Deal?” 411.

⁴⁶ Steiner, “The Leegin Factors” 31.

⁴⁷ See Dobson, Waterson, Chu, “Welfare Consequences” 6; J. Palamountain, Jr., *The Politics of Distribution* (Cambridge: Harvard University Press, 1955); J.K. Galbraith, *American Capitalism: The Concept of Countervailing Power* (Transaction Publishers, 1993 [1952]); also see below.

⁴⁸ Palamountain, *The Politics of Distribution*, 48.

⁴⁹ Dobson, Waterson, Chu, “Welfare Consequences” 6.

complexity of vertical restraints in their analysis.⁵⁰ As Steiner argues, failure to recognise such complexity of vertical relations and vertical competition leads to false conclusions in vertical-restraint cases and related policy.⁵¹ He sarcastically describes the existing policy which analyses vertical restrictiveness in antitrust law as “single-stage model in which the markets downstream from the manufacturer can be ignored because they are perfectly competitive”.⁵²

However, even Steiner openly admits that he does not know the best approach to determine the level of restrictiveness in cases on vertical restraints because of the complexity and complication of the matter.⁵³ Although he made such an attempt in his most recent article, his suggestion takes into consideration and builds on the existing US legal approach, but does not include all of the essential aspects of his arguments for determination of the anti-competitiveness/pro-competitiveness of RPM and VTR.⁵⁴

3.3.1. Interbrand and Intra-brand Competition and Bargaining Power

Retailers like large shopping stores usually distribute for more than one single producer. Such retailers can have a major effect on the sale of specific products. Indeed, in this situation, vertical integration between two sectors, or parts of the vertical chain, is unlikely to occur.⁵⁵ Thus, their application of bargaining power is usually aimed at upstream interbrand rather than intra-brand competition. Although intensive interbrand competition can increase retail margins, it is intra-brand competition that lowers the retail margins and it should thus be valued by competition policies.⁵⁶

Steiner observes that retailers have bargaining power when consumers tend to switch brands within the one store.⁵⁷ However, if consumers are loyal to their brands and switch stores rather than brands, manufacturers of such brands have the primary bargaining

⁵⁰ Compare with Chapter 4 “Development of the US Law of Vertical Territorial and Price Restraints” and Chapter 5 “Development of the EU Law of Vertical Territorial and Price Restraints”.

⁵¹ Steiner, “Vertical Competition” 253, 259-262; also see P.C. Carstensen, “Buyer Power, Competition Policy, and Antitrust: the Competitive Effects of Discrimination among Suppliers” (2008) 53 *Antitrust Bulletin* 272-275, 330; A.A. Foer, “Mr. Magoo Visits Wal-Mart: Finding the Right Lens for Antitrust” (2007) 39 *Connecticut LR*. 1307.

⁵² Steiner, “Vertical Competition” 255.

⁵³ Steiner, “Vertical Competition” 270; also see R.L. Steiner, “The Effect of GTE Sylvania on Antitrust Jurisprudence: Sylvania Economics – A Critique” (1991) 60 *Antitrust LJ*. 66.

⁵⁴ Steiner, “The Leegin Factors” 56-58 (compare with pages 25-56).

⁵⁵ W.S. Comanor, “The Two Economics of Vertical Restraints” (1992) 21 *Sw.U.L. Rev.* 1277-1278.

⁵⁶ Steiner, “The Leegin Factors” 25.

⁵⁷ Steiner, “The Leegin Factors” 31-34; R.L. Steiner, “The Nature of Vertical Restraints” (1985) 30 *Antitrust Bull.* 157.

power. Thus, although interbrand restrictions can have more significant effects on competition than intrabrand restrictions, in reality, this is not an always-applicable rule. For instance, Steiner explains that if a brand has a well-established reputation, such as Colgate, the price cut of such a product in one retail store will be noticeable for consumers and they will easily switch to this price-cutting retailer. On the other hand, the effect of discounting one product (Colgate) in one retail store and another product (Crest Toothpaste) competing with the first product in another store will be less direct. Such intrabrand competition will be intensive with lower distributors' or retailers' margins. If a retail store has higher prices on well-established brands, consumers will assume that such a store has higher prices on all products in general.⁵⁸ If retailers are continually decreasing retail prices of a well-established brand as part of competing, then they are highly motivated to use RPM.

In such a scenario, if a manufacturer increases the reputation of its brand, most notably through advertising, the elasticity of the demand curve decreases.⁵⁹ Thus, as Steiner claims and Lynch supports with empirical data and an economic model, interbrand competition among retailers can never be as intensive as intrabrand competition among retailers. Therefore, intrabrand and not interbrand competition is a significant factor, within the retailers' market, which can indeed influence the interbrand competition on the vertical chain.⁶⁰

Nevertheless, there are two situations where interbrand and intrabrand competition is equally intensive: when they are both very intensive or both very lenient, both of which are influenced by consumer behaviour. If they are lenient, this is due to a very low flexibility in consumer demand. In this scenario, retailers' and manufacturers' bargaining power and margins, which will most likely be high, are relatively the same. They are also relatively the same when both intrabrand and interbrand competition is intensive. However, in such situations, consumers are highly flexible in switching both the stores within brand and brands within a store and thus the margins of manufacturers and the retailers will be low

⁵⁸ Steiner, "The Leegin Factors" 31-34; Steiner, "Vertical Competition" 258; R.L. Steiner, "Exclusive Dealing + Resale Price Maintenance: A Powerful Anticompetitive Combination" (2004) 33 *Sw.U.L.Rev.* 454-455, 464-465; Steiner, "How Manufacturers Deal?" 411; also see P.J. Harbour, L.A. Price, "RPM and the Rule of Reason: Ready or Not, Here We Come?" (2010) 55 *Antitrust Bulletin* 240-242; Smith, Thanassoulis, "Bargaining" 46-47; Lynch, "Steiner's Theory" 926-940.

⁵⁹ Steiner, "Vertical Competition" 258-259; Steiner, "The Leegin Factors" 36-39

⁶⁰ Steiner, "How Manufacturers Deal?" 413-414, 440-441; Lynch, "Steiner's Theory" 926-940; also see Gundlach, Cannon, Manning, "Marketing Research" 418-419.

and their bargaining power will be balanced.⁶¹ Such flexibility depends also on distribution channels which, if enhanced, become a highly notable competitive means.⁶²

3.4. Market Structure and Power

Market structure directly and significantly influences market power. Easterbrook defines market power as “the ability to raise price significantly without losing so many sales that the increase is unprofitable”.⁶³ Such ability differs in different markets depending on the market structure.

Nevertheless, a simple form of a vertical chain which includes a seller and a buyer is based on two forms of power: the horizontal market power of the seller and the buyer, and the vertical bargaining power which consists of buyer power and seller power. Bargaining power is essential in vertical restrictions and relationships. Market power determines only partially the strength of the bargaining power of each player on the vertical chain. Market structure is an aspect, amongst others, that determines both market and bargaining power.

The term “buyer power” has been used to describe market power or bargaining power (countervailing power), or both.⁶⁴ Although, the meaning of horizontal market power is arguably unified, different definitions of bargaining power and buyer (seller) power exist.⁶⁵ This results from the fact that vertical competition has not been accepted by authorities and has not been properly analysed by a wide range of experts, as discussed previously.

In this thesis, the term “buyer power” (and the term “seller power”) is used to capture how strong the competitor is in relation to their vertical partner/competitor; thus, at the vertical level. This reflects the definition of the OECD, which defines buyer power as “the ability of a buyer to influence the terms and conditions on which it purchases goods”.⁶⁶ Such meaning is based on bargaining power and indeed specifies the owner of that power. The

⁶¹ Steiner, “The Leegin Factors” 32; W. Bowman, “Resale Price Maintenance – A Monopoly Problem” (1952) 25 *J.Bus.* 141.

⁶² Gundlach, Cannon, Manning, “Marketing Research” 418-419.

⁶³ Easterbrook, “Vertical Arrangements” 159.

⁶⁴ Y.S. Choi, K. Fuchikawa, “Comperative Analysis of Competition Laws on Buyer Power in Korea and Japan” (2010) 33 *World Competition*, 500; Smith, Thanassoulis, “Bargaining” 46; Z. Chen “Defining Buyer Power” (2008) 53 *Antitrust Bulletin* 241; Foer, “Mr. Magoo” 1307.

⁶⁵ Compare with Chen “Defining Buyer Power” 241; R.G. Noll, “‘Buyer Power’ and Economic Policy” (2005) 72 *Antitrust L.J.* 589; R.A. Skitol “Concerted Buying Power: Its Potential for Addressing the Patent Holdup Problem in Standard Setting” (2005) 72 *Antitrust LJ* 727.

⁶⁶ OECD, “Buying Power” (1998) p. 18; also see W.S. Grimes, “Buyer Power” and retail Gatekeeper Power: Protecting Competition and the Atomistic Seller” (2005) 72 *Antitrust L.J.* 565.

reason for the usage of the terms “buyer power” and “seller power” is that the terms “buyer” and “seller” indicate themselves that this power reflects interaction on the vertical and not on the horizontal chain.

3.4.1. Bargaining Power

Bargaining power, consisting of buyer power and seller power, exists in relation to a vertical relationship, at any stage of the vertical process.⁶⁷ Bargaining power is a power where one party has such a position that it can make a credible threat or, in other words, it can effectively threaten other parties on the vertical chain that, for instance, it will terminate their contract or pressure them to deal solely with them.⁶⁸

Bargaining power can significantly influence social welfare, not just manufacturer’s price.⁶⁹ Bargaining power increases and/or creates entrance barriers, as it is difficult for an entering company to compete against a competitor with the bargaining power to buy cheaper and sell dearer than the entering company.⁷⁰

Market power is one of the factors that influences bargaining power. It can be observed that players with a stronger market power do not necessarily have stronger bargaining power. When considering bargaining power, and also market power, aspects other than market share must be taken into account, for instance brand reputation. Steiner claims and Lynch supports this with empirical data and an economic model that shows that one of the best ways to increase bargaining power is *via* successful advertising and with a reputable

⁶⁷ Steiner, “Vertical Competition” 251; Palamountain, *The Politics of Distribution*, 50.

⁶⁸ J.B. Kirkwood, “Buyer Power and Exclusionary Conduct: Should *Brooke Group* Set the Standards for Buyer-Induced Price Discrimination and Predatory Bidding?” (2005) 72 *Antitrust L.J.* 627, 638-644; [For instance, monopolists who threatened their dealers: *Southeast Missouri Hospital and St. Francis Medical Center C.R. Bard, Inc.*, Not Reported in F.Supp.2d, 2008 WL 4372741 (E.D.Mo.), 2009-1 Trade Cases P 76,461; *United States v. Dentsply International, Inc.*, 399 F.3d 181 (3d Cir. 2005), cert. denied, 546 U.S. 1089 (2006); some form of bargain power plays role in almost all cases discussed in Chapter 4 “Development of the US Law of Vertical Territorial and Price Restraints”, for example, see: *Toledo Mack Sales & Service, Inc. v. Mack Trucks, Inc.*, 530 F.3d 204 (2008); *Euromodas, Inc. v. Zanella, Ltd.*, 368 F.3d 11 (1st Cir. 2004); *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988); *United States v. Colgate & Company*, 250 U.S. 300 (1919); and in Chapter 4 “Development of the US Law of Vertical Territorial and Price Restraints”, for example, see: C-501/06 P, C-513/06 P, C-515/06 P, C-519/06 P, *GlaxoSmithKline Services Unlimited v Commission of the EC* [2009] 4 CMLR 2; C-2/01 P and C-3/01 P *Bundesverband der Arzneimittel-Importeure EC and Commission v Bayer AG* [2004] ECR I-00023; C-277/87, T-208/01 *Volkswagen AG v. Commission* [2003] ECR II-5141; *Sandoz prodotti farmaceutici SpA v Commission of the European Communities* [1990] ECR I-45]; also see Smith, Thanassoulis, “Bargaining” 57; Dobson, “Exploiting Buyer Power” 532.

⁶⁹ Dobson, “Exploiting Buyer Power” 532; S.R. Walton, “Antitrust, RPM and the Big Brands: Discounting in Small-Town” (1983) 25 *Antitrust Law & Econ.Rev.* 16.

⁷⁰ Steiner, “Vertical Competition” 253.

brand name. A manufacturer can also strengthen its bargaining power by increasing its vertical downstream market share and thus become a stronger salesman.⁷¹

Smith and Thanassoulis explain that in situations where there is a clear upstream monopoly and a competitive buyers' market, larger buyers will tend to negotiate higher wholesale prices than smaller buyers. This conclusion could seem surprising; however, it is due to the consequence that the monopolist is able to "dictate" conditions and is well aware of the fact that higher wholesale prices will give them a higher profit if negotiated with buyers who buy more products than small buyers. They conclude that there is no direct relationship between the size of the buyers' market power and their bargaining power towards the monopolist.⁷² Conversely, stronger buyers obtain higher profits from private labels' suppliers by using bigger outlets than retailers with a smaller market power.⁷³

Carstensen recognises two main groups with strong buyer power. The first group occurs because of a significant disproportion between buyers and sellers; for example, farmers and a relatively small number of processing companies, doctors, dentists, hospitals and insurance companies in the US. The second group includes branded or specialised consumer products, as buyers have a significant ability to influence the price and other selling conditions.⁷⁴ Carstensen further shows that although buyers have significant bargaining power in both cases, their market share and horizontal market power differ significantly. The buyers' market is relatively competitive and unconcentrated in the second scenario.⁷⁵

However, Carstensen does not address one particularly vulnerable group, that of the private label producers. Large retailers have significant bargaining power over the private label producers as private labels create uncertainty for already small producers.⁷⁶ When compared to Carstensen's groups, this group could be part of the first group with some differences. For example, it is typical for the first group that a farmer's vertical market for selling their raw products such as chickens is geographically very limited; however, once

⁷¹ Steiner, "Vertical Competition" 258; Lynch, "Steiner's Theory" 926-940; R.L. Steiner, "Does Advertising Lower Consumer Prices? (1973) 37 *J. Marketing* 19; for example in the case of *Toys "R" Us, Inc. V. FTC*, 221 F3rd 928 (7th cir. 2000), 20% of market share of the buyer created significant bargain power.

⁷² Smith, Thanassoulis, "Bargaining" 48-52.

⁷³ *Ibid.*, pp. 63-65.

⁷⁴ Carstensen, "Buyer Power" 277; also see Steiner, "Vertical Competition" 258; Steiner, "Exclusive Dealing + RPM" 454-455, 464-465; Areeda, Hovenkamp, *Antitrust Law*, 47-51, 59-60; Steiner, "How Manufacturers Deal?" 411.

⁷⁵ Carstensen, "Buyer Power" 277, 279.

⁷⁶ Smith, Thanassoulis, "Bargaining" 45-70.

processed, the products can be shipped anywhere.⁷⁷ On the other hand, not all private label products have such a feature.

In the case of private label producers, it is obvious that short and easily-terminated contracts with no certainty, including no certainty of an outlet for suppliers, strengthen buyers' powers. Homogenous products are particularly eligible for such situations and a strengthening of buyer power.⁷⁸

Hovenkamp, Areeda and Carstensen explain that if ability, risk (for example, if the first buyer finds out that the seller is looking for a new buyer) and cost, including negotiating the cost of switching and finding a new buyer, are high, the buyer has significant bargaining power.⁷⁹ However, the seller has another option in such situations: vertical integration. Although this involves cost, time and other investments, it is an option for a seller, for instance, in the relationship between a farmer and a processing company, to reduce the buyer's bargaining power. However, this is not usually efficient, for example, in a situation where retail stores are essential and are therefore not an option for the seller.

Cartensen and Lande identify other aspects that influence bargaining power: transparent and correct information. Market failures in the form of defective information, such as misleading information at any level of the vertical chain, and the lack of transparent information among buyers and sellers, when the arrangements including price between sellers and buyers are kept secret, create bargaining power and thus unfair advantages which are not based on competitive efficiencies.⁸⁰

It appears that the SSNIP test is not the right method of determining bargaining power. Carstensen proposes several factors which must be analysed; one of them is that market must be defined "in the terms of seller's options in both geographic and product terms" which generally consists of narrow local markets for sellers.⁸¹ Another factor is the way products or services are sold to buyers, including transparency of information among

⁷⁷ Carstensen, "Buyer Power" 278; the characteristics of Cartensen's first group is also well demonstrated in the case of *George's Inc.* where a settlement was reached with the DOJ in June 2011 – see http://www.justice.gov/atr/public/press_releases/2011/272510.htm (29/16/2001).

⁷⁸ Smith, Thanassoulis, "Bargaining" 52-63.

⁷⁹ Carstensen, "Buyer Power" 278-280; Areeda, Hovenkamp, *Antitrust Law*, 59.

⁸⁰ Carstensen, "Buyer Power" 280-281, 288-289; R. Lande, "Market Power Without a Large Market Share: The Role of Imperfect Information and Other 'Consumer Protection' Market Failures", March 8, 2007, at http://www.justice.gov/atr/public/hearings/single_firm/docs/222102.htm; also see Grimes, "Dynamic Analysis" 101-149.

⁸¹ Carstensen, "Buyer Power" 289.

sellers; less transparent information means more power for the buyers.⁸² Finally, the number of potential buyers, regardless of whether sellers deal with a monopsonist or oligopsonists, is important.⁸³ This list is not complete,⁸⁴ for instance, advertising can significantly increase bargaining power.⁸⁵ As Steiner observes, successful advertising strengthens manufacturer's power and intrabrand competition, increasing its profit and decreasing the profits of retailers who compete more intensively within that brand.⁸⁶

Moreover, the last factor can be misguided in the so called "branded market", the market that belongs to the second group of Carstensen's discussion, because a seller needs a wide range of buyers to sell an efficient quantity of its products. The buyer who buys large numbers of the products has potentially better bargaining power than the one who buys only a small number.⁸⁷ However, this can have also a different effect, depending on the reputation of the brand. If the brand has no reputation at all, then Carstensen's presumption will apply. However, as explained by Steiner and showed by Lynch, if the seller's brand is well-established, consumers will follow the buyer who sells that brand and thus the buyer who buys a high quantity of such products fears losing this seller as loyal consumers will not switch to other substitutes. This in turn increases the seller's bargaining power.⁸⁸

The market of such products is geographically very narrow and is segmented into several markets for a seller as they need many outlets to satisfy production.⁸⁹ Such reality is not reflected in the SSNIP test, which is based on the final consumer demand in general and not on producers' or suppliers' options and efficiencies.

To conclude, it is obvious that a buyer (or a seller) does not have to have a monopolistic market share to exercise significant bargaining power and dictate those conditions on the vertical chain that influence horizontal markets at the buyer and seller levels. Indeed, vertical competition which exercises bargaining power has an impact on social welfare, efficiency and effective competition.

⁸² Carstensen, "Buyer Power" 289; also see Smith, Thanassoulis, "Bargaining" 45-70.

⁸³ Carstensen, "Buyer Power" 289.

⁸⁴ See further discussion in this Chapter; see Steiner, "Vertical Competition" 270.

⁸⁵ Steiner, "The Leegin Factors" 36-39; Steiner, "Vertical Competition" 258; R.L. Steiner, "Does Advertising Lower Consumer Prices? (1973) 37 *J. Marketing* 19.

⁸⁶ Steiner, "The Leegin Factors" 36-39.

⁸⁷ Carstensen, "Buyer Power" 290-294.

⁸⁸ Steiner, "Vertical Competition" 258; Steiner, "Exclusive Dealing + RPM" 454-455, 464-465; Steiner, "How Manufacturers Deal?" 411; Lynch, "Steiner's Theory" 926-940.

⁸⁹ Carstensen, "Buyer Power" 290-295; also see Hovenkamp, "Harvard, Chicago, and Transaction Cost" 626-627.

3.4.2. Market Structure

Different market structures occur in different markets. Basic and still-applied market structures on the vertical chain including buyers and sellers were discussed by Stackelberg from Germany in 1934.⁹⁰ These structures are illustrated in Table 1.⁹¹ A year before, in 1933, Chamberlin examined the relationship between price and the market explaining that as markets differed so did their price behaviour.⁹² Bain further developed this theory.⁹³ He differentiates the market structures accordingly and offers examples of aspects which influence the behaviour of undertakings including pricing strategy:

the number of and the degree of concentration among buyers; the durability of the good in question; whether the good is purchased by producers or by consumers; the adaptability of the good to variation over time, including the importance of style elements; the geographical dispersion of the market and the importance of transport cost.⁹⁴

Another aspect of markets and competition is transaction costs. Williamson observes that transaction costs differ in different market structures.⁹⁵ When analysing vertical restraints, all aspects including transaction costs should be considered at each stage of the vertical chain, otherwise the presumption concerning vertical restraints cannot be accurate. Indeed, the structure is more complicated than the one at the horizontal level, as it does not only include structures of horizontal monopolies, oligopolies and competitive markets but also the structure of buyers, which involves monopsony, oligopsony and competitive markets, as well as the interaction between sellers and buyers.

The complete market, including the whole vertical chain, is even more complicated than the analysis of sellers and buyers as the chain can include more than two horizontal markets.⁹⁶ This is illustrated in Table 2.⁹⁷ For instance, the production of furniture includes the producers of raw materials, such as wood; their distributors; manufacturers of furniture; their distributors and finally retailers. Illegal horizontal price cartels at the beginning of the chain, among the producers of raw materials, could influence prices for the final consumers of furniture. For example, Carstensen explains such an influence on the vertical

⁹⁰ H. von Stackelberg, *Marktform und Gleichgewicht* (1934, Julius Springer, Berlin) in Dobson, Waterson, Chu, "Welfare Consequences" 8.

⁹¹ See *Appendix*.

⁹² Chamberlin, E. *The Theory of Monopolistic Competition* (Cambridge 1933) Chapters 3 and 4.

⁹³ J.S. Bain, *Essays on Price Theory and Industrial Organization* (Little, Brown and Company, Boston, 1972) 6-12.

⁹⁴ Bain *Essays on Price Theory* 7.

⁹⁵ Williamson, *Antitrust Economics*, 123-160.

⁹⁶ See, for example, Piraino, "A Proposed Antitrust Approach" 1123.

⁹⁷ See *Appendix*.

chain in cheese production and distribution including the influence of raw milk.⁹⁸ This is also well documented in one of the oldest antitrust cases in the world from Ancient Greece, in 388 BC.⁹⁹

The question arises as to whether RPM of raw materials or VTR at the beginning of the chain could influence prices and other aspects of competition at the end of the chain. It is possible to assume that it can and that this can have an even more restrictive impact than if RPM implies at the end of the chain. Assume that the producer is a monopolist in a certain market, for instance Lesy Ceska Republika, s.p., producers of wood in the Czech Republic. If the producer applies RPM or VTR to its distributors, this can influence their price which will influence prices of the producers of furniture, their distributors and their retailers not only in the Czech Republic, but also in the market where the producer exports raw materials. However, the import of raw materials and of furniture into the Czech Republic must be also considered. Even if the producer is a monopolist of raw materials in the Czech Republic, it still does not mean that the import of furniture is not high in the Czech Republic. If the percentage of imported furniture was high, then the RPM or VTR would not have such a strong impact on the final consumers as it would if the percentage was low.

However, suppose that RPM and VTR are legal. It could then be assumed that if everybody applies such restraints, the interbrand competition of the whole chain could be seriously restricted and the prices could reach monopoly prices at all levels of the vertical chain in the naturally competitive markets. Obviously, results of different scenarios further depend on game theory and the market structures. This is further discussed below and the complexity of vertical chains based solely on market structures and related bargaining power is illustrated in Table 2.

3.4.2.1. Monopolies and Oligopolies

If manufacturers are oligopolists or monopolists and the buyer's market is competitive, the manufacturers will most likely have the bargaining power. Dobson, Waterson and Chu claim that in the case of monopoly, perfect competition at the retailer level can decrease a manufacturer's profit. Therefore, it is profitable for the manufacturer to select only some retailers.¹⁰⁰ However, this depends on the nature of the product concerned and the

⁹⁸ Carstensen, "Buyer Power" 287.

⁹⁹ L. Kotsiris, "An Antitrust Case in Ancient Greek Law" (1988) 22(2) *International Lawyer* 451.

¹⁰⁰ Dobson, Waterson, Chu, "Welfare Consequences" 21.

manufacturer's margin, including their production, as the manufacturer could be interested in covering as many retailers as possible to increase the number of consumers.¹⁰¹

- Vertical Restraints' Strategies

Vertical territorial and price restraints have the potential to lead to monopolistic prices and/or oligopolistic tendencies. Williamson states that vertical restraints are of a restrictive nature when considering transaction costs in situations where a vertical restraint enhances strategic purposes or oligopolistic interdependence.¹⁰² He recognises and highlights exclusive dealings as having the potential to restrict competition, while arguing that other vertical restraints can restrict competition only in exceptional circumstances.¹⁰³

US antitrust policy does not reflect Williamson's arguments on exclusive dealing in the form of absolute territories, which in practice have the tendency to lead to artificial oligopolies. In contrast, US policy considers RPM to be potentially more restrictive than absolute territorial restraints.¹⁰⁴

The network effect, as further discussed in Chapter 6 "Theories of Pro-Competitiveness v. Anti-Competitiveness", could lead to oligopolistic interdependence. Such situations occur when, for example, other manufacturers and/or retailers follow the retail prices of a "leader" using RPM. It is sufficient if RPM is used within one brand and the others follow the rise of the retail price of this brand. Steiner observes that others tend to follow well-established brands. He discusses the example of Levi Strauss jeans in the US, explaining that the price of jeans dropped significantly and a consumer surplus in men's jeans grew by approximately \$203 million in the US after Levi Strauss stopped using RPM.¹⁰⁵

¹⁰¹ For instance, see Carstensen, "Buyer Power" 290-295.

¹⁰² Williamson, *Antitrust Economics*, 130; also see P. Rey, J. Stiglitz, "Vertical Restraints and Producers' Competition" (1988) 32 *European Economic Review* 561.

¹⁰³ Williamson, *Antitrust Economics*, 130-160.

¹⁰⁴ See Chapter 4 "Development of the US Law of Vertical Territorial and Price Restraints" and Chapter 6 "Theories of Pro-Competitiveness v. Anti-Competitiveness".

¹⁰⁵ Steiner, "Vertical Competition" 260-261; Steiner, "Exclusive Dealing + RPM" 451; also see Steiner, "How Manufacturers Deal?" 415; Steiner, "The Nature of Vertical Restraints" 178-183; also see W.S. Comanor, "Antitrust Policy Toward Resale Price Maintenance Following *Leegin*" (2010) 55 *Antitrust Bulletin* 77; R.D. Blair, J.S. Haynes, "The Plight of Online Retailers in the Aftermath of *Leegin*: an Economic Analysis" (2010) 55 *Antitrust Bulletin* 262; M. Bennett, A. Fletcher, E. Giovannetti, D. Stallibrass, "Resale Price Maintenance: Explaining the Controversy, and Small Steps Towards a More Nuanced Policy" (2010) MPRA Paper No. 21121, posted 4 March 2010/18:02, (at <http://mpa.ub.uni-muenchen.de/21121/>), p. 24 (Ronald N. Lafferty et al. eds., 1984); also see *Coca-Cola Company, Pepsi Co. Inc. v. Federal Trade Commission*, 642 F.2d 1387 (1981); *First Beverages, Inc. of Las Vegas and Will Norton v. Royal Crown Cola Co. and H & M Sales Co.*, 612 F. 2d 1164 (1980).

Similarly, the elimination of RPM in the toy industry in the US in the early 1960s accompanied by a TV advertisement increased industry output, productivity and innovation and decreased retail prices.¹⁰⁶

However, this presumes that the brand using RPM must be the leading one or there must be another reason why others follow the leader, even if the leader has a minority market power. When considering game theory, this could occur because it could be more profitable for others to increase their prices while keeping the same output but receiving a higher profit per item.

In general, in situations where a monopoly or oligopoly already exists, RPM and VTR will have restrictive tendencies. Mathewson and Winter's analysis shows that in an imperfectly competitive market, where a manufacturer has some monopoly power, vertical restraints, even those minimally sufficient, maximise joint profit. On the other hand, in the competitive price system in a competitive market, vertical restraints would probably not lead to profit maximisation.¹⁰⁷

3.4.2.2. Monopsonies and Oligopsonies

A market structure can be such that at the sellers'/manufacturers' level, the market can be competitive, however, at the buyers'/distributors' level, the market can be based on monopsony or oligopsony. In such situations, buyers could have the bargaining power and could dictate the conditions of the vertical market.¹⁰⁸

Monopsony can have a negative impact on consumer welfare in a similar way to monopoly.¹⁰⁹ However, in certain situations, it can also have positive effects. If an upstream market is competitive because there is no monopoly or oligopoly, however

¹⁰⁶ Steiner, "Vertical Competition" 261; note that in the case of *Toys "R" Us, Inc. V. FTC*, 221 F3rd 928 (7th Cir. 2000), 20% of market share of the buyer created significant bargain power.

¹⁰⁷ G.F. Mathewson, R.A. Winter, "An Economic Theory of Vertical Restraints" (1984) 15 *Rand Journal of Economics* 27; however, compare with the discussion below.

¹⁰⁸ *Leegin Creative Leather Products, Inc. v. PSKS, Inc, DBA Kay's Kloset...Kays' Shoes*, 551 U.S. 877 (2007), at 2733 (Breyer, J., dissenting); Areeda, Hovenkamp, *Antitrust Law*, 48-49; R.M. Brunell, "Overruling *Dr. Miles*: The Supreme Trade Commission in Action" (2007) 52 *Antitrust Bulletin* 499-500; Kirkwood, "Buyer Power" 625, 638-44; Piraino, "A Proposed Antitrust Approach" 1125; OECD, "Buying Power" (1998) p. 19; Comanor, "Two Economics" 1265, 1277; Blair, Harrison, "Antitrust Policy and Monopsony" 297, 308; G. Stigler, *The Theory of Price*, 4th Edition (Prentice Hall College Div, 1987) 216-218.

¹⁰⁹ Dobson, Waterson, Chu, "Welfare Consequences" 9 – 16; Blair, Harrison, "Antitrust Policy and Monopsony" 303; also see Areeda, Hovenkamp, *Antitrust Law*, 33-34.

buyers are oligopsonists or monopsonists and so have bargaining power, the buyers have the potential, if they decide to do so, to lower upstream-market/wholesale prices. This is typified by the relationship between large retailers and their private label producers.¹¹⁰ Big retail chains have the power to negotiate low wholesale prices and can potentially pass these low prices on while still making a great profit and offering their own private brands to consumers as they compete with small local stores. Thus, low prices are key in their business.¹¹¹ However, this is due to interbrand competition. In the case of private labels, the retailer market can be relatively competitive.¹¹²

Monopsonies and oligopsonies can lead to situations where suppliers are forced to sell their products to buyers below the competitive price because they lack market power in comparison to buyers. However, this is not a situation which could exist forever because buyers need suppliers.¹¹³ Moreover, a lowering of supply prices by powerful buyers is not necessarily positive for competition. Indeed, it is questionable whether the final consumers will benefit from this situation as buyers are driven by profit maximisation and lower wholesale prices would be beneficial to retailers rather than to final consumers.

The courts could presume, and indeed the US Court of Appeals has presumed, that retailers' pressure to decrease wholesale prices does not decrease consumer welfare. It has ruled that such conduct is not anti-competitive.¹¹⁴ Blair and Harrison criticise the court's a ruling and argue that even the conduct of monopsonists or oligopsonists, which decrease wholesale prices, cause inefficiencies and are therefore anti-competitive.¹¹⁵ Although they pressure manufacturers to lower wholesale prices, monopsonists are interested in a higher profit for themselves; therefore, retail price does not necessarily decrease, but arguably increases because of the monopsonist's power.¹¹⁶ For example, one of the oldest known antitrust cases in the world shows that wholesalers do the maximum to keep as high a profit as possible for themselves, rather than passing on the benefits to their final consumers.¹¹⁷

¹¹⁰ UK Competition Commission, *The Supply of Groceries in the UK Market Investigation: Provisional Finding Report*, (Stationery Office Books, 2007); Smith, Thanassoulis, "Bargaining" 47-48.

¹¹¹ Piraino, "A Proposed Antitrust Approach" 1121-1124, 1137; OECD, "Buying Power" (1998) pp. 25-29; Dobson, Waterson, Chu, "Welfare Consequences" 13; Blair, Harrison, "Antitrust Policy and Monopsony" 301-306, 310-317; Steiner, "How Manufacturers Deal?" 414.

¹¹² Smith, Thanassoulis, "Bargaining" 52-57.

¹¹³ OECD, "Buying Power" (1998) p. 20.

¹¹⁴ *Balmoral Cinema v. Allied Artists Pictures*, 885 F.2d 313 (6th Cir. 1989) at 316-317; see Blair, Harrison, "Antitrust Policy and Monopsony" 298-300, 303-306.

¹¹⁵ Blair, Harrison, "Antitrust Policy and Monopsony" 298-340.

¹¹⁶ *Ibid.*, p. 306.

¹¹⁷ Kotsiris, "Ancient Greek Law" 451.

On the other hand, decreasing wholesale prices passes benefits to final consumers, as shown in some cases such as products in Wal-Mart supermarkets in the US. This can even have a positive effect on the entire state economy. For instance, Wal-Mart's policy helped reduce the inflation rate in the US.¹¹⁸ However, as Blair and Harrison demonstrate, such behaviour also decreases the quantity in comparison with competitive wholesale prices, even when the supply curve is inelastic, and as such a reduction of the manufacturers' profit has a negative impact on future supply.¹¹⁹ Or, as Piraino claims, such conduct can drive out innovation and services on the side of suppliers.¹²⁰ The question is moot as to what would be the best balance in such scenarios; indeed, the ideal situation would be perfect competition at each stage of the vertical chain.

- Vertical Restraints' Strategies

The likelihood of negotiating some forms of vertical restraints, such as exclusive territories, increases when buyers have bargaining power.¹²¹ It can be in the interest of a single retailer or a group of retailers to use RPM or VTR to decrease competition and/or restrict smaller but possibly more efficient competitors. They can have such strong bargaining power that they are able to "persuade" a manufacturer to enforce vertical restraints on the remaining retailers.¹²² For instance, it is in the interest of a strong retailer who charges higher prices than its competitors not to lose customers who are driven by price. It, therefore, has reason for the application of RPM and this results in efficiency loss, welfare decreases and the restriction of competition.

¹¹⁸ Piraino, "A Proposed Antitrust Approach" 1122.

¹¹⁹ Blair, Harrison, "Antitrust Policy and Monopsony" 303-306, 315-320, 339.

¹²⁰ T Piraino, "A Proposed Antitrust Approach" 1121-1125.

¹²¹ See, e.g., W.S. Comanor, "Antitrust Policy toward Resale Price Maintenance Following *Leegin*" (2010) 55 *Antitrust Bulletin* 60-63, 67-69, 75-77; Blair, Haynes, "The Plight of Online Retailers" 260; K.G. Elzinga, D.E. Mills, "The Economics of Resale Price Maintenance", in *Competition Law and Policy*, Collin W., (2008) *American Bar Association*, Chapter XX, p. 5; Areeda, Hovenkamp, *Antitrust Law*, 20; OECD, "Buying Power" (1998) p. 40; G. Shaffer, "Slotting Allowances and Resale Price Maintenance: A Comparison of Facilitating Practices" (1991) 22 *Rand Journal of Economics* 120-136; Williamson, *Antitrust Economics*, 123-160.

¹²² *Toledo Mack Sales & Service, Inc. v. Mack Trucks, Inc.*, 530 F.3d 204 (2008); *BabyAge.com, Inc. v. Toys 'R' Us*, 558 F. Supp. 2d 575 (E.D. Pa. 2008); *Euromodas, Inc. v. Zanella, Ltd.*, 368 F.3d 11 (1st Cir. 2004); *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988); Areeda, Hovenkamp, *Antitrust Law*, 35-41, 59; Comanor, "Two Economics" 1280; Chapter 4 "Development of the US Law of Vertical Territorial and Price Restraints" and Chapter 5 "Development of the EU Law of Vertical Territorial and Price Restraints".

3.4.2.3. Bilateral Monopoly/Oligopoly

The natural competitive market is positive for both consumer and total welfares. However, what happens if the market structure is based on a bilateral monopoly, with monopolistic buyer and seller powers? In such situations, both parties have a similar bargaining power; therefore, both parties need to find a way to maximise both of their profits. This will likely set prices high in a way that will be beneficial for each party but not for consumers.

Another result is that, as Steiner argues, a bilateral strong market power will neutralise effects on the final consumers as it lowers the retail price in comparison to situations where a monopoly power exists at only one end of the vertical chain, depending on the pass-through.¹²³ However, balancing buyer power can mean that sellers will try to merge to obtain better bargaining (market) power, which does not necessarily lead to efficiency, but rather inefficiency.¹²⁴

An OECD study from 1998 shows that it is impossible to make exact predictions of results in each market on the vertical chain if there is a bilateral (multilateral) monopoly or oligopoly. Results depend on negotiation abilities as both parties seek the best profit for themselves. Therefore, their relationship will be more balanced and the profit will be not concentrated within one party (monopoly, oligopoly/monopsony/oligopsony). Buyer power will leave the produce surplus, including buyer surplus, unchanged and high or even increase it up to its maximum as each player seeks to gain the highest possible profit for itself. However, in certain cases producers can be motivated to maximise their outputs.¹²⁵ Nonetheless, this could lead to monopolistic prices and non-excluding situations where producers maximise their output in order to obtain the highest possible profits.

Bilateral monopoly, in particular, has a strong potential to restrict the efficiencies based on a phenomenon known as double marginalisation.¹²⁶ However, this can also arise in situations where only one player (players) on the vertical chain has market power but both

¹²³ Steiner, "Vertical Competition" 262; also see Hovenkamp, "Harvard, Chicago, and Transaction Cost" 635-636, 638-639.

¹²⁴ OECD, "Buying Power" (1998) pp. 20-21, 58-60; Also see R. Hancock, M. Hviid, "Buyer Power and Price Discrimination: The Case of the UK Care Homes Market" (December 2010) CCP Working Paper 10-17 (<http://www.uea.ac.uk/ccp/publications/CCP10-17>).

¹²⁵ OECD, "Buying Power" (1998) pp. 20-25, 60; also see Hovenkamp, "Harvard, Chicago, and Transaction Cost" 638-639, 651.

¹²⁶ Hovenkamp, "Harvard, Chicago, and Transaction Cost" 635-638; OECD, "Buying Power" (1998) p. 19; N. Vettas, "Developments in Vertical Agreements" (2010) 55(4) *Antitrust Bulletin* 8855-857.

have bargaining power.¹²⁷ Marginalisation can be also triple or any other “multiple” depending on the market power of all the players on the vertical chain, which can include more entities than just a buyer and a seller. Although, it would seem to be an essential problem if multiple marginalisation occurs, such phenomena is limited by consumer demand. Depending on the elasticity of the demand curve, consumers would start decreasing their purchasing if prices were too high. In other words, each price has its monopolistic peak; if players go beyond it, they start to decrease rather than increase their profits.

- Vertical Restraints’ Strategies

RPM and potentially VTR can increase manufacturers’ bargaining powers in oligopoly-oligopsony or monopoly-oligopsony vertical markets because it prevents downstream players from pressuring upstream players to decrease wholesale prices.¹²⁸ In the case of VTR, it prevents intrabrand competition and, thus, depending on the market structure, it most notably strengthens the buyer’s power.

3.4.2.4. Bargaining Power in Other Market Structures

A single entity does not have necessarily to possess a pure monopoly or monopsony power or be part of oligopoly or oligopsony to execute its bargaining power. As Kirkwood argues, a buyer has excessive bargaining power even when it is not a pure monopsonist but when it possesses a strong, or dominant, position in its relationship with its sellers. As discussed previously, this depends on several factors aside from market power. It also depends on the differentiation of products and their reputations, the positions of both the buyer and the seller and the number of the seller’s buyers.¹²⁹ As Steiner observes, if a brand does not have loyal consumers and the market is competitive, it is easy for retailers to switch to different brands.¹³⁰

¹²⁷ OECD, “Buying Power” (1998) p. 19.

¹²⁸ P.W. Dobson and M. Waterson “The Competition Effects of Industry-Wide Vertical Price Fixing in Bilateral Oligopoly” (2007) 25 *International Journal of Industrial Organization* 935-962.

¹²⁹ Kirkwood, “Buyer Power” 627, 638-644; OECD, “Buying Power” (1998).

¹³⁰ Steiner, “Exclusive Dealing + RPM” 452, 454; also see Areeda, Hovenkamp, *Antitrust Law*, 49; Lynch, “Steiner’s Theory” 926-940.

- Vertical Restraints' Strategies

In general and regardless of market structure, Grimes shows (based on several cases) that manufacturers use RPM to more easily maintain higher wholesale prices as they guarantee retail margins through RPM.¹³¹ Other reasons for using RPM are that a manufacturer wants to maintain distributor loyalty. A dominant distributor or a dominant group of distributors is threatened by more efficient but smaller distributors, or the manufacturer is establishing a reputation for a premium, expensive brand.¹³² This also occurs in cases where there are upstream monopolies.¹³³

A manufacturer of a well-established brand does not have to use vertical restraints unless it is forced to do so by a retailer who has strong bargaining power, as was the case in *Business Electronics*.¹³⁴ However, a smaller producer may fear even being considered by a large retailer and/or it needs to lobby for better shelf position. Therefore, introducing RPM or territorial restraints can give it some benefit in the bargaining process.¹³⁵

Thus, even if the retailers' market does not create a monopsony or oligopsony and the manufacturer has a well-established brand, retailers can possess a certain amount of bargaining power and pressure the manufacturer to act in a certain way. Hovenkamp discusses an example of such a scenario. In the US, druggist retailers, through their association, pressured Pepsodent, a well-established brand of toothpaste, to return back to RPM, after it had stopped using it in the 1930s. They simply stopped displaying its products on their shelves, however, they had them in stock for loyal consumers of Pepsodent. That way, the retailers were not injured, but Pepsodent was. Such constraint was successful and Pepsodent returned to RPM.¹³⁶

- Strategies of Combination of Territorial and Price Restraints

The existence of a combination of vertical restraints is not unusual, it seems to be more common in practice; however, the US courts do not usually examine all restrictions but

¹³¹ Grimes, "Dynamic Analysis" 148.

¹³² *Ibid.*, p. 106.

¹³³ Bennett, Fletcher, Giovannetti, Stallibrass, "Resale Price Maintenance", pp. 22-23; P. Rey, T. Verge, "Bilateral Control with Vertical Contracts" 35 *Rand Journal of Economics*, 728-746; D. O'Brien, G. Shaffer, "Vertical Control with Bilateral Contracts" (1992) 23 *Rand Journal of Economics* 299-308.

¹³⁴ *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988).

¹³⁵ Steiner, "How Manufacturers Deal?" 443-444; also see Areeda, Hovenkamp, *Antitrust Law*, 35.

¹³⁶ Areeda, Hovenkamp, *Antitrust Law*, 49-50.

only one of them based on legal actions, in contrast with the EU cases.¹³⁷ Logically, if both vertical restraints are used in combination, the result would be more restrictive than the mere existence of one of them.¹³⁸ Steiner claims, and shows in two cases, that exclusive dealing, which could include exclusive territorial restraints although it did not, in combination with RPM results in “substantial anti-competitive effects” because exclusive dealing when applied by producers restricts interbrand competition raising each producer’s margin, and also RPM intrabrand competition thus increasing retailers’ margins. This would increase consumer prices, result in welfare losses and create entry barriers to protect the producer’s market power.¹³⁹ Therefore, Steiner states that RPM in combination with exclusive dealing restricts both intra- and interbrand competition.¹⁴⁰ A new competitor would have to be both a producer as well as a distributor/retailer to penetrate the market which is costly and technically difficult to do, even more so if such a combination of restraints covers an extensive geographic market.¹⁴¹

The first market that Steiner shows with significantly restricted competition when both vertical restraints were used is the US contact-grill market, a “monopolistically competitive market” which could be explained as a competitive market with a significant number of retailers.¹⁴² The second market, the US light bulb market, differs from the first. In contrast to grills, light bulbs are short-lived, low-cost products with a rather inelastic demand curve (the grills market has an elastic demand curve), which are bought by customers on a daily basis without the importance of brand loyalty.¹⁴³ Three major US producers of light bulbs established a collusion and used RPM and exclusive dealing. This led to the creation of a monopolistic power with profits on the 45.7% price/cost margin, 82% above the average of all manufacturing markets.¹⁴⁴ Steiner concludes that this combination of vertical restraints

¹³⁷ US cases: *Toledo Mack Sales & Service, Inc. v. Mack Trucks, Inc.*, 530 F.3d 204 (2008); *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988); *Albrecht v. Herald Co.*, 390 U.S. 145 (1968); *United States v. Arnold Schwinn & Co.*, 388 U.S. 365 (1967); *White Motor Co. v. United States*, 372 U.S. 253 (1963); *United States v. Bausch & Lomb Optical Co.*, 321 U.S. 707 (1944); EU cases: T-208/01 *Volkswagen AG v. Commission* [2003] ECR II-5141; appeal C-74/04 P *Commission v. Volkswagen AG* [2006] ECR I-06585; Commission Decision of 30 October 2002: COMP / 35.587 PO Video Games, COMP / 35.706 PO Nintendo Distribution and COMP / 36.321 Omega – Nintendo; 97/123/EC, IV / 35.679 – Novalliance / Systemform, Official Journal L 47, 18/02/1997 p.11; 107/82 *Allgemeine Elektrizitäts-Gesellschaft AEG-Telefunken AG v Commission of the EC* [1983] ECR 3151; also see the empirical study: P.M. Ippolito, “Resale Price Maintenance: Empirical Evidence from Litigation” (1991) 34 *The Journal of Law & Econ.* 266-267; further see Chapter 4 “Development of the US Law of Vertical Territorial and Price Restraints”, Chapter 5 “Development of the EU Law of Vertical Territorial and Price Restraints”.

¹³⁸ See Steiner, “Exclusive Dealing + RPM” 447-476.

¹³⁹ See *Ibid.*, pp. 447, 456-457.

¹⁴⁰ Steiner, “Exclusive Dealing + RPM” 447-476.

¹⁴¹ *Ibid.*, p. 457.

¹⁴² *Ibid.*, pp. 457-466.

¹⁴³ *Ibid.*, pp. 468-469.

¹⁴⁴ *Ibid.*, pp. 469-470.

led to high retail prices, prices higher than those based on a monopoly-monopsony chain, a monopoly or monopsony competitive market chain.¹⁴⁵

3.5. Conclusion

This chapter advocates several points. Firstly, it is the existence, importance and complexity of vertical competition, despite the fact that not much has been written in relation to it. Secondly, bargaining power and not horizontal market power determines the existence of VTR or RPM. Thirdly, vertical interactions and related market structures and results are highly complicated and it is difficult to predict the effects of certain actions on competition with any real certainty. For example, a monopolist could tend to negotiate higher wholesale prices with powerful retailers rather than with small retailers as small retailers buy a smaller number of products than the powerful ones.

The development and changes in distribution systems are based primarily on new technologies and technical progress rather than vertical restraints. The prohibition of RPM and VTR and changes in their approach have not led to any obvious changes in vertical integration.

Vertical interactions among buyers and sellers are based on different market structures. If RPM or VTR is used in a monopolistic/oligopolistic sellers-competitive buyers' structure, such conducts will restrict competition. Moreover, mainly VTR can lead to oligopolies/monopolies and thus restrict competition. If the market is based on a monopolistic/oligopolistic buyers' market, this would lead to lower wholesale prices, which do not necessary result in lower retail prices; however, the opposite could be true. Nonetheless, retailers have both the potential and the interest to use RPM and even VTR.

Although bilateral monopolies/oligopolies can result in more balanced bargaining power, this does not necessarily lead to competitive prices, but rather to monopolistic prices and other negative impacts. Nonetheless, such situations are difficult to predict as there are other aspects that influence bargaining power and strategies involving vertical restraints. This means that even two vertically related competitive markets can be based on the bargaining power of one group at one vertical stage and thus can restrict competition and efficiency. Furthermore, when there is some form of collusion, even a smaller retailer can

¹⁴⁵ Ibid., p. 476.

pressure a well-established manufacturer to introduce RPM and thus restrict competition. Finally, combination of vertical restraints leads to an even more harmful restriction of effective competition.

When considering the vertical chain and vertical competition, it seems to be impossible to state with any certainty that arrangements such as RPM and VTR have definite effects on competition as these effects depend on several factors. Moreover, it is also impossible to state in advance what the effect of a specific action on the vertical chain will be. Such a conclusion might be highly frustrating; however, it reflects the reality. Nevertheless, it is important to ensure that competition law and policy maintains effective, fair and free competition, where each player has equal opportunity in the sense that it is free and not restricted by others based on, for example, an “abuse” of bargaining power and thus its profit fairly reflects how efficient, and not how abusive, its business is, based on the ability to save costs and innovate.

Bargaining power on its own is not a negative but rather a natural factor which can lead to innovation, improvement of products and healthy competitive tensions.¹⁴⁶ However, bargaining power can be abused and this has not been recognised in the US antitrust policy and the EU competition policy, as will be discussed in the following chapters. Abusing bargaining power includes pressuring a second party to agree with vertical restrictions, such as RPM and territorial restrictions.

¹⁴⁶ For example, consider the situation of Walkers crisps successfully competing with private labels in the UK – Herbert, “Private Labels” 17-18.

Chapter 4: Development of the US Law of Vertical Territorial and Price Restraints

4.1. Introduction

This chapter analyses US vertical price and territorial restraints from a broad perspective. It is based on the assumption that the law is influenced by theories, politics and the social environment. It explains and discusses them (primarily antitrust legislation and antitrust development) because these aspects influence courts' decisions. The most significant cases are analysed in this chapter. Their doctrines, legal theories and development are explained, logically arranged and argued in the context of the facts of the cases. Current and future policies and their application are also discussed.

4.2. The Sherman Act and the Common Law

4.2.1. The Common Law Era

The modern antitrust law as introduced by the Sherman Act has its roots in the common law,¹ which stems from English law and was further developed by American law.² Thorelli relates the English common law to the period extending from the Middle Ages to the American Revolution, and it has influenced antitrust law ever since.³ National independence brought a different economic approach to the common law.

One of the most important eras in British history was the middle of the 18th century, the industrial revolution, which brought about an unrestricted freedom of contract as well as a freedom of trade and competition. British common law, although not specifically relating to competition, developed several terms used by antitrust law today: the rule of reason, the doctrine of conspiracy, restraint of trade and the *per se* rule.⁴

Before the Sherman Act was passed, antitrust violations had been judged under the common law. One of the main differences was that, under the common law, cartels were

¹ Senator John Sherman's speech in the United States Senate, March 21, 1890, 21 *Congressional Record* 3: 2457, 2456.

² H.B. Thorelli, *The Federal Antitrust Policy: Origination of an American Tradition* (P. A. Norstedt & Söner, Stockholm, 1954), 9.

³ Thorelli, *The Federal Antitrust Policy*, 9-10.

⁴ H. Hovenkamp, *Federal Antitrust Policy, The Law of Competition and Its Practice* 3rd Edn. (Thomson West, St. Paul, 2005), 53; Thorelli, *The Federal Antitrust Policy*, 9-35.

not considered to be illegal if all they did was increase prices and did not control the markets by dividing territories to avoid competition.⁵ The common law did not create a complex system of antitrust law.⁶ It classified forestalling as a crime of fraud and it included purchasing any amount of products on the market.⁷

The common law era was typified by small businesses where a maker did not use the services of independent distributors and retailers, but instead sold and distributed their products themselves. For instance, a shoemaker usually made shoes, repaired them and sold them. This form of production and distribution was concentrated on small local markets and was highly vertically integrated.⁸

After the American Civil War, corporations were not allowed to purchase other corporations' shares and stocks. Therefore, stock in corporations was placed into trusts. Several trusts, such as Standard Oil Trust, were powerful in manipulating markets by such actions as price fixing.⁹ The classic common law tolerated most vertical practices based on the understanding that the market could regulate competition itself. Later, in the 1870s and the 1880s, neoclassicism brought an awareness of the imperfections of a market that supported anti-competitive practices.¹⁰

4.2.2. The Sherman Act Era

Throughout the existence of the Sherman Act,¹¹ the concepts of antitrust law, antitrust policy and economic and legal theories have undergone various changes.¹² Pitofsky, Handler and Baker compare changes in US antitrust policy to “*pendulum narrative*”: there were active eras in the 1960s and 1970s, replaced by passive eras in the 1980s and a moderate era in the 1990s. Two extreme periods helped to create the “golden middle

⁵ See, e.g., *Wickens v. Evans*, 148 E.R. 1201, (1829) 3 Y. & J. 318; *Mitchel v. Reynolds* 24 E.R. 347, (1711) 1 P. Wms. 181; Hovenkamp, *Federal Antitrust Policy*, 56.

⁶ K.N. Hylton, *Antitrust Law: Economic Theory & Common Law Evolution* (Cambridge University Press, 2003), 31-37.

⁷ Hovenkamp, “Vertical Integration”, 878.

⁸ H. Hovenkamp, “The Law of Vertical Integration and the Business Firm: 1880-1960” (2010) 95 *Iowa Law Review* 865-870.

⁹ G.W. Stocking, M.W. Watkins, *Monopoly and Free Enterprise* (Twentieth Century Fund, New York, 1951), 80.

¹⁰ Hovenkamp, *Federal Antitrust Policy*, 60.

¹¹ The Sherman Antitrust Act (July 2, 1890, ch. 647, 26 Stat. 209, 15 U.S.C. §§ 1-7).

¹² E.T. Sullivan, H. Hovenkamp, *Antitrust Law, Policy and Procedure: Cases, Materials, Problems* 5th Edn. (LexisNexis, Newark, 2004), 1.

way”.¹³ However, as shown in the analysis below and explained by Kovacic, this comparison does not reflect the real historical development of antitrust policy precisely and it simplifies some historical and current issues.¹⁴

4.2.2.1. The Purpose of the Sherman Act

The Sherman Act passed in 1890. Bork explains the existence of the Sherman Act according to the theory of allocative efficiency and the theory of distributive justice;¹⁵ however, there are a few historical facts that indicate that these theories do not reflect the reasons for the Act's existence.¹⁶ Firstly, besides passing the Sherman Act, Congress also passed the McKinley Tariff, one of the largest and most anti-consumer tariffs in history of the United States of America. As Hovenkamp claims, most economists were opposed to the passing of the Sherman Act at the time because they believed that large firms ensured lower prices and higher output. The decade before the Sherman Act was a period of declining prices, therefore Congress was not concerned about consumers paying high prices; however, the declining prices resulted in rapid economic growth. Congress could have used the Sherman Act as a tool for maintaining this economic growth caused by the competitive lower prices. It is also important to highlight that the Sherman Act was passed before the theory of allocative efficiency was developed.¹⁷ Therefore, even if Congress had considered the impact of low prices on consumers and economy, the theory of allocative efficiency was not the reason for passing the Sherman Act.

The most accurate reason for the existence of the Sherman Act could be that Congress wanted to protect small businesses and thus tried to weaken the power of some strong combinations and monopolists, such as railway and oil companies. Those companies obtained their monopolistic power due to conditions throughout and after the Civil War.¹⁸

¹³ R. Pitofsky, “Proposals for Revised United States Merger Enforcement in a Global Economy” (1992) 81 *Geo.L.J.* p. 195-196; M. Handler, “Introduction” (1990) 35 *Antitrust Bulletin* 13-21; Early changes – before World War II: See J.B. Baker, “Competition Policy as a Political Bargain” (2005-2006) 73 *Antitrust L. J.* 483.

¹⁴ W.E. Kovacic, “The Modern Evolution of U.S. Competition Policy Enforcement Norms” (2003-2004) 71 *Antitrust L.J.* 377-478.

¹⁵ R.H. Bork, *The Antitrust Paradox: A Policy at War with Itself* (The Free Press, New York, 1978) 17-22.

¹⁶ Hovenkamp, *Federal Antitrust Policy*, 49; Sullivan, Hovenkamp, *Antitrust Law*, 1.

¹⁷ Hovenkamp, *Federal Antitrust Policy*, 49-51.

¹⁸ E. Gellhorn, W.E. Kovacic, S. Calkins, *Antitrust Law and Economics*, Fifth Edition (Thomson West, St. Paul, 2004), 17-22; D.G. Goyder, A.D. Neale, *The Antitrust Laws of the United States of America: A Study of Competition Enforced by Law*, Third Edition (Vermont, 1980), 15; Thorelli, *The Federal Antitrust Policy*, 54-163.

The Sherman Act, as an antitrust act, discouraged horizontal mergers and shortened monopolists' power.¹⁹ During the discussion of the Sherman Act in Congress, associations of independent and small businesses were among the most effective lobbying organisations as their existence was threatened by large vertically integrated competitors. Moreover, Senator Sherman could have acted on behalf of independent oil producers, which competed with the Standard Oil Company. Companies with strong market and political power brokered fear and their existence went against the American ideology which proposes that anybody can enter and compete in the US market. Therefore, the market should be free to create competition.²⁰ Finally, the term “antitrust law” itself indicates that the reason for the existence of the Sherman Act was to protect small businesses.

4.2.2.2. First Application of the Sherman Act

The purpose of the Sherman Act was to “federalise” and make the common law more effective by creating a statute with jurisdiction over more than one state, as stated by Senator Sherman and confirmed in the case of *Addyston Pipe*.²¹ The statute should have been used as a tool against (anti) trusts; however, it started as a process of protecting competition.

The agreements addressed under Section 1 of the Sherman Act were unenforceable under the common law. The Sherman Act prohibited them so that the aggrieved party could obtain damages or injunctions. The obvious element of novelty was that collusions restricting trade and monopolisation were declared to be public offences under the Sherman Act. However, the courts were partially influenced by the common law when applying the Sherman Act. They referenced the common law in their decisions using language not used in legislation, such as “the *per se* rule” and “the rule of reason”. Nevertheless, the Sherman Act changed courts' judgements and standards of justification. This is obvious even in the first Sherman Act cases, in particular the oldest cases of *Trans-*

¹⁹ D. Besanko. ... [et al.], *Economics of Strategy* (fourth edition, (John Wiley & Sons, Hoboken 2007) 176-178.

²⁰ Hovenkamp, *Federal Antitrust Policy*, 51-52; Hylton, *Antitrust Law*, 37-38; Thorelli, *The Federal Antitrust Policy*, 164-234; Stocking, Watkins, *Monopoly and Free Enterprise*, 80.

²¹ Senator John Sherman, 20 *Congressional Record*, year 1889, 1167; *United States v. Addyston Pipe & Steel Co.*, 85 Fed. 271, at 278-291 (6th Cir. 1898), affirmed 175 U.S. 211, 20 S.Ct. 96 (1899) (“*Addyston Pipe*”); also see Hovenkamp, *Federal Antitrust Policy*, 52; Goyder, Neale, *The Antitrust Laws*, 17; Thorelli, *The Federal Antitrust Policy*, 9.

*Missouri*²² and *Joint Traffic*²³, where the court rejected the common law standard of reasonableness.

4.2.2.3. The Content of the Sherman Act

The Sherman Act make unlawful multilateral as well as unilateral restrictions (including vertical restrictions). Section 1 prohibits only multilateral actions, which could have three different forms: “*every contract, combination in the form of trust or otherwise, or conspiracy.*” However, the courts have simplified these forms. Terms such as “combination” and “conspiracy” have not been individually defined by the US courts; however, all terms commune with each other and the broad definition of the term “agreement” can be used for all.²⁴ An agreement is illegal if it restrains trade or commerce as stated in the Sherman Act, however, this restraint must be unreasonable to be illegal, as specified in *Trans-Missouri*.²⁵

Section 2 of the Sherman Act included unilateral as well as multilateral conducts. Unilateral conduct must have a form of monopolisation or be an attempt to monopolise under Section 2. Case law specified that only harmful monopolisation was illegal.²⁶ Section 2 of the Sherman Act also prohibited multilateral conduct in the form of “*every person who ... combine or conspire with any other person or persons ...;*” this included all forms of multilateral conduct specified in Section 1.²⁷ Generally, Section 2 prohibited the process of monopolisation (not a situation) if illegal, as is obvious from language in the Sherman Act (“*monopolization or attempt to monopolize*”) and from relevant case law.²⁸

Violating Section 2 by using vertical practices is rare but not impossible.²⁹ A person can become a monopolist or use its monopolistic power unreasonably by restraining

²² *United States v. Trans-Missouri Freight Assn.*, 166 U.S.290 (1897) (“*Trans-Missouri*”).

²³ *United States v. Joint Traffic Assn.*, 171 U.S. 505 (1898).

²⁴ Compare: *Trans-Missouri*, 166 U.S. 290 (1897); *Addyston Pipe*; *Chicago Board of Trade v. United States*, 246 U.S. 231 (1918); *American Column & Lumber Co. v. United States*, 257 U.S. 377 (1921); *Maple Flooring Mfrs Ass’n v. United States*, 268 U.S. 563 (1925); *United States v. Topco Associates*, 405 U.S. 596 (1972); *National Society of Professional Engineers v. United States*, 435 U.S. 679 (1978); *Arizona v. Maricopa County Medical Society*, 457 U.S. 332 (1982).

²⁵ *Trans-Missouri*.

²⁶ Since the case of *Standard Oil Co. v. United States*, 221 U.S. 1 (1911) (“*Standard Oil*”).

²⁷ American Bar Association, *Antitrust Law Development*, Volume I, Fifth Edition (ABA Book Publishing, Chicago 2002), 308 – 313.

²⁸ See, e.g., *Standard Oil Co. v. United States*, 221 U.S. 1 (1911); *United States v. Aluminum Co. of America*, 148 F.2d 416 (2nd Cir. 1945).

²⁹ H. Hovenkamp, *The Antitrust Enterprise: Principle and Execution* (Harvard University Press, London, 2005), 183.

competition at the vertical level through its distributors. In particular, monopolists can use vertical collusions to set high or predatory prices or create boundaries for other competitors willing to join the market. The distributors have little choice but to cooperate with the monopolist if they wish to stay in the market. However, Section 1 also included collusions between distributors and a manufacturer having a monopoly in the market. The question is whether these examples should be judged under Section 2 or Section 1, as an “agreement”, considering that one party was pressured by another. In reality, both Sections have applied in these cases.³⁰ It depends on private parties and their actions in private litigations as to which Section will apply in a particular case.

4.3. Vertical Territorial and Price Restraints throughout the Sherman Act Era

4.3.1. Early Period: *Dr. Miles* Doctrine

4.3.1.1. Background

Throughout the first period of the existence of the Sherman Act, antitrust law started to hold an important position in US society. The era between passing the Sherman Act and the end of the World War I was crucial for forming the first rules and interpretations of the Sherman Act. The courts referred to common law in early cases of the Sherman Act.³¹ However, the Sherman Act began the development of a different legal field, as discussed previously. Even though the roots of the rule of reason were set in common law,³² the existence of the Sherman Act developed and changed the application of the rule of reason to accommodate new antitrust law.³³

The Supreme Court stated that the Sherman Act condemned not all restraints but only unreasonable restraints of trade.³⁴ In the case of *Addyston Pipe*, the Court explained that the term “reasonable” did not mean whether the prices in the market were reasonable but whether the practices, such as setting the prices, were reasonable.³⁵ In the case of *Chicago*

³⁰ Compare: *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328 (1990), Section 1; *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir.), cert. denied, 534 U.S. 952 (2001), Section 2.

³¹ E.g. *United States v. Addyston Pipe*; *Connally v. General Construction Co.*, 269 U.S. 385 (1926); *Cline v. Frink Dairy Co.*, 274 U.S. 445 (1927).

³² *Mitchel v. Reynolds*, 1 P.Wms. 181, 24 Eng. Rep. 347 (K.B. 1711): This was part of contract law.

³³ See *Standard Oil*, at 31 S.Ct. 502, 55 L.Ed. 619 (1911); *United States v. American Tobacco Co.*, 221 U.S., 106, 31 S.Ct. 632 (1911).

³⁴ *Standard Oil*, at 3-4.

³⁵ *Addyston Pipe & Steel Co. v. United States*, 175 U.S. 211 (1899), at 235-236.

Board of Trade,³⁶ the Court stated that the restriction concerned had to have an appreciable effect on the market and had to restrict competition to be unreasonable.

Antitrust law and its policy were at the centre of attention throughout the presidential election in 1912 when the major political parties promised stronger and stricter antitrust law.³⁷ The majority of politicians disagreed with the Court's ruling that the Sherman Act prohibits only unreasonable restraints³⁸ and that the Sherman Act did not include tying arrangements.³⁹ Indeed, Congress approved two acts in this respect. First, the Clayton Act (1914), focusing on unfair competition and prohibiting anti-competitive forms of tying, exclusive dealing (§3) and price restraints (§2) as price discrimination and other unfair methods of competition. These restraints were illegal also at the vertical level. For example, if a manufacturer discriminated against distributors in price without legal justification, this would be illegal under §2. The second act, the FTC Act (1914),⁴⁰ established the Federal Trade Commission with the authority to enforce antitrust law. The FTC Act protects not only competition, but also consumers, against unfair practices.

The beginning of the 20th century and the year 1911 were important milestones for the existence of vertical restraints case law. Firstly, merging, including vertical integration, was seen as suspicious and was consequently considered to be unwanted and illegal.⁴¹ Section 2 of the Sherman Act was used to attack vertical integrations.⁴² This trend continued in later periods and was reflected in Section 7 of the Clayton Act (1914).⁴³ Secondly, the Sherman Act was in existence for roughly 20 years before the first doctrine and first case dealing with RPM was discussed by the Supreme Court. Although the courts had already been applying both the rule of reason and the *per se* rule, the Supreme Court decided to apply a stricter approach, the *per se* rule, to RPM cases.⁴⁴ This was a logical outcome considering the antitrust policy of the time.

³⁶ *Chicago Board of Trade v. United States*, 246 U.S. 231 (1918).

³⁷ H. Hovenkamp, H.A. Shelanski, E.T. Sullivan, *Antitrust Law, Policy and Procedure: Cases, Materials, Problems* 6th edn. (LexisNexis, 2009), 669.

³⁸ *Standard Oil*.

³⁹ *Henry v. A.B. Dick Co.*, 224 U.S. 1, 32 S.Ct. 364 (1912).

⁴⁰ Federal Trade Commission Act (15 U.S.C. §§ 41-58, as amended), most notably, Section 5.

⁴¹ Hovenkamp, "Vertical Integration", 879-880.

⁴² See *Standard Oil*.

⁴³ Clayton Antitrust Act of 1914 (Pub.L. 63-212, 38 Stat. 730, enacted October 14, 1914, codified at 15 U.S.C. § 12-27, 29 U.S.C. § 52-53); see *United States v. Paramount Pictures*, 334 U.S. 131 (1948); *United States v. E.I. Du Pont de Nemours and Co.*, 353 U.S. 586 (1957).

⁴⁴ See below the discussion on *Dr Miles Medical Company v. John D. Park & Sons Company*, 220 U.S. 373 (1911) ("*Dr Miles*").

4.3.1.2. The First RPM Doctrine

A) *Dr. Miles*⁴⁵

The Dr Miles Medical Company sold medicines that were protected by trade secret, distinctive packages and labels and trademarks.⁴⁶ The company fixed minimum prices for both wholesale and retail prices, with the set minimum prices part of agreements signed between the Dr Miles Medical Company and over 400 US wholesalers and 25,000 US retailers.⁴⁷

According to the Court, the agreements violated both the Sherman Act and the common law.⁴⁸ The Court stated that vertical agreements fixing prices and thus restricting competition were against the public interest, were illegal and were without reasonable justification.⁴⁹ While it was not directly expressed that this kind of restriction was illegal *per se*, this is obvious from the court's ruling.

Areeda and Hovenkamp criticise the court for not analysing the intentions of the manufacturer to fix retail prices as such an analysis could have led to the reasonableness of the restriction.⁵⁰ Peritz claims that the court, when applying the Sherman Act, based its hypothesis on common law doctrines by attempting to find a balance between competition and property rights, favouring free competition.⁵¹ However, it can be argued that the *Dr. Miles* doctrine is based on several legal theories:

1) IP Rights as Entitlement to Vertical Restraints

The Supreme Court differentiated statutory IP rights, such as patents and copyrights, from other rights including trade secrets. It stated that trade secrets protected the process of manufacturing and, therefore, did not entitle the holder to have the intrabrand monopolist's rights over its products and to freely restrict competition including RPM.⁵²

⁴⁵ *Dr Miles Medical Company v. John D. Park & Sons Company*, 220 U.S. 373 (1911).

⁴⁶ *Ibid.*, at 374.

⁴⁷ *Ibid.*, at 374, 381.

⁴⁸ *Ibid.* at 409.

⁴⁹ *Ibid.*, at 408.

⁵⁰ P.E. Areeda, H. Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application*, Volume VIII, Second Edition (Aspen Publishers, Frederick, 2004), 215.

⁵¹ R.J. Peritz, "A Genealogy of Vertical Restraints Doctrine" (1988-1989) 40 *Hastings L. J.* 516-529.

⁵² *Dr Miles*, at 400-403.

Firstly, the Court asked whether there was any difference between the products produced by a manufacturer with trade secret and without.⁵³ The Court stated that the patents were granted statutorily; it recognised that an owner of the patent could use the benefit of the market control that arises from exclusive manufacturing with the aim to promote invention.⁵⁴ However, this case was not based on a statutory grant and, therefore, could not benefit from the same privileges as the case of patents.⁵⁵

Secondly, the Court stated that the trade secret allowed the owner to sell licenses. It was also a subject of confidential communication and concerned the process of manufacturing. However, the minimum prices were fixed for the products not for the manufacturing process and the process was not communicated to the wholesalers, retailers and consumers. Therefore, it cannot be concluded that the trade secret entitled the manufacturer to control sales through minimum price setting. The purpose of the trade secret in this case was to restrict others from producing the product as the process of production was secret.⁵⁶

2) The Theory of Ownership and Freedom

The Supreme Court ruled that the manufacturer lost its ownership rights when it sold its products to distributors and to retailers, and was therefore not entitled to determine resale prices and other sales conditions; only the owners of the products were entitled to do so. In this case, the distributors and retailers were free to do whatever they wanted to with the products they owned.⁵⁷ The owners of the product must be free to determine its business and to compete.⁵⁸

The Supreme Court confirmed that the previous doctrine established by the common law that had regulated contracts restricting trade was “substantially modified” by the Sherman Act. The Supreme Court recognised public interest as the most important goal, as it is in the interests of both individuals and the public that every person is free and not restricted in their own business.⁵⁹

⁵³ *Dr Miles*, at 400-401; the Court cited a case on patents: *Bement v. National Harrow Company*, 186 U.S. 70, pp. 92, 93.

⁵⁴ *Dr Miles*, at 401-402.

⁵⁵ *Ibid.* at 402.

⁵⁶ *Ibid.*, at 402-403.

⁵⁷ *Ibid.*, at 404-405.

⁵⁸ *Ibid.*, at 406.

⁵⁹ *Ibid.*, at 406.

Mr Justice Holmes dissenting opinion overturned the theory of freedom. He argued that it was the manufacturer who should have been free to determine the retail prices of the products it manufactured as this was part of the manufacturer's business.⁶⁰ He explained that the company had tried to set profitable, and for consumers affordable, prices, which were therefore fair prices. If the price was not affordable for the consumers, they would choose different products.⁶¹ This idea was partially reflected in the later case of *Colgate*.⁶²

Firstly, it could be argued that free competition should determine the retail prices and not the manufacturer. Secondly, if the theory of ownership is applied then, in this case, the owners of the products were the retailers and the wholesalers, and so they should have been free to determine the prices and not the manufacturer. It can be argued that the distributors and the retailers know their customers and consumers and should hence be free to make their own business decisions and determine the best and fairest prices for them. The manufacturer already does this when setting the wholesale prices. Under Justice Holmes' scope, the agreements concerned would clearly violate retailers' and wholesalers' business freedom, which includes the freedom to set their own prices.

One could reasonably argue that the distributors and retailers concerned made their business decisions on prices when agreeing with the manufacturer's price policy. Therefore, the case involved collusion, but the ownership theory could not apply as justification for the *per se* rule. It was the agreement itself that restricted trade. The affiliated problem was the language used by the Supreme Court, which created the assumption that the manufacturer itself restricted competition by fixing minimum retail prices. However, Section 1 of the Sherman Act requires multilateral conduct, which existed in this case.

3) Intrabrand monopolists

The Supreme Court did not differentiate between intrabrand and interbrand competition and different forms of competition. It ruled that the entire retailer's competition was completely foreclosed because the manufacturer controlled the prices of all sales by reaching restrictive agreements.⁶³ It cited *Park & Sons*,⁶⁴ where the Court of Appeals

⁶⁰ *Ibid.*, at 412.

⁶¹ *Ibid.*, at 412.

⁶² *United States v. Colgate & Co.*, 250 U.S. 300 (1919).

⁶³ *Dr Miles*, at 394, 399.

explained that the kind of practice that set minimum prices and did not allow retailers to sell to other retailers had destroyed all of the retailers' competition.⁶⁵

Areeda and Hovenkamp assume that the Court believed that dealers pressured the manufacturer. They further explain that the manufacturer's intention to fix RPM would almost always be pro-competitive.⁶⁶ However, wording used by the Court suggests that the Court assumed that the manufacturer had initiated the price fixing and the Court did not differentiate between the foreclosure of intrabrand and interbrand competition.

Shores argues that the illegality of *Dr. Miles* is based on two values: economic values, which are the foreclosure of competition; and social or political values, which protect the freedom of dealers. He also claims that the objective of the Sherman Act is to protect economic values and not any others.⁶⁷ Although the purpose of the Sherman Act is the protection of economic values, the theory of ownership does not purely reflect political or social values but rather sets boundaries between the rights and responsibilities of different parties at the vertical level and, thus, it assists the understanding of those who bear the responsibility for antitrust conduct.⁶⁸

B) *Park & Sons*⁶⁹

The case of *Park & Sons* introduced the theory of free riding in RPM. Similar to the case of *Dr. Miles*, the Court of Appeals examined the common law exemption and the ownership rules in its decision from 1907. As in *Dr. Miles*, the manufacturer controlled sales and resales of medicine through their distribution system. This distribution system maintained minimum prices for wholesalers and retailers and controlled the sales of proprietary medicines, initially for patented products or products protected by copyrights. This later included all products protected by trade secrets.⁷⁰ The Court described this as an absolute elimination of competition.⁷¹ Similar to *Dr. Miles*, the Court of Appeals did not consider interbrand competition or other forms of competition. It also used wording in its

⁶⁴ 153 Fed. Rep. 24.

⁶⁵ *Dr Miles*, at 399; *John D. Park & Sons Company v. Samuel B. Hartman*, 153 Fed. Rep. 24 (Sixth Circuit, 1907), at 42.

⁶⁶ Areeda, Hovenkamp, *Antitrust Law*, 213-217.

⁶⁷ D.F. Shores, "Vertical Price-Fixing and the Contract Conundrum: Beyond Monsanto" (1985) 54 *Ford. L. Rev.* 386.

⁶⁸ See Chapter 6 "Theories of Pro-Competitiveness v. Anti-Competitiveness".

⁶⁹ *Park & Sons*, 153 Fed. Rep. 24 (Sixth Circuit 1907).

⁷⁰ *Ibid.*, at 26, 41-42.

⁷¹ *Ibid.*, at 42.

decision that the manufacturer had restricted competition and not multilateral conduct of the manufacturer and its distributors.

1) Common Law

The ruling on the common law of the Court of Appeals is comparable to the ruling of the Supreme Court delivered in *Dr. Miles*. The Court of Appeals explained that trade secret owners were not free to create “exclusive monopolies”. Therefore, they are prohibited from controlling trade, in the form of fixing prices for example, because the existence of the trade secret is only based on the fact that the process is secret.⁷² The common law rule explains that once a product is sold, the buyer is free to do with it whatever it wants; patents and copyrights, however, are exempt from this rule.⁷³ The patent statute gives an advantage only to the patentee in the form of an “exclusive monopoly”. If the owner of the secret process cannot bring the process under the protection of the patent statute, based on the complete publication of the invention, it also cannot claim the advantages from this statute.⁷⁴ Therefore, the trade secret does not have any impact on, and cannot be used as a justification for, restrictions on trade.

2) Restriction and Free Riding Theory

Considering the fact that there was not a decision on RPM by the Supreme Court in 1907, the Court of Appeals *de facto* applied the rule of reason to analyse whether this restraint was reasonable.⁷⁵ The Court quoted *Addyston Pipe* and stated that the restriction could be ancillary to the purpose of protecting the secret process and its business. It further analysed the necessity of this restraint asking “whether the restraint was necessary to the retained business and therefore ancillary to the principal purpose of the agreement”.⁷⁶ It concluded that the system of contracts had restrained trade and, therefore, the complainant had to prove that this was necessary for the protection of his business. However, the complainant failed to justify this restriction.⁷⁷

⁷² *Ibid.*, at 29.

⁷³ *Ibid.*, at 39.

⁷⁴ *Ibid.*, at 32.

⁷⁵ *Ibid.*, at 43-45.

⁷⁶ *Ibid.*, at 40-41.

⁷⁷ *Ibid.*, at 44-45.

Surprisingly, in 1907, the Court itself, not the complainant, expressed the possibility of using such a restraint to avoid price-cutting, in other words to protect the business and businesses of its retailers against free riding. This justification occurred for the first time. Nevertheless, this was not proved in this case.⁷⁸ However, as the Supreme Court applied the *per se* rule in *Dr. Miles*, the free riding theory was not used as justification for RPM for a century.

Generally, “competition is desirable” and partial restriction of competition can only be allowed under reasonable and necessary circumstances. Such restriction must only be ancillary to require protection. However, the restraint is not ancillary if the only purpose of the contract is the restriction of competition, as it was in this case.⁷⁹ The question is moot as to whether the Court would have found this restriction ancillary if the complainant had introduced the free riding justification as mentioned by the Court itself.

4.3.2. New Deal Era: Controversial Era

4.3.2.1. Background

In the 1920s and 1930s, antitrust-theory and policy debates were full of contrast over whether to believe in the freedom of the market or stricter antitrust enforcement. The beginning of this period was significant for free market policy, as illustrated in the new *Colgate* doctrine. However, in later years and until the end of World War II, the ideology that advocated primarily the protection of small businesses became state policy.⁸⁰ This stricter approach was reflected in the case of *Bausch & Lomb*,⁸¹ where the court was suspicious of exclusive dealing. It established a quasi *per se* rule, as in the case of *Standard Oil*.⁸² This rule was less strict than the *per se* rule with regards to tying as the courts believed that tying was more restrictive than exclusive dealing.⁸³

⁷⁸ *Ibid.*, at 45.

⁷⁹ *Ibid.*, at 45.

⁸⁰ Hovenkamp, *Federal Antitrust Policy*, 51, 57-58; E.Hawley, “Herbert Hoover and the Sherman Act, 1921-1933: an Early Phase of a Continuing Issue” (1989) 74 *Iowa L. Rev.* 1067.

⁸¹ *United States v. Bausch & Lomb Optical Co.*, 321 U.S. 707 (1944).

⁸² *Standard Oil Co. of California v. United States*, 337 U.S. 293 (1949).

⁸³ Gellhorn, Kovacic, Calkins, *Antitrust Law and Economics*, 394-395; see *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594 (1953); *International Salt Co. v. United States*, 332 U.S. 398 (1947).

The *per se* rule was also applied in cases of buyer power. *Mandeville Island Farms v. American Crystal Sugar*⁸⁴ is one of the oldest cases where buyer power played a major role. The refiners, who were buying sugar beets from growers, were shown to have fixed prices and such a horizontal buyers' cartel was found to be illegal *per se*, although the directly injured party was the sellers.⁸⁵

Throughout the New Deal era, the main economic ideology and antitrust policy focused on government regulation which began to regulate several industries, creating various degrees of antitrust immunity. The economic ideology of the early New Deal supposed that antitrust policy existed to avoid the problems of unregulated markets. This was reflected in the antitrust policy in strict vertical practices and mergers after 1935. By that time, economic theories had already changed,⁸⁶ for instance, Ronald Coase fully developed the marginalist theory of firm organisation and structure. He explained the reasoning behind vertical integration and vertical interactions among companies and argued that it was cheaper for companies to be vertically integrated.⁸⁷ However, marginalism's boom began in earnest several decades later.⁸⁸

Antitrust legislation reflecting policy included some contradictions. In 1936, the Robinson Patman Act amended Section 2 of the Clayton Act, which forbade various forms of price discrimination. The Robinson Patman Act became a far more complex statute. It was passed to protect small firms against unfair, price discriminative competition from vertically integrated, multi-location chain stores which, Congress believed, could dominate markets through predation and other forms of economic advantages.⁸⁹

On the contrary to the strict approach, the situation and the view on RPM temporarily changed when the Miller-Tydings Act permitted states to authorise resale maintenance agreements. This was passed only one year after the Robinson Patman Act⁹⁰ in 1937 and the exception was broadened in the McGuire Act⁹¹ in 1952. The Act allowed states to create laws which would permit manufacturers to enforce RPM as unilateral conducts or

⁸⁴ 334 U.S. 219 (1948).

⁸⁵ *Ibid.* at 235.

⁸⁶ Hovenkamp, *Federal Antitrust Policy*, 60 – 61; Hovenkamp, *The Antitrust Enterprise*, 3.

⁸⁷ Coase, R. H., "The Nature of the Firm" (1937) 4 *Economic (N.S.)* 386, 404.

⁸⁸ Hovenkamp, H., "Vertical Integration", 4.

⁸⁹ Clark, D.S. (Secretary, Federal Trade Commission) *The Robinson-Patman Act: General Principle, Commission Proceedings and Selected Issues, Retail Channel Conference for the Computer Industry*, San Jose, June 7, 1995; <http://www.ftc.gov/speeches/other/patman.shtm>; 19/12/2007.

⁹⁰ 50 Stat. 693.

⁹¹ 66 Stat. 632.

even in an agreement with dealers. The acts and their authorisations were withdrawn by the Consumer Goods Pricing Act⁹² in 1975.

4.3.2.2. The *Colgate* Doctrine

The approach to RPM of the Supreme Court was amended just eight years after ruling of *Dr. Miles*. The Supreme Court started to change its view before the 1920s and decided to follow the ideology of the free market.

A) *Colgate*:⁹³ The Reversed Theory of Ownership and Unilateral Conduct

Colgate & Company was a US manufacturer producing soap and toiletries. It sold its products through distributors and wholesalers in the US.⁹⁴ The defendant circulated letters, telegrams and other lists to dealers requiring uniform prices stating that sales would be cancelled to those who did not follow its policy. The manufacturer put dealers who did not follow the policy on a suspended list and business with them was terminated. Furthermore, the manufacturer requested assurances and promises from its dealers to follow the price policy, many of which were given. In cases where the promise was not given, the manufacturer refused to sell. Sales were unrestricted to all dealers who complied with the new price policy and gave their assurances.⁹⁵

The Supreme Court based its decision primarily on the control and the disposal of property.⁹⁶ It explained that the retailer was free to do whatever it wanted after it had bought the product. However, it was also aware that the manufacturer could refuse to sell its products if they did not respect the manufacturer's price policy. Therefore, the Supreme Court found this conduct unilateral, contrary to the *Dr. Miles* doctrine, which involved agreements between the manufacturer and its dealers.⁹⁷

It should be noted, however, that the Supreme Court changed its view on the freedom to make business decisions relating to ownership rights, because it stated that the manufacturer could set retail prices before it chose its retailers and could terminate

⁹² See Section 11.5a (89 Stat.801).

⁹³ *United States v. Colgate & Company*, 250 U.S. 300 (1919).

⁹⁴ *Ibid.*, at 302.

⁹⁵ *Ibid.*, at 302-303.

⁹⁶ *Ibid.*, at 305.

⁹⁷ *Ibid.*, at 305-306.

distribution on this basis. Retail prices would normally be in the scope of retailers under the *Dr. Miles* doctrine. Shores claims that the Court completely changed one of the pillars established in *Dr. Miles* with regards to upholding the manufacturer's freedom to trade. Moreover, the Court did not discuss another important aspect of *Dr. Miles*: the economic impact on trade, the key element of the Sherman Act.⁹⁸

The Court stated that except for creating and/or maintaining a monopoly, the Sherman Act did not restrict the rights of a person, in this case the manufacturer, freely to choose its business partners, in other words, with whom it would deal. This also included the announcement of conditions under which the manufacturer will sell. The Court cited the case of *United States v. Trans-Missouri Freight Association*,⁹⁹ where the Supreme Court confirmed that traders were free to sell to whomever they wished.¹⁰⁰

However, it could be argued that, firstly, the law should balance the rights of both parties, the rights of manufacturers and the rights of distributors, and not give preference to anyone, particularly if preference means that competition is restricted. Secondly, the boundary between multilateral and unilateral conduct is not clear in this case as the prices could not have been maintained if the retailers did not agree and/or comply with the price policy. Dealers had to promise to follow the prices; therefore, RPM was based on multilateral conduct not on unilateral actions. The District Court found this conduct illegal under Section 1 of the Sherman Act claiming that the defendant together with the dealers did not conclude an agreement but instead engaged in a combination with wholesalers and retailers to maintain fixed prices.¹⁰¹ Additionally, Gellhorn, Kovacic and Calkins argue that there was collusion between the manufacturer and hits dealers.¹⁰²

B) *Frey & Son*¹⁰³

Two years after *Colgate*, the courts fully applied the *Colgate* doctrine on price fixing in the case of *Frey & Son*, stating that issuing letters by a manufacturer from time-to-time urging its distributors to apply its fixed prices constituted unilateral conduct.¹⁰⁴

⁹⁸ Shores, "Vertical Price-Fixing", 387-388.

⁹⁹ 166 U.S. 290, at 320.

¹⁰⁰ *Colgate*, 307.

¹⁰¹ *Ibid.*, at 303-304.

¹⁰² Gellhorn, Kovacic, Calkins, *Antitrust Law and Economics*, 373.

¹⁰³ *Frey & Son, Incorporated v. Cudahy Packing Company*, 256 U.S., 208 (1921).

¹⁰⁴ *Ibid.*, at 213.

C) *General Electric*¹⁰⁵

In the case of *General Electric*, the Court, without changing the *per se* rule, found an agreement for fixing prices at the vertical level legal because the manufacturer was an owner of patents and the distributors were genuine agents which justified the existence of price restrictions under the theory of ownership.

D) *Bausch & Lomb*¹⁰⁶

Bausch & Lomb had dealings with Soft-Lite's distribution system, an exclusive distributor of pink tinted lenses.¹⁰⁷ Soft-Lite bought the non-patented lenses from the producer Bausch & Lomb and sold them on to wholesalers (who sold to retailers) under its trade name "Soft-Lite". Soft-Lite's long-running integrated distribution plan contained a provision, among others, that wholesalers would provide the retailers with optical glasses as well and that retailers provided sales promotions to customers.¹⁰⁸

Soft-Lite published a list of prices for wholesalers and retailers where it indicated the prices wholesalers should charge retailers.¹⁰⁹ Soft-Lite dealt only with wholesalers who were willing to follow Soft-Lite's distribution policy, including their price policy. They were free to distribute to competitors of Soft-Lite but Soft-Lite lenses could only be distributed to retailers who were holders of licenses from Soft-Lite. If a wholesaler had delivered to a retailer without the licence, Soft-Lite would have excluded the wholesaler from its distribution.¹¹⁰

In 1940, after the Miller-Tydings Act introduced an exception for states to legalise minimum price fixing between manufacturers and distributors, Soft-Lite concluded its price maintaining contracts in those states. The District Court called these contracts "a patch upon an illegal system of distribution of which they have become an integral part".¹¹¹

¹⁰⁵ *United States v. General Electric Co.*, 272 U.S. 476 (1926).

¹⁰⁶ *United States v. Bausch & Lomb Optical Co.*, 321 U.S. 707 (1944).

¹⁰⁷ *Ibid.*, at 709-710.

¹⁰⁸ *Ibid.*, at 710-711.

¹⁰⁹ *Ibid.*, at 715.

¹¹⁰ *Ibid.*, at 714.

¹¹¹ *Ibid.*, at 716.

1) The Theory of Complex Restriction

Among other restrictions, the Court discussed RPM in this case.¹¹² The Supreme Court explained that each illegal practice in this case had to be considered in context and as part of the Soft-Lite distribution system.¹¹³ Therefore, different aspects were recognised as parts of one illegal conduct and not as different, separate restrictions.

2) Changing the *Colgate* Doctrine

The Supreme Court also applied *Colgate*, however, it can be surmised that this case made the boundaries of the *Colgate* doctrine unclear. The appellant based its claim on unilateral refusals to deal and cited *Colgate*. The Supreme Court replied that although this case did not include written agreements, it went beyond the *Colgate* doctrine saying that Soft-Lite illegally conspired with at least some wholesalers.¹¹⁴

Analysing *Bausch & Lomb* in comparison with the two previous cases of *Colgate* and *Frey & Son*, it is difficult to determine when an action is unilateral and when it is multilateral if there was no written agreement between the manufacturer and its distributors fixing prices. Moreover, the Supreme Court stated that it was usually the seller who made others comply.¹¹⁵ The same language was used in the aforementioned older cases on RPM. This language assumes the existence and imposing of the seller's power and a lack of free will on the part of the participants.

3) Luxury Products – Justification

For the first time, the Supreme Court simply claimed that choosing its customers was essential for Soft-Lite due to the luxurious nature of its products and its aim to achieve “the highest standard of service”, however, the Court did not classify this as sufficient justification for vertical restrictions.¹¹⁶

¹¹² Ibid., at 717.

¹¹³ Ibid., at 720.

¹¹⁴ Ibid., at 723.

¹¹⁵ Ibid., at 721.

¹¹⁶ Ibid., at 728.

One could argue that services were not the basis for the selection, but price was. Moreover, such policy based on RPM created a luxurious character artificially. It was not the customers who would recognise high quality, nor was it the customers who would group this product among luxury products. Is this competition at its most effective? Certainly, the artificially-created luxury products keep prices high and outputs low without further justification.

4.3.3. Strict Era: the 1950s to the beginning of the 1970s

4.3.3.1. Background

After World War II, the importance of efficiency and economic theories increased.¹¹⁷ There were obvious influences from the Harvard School theory, which was based on the empirical studies of American industries,¹¹⁸ and the Chicago School theory, which established its own theory as a reaction to the Harvard School. The school introduced a revolutionary approach to antitrust theory, which was theoretical rather than empirical, in the 1950s. It determined economic efficiency as the antitrust goal based on a free market. The Chicago School believed that inefficiency occurred only randomly in the market, arguing that monopolists had no interest in facilitating a monopoly or in narrowing access in vertically related markets and, thus, vertical restraints were usually efficient.¹¹⁹

However, the antitrust policy of that period was very different from the Chicago School. Throughout the era of Earl Warren, Chief Justice of the Supreme Court, the most important antitrust policy issue was the protection of small businesses and their “right” to compete with larger companies. This was the main objective of antitrust law of that time. The Court was also suspicious of innovation and IP law and reviewed a high number of petitions.¹²⁰ The Celler-Kefauver amendment, which passed in the 1950s, confirmed that market

¹¹⁷ See J. Clark, “Toward a Concept of Workable Competition” (1940) 30 *AER* 243; W. Kovacic, “Failed Expectations: the Troubled Past and Uncertain Future of the Sherman Act as a Tool for Deconcentration” (1989) 74 *Iowa L. Rev.* 1105.

¹¹⁸ See e.g. Bain, J.S., *Essays on Price Theory and Industrial Organization* (Little, Brown and Company, Boston, 1972); Mason, E.S., *Economic Concentration and the Monopoly Problem* (Harvard University Press, 1957); Bain, J. S., *Barriers to New Competition* (Harvard University Press, 1956).

¹¹⁹ Hovenkamp, *Federal Antitrust Policy*, 62 – 63; R. Posner, “The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision” (1977) 45 *U.Chicago.L.Rev.* 1; R. Bork, “The Rule of Reason and Per Se Concept: Price Fixing and Market Division” (1966) Part 2, 75 *Yale L.J.* 373; further see Chapter 6 “Theories”.

¹²⁰ Hovenkamp, “Vertical Integration”, 881-882; Hovenkamp, *The Antitrust Enterprise*, 1-6; Kovacic, “The Modern Evolution”, 464; see *United States v. Aluminium Co. of America*, 148 F.2d 416, 429 (2nd Cir. 1945).

imperfections had become a priority, which increased the strictness of antitrust policy suppressing innovation.¹²¹

Inevitably, this had an impact on vertical restraints. American agencies became stricter when dealing with RPM and they also started to pay attention to vertical non-price restraints and mergers. Vertical integration was recognised as being usually restrictive in vertical cases.¹²² In 1975, the Consumer Goods Pricing Act emulated the *Dr. Miles* doctrine and repealed the Miller-Tydings Act and the McGuire Act. In the 1960s and 1970s, the DOJ, the FTC and the courts were active in declaring illegal a wide range of business conduct with an emphasis on vertical distribution practices.¹²³

Although, the *per se* rule was winning over the rule of reason in vertical restraints,¹²⁴ the Supreme Court stated in the case of *Arnold Schwinn*¹²⁵ that exclusive distributorships were legal as long as the product concerned competed with other products.¹²⁶ Further cases from this era established some boundaries of legality for exclusive dealerships. Exclusive distributorships were subject to challenge when the territory was unreasonably broad,¹²⁷ if their duration was unreasonably long,¹²⁸ if the distributor concerned also had exclusive distributorships with other suppliers¹²⁹ and if either the distributor or the supplier had a dominant market position.¹³⁰

4.3.3.2. Price Fixing: Changes in the *Colgate* Doctrine

A) *Parke, Davis*:¹³¹ *Colgate* Doctrine v. *Dr. Miles* Doctrine

This case dealt with an allegation against the appellee, the Parke, Davis Company that they and their retail and wholesale druggists illegally conspired and violated Section 1 (and

¹²¹ Hovenkamp, *Federal Antitrust Policy*, 59.

¹²² See *United States v. Yellow Cab Co.*, 332 U.S. 218 (1947); *International Salt Co. v. United States*, 332 U.S. 392 (1947); *United States v. Griffith*, 334 U.S. 100 (1948); *Standard Oil Co. of California v. United States*, 337 U.S.293 (1949); *Brown Shoes v. United States*, 370 U.S. 294 (1962).

¹²³ Kovacic, "The Modern Evolution", 383-384, 402; see the cases below.

¹²⁴ Gellhorn, Kovacic, Calkins, *Antitrust Law and Economics*, 333-334.

¹²⁵ *United States v. Arnold Schwinn & Co.*, 388 U.S. 365 (1977).

¹²⁶ *Ibid.* at 376.

¹²⁷ *United States v. Chicago Tribune-N.Y. News Syndicate, Inc.*, 309 F. Supp. 1301 (1970), at 1308-1309.

¹²⁸ *Quality Mercury, Inc. v. Ford Motor Co.*, 542 F.2d 466 (1976), at. 471-472.

¹²⁹ *United States v. Blitz*, 153 U.S. 308 (1894).

¹³⁰ *Hershey Chocolate Corp. v. FTC*, 121 F.2d 968 (1941).

¹³¹ *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1959).

Section 3) of the Sherman Act by maintaining prices of around 600 different Parke, Davis pharmaceutical products marketed nationally through wholesalers and retailers.¹³²

Retailers and wholesalers were informed that they would lose their supply from Parke, Davis if they did not maintain the suggested minimum retail prices. Furthermore, wholesalers were prohibited from selling to retailers who did not follow the suggested minimum retail prices.¹³³ Each wholesaler and retailer was interviewed individually by Parke, Davis and was informed that every other wholesaler and retailer had been told the same. Some retailers refused to assure the company that they would comply with the suggested resale prices and continued selling below these prices. These retailers lost their supply from Parke, Davis and wholesalers refused to supply to them also.¹³⁴

Following this, Parke, Davis again interviewed retailers individually. One of the retailers announced that it was willing to stop advertising but would not necessarily keep selling under the suggested minimum prices. Other retailers followed suit saying they would cease advertising; their supplies were not cancelled. After a month, one retailer started to advertise again and others followed.¹³⁵

The District Court followed the *Colgate* doctrine stating that the Sherman Act was not violated because the actions concerned appeared to be unilateral.¹³⁶ However, the Supreme Court argued that the basic difference between the case of *Colgate* and the case of *Dr. Miles* is that *Dr. Miles* was based on written contracts between distributors and the manufacturer, whereas *Colgate* did not involve an agreement, it merely protected the manufacturer's right to deal with whomever they chose.¹³⁷

The Supreme Court pointed out that the cases of *Bausch & Lomb* and *Beech-Nut*¹³⁸ had narrowed and clarified the *Colgate* doctrine. Both cases explained that the *Colgate* doctrine included a simple refusal to sell to the distributors who did not resell at the prices suggested by the manufacturer. The Sherman Act includes not only agreements but also any other combination, such as when a manufacturer goes beyond the refusal to sell.¹³⁹ The

¹³² *Ibid.*, at 30-32.

¹³³ *Ibid.*, at 33.

¹³⁴ *Ibid.*, at 33-34.

¹³⁵ *Ibid.*, at 35-36.

¹³⁶ *Ibid.*, at 36.

¹³⁷ *Ibid.*, at 38-39.

¹³⁸ *Federal Trade Commission v. Beech-Nut Packing Co.*, 257 U.S. 441, at 455.

¹³⁹ *Parke, Davis*, at 43.

most important aspect is the actions of the parties and not the language, phrases and words used.¹⁴⁰

The Supreme Court explained that *Parke, Davis* exceeded the *Colgate* doctrine and fulfilled conditions set in the cases of *Bausch & Lomb* and *Beech-Nut*, as *Parke, Davis* had not only announced retail prices and stopped supplying to retailers who were not willing to follow the price policy, but it had cooperated with wholesalers to avoid the possibility that retailers would buy from them directly and sell below the price.¹⁴¹ Moreover, it was willing to make exceptions for larger retailers.¹⁴² *Parke, Davis* not only announced a refusal to deal, it also discussed the subject with Dart Drug and other retailers. *Parke, Davis* required and offered assurances of compliance, and without this, it would not have been able to change its policy.¹⁴³

Mr. Justice Harlan, Mr. Justice Frankfurter and Mr. Justice Whittaker, jointly dissenting, argued that the Supreme Court *de facto* overruled *Colgate*.¹⁴⁴ Additionally, in *Colgate*, the distributors were made to promise the manufacturer that they would follow its price policy. This case, and the cases of *Bausch & Lomb* and *Beech-Nut*, narrowed the boundaries in that anything more than a pure announcement of price policy and its observation went beyond the *Colgate* doctrine.

B) *Simpson v. Union Oil*:¹⁴⁵ *Dr. Miles's* Theory of Ownership

The Union Oil Company sold gasoline. It signed one-year agreements with retailers requiring lessees of retail outlets and that the ownership of gasoline remained with Union Oil until it was sold to consumers. Retailers were responsible for all personal and property insurance. An agreement fixed the price of gasoline, however *Simpson*, one of the retailers, sold gasoline below the fixed price. Union Oil then refused to renew their lease with *Simpson*.¹⁴⁶

In this case, the Supreme Court confirmed *Dr Miles's* theory of ownership. It found the agreements illegal, claiming that independent dealers should have been free to make their

¹⁴⁰ *Ibid.*, at 44.

¹⁴¹ *Ibid.*, at 45-46.

¹⁴² *Ibid.*, at 45.

¹⁴³ *Ibid.*, at 46.

¹⁴⁴ *Ibid.*, at 49-57.

¹⁴⁵ *Simpson v. Union Oil Co. of California*, 377 U.S. 13 (1964).

¹⁴⁶ *Ibid.*, at 14-15.

own decisions on prices.¹⁴⁷ This means that the Supreme Court shifted its focus from the manufacturer's freedom to make business decisions, established in the *Colgate* doctrine, back to the dealers' freedom.

4.3.3.3. Maximum Price Fixing

Before vertical maximum price fixing was challenged in the Supreme Court, the case of *Kiefer-Stewart*¹⁴⁸ discussed horizontal maximum price fixing. Although the Court of Appeals found this kind of conduct legal and beneficial for competition applying the rule of reason,¹⁴⁹ the Supreme Court ruled that horizontal maximum price fixing restricted competition and was illegal because agreements to fix maximum prices "cripple[d] the freedom of traders and thereby restrain[ed] their ability to sell in accordance with their own judgment".¹⁵⁰ Sixteen years after the horizontal case, the Supreme Court discussed vertical maximum price fixing in the case of *Albrecht*¹⁵¹ stating that maximum price fixing was illegal *per se*.

A) *Albrecht*

The respondent in this case was a publisher of the morning newspaper, the *Globe-Democrat*, distributed by independent carriers. Each carrier had its own exclusive territory under the condition that the carrier would not exceed the suggested price. The respondent printed the suggested maximum retail price in its newspapers.¹⁵²

The petitioner increased the price above the maximum level in 1961. The respondent then sent a letter to the petitioner stating that it would deliver the newspaper for customers who did not want to pay the overcharged price. It also warned the petitioner that it would terminate their contract if they did not stop selling for the overcharged price.¹⁵³

The respondent offered the lower price and direct delivery to customers over the phone through a company, Milne Circulation Sales, Inc. Roughly 300 out of the 1200 petitioner's

¹⁴⁷ *Ibid.*, at 16, 20.

¹⁴⁸ *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.*, 340 U.S. 211 (1951).

¹⁴⁹ *Ibid.*, at 212.

¹⁵⁰ *Ibid.*, at 213.

¹⁵¹ *Albrecht v. Herald Co.*, 390 U.S. 145 (1968).

¹⁵² *Ibid.*, at 147.

¹⁵³ *Ibid.*, at 147.

customers switched to the direct delivery from the publisher. Following this, the respondent granted its 300 customers to another carrier, George Kroner.¹⁵⁴

1) The *Dr Miles* Doctrine v. the *Colgate* Doctrine

The District Court applied the *Dr. Miles* doctrine, in which it found a violation of Section 1 of the Sherman Act based on a combination to fix resale prices between the respondent and the plaintiff's customers and/or Milne Circulation Sales, Inc. and/or George Kroner and stated that this conduct was *per se* illegal.¹⁵⁵ On the contrary, the Court of Appeals applied the *Colgate* doctrine and ruled that there was no violation of the Sherman Act as, firstly, this was unilateral conduct and, secondly, maximum price fixing did not establish a restraint of trade. Moreover, the Court of Appeals observed, rightly, that the maximum prices were established in exclusive territories.¹⁵⁶

However, the Supreme Court disagreed with the Court of Appeals. It argued that there was a combination because the respondent had gone beyond the "mere announcement of his policy and the simple refusal to deal..." as quoted in *Parke, Davis & Co.*¹⁵⁷ as the petitioner was pressured by the respondent and by Milne and Kroner.¹⁵⁸

Mr. Justice Harlan dissenting disagreed with the existence of a combination with Milne and Kroner as they had had no special interest in the respondent's reason for setting a maximum price.¹⁵⁹ He said that there had to be some power generated in the combination, simply hiring companies such as advertisers by telephone or delivery companies is not a combination under the Sherman Act. These are jobs that the respondent could do itself.¹⁶⁰ One could argue that distribution could also be done by the manufacturer; however, the main difference is that advertising is the advertising companies' only business and they do not, therefore, compete with the distributor and have no interest to drive the distributor out.

¹⁵⁴ *Ibid.*, at 147.

¹⁵⁵ *Ibid.*, at 148.

¹⁵⁶ *Ibid.*, at 149.

¹⁵⁷ *Albrecht*, 149; *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960) at 44.

¹⁵⁸ *Albrecht*, 149-150.

¹⁵⁹ *Ibid.*, at 160.

¹⁶⁰ *Ibid.*, at 161.

2) Complex Restriction - Exclusive Territories

Unfortunately, exclusive territories were not part of the petition and hence they were not discussed before the jury at the lower court.¹⁶¹ The Supreme Court expressed that if exclusive territories had been part of the petition and these exclusive territories had had a negative impact on the public, then the Court of Appeals would have had to find the entire scheme, including both the exclusive territories and the maximum prices, illegal under Section 1 of the Sherman Act.¹⁶² The Supreme Court obviously followed the theory of complex restriction discussed in *Bausch & Lomb*.

3) Intrabrand Monopoly

Mr. Justice Stewart dissented. He partly applied the traditional ideology of intrabrand monopolies obvious in the oldest cases such as *Dr. Miles*. He stated that the respondent had only protected consumers from being charged monopolistic prices and the exclusive territories were granted only if the maximum price was not exceeded and this was agreed by the distributors.¹⁶³ However, the respondent was not a monopolist as such. Even though it was the only daily morning newspaper in that municipality, it is likely that it was competing with other newspapers and thus did not want to risk a decrease in output and a subsequent profit loss.

Mr. Justice Stewart argued that both cases, *Kiefer-Stewart Co.* and *Parke, Davis*, could not apply here because they did not include monopoly products distributed through exclusive territories. Due to the fact that the reseller was a monopolist in its territory, the protection of the retailer's free judgement as an objective did not apply here.¹⁶⁴ The respondent cannot be liable under antitrust law for not allowing its distributor to hold a complete monopoly. Therefore, Mr. Justice Stewart concluded: "The Court today stands the Sherman Act on its head".¹⁶⁵

¹⁶¹ Ibid., at 153.

¹⁶² Ibid., at 154.

¹⁶³ Ibid., at 168-169.

¹⁶⁴ Ibid., at 169.

¹⁶⁵ Ibid., at 170.

4) Restriction – Effect on Competition

The Supreme Court ruled that maximum price fixing restricted competition. Even though maximum and minimum price fixing can have different impacts on trade, maximum price fixing restricts competition for several reasons. It restricts the ability of buyers to compete and, if the price is set too low, the dealer does not have the ability to furnish services for customers or to compete at all.¹⁶⁶ There was no other explanation for the illegality of maximum price fixing.

One could argue that, firstly, if there are no dealers able to compete, the manufacturer would have to increase the maximum price. If only some are not able to compete, this can simply mean that the others are not as effective as dealers who are able to compete. Secondly, it is a paradox that by applying the *per se* rule in RPM, the Supreme Court refused the service-theory justification and by applying the *per se* rule in maximum price fixing, the Court agreed with this theory. Moreover, the manufacturers can always pay extra for services while setting maximum prices.

Mr. Justice Harlan dissenting highlighted some additional economic considerations. He claimed that minimum and maximum price fixings differed.¹⁶⁷ He said that RPM had its effect in “higher prices, less efficient use of resources and an easier life for resellers”.¹⁶⁸ It lessens intrabrand competition without any importance of its form, whether distributors horizontally agree among themselves on this practice or it is vertically dictated by a manufacturer.¹⁶⁹ He continued his argument explaining that these actions including RPM presented as vertical unilateral policy created combinations because they were in the interest of distributors and not that of manufacturers. The *per se* rule is the correct approach as there is no acceptance of the proffered justification as price floors are fixed in such cases.¹⁷⁰

However, this is economically different to vertically imposed price ceilings.¹⁷¹ Minimum price fixing is in the interest of distributors as they “may treat the product better if they

¹⁶⁶ Ibid., at 152-153.

¹⁶⁷ Ibid., at 156.

¹⁶⁸ Ibid., at 157.

¹⁶⁹ Ibid., at 157.

¹⁷⁰ Ibid., at 157.

¹⁷¹ Ibid., at 157.

have a secure high margin of profits”; however, the maximum price setting is in the manufacturer’s interest in avoiding anti-competitive actions of their distributors.¹⁷²

The mere statement of the Court that both practices “cripple the freedom of traders” to sell under their own judgment does not justify the application of the *per se* rule. Even if one of the objectives of the Sherman Act is to protect freedom and multiplicity of traders, this itself does not justify the application of the *per se* rule.¹⁷³ The price ceilings have a justification in the prevention of distributors charging monopoly prices and receiving monopoly profits in situations where the manufacturer assumes that there is insufficient competition. Therefore, this practice sets prices closer to prices which would arise from intense competition and does not lessen competition unless both parties miscalculate the maximum price.¹⁷⁴

4.3.3.4. Territorial Restrictions

In 1963, territorial restraints were addressed by the Supreme Court for the first time in *White Motor*.¹⁷⁵ The strict approach is not necessarily obvious at first sight here. However, in this case, the Supreme Court protected a small company that was in compliance with the antitrust policy of that era. It stated that it did not have a good knowledge of this kind of restraint from previous cases, therefore, it did not declare it *per se* illegal but it did not confirm that the rule of reason should apply to VTR either.¹⁷⁶ A few years later, territorial restraints were declared to be *per se* illegal in *Schwinn*;¹⁷⁷ however, conducts were unilateral and legal if territorial restraints were part of franchising systems.¹⁷⁸

A) *White Motor*¹⁷⁹

In this case, the appellant, White Motor Co., was a manufacturer of trucks and spare parts for trucks. It sold its products to distributors, dealers and directly to large users. Distributors then sold the products to users and dealers selected by the appellant.¹⁸⁰

¹⁷² *Ibid.*, at 158.

¹⁷³ *Ibid.*, at 158.

¹⁷⁴ *Ibid.*, at 159.

¹⁷⁵ *White Motor Co. v. United States*, 372 U.S. 253 (1963).

¹⁷⁶ *Ibid.*, at 263.

¹⁷⁷ *United States v. Arnold, Schwinn and Co.*, 388 U.S. 365 (1967).

¹⁷⁸ See below.

¹⁷⁹ *White Motor Co. v. United States*, 372 U.S. 253 (1963).

¹⁸⁰ *Ibid.*, at 255.

The appellant instituted agreements with its distributors and dealers limiting exclusive territories and persons or classes of persons for each distributor and dealers.¹⁸¹ The consumer clause restrained distributors and dealers from selling to public entities. Therefore, the only company who could sell trucks and White Motor's spare parts directly to the public entities was the manufacturer.¹⁸² Moreover, distributors agreed to charge the same price to dealers as the appellant charged when selling its products directly to dealers. This type of agreement constituted 5% of White Motor Co. sales.¹⁸³

1) Complex Restriction - Price Fixing without an Appreciable Effect on Sales

As the percentage of price fixing was low, the Supreme Court refused to apply the case of *Bausch & Lomb*.¹⁸⁴ The Supreme Court stated that price fixing and other restraints did not create "an integral part of the whole distribution system" as found in the case of *Bausch & Lomb*.¹⁸⁵ However, it confirmed that the *per se* rule applied in this case of price fixing.¹⁸⁶ One could argue that this contradicts the ruling in *Bausch & Lomb*. Even if this on its own involved only a small percentage of sales of the manufacturer's products, it was a restraint and should thus be considered. Indeed, the issue here is the unwillingness of the Supreme Court to set a precedent on exclusive territorial restraints and to protect a small producer.

2) Effect and Interest

Although the Supreme Court refused to state whether the rule of reason or the *per se* rule should apply to territorial restraints, it said that "a vertical arrangement by one manufacturer [was] restricting the territory of his distributors or dealers".¹⁸⁷ The point is moot as to just how illegal this conduct was under Section 1 of the Sherman Act when the Court expressly stated that the manufacturer itself, not in conduct with others, had arranged this territorial restriction.

Mr Justice Brennan agreed with the Court that there was not enough knowledge about this issue; however, he added his opinion because of the novelty of this case.¹⁸⁸ He observed

¹⁸¹ *Ibid.*, at 255-256.

¹⁸² *Ibid.*, at 256.

¹⁸³ *Ibid.*, at 260.

¹⁸⁴ *Ibid.*, at 260-261.

¹⁸⁵ *Ibid.*, at 260.

¹⁸⁶ *Ibid.*, at 264.

¹⁸⁷ *Ibid.*, at 261.

¹⁸⁸ *Ibid.*, at 264.

that, unlike in a franchising system, the agreement was a disadvantage for distributors and dealers and therefore the agreements served the manufacturer's interests exclusively.¹⁸⁹

He compared territorial restraints to RPM stating that the intrabrand effect could be the same in territorial restrictions. However, this was not necessarily true of the interbrand effect as RPM restricts interbrand and intrabrand competition.¹⁹⁰ He did not explain why he believed so; he only highlighted the appellant's general claim that its restriction fostered interbrand competition.¹⁹¹

3) The Protection of Small and/or New Entities

The appellant argued that the restrictions in question were "fair, reasonable and necessary" to compete against large competitors; its distribution system was the only method they had to effectively compete.¹⁹² The Supreme Court did not deny that such a practice was a practicable means of a small company to compete with aggressive competitors.¹⁹³

Mr Justice Brennan also argued that such a restriction could allow the manufacturer to penetrate a market if the manufacturer was a small company, or if it started with a "risky" product, or in order to ensure that its products were promoted and/or serviced.¹⁹⁴ He claimed that these justifications distinguished VTR from horizontal territorial restraints and from RPM.¹⁹⁵ However, as discussed in Chapter 6 "Theories of Pro-Competitiveness v. Anti-Competitiveness", RPM can have the same benefits.

4) The Principle of Proportionality

Mr Justice Brennan further stated that a mere justification of conduct was not enough, it had to be proved that the restriction concerned was necessary or proportionate. Therefore, a comparison must be made between the restrictive anti-competitive effects, including any possible disadvantages, which distributors must bear and the benefits arising from the restriction. Moreover, the Court must also consider whether there are no other means (e.g.

¹⁸⁹ Ibid., at 267.

¹⁹⁰ Ibid., at 268.

¹⁹¹ Ibid., at 268.

¹⁹² Ibid., at 256-257.

¹⁹³ Ibid., at 263.

¹⁹⁴ Ibid., at 269.

¹⁹⁵ Ibid., at 270.

franchising systems) that are less anti-competitive and would introduce the same benefits as the restriction.¹⁹⁶

B) *Schwinn*¹⁹⁷

The complaint was based on three restrictions of competition which were held to violate Section 1 of the Sherman Act:

1. Conspiracy involving price fixing;
2. Conspiracy involving allocation of exclusive territories; and
3. Confinement of merchandise to franchised dealers.¹⁹⁸

The government's appeal concerned only the last restriction, the distribution limitations (not price fixing), which included territorial restraints in a franchising system.¹⁹⁹

In contrast with White Motor, Schwinn was not a newcomer but a well-established manufacturer.²⁰⁰ Schwinn produced bicycles and spare parts for bicycles. Schwinn introduced the aforementioned restrictive conducts in 1952. In 1951, it was the largest manufacturer of bicycles in the US with a market share of 22.5%. Its market share decreased to 12.8% in 1961 and the largest bicycle company became Murray Ohio Manufacturing Company, which increased its market share from 11.6% in 1951 to 22.8% in 1961. However, Schwinn's production increased throughout these ten years, despite its reduced market share.²⁰¹

One of Schwinn's methods of sale included sales to retailers under the "Schwinn Plan". The Plan covered more than half of Schwinn's distribution, around 75% in 1962. It was based on a form of franchising which did not prevent the franchisees from selling other brands but required the promotion of Schwinn products and purchasing only from a distributor authorised to sell in that exclusive territory. The distributors with exclusive territories were authorised to sell only to the franchisees and not to other dealers.²⁰²

¹⁹⁶ *Ibid.*, at 270-272.

¹⁹⁷ *United States v. Arnold Schwinn & Co.*, 388 U.S. 365 (1967).

¹⁹⁸ *Ibid.*, at 367.

¹⁹⁹ *Ibid.*, at 368.

²⁰⁰ *Ibid.*, at 374.

²⁰¹ *Ibid.*, at 368-369.

²⁰² *Ibid.*, at 370-371.

1) Complex Restriction

In contrast to *White Motor*, the Supreme Court considered territorial and price restrictions as part of one illegal conduct following the theory established in *Bausch & Lomb*. It stated that there was no need to examine the reasonableness and the competitive effect in this case when VTR was “ancillary to the price-fixing”²⁰³ or if it was “an integral part of the whole distribution system” with price-fixing.²⁰⁴

2) Theory of Ownership and Franchising Systems

The government argued that once distributors purchased goods from the manufacturer, they could not be territorially restricted in their sales because the distributors owned the goods.²⁰⁵ The Supreme Court agreed with the government’s argument. The Court stated that the distributors should have been free to decide who they would deal with.²⁰⁶

However, the Supreme Court further explained that this case included unilateral conduct on the part of the manufacturer, based on the franchising and allocation of territories.²⁰⁷ The Court claimed that under Section 1 of the Sherman Act, the outcome was different regarding whether the manufacturer completely retained ownership and the risk of loss or not.²⁰⁸

The District Court ruled that territorial restrictions were *per se* illegal if used once the products were sold to distributors. This also applies to the restrictions of outlets. Both situations are unreasonable under the Sherman Act.²⁰⁹ The Supreme Court confirmed this, however it also argued that the *per se* rule did not apply in territorial vertical restrictions in franchising systems in cases where the manufacturer remained the owner of the products.²¹⁰

Mr. Justice Stewart and Mr. Justice Harlan dissented. Mr. Justice Stewart argued that the Court did not follow the rule of reason when judging distribution through sales to

²⁰³ Ibid., at 375-376.

²⁰⁴ *Schwinn*, at 375-376; (*Baush & Lomb*, 321 U.S. at 720).

²⁰⁵ *Schwinn*, at 377.

²⁰⁶ Ibid., at 378.

²⁰⁷ Ibid., at 378.

²⁰⁸ Ibid., at 378-379.

²⁰⁹ Ibid., at 379.

²¹⁰ Ibid., at 379-380; 382.

wholesalers. The Court found this *per se* illegal, even though the government asked the Court to judge this under the rule of reason.²¹¹ Thus, it overruled the 4-year old case of *White Motor* without providing any new data supporting this change.²¹² However, the *per se* rule applied only to some territorial restraint situations and did not apply to franchising systems, as later confirmed by lower courts.²¹³

Changing the ownership approach based on franchised and non-franchised products, particularly when the term “franchising” may not even be completely correct as the dealers also distributed other products, is rather demagogic and in contrary to the objective of the law of vertical restraints as discussed in Chapter 2 “Objective of the Law of Vertical Territorial and Price Restraints”, and the theory of ownership itself. In fact, this was a selective system rather than a franchising one.

3) Effective Distribution

Mr. Justice Stewart claimed that, according to studies, Schwinn’s previous distribution system had been ineffective and had restricted the promotion of Schwinn’s products. For that reason, Schwinn created a new qualitative, “active and stable” distribution system which included maintaining services and promotions.²¹⁴ Schwinn chose its distributors based on qualitative requirements, hence, distribution was provided by small companies. By choosing small companies, Swchinn was able to compete with giant chain distributors and even though profits decreased, sales increased.²¹⁵ Mr. Justice Stewart believed that a franchising system was a way for smaller companies to compete effectively and efficiently with larger, integrated companies.²¹⁶

Williamson argues that Schwinn’s system was effective in the sense that it assisted the manufacturer firstly to target its consumers, provide them with information and services

²¹¹ *Ibid.*, at 388.

²¹² *Ibid.*, at 389.

²¹³ *T’ai Corp. v. Kalso Systemet*, 568 F.2d 145 (10th Cir. 1977); *America Oil Co. v. McMullin*, 508 F.2d 1345 (10th Cir.1975); *Eastex Aviation v. Sperry and Hutchinson Co.*, 522 F.2d 1299, 1305-1306 (5th Cir. 1975); *Redd v. Shell Oil Co.*, 524 F.2d 1054, 1057-1058 (10th Cir. 1975), cert. denied, 425 U.S. 912 (1976); *Brothers v. Monsanto Co.*, 525 F.2d 486 (8th Cir. 1975), cert. denied, 423 U.S. 1055 (1976); *Edwin K. Williams & Co. v. Edwin K. Williams & Co.-East*, 542 F.2d 1053 (9th Cir. 1976), cert. denied, 433 U.S. 908 (1977); *Janel Sales Corp. v. Lanvin Parfums*, 396 F.2d 398, 406 (2d Cir.), cert. denied, 393 U.S. 938 (1968); see Areeda, Hovenkamp, *Antitrust Law*, 387-388.

²¹⁴ *Schwinn*, at 383.

²¹⁵ *Ibid.*, at 384.

²¹⁶ *Ibid.*, at 386-387.

and simplify the way consumers located Schwinn's bicycles. Secondly, it resulted in a saving on transaction costs.²¹⁷

However, it could be argued that it is not obvious which system this situation is compared with when claiming that transaction costs were saved. It is not obvious why price restrictions were necessary and whether territorial restriction had to be absolute to achieve such aims, as described by Williamson. It is also arguable whether small retail shops made the search for Schwinn's bicycles easy, because customers still had to locate the shops that sold Schwinn's bicycles and locating small retail shops can be more complicated than locating larger, specialised stores. Moreover, if Schwinn aimed its policy at customers interested in quality bicycles, as explained by Williamson, it is questionable whether small retail shops were the best option for such customers as they have a restricted choice with which to compare Schwinn's bicycles. Finally, it could be assumed from the dramatic drop in Schwinn's market share after introducing its new policy, that its system was not the most efficient one or the one with the lowest transaction costs. It cannot be claimed that such a decrease in market share was caused by the entrance of foreign low-cost bicycles into the market given that Murray Ohio Manufacturing Company was a US company. Nonetheless, the last part of Williamson's arguments, which conclude that interbrand competition was not restricted,²¹⁸ is presumably correct.

4.3.4. Free Era: the 1970s and the 1980s

4.3.4.1. Background

Throughout the period of the 1970s and 1980s, and mainly throughout Reagan's administration, antitrust policy began to focus more on the economic aspects of competition and became inspired by the Chicago School theory, which argued that vertical restraints enhanced competition and consumer welfare.²¹⁹ Hovenkamp recognises this

²¹⁷ O. Williamson, *Antitrust Economics: Mergers, Contracting, and Strategic Behaviour* (Basil Blackwell, New York, 1987), 143-148.

²¹⁸ Williamson, *Antitrust Economics*, 148-153.

²¹⁹ Buttigieg, *E. Competition Law: Safeguarding the Consumer Interest: A Comparative Analysis of US Antitrust Law and EC Competition Law* (Kluwer Law International, 2009) p. 17; Hovenkamp, *Federal Antitrust Policy*, 69 – 70; B.G. Macedo "Economics and Law: Interaction between Equals" (2009, London, UK) *The Handbook of Competition Economics*, Global Competition Review, p.15; Baker, "Competition Policy", 522; A. Jones, B. Sufrin, *EU Competition Law: Text, Cases, and Materials*, Fourth Edition (Oxford University Press, 2011) 23-30; Gellhorn, Kovacic, Calkins, *Antitrust Law and Economics*, III; J.W. Burns, "Vertical Restraints, Efficiency, and the Real World" (1993) 62 *Ford. L. Rev.* 597, p. 607; W.S. Comanor, "The Two Economics of Vertical Restraints" (1992) 21 *Sw.U.L. Rev.* 1265-1266.

period as “the antitrust counterrevolution”, concentrating on consumer welfare and economic understanding of competition as a process that should maintain low prices, high output and innovation.²²⁰ However, this was still insufficient. Fox argues that even in this time the importance of economic efficiency and proper economic studies were still missing in antitrust cases.²²¹

By the late 1970s, the courts started to narrow the wide range of illegal business conducts. This continued into the 1980s when antitrust cases including VTR and RPM decreased.²²² The DOJ and the FTC did not deal with RPM cases in the 1980s.²²³ From being strict and very active, the antitrust policy reached a point where the competition system was in danger because antitrust policy had become passive in its enforcement. The area of illegal vertical restraints was also narrowed.²²⁴ In 1982, the FTC started to take a more tolerant approach to exclusive dealing.²²⁵ This freedom and the tolerant approach were new in antitrust policy compared to previous periods and their concentration on small firms.

The free approach is also obvious in the case of *Balmoral Cinema*,²²⁶ which deals with buyer power, where the buyers agreed not to engage in competitive bidding for films. The Court applied the rule of reason and ruled that buyers had not decreased consumer welfare and, thus, trade had not been restricted. Blair and Harrison disagree with the Court and argue that consumer welfare was reduced.²²⁷ Nevertheless, in comparison with *American Crystal Sugar* from 1948, where the Supreme Court applied the *per se* rule on fixing wholesale prices by buyers, the Court obviously applied a rather more relaxed approach to the conduct caused by buyers’ power when it did not find any violation of antitrust law.

In general, the approach to vertical restraints was still unsettled. In 1985, the DOJ issued Vertical Restraints Guidelines (“Guidelines 1985”),²²⁸ which were withdrawn by the

²²⁰ Hovenkamp, *The Antitrust Enterprise*, 2.

²²¹ See e.g. E.M. Fox, “The Modernization of Antitrust: A New Equilibrium” (1980-1981) 66 *Cornell Law Review* 1140-1192.

²²² Gellhorn, Kovacic, Calkins, *Antitrust Law and Economics*, III; Kovacic, “The Modern Evolution”, 383-384, 463.

²²³ Except for the last DOJ case issued in 1980: *United States v. Cuisinarts Inc.*, No. H80-49 (D. Conn. 1980) – paradoxically, this is the only RPM criminal case.

²²⁴ Kovacic, “The Modern Evolution”, 386, 397; E.M. Fox, R. Pitofsky, “The Antitrust Alternative” (1987) 62 *N.Y.U. Law Rev.* 931.

²²⁵ See *Belton Elecs. Corp.*, 100 F.T.C. 68 (1982).

²²⁶ *Balmoral Cinema v. Allied Artists Pictures*, 885 F.2d 313 (6th Cir. 1989).

²²⁷ R.D. Blair, J.L. “Harrison, Antitrust Policy and Monopsony” (1990-1991) 76 *Cornell L. Rev.* 299-201.

²²⁸ The Guidelines, issued on January 23, 1985 and published at 50 Fed. Reg. 6,263 (Feb. 14,1985) and 4 TRADE REG. REP. (CCH) P 13,105 (1988) (“the Guidelines 1985”).

Assistant Attorney General Anne Bingaman in 1993.²²⁹ Guidelines 1985 distinguished between non-price and *per se* illegal price vertical restraints. They pointed out that any vertical restraint could have an impact on price but that was not a reason for the application of the *per se* rule.²³⁰ Initially, its existence only minimally influenced private cases as there were only two opinions that cited the Guidelines 1985 throughout the first 2 years of its existence.²³¹ In 1985, Congress stated that the Guidelines 1985 should not be treated as an “accurate expression of the Federal antitrust laws or of congressional intent with regard to the application of such laws to resale price maintenance and other vertical restraints of trade”.²³² Moreover, Assistant Attorney General William Baxter believed in the free market and, thus, favoured overruling the *Dr. Miles’ per se* rule.²³³

The approach in private litigation differed. In *Sylvania* in 1977,²³⁴ territorial restraints were declared to be judged under the rule of reason and not under the *per se* rule. Several cases followed *Sylvania* in the 1980s in which the Supreme Court confirmed the rule of reason.²³⁵ The Supreme Court’s view on RPM at the vertical level also changed. Distribution was considered an important tool for manufacturers, and for the RPM aspect of strategies, to enhance interbrand competition. Furthermore, although the cases on RPM were ruled under the *per se* rule, there were obvious tendencies to limit this scope in cases in the 1980s.²³⁶ *Business Electronics* stressed interbrand competition as the aim of competition at the vertical level. *Chevrolet*²³⁷ and *Caymen*²³⁸ explained that the *per se* rule of RPM applied only to retail prices and not to prices at different vertical levels, such as wholesale prices. The courts stated that mere suggestion of retail prices without an obligation to maintain them did not create RPM agreements and were legal.²³⁹ These

²²⁹ See The Guidelines, issued on March 27, 1995, reprinted in 4 TRADE REG. REP. (CCH) P 13,400; Section 605 of Public Law No. 99-180,99 Stat. 1169 (Dec. 13 1985).

²³⁰ See the Guidelines 1985, P 2.3.

²³¹ See A.A. Fisher, F.I. Johnson, R.H. Lande, “Do the DOJ Vertical Restraints Guidelines Provide Guidance?” (1987) 32 *Antitrust Bulletin* 609.

²³² Section 605 of Public Law No. 99-180,99 Stat. 1169 (Dec. 13 1985).

²³³ W. Baxter, “Vertical Practices - Half Slave, Half Free” (1983) 52 *Antitrust L.J.* 743, p. 750.

²³⁴ *Continental T.V. v. GTE-Sylvania*, 433 U.S. 36 (1977).

²³⁵ See *Coca-Cola Company, PepsiCo. Inc. v. Federal Trade Commission*, 642 F.2d 1387 (1981); *First Beverages, Inc. of Las Vegas and Will Norton v. Royal Crown Cola Co. and H & M Sales Co.*, 612 F. 2d 1164 (1980).

²³⁶ See *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984); *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988).

²³⁷ *Chevrolet v. General Motors Corp.*, 803 F.2d 1463 (9th Cir. 1986), cert. denied, 480 U. S. 947 (1987).

²³⁸ *Cayman Exploration Corp. v. United Gas Pipe Line*, 873 F.2d 1357 (10th Cir. 1989).

²³⁹ *Mesirow v. Pepperidge Farm*, 703 F.2d 339 (9th Cir.), cert. denied, 464 U.S. 820 (1983); *Yentsch v. Texaco*, 630 F.2d 46, 53 (2d Cir. 1980); *Morrison v. Nissan Motor Co.*, 601 F.2d 139 (4th Cir. 1979); *Hanson v. Schell Oil Co.*, 541 F.2d 1352, 1357 n.4 (9th Cir. 1976), cert. denied, 429 U.S. 1074 (1977); *Umphres v. Shell Oil. Co.*, 512 F.2d 420, 422 (5th Cir.), cert. denied, 423 U.S. 929 (1975); *Chisholm Bros. Farm Equipment Co. v. International Harvester Co.*, 498 F.2d 1137, 1141-1142 (9th Cir.), cert. denied, 419 U.S.

changes in the approach to vertical restraints were based mainly on the Chicago School's doctrine.²⁴⁰ Nevertheless, the inconsistency and overly formalistic decisions without reasons to differentiate price and non-price restrictions in vertical restraints case law were criticised by Liebler and Peritz.²⁴¹

4.3.4.2. RPM – Further Limitation of the *Per Se* Rule

A) *Monsanto*:²⁴² Existence of an Agreement

The Supreme Court specified that in the case of RPM, the respondent had to provide direct or circumstantial evidence which would exclude the possibility of independent acting by the manufacturer and non-terminated distributors.²⁴³ The evidence presented must show activities towards collusion on both parties.²⁴⁴ The Court argued that even the disclosure of an intention to set retail prices and marketing strategy did not prove the existence of collusion, and that exchanging this kind of information was legitimate.²⁴⁵ Therefore, an assumption based on indirect evidence was not enough to prove the existence of collusion. An exchange of information, including information on prices, arises in the normal course of business and this includes the coordination of activities between a manufacturer and its distributors with the aim to be efficient.²⁴⁶

In *Monsanto*, the Court found sufficient direct evidence of the existence of an agreement between Monsanto and its distributors based on:

1. Monsanto's threats against Spray-Rite to terminate the contract if it did not raise prices;
2. Threatening actions against other price cutters shortly after the plaintiff's termination, followed by maintaining prices by distributors;
3. Evidence of discussions between Monsanto and Spray-Rite on maintaining prices;

1023 (1974); *Gray v. Schell Oil Co.*, 469 F.2d 742, 747-748 & n.3 (9th Cir. 1972), cert. denied, 412 U.S. 943 (1973); *Susser v. Carvel Corp.*, 332 F.2d 505 (2d Cir. 1964), cert. dismissed, 381 U.S. 125.

²⁴⁰ See also, Wegener, R.J., "Dancing with Dinosaurs: Using Legal Analysis to Determine the Role of Vertical Non-Price Restraints in Competition Strategy" (March 6, 1997) American Law Institute, ALI-ABA Course of Study (Westlaw, 12/2007); Liebler, W.J., "Resale Price Maintenance and Consumer Welfare: Business Electronics Corp. v. Sharp Electronics Corp." (1988-1989) 36 *UCLA Law R.* 889-913.

²⁴¹ See W.J. Liebler, "Resale Price Maintenance and Consumer Welfare: Business Electronics Corp v. Sharp Electronics Corp." (1988-1989) 36 *UCLA Law Rev.* 889, pp. 889-913; Peritz, "A Genealogy", pp. 511-576.

²⁴² *Monsanto Co. v. Spray-Rite Svc. Corp.*, 465 U.S. 752 (1984).

²⁴³ *Ibid.*, at 757, 764, 768.

²⁴⁴ *Ibid.*, at 764.

²⁴⁵ *Ibid.*, at 762.

²⁴⁶ *Ibid.*, at 764.

4. A newsletter for distributors published prior to the termination of Spray-Rite urging distributors to follow Monsanto's policy.²⁴⁷

The Court also confirmed that there was evidence that the termination was part of collusion.²⁴⁸

B) *Business Electronics*:²⁴⁹ RPM or Non-Price Restraint?

The Supreme Court went further in *Business Electronic* than in *Monsanto*, mainly because it stated that any collusion between a distributor and a manufacturer to terminate an agreement with a price cutter was not *per se* illegal unless there was an agreement on RPM.²⁵⁰

The respondent, the Sharp Electronics Corporation, manufactured electronic calculators. The petitioner, Business Electronics, became the exclusive retailer of Sharp Electronics calculators in the Houston Area in Texas in 1968. The respondent appointed another retailer, Gilbert Hartwell, in the same territory in 1972.²⁵¹

The respondent published a list of suggested retail prices but there was no evidence that the retailers were obliged to follow these prices. The petitioner's prices were often below the suggested prices and, generally, its prices were lower than Hartwell's prices, which were only seldom below the suggested minimum prices. Hartwell complained to the respondent about the petitioner's prices several times giving the respondent an ultimatum in June 1973 claiming that they would terminate the contract unless the respondent finished dealing with the petitioner within 30 days. The respondent terminated the contract with the petitioner in July 1973. Although the Court raised a question as to whether the respondent had been free riding on Hartwell's educational and promotional services, it did not examine it further.²⁵²

²⁴⁷ *Ibid.*, at 765-768.

²⁴⁸ *Ibid.*, at 767.

²⁴⁹ *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988).

²⁵⁰ *Ibid.*, at 726-727.

²⁵¹ *Ibid.*, at 721.

²⁵² *Ibid.*, at 721.

1) Limits of Application of the *Per Se* Rule

The Supreme Court set the boundaries for the application of the *per se* rule. It argued that certain categories of agreements were illegal *per se* because they were “manifestly anti-competitive” and tended to “always or almost always restrict competition and decrease output”.²⁵³ The restriction concerned must have an obvious, demonstrable economic impact on trade to apply the *per se* rule.²⁵⁴

Interestingly, the Court highlighted that the *per se* rule was not justified in this case because the simple cancellation of distribution to a “price cutter” based on an agreement between the manufacturer and its second distributor without the existence of an agreement on price or minimum price setting did not demonstrate a restriction of competition or a reduction of output.²⁵⁵ One could argue that the conduct in question served the purpose of maintaining the prices and therefore it cannot be stated that this was a non-price restriction. Moreover, the Court confirmed the existence of an agreement between the manufacturer and its distributor who agreed to terminate its dealings with the price cutter. Indeed, the only reason for the termination was that the price cutter did not maintain the suggested prices.

Justices Stevens and White disagreed with the Majority on the Supreme Court that this practice was a non-price vertical restraint. Rather, they claimed that it should have been considered as a non-price horizontal restraint, where one or more distributors boycotted a manufacturer.²⁵⁶ Such situations are also described by Steiner, who claims that it is common practice and that such situations result from a significant bargaining power on the part of the retailers.²⁵⁷ He also argues that the market data indicates that Business Electronics Corp. had lower prices not because it was free riding but because it was more efficient than Hartwell. However, Hartwell possessed significant bargaining power and, therefore, Sharp decided to comply with Hartwell’s demand to keep a higher profit from the Hartwell purchase.²⁵⁸ It can be concluded that the Court agreed with foreclosing

²⁵³ Ibid., at 723.

²⁵⁴ Ibid., at 723 - 724.

²⁵⁵ Ibid., at 726-727.

²⁵⁶ Ibid., at 736.

²⁵⁷ R.L. Steiner, “How Manufacturers Deal with the Price-Cutting Retailer: When Are Vertical Restraints Efficient?” (1997) 65 *Antitrust LJ* 414-416; also see W.S. Comanor, “Antitrust Policy toward Resale Price Maintenance Following *Leegin*” (2010) 55 *Antitrust Bulletin* 67-69.

²⁵⁸ Steiner, “Price-Cutting Retailer” 418-419.

competition for the more efficient competitor, which is contrary to the objective of effective competition.

2) Vertical Price v. Vertical Non-Price Restrictions

The Supreme Court believed that there was “a significant distinction” between non-price and price vertical restrictions in that the price restrictions tended to reduce interbrand price competition because they “facilitate[d] cartelizing”.²⁵⁹ With regards to non-price vertical restraints, the Supreme Court, citing *GTE Sylvania* and *Monsanto*, took the approach that a presumption in favour of a rule-of-reason standard always existed.²⁶⁰ Therefore, the Court required a demonstration of the existence of “economic effect, such as the facilitation of cartelizing.”²⁶¹

Unfortunately, the Court did not base its claim and distinction on any economic or market study. Thus, it is difficult to agree that vertical price restraints usually facilitate cartels and that non-price restraints normally do not and, indeed, that this statement should constitute a distinction between non-price and price vertical restraints for the application of two different rules: the *per se* rule and the rule of reason. Finally, it is difficult to agree that this practice was not a vertical price restriction.

Justice Stevens recognised that the agreement to stop dealings with the petitioner eliminated price competition.²⁶² This supports the petitioner’s theory that the agreement had the same effect as a price-fixing agreement.²⁶³ Indeed, the manufacturer and the second distributor boycotted the first distributors with the purpose of eliminating price-cutting. When entities multilaterally maintain and pursue set prices and stop dealing with entities that do not follow the set prices this is, in fact, the core aspect of RPM.

3) Justification: Providing Services and Free Riding

The Supreme Court assumed that the manufacturer’s reasons for termination were to ensure the provision of adequate services.²⁶⁴ Non-price vertical restraints can lead to higher

²⁵⁹ *Ibid.*, at 725-726.

²⁶⁰ *Ibid.*, at 726.

²⁶¹ *Ibid.*, at 726.

²⁶² *Ibid.*, at 744-745.

²⁶³ *Ibid.*, at 751.

²⁶⁴ *Ibid.*, at 727-728.

prices but have the aim of ensuring services and stopping free riders. This can be seen as the true motivation for its application.²⁶⁵ However, based on the existence of exclusive territories, this motivation can be difficult to prove because it is possible the manufacturer simply dislikes cutting prices.²⁶⁶

Justice Stevens said that eliminating price competition did not absolutely assure the increase of service competition and, therefore, “a better marketplace for consumers.”²⁶⁷ However, there was the certainty of the elimination of price competition. This was just a theoretical possibility of not even providing increased services. Thus, Justice Stevens did not see the service justification as effective justification.²⁶⁸ Simply, this practice had its sole object in the restriction of trade, thus it was not a pro-competitive vertical non-price restraint.²⁶⁹ The purpose of this practice was to “eliminate price competition at Hartwell’s level” and, thus, it was naked restraint.²⁷⁰ Moreover, the Court of Appeal clarified this conduct when Hartwell followed the suggested prices and pressured the manufacturer to terminate the contract with the second distributors because the cutting of prices was seen as evidence of the existence of an agreement.²⁷¹

The lower courts had been following the Supreme Court rulings and applied the limits set in *Monsanto* and *Business Electronics*, which narrowed the *per se* rule for decades.²⁷² The approach was changed in the case of *Leegin* in 2007, discussed below.

²⁶⁵ *Ibid.*, at 728; 731.

²⁶⁶ *Ibid.*, at 728.

²⁶⁷ *Ibid.*, at 756.

²⁶⁸ *Ibid.*

²⁶⁹ *Ibid.*, at 757.

²⁷⁰ *Ibid.*, at 757-758.

²⁷¹ 780 F. 2d 1212, at 1219 (CA5 1986).

²⁷² *Business Electronics* approach and *Monsanto* approach: *Euromodas, Inc. v. Zanella, Ltd.*, 368 F. 3d 11 (2004); *Ezzo’s Investments, Inc. v. Royal Beauty Supply, Inc.*, 243 F.3d 980 (2001); *Beach v. Viking Sewing Machine Co.*, 784 F.2d 746 (1986); *Link v. Mercedes Benz of North America*, 788 F.2d 918 (1986); *National Marine Elec. Distribs., Inc. v. Raytheon Co.*, 778 F.2d 190 (1985).

Business Electronics approach: *Miles Distribs., Inc. v. Speciality Construction Brands, Inc.*, 476 F.3d 442 (2007); *Rossi v. Standard Roofing, Inc.*, 156 F.3d 452 (1998); *The Jeanery, Inc. v. James Jeans, Inc.*, 849 F.2d 1148 (1988); *Lomar Wholesale Grocery, Inc. v. Dieler’s Gourmet Foods, Inc.*, 824 F.2d 582 (1987); *Richards v. Neilson Freight Lines*, 810 F.2d 898 (1987); *Garmet District, Inc. v. Belk Stores Services, Inc.*, 799 F.2d 905 (1986); *McCabe’s Furniture, Inc. v. La-Z-Boy Chair Co.*, 798 F.2d 323 (1986); *Morrison v. Murray Biscuit Co.*, 797 F.2d 1430 (1986); *Westman Commission Co. v. Hobart International Inc.*, 796 F.2d 1216.

Monsanto approach: *Country of Tuolumne v. Sonora Community Hospital*, 236 F.3d 1148 (2001); *American Distributing Corp. v. ACS Communications, Inc.*, 990 F.2d 223 (1993); *Lovett v. General Motors Corp.*, 998 F.2d 575 (1993); *International Logistics Group, Ltd. v. Chrysler Corp.*, 884 F.2d 904 (1989); *H.L. Hayden Co. v. Siemens Medical Systems, Inc.*, 879 F.2d 1005 (1989); *Parkway Gallery Furniture Inc. v. Kittinger/Pennsylvania House Group, Inc.*, 878 F.2d 801 (1989); *H.J. Inc. v. Int’l Telephone and Telegraph Corp.*, 867 F.2d 1531 (1989); *Winn v. Edna Hibbel Corp.*, 858 F.2d 1517 (1988); *Ryko Mfg. Co. v. Eden Services*, 823 F.2d 1215 (1987); *Culberson Inc. v. Interstate Elec. Co.*, 821 F.2d 1092 (1987); *O.S.C. Corp. v. Apple Vommutter, Inc.*, 792 F.2d 1464 (1986); *Pumps & Power Co. v. Southern States Indus.*, 787 F.2d 1252

4.3.4.3. Territorial Restraints

A) *Sylvania*²⁷³

The respondent, GTE Sylvania Inc., a manufacturer of television sets, adopted a new franchise plan in 1962 selling directly to its smaller franchised retailers and granting each retailer one non-exclusive territory. Sylvania hoped that this new distribution system would increase its market share.²⁷⁴ The new franchise plan was a success with Sylvania's market share increasing approximately 5% between 1962 and 1965. At the time, the company was the eighth largest manufacturer of colour television sets in the US.²⁷⁵

In 1965, Sylvania decided to franchise Young Brothers, an established television retailer in San Francisco, as an additional retailer because Sylvania was not satisfied with the existing retailers' sales in that geographical market. The proposed location for Young Brothers was approximately one mile from a retail outlet operated by the petitioner, Continental T.V., Inc., which was a successful Sylvania franchisee. Continental did not agree with the location for the new retailer claiming that it was against Sylvania's marketing policy, to which Sylvania disagreed. Continental then replaced a large order of Sylvania's products with televisions from Phillips.²⁷⁶ At the same time, Continental was negotiating with Sylvania for the opening of a new store in Sacramento in California. Sylvania refused and terminated Continental's franchises.²⁷⁷

Among other complaints, Continental claimed that Sylvania had violated Section 1 of the Sherman Act by entering into franchise agreements, including territorial restraints.²⁷⁸

(1986); *Burlington Coat Factory Warehouse Corp. v. Esprit de Corp.*, 769 F.2d 919 (1985); *Terry's Floor Fashions Inc. v. Burlington Indus., Inc.*, 763 F.2d 604 (1985); *World of Sleep Inc. v. La-Z-Boy Chair Co.*, 756 F.2d 1467 (1985); *Landmark Development Corp. v. Chambers Corp.*, 752 F.2d 369 (1985).

Cases finding sufficient evidence of collusions: *Alvord-Polk, Inc. v. F. Schumacher & Co.*, 37 F.3d 996 (1994); *Big Apple BMW, Inc. v. BMW of North America, Inc.*, 974 F.2d 1358 (1992); *DeLong Equipment Co. v. Washington Mills Abrasive Co.*, 887 F.2d 1499 (1989); *Isaksen v. Vermont Castings, Inc.*, 825 F.2d 1158 (1987); *Tunis Bros., Inc. v. Ford Motor Co.*, 823 F.2d 49 (1987); *Helicopter Support Sys. v. Hughes Helicopter*, 818 F.2d 1530 (1987); *Dimidovich v. Bell & Howell*, 803 F.2d 1473 (1986); *McCabe's Furniture Inc. v. La-Z-Boy Chair Co.*, 798 F.2d 323 (1986); *Arnold Pontiac-GMC, Inc. v. General Motors Corp.*, 786 F.2d 564 (1986); *Victorian House, Inc. v. Fisher Camuto Corp.*, 769 F.2d 466 (1985); *Fragale & Sons Beverage Co. v. Dill*, 760 F.2d 469 (1985).

²⁷³ *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977).

²⁷⁴ *Ibid.*, at 38.

²⁷⁵ *Ibid.*, at 38-39.

²⁷⁶ *Ibid.*, at 39.

²⁷⁷ *Ibid.*, at 39-40.

²⁷⁸ *Ibid.*, at 40.

1) Ownership

In contrast with *Schwinn*, where the Supreme Court stated that Schwinn was the owner of its products, in this case the Court ruled that Sylvania had passed the ownership of its products to Continental.²⁷⁹ Thus, under *Schwinn*, the Court should apply the *per se* rule unless this case fell outside the *Schwinn* doctrine.²⁸⁰ Furthermore, the Court's language brought some confusion as it used the term "franchising" in this case and it was the franchising system that was exempt from the *per se* rule under *Schwinn*. Indeed, the Court did not clarify the meaning of the term "a franchising system" in both cases and it is arguable whether Sylvania's system was a genuine franchising system.

2) Intrabrand v. Interbrand Competition

The Court observed that the restraint in question could reduce intrabrand competition and simultaneously stimulate interbrand competition.²⁸¹ The Court recognised that intrabrand competition had been reduced because the number of sellers had been limited by and within VTR.²⁸² This observation of the difference between intrabrand and interbrand competition was not discussed in *Schwinn*.²⁸³ In contrast to *Schwinn*, Sylvania held a small market share and its products were competing with a number of substitutive TV sets. Therefore, at the interbrand level, consumers were able to switch to other products easily. Moreover, the practice potentially promoted interbrand competition because of the small market share and the existence of other competitors in the competitive market.²⁸⁴

Steiner disagrees with the Court's arguments and explains that the restriction of intrabrand competition did not increase interbrand competition in this case but competition in general was restricted.²⁸⁵ Furthermore, it is questionable whether being the eighth biggest manufacturer of colour TV sets in the US in the 1960s creates "a small market share". Nonetheless, this must be determined from the market shares of other competitors in the relevant market.

²⁷⁹ *Ibid.*, at 45.

²⁸⁰ *Sylvania*, at 45-46; *Schwinn*, at 378.

²⁸¹ *Sylvania*, at 51-52.

²⁸² *Ibid.*, at 54.

²⁸³ *Ibid.*, at 52.

²⁸⁴ *Ibid.*, at 65.

²⁸⁵ R.L. Steiner, "Sylvania Economics – A Critique" (1991) 60 *Antitrust L.J.* 41-59; further see Chapter 3 "Vertical Competition and Structure".

3) Justification: Providing Services, Penetrating the Market

The Supreme Court listed several benefits of VTR. Firstly, the manufacturer who wishes to penetrate the market can use VTR to motivate retailers to sell its products and to cover investments. Secondly, established manufacturers can use VTR to facilitate promotion and/or services which influence the competitiveness of its products and eliminate free riders.²⁸⁶

The Court therefore reasoned that there was no justification for the distinction between “sale and non-sale transactions” as introduced in *Schwinn*.²⁸⁷ The Court overruled *Schwinn* explaining that the *per se* rule was not justified as VTR also had pro-competitive effects, thus returning to the rule of reason.²⁸⁸

Marvel, Baxter, Peritz, Gellhorn, Kovacic and Calkins believe that the effect on competition of both RPM and VTR is similar with an even higher probability of anti-competitiveness than RPM and, thus, they argue that the distinction highlighted in *Sylvania* is unreasonable.²⁸⁹ Moreover, the Court did not explain specifically what is and what is not a price and/or a non-price restraint. Such differentiation was essential for making the right choice of the rule that the courts should have applied, for instance, exclusive territories will probably affect prices.²⁹⁰ Therefore, is this a price or a non-price restraint? This distinction is confusing for US courts even today, as will be discussed below.²⁹¹

Finally, *Sylvania* did not clarify how the rule of reason should apply to VTR. In the 1980s, after *Sylvania*, the courts confirmed the application of the rule of reason in cases dealing with territorial restraints.²⁹² Judge Posner argued that use of the rule of reason in vertical

²⁸⁶ *Sylvania*, at 55; see also *Sylvania*, at 56: Bork, “The Rule of Reason”; W.S. Commanor, “Vertical Territorial and Customer Restrictions: White Motor and Its Aftermath”, (1968) 81 *Harv. L. Rev.* 1419; A. Phillips, “Schwinn Rules and the ‘New Economics’ of Vertical Relation”, (1975) 44 *Antitrust L.J.*, 573.

²⁸⁷ *Sylvania*, at 57.

²⁸⁸ *Ibid.*, at 57-59.

²⁸⁹ H.P. Marvel, “Resale Price Maintenance and Resale Prices: Paying to Support Competition in the Market for Heavy Trucks” (2010) 55 *Antitrust Bulletin* 84; Gellhorn, Kovacic, Calkins, *Antitrust Law and Economics*, 334, 366-367, Peritz, “A Genealogy”, p. 511; Baxter, W.F., “The Viability of Vertical Restraints Doctrine”, (1987) 75 *Calif.L.Rev.*, 933.

²⁹⁰ See Gellhorn, Kovacic, Calkins, *Antitrust Law and Economics*, 366-367.

²⁹¹ See *Toledo Mack Sales & Service, Inc. v. Mack Trucks, Inc.*, 530 F.3d 204 (2008).

²⁹² See *Darrell Murphy v. Business Cards Tomorrow, Inc.*, 854 F.2d 1202 (1988); *Assam Drug Co. v. Miller Brewing Co.*, 798 F.2d 1430 (1986); *Beach v. Viking Sewing Mach. Co.*, 784 F.2d 746 (1986); *Dart Industries, Inc. v. Plunkett Co.*, 704 F.2d 496 (1983); *Mesirow v. Pepperidge Farm, Inc.*, 703 F.2d 339, cert. denied, 464 U.S. 820 (1983); *JBL Enters., Inc. v. Jhirmack Enters., Inc.*, 698 F.2d 1011, 1016, cert. denied,

restraints was wrong and unfeasible;²⁹³ reality confirms this. Since that period, territorial restraints have all but disappeared, not just in public but also in private litigations. There are two reasons for this. Firstly, the test of the rule of reason is set in VTR in the way that it presumes that these restraints increase efficiency and should thus be legal.²⁹⁴ Secondly, the rule of reason litigation, including burden of proof, is too expensive and complicated for private parties, mainly small companies, to sue and win the case.

B) *First Beverages*²⁹⁵

The appellants, First Beverages and Will Norton, claimed that Royal Crown Cola, a producer of soft drinks, had violated Section 1 of the Sherman Act because it had vertically imposed exclusive territories.²⁹⁶ Exclusive territories became typical practice for all major soft drinks producers after the application of the rule of reason in *Sylvania*.²⁹⁷

In this case, the Supreme Court confirmed the absolute application of the rule of reason in VTR.²⁹⁸ The appellants had taken their claim to the District Court before the Supreme Court overruled the *per se* rule in *Sylvania*, therefore it is difficult to determine what kind of claim and supporting evidence they would have introduced if they had known that the case would have been judged under the rule of reason. In the appeal, they tried to persuade the Supreme Court that their case should be viewed under the *per se* rule and not under the rule of reason; if decided under the rule of reason, the appellant required a new trial. Both claims were refused by the Supreme Court.²⁹⁹

464 U.S. 829 (1983); *Mendelovitz v. Adolph Coors Co.*, 693 F.2d 570 (1982); *Davis-Watkins Co. v. Service Merchandise Co.*, 686 F.2d 1190 (1982), cert. denied, 466 U.S. 931 (1984); *Muenster Butane, Inc. v. Stewart Co.*, 651 F.2d 292 (1981); *Donald B. Rice Tire Co. v. Michelin Tire Corp.*, 638 F.2d 15, cert. denied, 454 U.S. 822 (1981); *Cowley v. Braden Indus., Inc.*, 613 F.2d 751, cert. denied, 446 U.S. 965 (1980); *First Beverages, Inc. v. Royal Crown Cola Co.*, 612 F.2d 1164, cert. denied, 447 U.S. 924 (1980); *Del Rio Distribution Inc. v. Adolph Coors Co.*, 589 F.2d 176, cert. denied, 444 U.S. 840 (1979).

²⁹³ Posner, R.A., "The Next Step in the Antitrust Treatment of Restricted Distribution: *Per Se* Legality", (1981) 48 *U.Chicago L.Rev.*, 6.

²⁹⁴ Burns, "Vertical Restraints", 615-616; D.H. Ginsburg, "Vertical Restraints: De Facto Legality under the Rule of Reason", (1991) 60 *Antitrust L.J.*, 67.

²⁹⁵ *First Beverages, Inc. of Las Vegas and Will Norton v. Royal Crown Cola Co. and H & M Sales Co.*, 612 F. 2d 1164 (1980).

²⁹⁶ *Ibid.*, at 1166.

²⁹⁷ *First Beverages*, at 1166; See *In re Coca Cola Co.*, No. 8855 (F.T.C. April 25, 1978), Trade Reg.Rep. (CCH) Supp. No. 330; *In re PepsiCo, Inc.*, No. 8856 (F.T.C. April, 1978).

²⁹⁸ *Ibid.*, at 1170.

²⁹⁹ *Ibid.*, at 1170-1171.

C) *Business Cards Tomorrow*³⁰⁰

1) Test for Exclusive Territories

The Court of Appeals set the test for the determination of a violation of Section 1 of the Sherman Act based on vertical exclusive territories. This test consisted of three elements, which includes the importance of intention as well as the actual restriction:

1. The existence of an agreement;
2. Intention to harm or restrict competition;
3. Actual restriction or injury of competition that had an impact upon competition in a relevant market.³⁰¹

The plaintiff argued that the exclusive territories had caused some prices to be artificially high.³⁰² The Court did not find this allegation sufficient to prove that this franchising system affected the competitiveness of the entire wholesale thermography market. The court was of the opinion that it only showed that the franchising system was in Business-Cards-Tomorrow and his franchisees' economic interests. Therefore, the plaintiffs did not prove the cause of an anti-competitive effect.³⁰³ It could be deemed necessary that, generally, this practice increased prices and prices would be lower without such practice, and for this reason the practice violated antitrust law. Moreover, it should not be a legitimate argument if, for instance, a monopolist claims that it is in its interest to charge monopolistic prices.

2) Importance of Interbrand Competition

Analysing the restrictive effect, the Court of Appeals stated that the effect on intrabrand competition was irrelevant. The plaintiffs themselves agreed that interbrand competition was intense and faced substantial competition with low barriers to entry in the local wholesale thermography market. Thus, there was no significant restriction on competition.³⁰⁴ However, as argued above, it is difficult to prove that the conduct in question influenced competitors' prices, particularly in private litigation, because it can be complicated, costly and maybe even impossible to ask for information from other

³⁰⁰ *Darrell Murphy v. Business Cards Tomorrow, Inc.*, 854 F. 2d 1202 (1988).

³⁰¹ *Ibid.*, at 1205.

³⁰² *Ibid.*, at 1205.

³⁰³ *Ibid.*, at 1205.

³⁰⁴ *Ibid.*, at 1205.

competitors who are not part of the litigation so as to compare and evaluate the necessary and relevant data.

4.3.5. The Rule of Reason Era: the 1990s and New Millennium

4.3.5.1. Background

Throughout the Clinton and most notably Bush presidencies, antitrust policy and its possible changes were not considered top priorities and presidential elections did not highlight antitrust policy on their list of discussion points.³⁰⁵ Baker explains that this decline in political interest in antitrust policy was caused by creating a balance between consumers' and producers' interests throughout the development of antitrust law.³⁰⁶ Clinton's newly appointed officials were inspired by "Post-Chicago" economic concepts and began to increase their investigation and improve their antitrust enforcement by adopting the leniency policy, for example.³⁰⁷

The recent situation of antitrust law and policy could be considered more soundly-based. Nevertheless, the law of vertical restraints has remained unsettled and the rules have continued to change.³⁰⁸ The 1980s were the last decade when VTR reached the Supreme Court and the Court of Appeals. Rather, both the DOJ and the FTC have been dealing with "more serious" restraints than VTR. Furthermore, in the case of *Consulting*,³⁰⁹ the Court of Appeals stated that exclusive distributorships were "presumptively legal"; however, the presumption of legality of VTR is based on a lack of studies in this matter.³¹⁰

The FTC and the DOJ began to be more active in RPM cases. In 1991, the FTC and the DOJ brought their first RPM cases after a decade.³¹¹ In 1995, the DOJ issued new Guidelines explaining the meaning of resale price maintenance as any vertical collusion

³⁰⁵ Baker, "Competition Policy", 483; Kovacic, "The Modern Evolution", 377.

³⁰⁶ Baker, "Competition Policy", 483-530.

³⁰⁷ Gellhorn, Kovacic, Calkins, *Antitrust Law and Economics*, III.-VIII; DOJ, "Corporate Leniency Policy" (08/10/1993); DOJ, "Individual Leniency Policy" (08/10/1994).

³⁰⁸ See below.

³⁰⁹ *E&L Consulting, Ltd. v. Domain Indus., Ltd.*, 427 F.3d 23 (2d Cir. 2006), *cert. denied*, 128 S.Ct. 97 (2007).

³¹⁰ See Chapter 1 "Introduction".

³¹¹ FTC cases: *Kreepy Krauly, U.S.A., Inc.*, Dkt. C-3490, 5 TRADE REG. REP. (CCH) P 23,463 (1991) – it finished as consent order; *Nintendo of America, Inc.*, FTC File No. 901-0028 (April 10, 1991) – proposed consent order;

DOJ cases: *United States v. Playmobile U.S.A., Inc.*, 1995-1 Trade Cas. (CCH) 71000 (D.D.C.1995); *United States v. California SunCare, Inc.*, 1994-2 Trade Cas. (CCH) 70,843 (C.D. Cal. 1994)7.

when independent entities “agree to fix, raise, lower, maintain or stabilize the price at which goods or services will be resold”.³¹²

In 1997, the *per se* approach to RPM was changed when the Supreme Court overruled *Albrecht* in the case of *Khan*,³¹³ stating that the rule of reason applied when the maximum price was maintained. Horizontal agreements among manufacturers imposing maximum prices on their dealers remained within the application of the *per se* rule.³¹⁴

During a short period before judgment was given in *Leegin*,³¹⁵ the FTC and the DOJ were very active in dealing with RPM cases.³¹⁶ However, the case of *Leegin* in 2007 changed the approach to vertical restraints dramatically. The Supreme Court overruled the *Dr Miles per se* rule with five justices agreeing and four dissenting stating that vertical price restraints are to be judged under the rule of reason because RPM, including minimum price setting, stimulates interbrand competition. The rule of reason won completely against the *per se* rule in both VTR and RPM.

When analysing vertical chains, buyer power became one of the most important aspects to observe. For instance, buyer power was a significant element in the case of *Toys ‘R’ Us*.³¹⁷ In this case, the FTC challenged the purchasing practices of Toys ‘R’ Us as preventing price competition and its comparison. The allegation was based, among others, on direct evidence of vertical collusion between the retailer and at least 10 toy manufacturers. Toys ‘R’ Us, the largest toy retailer in the US, was free to dictate which toys were not allowed to be sold to chain discounters and club stores, and which could not even be sold at all.³¹⁸ The

³¹² The Guidelines, issued on March 27, 1995, reprinted in 4 TRADE REG. REP. (CCH) P 13,400; Section 605 of Public Law No. 99-180, 99 Stat. 1169 (Dec. 13 1985), at 2.1.

³¹³ *State Oil Company v. Khan*, 522 U.S. 3 (1997).

³¹⁴ See, *Arizona v. Maricopa County Medical Society*, 457 U.S. 332 (1982); *Kiefer-Stewart*; *Areeda, Hovenkamp, Antitrust Law*, 361.

³¹⁵ *Leegin Creative Leather Products, Inc. v. PSKS, Inc, DBA Kay’s Kloset...Kays’ Shoes*, 551 U.S. 877 (2007).

³¹⁶ DOJ cases: *United States v. Brush Fibres, Inc.*, 1997-2 Trade Cas. (CCH) 71,915 (E.D.Pa.1996); *United States v. Anchorshade, Inc.*, 1996-2 Trade Cas. (CCH) 71,640 (S.D.Fla. 1996); *United States v. Playmobil USA, Inc.*, 1995-1 Trade Cas. (CCH) 71000 (D.D.C.1995); *United States v. California SunCare, Inc.*, 1994-2 Trade Cas. (CCH) 70,843 (C.D. Cal. 1994); *United States v. Canstar Sports USA, Inc.*, 1993-2 Trade Cas., (CCH) 70,372 (D. Vt. 1993); FTC cases: In re *Sony Music Entertainment, Inc.*, File No. 971 0070, Docket No. C-3971 (F.T.C. 2000); In re *Nine West Group, Inc.*, File No. 981 0386, Docket No. C-3937 (F.T.C. 2008); In re *American Cyanamid Co.*, 123 F.T.C. 1257 (1997); In re *New Balance Athletic Shoe, Inc.*, 122 F.T.C 137 (1996); In re *Reebok International, Ltd.*, 120 FTC 20 (1995); In re *the Keds Corp.*, 117 F.T.C. 389 (1994); In re *Kreepy Krauly USA, Inc.*, 114 F.T.C. 777 (1991); In re *Nintendo of America Inc.*, 114 F.T.C. 702 (1991).

³¹⁷ *Toyes “R” Us*, 5 TRADE REG. REP. (CCH) P 24, 516 (FTC 1998); *Toyes “R” Us, Inc. v. FTC*, 221 F.3d 928 (2000).

³¹⁸ *Toyes “R” Us*, 5 TRADE REG. REP. (CCH) P 24, 516 (FTC 1998), at 24, 383-85.

FTC applied the rule of reason to vertical collusion and found that these practices restricted price competition between Toys ‘R’ Us’s holding market power and its competitors – the discounters.³¹⁹ It could be assumed that the manufacturers concerned were driven by the threat that the retailer would stop purchasing from them based on significant bargaining power.

Since *Microsoft*,³²⁰ the courts have begun to regularly apply Section 2 of the Sherman Act in cases of vertical restrictions. The courts have been dealing with several cases where exclusionary contracting at the vertical level has been ruled under Section 2³²¹ and also with cases where vertically imposed power played a role.³²² In 2006, in the case of *Dentsply*, the Court stated that vertical exclusive contracting arrangements violated Section 2 of the Sherman Act.³²³ In this case, the manufacturer with a monopoly power wished to deal with dealers exclusively. This meant that dealers were not allowed to distribute its rivals’ products. The dealers agreed with the manufacturer. Surprisingly, the Court did not consider it an agreement but “a series of independent sales” because of the economic pressure used by the monopolist against its dealers and, following the *Colgate* doctrine, its interpretation of the term “agreement” was not easy to understand.

4.3.5.2. Maximum Price Setting

A) *State Oil v. Khan*:³²⁴ The Rule of Reason and the Protection of Interbrand Competition

The Supreme Court overruled *Albrecht* concluding that there was not sufficient economic justification for the application of the *per se* rule in vertical maximum price fixing.³²⁵ It explained that the rule of reason applies to most antitrust claims because only unreasonable

³¹⁹ *Id.* at 24, 411.

³²⁰ *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir.), *cert. denied*, 534 U.S. 952 (2001).

³²¹ *Southeast Missouri Hospital and St. Francis Medical Center v. C.R. Bard, Inc.*, Not Reported in F.Supp.2d, 2008 WL 4372741 (E.D.Mo.), 2009-1 Trade Cases P 76,461; *Natchitoches Parish Hospital Service District and J.M. Smith Corp. d/b/a Smith Drug Co. v. Tyco International, Ltd., Tyco International (U.S.), Inc., Tyco Healthcare Group, L.P., and The Kendall Healthcare Products Company*, 247 F.R.D. 253, 2008-1 Trade Cases P 76,049, 69 Fed.R.Serv.3d 1457; *United States v. Dentsply International, Inc.*, 399 F.3d 181 (3d Cir. 2005), *cert.denied*, 546 U.S. 1089 (2006); *Lepage’s Incorporated, LePage’s Management Company, L.L.C. v. 3M (Minnesota Mining and Manufacturing Company), Kroll Associates, Inc. Minnesota Mining and Manufacturing Company*, 324 F.3d 141, 2003-1 Trade Cases P 73,989, 61 Fed. R. Evid. Serv. 60.

³²² For example, see: *Pacific Bell Telephone CO. dba AT&T California v. Linkline Communications, Inc.*, 129 S. Ct. 1109 (2009); *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C.Cir.2001), *cert. denied*, 534 U.S. 952 (2001).

³²³ *United States v. Dentsply International, Inc.*, 399 F.3d 181 (3d Cir. 2005), *cert. denied*, 546 U.S. 1089 (2006).

³²⁴ *State Oil Co. v. Khan*, 522 U.S. 2 (1997).

³²⁵ *Ibid.*, at 18.

restraints are illegal; only some types of restraints which have predictable uncompetitive effects are analysed under the *per se* rule.³²⁶ The Court further explained that there was no obvious reason to believe that vertically imposed maximum prices could “harm consumers or competition”.³²⁷ This statement does not seem to be exact as harming consumers can also mean harming competition. Nevertheless, the Supreme Court considered the protection of interbrand competition as the primary objective.³²⁸

The Supreme Court acknowledged the criticism of *Albrecht*.³²⁹ For instance, Lopatka argued that the Court’s claim in *Albrecht* if maximum prices are set too low it could restrict essential services. He said that it was not in the manufacturer’s interest to set prices too low as it could lose its distributors. However, if the price is low in a way that limits only some distributors, then the consequence of limiting inefficient distributors does not harm competition or consumers. Additionally, if there was a negative impact on competition in the particular case, there is no reason why it should not be recognised under the rule of reason. These impacts can also include the Court’s concern in *Albrecht* that maximum price fixing can *de facto* be minimum price fixing.³³⁰

One could argue that if the set maximum price is too high, then normal competition exists, unless there is something else that could indicate coordination and a secret price fixing or a minimum price fixing. If it is too low, distributors will not be able to conduct business. These are the extremes of maximum price fixing. There is nothing else which would harm competition if it is only maximum price fixing. Pitofsky believes that the ruling in *Khan* was also correct because maximum price fixing can hardly facilitate a cartel.³³¹ Finally, as Hovenkamp highlights, setting maximum prices can eliminate the negative effects of double marginalisation in double-monopoly situations.³³²

If the theory of ownership applies, then it is obvious that the dealer’s freedom to determine his retail prices was restricted by the setting of maximum prices. However, if the aim of

³²⁶ *Ibid.*, at 10.

³²⁷ *Ibid.*, at 15.

³²⁸ *Ibid.*, at 15.

³²⁹ *Ibid.*, at 16-17.

³³⁰ *State Oil v. Khan*, at 17; Lopatka, Stephen Breyer and Moredn Antitrust, “A Snug Fit” (1996) 40 *Antitrust Bulletin* 1, 60; *Albrecht*, at 390.

³³¹ R. Pitofsky, “Are Retailers Who Offer Discounts Really ‘Knives’?: The Coming Change to the *Dr. Miles* Rule” (Spring 2007) *Antitrust* 63.

³³² H. Hovenkamp, “Harvard, Chicago, and Transaction Cost Economics in Antitrust Analysis” (2010) 55 *Antitrust Bulletin* 639-640.

antitrust law is to protect effective competition, then setting maximum prices did not restrict trade.

4.3.5.3. Minimum Price and Price Setting

A) *Euromodas*³³³

The plaintiff, Eoromodas, Inc., and defendant, Clubman, Inc., were both retailers of men's clothing competing in San Juan, Puerto Rico. The other defendant, Zanella, Ltd., was an Italian manufacturer of fine men's clothing who sold products to both Euromodas and Clubman until 1997.³³⁴

Euromodas accused Clubman, who operated several stores in Puerto Rico and had a significant market power there, that it had pressured Zanella to apply minimum resale prices.³³⁵ According to Euromodas, Clubman conspired to maintain artificially high prices for trousers and managed to persuade Zanella to stop selling to Euromodas, who had been cutting the minimum prices.³³⁶ This violated Section 1 of the Sherman Act.³³⁷

1) *Business Electronics* Doctrine

Citing *Business Electronics*, the Court of Appeals held that the termination of a price-cutter and its subsequent replacement with another dealer was not *per se* a violation of Section 1 of the Sherman Act.³³⁸ The Court did not recognise any of the evidence presented as a direct confirmation of an agreement.³³⁹ The Court summarised that showing that Clubman pressured the manufacturer to deal with the under-cutting retailer was not proof enough that there was illegal multilateral conduct. This could be nothing more than Zanella's unilateral decision not to supply the plaintiff.³⁴⁰

³³³ *Euromodas, Inc. v. Zanella, Ltd.*, 368 F.3d 11 (1st Cir. 2004).

³³⁴ *Ibid.*, at 13.

³³⁵ *Ibid.*, at 13-14.

³³⁶ *Ibid.*, at 18.

³³⁷ *Ibid.*, at 14.

³³⁸ *Business Electronics*, at 726-727.

³³⁹ *Euromodas*, at 19.

³⁴⁰ *Ibid.*, at 19.

The Court made no comment on the fact that no justification was introduced, stating simply that it was not necessary.³⁴¹ Moreover, the Court considered the fact that the manufacturer took sides between the two distributors as a legitimate business decision.³⁴² However, the Court did not acknowledge the fact that if Zanella had not been pressured, it would most likely have maintained its relationship with both retailers.

Interestingly, although the Court applied Section 1 of the Sherman Act which requires the existence of multilateral conduct, it said that the *per se* illegality would be proved only if there was an agreement on price. With no such agreement, the case must be analysed under the rule of reason.³⁴³ However, firstly, if the potential restriction is based only on unilateral conduct, Section 1 does not apply at all. Secondly, the form of multilateral conduct is not, and should not be, the reason for the application of a different rule, as it does not lessen the potential effects.

B) *Leegin*³⁴⁴

The Supreme Court overruled the *Dr. Miles* doctrine, which set the *per se* rule for minimum price vertical collusions, because vertical price restraints can have pro-competitive effects according to “[r]espected economic analysts”.³⁴⁵ The Court went even further by announcing the application of the rule of reason to all vertical price restraints including vertical price fixing.³⁴⁶

Leegin, a manufacturer, designer and distributor of leather goods and accessories, started to sell women’s belts and other products under the brand name “Brighton” across the US in 1991, selling to independent small boutiques and specialised stores. *Leegin*’s policy was based on promoting better and more personal treatment, more services and a satisfactory experience for consumers. *Leegin* believed that smaller retailers were more suitable for its policy rather than large stores such as Wal-Mart.³⁴⁷

³⁴¹ *Ibid.*, at 20.

³⁴² *Ibid.*, at 20.

³⁴³ *Ibid.*, at 21.

³⁴⁴ *Leegin Creative Leather Products, Inc. v. PSKS, Inc, DBA Kay’s Closet...Kays’ Shoes*, 551 U.S. 877 (2007).

³⁴⁵ *Leegin*, at 881.

³⁴⁶ *Ibid.*

³⁴⁷ *Ibid.*, at 882.

In 1997, Leegin wrote letters to its retailers announcing a new policy, which included minimum price fixing, refusing to sell to retailers such as PSKS who would sell below the prices. In December 2002, Leegin found out that PSKS was selling its products at 20% below the minimum prices. PSKS explained to Leegin that other nearby retailers were doing the same, therefore, it had dropped their prices in order to compete.³⁴⁸ PSKS refused to increase its prices of Brighton products and thus Leegin terminated the contract.³⁴⁹

Losing its sale, PSKS sued Leegin for a violation of the Sherman Act. Leegin claimed at the District Court that it had acted unilaterally under the *Colgate* doctrine; however, the jury found the existence of an illegal agreement. Leegin appealed and rather than basing its claim on *Colgate*'s unilateral conduct, it contended that the rule of reason should be applied to this agreement. The District Court and the Court of Appeals applied the *per se* rule in accordance with *Dr Miles*.³⁵⁰

1) Overruling *Dr. Miles*

The Supreme Court explained that the Court had applied the common law rule in *Dr. Miles*,³⁵¹ therefore its justification was based on a "formalistic" legal doctrine rather than the real economic analysis in *Dr. Miles*.³⁵² The Court confirmed that the old common law was irrelevant to vertical restraints.³⁵³

The Court further claimed that it recognised in *Dr. Miles* that the restraint in question was the horizontal interest of competing distributors.³⁵⁴ However, when analysing *Dr. Miles*, one could argue that the Court was actually discussing the ownership of dealers in that cited part of the *Dr. Miles* decision.³⁵⁵ It is not clear from the case of *Dr. Miles* who had the interest in facilitating RPM.

Simultaneously, and in contradiction with its own aforementioned criticism, the Supreme Court criticised *Dr. Miles* for not analysing the possible motivations for using vertical price

³⁴⁸ *Ibid.*, at 882-883.

³⁴⁹ *Ibid.*, at 884.

³⁵⁰ *Ibid.*, at 884.

³⁵¹ *Leegin*, 887, (*Dr. Miles*, at 404-405).

³⁵² *Leegin*, at 887 citing *Sylvania*, at 58-59.

³⁵³ *Leegin*, at 888; also confirmed in *Sylvania*, at 53.

³⁵⁴ *Leegin*, at 887, 888 citing *Dr. Miles*, at 407-408.

³⁵⁵ *Dr. Miles*, at 407-408.

restraints.³⁵⁶ One could argue that Section 1 of the Sherman Act does not require the analysis of the intentions of persons and it is thus understandable that the Court did not analyse intentions 100 years ago.

The Court based the overruling of *Dr. Miles* on two reasons. Firstly, the *per se* rule means that minimum resale price agreements always, or almost always, restrict competition and decrease output, however this is contradicted by the economic pro-competitive theories and justifications regarding RPM and by the limited amount of empirical evidence that suggests the efficient use of minimum resale price agreements is not hypothetical. The second reason was the Court's *stare decisis* analysis.

2) Justifications based on Effects and Theories

The Court recognised three pro-competitive justifications for overruling the *per se* rule:

1. The “free riding” theory;
2. Providing services; and
3. Increasing interbrand competition including “new entrant” justification.

The Court confirmed the importance of an economic analyse of the effects of vertical minimum price restrictions, as previously recognised in *Business Electronics*.³⁵⁷ The Court stated that economic literature offers pro-competitive justifications for RPM based on the promotion of interbrand competition and consumer-welfare-enhancing efficiency. The practice is unlikely to have any anti-competitive effect.³⁵⁸

a) Empirical Studies and Providing Services

The Court mentioned two, in its words “recent”, empirical studies from 1983, which should prove the competitive effects of RPM: Overstreet's study and Ippolito's study.³⁵⁹ Ippolito concluded that the majority of RPM cases could be explained by the services theory, stating that between 42% and 50% concerned “complex products” which, according to the author, are products where quality and information are important

³⁵⁶ *Leegin*, at 888.

³⁵⁷ *Leegin*, at 889 (*Business Electronics*, at 726).

³⁵⁸ *Leegin*, at 889; the Court cites among others Hovenkamp, *The Antitrust Enterprise*, 184-191; Bork, R., *The Antitrust Paradox*, 288-291.

³⁵⁹ *Leegin*, 890, 894; P.M. Ippolito, “Resale Price Maintenance: Empirical Evidence from Litigation” (1991) 34 *J.Law & Econ.* 292-293; Ippolito, Report, FTC (1983); T.R. Overstreet, “Resale Price Maintenance: Economic Theories and Empirical Evidence”, (1983) Bureau of Economics Staff Report, FTC, p. 170.

attributes. However, it can be surmised that between 42% and 50% is not a majority and simply using RPM for quality products where some kind of explanation is necessary is not enough to conclude that RPM was used in these cases to increase services or drive out free riders.³⁶⁰ As Brunell said:

This can hardly be described as “evidence” that free riding was involved in any of these cases; at most it suggests that free riding could not be ruled out.³⁶¹

Overstreet assumed in his study that 80% of the analysed cases did not involve distributor collusions due to the high number of distributors in those cases. Moreover, he claimed that it is not likely that the cases included anti-competitive intentions where the market was structurally competitive with small rivals.³⁶² However, there does not have to be a high concentration and/or manufacturers do not have to have a high market share for a cartel to exist or for anti-competitive intentions to occur, as recognised by Overstreet himself in 1985.³⁶³ Nonetheless, these arguments do not exclude that RPM in these cases simply restricted competition without any pro-competitive effect, as the existence of a cartel is not the only explanation for the anti-competitive effect of RPM.³⁶⁴

More recent studies show that RPM increases prices.³⁶⁵ In 2000, the FTC estimated that the restriction of the resale prices of CDs had brought an extra \$480 million in 3 years for 85% of US music companies.³⁶⁶ The Supreme Court did not include this study in its decision. Furthermore, Justice Breyer dissenting pointed out a few more facts from Overstreet’s study. He stated that empirical studies also support the assumption that vertical minimum price fixing increases prices. By the time Congress repealed the Miller-Tydings Fair Trade Act³⁶⁷ and the McGuire Act,³⁶⁸ 36 states had permitted minimum resale price maintenance and 14 states had not.³⁶⁹ Throughout that time, prices raised from 19% to 27%.³⁷⁰ The FTC

³⁶⁰ For further explanation see Chapter 6 “Theories of Pro-Competitiveness v. Anti-Competitiveness”.

³⁶¹ R.M. Brunell, “Overruling *Dr. Miles*: The Supreme Trade Commission in Action” (2007) 52 *Antitrust Bulletin* 475, p. 509-510.

³⁶² Overstreet, at 73, 78-80.

³⁶³ A.A. Fisher, T.R. Overstreet, “Resale Price Maintenance and Distributional Efficiency: Some Lessons from the Past”, (1985) 3 *Contemp. Policy Issues* 43, pp. 49-50; also see Brunell, “Overruling”, pp. 510-511.

³⁶⁴ See Chapter 6 “Theories of Pro-Competitiveness v. Anti-Competitiveness”.

³⁶⁵ Also see Chapter 3 “Vertical Competition and Structure”.

³⁶⁶ Press Release, FTC, Record Companies Settle FTC Charges of Restraining Competition in CD Music Market (May 10, 2000), <http://www.ftc.gov/opa/2000/05/cdpres.shtml>; W.S. Grimes, “A Dynamic Analysis of Resale Price Maintenance: Inefficient Brand Promotion, Higher Margins, Distorted Choices, and Retarded Retailer Innovation” (2010) 55 *Antitrust Bulletin* 134-137; also see Chapter 3 “Vertical Competition and Structure” and Chapter 6 “Theories of Pro-Competitiveness v. Anti-Competitiveness”.

³⁶⁷ 50 Stat.693.

³⁶⁸ 66 Stat. 631 in 1975.

³⁶⁹ *Leegin*, at 913 [See Hearings on S. 408 before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, 94th Cong., 1st Sess., 173 (1975)].

study from 1983 concluded that resale price maintenance led to higher prices in most cases.³⁷¹

b) Promotion of Interbrand Competition

The Court claimed that RPM may increase interbrand competition by decreasing intrabrand competition.³⁷²

A single manufacturer's use of vertical price restraints tends to eliminate intrabrand price competition; this in turn encourages retailers to invest in tangible or intangible services or promotional efforts that aid manufacturer's position as against rival manufacturers.³⁷³

On the other hand, the Court stated that

Resale price maintenance also has the potential to give consumers more options so that they can choose among low-price, low-service brands; high-price, high-service brands; and brands that fall in between.³⁷⁴

This contradicts the first statement of the Supreme Court. Indeed, RPM can increase non-price intrabrand competition but this does not involve offering more options for consumers because it does not give the option of lower prices and, thus, competition is restricted.

c) Prevention of Free-Riding

The Court believed that the prevention of free riding was also an example of a pro-competitive effect of RPM.³⁷⁵ However, one should note that a manufacturer can select its distributors without using RPM. If such selection is based on distributors providing services, they should also be free to decide the price they wish to sell the product for and whether they want to discount or sell to discounters.³⁷⁶

³⁷⁰ *Leegin*, at 913 (See Hearings on H.R. 2384 before the Subcommittee on Monopolies and Commercial Law of the House Committee on the Judiciary, 94th Cong., 1st Sess., 122 (1975) – Statement of Keith I. Clearwaters, Deputy Assistant Attorney General, Antitrust Division).

³⁷¹ *Leegin*, at 913-914 (Overstreet, T.R., “Resale Price Maintenance: Economic Theories and Empirical Evidence (1983) FTC Bureau of Economics Staff Report, p. 160).

³⁷² *Leegin*, at 890.

³⁷³ *Ibid.*, at 890.

³⁷⁴ *Ibid.*, at 890.

³⁷⁵ *Ibid.*, at 890-892.

³⁷⁶ See Chapter 6 “Theories of Pro-Competitiveness v. Anti-Competitiveness”.

d) Penetrating the Market

Another of the Court's examples of a pro-competitive effect of RPM is that RPM can assist new companies in entering the market and thus increase interbrand competition, as previously expressed in *Sylvania*.³⁷⁷ It can also be said that it can attract new companies to penetrate the market if intrabrand RPM increases prices in interbrand competition. Depending on the market structure and vertical competition, this is possible if other manufacturers and their distributors decide to follow the manufacturer and its distributors to maintain and/or increase their prices. For instance, in *First Beverages*, exclusive territories became common practice after the *per se* rule had been changed to the rule of reason for VTR, in short, other manufacturers followed the first one.³⁷⁸

3) Anti-competitive Effects

On the other hand, the Court acknowledged some forms of potential anti-competitive effects of RPM. The primary reason for the existence of RPM is to obtain monopoly profits, because, for instance, particular price fixing facilitates and assists a manufacturer cartel or a retailer/distributor cartel.³⁷⁹

However, the Court argued that the increase of prices can be justified by the increase of other pro-competitive effects or even a decrease of prices within interbrand competition.³⁸⁰ Peeperkorn disagreed with this part of the judgement stating that any form of competition that is of benefit to consumers, including intrabrand competition, should be protected.³⁸¹

One could argue that the decreasing of prices in interbrand competition is highly speculative and illogical. Firstly, if one or more competitors increase prices using RPM, others, who maintain the same prices, will likely attract more consumers and sell more products. Decreasing their own prices can result in less profit per product without an increase in output. A more profitable scenario could be to increase prices while keeping the same output and without increasing production. This means, generally, that RPM maintained by one manufacturer and his distributors can increase prices within interbrand

³⁷⁷ *Leegin*, at 891; *Sylvania* at 55.

³⁷⁸ *First Beverages*, at 1166.

³⁷⁹ *Leegin*, at 892-893 quoting *Business Electronics*, at 725-726.

³⁸⁰ *Leegin*, at 895-896.

³⁸¹ L. Peeperkorn, "Resale Price Maintenance and Its Alleged Efficiencies" (2008) June *European Competition Journal* 206-207.

competition. However, even if the market structure is such that there is any likelihood that competitors would decrease prices if the manufacturer maintaining RPM increased its prices, it would be illogical to maintain RPM as that could cause the manufacturer and its distributors a dramatic decrease of output and hence a loss. The market structure is essential in predicting the possible results when facilitating RPM.

The Court stated that:

A retailer cartel is unlikely when only a single manufacturer in a competitive market uses resale price maintenance. Interbrand competition would divert consumers to lower priced substitutes and eliminate any gains to retailers from their price-fixing agreement over a single brand.³⁸²

This statement contradicts the statement that RPM can increase pro-competitive effects and confirms what was said previously because it means that RPM can never work as it would be always loss-making. However, in practice, the situation is different as it shows that RPM has been used to advantage.

The Court also argued that there are other practices that increase the price of products or services, such as advertising and increasing quality, but they are not illegal under antitrust law.³⁸³ This is true, however the main difference is that these practices are in the interest of effective competition and consumers, and their first and main purpose is not to increase prices. On the other hand, RPM's primary aim is to set prices without any guarantee of a positive impact on effective competition.

The Court further stated that the administrative advantages of the *per se* rule, costs and minimising of burdens on litigants and the judicial system, do not in themselves justify the application of the *per se* rule.³⁸⁴

Pitofsky argued that pro-competitive justifications are only theoretical but the anti-competitive results of minimum price fixing are "virtually certain" and, therefore, the *per se* rule should remain.³⁸⁵ Justice Breyer dissenting stated that the ultimate question is not whether distributors free ride on services nor is it a question of the quality or reputation of another distributor, but how often free riding occurs and how often the possible benefits

³⁸² Ibid., at 897.

³⁸³ Ibid., at 897.

³⁸⁴ Ibid., at 895.

³⁸⁵ Pitofsky, "Are Retailers", 64.

outweigh the potential harms. This is difficult to determine.³⁸⁶ He based his analysis on three groups of arguments: “(1) potential anticompetitive effects, (2) potential benefits, and (3) administration”.³⁸⁷ He argued that the Sherman Act’s objective was to “maintain a marketplace free of anticompetitive practices ... [which] will tend to bring about the lower prices, better products, and more efficient production process that consumers typically desire”.³⁸⁸ In circumstances where a particular practice is seriously anti-competitive with only a few possible justifications, the courts apply the *per se* rule instead of applying the rule of reason.³⁸⁹

The anti-competitive danger of RPM has two main forms: the restriction of intrabrand competition and also the restriction of interbrand competition if more than one manufacturer facilitates RPM. Manufacturers can be driven by collusion among themselves in concentrated industries where they can easily observe their prices and RPM can be a useful tool in such a matter. The anti-competitive effect of RPM itself is based on high prices, for instance, preventing dealers from responding to price-demand changes thus restricting more efficient dealers.

In this case, PSKS and others were able to decrease prices and thus compete on price, while still promoting Leegin’s products. The Supreme Court did not analyse the needs of consumers. Mr. James Donahau, who managed to buy a discounted Leegin product prior to the final decision, argued that, in the case of *Leegin*, there was no benefit for consumers in facilitating RPM because retailers did not repair or offer any other important services. The applied RPM only had a negative impact, which was the price increase of Leegin products and the restriction of intrabrand competition.³⁹⁰

4) Power and Motivation

The Court highlighted that the market power of a manufacturer or retailer is important in RPM because both parties can abuse their power to pressure others to facilitate RPM.³⁹¹ The Court stated that the interest of retailers is different from that of consumers and

³⁸⁶ *Leegin*, at 917.

³⁸⁷ *Ibid.*, at 911.

³⁸⁸ *Ibid.*, at 910.

³⁸⁹ *Ibid.*, at 910.

³⁹⁰ The American Bar Association, Section of Antitrust Law, “The Antitrust Fall Forum” (November 13, 2009) Washington D.C. (Mr. James Donahau – Chief Deputy Attorney General of the Antitrust Section).

³⁹¹ *Leegin*, at 885, 893-894.

manufacturers. Consumers generally desire lower prices,³⁹² while the manufacturer wants to minimise distribution costs and not overcompensate retailers, who are the ones that gain from higher retailer prices.³⁹³

In partial contradiction to the Court's aforementioned argument, the Court held that using the manufacturer's or retailer's power to introduce RPM need not concern the courts, as there are still other competing retailers and manufacturers, unless the power is seriously monopolistic.³⁹⁴ The Court did not discuss this issue further. As Chapter 3 "Vertical Competition and Structure" explains, however, power is important and should be considered, in terms of bargaining power and not only horizontal market power.

The Court also discussed the importance of the initiators of RPM. If the initiator is a powerful retailer (or retailers), it can constitute evidence of the abuse of a dominant position or the facilitation of a retailer cartel, which is anti-competitive conduct. On the other hand, a manufacturer would most likely use RPM to increase services.³⁹⁵

The existence of a retailer cartel is not as important as the potential retailers' interest for using RPM, which is to increase their profits. This is not primarily in the interest of the manufacturer, however, this does not mean that the manufacturer has no reason for introducing RPM. For example, if fixed prices mean that there are more retailers interested in selling its products, even if this does not directly increase its profits by an increased price, it can increase output, which would therefore increase profits.

Another example of this is when a manufacturer faces a situation where it could lose one of its important but less efficient retailers. Although, in the end, this can lead to bigger sales from its remaining retailers once the market is settled, the first effect of losing a big retailer can and probably will lead to a decrease in manufacturing output. At least until the manufacturer finds a new retailer and/or its consumers use the new retailer, provided they do not switch to competing products.

³⁹² *Ibid.*, at 896.

³⁹³ *Ibid.*, at 896.

³⁹⁴ *Ibid.*, at 898.

³⁹⁵ *Ibid.*, at 898.

Justice Breyer observed that it is difficult to recognise who, the manufacturer or dealer, initiated RPM in this particular case.³⁹⁶ As he rightly highlighted, even if a retailer is a strong company with a large market share at the horizontal level, a small producer can initiate RPM to motivate the retailer to obtain the best space on its shelves.³⁹⁷

Moreover, in context with the facts of the case, unfortunately the petitioner did not address the fact that Leegin was a dual distributor of its own products and was thus horizontally competing with the petitioner.³⁹⁸ This indicates the existence of intrabrand horizontal conduct, not just a vertical one. However, although this could provide Leegin with a reason for fixing retail prices, increasing the wholesale price could be a more efficient and profitable way, as discussed in Chapter 3 “Vertical Competition and Structure”.³⁹⁹ In dual distribution, it is more probable that the manufacturer will use RPM for reasons that follow from its vertical relationships rather than their horizontal ones.

5) Vertical v. Horizontal Effects

The Supreme Court refused analogous treatment between vertical and horizontal combinations because vertical restraints are more defensible than horizontal restraints.⁴⁰⁰ The Court confirmed that price fixing among manufacturers or among retailers (at the horizontal level) is *per se* illegal; however, if parties collude vertically to fix prices, the case must be ruled under the rule of reason.⁴⁰¹

The Court did not differentiate between an intrabrand horizontal agreement among retailers with just the one brand and retailers’ horizontal collusion covering more than one brand. Although this distinction between horizontal agreements among dealers and vertical agreements was obvious in previous cases,⁴⁰² one could argue that intrabrand horizontal agreements can have the same effect on competition and the same purpose as a vertical agreement. For instance, Mr. Justice Harlan, dissenting in *Albrecht*, said that the form is

³⁹⁶ *Ibid.*, at 917.

³⁹⁷ *Ibid.*, at 918; further see Chapter 3 “Vertical Competition and Structure”.

³⁹⁸ *PSKS, Inc. v. Leegin Creative Leather Products, Inc.*, 615 F.3d 412 (2010, 5th Circuit) at 416; Pitofsky, “Are Retailers?”, 64.

³⁹⁹ Areeda, Hovenkamp, *Antitrust Law*, 68-81; compare with D. Gilo, “Private Labels, Dual Distribution, and Vertical Restraints – An Analysis of the Competitive Effects” in *Private Labels, Brands, and Competition Policy* (2009, Oxford University Press), 141-152.

⁴⁰⁰ *Leegin*, at 888 citing *Maricopa County*, at 348.

⁴⁰¹ *Leegin*, at 893.

⁴⁰² See *Business Electronics*, at 736; *United States v. General Motors Corp.*, 384 U.S. 127 (1966), at 140, 146.

not important when determining the effect of the conduct on competition.⁴⁰³ Areeda and Hovenkamp also recognise that vertical or horizontal intrabrand agreements can have the same intentions and the same effects but they are treated differently in case law.⁴⁰⁴

6) Litigation

Justice Breyer pointed out that the law differs from the economy. Litigation is an administrative system applying rules and precedents and, as such, must be balanced to be workable for parties.⁴⁰⁵ Proving market share is highly costly, highly technical and time-consuming in litigation. This is true even more so for RPM over a major monopoly or merger case because such cases can include a lot of parties.⁴⁰⁶

The Supreme Court did not give much guidance for litigation for subsequent RPM cases. It stated generally that the scope of operation and the existence of the agreement were important elements. However, it noted that future practice would provide more specific rules for how to use the rule of reason in RPM cases.⁴⁰⁷

Justice Breyer disagreeing with overruling *Dr. Miles* summarised the decision in the following, and arguably correct, way:

The only safe predictions to make about today's decision are that it will likely raise the price of goods at retail and that it will create considerable legal turbulence as lower courts seek to develop workable principles.⁴⁰⁸

Areeda and Hovenkamp recognise three difficulties in applying the rule of reason in RPM:

1. Little guidance from the Supreme Court;
2. Complexity of economic understanding of RPM; and
3. *Dr. Miles* doctrine's baggage.

They believe that the courts should determine whether the restriction caused by RPM led to "higher prices resulting from lower output".⁴⁰⁹ There is a pro-competitive reason for using

⁴⁰³ *Albrecht*, at 157.

⁴⁰⁴ Areeda, Hovenkamp, *Antitrust Law*, 7, 31.

⁴⁰⁵ *Leegin*, at 916

⁴⁰⁶ *Ibid.*, at 918.

⁴⁰⁷ *Ibid.* at 899.

⁴⁰⁸ *Ibid.* at 931.

⁴⁰⁹ P.E. Areeda, H. Hovenkamp, *2009 Supplement to Antitrust Law: An Analysis of Antitrust Principles and Their Application*, (Aspen Publishers, Frederick, 2009), 238-239, 243; also see Comanor, "Antitrust Policy" 59; F. H. Easterbrook, "Vertical Arrangements and the Rule of Reason", 53 (1984) *Antitrust L.J.* 163.

RPM in situations when RPM causes prices increases and output does not decrease or even increases as well. This means that RPM resulted in an increase of services or in the quality of products.⁴¹⁰ However, if the output did not decrease or did not decrease adequately, it can also mean that the brand was so popular or so dominant that the increase in price did not have an obvious impact on customer choice, or that RPM of one brand had an impact on the whole of interbrand competition and the competitors or some of them also increased their prices. As discussed in Chapter 3 “Vertical Competition and Structure”, there is a wide range of factors which should be analysed to make the correct conclusion in each case.

4.3.6. Post-*Leegin* Development - Obama Presidency

4.3.6.1. Background

The recent economic crises have raised the question as to whether some areas of US antitrust policy and its law have been soundly based. Generally, Obama’s presidency has increased interest in antitrust enforcement and on antitrust issues.⁴¹¹ The Department of Justice’s Antitrust Division has started to focus on economic freedom, fairness, transparency and legal certainty within antitrust law and policy.⁴¹² The FTC attempted to introduce a structural approach to RPM, including burden shifting between two parties.⁴¹³ The DOJ seems to be of the same opinion as the FTC in thinking that it is necessary to create alternatives to the traditional rule of reason.⁴¹⁴

Indeed, the case of *Leegin* aroused significant controversy in the US sparking intensive discussions on the application of the *per se* rule.⁴¹⁵ Even though there are no exact figures,

⁴¹⁰ Areeda, Hovenkamp, *2009 Supplement*, p. 239; also see K.G. Elzinga, D.E. Mills “Leegin and Procompetitive Resale Price Maintenance” (2010) 55 *Antitrust Bulletin* 349-379; Comanor, “Antitrust Policy” 75-78.

⁴¹¹ The American Bar Association, Section of Antitrust Law, “The Antitrust Fall Forum” (November 12-13, 2009) Washington D.C.

⁴¹² <http://www.justice.gov/atr/public/speeches/272536.pdf> (DOJ WebPages: Ch.A. Varney, “Vigorously Enforcing the Antitrust Laws: Developments at the Division,” Washington, DC, 24/6/2001, pp. 1, 15, 18).

⁴¹³ Gavil, “RPM in the Post-*Leegin* World” 4-5; The American Bar Association, Section of Antitrust Law, “The Antitrust Fall Forum” (November 12-13, 2009) Washington D.C.

⁴¹⁴ Ch.A. Varney (Assistant Attorney General, Antitrust Division, DOJ) “Antitrust Federalism: Enhancing Federal/State Cooperation” Speech from October 7, 2009, available at <http://www.justice.gov/atr/public/speeches/250635.pdf>; Gavil, “RPM in the Post-*Leegin* World” 5-6.

⁴¹⁵ A.I. Gavil, “Resale Price Maintenance in the Post-*Leegin* World: A Comparative Look at Recent Developments in the United States and European Union” (2010) 1 *The CPI Antitrust Journal* 2-3; W.T. Miller, K.N. Shaw, “Pricing Practices: A Comparative Perspective” (2009) *The Antitrust Review of the Americas*, 14; A. Jones, “Competition of the Revolution in Antitrust Doctrine on Restricted Distribution:

it appears that RPM has increased in the US since the delivery of the Supreme Court's decision on *Leegin*.⁴¹⁶

Federal cases on RPM would clarify the rule of reason in respect to RPM; however, to date these have proved elusive. Additionally, the courts have the tendency to follow the rule of reason under state law.⁴¹⁷ The Court of Appeals delivered its decision in *Leegin 2*,⁴¹⁸ which not only further explained the application of the rule of reason, but also confirmed the jury award of \$3,975,000 to PSKS. This increased the threat of establishing the rule of reason *de facto* legality in RPM cases.

Nevertheless, as the future may reveal, there is still some hope left that *Leegin* commenced the process of establishing a new approach to the rule of reason within RPM.⁴¹⁹ However, there also remains the possibility that the US will re-establish the *per se* rule in relation to RPM. Several states have overturned or lessened the impact of *Leegin* by statutes reintroducing *per-se* illegality, primarily because retailers had been complaining that it was impossible to win a case if the rule of reason was applied.⁴²⁰ Since this change, the Federal Government has tried to overturn the rule of reason in the US Congress; however, thus far, it has not succeeded.⁴²¹ The FTC has continued investigating and prohibiting RPM in industries, albeit with a more benevolent approach to RPM respecting ruling in *Leegin*.⁴²²

On a positive note, although bargaining power and vertical competition have not been properly reflected in US antitrust law and its policies as yet, there are some signs that such an approach could be changed in future. As discussed previously, the courts have recently

Leegin and Its Implications for EC Competition Law" (2008) 53(4) *Antitrust Bulletin* 903-965; Brunell, "Overruling", 475-529.

⁴¹⁶ R.D. Blair, J.S Haynes, "The Plight of Online Retailers in the Aftermath of *Leegin*: An Economic Analysis" (2010) 55 *Antitrust Bulletin* 256 ("...BabyAge.com, for example, reported that nearly 100 of its 456 suppliers now have RPM programs."); G.T. Gundlach, "Overview and Contents of the Special Issue: Antitrust Analysis of Resale Price Maintenance after *Leegin*" (2010) 55 *Antitrust Bulletin* 10-14.

⁴¹⁷ For example, see Tennessee jurisdiction: *Sphar v. Leegin Creative Leather Products, Inc.*, No. 07-CV-187, 2008 WL 3914461 (E.D. Tenn. Aug. 20, 2008), *appeal dismissed* (6th Cir. Nov. 20, 2008) (No. 08-6165); Kansas jurisdiction: *O'Brien v. Leegin Creative Leather Products, Inc.*, No. 04-CV-1668 (Sedgwick Cty. Kan. July 9, 2008), *direct appeal to Kansas Supreme Court granted*, File No. 101,000 (Oct. 6, 2008).

⁴¹⁸ *PSKS, Inc. v. Leegin Creative Leather Products, Inc.*, 615 F.3d 412 (2010, 5th Circuit).

⁴¹⁹ See above the discussion on *Leegin*; Gundlach, "Overview" 3-4.

⁴²⁰ The American Bar Association, Section of Antitrust Law, "The Antitrust Fall Forum" (November 12-13, 2009) Washington D.C.; Gavil, "RPM in the Post-*Leegin* World" 6-7; this is reflected in relevant state cases, for instance: *California v. DermaQuest*, No. RG10497526 (Sup. Ct. Cal. Feb. 5, 2010); *New York v. Tempur-Pedic International*, No. 400837/10 (Sup. Ct. Cal. Jan. 14, 2011).

⁴²¹ The most recent Bill proposal has been introduced – S75, the Discount Pricing Consumer Protection Act, 2011; the previous one – S148, the Discount Pricing Consumer Protection Act, 2009 – never became law; also see Gavil, "RPM in the Post-*Leegin* World" 3; Miller, Shaw, "Pricing Practices".

⁴²² For example, *In re National Association of Music Merchants, Inc.*, No. C-4255, 2009, FTC File No. 0010203; *In re Nine West Group, Inc.*, File No. 981 0386, Docket No. C-3937 (F.T.C. 2008).

been discussing buyer power.⁴²³ Generally, this issue has been receiving more attention in the US.⁴²⁴

4.3.6.2. Price Fixing and Territorial Restrictions: *Mack Trucks*⁴²⁵

In this case, the Court of Appeals dealt with a combination of RPM and territorial restrictions; however, it did not discuss territorial restraints as vertical non-price restraints but applied *Leegin*.

The company Mack Trucks had “significant power” in the market of heavy trucks in the US. Its distribution system was based on a network of authorised dealers, with each dealer being assigned its own territory.⁴²⁶ In this case, a potential customer called one of the dealers giving it specifications and requirements for a product. The dealer submitted a list of these specifications to Mack Trucks who informed the dealer of the price, which usually included a discount called “sales assistance”. The sales assistance was calculated based on different factors, such as the amount of ordered trucks or potential competition in the market.⁴²⁷ If the dealer did not agree with the amount of sales assistance, it could ask a Regional Vice President for further sales assistance and then ask the controller for a further discount.⁴²⁸ The sales assistance was offered only if the product concerned was sold within its own territories.⁴²⁹ Toledo had aggressively focused on a low price policy for its customers since 1982 and had, therefore, been competing on price against other Mack Trucks dealers.⁴³⁰

1) Violation and Evidence

Toledo claimed that Mack Trucks and its other dealers violated Section 1 of the Sherman Act because they illegally conspired which resulted in artificially high prices. Firstly, in the middle of the 1980s, individual Mack Trucks dealers concluded a horizontal “gentleman’s

⁴²³ Also see *Weyerhaeuser v. Ross-Simmons Hardwood Lumber Company, Inc.*, 549 U.S. 312 (2007); *Pickett v. Tyson Fresh Meats, Inc.*, 420 F.3d 1272 (11th Cir. 2005), *cert.denied*, 126 S.Ct. 1619 (2006).

⁴²⁴ P.J. Harbour, “An Enforcement Perspective on the Work of Robert L. Steiner: Why Retailing and Vertical Relationships Matter” (2004) Winter *Antitrust Bulletin* 985; *Antitrust Bulletin*: Vol. 53, No. 2/Summer 2008; see Chapter 3 “Vertical Competition and Structure”.

⁴²⁵ *Toledo Mack Sales & Service, Inc. v. Mack Trucks, Inc.*, 530 F.3d 204 (2008).

⁴²⁶ *Ibid.*, at 209.

⁴²⁷ *Ibid.*, at 209.

⁴²⁸ *Ibid.*, at 209-210.

⁴²⁹ *Ibid.*, at 213.

⁴³⁰ *Ibid.*, at 210.

agreement” not to compete with each other on price. Secondly, in 1989, Mack Trucks and its dealers vertically agreed that Mack Trucks would delay or deny sales to dealers who wished to sell outside their territories to protect dealers selling in their own territories. This *de facto* arrangement created exclusive territories.⁴³¹ Both arguments were supported by several pieces of evidence, such as witness testimonies, Mack Trucks bulletins and various telephone conversations.⁴³²

It appears that in this case the producer was partly pressured by the other dealers and that the restrictions in question were in the interest of dealers. A telephone conversation between Mack Trucks and Toledo illustrates this point.

“...there are certain dealers that are sending glider kits in other people’s backyards and we are getting calls on it.”⁴³³

Examples of further telephone conversations follow:

If there is ever a manufacturer that protected their distributor organisation... It’s the Mack Trucks Company, to a fault.⁴³⁴

Dealers ‘constantly want Mack to get involved in these territorial disputes... and to protect them from one another’.⁴³⁵

The presented bulletin included this statement:

The express purpose of the policy [to protect its own territory] was to create ‘increased profit margins for Mack distributors as well as the Company’.⁴³⁶

The last quotation suggests that the applied restraints were in the interests of both the manufacturer and his dealers.

2) Horizontal Agreement among Dealers

The Supreme Court qualified the first restriction as a horizontal agreement among dealers controlling price, which is illegal *per se*.⁴³⁷ As discussed previously, one could argue that it is not important whether the conduct concerned is a form of vertical agreement or horizontal intrabrand agreement because the effect on competition is the same in both

⁴³¹ Ibid., at 210.

⁴³² Ibid., at 211-215; 220-221.

⁴³³ Ibid., at 214.

⁴³⁴ Ibid..

⁴³⁵ Ibid.

⁴³⁶ Ibid., at 212.

⁴³⁷ Ibid., at 221.

cases. However, when the *per se* rule is applied, the effect is not analysed and the paradox of applying two different rules for the same conduct but in different forms occurs. If the rule of reason had been applied here it is possible that the Court would have found this restriction legal.

3) *Leegin* and Territorial Restraints

The Supreme Court analysed the second conduct of establishing territories as a vertical restriction, stating that Mack Trucks supported dealers' illegal conspiracy to control prices which caused a *de facto* ban on out-of-territory sales and price competition.⁴³⁸ This was a vertical agreement and, therefore, the Supreme Court applied the rule of reason. However, instead of analysing any VTR cases, the court cited the case of *Leegin*, a vertical price restraint case.⁴³⁹

Areeda and Hovenkamp explain that both vertical non-price and price restraints can affect price and be used for the same purpose, for instance, to prevent free riding.⁴⁴⁰ Shores adds that exclusive territories, in particular, eliminate intrabrand competition but can also influence interbrand competition. In contrast to RPM, territorial restraints have an indirect impact on prices.⁴⁴¹ Thus, the application of RPM case law on territorial restraints because of its impact on prices is incorrect. Territorial restraints are not exactly the same as RPM. One of the possible restraints on competition of VTR, and probably the most common, is price restriction. However, VTR can restrict competition in other ways: it can have an impact on both quality and innovation.

The Supreme Court highlighted two extra factors essential for the consideration of vertical price restraints under *Leegin*.⁴⁴² Firstly, evidence such as the interest of dealers, can lead to the assumption of the existence of a retailer cartel rather than that of a vertical restraint.⁴⁴³ One could argue that the form is not important as a retailer-intrabrand cartel and a vertical restraint have the same impact on competition. Secondly, a vertical restraint concerns the Court if there is market power of conspired entities.⁴⁴⁴ Unfortunately, this statement does

⁴³⁸ *Ibid.*, at 221.

⁴³⁹ *Ibid.*, at 221, 225.

⁴⁴⁰ Areeda, Hovenkamp, *Antitrust Law*, 247.

⁴⁴¹ Shores, "Vertical Price-Fixing", 383.

⁴⁴² *Mack Trucks*, at 225.

⁴⁴³ *Mack Trucks*, at 225, citing *Leegin*, at 2719.

⁴⁴⁴ *Mack Trucks*, at 225, citing *Leegin*, at 2720.

not explain the minimum of market power, the boundaries and when the Court should be concerned with market power and when it should not.

The Court explained that there are several ways to prove anti-competitive effects. For instance, it can be demonstrated that “the restraint is facially anticompetitive or that its enforcement reduced output, raised prices or reduced quality”.⁴⁴⁵ In *Gordon*,⁴⁴⁶ the Court recognised that it could be very difficult to prove these effects; therefore, it stated that, alternatively, it could be proved that defendants had sufficient market power.⁴⁴⁷ As noted previously, aside from not explaining further what was meant by the statement that the participants of a cartel must hold market power, it does not clarify the meaning of “sufficient market power”.

4.3.6.3. Maximum Price Setting: *Leegin 2*⁴⁴⁸

PSKS’s second complaint against Leegin alleged that Leegin, as a producer and a retailer, colluded horizontally and vertically with some of its retailers to set minimum retail prices. The horizontal conspiracy was a new complaint that was not included in the first allegation in *Leegin*. In this context, PSKS claimed that Leegin was the largest single retailer of its products. The petitioner highlighted the existence of horizontal intrabrand collusion and the importance of Leegin’s intrabrand competition on consumers.⁴⁴⁹

1) The Relevant Market

PSKS identified two relevant markets: the intrabrand market for Brighton’s women’s accessories and the interbrand wholesale brand-name women’s accessories to independent retailers. The Court of Appeals refused the petitioner’s determination of the relevant product and geographic markets and thus granted a motion to dismiss without any further detailed analysis of other aspects of the case.⁴⁵⁰ The Court disagreed with PSKS’s belief that the aforementioned market constituted a single-brand market and that the Brighton brand constituted a submarket within broader markets, however no clear explanation as to

⁴⁴⁵ *Mack Trucks*, at 226.

⁴⁴⁶ *Gordon v. Lewistown Hospital*, 423 F.3d 184 (3d Cir. 2005), at 210.

⁴⁴⁷ *Mack Trucks*, at 226.

⁴⁴⁸ *PSKS, Inc. v. Leegin Creative Leather Products, Inc*, 615 F.3d 412 (2010, 5th Circuit).

⁴⁴⁹ *Ibid.*, at 416.

⁴⁵⁰ *Ibid.*, at 416

why was offered.⁴⁵¹ Therefore, it could be argued that the Court failed to apply Steiner's analysis, as discussed in Chapter 3 "Vertical Competition and Structure".

In relation to the second relevant market as defined by the petitioner, the Court rejected such a definition, as well as legal insufficiencies caused by a lack of product focus. It did not clarify this further. On one hand it refuted the fact that a relevant market could focus solely on wholesale and on the other hand it considered the product market of "women's accessories" as being too broad.⁴⁵² Arguably, there is no sufficient reason as to why wholesale on its own could not establish a market as it forms one whole part of the vertical chain and is thus one horizontal market. Although "women's accessories" may appear to be quite a vague product market, the relevant explanation was missing in the case.

2) Market Power and Anti-competitive Harm

The issue of proving sufficient market power with relation to the rule of reason applicable to RPM was opened but not explained in the case of *Leegin*. The Supreme Court only expressed its concerns in the case that market power was seriously monopolistic.⁴⁵³ The Court of Appeals had previously mentioned the sufficient market power in the case of *Mack Trucks*. In this case, it stated that rather than proving any anti-competitive effects, which could be complicated and even impossible for the plaintiff, the plaintiff could only prove that the defendant(s) had sufficient market power.⁴⁵⁴ However, the case of *Leegin 2* does not appear to be consistent with *Mack Trucks*, although both cases were decided by the Court of Appeals. In this case, the Court indicated that the plaintiff must always prove that the defendant possesses sufficient market power to allege a vertical claim successfully.⁴⁵⁵

The Court noted that the plaintiff did not consider interbrand competition, which overcompensates for any possible anti-competitive harm as it assures competition in both services and price.⁴⁵⁶ Firstly, minimum price setting within the Brighton brand did not enhance but, rather, restricted price competition possibly even at the interbrand level. Secondly, the nature of Brighton's products being women's accessories presumes zero

⁴⁵¹ *Ibid.*, at 418; Submarkets were recognised and explained in the case of *Brown Shoe Co. v. United States*, 370 U.S. 294, 325, 82 S.Ct. 1502, 8 L.Ed.2d 510 (1962).

⁴⁵² *Leegin 2*, at 418.

⁴⁵³ *Leegin*, at 896, 898

⁴⁵⁴ *Mack Trucks*, at 226.

⁴⁵⁵ *Leegin 2*, at 419.

⁴⁵⁶ *Ibid.*, at 419

demand for genuine consumer services. Therefore, interbrand competition and competition in services had not increased.⁴⁵⁷ Steiner argued that retailers selling Brighton's products did not face vigorous competition because they specialised in the Brighton brand. The lack of interbrand competition and the importance of intrabrand competition were also obvious from the fact that the petitioner went out of business after Leegin stopped its supplies and Leegin's confirmation that Brighton consumers would switch retailers to find Brighton products rather than switch products.⁴⁵⁸ Furthermore, Steiner highlighted that Leegin did not argue that PSKS were free riding nor did they refuse to furnish presale services.⁴⁵⁹ This argument was introduced by the Court itself but was not supported by the facts or reality.

The Court refused the allegation of the existence of a horizontal cartel as this argument was not introduced in the case of *Leegin*.⁴⁶⁰ Furthermore, it explained that any potential anti-competitive effects were illogical; Leegin, as the strongest retailer of the Brighton brand and simultaneously a dual distributor, could have achieved a higher profit by increasing wholesale prices and not by using RPM.⁴⁶¹ This presumption would be correct only if Leegin did not face the risk of losing its retailers if it had increased its wholesale prices. Moreover, this ruling was in contradiction with the recent Court of Appeals case, *Mack Trucks*, where the Court found it sufficient for the plaintiff to prove the existence of horizontal conspiracy through the application of the *per se* rule, and found such conduct to be anti-competitive and in violation of Section 1 of the Sherman Act.⁴⁶²

3) The Rule of Reason

The Court of Appeals avoided resolving the question of a potential modification of the rule of reason with respect to RPM because PSKS failed to sufficiently define the relevant market. However, it simultaneously quoted older cases which supported the traditional and strict rule of reason.⁴⁶³

To summarise, in contrast to another recent Court of Appeals case, *Mack Trucks*, *Leegin 2* followed the *Sylvania* rule of reason rather than establishing a new approach and

⁴⁵⁷ See the discussion on the case of *Leegin*, further see Chapter 3 "Vertical Competition and Structure" and Chapter 6 "Theories of Pro-Competitiveness v. Anti-Competitiveness".

⁴⁵⁸ R.L. Steiner, "The Leegin Factors – a Mixed Bag" (Spring 2010) 55 *Antitrust Bulletin* 47-49.

⁴⁵⁹ *Ibid.*, p. 48.

⁴⁶⁰ *Leegin 2*, at 420; citing *Sylvania*, at 1051-1052.

⁴⁶¹ *Leegin 2*, at 420-421.

⁴⁶² *Mack Trucks*, at 221.

⁴⁶³ *Ibid.*, at 417.

explaining some aspects that were not clarified in both *Leegin* and *Leegin 2*, such as the definition of “sufficient market power”. *Leegin 2* increased the risk of establishing *de facto* legality for RPM based on the traditional rule of reason. Moreover, it increased the legal uncertainty as the same court, the Court of Appeals, had recently delivered two cases on RPM, *Leegin 2* and *Mack Trucks*, with different approaches. Nevertheless, the Supreme Court may rule differently in the future.

4.4. Procedural Rules

Throughout the existence of the Sherman Act, the courts have introduced two main approaches: the *per se* rule and the rule of reason. The approach and application of the rule of reason or the *per se* rule differ depending on the particular restraint in question.⁴⁶⁴ The *per se* rule is used for naked restrictions. When applying the traditional rule of reason both parties must include all information about themselves, the market and their businesses. The test was set by *Chicago Board*,⁴⁶⁵ which named several factors that must be considered in each case:

[T]he court must ordinarily apply: its condition before and after the restraint was imposed, the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained ... [T]he rule of reason does not support a defense based on the assumption that competition itself is unreasonable.⁴⁶⁶

Therefore, everything is relevant and for that reason some cases are monstrous and cost millions of dollars, as was the case in *Matsushita*.⁴⁶⁷

4.4.1. Current Rule of Reason Analysis in Vertical Territorial and RPM Cases

Leegin introduced the rule of reason for all forms of RPM in 2007. The plaintiff can improve its position if it proves the existence of a horizontal distributors’ agreement rather than a vertical restraint. In this case, the court would apply the *per se* rule.⁴⁶⁸ One of the important aspects for the differentiation between horizontal and vertical arrangements is

⁴⁶⁴ H. Hovenkamp, Antitrust-Law Classes, University of Iowa (October 15th, 2009); discussion with W. Kovacic, FTC, Washington D.C. (November 13th, 2009).

⁴⁶⁵ *Chicago Board of Trade v. United States*, 246 U.S. 231 (1918).

⁴⁶⁶ *Ibid.*, at 238.

⁴⁶⁷ *Matsushita Elec. Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986).

⁴⁶⁸ *Leegin*, at 893.

the interest of both the distributors and the manufacturer.⁴⁶⁹ If competition was restricted vertically through the use of RPM, then, firstly, the manufacturer and their distributor must be separate entities;⁴⁷⁰ the distributor cannot be the manufacturer's agent.⁴⁷¹ Secondly, multilateral conduct must be proved. A simple announcement of price policy and its enforcement by the manufacturer without any collusion is unilateral conduct and is, according to *Colgate*, legal.⁴⁷² The plaintiff must provide direct or circumstantial evidence which would exclude the possibility that one or both parties, the manufacturer or the distributor, were simultaneously acting independently.⁴⁷³ Evidence must show activities towards collusion on the part of both parties.⁴⁷⁴ Finally, cancelling distribution with a price cutter based on an agreement between the manufacturer and its second distributor without the existence of an agreement on price or minimum price is a non-price vertical restriction and would probably not demonstrate a restriction of competition.⁴⁷⁵

After the plaintiff proves the existence of multilateral collusion to maintain retail prices, it must show the anti-competitive effect of the action concerned.⁴⁷⁶ It can demonstrate that the price setting caused the reduction of output, a raising of prices or a reduction of quality in a relevant product and geographic market.⁴⁷⁷ The impact on interbrand competition is more important than on intrabrand competition;⁴⁷⁸ however, this can be very difficult to prove. Therefore, the anti-competitive effect can be reflected by the existence of significant market power. The question is whether this is enough for establishing an anti-competitive effect, as stated in *Mack Trucks* and in *Gordon*,⁴⁷⁹ or whether it is an important aspect of restriction only if the power is seriously monopolistic, as expressed in *Leegin*.⁴⁸⁰ Moreover, after the ruling of the Court of Appeals in *Leegin 2*, it is possible that the courts will apply the traditional rule of reason and would require evidence of both a sufficient

⁴⁶⁹ *Mack Truck*, at 225.

⁴⁷⁰ See *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984); *Guzowski v. Hartman*, 969 F.2d 211, 214 (6th Cir. 1992), cert. denied, 506 U.S. 1053 (1993); *Century Oil Tool Inc. v. Production Specialities, Inc.*, 737 F.2d 1316 (5th Cir.1984); *Bell Atl. Bus. Sys. Servs. V. Hitachi Data Sys.Corp.*, 849 F. Supp. 702 (N.D. Cal. 1994); *Fibreglass Insulators, Inc. v. Dupuy*, 856 F.2d 652 (4th Cir. 1988); *Rio Vista Oil, Ltd. v. Southland Corp.*, 667 F. Supp. 757, 761 (D. Utah 1987).

⁴⁷¹ See *Simpson v. Union Oil Co.*, 377 U.S. 13 (1964); *United States v. General Electric Co.*, 272 U.S. 476 (1926); *Ozark Heartland Electronics Inc. v. Radio Shack*, 278 F.3d 759 (8th Cir. 2002); *Hardwick v. Nu-Way Oil Co.*, 589 F.2d 806, 808 (5th Cir. 1979); *Call Carl, Inc. v. BP Oil Corp.*, 554 F.2d 623,627-28 (4th Cir. 1977).

⁴⁷² *Colgate*, at 305-307; further explained in *Bausch & Lomb, Parke, Davis and Albrecht*.

⁴⁷³ *Monsanto*, at 757, 764, 768.

⁴⁷⁴ *Ibid.*, at 764.

⁴⁷⁵ *Business Electronics*, at 726-727.

⁴⁷⁶ *Leegin*, at 889; *Business Electronics*, at 726; *Euromodas*, at 19, 21.

⁴⁷⁷ *Mack Trucks*, at 226.

⁴⁷⁸ *Leegin*, at 889, 895-896.

⁴⁷⁹ *Gordon v. Lewistown Hospital*, 423 F.3d 184 (3d Cir. 2005), at 210; *Mack Trucks*, at 226.

⁴⁸⁰ *Leegin*, at 898.

market power and an anti-competitive effect.⁴⁸¹ On the other hand, if the product that is subject to the restriction does not create a significant market share, the courts are unlikely to find the restraint unreasonable and illegal.⁴⁸² The final stage should consider any possible justifications by balancing proven anti-competitive effects against an increase of possible pro-competitive effects caused by the RPM.⁴⁸³

The rule of reason approach to VTR is strict and is similar to that of RPM, as applied in the case of *Leegin 2*. Firstly, in VTR, it is only interbrand competition which should be examined.⁴⁸⁴ Secondly, aside from the restrictive effect, the restriction must be based on an anti-competitive intention,⁴⁸⁵ a requirement that is not included in the approach to RPM. Furthermore, the plaintiff must always prove a significant market power, which is an indication of the potential of an anti-competitive effect and can be proved if the defendant possesses a significant market power and the competitiveness of the market is lessened based on an examination of the market shares of competitors.⁴⁸⁶ In *McDaniel*,⁴⁸⁷ 43% of the market share was deemed insufficient market power because the market was highly competitive. The approach appears to be so strict that the point of whether the plaintiff has any real chance to prove illegality of vertical territorial restraint is moot. Moreover, the question remains open as to whether the approach of VTR would change if a case dealing with this kind of restriction reached the Supreme Court. Unfortunately, this kind of issue has not been discussed at the Supreme Court since *Sylvania*. Finally, approaches to both RPM and VTR do not respect the existence of vertical competition and the nature of vertical restraints, which involve bargaining power rather than horizontal market power, as discussed in Chapter 3 “Vertical Competition and Structure”.

4.4.2. New Rules

After the case of *Leegin*, the intensity of the scholarly debate on the right approach to RPM has dramatically increased. Most notably, suggestions involve different forms of a

⁴⁸¹ *Leegin 2*, at 419.

⁴⁸² *White Motors*, at 260-261.

⁴⁸³ *Leegin*, at 895-896.

⁴⁸⁴ *Darrell Murphy v. Business Cards Tomorrow*, at 1205.

⁴⁸⁵ *Ibid.*

⁴⁸⁶ *Jayco Systems v. Savin Business Mach. Corp.*, 777 F.2d 306, 320 (5th Cir. 1985), cert. denied, 479 U.S. 816 (1986); *Valley Liquors v. Renfield Importers*, 678 F.2d 742, 745 (7th Cir. 1982); See Areeda, Hovenkamp, *Antitrust Law*, 402-406; Gellhorn, Kovacic, Calkins, *Antitrust Law and Economics*, 368-369.

⁴⁸⁷ *McDaniel v. Greensboro News Co.*, 679 F.2d 883 (4th Cir. 1983).

structured rule of reason.⁴⁸⁸ Kovacic states that the *per se* rule was and still is popular because the traditional rule of reason is unmanageable. If the rule of reason means that the courts must examine everything, then the plaintiff almost automatically loses because such a task can be impossible in practice. However, if there are alternatives, the case is better balanced.⁴⁸⁹

Scholarly discussions have begun to be reflected in current cases. Although the recent cases of *Leegin 2* and of *Twombly*⁴⁹⁰ placed heavy burdens on the plaintiff,⁴⁹¹ other cases indicate that some changes have already appeared as the courts have moved away from the rigid application of the rule of reason. The first attempts to change the rule of reason are obvious in *California Dental Association*,⁴⁹² decided by the Supreme Court, who still used an “open-ended” approach. In this case, the Court explained that the plaintiff had to prove that the practice concerned significantly restricted competition. This included the definition of the relevant market and proving the significant market power of the defendant. If the defendant could argue that the practice was enforced for a legitimate business purpose, the plaintiff must show that the practice failed to serve this purpose or there existed less restrictive alternatives which were not more costly than the practice used, while the benefit of the conduct concerned was smaller than its anti-competitive effects.⁴⁹³

Both the DOJ and the FTC recognised the need for the change of the rule of reason and began to modify it, lobbying for a structured rule of reason.⁴⁹⁴ The FTC approach was used by the Court of Appeals in the case of *Polygram*,⁴⁹⁵ which was based on a horizontal

⁴⁸⁸ For instance, a compromise between the *per se* rule and the rule of reason (applying one or another depending on the market power): Areeda, Hovenkamp, *2009 Supplement*, 242; Areeda, Hovenkamp, *Antitrust Law*, 330-339; different forms of a structured rule of reason: S.M. Colino, *Vertical Agreements and Competition Law: A Comparative Study of the EU and US Regimes* (Hart Publishing, Oxford, 2010), 153-181; M. Lao, “Resale Price Maintenance: The Internet Phenomenon and Free Rider Issues” (2010) 55 *Antitrust Bulletin* 511; J.B. Kirkwood, “Rethinking Antitrust Policy toward RPM” (2010) 55 *Antitrust Bulletin* 423-472; Steiner, “The *Leegin* Factors” 56-58; T.A. Lambert, “A Decision-Theoretic rule of Reason for Minimum Resale Price Maintenance” (2010) 55 *Antitrust Bulletin* 214-224; Ch.A. Varney, “A Post-*Leegin* Approach to Resale Price Maintenance Using a Structured Rule of Reason” (2010) 24 *Antitrust* 22; Rey, P., Stiglitz, J., “The Role of Exclusive Territories in Producers’ Competition” (1995) 26 *Rand Journal of Economics* 446.

⁴⁸⁹ Discussion with W. Kovacic, FTC, Washington D.C. (November 13th, 2009).

⁴⁹⁰ *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007).

⁴⁹¹ *Ibid.*, at 1965-1966, 1974.

⁴⁹² *California Dental Association v. FTC*, 526 U.S. 756 (1999).

⁴⁹³ Areeda, Hovenkamp, *Antitrust Law*, 329-330.

⁴⁹⁴ Discussion with W. Kovacic, FTC, Washington D.C. (November 13th, 2009); Ch.A. Varney, Assistant Attorney General, Antitrust Division, U.S. Department of Justice, “Antitrust Federalism Enhancing Federal/State Cooperation”, Remarks Prepared for the National Association of Attorneys General (Oct. 7, 2009), pp. 8-9, at <http://www.justice.gov/atr/public/speeches/250635.htm>.

⁴⁹⁵ *Polygram Holding, Inc., v. Federal Trade Commission*, 416 F.3d 29 (D.C. Cir. 2005); (also see *In re Matter of Realcomp II Ltd.*, File No. 061-0088, (F.T.C. 2009) Docket No. 9320).

agreement: a joint venture. The Court also recognised the “quick look” approach used in the case of *NCAA v. Board of Regents*.⁴⁹⁶ However, the Court of Appeals refused officially to confirm the existence of a new, structured rule of reason. Instead, it claimed that it is still the same rule of reason,⁴⁹⁷ which thus made it possible for the same Court to apply the traditional rule of reason to RPM in *Leegin 2* in 2010.

Current cases, *Polygram* and *Leegin 2*, indicate that the rule of reason used within horizontal arrangements not only differs from RPM’s rule of reason but also that this difference will remain in the future. Nevertheless, the question of the courts’ approach to RPM remains open and only future cases will unveil a, hopefully, more modern approach to RPM and potentially to VTR in the US. The change of the rule in *Leegin* has re-opened highly intensive discussion among scholars on what is the right approach to vertical restraints in the US, most notably RPM, which has confirmed the lack of knowledge and research in this matter and the complexity of this area of competition law.⁴⁹⁸

4.5. Conclusion

The approaches to RPM and VTR have been constantly changing and evolving since the first Supreme Court case, *Dr. Miles*, in 1911. The development and cases of both types of restrictions are full of paradoxes. Firstly, the VTR approach is based on a distinct lack of knowledge of its effects. The cases include mainly theoretical arguments and are not based on proper studies for the simple reason that these kinds of studies did not and do not exist. This led to the final and settled conclusion in *Sylvania* that VTR were not usually sufficiently anti-competitive. This conclusion was based primarily on the assumption that VTR could increase interbrand competition and, thus, the application of the *per se* rule was wrong. The application of the existing rule of reason means *de facto* the legalisation of VTR, as is obvious from *First Beverages*.⁴⁹⁹ The FTC and the DOJ have not been investigating actions that just include VTR because they are not seen as restrictive or seriously restrictive.

⁴⁹⁶ 468 U.S. 85, 100, 104 S.Ct. 2948, 82 L.Ed.2d 70 (1984).

⁴⁹⁷ *Polygram*, at 35.

⁴⁹⁸ There have been numerous articles published discussing RPM in the US in last 4 years, most notably in 2010, for example, *Antitrust Bulletin*: Vol. 55 No. 2/Summer, No. 1/Spring – both issue are dedicated to RPM.

⁴⁹⁹ *First Beverages*, at 1166.

The theory of ownership in *Dr. Miles* explained that the manufacturer should be free to do whatever it pleases with the products it owns. However, once it sells these products to distributors, it is subsequently the distributors who are free to deal with the products, as they now own them and not the manufacturer. This approach appears to be correct from a jurisprudential and ethical perspective. However, the *Colgate* doctrine shifted the *Dr. Miles* arguments as it allowed manufacturers to determine retail prices as part of their policies. This doctrine, therefore, restricts distributors' freedom to determine their own business. Further developments in the *Colgate* doctrine led to the paradox that legalised arrangements between a distributor and a manufacturer to terminate a contract with a price-cutting distributor, as ruled in *Business Electronics* and *Euromodas*. Indeed, is this not *de-facto* price-maintaining multilateral conduct?

The case of *Leegin* changed the approach to RPM significantly by introducing the rule of reason to all forms of RPM. The analysis of the court's arguments for changing the rule reveals some contradictions and finds most of them to be hypothetical or even illogical. The paradox of the results of the latest development of RPM and VTR was concluded in *Mack Trucks*, which does not clearly differentiate between these two forms of vertical restraints but applies *Leegin* to territorial restraints and, moreover, finds horizontal intrabrand agreements among retailers illegal *per se*. Furthermore, the Court of Appeals contradicted some aspects of its rulings from *Mack Trucks* in *Leegin 2* and thus increased legal uncertainty in the matter of RPM.

The application of the rule of reason in maximum price fixing, as set in *Khan*, seems to be correct considering that maximum prices can primarily lead to lower prices and, thus, only efficient distributors can benefit from this. On the other hand, price fixing and minimum price fixing lead to situations from which less efficient competitors can benefit as efficiency is suppressed.

Recently, discussion on the importance of market power, including buyer power, and its interest has occurred. However, only the cases of *Euromodas* and *Mack Trucks* show that the interests of distributors influenced the existence of vertical restraints. One of the explanations could be that, in contrast to the past where manufacturers used vertical restraints, recent retail market developments have shifted the bargaining power to retailers

who have begun to impose vertical restraints, as argued in study of Office of Fair Trade from 1997 in the UK.⁵⁰⁰

Logic dictates that RPM based on setting prices or setting minimum prices and even VTR can be against the manufacturer's interests because high retail prices will likely decrease output and the manufacturer's profit.⁵⁰¹ However, facts of the presented cases show that, for the most part, manufacturers applied them as part of their distribution systems. However, their reasons for applying such restraints differed. They used them to persuade powerful distributors to distribute for them and to maintain and/or increase their market share, as in *Sylvania*.

Another reason is that manufacturers want to succeed over other competitors in interbrand competition, as was claimed by the manufacturers in *Albrecht* and *White Motor*. Simply, if retail prices are set, it can be easier for a manufacturer to predict the situation on the market and to adjust its future business strategies, including a correct assumption of future output, the most profitable retail prices in relation to the output and the conditions in the market. For instance, in *Dr. Miles, Park & Sons, Colgate, Parke, Davis*, the manufacturers simply claimed that they had the right to maintain retail prices without any further and possible pro-competitive justifications. Most notably in *Park & Sons*, it was obvious that the distributors did not generally agree with RPM. Finally, the manufacturers can be motivated to use vertical restraints to create a reputation for luxury products and to improve services, as manufacturers did in *Leegin, Schwinn* and *Bausch & Lomb*.

It was always the manufacturers who were found guilty of violation of the Sherman Act in the presented cases, although Section 1 prohibits multilateral conducts. This is logical because, in private litigation on damages, the party usually sues only one and not everybody for a violation of antitrust law: the one who caused the direct damages. This must have an impact on the courts' ruling as is obvious in the wording used in older cases. One could argue that the arguments of the parties at the beginning of the application of the Sherman Act are the most truthful as they had not been influenced by any theories and doctrines developed later. However, as such, they did not reveal that RPM and/or VTR would be used to increase customer welfare through the improvements of services, for example.

⁵⁰⁰ Office of Fair Trading, *Competition in Retailing*, Research Paper No. 13 (1997, London Economics, London, UK).

⁵⁰¹ See Gellhorn, Kovacic, Calkins, *Antitrust Law and Economics*, 342, 344.

Chapter 5: Development of the EU Law of Vertical Territorial and Price Restraints

5.1. Introduction

This chapter analyses the EU law of vertical territorial and price restraints from a broad perspective. It puts EU competition law and policies in context with EU developments, including politics, the economy and the social environment. It explains and discusses the interaction and the influence of these aspects. Finally, the most significant cases are analysed. Their doctrines and legal theories, with developments are explained, logically arranged and argued in the context of the facts of the cases, while some aspects are compared with US case law and the US approach. The chapter ends with a survey of the current EU procedural legal system on vertical territorial and price restraints.

5.2. EU Competition Law within the Process of Market Integration

5.2.1. The Origin of EU Competition Law

The current existence of European Union competition law and the existence of the European Union itself (originally, the European Economic Community) were arguably two significant consequences of World War II. The ideas to prevent wars and conflicts in Europe and to create an economically strong and unified Europe were not being discussed for the first time but they appeared more significant after the end of the World War II.¹

The beginning of EU competition law was influenced by the US and US antitrust law, as well as by different European competition law systems and theories. In the 1950s, following World War II, there was a strong need for governments to control and regulate their economies with an increased social and socialist influence. The War also increased the influence from the US. At the time, the US assisted European countries by providing loans,² and US antitrust law was one of the most dominant competition laws in the world. Additionally, the EU market included some similarities with the US market. The influence

¹ The EEC Treaty of Rome, *Preamble*: “preserving and strengthening peace and liberty”; D.G. Goyder, J. Goyder, A. Albors-Llorens *Goyder’s EC Competition Law*, Fifth Edition (Oxford University Press, 2009), 24-25; D. Chalmers, et al *European Union Law: Text and Materials*, Second Edition (Cambridge University Press, 2010), 7-9; N. Green, T.C. Hartley, J.A. Usher *The Legal Foundations of the Single European Market* (Oxford University Press, 1991), 199, 334, 343.

² Primarily, the Marshall Plan, 1948; Goyder, Goyder, Albors-Llorens *Goyder’s EC*, 24-25; D. Gerber *Law and Competition in Twentieth Century Europe: Protection Prometheus* (Clarendon Press, 1998), 166-168.

of the US was arguably at its strongest at the outset of the EU system, when the originators needed to establish a new European competition law system and were thus influenced by the US antitrust experience.

The origin of EU competition law was also affected by other European states and their competition theories, legislations and policies. Some of the European ideas on competition policy and competition law appeared during the French Revolution. The period from the French Revolution to the mid-1870s was characteristic of the ideas of government restraints on economic actors, which ensured economic wealth and growth. This resulted in a new theory, the theory of European liberalism, Ordoliberalism. It included the first idea of a competition law statute based on the administrative protection of public interests. This idea was developed in Austria in the 19th century; however, it was not put into practice at the time.³

After World War I, in 1923, Germany introduced its written competition law statute. It was a tool assisting the post-war, German economy to avoid a deepening economic crisis that recognised industrial production as a key element to military success and recognised the economy as a means to serve the interests of society. Cartelisation was recognised as a positive process because the government found these easier to control than small firms. The German statute was later changed due to a Nazi ideological influence.⁴

A new German competition law system came into force in the same year as the Treaty of Rome and is still in an amended form, in force today. This German system was required by the US, as one of the conditions for German sovereignty, thus reflecting that competition affects not just the economy, but also other socio-political aspects. As history shows, the concentrated and heavy cartelised pre-war German industry helped to consolidate military power throughout World War II.⁵

Some differences between Continental Europe and UK competition law and policy existed then and still exist today. The legal systems and origin of competition laws are also different. Competition law in Continental Europe has its origins in Austrian and German

³ M. Vatterio, "The Ordoliberal Notion of Market Power: An Institutional Reassessment" (2010) 6 *European Competition Journal* 689-691; D.J. Gerber, "Europe and the Globalization of Antitrust Law" (1999) 14 *Connecticut Journal of International Law*, 15, 26; Gerber, *Competition in Twentieth Century Europe*, 6, 16, 43-44.

⁴ Gerber, *Competition in Twentieth Century Europe*, 7-8, 115-164.

⁵ H. Hovenkamp, *Federal Antitrust Policy, The Law of Competition and Its Practice* 3rd Edition. (Thomson West, St. Paul, 2005), 30; Gerber, *Competition in Twentieth Century Europe*, 7-8.

ordoliberalism, which is based on free competition and the protection of the freedom of its participants and which has continued to influence EU competition law.⁶ On the other hand, UK competition law was regulated mainly by common law, which had an impact on the origin of US antitrust law.⁷ Some similarities still remain between the UK and the US systems;⁸ however, the UK, as an EU member, has at least partially harmonised its competition law with other EU members.⁹

5.2.2. From Common Market to Internal Market

In 1951, France, Germany, Italy, Belgium, the Netherlands and Luxembourg signed the Treaty Establishing the European Coal and Steel Community (“the ECSC Treaty”), with economic integration in the relevant sectors as its main objective. It recognised and highlighted rivalry, a large part of the competitive process, as necessary for a strong European economy.¹⁰ The Treaty expired in 2002.

The Treaty of Rome from 1957 constituted the European Economic Community (“EEC”).¹¹ The main objective of the EEC was to establish a common market, which required a supranational, decision-making framework. The creation of the common market by the EEC contained a number of elements. The basic element consisted of establishing a customs union with a common external tariff. Other elements were the free movements of goods, persons, services and capital, including harmonising relevant national laws; competition law and policy; regulation of state intervention in the economy, such as state aids; and others.¹²

Therefore, the existence of the EEC was based on economic integration with the main, but not only, objective of establishing a common market with undistorted competition and an

⁶ A. Weitbrecht, “From Freiburg to Chicago and Beyond, the First 50 Years of European Competition Law” (2008) 29 *ECLR*, pp. 81-82; D. Gerber, “Constitutionalizing the Economy: German Neo-liberalism, Competition Law and the ‘New Europe’ ” (1994) 42 *American Journal of Competition Law* p. 25; see also R. Van den Bergh, P. Camesasca, *European Competition Law and Economics, A Comparative Perspective* 2nd Edition (Sweet & Maxwell, London 2006), 65; European Commission, XV Annual Report on Competition Policy 1985 (1986).

⁷ See above.

⁸ Hovenkamp, *Federal Antitrust Policy*, 32.

⁹ Compare the current UK Competition Act 1998, with Articles 101 and 102 and EU legislation on competition law; See Goyder, Goyder, Albors-Llorens *Goyder’s EC*, 26-27.

¹⁰ ECSC Treaty, Preamble; <http://eur-lex.europa.eu/en/treaties/index.htm#other> (10/07/2010); See Goyder, Goyder, Albors-Llorens *Goyder’s EC*, 28-30.

¹¹ <http://eur-lex.europa.eu/en/treaties/index.htm#other> (10/07/2010); see Article 2 of the Treaty of Rome.

¹² The Treaty of Rome, Principles: Articles 2 and 3, Part Two: “Foundations of the Community”; for further discussion see Chalmers, *European Union Law*, pp. 12-13.

efficient use of resources.¹³ Integration not only had an economic dimension, based on free trade, but also a political dimension that meant that Member States made decisions collectively. This is confirmed by the principles of supremacy and direct effect, and by provisions on common rules and policies.¹⁴

The Community shifted its focus from market integration to policy integration in the second half of the 1980s. This new process started with the "White Paper Completing the Internal Market".¹⁵ The White Paper was a tool for establishing an internal market and was followed by the Single European Act in 1986,¹⁶ which identified its main aim in Article 13 as the establishment of the internal market by the end of 1992. The internal market is defined in Article 13 as an area without boundaries that includes the free movement of goods.¹⁷ The aim included a reformation of EEC institutions and also the establishment of a legal basis for other policies.¹⁸

In 1993, Member States ratified the Treaty on European Union.¹⁹ The Treaty on European Union was the result of the aims contained in the Single European Act.²⁰ The Treaty established the European Union with the new Community's competences including education, environment, consumer protection, public health, industry and culture. The previous name, "The European Economic Community", changed to "The European Community".²¹

The Treaty of Amsterdam²² amended the objectives of the European Community, elaborating on the integration of Member States, and focused on more than just pure economic integration. The Treaty of Amsterdam had two additional main objectives, aside

¹³ The Treaty of Rome, Principles: Articles 2, 8; Korah, *Guide to Competition* 2-3; A. Jones, B. Sufrin, *EU Competition Law: Text, Cases, and Materials*, Fourth Edition (Oxford University Press, 2011) 1-18; D. Barounos, D.F. Hall, J. Rayner James, *EEC Antitrust Law, Principles and Practice* (London, Butter Worths, 1975), 1.

¹⁴ See Case 26/62 *Van Gend en Loos v Nederlandse Administratie der Belastingen* [1963] ECR 95 (see "II - the first question"); Case 6/64 *Costa v ENEL* [1964] ECR 585; Gerber, *Competition in Twentieth Century Europe*, 347-348; R.B. Bouterse, *Competition and Integration – What Goals Count?: EEC Competition Law and Goals of Industrial, Monetary, and Cultural Policy* (Kluwer Law and Taxation Publishers, 1994), 3-4.

¹⁵ White Paper on completing the internal market from the Commission to the European Council, COM (85) 310, 28 and 29 June 1985; see Bouterse, *Competition and Integration*, 8.

¹⁶ *Official Journal L 169 of 29 June 1987*.

¹⁷ Article 8a of the consolidated version of the Treaty of Rome (1987).

¹⁸ See the provisions of the Single European Act.

¹⁹ *Official Journal C 191 of 29 July 1992*.

²⁰ See above.

²¹ Further see: Maastrich Treaty on European Union; Chalmers, *European Union Law*, pp. 23-25. Korah, *Guide to Competition*, 2-3; Bellamy, Child, *European Community*, 4-5; Bouterse, *Competition and Integration*, 9-10.

²² Treaty of Amsterdam, *Official Journal C 340 of 10 November 1997*.

from the establishment of the single market; namely, establishing an economic and monetary union and implementing common policies or activities. While the objective of a harmonious, balanced and sustained development of economic activities remained,²³ the objectives of a continuous and balanced expansion and an increase in stability were shifted to a high level of employment and social protection, equality between the sexes, sustainable and non-inflationary growth, a high degree of competitiveness and a convergence of economic performance.²⁴

After the success of new Treaties and a short period of time within which the previous treaties had been adopted, the process of changes and the adopting of binding treaties slowed down. The Charter of Fundamental Rights of the European Union having no legal power was proclaimed by the European Parliament, the Council and the Commission in 2000.²⁵ A right of a fair trial and the right of defence on matters of privacy were also applicable to competition law.²⁶

In December 2009, the Treaty of Lisbon²⁷ came into force. It is recognised as a treaty similar to the Amsterdam Treaty and the Nice Treaty from 2001²⁸ amending the founding treaties.²⁹ It merged the European Community with its three pillars into the European Union and recast the existing treaties into two treaties, the Treaty on the European Union and the TFEU. The basic process of creating an internal market has arguably been finalised. The existence of the internal market reflects that the EU market had become even more integrated including further objectives of the EU.³⁰

²³ Articles 1.5, 2.2.

²⁴ Articles 1.5, 2.2, 2.3, 2.19, 2.22; also see other objectives as introduced in Articles 1.2, 1.10., 2.2, 2.4, 2.17, 2.22, 2.34.

²⁵ OJ 2000 C364/1; currently OJ C83 of 30 March 2010.

²⁶ §§12-118.

²⁷ Treaty of Lisbon amending the Treaty on European Union and the Treaty Establishing the European Community, *O.J. C 306 of 17 December 2007*.

²⁸ Treaty of Nice, Official Journal C 80 of 10 March 2001.

²⁹ Compare: <http://eur-lex.europa.eu/en/treaties/index.htm#other> (10/07/2010); Chalmers, *European Union Law*, pp. 23-30.

³⁰ Article 3 of the Treaty of the European Union, which repealed Article 2 of the Treaty Establishing the European Union, discussed objectives of the EU. It is obvious that the TFEU broadened its policies as it included six paragraphs where the old Article had only one. Additionally, in its opening paragraph it states that “[t]he Union’s aim is to promote peace, its values and the well-being of its peoples.” Among others, it also includes an international relations policy in Paragraph 5, Article 3(2) TFEU and protects cultural and linguistic diversity as discussed in Article 3(3); Article 4(2) TFEU.

5.2.3. Articles on Competition

The key EU competition-antitrust rules can be found, as of 2011, in Articles 101 and 102 of the TFEU. These articles were first enacted as Articles 85 and 86 of the Treaty of Rome in 1957, and then recast as Articles 81 and 82 in the Treaty Establishing the European Community as renumbered by the Treaty of Amsterdam.³¹ For the sake of simplicity and consistency, throughout the rest of this Chapter the current terminology as applied in the TFEU and the Treaty on the European Union will be employed.

Article 101 prohibits forms of multilateral conducts which restrict competition in the EU market and also includes exceptions to this prohibition. Article 102 prohibits the abuse of dominant power in the EU market. These actions are incompatible with the internal market and are illegal. Article 101 also regulates vertical multilateral conducts and Article 102 includes primarily unilateral but also multilateral restrictions. Both forms of conduct may influence the behaviour of suppliers and distributors, for instance a dominant undertaking can abuse its position towards the distributors, exemplified by the action of tying. Moreover, a manufacturer and its distributor can abuse their dominant positions collectively.³² Although Article 102 has never been used in respect of RPM and VTR, theoretically it is possible in situations when such restraints are forced upon the other party by a monopolist(s) or a monopsonist(s).

Vertical restraints, as for any other multilateral conducts, are subject to two steps of examination under Article 101 TFEU. Firstly, it must be decided whether a particular vertical restriction takes the form of a multilateral conduct (an agreement, concerted practice or decision of an association), and has its object or effect in the prevention, restriction or distortion of competition within the EU, thus affecting trade between Member States. If the answer is yes, then it must be decided whether this restriction might benefit from a block or individual exemption under Article 101(3).³³

³¹ The term “the common market” was replaced with the term “the internal market” in Articles 101 and 102 of the TFEU.

³² See Chapter 4 “Development of the US Law of Vertical Territorial and Price Restraints”.

³³ See below.

5.3. The Beginning of Integration: Stability and Growth in the 1950s through the mid 1970s

5.3.1. Background

The economies of member states were in reconstruction at the beginning of the existence of the EU (originally, EEC) in an attempt to secure political and economic stability and economic growth.³⁴ This period began the process of European integration assisting Europe and European firms to become stronger and more competitive with a better perspective to increase European productivity and, thus, stability.³⁵

The beginning of EU competition law was influenced not only by US antitrust law and the German ordoliberal view, with a strict legal form of competition law supported by Netherlands, but also by the French administrative-political approach supported by Italy. Therefore, some Member States, such as France, had a tendency to interpret EU competition law (originally, EEC competition law), Articles 101 and 102 TFEU, as political and policy terms rather than enforceable law. However, gradually, EU competition law became an essential and enforceable part of the EU and European integration.³⁶

The Commission was empowered as the central executive enforcer of EU competition rules (originally, EEC competition law) in 1962.³⁷ The Court of Justice of the European Union (“CJEU”)³⁸ was already established in the ECSC Treaty in Paris in 1951, among others, as a judicial-review body for competition law.³⁹

The Preamble of the Treaty of Rome stresses the importance of “steady expansion, balanced trade and fair competition”. The Community policies were set out in Articles 2, 3, 4 of the Treaty of Rome also referring to the principle of free competition. The first goal of EU competition law was to ensure competitiveness on the EU market. This was based on an idea that the protection of competition interferes with free trade, including economic

³⁴ Gerber, *Competition in Twentieth Century Europe*, 168.

³⁵ Goyder, Goyder, Albors-Llorens *Goyder's EC*, 31-32.

³⁶ See, e.g., Case 26/62 *Van Gend en Loos v Nederlandse Administratie der Belastingen* [1963] ECR 95; Gerber, *Competition in Twentieth Century Europe*, 343-347.

³⁷ The Council Regulation 17/62/EEC [1959] OJ Spec. Ed. 87.

³⁸ Originally, “the European Court of Justice”.

³⁹ EEC Treaty, Article 164.

integration, and assists in providing a self-regulating economic system ensuring the most efficient use of resources. The second goal of EU competition law was to aid in the creation and maintenance of the common market to ensure that undertakings did not undermine the prohibitions on state barriers by setting private market barriers such as VTR. *Vice versa*, the existence of the common market was essential for the creation of fair and efficient competition and its competition legislation.⁴⁰ This objective prevailed in the beginning, for example, the vertical restraint case of *Consten & Grundig*⁴¹ in 1966 highlighted that the objective of EU competition law was single/common market integration.⁴²

5.3.2. First Cases and Legislation

At the beginning of the EU competition law's existence, both the EU (originally, EEC) and national authorities applied the EU competition rules.⁴³ This changed with Regulation 17,⁴⁴ which introduced a notification system with centralised enforcement and policy-making power within the Commission. The Court of Justice played a central role in court judgements to minimise the different influences of Member States.⁴⁵ The notification system overburdened undertakings, as well as the Commission, which was also criticised when ruling on vertical agreements.⁴⁶ Regarding vertical restraints, Hawk pointed out that the notification system was inconsistent with CJEU's judgements and Article 101(1) was overly and broadly applied. It brought about and maintained legal uncertainty, legal formalism and analysis by categories rather than an economic approach.⁴⁷

EU competition law emphasised vertical relationships in comparison with both US antitrust case law and the Member States' traditional horizontal agreement focus. This was due to the fact that vertical restraints were the most obvious relationships in trans-border

⁴⁰ Goyder, Goyder, Albers-Llorens *Goyder's EC*, 34-35; Bouterse, *Competition and Integration*, 5; Gerber, *Competition in Twentieth Century Europe*, 334-335 Barounos, Hall, Rayner James, *EEC Antitrust Law*, 2-3.

⁴¹ Case 56/64, 58/64 *Établissements Consten S.à.R.L. and Grundig-Verkaufs-GmbH v. Commission of the European Economic Community*, [1966] ECR 299 ("*Consten & Grundig*").

⁴² *Consten & Grundig*, p. 340.

⁴³ EEC Treaty, Articles 87, 88, 89; for further discussion see Gerber, *Competition in Twentieth Century Europe*, 349.

⁴⁴ Regulation 17/62, 1962 OJ 204.

⁴⁵ For more see Gerber, *Competition in Twentieth Century Europe*, 6, 349-353.

⁴⁶ D. Deacon, "Vertical Restraints under EC Competition Law: New Directions" [1995] *Fordham Corp L Inst* p. 307; B.E. Hawk, "System Failure: Vertical Restraints and EC Competition Law" [1995] 32 *CMLRev* p. 973; see below.

⁴⁷ Hawk, "System Failure", pp. 974 – 986; also see A. Jones, "Competition of the Revolution in Antitrust Doctrine on Restricted Distribution: *Leegin* and Its Implications for EC Competition Law" (2008) 53(4) *Antitrust Bulletin* 935-937.

trade used between manufacturers and distributors to separate and protect national markets from parallel imports and to create other boundaries which hindered the main objective of the Community: the creation of the single market.⁴⁸

In the first vertical restraint case of *Grosfillex*,⁴⁹ the Commission found that an agreement, where a distributor had obtained an exclusive territory outside the common market, did not violate EU competition law as the product had been re-exported to the common market. The first CJEU case on vertical restraints, *Consten & Grundig*, discussed the exclusive territories based on trademarks. The CJEU agreed that maintaining the exclusive territory and preventing parallel imports of the product protected by its trademark had infringed Article 101 TFEU. This case was the first that assisted the Commission in establishing a policy on vertical restraints.⁵⁰ Furthermore, not only using trademarks but also the use of patents to protect national markets and prevent parallel imports were found to be inconsistent with the Treaty of Rome by the Commission and this was confirmed by the CJEU in the case of *Parke-Davis v. Probel*.⁵¹

The case of *Minière v. Maschinenbau*⁵² held that an exclusive distribution agreement was not illegal if it had been necessary for penetrating a new territory. The case also stated that EU competition law included two main objectives: integration and competition. At the time, exclusive distribution systems were common in Europe,⁵³ therefore, the Commission introduced a block-exemption regulation in 1967⁵⁴ and updated it in 1983⁵⁵ confirming that exclusive distributions could have a positive impact on the market in the form of distribution improvement, international trade, promotion of products, stimulation of interbrand competition and effectiveness.⁵⁶

⁴⁸ *Consten & Grundig*, pp. 343, 349; Green Paper on Vertical Restraints in EC Competition Policy, Executive Summary, COM (96) 721, paragraphs 1,2; Jones, “*Leegin* and Its Implications for EC” 936; Gerber, *Competition in Twentieth Century Europe*, 354-355.

⁴⁹ 64/233/CEE, *Grosfillex Sàrl (Re the agreement of)*, Official Journal 58, 09/04/1964 p. 915 [1964] CMLR 237.

⁵⁰ Goyder, Goyder, Albors-Llorens *Goyder’s EC*, 55-56.

⁵¹ See Case 24/67, *Parke-Davis v. Probel* [1968] ECR 55 (patents); Case 40/70, *Sirena v. Eda* [1971] ECR 69 (trade marks).

⁵² Case 56/65, *Société La Technique Minière v Maschinenbau Ulm GmbH* [1966] ECR 235, [1966] CMLR 357, CMR 8047.

⁵³ Green, Hartley, Usher, *The Legal Foundations*, 241.

⁵⁴ Regulation 67/67 applying Article 85(3) to exclusive dealing agreements [1967] O.J. 57/849.

⁵⁵ Regulation 1983/83 applying Article 85(3) to exclusive distribution agreements [1983] O.J. L 173/1; Regulation 1984/83 applying Article 85(3) to exclusive purchasing agreements [1983] O.J. L 173/7.

⁵⁶ Regulation 1983/83, recitals 5, 6.

5.3.2.1. VTR

A) *Consten & Grundig*⁵⁷

1) Vertical Conduct

In this case, the CJEU discussed the application of Article 101 to vertical agreements. It held that neither Article 101 TFEU nor Article 102 TFEU excluded infringements in the form of vertical conducts as the Treaty did not make any distinction between horizontal and vertical conduct. Therefore, similarly, the court or any other body applying the Treaty, could not make a distinction and exclude conduct which is not excluded in the Treaty.⁵⁸ However, Article 101 TFEU does not apply to conduct within one undertaking that creates an integrated distribution network.⁵⁹

2) Test on Restricting Trade

The Commission decided that the applicants had created absolute territorial protection which had restricted trade between the Member States.⁶⁰ The applicants and the German government subsequently claimed that the Commission had not proved that trade would have been greater without the existence of the agreement concerned. The Commission, argued that once trade had been established in France, the agreement had restricted trade between the Member States primarily because it had restricted exports from and imports into France. The Commission explained that the test was based on the constitution of “a threat, direct or indirect, actual or potential, to freedom of trade between the Member States in a manner which might harm the attainment of the objectives of a single market between the states”.⁶¹

It does not matter whether the agreement increased trade as long as the threat to restrict trade or its actual restriction existed. In this case, trade was restricted by prohibiting Consten from exporting and by establishing Consten as the only distributor for the French

⁵⁷ C-56/64 *Établissements Consten S.à.R.L. and Grundig-Verkaufs-GmbH v EEC Commission* [1966] ECR 299.

⁵⁸ *Consten & Grundig*, p. 339.

⁵⁹ *Ibid.*, p. 340.

⁶⁰ *Ibid.*, p. 346.

⁶¹ *Ibid.*, p. 341.

market *via* the trademark.⁶² The Court agreed with the Commission and stated that it was obvious from the agreement that the aim of some of the clauses was to create absolute territorial protection, which was thus an infringement of Article 101 TFEU.⁶³

3) Interbrand v. Intrabrand Competition

The applicants and the German government claimed that the test should have been aimed at interbrand competition, arguing that the agreement had increased interbrand competition. The Court disagreed. It explained that if intrabrand competition was restricted, the effect on interbrand competition did not have to be examined. It also stated that if the restrictive object was proven, the effect did not have to be analysed.⁶⁴

4) IP Rights

The Court stated that it was obvious from the agreement that the aim of some of the clauses was to create absolute territorial protection.⁶⁵ The Court further explained that it was not by virtue of the trademark itself but the agreement with Grundig that had affected trade.⁶⁶ Therefore, it is the agreement, or clauses of the agreement, and not the trademark that restricted competition.

This issue was also discussed and the boundaries between IP rights and illegal vertical restraints were established in the first US cases on RPM. However, the first US cases still involved an assessment based on the common law and the right of ownership. The Supreme Court strictly differentiated between statutory IP rights, such as patents and copyrights, where the manufacturer, the owner of the IP rights, was free to set the conditions for retail sale. This was in contrast to non-statutory IP rights, such as trade secrets, where the manufacturer was not excepted and could not restrict trade.⁶⁷ Similar to the case of *Consten & Grundig*, where the court stated that the trademark did not entitle the parties to restrict competition in certain forms such as absolute territorial restriction, the

⁶² *Ibid.*, p. 341.

⁶³ *Ibid.*, p. 344.

⁶⁴ *Ibid.*, p. 342.

⁶⁵ *Ibid.*, p. 344.

⁶⁶ *Ibid.*, p. 345.

⁶⁷ *Park & Sons*, at 39; *Dr Miles*, at 401-402.

Supreme Court explained that the existence of the trade secret did not restrict trade as such, but it allowed for the protection of the secret manufacturing process.⁶⁸

5) Article 101(2)

The Court of Justice confirmed that Article 101(2) applied only to the parts of the agreement which restricted competition if they were able to be separated from the agreement itself. In this case, only the restrictive clauses of the agreement should have been annulled under Article 101(2).⁶⁹

6) Article 101(3): Test

This case introduced a test on Article 101(3) which still applies although with some more recent additions. The Court explained that, although the applicants were responsible for introducing the arguments for the application of the exemption under Article 101(3), the Commission had to examine the available evidence to consider the fulfilment of Article 101(3). Furthermore, the Commission must evaluate “economic matters”.⁷⁰ Any pro-competitive improvements that the restriction in question introduced must show “appreciable objective advantages” that sufficiently compensate for any anti-competitive effects caused by the restriction.⁷¹ The Court explained that the Commission had to consider whether the restriction concerned was necessary for such pro-competitive improvements in the production and distribution of the goods by evaluating the effectiveness of any possible justifications.⁷²

7) Business Tool – Justification

The applicant claimed that absolute territorial protection assisted Consten’s ability to plan its business in advance. The Court stated that risks, including parallel imports, were commonplace in competition and in all commercial activities and, therefore, this was not a reasonable justification.⁷³ Despite the accuracy of the explanation,⁷⁴ it does offer an

⁶⁸ *Park & Sons*, at 29; *Dr Miles*, at 400-403.

⁶⁹ *Consten & Grundig*, p. 344 (“Ruling”, paragraph 1).

⁷⁰ *Consten & Grundig*, p. 347.

⁷¹ *Ibid.*, p. 348.

⁷² *Ibid.*, p. 348.

⁷³ *Ibid.*, p. 348.

⁷⁴ Chapter 6 “Theories of Pro-Competitiveness v. Anti-Competitiveness”.

explanation for a motivation to introduce VTR, and potentially RPM, not only of the distributor but also of the manufacturer in some cases.⁷⁵

8) Services and Reputation – Justification

The applicant complained that the Commission had not considered whether it would have been possible to provide guarantees, such as the protection of the Grundig name and after-sales services, without introducing absolute territories in the market. Consten would have had to refuse to provide after-sales services, in particular, repair of the machines – products imported by Consten’s competitors if the parallel import had existed which is against consumer interest.⁷⁶

The Court did not find this fear justified because consumers could only demand the aforementioned services from the company from which they purchased their products’ Moreover, the main competitor of Consten also offered after-sale services, therefore, the non-existence of absolute territorial restraint would not have led to such a situation.⁷⁷

9) Penetrating the Market – Justification

The applicants also claimed that the Commission had not considered the necessity of the absolute territorial protection to penetrate the market, including bearing the risks of penetrating a market. The Court found this justification unfounded because this statement was not disputed by the defendant. The Court also ruled that such penetration did not influence improvements in distribution.⁷⁸ Although the Court did not examine this justification, it cannot be claimed that the Commission did not consider the penetrating argument as the Commission claimed that the conduct had been illegal only after trade had been established in France.⁷⁹

⁷⁵ See below; see Chapter 3 “Vertical Competition and Structure”; Chapter 4 “Development of the US Law of Vertical Territorial and Price Restraints”.

⁷⁶ *Consten & Grundig*, p. 349.

⁷⁷ *Ibid.*, p. 349.

⁷⁸ *Ibid.*, p. 349.

⁷⁹ See *Consten & Grundig*, p. 341.

10) The Main Objective: Market Integration

Although this case concerned private entities, the Court applied the main objective of the Treaty, creating common trade without barriers, explaining that the Treaty could not allow certain undertakings to create barriers on trade between Member States.⁸⁰

Jones and Sufrin argue that the market integration objective overruled competition efficiency in this case.⁸¹ This statement appears accurate as, firstly, the court stated that market integration was the main objective of EU competition law.⁸² Secondly, although it required economic, or rather objective proof, of positive effects under Article 101(3), it ruled that it was enough to prove a threat to or object of in the restriction of competition under Article 101(1).⁸³ Furthermore, Goyder highlighted the importance of this case at that time because it provided a sound basis for future policy in this area of competition law focusing on the maximum protection of a single market.⁸⁴

B) *Minière v. Maschinenbau*⁸⁵

This preliminary ruling case concerned a vertical agreement, which granted an exclusive right of sale. However, at the same time, it allowed the distributor to freely re-export the goods and distributors from other Member States were free to sell to the market concerned: the French market. Dealers and consumers were allowed to buy from wherever and whomever they wished, including parallel importers. Moreover, if the manufacturer had agreed, the distributor concerned would have been allowed to distribute the products of the manufacturer's competitor.⁸⁶

1) The Object and the Effect on Competition and on Trade

This case set a test and some important explanations on the restriction of trade and competition in object or in effect, which have applied in cases since. The Court explained

⁸⁰ *Consten & Grundig*, p. 340.

⁸¹ Jones, Sufrin, *EU Competition Law*, 653-654; G. Monti, "Article 81 EC and Public Policy" [2002] *CMLRev* p. 1065.

⁸² *Consten & Grundig*, p. 340.

⁸³ *Ibid.*, pp. 341, 347.

⁸⁴ Goyder, Goyder, Albors-Llorens *Goyder's EC*, 55.

⁸⁵ C-56/65 *Société Technique Minière v. Maschinenbau Ulm GmbH* [1966] ECR 235.

⁸⁶ *Minière v. Maschinenbau*, p. 247.

that an agreement containing a clause “granting an exclusive right of sale” may have fulfilled the condition to be notified and was thus possibly illegal.⁸⁷

The Court further discussed the effects on trade between Member States explaining that this meant that the agreement was “incompatible with the common market”.⁸⁸ The test, which still applies, is as follows:

[I]t must be possible to foresee with a sufficient degree of probability on the basis of a set objective factors of law or of fact that the agreement in question may have an influence, direct or indirect, actual or potential, on the pattern of trade between the Member States.⁸⁹

The Court explained that the part of Article 101(1) that states “object or effect the prevention, restriction or distortion of competition within the common market” involved alternative and not cumulative requirements. Therefore, firstly, the purpose of the agreement or some clauses in the agreement must be analysed “in the economic context”. It follows from the Court’s ruling that this is necessary as this first step determines the effect on competition.⁹⁰ If analysing the purpose of the clauses does not reveal the effect, the consequences of these clauses must then be considered. It must be shown that “the competition has in fact been prevented or restricted or distorted to an appreciable extent”.⁹¹

The Court listed aspects which should be considered in deciding whether the agreement restricted competition either in object or in effect:

the nature and quantity, limited or otherwise, of the products covered by the agreement, the position and importance of the grantor and the concessionaire on the market for the product concerned, the isolated nature of the disputed agreement or, alternatively, the position in the series of agreements, the severity of the clauses intended to protect the exclusive dealership or, alternatively, the opportunities allowed for other commercial competitors in the same products by way of parallel re-exportation and importation.⁹²

⁸⁷ Ibid., p. 248.

⁸⁸ Ibid., p. 249.

⁸⁹ Ibid., p. 249.

⁹⁰ Ibid., p. 249.

⁹¹ Ibid., p. 249.

⁹² Ibid., p. 250.

2) Penetrating the Market – Justification

The Court discussed penetrating the market as a possible justification. It went further than in the case of *Grundig & Consten* as it explained that competition was not restricted if the agreement was necessary to penetrate the market.⁹³

3) Some Clauses v Whole Agreement

With regards to Article 101(2), the Court confirmed the ruling in *Grundig & Consten* when it stated that this Article had to be interpreted in relation to Community Law. Only the clauses which are illegal under Article 101(1) are nullified. In the situation where these clauses are not separable from the agreement itself, the entire agreement is nullified.⁹⁴

5.4. Crisis and Changes – the mid 1970s through the 1980s

5.4.1. Background

After the first oil shock in 1973, an international economic crisis began, which led to widespread inflation and unemployment. Economic growth in Europe stopped for the first time since the end of World War II. Furthermore, Japanese firms began to emerge as major competitors. The European economic policy of the time reflected this situation. The response to the crisis was to strengthen and move forward with the integration process.⁹⁵

At the beginning of the 1980s, there was almost no positive news relating to the achievement of community goals.⁹⁶ To overcome the crisis, the CJEU maintained its role as “the momentum of integration” relying mainly on the competition law system and strengthening its power. For instance, it began to apply Article 102 TFEU to mergers. It also started to demand more sufficient evidence. Similarly, the Commission became more active in competition law and policy to protect European national economies, primarily by strengthening the competitiveness of European undertakings. In the 1980s, the Commission started to focus on the efficiency of competition. Vertical restraints remained

⁹³ Ibid., p. 250.

⁹⁴ Ibid., p. 250.

⁹⁵ Chalmers, *European Union Law*, pp. 18-19; Gerber, *Competition in Twentieth Century Europe*, 168-169, 359.

⁹⁶ Chalmers, *European Union Law*, pp. 19-20; Gerber, *Competition in Twentieth Century Europe*, 359.

at the centre of competition policy; however, at the end of the 1980s, the Commission increased its focus on horizontal agreements.⁹⁷

The CJEU emphasised the importance of the common market in EU competition law (in that time EEC competition law) in the cases of *Metro v. Commission*⁹⁸ and *Polydor Ltd et al. v. Harlequin Record Shops Ltd et al.*⁹⁹ Following *Consten & Grundig*, it repeated that one of the objectives of the Treaty of Rome was the creation of a single market with similar conditions to a unified domestic market. The significance of the objective of the internal market is also obvious in the vertical restraint case of *Nungesser & Eisele*.¹⁰⁰

Importantly, Decision 88/591/ECSC/EEC¹⁰¹ established the General Court (originally, the Court of First Instance) to judge cases in competition and employment. This Court began operation in 1989.

5.4.2. Cases and Legislation

In this era, the Commission and the CJEU broadened their vertical cases to include other forms of vertical restraints and distribution mechanisms, such as RPM, franchising systems and selective distribution systems. In the 1980s, based on these vertical cases, the Commission issued new regulations, including three vertical restraint block exemptions: Regulation on Exclusive Distribution Agreements 1983/83¹⁰², Regulation on Exclusive Purchasing Agreements 1984/83¹⁰³ (including special provisions on beer supply and petrol agreements) and Regulation on Franchising Agreements 4087/88.¹⁰⁴

The case of *Metro*¹⁰⁵ introduced a basic rule for selective distribution systems. It stated that distributors should not be chosen according to the quantitative restrictions of distributors, rather they should be chosen according to “objective non-discriminatory, qualitative

⁹⁷ Green, Hartley, Usher, *The Legal Foundations*, 203-204; Gerber, *Competition in Twentieth Century Europe*, 364-368; 384; compare with Chapter 4 “Development of the US Law of Vertical Territorial and Price Restraints”.

⁹⁸ Case 26/76, [1977] ECR 1875, [1978] 2 CMLR 1, para 20.

⁹⁹ Case 270/80, (1982) ECR 348, paragraph 16.

¹⁰⁰ *Nungesser & Eisele*, paragraphs 47-58.

¹⁰¹ OJ 1988, L319/1.

¹⁰² [1988] OJ L173/1.

¹⁰³ [1983] OJ L173/5.

¹⁰⁴ [1988] OJ L359/46.

¹⁰⁵ Case 26/76 *Metro SB-Großmärkte GmbH & Co. KG v. Commission of the EC* [1977] ECR 1875.

criteria relating to the technical qualifications and the suitability of trading premises”.¹⁰⁶ The CJEU highlighted that price competition should never be eliminated. Nevertheless, it also stated that price competition was not the only form of competition.¹⁰⁷

In the case of *Schmidt*,¹⁰⁸ the CJEU further ruled that a manufacturer had no duty to supply all distributors who fulfil the objective criteria.¹⁰⁹ In the case of *AEG Telefunken*,¹¹⁰ in 1985, the CJEU acknowledged that the system of selective distribution was legal if it was required for specialised handling and sophisticated products.¹¹¹

In the case of *Binon*,¹¹² the Court stated that any price fixing, including the fixing of newspaper and periodical prices, infringed Article 101(1).¹¹³ However, this could be exempted under Article 101(3). At that time it was the Commission who was responsible for granting exemptions under Article 101(3). As this was a preliminary ruling, the Court did not discuss this issue further.¹¹⁴

Franchising was introduced into Europe in the 1960s after a long existence in the US.¹¹⁵ The case of *Pronuptia*¹¹⁶ set the rules for franchising systems. It confirmed that franchising systems did not generally restrict competition, with the exception of restrictions on RPM and absolute territorial protections. In several cases, the Court confirmed the Commission’s opinion that an agreement that set minimum prices or fixed prices had an illegal object and infringed Article 101(1). However, despite this approach, a franchisor or other suppliers were able to provide their distributors with price guidelines.¹¹⁷

¹⁰⁶ *Metro*, paragraph 20.

¹⁰⁷ *Metro*, paragraph 21; also see Case 107/82, *AEG – Allgemeine Elektrizitäts – Gesellschaft AEG - Telefunken AG v Commission* [1983] ECR 3151, [1984] 3 CMLR 325, CMR 14018, paragraph 33.

¹⁰⁸ Case 210/81, *Demo-Studio Schmidt v. Commission*, [1983] ECR 3045, 3056, [1984] 1 CMLR 63, CMR 14009.

¹⁰⁹ *Demo-Studio; Metro*, paragraph 12.

¹¹⁰ Case 107/82, *AEG – Allgemeine Elektrizitäts – Gesellschaft AEG - Telefunken AG v Commission* [1983] ECR 3151, [1984] 3 CMLR 325, CMR 14018.

¹¹¹ *AEG-Telefunken*, paragraph 34; also see *Ideal Standard*, OJ 1985, L 20/38; *Grohe*, OJ 1985, L 19/17; *IBM Personal Computer* [1984] 2 CMLR 347.

¹¹² Case 243/83 *SA Binon & Cie v SA Agence et Messageries de la Presse* [1985] ECR 2015; C- 31/80 *L’Oreal v. De Nieuwe AMCK* (1980) ECR 3775 at paragraphs 5 and 16.

¹¹³ *Binon*, paragraph 44.

¹¹⁴ *Binon*, paragraphs 46-47.

¹¹⁵ Korah, *Guide to Competition*, 318.

¹¹⁶ Case 161/84 *Pronuptia de Paris GmbH v Pronuptia de Paris Ismgard Schillgalis* [1986] ECR 353; [1986] 1 CMLR 414.

¹¹⁷ See Case 243/85, *SA Binon & Cie v. SA Agence et Messageries de la Presse* [1985] ECR 2015, [1985] 3 CMLR 800; *Pronuptia; Metro*.

In the case of *Nungesser & Eisele*,¹¹⁸ the CJEU confirmed that absolute territorial protection was prohibited. Nevertheless, the CJEU ruled that exclusive licences were justifiable on the basis that investment was necessary to penetrate the market and to protect intellectual property rights. Also, the case of single branding in *Delimitis*,¹¹⁹ clarified that vertical restrictions were allowed if difficulties in penetrating a new market existed.¹²⁰ In the case of *Remia*,¹²¹ the CJEU ruled that territorial restrictions protecting goodwill did not infringe Article 101(1).

The Commission and CJEU started to develop a doctrine which differentiated between multilateral and unilateral conducts. They confirmed the existence of illegal agreements in situations where suppliers announced restrictive policies and their distributors generally, and in various forms, followed.¹²² For example, in the case of *Sandoz*,¹²³ the CJEU confirmed the Commission's decision that sending invoices by the supplier with the wording "export prohibited", which were then followed by non-exporting distributors constituted an agreement that restricted competition. In another case, *Eco System/Peugeot*,¹²⁴ the Commission stated that it was not necessary to prove that written instructions sent by a manufacturer had been accepted by its distributors, as such instructions created an agreement within the meaning of Article 101.¹²⁵ However, later, the newly established General Court started to change this broad approach to the meaning of "the agreement", requiring further evidence of an offer and an acceptance.¹²⁶

¹¹⁸ Case 258/78 *Nungesser (LC) KG and Kurt Eisele v Commission* [1982] ECR 2015; [1983] 1 CMLR 278.

¹¹⁹ Case C-234/89, *Delimitis (Stergios) v. Henninger Bräu*, 28 February 1991, [1991] ECR I-935, [1992] 5 CMLR 210, [1992] 2 CEC 530.

¹²⁰ Paras 13-27.

¹²¹ Case 42/84 *Remia BV v Commission* [1985] ECR 2545; [1987] 1 CMLR 1.

¹²² CJEU cases: C-277/87, *Sandoz prodotti farmaceutici SpA v Commission of the European Communities* [1990] ECR I-45; C-25-26/84, *Ford Werke AG v. Commission of the European Communities* [1985] 3 CMLR 528; *AEG*; C-32, 36, 82/78, *BMW Belgium SA v Commission of the European Communities* [1979] ECR 2435; Commission's decisions: *Eco System / Peugeot* [1992] OJ L66/1; *Bayo-n-ox* [1990] OJ L21/71; *Konica* [1988] OJ L78/34; see B. Jedličková McCabe, "Boundaries between Unilateral and Multilateral Conducts in Vertical Restraints" (2008) 10 *ECLR* p. 600; U. Wickihalder, "The Distinction between an 'Agreement' within the Meaning of Article 81(1) of the EC Treaty and Unilateral Conduct" [2006] 1 *European Competition Journal* 91; P.S. Jakobsen and M. Broberg, "The Concept of Agreement in Article 81 EC: On the Manufacturers' Right to Prevent Parallel Trade within the European Community" [2002] 23(3) *ECLR* 130.

¹²³ C-277/87, *Sandoz prodotti farmaceutici SpA v Commission of the European Communities* [1990] ECR I-45.

¹²⁴ [1992] OJ L66/1.

¹²⁵ *Eco System / Peugeot* [1992] OJ L66/1, paragraph 23.

¹²⁶ For instance, T-43/92 *Dunlop Slazenger International Ltd. v. Commission* [1994] ECR II-441, paragraph 60; for other cases, see below.

5.4.2.1. VTR

A) *Nungesser & Eisele*¹²⁷

This case discussed the breeding of a new plant variety, regulated by national law and requiring a registration of the plant variety.¹²⁸ The case concerned exclusive dealership in the Federal Republic of Germany which, at the time, constituted one geographic market.¹²⁹ A French company assigned its breeders the rights of its new plant variety to be registered under its exclusive distributor in Germany.¹³⁰ In this case, the only entity allowed to enter the German market was the exclusive distributor and the French producer but only on the proviso that it did not cover more than one third of German consumer demand.¹³¹

As in *Consten & Grundig*, the Court analysed whether IP protection had caused the restriction of competition or whether the restriction had resulted from the agreement between the producer and the distributor. In addition to this, the Court used the principle of proportionality when applying both Articles 101(1) and 101(3) and concluded that, although absolute territorial protection could not be justified, an open exclusive licence could be proportionate and thus justifiable under Article 101(3).

1) Territorial Protection: the Principle of Proportionality in IP Rights and Competition Law

The first question discussed by the CJEU was whether the relevant German legislation legalised territorial restrictions to protect the new plant variety.¹³² The Court observed that the legislation in question did not require exclusive production; the applied territorial restriction was merely based on contractual arrangements between the French producers and the German distributor.¹³³ The Court applied the principle of proportionality, stating that absolute territorial protection that did not allow parallel import when exercising intellectual property rights could infringe Article 101.¹³⁴

¹²⁷ Case 258/78 *Nungesser KG and Kurt Eisele v Commission of the EC* [1982] ECR 2015.

¹²⁸ This issue is regulated in the International Convention for the Protection of New Varieties of Plants of 2 December 1961.

¹²⁹ *Nungesser & Eisele*, paragraphs 2-3, 15.

¹³⁰ *Ibid.*, paragraphs 10-11, 31.

¹³¹ *Ibid.*, paragraph 32.

¹³² *Ibid.*, paragraphs 23-25.

¹³³ *Ibid.*, paragraphs 37-42.

¹³⁴ *Ibid.*, paragraph 29.

2) Justification in General: the Principle of Proportionality

The Court highlighted that the collusion in question needed to improve the production or distribution of goods or promote technical progress to satisfy the conditions set out in Article 101(3). The restriction could not go beyond what is necessary for these pro-competitive effects to be realised.¹³⁵ Among others, the seeds concerned were used by a large number of farmers and, thus, absolute territorial protection went beyond what is necessary, as technological innovation does not offer a reason for other distributors not competing once the seeds were available for purchase.¹³⁶

The principle of proportionality is the correct approach when two legal interests, two areas of law such as competition law and IP law, meet. If the restriction of one interest is reasonably based on the second interest, it must be also proportionate to ensure the right balance and the protection of both interests.

3) Penetrating the Market – Justification

The applicants argued that the Commission should have granted them an exemption based on the fact that the agreements concerned, including absolute territorial protection, assisted in penetrating a new market and launching new products in that market. The purpose of the agreement was to penetrate a new market and exclusivity did not go beyond what was necessary for this purpose and for the improvement of the production and distribution of goods.¹³⁷

The Court explained that the agreement that had constituted the exclusive distribution was signed because the French producer did not have the capacity to distribute to a new market itself.¹³⁸ However, the agreement in question constituted an absolute territorial protection including a ban on parallel imports from third parties.¹³⁹ Following older cases and applying the principle of proportionality, the Court concluded that it would have been reasonable if the seeds in question, with their technological and innovative aspects, were

¹³⁵ Ibid., paragraph 76.

¹³⁶ Ibid., paragraphs 33, 77.

¹³⁷ Ibid., paragraphs 44, 68.

¹³⁸ Ibid., paragraph 47.

¹³⁹ Ibid., paragraph 53.

protected with “an open exclusive licence” without the ban on parallel imports.¹⁴⁰ Moreover, the Court highlighted several times that the prohibition of parallel imports by any kind of licensee would be in contrary to the objectives of the Treaty.¹⁴¹

5.4.2.2. Selective Distribution System

A) *AEG-Telefunken*:¹⁴² RPM with Partial Territorial Protection

In this case, the applicant was a German producer and distributor of electronic products, selling its products through its branches and subsidiaries in Europe.¹⁴³ It introduced a selective distribution system, called the “Five-Point Programme”.¹⁴⁴ The Commission suspected that the selective distribution system had not been applied according to the scheme outlined to the Commission but that, in reality, it had involved RPM and other non-notified practices, such as non-written selective criteria. It found evidence that confirmed this suspicion and imposed a fine.¹⁴⁵

1) Selective Distribution Systems

The Court explained that it had already stated several times that although a selective system affected competition in the common market, it could be legal in some circumstances, such as a necessity to provide specific services regarding high-quality and high-technology products. These products could even justify a reduction in price competition in so far as it improved non-price competition.¹⁴⁶ Such a limitation is only acceptable if the selective distribution leads to an improvement of competition. Otherwise, the only effect would be a reduction of price competition.¹⁴⁷

As explained in *Metro*, a selective distribution system is permissible if the distributors are chosen based on objective qualitative criteria that do not discriminate against any other

¹⁴⁰ Ibid., paragraphs 54-58.

¹⁴¹ Ibid., paragraphs 54-58.

¹⁴² Case 107/82 *Allgemeine Elektrizitäts-Gesellschaft AEG-Telefunken AG v Commission of the EC* [1983] ECR 3151.

¹⁴³ *AEG-Telefunken*, paragraph 2.

¹⁴⁴ Ibid., paragraph 3.

¹⁴⁵ Ibid., paragraph 4.

¹⁴⁶ Ibid., paragraph 33.

¹⁴⁷ Ibid., paragraph 34.

distributors. Any other criteria infringe Article 101(1). Therefore, RPM, as part of a selective distribution system, is unlawful.¹⁴⁸

2) Multilateral Conduct

The applicant, AEG, claimed that influencing and setting retail prices were unilateral conducts.¹⁴⁹ The Court disagreed. It explained that a situation where it is advisable for distributors to engage in certain conduct did not in itself prove the existence of multilateral conduct. However, it agreed with the Commission in that this could indicate that the distributors concerned had not taken excessive risks by maintaining high prices because they had known about the price policy and had been willing to follow it.¹⁵⁰

The Commission observed and assumed that a great majority of distributors had followed the policy and, thus, they had opposed low prices. Their willingness assisted the producer in maintaining prices and threatening others who were against the policy.¹⁵¹

RPM, as part of selective distribution, does not constitute a manufacturer's unilateral conduct but is based on a contractual relationship between the manufacturer and its distributors. Distributor approvals, which can be tacit or expressed, were required by the manufacturer as a condition to join the selective distribution system.¹⁵² Furthermore, refusals to accept distributors who fulfilled the objective qualitative criteria but did not wish to follow the price policy prove the existence of RPM.¹⁵³

The Commission ruled in its decision that the applicant had maintained high prices through an improper application of its selective distribution system and had therefore infringed Article 101(1) TFEU.¹⁵⁴ Non-acceptances or terminations of distribution contracts with distributors who fulfilled the conditions of the objective quantitative criteria were not just sporadic mistakes but deliberate and systematic actions based on RPM.¹⁵⁵

¹⁴⁸ Ibid., paragraph 35.

¹⁴⁹ Ibid., paragraph 31

¹⁵⁰ Ibid., paragraph 17.

¹⁵¹ Ibid., paragraph 45.

¹⁵² Ibid., paragraph 38

¹⁵³ Ibid., paragraph 39.

¹⁵⁴ Ibid., paragraph 67.

¹⁵⁵ Ibid., paragraph 68.

The Commission's inspections of the applicant's premises showed that the applicant, the producer, had deliberately maintained a high profit margin to provide "the very expensive services associated with the specialist trade".¹⁵⁶ In some cases, AEG also used territorial protections to motivate its distributors to join the network.¹⁵⁷ For example, the Commission found that in the Federal Republic of Germany, the applicant did not accept a German undertaking to sell its products because it was a discount store.¹⁵⁸ Another distributor would not provide a guarantee to the applicant that it would not supply discount stores and would not export to other Member States and for these reasons the applicant banned it from its distribution network.¹⁵⁹ One distributor promised not to sell under the lowest price on the market but to sell somewhere between the average retail prices.¹⁶⁰

In France, the applicant issued a memorandum where it promoted fixed prices and required an assurance of compliance with the price policy.¹⁶¹ The applicant asked one of its distributors to increase its prices for the applicant's products in their promotional catalogue.¹⁶² Two distributors asked the applicant to indicate minimum retail prices.¹⁶³ Another distributor promised the appellant that they would not use an obtained promotional discount to decrease their retail prices.¹⁶⁴

The Court confirmed that the aforementioned examples, as well as other conduct, proved the improper application of the selective distribution system and an infringement of Article 101.¹⁶⁵

It is questionable whether this case would be recognised as involving unilateral or multilateral conducts if it was judged in the US. One could assume that the US Federal Court would have found some actions as unilateral under the *Colgate* doctrine, given the fact that manufacturers in the US are free to determine retail (sale) prices, announce them and choose their distributors based on whether the distributors follow the announced prices

¹⁵⁶ Ibid., paragraph 71.

¹⁵⁷ Ibid., paragraphs 98-106.

¹⁵⁸ Ibid., paragraphs 79-83.

¹⁵⁹ Ibid., paragraphs 84-86.

¹⁶⁰ Ibid., paragraph 107.

¹⁶¹ Ibid., paragraphs 92-94.

¹⁶² Ibid., paragraph 116.

¹⁶³ Ibid., paragraphs 117-118.

¹⁶⁴ Ibid., paragraph 120.

¹⁶⁵ Ibid., paragraphs 72, 76, 135-138.

or not. Similarly, they are free to terminate distributorship contracts if they charge different prices.¹⁶⁶

However, the actions that went beyond the *Colgate* doctrine, as they involved further cooperation between AEG and its distributors, could be also considered as multilateral in the US.¹⁶⁷ In general, the exact boundaries between unilateral and multilateral conducts are difficult to establish under the *Colgate* doctrine and subsequent cases.¹⁶⁸

3) The Justification of Higher Prices Including the Theory of Services

The applicant also argued that the higher prices were justified by the higher cost of the specialised trade which increased prices. A distribution system should offer distributors an assurance of the enjoyment of a minimum margin. Furthermore, it claimed that the system was beneficial for consumers as it preserved continuity in the distribution channel, which was in accordance with both Article 101(1) and 101(3).¹⁶⁹

The Court explained that, contrary to *Metro*, which had not included direct price restrictions but the system had influenced price competition only indirectly, this case included RPM. It stated that RPM could be justified only up to a certain level and only in some circumstances, such as obtaining an appropriate profit margin to ensure the quality of services. This is lawful only if the system in question performs the functions assigned to it by the Treaty. Therefore, the system must improve competition.¹⁷⁰

However, RPM in the selective distribution system was generally unjustified because it did not motivate distributors to keep fulfilling objective qualitative criteria to remain in the network but was a reason to stop supplying to distributors who did not want, or were not able, to maintain the prices. Therefore, RPM in this selective distribution system was illegal and restricted competition.¹⁷¹ However, this does not eliminate the producer's right to observe whether discounting distributors were capable of providing the required services based on the selective distribution system.¹⁷²

¹⁶⁶ *Colgate*, at 305-306.

¹⁶⁷ *Parke, Davis*, at 38-46.

¹⁶⁸ *Leegin*, at 884; *Parke, Davis*, at 38-46; *Bausch & Lomb*, 723; *Colgate*, at 305-306; see Chapter 4 "Development of the US Law of Vertical Territorial and Price Restraints".

¹⁶⁹ *AEG-Telefunken*, paragraph 40.

¹⁷⁰ *Ibid.*, paragraphs 41, 42.

¹⁷¹ *Ibid.*, paragraph 43.

¹⁷² *Ibid.*, paragraph 75.

5.4.2.3. RPM and VTR in Franchising Systems

A) *Pronuptia*¹⁷³

This preliminary ruling dealt with the application of Article 101(3) based on a franchising agreement, including exclusive dealing arrangements.¹⁷⁴ The franchising agreement was concluded between Pronuptia de Paris, a French franchisor, and a German franchisee to distribute wedding dresses and other wedding articles of clothing protected by the trademark “Pronuptia de Paris”. The products were distributed *via* franchisees and other non-franchising distributors in the Federal Republic of Germany.¹⁷⁵

The franchisee signed three franchising agreements with the franchisor for three different locations.¹⁷⁶ Among others, the agreements included granting an exclusive territory, the exclusive use of the trademark for marketing and promoting the goods and services and the restriction to resell to third retailers/distributors. The franchisor undertook to assist the franchisee with commercial aspects such as staff training and promoting and disclosed its know-how on improving the franchisee’s turnover and profitability.¹⁷⁷

1) Franchising Systems - RPM and Territorial Restrictions

In contrast to US cases on vertical restraints in antitrust law, where the US Federal Courts applied the term “franchising” without further determination of its meaning and without strict differentiation between franchising and non-franchising systems,¹⁷⁸ the EU courts clearly explained the term “franchising” and established the boundaries between justified and illegal franchising under competition law.¹⁷⁹

The CJEU highlighted the diversity of franchising agreements as franchising systems themselves differ strongly. There are franchising systems that offer services, as well as producing franchising systems under which the franchisee manufactures some products,

¹⁷³ C-161/84 *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schlillgalls* [1986] ECR 353.

¹⁷⁴ *Pronuptia*, paragraph 1.

¹⁷⁵ *Ibid.*, paragraph 2-3.

¹⁷⁶ *Ibid.*, paragraph 4.

¹⁷⁷ *Ibid.*, paragraphs 5-6.

¹⁷⁸ See *Business Cards Tomorrow; Sylvania; Schwinn*.

¹⁷⁹ Also see Guidelines on Vertical Restraints, Official Journal C 130, paragraphs 189-191.

and a distribution franchising system under which a franchisee sells the franchisor's products.¹⁸⁰

In the distribution franchising system, a franchisee benefits from, and does not have to invest its own capital in an already-existing successful business name and business methods. Therefore, franchise agreements differ from dealerships or selective-distribution agreements because, with the exception of selling products, the distributors do not profit from the success, the business name and the business methods of the producer.¹⁸¹

In this particular case, the Court applied the principle of proportionality when discussing the different conditions of franchising systems. It recognised two conditions that had to apply to guarantee the same quality for the public.¹⁸²

First, the franchisor must disclose its know-how to the franchisee and provide its assistance so that the franchisee can start and maintain its business and bear any risks associated with the business. On the other hand, the franchisee is not allowed to compete with the franchisor for a reasonable period after the termination of the franchise agreement. The franchisee is also not allowed to transfer its business to another party. This does not constitute restrictions on competition under Article 101(1) as its intention is to protect know-how.¹⁸³

Second, any provision which necessarily controls the maintenance of the identity and reputation of the franchisor's business and network, including decorating the shop according to franchisor's instructions and other promotional conditions, does not infringe Article 101(1).¹⁸⁴

On the other hand, any RPM and market differentiation, including territorial restrictions, go beyond what is necessary within a franchising system and thus infringe Article 101(1). Such actions restrict competition and do not serve the purpose of protecting know-how.¹⁸⁵ However, if this serves the purpose of penetrating the market by motivating an undertaking

¹⁸⁰ *Pronuptia*, paragraph 13.

¹⁸¹ *Ibid.*, paragraph 15.

¹⁸² *Ibid.*, paragraphs 15, 21.

¹⁸³ *Ibid.*, paragraph 16.

¹⁸⁴ *Ibid.*, paragraphs 17-18.

¹⁸⁵ *Ibid.*, paragraphs 23-24, 27.

to become a franchisor, this must be considered and analysed as an exemption to Article 101(3).¹⁸⁶

Market sharing within a franchising system has the potential to affect trade between Member States, even though the market is shared within one Member State, in so far as such a provision prevents franchisees from establishing themselves in another Member State.¹⁸⁷ As this was a preliminary-ruling case, the question remains whether territorial restraints in this case could be exempted under Article 101(3).

5.5. The Beginning of the European Union and the Monetary Union – the 1990s

5.5.1. Background

Competition and its policies have strengthened since their inception and have become the central goals of the Community.¹⁸⁸ The Maastricht Treaty states that Member States should create economic policy based on the principle of an open-market economy with free competition.¹⁸⁹ The single market remains the fundamental political objective.¹⁹⁰ Indeed, the importance of the market integration continued to be emphasised in EU competition case law (in that time, after the Maastricht Treaty, EC competition case law).¹⁹¹

The Commission, being aware of a lack of a vertical framework, published the Green Paper on vertical restraints in 1996.¹⁹² The Commission observed that distribution had been changing due to developments in information technology and new distribution systems, which had resulted in an ongoing greater concentration and integration, and the decline of traditional distribution channels (manufacturers-wholesalers-retailers).¹⁹³

¹⁸⁶ Ibid., paragraph 24.

¹⁸⁷ Ibid., paragraph 26.

¹⁸⁸ XXIIIrd Report on competition policy [1993]; ¹⁸⁸ The 1993 Delors White Paper on Growth, Competitiveness and Employment: the Challenges and Ways Forward into the 21st Century, COM(93)700.

¹⁸⁹ Article G of the Treaty on the European Union which amends the Treaty of Rome (the EC Treaty): Articles 3(a), 102(a), 105 of the consolidated version of the Treaty of Rome (1992) – the Treaty Establishing the European Community.

¹⁹⁰ Paper on Vertical Restraints in EC Competition Policy, Economic Analysis, COM (96) 721, paragraph 1.

¹⁹¹ C- 415/93 *Union Royal Belge des Société de Football Association ASBL & others v. Jean-Marc Bosman* [1995] ECR I-4921, [1996] 1 CMLR 645; Jones, Sufrin, *EU Competition Law*, 38; Bouterse, *Competition and Integration*.

¹⁹² Paper on Vertical Restraints in EC Competition Policy, Economic Analysis, COM (96) 721.

¹⁹³ Green Paper 1996, paragraphs 20, 40, 41, 44 (“Introduction to Green Paper and Invitation to Third Parties to Comment”).

The Green Paper stressed the integration of the different economic systems of the Member States and the creation of a single market as the main objective of EU competition policy (in that time, EC competition policy), placing singular importance on market penetration without the barriers that could be created by vertical agreements.¹⁹⁴ Moreover, it highlighted the importance of the existence and protection of parallel trade in the Community market.¹⁹⁵ On the other hand, the Green Paper stated that a review was also important because the single market legislation was largely in place and the methods of distribution had changed.¹⁹⁶

Economic efficiency and a full economic assessment began to be central to Commission's decisions and policies. The Commission recognised that vertical restraints could promote objective efficiencies; "efficiency" and "fairness" of competition were the primary objectives of EU competition law.¹⁹⁷ This is also reflected in the Green Paper, which stressed that the form of conduct is not important but the impact on the market is essential. Vertical restraints can be allowed for a certain period when they are being used to expand or penetrate the market. Vertical restraints can promote objective efficiencies.¹⁹⁸ It observed that the previous system was criticised mainly for a lack of analysis of economic impacts, a lack of flexibility resulting in a strait-jacket effect, over-regulation and discrimination against the plurality of distribution systems.¹⁹⁹ It analysed the relationship between and the importance of intrabrand and interbrand competition, the market structure and the structure of distribution.²⁰⁰

In *Van den Bergh Foods Ltd.*,²⁰¹ the General Court acknowledged that economic understanding and market analysis were essential in competition cases.²⁰² Furthermore, the

¹⁹⁴ Green Paper 1996, paragraphs 1-2 ("Executive Summary"), paragraphs 1-2 ("Introduction to Green Paper and Invitation to Third Parties to Comment").

¹⁹⁵ Green Paper 1996, paragraph 9 ("Executive Summary"), 39 ("Introduction to Green Paper and Invitation to Third Parties to Comment").

¹⁹⁶ Green Paper 1996, paragraph 3 ("Introduction to Green Paper and Invitation to Third Parties to Comment").

¹⁹⁷ Green Paper 1996, paragraphs 10-13, 25; Jones, "Leegin and Its Implications for EC" 940; S. Marco Colino, *Vertical Agreements and Competition Law, a Comparative Study of the EU and US Regimes* (Hart Publishing, Oxford and Portland, Oregon, 2010), 98; Green, Hartley, Usher, *The Legal Foundations*, 200.

¹⁹⁸ Green Paper 1996, paragraph 12 ("Economic Analysis"), paragraph 25 ("Current Rules").

¹⁹⁹ Green Paper 1996, paragraph 37 ("Current Rules").

²⁰⁰ Green Paper 1996, paragraphs 10, 12, 13 ("Economic Analysis"), paragraphs 4-39 ("Introduction to Green Paper and Invitation to Third Parties to Comment").

²⁰¹ 98/531/EC, Official Journal L 246, 04/09/1998 p. 1, appeal: T-65/98, *Van den Bergh Foods Ltd v Commission of the European Communities*, [2003] ECR II-4653, [2004] 4 CMLR 14.

²⁰² Appeal, paragraph 84.

jurisdiction of the General Court broadened in the 1990s including, for instance, trademarks and state aid.²⁰³

There are several other issues that the Green Paper addressed. For example, distinguishing between the pro-competitive and anti-competitive effects of restrictions, facilitating market integration, permitting new and innovative distribution systems, consumer welfare and market share thresholds, legal certainty, decentralisation and a possible need for substantive legal changes, to name a few.²⁰⁴

5.5.2. Cases and Legislation

Based on the Green Paper, the Commission adopted a new block exemption on vertical restraints, Regulation 2790/99 (“Regulation 1999”),²⁰⁵ with guidelines on vertical restraints (“Guidelines 1999”) in December 1999.²⁰⁶ These replaced the three previous vertical regulations. In comparison with the older regulations, the new ones introduced significant changes recognising the possible benefits of vertical restraints and heralding a more economic approach to vertical restraints.²⁰⁷

Generally, Regulation 1999 lightened the burden of individual exemptions on vertical agreements by introducing a system where parties were responsible for determining whether their vertical agreements and arrangements fulfilled the conditions of the block exemption.²⁰⁸ Both documents covered all forms of vertical restraints for products and services and were applied to vertical restraints in general for the first time. The block exemption applied only if the supplier’s market share was below 30%. The Regulation reflects the fact that the Commission had to merge different interests and opinions. One of the Commission’s main concerns was that territorial restrictions imposed on distributors contradicted the single market objective.²⁰⁹ Simultaneously, case law highlighted the benefits of territorial restrictions when making investments to launch new products or penetrating new markets.²¹⁰ These aspects were included in Guidelines 1999.²¹¹

²⁰³ Council Decision, OJ 1993, L 144/21; Council Decision, OJ 1994, L 66/29; Council Regulation (EC) 40/94 on Community trade mark, OJ L 11/1.

²⁰⁴ See Green Paper 1996, paragraph 46 (“Current Rules”).

²⁰⁵ [1999] O.J. L336/21.

²⁰⁶ [2000] O.J. C291/1.

²⁰⁷ See, for instance, the Guidelines 1999, paragraphs 6 and 115.

²⁰⁸ Jones, Sufirin, *EU Competition Law*, 645-646, 650-651.

²⁰⁹ See Guidelines 1999, paragraph 103; Green Paper 1996, paragraphs 26 (“Current Rules”), 70, 78; Hawk, “System Failure”, p. 973.

²¹⁰ See above; Green Paper 1996, paragraph 12.

Further regulations and guidelines were introduced tackling issues such as technology transfer agreements, joint ventures, research and development.²¹² In 1998, guidelines on fines²¹³ were issued and other regulations were adopted.²¹⁴

The case of *Leclerc v. Commission* discussed the position of a selective distribution system based on luxury criteria. In particular, if a manufacturer selected only those resellers who provided luxury goods or services, this was considered to be legal as far as the criteria were necessary and also included hypermarkets.²¹⁵ In the case of *Novalliance/Systemform*,²¹⁶ the Court argued that conduct based on an agreement that did not explicitly include an absolute territorial protection or an export ban on a distributor but whose purpose was such a restriction infringed Article 101(1). The case of *Delimitis* explained that even a small, relevant market such as Frankfurt in Germany could have an impact on the trade between Member States.

5.5.2.1. Territorial Restrictions with Partial RPM: *Novalliance/Systemform*²¹⁷

Systemform GmbH was a German undertaking who, among other activities, manufactured equipment for processing computer printouts. The company was sold to ECV Edition Cantor Verlag in 1995.²¹⁸ Novalliance, the complainant, was a French dealer who sold office equipment, primarily in computer-printing and post-handling systems. Novapost, a Greek undertaking, distributed for Systemform. Both Novalliance and Novapost formed one economic entity with Eurinvest.²¹⁹

The relevant product market was created by devices for handling and processing large computer printouts of medium-volume applications.²²⁰ The geographic market could be

²¹¹ Paragraph 119.

²¹² Regulation 772/2004 on technology transfer agreements OJ 2004, L123/11; Commission Regulation 2658/2000 on specialization agreements [2001] O.J. L304/3; R&D Regulation 2659/2000, [2000] O.J. L304/7; Guidelines on research and development agreements, [2001] OJ C3/2.

²¹³ [1998] OJ C9/3, [1998] 4 CMLR 472.

²¹⁴ See Regulation 1617/93 on passenger transit consultations and slot allocations at airports, [1993] OJ L155/18, Regulation 3652/93 on agreements relating to computerized reservation systems, [1993] OJ L333/37, Regulation 1475/95 on motor vehicle distribution, [1995] OJ L145/25.

²¹⁵ T-88/92 *Leclerc (Association des Centres Distributeurs Edouard) v. Commission*, [1996] ECR II 1961, paragraphs 109-15.

²¹⁶ [1997] OJ L47/11, [1997] 4 CMLR 876.

²¹⁷ 97/123/EC, IV / 35.679 – *Novalliance/Systemform*, Official Journal L 47, 18/02/1997 p.11.

²¹⁸ *Novalliance/Systemform*, paragraph 6.

²¹⁹ *Ibid.*, paragraphs 5,7.

²²⁰ *Ibid.*, paragraphs 8-10.

considered to be the whole EU; however, the Commission left this question open as the restriction was not affected by the market size.²²¹

1) Agreements including Territorial and Price Restraints and Export Ban

Systemform concluded agreements with exclusive distributors outside of Germany and with several distributors inside Germany.²²² Both the exclusive and German distribution systems included territorial restrictions,²²³ in that the distributors agreed not to sell to any undertaking passively or actively outside their own territories.²²⁴ The Commission stated that the aforementioned agreements infringed Article 101(1) in both their anti-competitive object and effect.²²⁵

Novalliance complained that Systemform had imposed a ban on exports by delaying supplies.²²⁶ The Commission further explained that the territorial restrictions prohibiting selling to any undertaking with an office outside the contractual territory was an export ban. Moreover, some agreements also included a prohibition to sell to undertakings inside the territory but who intended to export the products.²²⁷ This restricted the freedom of distributors to choose their own customers.²²⁸

The agreements also included price restrictions. Systemform fixed retail prices for the territory concerned with each of its distributors and some distributors agreed to inform Systemform if prices changed.²²⁹ Systemform claimed that those clauses fixing prices were not enforced.²³⁰ However, the Commission found that the agreements restricted the freedom of distributors to determine their own resale prices.²³¹

The Commission highlighted that distributors should have the freedom to conduct their business, which includes freedom of choice of price and customers. This complemented the understanding of ownership rights as explained by the Supreme Court in the previous

²²¹ Ibid., paragraph 11.

²²² Ibid., paragraph 14.

²²³ Ibid., paragraph 15.

²²⁴ Ibid., paragraphs 16-29, 60.

²²⁵ Ibid., paragraph 52.

²²⁶ Ibid., paragraph 45.

²²⁷ Ibid., paragraphs 56-59.

²²⁸ Ibid., paragraph 60.

²²⁹ Ibid., paragraphs 30-42.

²³⁰ Ibid., paragraph 43.

²³¹ Ibid., paragraph 61.

US case of *Dr Miles*.²³² It is also further discussed and advocated in Chapter 6 “Theories of Pro-Competitiveness v. Anti-Competitiveness”.

2) The Effect on Trade

Both territorial restrictions and RPM had their effect in restricting competition in the cases where Systemform did not enforce these restrictions. When they were enforced, competition was restricted by object.²³³ The effect on trade between the Member States was appreciable because of the market share of Systemform, the nature of the restrictions and the fact that restrictions occurred in several contracts during that time in the EEA.²³⁴

3) Pro-Competitive Effects

The Commission confirmed that even exclusive distribution could have possible benefits if the exclusive distributions lead to technical and economic progress by improving the distribution of goods. However, the agreements in question contained such restrictions on competition which completely prohibited distributors from selling outside their territories or to other customers and this harmed consumers. Therefore, the conditions for an exemption were not met.²³⁵

4) Interbrand Competition – Market Shares

The Commission also discussed the possibility of the effect on interbrand competition. However, it simply stated that interbrand competition was likely not to be affected because Systemform did not have a sufficient market share.²³⁶ It could be argued, however, that a lack of market share on its own does not prove the non-existence of an impact on interbrand competition in vertical restraints and does not even determine whether vertical competition was restricted significantly.²³⁷

²³² See Chapter 4 “Development of the US Law of Vertical Territorial and Price Restraints”.

²³³ *Novalliance / Systemform*, paragraphs 60-61.

²³⁴ *Ibid.*, paragraphs 63-65.

²³⁵ *Ibid.*, paragraphs 70-72, 74-75.

²³⁶ *Ibid.*, paragraph 76.

²³⁷ See Chapter 3 “Vertical Competition and Structure”; Chapter 6 “Theories of Pro-Competitiveness v. Anti-Competitiveness”.

Although it can be enough to find a restriction on intrabrand competition under the EU law of vertical restraints,²³⁸ the differentiation between interbrand and intrabrand competition plays a rather important role in the US approach. The US courts generally presume that a decrease in intrabrand competition increases interbrand competition. Such situations are typical not only for VTR but also for RPM and such “restraints” would be legal because interbrand competition is economically more valuable than intrabrand competition under US antitrust law.²³⁹ However, the approach and understanding differ when horizontal intrabrand restrictions are included, which are illegal *per se*.²⁴⁰

5.6. The Beginning of New Millennium

5.6.1. Background

The Commission has been very active in reviewing and issuing new legislation. Since 2002, the Commission has reviewed and changed several regulations and has issued a number of new guidelines and regulations in new areas.²⁴¹ In June 2010, the new Regulation and Guidelines on Vertical Restraints (“Regulation and Guidelines”)²⁴² came into force and will be valid until 2022. Furthermore, the economic crisis, which started in 2008, changed the competition-policy focus to crucial areas such as state aid, the banking sector and the automobile sector. The Commission has also acknowledged the importance of simplifying and communicating competition law and policy to the public by issuing best

²³⁸ Also see below “8. Application of Competition Law in RPM and Vertical Restraints Cases”.

²³⁹ *Leegin*, at 890; *Business Cards Tomorrow*, at 1205; *Sylvania*, at 51-52, 65.

²⁴⁰ *Mack Truck*, at 221, 225; *Leegin*, at 893; see Chapter 4 “Development of the US Law of Vertical Territorial and Price Restraints”.

²⁴¹ For instance, Regulation 1400/2002 (with Guidelines) on motor vehicles [2002] O.J. L203/30 changed Regulation 1475/1995; and the recent Regulation 461/2010 on vertical arrangements in the motor vehicle sector [2010] OJ L 129/52; Guidelines on horizontal co-operation agreements [2011] OJ C11/1; Regulation 1218/2010 on categories of specialization agreements [2010] OJ L335/43; Regulation 1217/2010 on research and development agreements [2010] OJ L335/36; Regulation on technology transfer agreements, 772/2004 [2004] OJ L123/11 with Guidelines on the application of Article 101 to technology transfer agreements, [2004] OJ C101/2; Regulation on air transport, 411/2004 [2004] OJ L68/1; Regulation on Liner Shipping Consortia 823/2000 [2000] OJ L100/24; Guidelines on horizontal mergers [2004] OJ C31/5; Guidelines on effect on trade concept contained in Articles 81 and 82 [2004] OJ C101/96; Guidelines on the application of article 81(3) [2004] OJ C101/97; Communication from the Commission — Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings [2009] Official Journal C 045 , 24/02/2009 P.

²⁴² Commission Regulation 330/2010 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, O.J. L 1021; Commission Notice, Guidelines on vertical restraints [2010] O. J. C 130/1.

practices for proceedings under Articles 101 and 102 TFEU, merger controls and the submission of economic evidence.²⁴³

In the 2000s, discussion on assisting consumers to obtain redress for the damage caused through cartels began with support from the Commission.²⁴⁴ In December 2005, the Commission adopted the Green Paper on Damages Actions²⁴⁵ together with a Commission Staff Working Paper on the topic. In April 2008, the Commission presented its White Paper on private damages actions²⁴⁶ and, in June 2011, the Commission asked the public for consultation of its draft. The main aim was to increase the level of private enforcement in order to help victims of infringements to obtain compensation.

One of the objectives of the Community was to establish a “system ensuring that competition in the internal market is not distorted” as stated in Article 3(1)(g) of the EC Treaty. The Treaty of Lisbon repealed this Article and replaced it with Protocol 27 which links the system of undistorted competition with establishing a fully-effective internal market. Lisbon’s Protocols have the same legal status as the treaties; therefore, this objective remains with the same legal power.

For the first time, Article 3(1)(b) TFEU ensured the exclusive competence of the EU to establish competition rules necessary for the functioning of the internal market. Article 120 of the TFEU requires that the EU and Member States act in accordance with the “principle of an open market economy with free competition”.

Pivotal legislation, Council Regulation 1/2003,²⁴⁷ became effective in May 2004 and was a result of the Commission’s White Paper from 1999.²⁴⁸ It included changes in enforcement based on the direct applicability of Article 101(3) and empowered both national competition authorities and national courts to apply the EU antitrust rules (in that time, EC antitrust rules) directly and in an effective manner. A cooperative competition network with national competition authorities, the European Competition Network, was created to

²⁴³ See Commission press release IP/10/2; Competition Handbooks, <http://ec.europa.eu/competition/antitrust/legislation/legislation.html>.

²⁴⁴ J. Ratliff, “Major Events and Policy Issues in E.C. Competition Law”, 2000: Part 2” (2001) *International Company and Commercial Law Review* p. 72.

²⁴⁵ Commission, Green Paper, “Damages actions for breach of the EC antitrust rules,” December 19, 2005, COM (2005) 672 final, IP/05/1634 and MEMO/05/489, December 20, 2005.

²⁴⁶ COM(2008) 165 final of April 2, 2008.

²⁴⁷ [2003] OJ L1/1.

²⁴⁸ White Paper on modernisation of the rules implementing Articles 81 and 82 of the EC Treaty [1999] OJ C132/1, [1999] 5 CMLR 208.

control who decides what, informing each other about their cases and other issues. The Commission's power was strengthened to investigate possible infringements more effectively.²⁴⁹

On 29th of April 2009, the Commission published the "Report on the Functioning of Regulation 1/2003". The general conclusion of the report was that Regulation 1/2003 had contributed to more efficient and effective enforcement of EU competition law and the modernised enforcement of EU antitrust rules had come into force. However, the report also highlighted a few problems, such as the problematic cooperation with national courts.²⁵⁰

At the beginning of the existence of EU competition law, the importance of and strict opinions on vertical restraints were formed. The situation slowly changed from the previous era when the Commission had started to concentrate more on cartels, including criminalisation of cartels, and mergers assuming that vertical restrictions were not as harmful as horizontal restrictions and illegal mergers.²⁵¹

However, the public interest in vertical restraints increased after 2007 as this year was an important milestone for US policy on vertical restraints, most notably RPM. That was the year that the US Supreme Court changed the *per se* rule to the rule of reason for all RPM forms in *Leegin*.²⁵² This also shifted the focus of RPM in the EU. Nevertheless, the Commission confirmed the existing approach in its new Regulation and Guidelines.²⁵³

In 2009, the Commission published a draft of new Regulations and Guidelines on vertical restraints and invited the public to take part in discussions on the matter. The documents

²⁴⁹ The Commission used the new tools in, for instance, Rapsol's motor fuel distribution practices, O.J. C258/7, October 20 2004, on "Article 9 commitments" see MEMO/04/217, September 17, 2004.

²⁵⁰ See below.

²⁵¹ Ratliff, "Major Events", p. 71; also as discussed with the Deputy Head of Unit A2 Mr. Donnadh Woods and Mr. Lucas Peepkorn at DG Comp, the Commission, 2.12.2008; e.g., In 2001, discussion began as to whether criminal sanctions should be applicable to individuals for hard core cartels (price-fixing, market-sharing and bid-rigging); however, discussions have not found their legal base within EU legislation yet.

²⁵² See Chapter 4 "Development of the US Law of Vertical Territorial and Price Restraints"; see below the discussion on new Regulation and Guidelines.

²⁵³ See below; see, e.g., M. Velez, "The Tenuous Evolution of Resale Price Maintenance" (2011) 32(6) *ECLR* 297; C. Callery, "Should the European Union Embrace or Exorcise *Leegin*'s 'Rule of Reason'?" (2011) 32 *ECLR* 42; N. Vettas, "Developments in Vertical Agreements" (2010) 55(4) *Antitrust Bulletin* 843-874; A. Jones, "Resale Price Maintenance: A Debate about Competition Policy in Europe?" (2009) 5(2) *European Competition Journal* 479-514; Marco Colino, *EU and US Regimes*; F. Dethmers and P. Posthuma de Boer, "Ten Years on: Vertical Agreements under Article 81" [2009] 9 *ECLR* p. 424; Jones, "*Leegin* and Its Implications for EC" 903-965; M. Kneepkens, "Resale Price Maintenance: Economic Call for a More Balanced Approach" [2007] 28(12) *ECLR* 656-664.

did not change the policy of vertical restraints dramatically and passive sale, minimum resale maintenance and retail price fixing remained as the hard core restrictions.

Logically, consumers appealed to the Commission to keep the protective approach and to take it even further, as they believed there was no justification for the 2-year protection of new products to penetrate the market.²⁵⁴ On the other hand, businesses represented by law firms welcomed this period for starting a new distribution and/or penetrating a new market.²⁵⁵ Consumers agreed with the Commission's view on keeping the hard core approach to RPM in the EU, which differed from the US case of *Leegin*.²⁵⁶ They explained that free riding is of benefit to society and consumers as it decreases prices, improves innovation and adapts to consumer demand. The message was very strong urging the Commission to protect free riding and freedom of choice.²⁵⁷

Generally, the main change in the new Regulation and the new Guidelines was the introduction of a 30% threshold of buyer power.²⁵⁸ This was recognised as a further burden on companies by the public. The practical side of this change was questioned based on the difficulties of estimating the market share regarding the length of time, obtaining and possessing data, the market structure including its concentration and the existence of the same vertical agreements with a number of buyers, or a vertical network. The Commission was asked to abandon this change.²⁵⁹ The public demanded further explanation of the analysis of buyer power as provided in paragraph 112 of the Guidelines.²⁶⁰ It was suggested that, instead, the Commission should provide the public with a list of the types of vertical restraints where the market share of the buyers is relevant.²⁶¹ Specifically, the AMCHAM EU believed that only exclusive supply contracts should be concerned with

²⁵⁴ Consumer Focus (the statutory organization for consumers across England, Wales, Scotland and Northern Ireland) "Consumer Focus Response to Vertical Restraints Block Exemption Regulation" (September 2009, London), pp. 5, 12-14.

²⁵⁵ LAWIN "Review of the Competition Rules Applicable to Vertical Agreements: Response to Consultation" (28 September, 2009) Tallinn, Riga, Vilnius, p. 2.

²⁵⁶ Consumer Focus "Focus Response" 14.

²⁵⁷ *Ibid.*, pp. 5, 11-13.

²⁵⁸ Regulation, Article 3 and 8(g).

²⁵⁹ Consumer Focus "Focus Response" 6-7; European Federation of Pharmaceutical Industries and Associations (representing 31 national pharmaceutical industry associations and 44 leading pharmaceutical companies in Europe) "The proposal to Revise the Vertical Restraints Block Exemption Regulation" (2009) p. 2; LAWIN "Review" 1; American Chamber of Commerce to the European Union ("AMCHAM EU") "AMCHAMEU Response to the European Commission's Consultation on the Review of the Vertical Restraints Block Exemption Regulation and Guidelines" (2009) Brussels, Belgium, pp. 1-2; ICC ("International Chamber of Commerce") Commission on Competition "Review of EC Competition Rules Applicable to Vertical Agreements" (28 September 2009) Document No. 225/662, p. 3.

²⁶⁰ LAWIN "Review" 2.

²⁶¹ LAWIN "Review" 1.

buyer market power.²⁶² The ICC explained that some forms of concentration among buyers can establish illegal horizontal agreements and, therefore, analysis of horizontal actions in such cases would be more appropriate than the 30% threshold of buyer power in vertical arrangements.²⁶³

Logically, consumers were concerned and disagreed with any possibility of a weakening of hard core restrictions.²⁶⁴ Additionally, they welcomed the protection of the freedom of distributors' internet-advertising, asking for even more freedom for distributors with regards to, among others, exclusive distribution systems.²⁶⁵ On the other hand, businesses and the ICC welcomed a weakening of further limitations to the hard core restrictions, for instance, paragraph 225 of the Guidelines allows franchisors to fix resale prices, to organise a coordinated short-term low price campaign for a duration of up to 6 weeks, and recognises other efficiencies of RPM.²⁶⁶

AMCHAM EU, EFPIA and the ICC criticised the proposed Regulation for prohibiting some active sales in VTR and urged the Commission to keep only the prohibition of passive sales as hard core restrictions.²⁶⁷ AMCHAM EU pointed out that suppliers could be driven by this policy to choose more restrictive distribution systems, such as exclusive distribution, because that would be the only way they could legally apply active sales restrictions. Furthermore, it appealed to the Commission to extend the recognition of the efficiencies of restrictions on active sales beyond exclusive distribution agreements, as it did not recognise any reason why such efficiencies should not apply to other distribution systems as well.²⁶⁸

The Commission accepted some of the suggestions from the public and made adjustments accordingly. For instance, Article 4(b)(iii) of the proposed Regulation originally stated "in the markets where such a system is operated". However, in the published Regulation, it says: "The restriction of sales by the members of a selective distribution system to unauthorised distributors ...", which was at the suggestion of the legal firm LAWIN.²⁶⁹

²⁶² AMCHAM EU "AMCHAM EU Response" 1.

²⁶³ ICC "Review" 3.

²⁶⁴ Consumer Focus "Focus Response" 8.

²⁶⁵ Consumer Focus "Focus Response" 9-10.

²⁶⁶ LAWIN "Review" 3; AMCHAM EU "AMCHAM EU Response" 6; ²⁶⁶ ICC "Review" 4.

²⁶⁷ AMCHAM EU "AMCHAM EU Response" 3; Pharmaceutical Industries "The Proposal" 5; ICC "Review" 8.

²⁶⁸ AMCHAM EU "AMCHAM EU Response" 3.

²⁶⁹ LAWIN "Review" 2; ²⁶⁹ ICC "Review" 7.

Nevertheless, some criticisms remained. For example, Dethmers and Posthuma de Boer highlighted that, under Guidelines 1999 and Regulation 1999, the system of vertical restraints was not clear; it lacked legal certainty and was inconsistent.²⁷⁰ Among others, they argued that it was not obvious whether the list of hard core restrictions were exhaustive as paragraph 23 in Guidelines 1999 stated that it was not, but the nature of Regulation indicated the opposite.²⁷¹ Furthermore, it was not clear whether Article 101(3) also applied to hard core restrictions and paragraph 135 in the Guidelines 1999 stated that it was not applicable to dominant undertakings.²⁷² Even following the adoption of the revised regulations and the revised Guidelines in May 2010, the existence of hard core restrictions has been criticised, arguing that the same approach taken to non-hard core restrictions should also apply to hard core restrictions.²⁷³ Jones highlights that restrictions by object have expanded since the beginning of the EU (originally, EEC); however, the list has not been narrowed.²⁷⁴ Colino argues that it is even questionable whether vertical restraints, or at least some of them, infringe Article 101(1) in the first place.²⁷⁵ However, as this thesis argues, although RPM and VTR can have pro-competitive effects and thus can be, at least theoretically, justified under Article 101(3), they restrict competition in the first place. The key problem is the requirement of multilateral forms under Article 101(1).

Although the revised Regulation and Guidelines were not so different from Regulation 1999, they both highlight that Article 101(3) also applies to hard core restrictions;²⁷⁶ and the list of hard core restrictions is exhaustive.²⁷⁷ Thus, they eliminated any doubts in that sense. Furthermore, any presumption of applying the same approach to hard core restrictions in the EU as the *per se* rule in the US was avoided. Nevertheless, as Jones discusses, it will be difficult to eliminate the long-existing presumption that hard core restraints are illegal *per se* and that entities will risk the application of hard core

²⁷⁰ Dethmers, Posthuma de Boer, “Ten Years on:” p. 424; see below.

²⁷¹ Dethmers, Posthuma de Boer, “Ten Years on:” pp. 425-426.

²⁷² Dethmers, Posthuma de Boer, “Ten Years on:” p. 427; D. Ridyard, S. Bishop, “E.C. Vertical Restraints Guidelines: Effects Based on Per Se Policy?” [2002] 23(1) *ECLR* 35-38.

²⁷³ Vettas, “Vertical Agreements” 871-873; Velez, “The Tenuous Evolution” 297-302; Dethmers, Posthuma de Boer, “Ten Years on:” pp. 424-439; Kneepkens, “Resale Price Maintenance” 656-664; Ridyard, Bishop, “E.C. Vertical Restraints” 35-38; see Chapter 6 “Theories of Pro-Competitiveness v. Anti-Competitiveness”.

²⁷⁴ A. Jones, “Left Behind by Modernisations? Restrictions by Object under Article 101(1)” (2010) 6(3) *European Competition Journal* 660-668.

²⁷⁵ Marco Colino, *EU and US Regimes*, 93-95.

²⁷⁶ Regulation, Preamble, paragraph 7; Guidelines, paragraphs 6, 23, 97, 99, 106, 110-111.

²⁷⁷ Regulation, Article 4; Guidelines, paragraphs 47-64.

restrictions. Furthermore, it is not even clear whether the Commission will start changing the strict approach in practice.²⁷⁸

5.6.2. Cases and Legislation

New Regulation and Guidelines on Vertical Restraints came into force in June 2010 and will be valid until 2022. The main change introduced was to stipulate that for the block exemption, the market share of the producer as well as the market share of the buyer must not exceed 30%.²⁷⁹ This had already been changed in the technology transfer block exemption in 2004.²⁸⁰ With respect to RPM and VTR, the main policy remained the same. The only change was that the Guidelines added further exemptions to the main hard core rule and explanations, which are reflected in the difference between active and passive sales, internet sales, promotion and advertising.²⁸¹

Interestingly, the Commission started to shift its focus from the protection of competition to the protection of consumers in its policy and decisions since it started the process of reviewing the existing Regulations and Guidelines in the new millennium.²⁸² This objective of competition law is also reflected in new Regulation and the Guidelines on vertical restraints.²⁸³ Naturally, this shift was welcomed by consumers and their associations.²⁸⁴ However, the CJEU primarily disagreed with highlighting that the objective of EU competition law was not the protection of effective competition and has refused any understanding of strict shift of the objective of EU competition law to consumer welfare.²⁸⁵

Furthermore, in this last era and since the notification system has changed, the main interest of the Commission has been parallel imports, most notably in the car industry,

²⁷⁸ Jones, “Left Behind?” 668-676.

²⁷⁹ Regulation, Article 3.

²⁸⁰ Regulation on technology transfer agreements, 772/2004 [2004] OJ L123/11, Article 3(2).

²⁸¹ Guidelines, paragraphs 51-54.

²⁸² For instance, Guidelines on the application of Article 81[3] [Article 101(3) TFEU] [2004] OJ C101/08, paragraph 13; Guidance on Article 82 of the EC Treaty; Green Paper on Damages Actions 2005; also see Consumer Focus “Focus Response” 15.

²⁸³ Regulation, Preamble 10, paragraphs 7, 101-102, 122.

²⁸⁴ Consumer Focus “Focus Response” 6.

²⁸⁵ GSK appeal paragraph 63, citing C-8/08 *T-Mobile Netherlands BV v Road van bestuur van de Nederlandse Mededingingsautoriteit* [2009] 5 CMLR 11, paragraphs 38-39; Case C-52/07 *Lelos kai Sia EE v GlaxoSmithKline AVEE Farmakeftikon Proionton* [2008] ECR I-7139, [2008] 5 CMLR 20.

which is reflected in the Commission's decisions on vertical restraints.²⁸⁶ Given that it was the Commission itself who initiated or decided to begin investigations, and not the entities notifying their policies, these decisions reveal the Commission's genuine policy in practice. This leads to the assumption that, in reality, market integration is still the essential and even the main objective of the EU law of vertical restraints. This is in accordance with both Article 3(1)(g) of the EC Treaty and Protocol 27 of the Lisbon Treaty.

This period, beginning with the new millennium, is typified by the judicial changes of the strict view on vertical restraints and on the existence of multilateral conducts among parties, as required under Article 101. The Commission's strict approach has continued to be challenged by the EU Courts, particularly by the General Court.²⁸⁷ For instance, as discussed below, the *Bayer* case²⁸⁸ clarified that the mere application of anti-competitive policy on distributors was unilateral conduct; unless, the distributors had known about the policy through the manufacturer, which was qualified as an offer, and had decided to follow the policy, which is recognised as acceptance.

The General Court's judgment in *Volkswagen II*²⁸⁹ introduced another positive change, stating that distributors could not agree with any supplier's future policy in advance, namely when this policy infringed the law and thus such conduct could not establish an agreement.²⁹⁰ On appeal,²⁹¹ the CJEU upheld the General Court's judgment; however, it did not agree that future measures of a supplier had to be foreseen by the dealership agreement. It further stated that the clauses of the dealership agreement had to be examined to determine whether they authorised RPM.²⁹²

²⁸⁶ Commission Decisions – after notification system was changed – parallel import: 2006/431/EC, *Automobiles Peugeot SA and Peugeot Nederland NV* (Cases COMP / E2 / 36623, 36820 and 37275), OJ 2006 L173/20; 2006/895/EC, *Souris-Topps* (Case No COMP / C-3 / 37.980), OJ 2006 L353/5;

Commission Decisions – during the notification – parallel import: 2002/758/EC, Case COMP / 36.264, *Mercedes-Benz*, OJ 2002 L257/1; Commission Decision C(2001)1202 (Cases IV/36.957/F3 Glaxo Wellcome, IV/36.997/F3 Aseprofar and Fedifar, IV/37.121/F3 Spain Pharma, IV/37.138/F3 BAI and IV/37.380/F3 EAEPIC); 2002/190/EC, COMP.F.1 / 35.918 - *JCB*, OJ 2002 L69/1; 2001/135/EC, COMP / F.1 / 36.516 - *Nathan-Bricolux*, OJ 2001 L54/1;

Commission Decision – other: 2001/711/EC: COMP / F-2 / 36.693 - *Volkswagen*, OJ 2001 L262/14.

²⁸⁷ See Jedlickova McCabe, "Boundaries".

²⁸⁸ T-41/96, *Bayer AG v Commission of the European Communities* [2000] E.C.R. II-3383, appealed C-2/01 P, C-3/01 P, *Bundesverband der Arzneimittel-Importeure EC and Commission v Bayer AG* [2004] ECR I-23 .

²⁸⁹ T-208/01 *Volkswagen AG v. Commission* [2003] ECR II-5141.

²⁹⁰ *Ibid.*, paragraphs 39, 43.

²⁹¹ C-74/04 P, *Commission v Volkswagen* [2006] ECR I-6585.

²⁹² *Ibid.*, paragraphs 45, 48.

In the case of *Peugeot Nederland*,²⁹³ the General Court confirmed that proof of a tacit acquiescence in relation to given unilateral behaviour was the minimum standard for establishing an agreement under Article 101(1). The General Court further highlighted that the restrictions of passive sales and parallel trade of the agreements in question constituted an infringement by object under Article 101(1) TFEU. Proof of the absence of anti-competitive effects is not relevant in the rebuttal to the existence of an infringement by object. However, the actual impact of the infringement on the market is relevant, particularly where this could be measured to assess the gravity of that infringement.²⁹⁴ Finally, the General Court approved the Commission's characterisation of the restrictions of passive sales and parallel trade as very serious infringements of EU competition rules since it, *inter alia*, contradicted the internal market as one of the most fundamental objectives of the EU (that time, EC).²⁹⁵

The case of *GSK*²⁹⁶ shows that interbrand competition must be included in the analysis of vertical restraint cases. This is a significant change since *Consten & Grundig* and reflects the importance of the economic approach.²⁹⁷ The General Court's tolerant approach towards parallel trade in the pharmaceutical sector is obvious here.²⁹⁸ It stated that GSK's dual pricing did not have its object in the prevention, restriction or distortion of competition.²⁹⁹ Although this case introduced a few changes, most notably that the infringement of a vertical restriction cannot be assumed from the nature of multilateral conduct,³⁰⁰ in the appeal, the CJEU retained the traditional view.³⁰¹ The CJEU endorsed the General Court's ruling that the Commission had not properly examined GSK's arguments for exemption under Article 101(3). However, it overturned the General Court's finding that multilateral conduct could infringe Article 101(1) by its object only when it clearly harmed consumers. The CJEU clarified that any vertical agreement restricting parallel trade is restrictive by object.³⁰² Similarly, any unilateral conduct that intends to

²⁹³ T-450/05, *Automobiles Peugeot SA, Peugeot Nederland NV v. Commission*, [2009].

²⁹⁴ *Peugeot Nederland*, paragraphs 22, 43-141.

²⁹⁵ Paragraph 281; see also paragraph 1A of the 1998 Fines Guidelines.

²⁹⁶ T-168/01, *GlaxoSmithKline v. Commission*, [2006] ECR II-2969 ("GSK"); appeal: C-501/06 P, C-513/06 P, C-515/06 P, C-519/06 P, *GlaxoSmithKline Services Unlimited v Commission of the EC* [2009] 4 CMLR 2.

²⁹⁷ See below.

²⁹⁸ Also see C-53/03, *Synetairismos Farmakopoion Aitolias & Akarnanias and Others v GlaxoSmithKline plc and GlaxoSmithKline AEVES ("Syfait")*, [2005] ECR I-4609.

²⁹⁹ *GSK*, paragraph 118.

³⁰⁰ Similarly stated in a horizontal restriction General Court's case of T-328/03, *O2, T-Mobile v EC Commission* [2006].

³⁰¹ C-501/06 P, C-513/06 P, C-515/06 P, C-519/06 P, *GlaxoSmithKline Services Unlimited v Commission of the EC* [2009] 4 CMLR 2 ("GSK appeal").

³⁰² *GSK* appeal, paragraphs 62-64.

prevent parallel trade in the pharmaceutical sector can infringe Article 102 TFEU if it eliminates effective competition.³⁰³

Significantly, the CJEU's ruling in *GSK* clarified that restriction by object could require an economic evaluation. The object is measured by an objective standard. Furthermore, the intention of parties is not an essential factor and the restrictive intention itself is not illegal but can be taken into account.³⁰⁴ This approach was also confirmed in the case of *T-Mobile Netherlands*, which dealt with a horizontal restriction.³⁰⁵

In the case of *CISAC*,³⁰⁶ the Commission found the common practice of bundling the copyrights and not allowing even online and broadcasting distribution among entities in different Member States to be an illegal territorial concerted practice. In the merger case of *Yamaha*,³⁰⁷ the Commission stated that an obligation on the part of the distributors to contact the producer if the distributors wished to export *via* the internet formed an illegal territorial restriction.

In the case of *Nintendo*,³⁰⁸ the Commission fined Nintendo a large amount for a vertical infringement, €167,8 million for Nintendo and seven of its European distributors, which gave Nintendo itself a fine of €149.128 million. The Commission found evidence of practices to block parallel trade from low-priced to high-priced territories or Member States. Exclusive distributions were replaced by absolute territorial protections and all competition was eliminated in each territory.

The case on preliminary ruling, *Pedro IV*,³⁰⁹ included recommended retail prices. The CJEU stated that having a supplier fix a distribution margin restricts competition.³¹⁰ With

³⁰³ C-468/06, C-476/06 *Lelos kai Sia EE v GlaxoSmithKline AVEE Farmakeftikon Proionton* [2008] ECR I-7139, [2008] 5 CMLR 20.

³⁰⁴ *GSK* appeal, paragraphs 55-66, 72.

³⁰⁵ C-8/08 *T-Mobile Netherlands BV v Raad van Bestuur van de Nederlandse Mededingingsautoriteit* [2009] 5 CMLR 11, at 27; also see C-209/07 *Competition Authority v. Beef Industry Development Society and Barry Brothers Meats Ltd.*, [2008] ECR I-8637.

³⁰⁶ Decision of 16 July 2008 relating to a proceeding under Article 101 of the TFEU and Article 53 of the EEA Agreement, COMP/C-2/36.698-*CISAC* [2008] OJ C323/12.

³⁰⁷ IP/03/1028.

³⁰⁸ Commission Decision 2003/675/EC of 30 October 2002: COMP / 35.587 PO Video Games, COMP / 35.706 PO Nintendo Distribution and COMP / 36.321 Omega – Nintendo, [2003] OJ L255/33.

³⁰⁹ C-260/07, 02/04/2009, *Pedro IV Servicios v Total Espana*, [2009] ECR I-2437.

³¹⁰ *Pedro IV*, paragraphs 76-78.

respect to price recommendation, the CJEU concluded that the national court must determine whether the price was fixed in reality.³¹¹

The case of *Daimler Chrysler*³¹² was the first case of its type after the Guidelines 1999 framed the application of competition rules on agency agreements. It showed that a genuine agency could be responsible for some forms of risk. The General Court stated that an agency was not genuine if it carried similar obligations and rights as an independent undertaking, and that it was economically independent if the principal did not bear all of the risks associated with the contract negotiated on the principal's behalf and the agent was not an auxiliary integrated into the principal's business.³¹³ The General Court concluded that the agents had no actual authority to sell vehicles to customers directly, they were not able to conclude the final terms of the contract or set the price of the sale, nor could they tie the principal to discounts or rebates without its consent. Such facts would show that the agencies were acting on behalf of the principal.³¹⁴

5.6.2.1. VTR - Parallel Trade

A) *Nintendo*³¹⁵

Nintendo, a Japanese manufacturer, had exclusive distributors in Europe: The Games Ltd in Ireland and the UK; Concentra ...SA in Portugal; Linea GIG SpA in Italy; Bergsaia AB in Sweden; Itochu Hellas EPE (1991-1997) and Nortec AE (since 1997) in Greece; and subsidiaries of CD-Contract Data GmbH in Belgium, in Luxembourg and in the Netherlands.³¹⁶ Nintendo competed with two other Japanese companies, Sony and Sega, in the relevant market in 1997. In 1997, Nintendo had € 2 990 million worldwide turnover, Sony had € 3 001 million and Sega had € 820 million³¹⁷

³¹¹ Ibid., paragraph 80.

³¹² T-325/01 *Daimler Chrysler AG v. Commission*, [2007] 4 CMLR 15.

³¹³ *Daimler Chrysler*, paragraph 87.

³¹⁴ Ibid., paragraphs 93-96.

³¹⁵ Commission Decision 2003/675/EC of 30 October 2002: COMP/35.587 PO Video Games, COMP/35.706 PO Nintendo Distribution and COMP/36.321 Omega – Nintendo, [2003] OJ L255/33.

³¹⁶ *Nintendo*, Chapter 1.1.

³¹⁷ *Nintendo*, paragraphs 69-70.

In 1996, Omega Electro BV, a company registered in the Netherlands, lodged a complaint that Nintendo had hindered parallel trade (territorial restriction) and maintained resale prices in the Netherlands.³¹⁸

1) Relevant Market

The Commission determined that the relevant product market involved game consoles and video games or games cartridges which were not substitutable with static game consoles or hand-held consoles because of differing user needs.³¹⁹ The geographical market was worldwide, covering, therefore, the whole EEA. However, it was divided into sections depending on different standards of TV sets in different Member States.³²⁰ The prices of Nintendo's products differed as a result of a limitation of parallel trade, not because of the existence of different geographical markets.³²¹

2) Parallel Import

The prices of Nintendo products were low in the UK, with prices between 20-31% higher for game consoles and 4-65% higher for game cartridges in Germany than in the UK. Prices were also higher in other Member States,³²² which resulted in parallel imports in 1994.³²³

Nintendo sent letters to its distributors asking them not to sell to undertakings that intended to or were known to export products. Nintendo also threatened distributors in a letter stating that if parallel imports remained they would cease the parallel import "with all measurements possible immediately". Another letter included detailed rules for limiting parallel trade and for coordination.³²⁴ Despite these measures, interests in parallel trade remained.³²⁵

³¹⁸ *Nintendo*, Chapter 1.1.3.

³¹⁹ *Nintendo*, Chapter 1.2.

³²⁰ *Nintendo*, Chapter 1.3.1.

³²¹ *Nintendo*, Chapter 1.3.2.

³²² *Nintendo*, paragraph 116.

³²³ *Ibid.*, paragraphs 104-106.

³²⁴ *Ibid.*, paragraphs 104-106.

³²⁵ *Ibid.*, paragraph 116.

Nintendo boycotted the business of The Games because it had not been completely successful in its limitation of parallel trade.³²⁶ As a response, The Games took actions to stop selling to parties who were exporting the products, referring to the main distribution agreement with Nintendo. Due to The Games' arrangements, parallel trading significantly reduced during 1996.³²⁷

The Games actively continued the collaboration on limiting parallel exports. Simultaneously, The Games also expected Nintendo to take action to eliminate any parallel imports to the UK.³²⁸ Nintendo set its policy to exclude parallel exports and imports from Spain. It also had an arrangement with its distributor in the Netherlands to limit parallel exports and imports, and also implemented different methods in other Member States to monitor parallel imports and exports.³²⁹ The Commission concluded that not even passive exports were allowed and that this conduct had an impact on prices.³³⁰

3) Multilateral Conduct

The Games argued that its actions towards its distributors (customers) were unilateral and not multilateral.³³¹ According to the Commission, the multilateral actions were based on a written understanding between The Games and its customers that the customers would not export the products and/or resell them for export but would sell them only to UK final customers.³³² When looking at intentions, the distributors wanted to export, The Games announced its own policy and pressured them to comply, thus the obvious question that arises is whether this action can really be classified as an agreement between The Games and its distributors?³³³

According to the Commission, all of the actions in question were a combination of agreements and concerted practices forming a single and continuous infringement between the producer and its exclusive distributors and others.³³⁴

³²⁶ Ibid., paragraphs 119-131.

³²⁷ Ibid., paragraphs 132-141.

³²⁸ Ibid., paragraphs 143-160.

³²⁹ Ibid., paragraphs 170-229, 230-236.

³³⁰ Ibid., paragraph 168.

³³¹ Ibid., paragraph 306.

³³² Ibid., paragraph 283.

³³³ See Jedlickova McCabe, "Boundaries"; see discussions below; see Chapter 6 "Theories of Pro-Competitiveness v. Anti-Competitiveness".

³³⁴ *Nintendo*, paragraphs 261-286.

The participants, including the exclusive distributors, were aware of the participation of others. This is based on several pieces of evidence.³³⁵ Similar to this case, after the *Colgate* doctrine had been introduced in the US, the Supreme Court ruled in *Parke, Davis* that anything going beyond an announcement of retail prices and a refusal to supply to distributors who had not followed the price policy was multilateral conduct.³³⁶ Although, in contrary to the US cases in question, *Nintendo* was based on VTR, both the US and the EU cases involved combinations which went beyond the mere refusal to sell and which included further communication and actions in mutual agreements and were thus multilateral conducts.

The Commission even expressed its opinion that acting likewise, in other words by following the manufacturer's policy, the distributors confirmed the existence of multilateral conduct.³³⁷ However, such an assumption could contradict the *Colgate* doctrine and, therefore, the US Supreme Court could explain this aspect differently: as the application of unilateral conduct rather than multilateral conduct.³³⁸ Nevertheless, the case of *Nintendo* included further actions that prove the existence of a combination, such as letters and a mutual expectation of actions, and, hence, in accordance with *Parke, Davis* could be interpreted in the same way in the US.³³⁹

4) Restriction of Competition – Territorial Protection

The object of the agreements and/or concerted practices in question restricted competition and formed an infringement within the meaning of Article 101(1) as it established absolute territorial protection eliminating even passive sales. Due to the existence of an illegal object, the Commission stated that the effects upon competition did not have to be determined.³⁴⁰ Nevertheless, the Commission listed examples where the anti-competitive effect occurred in the form of hindering parallel trade.³⁴¹

When applying Article 101(3), the Commission simply stated that the actions in question did not qualify for an exemption because exclusive territorial protection constitutes a hard

³³⁵ Ibid., paragraphs 288-296.

³³⁶ *Parke, Davis*, at 43-46.

³³⁷ *Nintendo*, paragraph 289.

³³⁸ *Parke, Davis*, at 38-46; *Bausch & Lomb*, 723; *Colgate*, at 305-306; see Chapter 4 “Development of the US Law of Vertical Territorial and Price Restraints”.

³³⁹ See *Nintendo*, paragraphs 116-131, 143-160

³⁴⁰ Ibid., paragraphs 331-332.

³⁴¹ Ibid., paragraph 333.

core restriction and the actions did not improve the distribution of the products, nor did the consumers benefit from them.³⁴²

Nintendo appealed to the General Court regarding just the fine itself, which the court reduced to a total amount of € 119.2425 million.³⁴³ One distributor, CD-Contact Data GmbH (currently, Activision Blizzard Germany, GmbH), appealed claiming an insufficiency of evidence that it was involved in this illegal collusion constituting restrictive agreements and/or concerted practices.³⁴⁴ Although, CJEU disagreed with some evidential aspects of the Commission's decision, it generally approved the Commission's findings of the existence of a concurrence of wills.³⁴⁵

Nevertheless, if the applied parties had based their claims for appeals on similar reasons as the parties had done in *GSK*, one would have to ask the question as to what the ruling of the General Court and the CJEU would have been.³⁴⁶ Applying the CJEU's ruling, the CJEU would probably have confirmed the restriction of competition in object.³⁴⁷ However, applying the test on Article 101(3), both the CJEU and the General Court would have not been satisfied with the Commission's application of Article 101(3) if The Games and Nintendo had introduced a possible justification during the Commission's proceedings.³⁴⁸

B) *Bayer*³⁴⁹

The case of *Bayer* followed by *Volkswagen* started the process of gradually challenging the Commission's broad and highly flexible view on the term "agreement", including the term "concerted practice".

The applicant, Bayer AG, was a pharmaceutical company selling a product "Adalat". Bayer AG sold to all Member States via subsidiaries who sold the product to wholesalers. The price of pharmaceutical products, including Adalat, was directly or indirectly fixed by

³⁴² *Ibid.*, paragraph 341.

³⁴³ Case T-13/03 *Nintendo Co., Ltd and Nintendo of Europe GmbH v Commission of the EC* [2009] ECR II-00947, paragraph 215.

³⁴⁴ Case T-18/03, *CD-Contact Data GmbH v European Commission* [2009] ECR II-1021 ("*CD-Contact*"); appealed to the CJEU: C-260/09 *Activision Blizzard Germany GmbH v European Commission* [2011] ("*Activision*").

³⁴⁵ *Activision*; paragraphs 33-40, 50-58, 70-87 (*CD-Contact*, paragraphs 55-68).

³⁴⁶ See below the analysis of *GSK*.

³⁴⁷ Compare with *GSK* appeal, paragraphs 55-66.

³⁴⁸ Compare with *GSK* paragraphs 248, 294.

³⁴⁹ C-2/01 P and C-3/01 P *Bundesverband der Arzneimittel-Importeure EC and Commission v Bayer AG* [2004] ECR I-00023 ("*Bayer* appeal"); T-41/96, *Bayer v Commission* [2000] ECR II-3383 ("*Bayer*").

the national health authorities in many Member States, which led to different prices. The price of Adalat was 40% more expensive in the UK than in Spain and France between 1989 and 1993. Thus, French and Spanish wholesalers were re-exporting the product to the UK. Bayer AG introduced its new policy based on quotas to stop the re-exporting of Adalat. Bayer AG supplied its distributors with Adalat in amounts that did not exceed the demand on domestic markets. Prior to this policy, Bayer had supplied distributors at their request.³⁵⁰

1) Multilateral v Unilateral Conduct

The CJEU highlighted that it only has jurisdiction over points of law not points of facts.³⁵¹ It confirmed that the General Court correctly noted, from the documents provided by the Commission, that certain wholesalers had pretended that the demand for Adalat destined for the national market had increased. Based on this fact, the Court argued that this contradicted the fact that these wholesalers had acquiesced with Bayer's policy.³⁵²

The General Court claimed that the alleged intention of Bayer to impose an export ban had not been proved by the Commission.³⁵³ The General Court held that the absence of a monitoring system and a non-demonstration of threats and penalties were two relevant aspects in deciding the existence of an agreement between the wholesalers and Bayer. The CJEU agreed with these findings.³⁵⁴

Parties must express "their common intention to conduct themselves on the market in a specific way".³⁵⁵ The General Court examined the intention of the wholesalers, which did not correspond with the ban on parallel export, and concluded that Bayer's new policy could not have constituted an agreement.³⁵⁶ However, the CJEU argued that it was not necessary for the interests of the parties to correspond:

[A]n agreement exists within the meaning of Article [101(1)] of the Treaty, even if one of the parties to that agreement is forced to conclude it against its own wishes.³⁵⁷

³⁵⁰ *Bayer* appeal, paragraphs 2-4.

³⁵¹ *Ibid.*, paragraph 47.

³⁵² *Ibid.*, paragraphs 54-56.

³⁵³ *Bayer*, paragraphs 126-129, 148, 183.

³⁵⁴ *Bayer* appeal, paragraphs 83,89; *Bayer*, paragraphs 108-109, 119.

³⁵⁵ *Bayer* appeal, paragraph 97.

³⁵⁶ *Bayer*, paragraphs 126-129, 148,183.

³⁵⁷ *Bayer* appeal, paragraph 114.

The CJEU explained that the General Court merely stated that for an agreement to exist there had to be an intention of both parties to conduct themselves in a specific way.³⁵⁸ It is questionable whether the CJEU's understanding of the intentions of all parties to act in a certain way, based on threats, does not contradict the General Court's ruling, as well as the British national contract law's recently-established doctrine of economic duress.³⁵⁹ Although the UK doctrine of economic duress is relatively new and is still developing, the idea of the unfairness of such arrangements on the side of an economically weaker party is not new. This had already been recognised by the Court in the UK in the case of *Rogers v. Parry*³⁶⁰ in 1963, when the Court stated that an unreasonable bond was probably enforced against a weaker party when this party, a joiner, promised not to trade from its home for 21 years.³⁶¹ Nevertheless, the General Court refused justification based on under-duress doctrine in *Tréfileurope*.³⁶²

The CJEU further interpreted the General Court's ruling in the following way. Firstly, the General Court refused to accept that there had been a tacit acceptance of the ban on exports, as the Commission had not sufficiently established in law that such a ban was imposed or that the medicines were supplied only with the condition of not exporting them.³⁶³ However, one could argue that imposing the ban and/or supplying a product with a condition is still part of an offer and not an acceptance. Moreover, it is not clear whether the General Court analysed these options as part of an acceptance.³⁶⁴

Secondly, the Court of Justice stated that, as the existence of the ban was not proved, the General Court examined whether the parties had intended to prevent parallel trade. Thus, the General Court was correct when determining the genuine wishes of the parties.³⁶⁵ The strategy of the wholesalers who pretended that they needed a higher supply for their

³⁵⁸ *Ibid.*, paragraph 118.

³⁵⁹ For instance, *Universe Tankships Inc of Monrovia v International Transport Workers Federation (The Universe Sentinel)*, [1983] 1 A.C. 366, [1982] 2 W.L.R. 803, [1982] I.C.R. 262; also see UNIDROIT Principles 2010, Article 3.9 ("Threat") and Article 3.10; the CJEU's ruling would be in accordance with Czech commercial contract law: Czech Commercial Codex - Zákon č. 513/1991 Sb., podle platného znění, § 267/2.

³⁶⁰ *Rogers v. Parry*, 79 E.R. 278, (1613) Cro. Jac. 326.

³⁶¹ Compare with early development: *Broad v. Jollyfe*, 9 E.R. 509, (1619) Cro. Jac. 596; *Mitchell v. Reynolds*, 24 E.R. 347, (1711) 1 P. Wms. 181; *Roussillon v. Roussillon* (1880) 14 Ch. D. 351; *Mason v. The Provident Supply and Clothing Co.* [1913] AC 724.

³⁶² Case T-141/89 *Tréfileurope v. Commission* [1995] ECR II-791, paragraph 58.

³⁶³ *Bayer* appeal, paragraph 119.

³⁶⁴ Compare with *Bayer*, paragraphs, 126-129, 148, 173.

³⁶⁵ *Bayer* appeal, paragraph 121.

national market to turn Bayer's policy to their advantage confirms that there was no existence of the meeting of the minds.³⁶⁶

5.6.2.2. RPM

A) *Volkswagen*³⁶⁷

In this case, Volkswagen, a manufacturer of motor vehicles, sold its products through a selective, exclusive distribution system on the basis of dealership agreements with its dealers, where the dealers agreed to comply with Volkswagen's future instructions on recommended retail prices and discounts.³⁶⁸ The Commission ruled that Volkswagen had infringed Article 101(1) by setting retail prices of the VW Passat.³⁶⁹ The Commission's decision was annulled by the General Court and the Commission appealed to the CJEU.³⁷⁰

1) Multilateral v Unilateral Conduct

The Commission claimed that the calls and letters from Volkswagen to their German distributors announcing fixed resale prices for the Volkswagen Passat model had formed part of a dealership agreement. According to the Commission, the distributors agreed with the new Volkswagen policy to fix the price in advance on the signing of the dealership agreement.³⁷¹

Colino argues that both courts interpreted this conduct based on letters and calls sent and made by the manufacturer to its distributors as unilateral because it lacked distributor acceptance, as the distributors "were not considered to be in a solid bargaining position *vis a vis* the manufacturer".³⁷² Although, both courts ruled that the Commission had not sufficiently established the existence of a concurrence of wills as an important aspect of Article 101(1), they did not base the non-existence of the agreement or one aspect of it, the acceptance, on bargaining position but rather on knowledge of the offer. Although, bargaining power should be an important aspect of the law of vertical restraints, as

³⁶⁶ *Ibid.*, paragraph 123.

³⁶⁷ T-208/01 *Volkswagen AG v. Commission* [2003] ECR II-5141 ("*Volkswagen*"); appeal C-74/04 P *Commission v. Volkswagen AG* [2006] ECR I-06585 ("*Volkswagen appeal*").

³⁶⁸ *Volkswagen appeal*, paragraphs 3-4.

³⁶⁹ *Volkswagen*, paragraph 10.

³⁷⁰ *Volkswagen appeal*, paragraph 1.

³⁷¹ *Ibid.*, paragraph 16.

³⁷² Marco Colino, *EU and US Regimes*, 95.

discussed in Chapter 3 “Vertical Competition and Structure”, it was not an important element in both courts’ rulings when determining the non-existence of the agreement.

The General Court rejected the Commission's claim that this conduct had been part of the main dealership agreement because the distributors had agreed in advance to adhere to it. The General Court ruled that the existence of an agreement had to be established with a concurrence of wills, which required knowledge of the conduct that the parties should have agreed on at the time the agreement was concluded.³⁷³ The dealers cannot sign in advance a variation that they cannot foresee or which they could not refuse. This illegal act could not be foreseen by dealers and therefore they cannot agree to it in advance.³⁷⁴

The General Court, citing its judgment in *Bayer*, stressed the importance of the existence of a concurrence of wills between at least two parties based on a “faithful expression of the parties’ intention.”³⁷⁵ It distinguished this from genuine unilateral conducts.³⁷⁶

The General Court explained that an unlawful contractual variation could not be lawfully accepted in advance in a distribution agreement.³⁷⁷ Therefore, the mere fact that the distributors signed distribution agreements agreeing with manufacturer’s unknown future policy does not constitute a concurrence of wills with regards to anti-competitive measures.³⁷⁸ The concurrence of wills can only be based on conduct known to the parties when they accept it.³⁷⁹

The CJEU confirmed the necessity of proving a concurrence of wills of at least two parties.³⁸⁰ This can be in a form of a clause of an agreement or other conducts of parties, for instance, tacit acquiescence by a distributor during a telephone call.³⁸¹

The Commission argued that, according to previous case law, the parties concerned had indeed concluded agreements.³⁸² It claimed that the concurrence of wills existed merely

³⁷³ *Volkswagen*, paragraph 36.

³⁷⁴ *Volkswagen* appeal , paragraph 17, 18; *Volkswagen*, paragraphs 39, 43

³⁷⁵ *Volkswagen* appeal , paragraph 12.

³⁷⁶ *Ibid.*, paragraph 14.

³⁷⁷ *Volkswagen* appeal, paragraph 18; *Volkswagen*, paragraph 45.

³⁷⁸ *Volkswagen* appeal, paragraph 20.

³⁷⁹ *Ibid.*, paragraph 21.

³⁸⁰ *Ibid.*, paragraph 37.

³⁸¹ *Ibid.*, paragraph 39.

³⁸² *Volkswagen* appeal , paragraphs 28-30 (The Commission refers to the cases: *AEG-Telefunken*, paragraph 38; *Ford*, paragraph 21; C-2/01 P and C-3/01 P *BAI and Commission v Bayer* [2004] ECR 123, paragr.144;

because of the existence of the clauses in question.³⁸³ The CJEU stated that this was not sufficient; there must be another aspect to claim that dealers agreed with the specific conduct in question.³⁸⁴

The General Court found that the clauses of the agreement in question could not have authorised Volkswagen to maintain retail prices and, therefore, this did not constitute an agreement.³⁸⁵ The CJEU explained that it was not in its jurisdiction to find and assess facts but merely to review legal characterisation and conclusions of those facts under Article 256 TFEU.³⁸⁶ Therefore, the CJEU did not analyse whether the distribution agreements in question were drafted in neutral terms, thus avoiding an understanding of future binding prices and confirming the conclusion of the General Court.³⁸⁷

Finally, the Court found an error of law in the ruling that the agreement in question did not authorise calls, which is contrary to Article 101(1). However, the Court also stated that such an error did not affect the rightness of the conclusion that the contested decision should be annulled.³⁸⁸

In 2009, due to the public response to the proposed Regulation and Guidelines, the European Federation of Pharmaceutical Industries and Associations (“EFPIA”) criticised the Commission’s proposal for aspects that constitute an agreement, in other words, the concurrence of wills or joint intention.³⁸⁹ The Commission recognised two forms of acquiescence to constitute an agreement.

Firstly, a distribution agreement can authorise the supplier to set future policy, for which the Commission referred to the CJEU’s case of *Volkswagen*. EFPIA objected that in its decision, while the CJEU explained that this on its own does not have to constitute a concurrence of wills but all relevant factors must be taken into account.³⁹⁰ However, the CJEU did not deny the possibility of the authorisation of the producer to introduce a binding future policy merely based on the main distribution agreement. This option is left

Bayerische Motorenwerke, paragraphs 15 and 16; case C-338/00 P *Volkswagen v Commission* [2003] ECR I9189, paragraph 60.).

³⁸³ *Volkswagen* appeal, paragraph 40.

³⁸⁴ *Volkswagen* appeal, paragraph 47; *Volkswagen*, paragraphs 62-68.

³⁸⁵ *Volkswagen* appeal, paragraph 52.

³⁸⁶ *Ibid.*, paragraph 49.

³⁸⁷ *Ibid.*, paragraph 53.

³⁸⁸ *Ibid.*, paragraphs 53-55.

³⁸⁹ Pharmaceutical Industries, “The Proposal”, 3.

³⁹⁰ *Ibid.*

open and must be determined on a case-by-case basis.³⁹¹ It is arguable whether the General Court ruled the same as it clearly stated that a clause which included unforeseeable future policy did not constitute an agreement on this future policy.³⁹² However, the clauses in question expressly included possible future policy on recommended prices, but not on price fixing. Therefore, the question is whether the General Court would have ruled the same if the clauses in question had been general and had simply stated that distributors had agreed with any of the manufacturer's future policies.

Nevertheless, as the CJEU did not qualify this as an error in law, it must be concluded that only a clause in the main agreement which includes a foreseeable future policy could constitute an illegal agreement if applied for illegal restriction, this is also seen in the wording used in Guidelines.³⁹³ However, the question as to what constitutes "foreseeable policy" or, in other words and under the ruling of the CJEU, what the term "neutral clause" means remains open. Future cases could specify this matter.

Secondly, the Guidelines explain that an agreement exists if one party requires the explicit or implicit cooperation of a downstream or upstream party to implement its unilateral policy and if the second party cooperates without finding different means to engage in the original situation, for instance, in parallel trade. This, according to the Commission, also included cases when unilateral policy is imposed on the other party with the assistance of a system of penalties and monitoring. Here, the Commission referred to the CJEU's case of *Bayer*. EFPIA and AMCHAM EU disagreed. As EFPIA argued, the CJEU stated in *Bayer* that the system of penalties and monitoring did not itself constitute an agreement but it could be an indicator of its existence.³⁹⁴ However, the Guidelines do not expressly state that the introduced policy, the system of penalties and monitoring on their own constitute an agreement; however, one could understand it in the same way as EFPIA, as the Guidelines state in paragraph 25 "...points to tacit acquiescence".

The US cases do not involve a vertical restraint case which would be based on a clause on a future policy such as *Volkswagen* and *Ford*. The second example is also questionable under the US case law as a mere announcement of policy and its following could be unilateral conduct according to the *Colgate* doctrine. However, if such conduct involves

³⁹¹ Compare with *Volkswagen* appeal, paragraph 53.

³⁹² Compare *Volkswagen*, paragraphs 36, 39, 43.

³⁹³ Paragraph 25 (a) "...a specific unilateral policy..."

Pharmaceutical Industries "The Proposal" 3-4; see AMCHAM EU "AMCHAM EU Response" 5; compare with *Bayer* appeal, paragraphs 83, 85.

monitoring systems, the US courts would probably find such conduct multilateral.³⁹⁵ In *Bayer*, the Commission's decision was dismissed because not even the existence of an offer or of an explicit introduction of the restrictive policy had been proved.³⁹⁶

Dethmers, Posthuma de Boer, Ablasser-Neuhuber and Plank argue that the meaning of the term "agreement" is too broad and that the Commission concentrated too much on the definition and proving its existence in vertical, parallel trade restriction cases rather than evaluating the pro-competitive and anti-competitive effects in each case.³⁹⁷ Although the second statement can appear to be true, this is partially a consequence of recent annulments and dismissals of the Commission's understanding of this term by the EU Courts, which have resulted in a narrowing of this understanding. Therefore, the first statement is partially arguable, although this concentration is clearly obvious when analysing cases on vertical restraints.

Finally, with respect to the wording of the Guidelines, in both instances the Commission used the term "unilateral policy" which is imposed upon a second party, implemented by the first party or agreed to in advance without the exact knowledge of the content. In reality, are these examples of joint intentions or simply the intentions of one party with the second party going along with these intentions so as not to lose a contract with the first party?³⁹⁸ And, therefore, is it in accordance with morality and justice that both parties are liable and potentially punished? Indeed, this doctrine of multilateral conduct appears to be established to capture different conducts under Article 101(1) without reflecting the real nature of vertical arrangements.³⁹⁹

B) *GSK*⁴⁰⁰

This case reflects the importance of economic analysis, including market structure and interbrand competition, and summarises the approach that exists in the present day.

³⁹⁵ See *Leegin*, at 884; *Parke, Davis*, at 38-46; *Bausch & Lomb*, 723; *Colgate*, at 305-306.

³⁹⁶ See above; *Bayer* appeal, paragraphs 54-56, 80, 119.

³⁹⁷ F. Dethmers, Posthuma de Boer, "Ten Years on:" pp. 428-429, 432-433.

³⁹⁸ See Jedlickova McCabe, "Boundaries".

³⁹⁹ Further see Chapter 3 "Vertical Competition and Structure"; Chapter 6 "Theories of Pro-Competitiveness v. Anti-Competitiveness".

⁴⁰⁰ T-168/01 *GlaxoSmithKline Services Unlimited v Commission of the EC* [2006] ERC II-02969 ("*GSK*"); appeal C-501/06 P, C-513/06 P, C-515/06 P, C-519/06 P, *GlaxoSmithKline Services Unlimited v Commission of the EC* [2009] 4 CMLR 2 ("*GSK* appeal").

The applicant was an English company, GlaxoSmithKline Services Unlimited (“GSK”), who belonged to the GSK group, one of the world’s leading producers of pharmaceutical products. Glaxo Wellcome, SA (“GW”) was a Spanish subsidiary of the GSK group. It manufactured, developed and distributed medicines in Spain.⁴⁰¹

GW applied for an exemption for a document entitled “General Sales Conditions of Pharmaceutical Specialities Belonging to [GW] and its Subsidiaries to Authorised Wholesalers” (“Conditions”). The Conditions concerned 82 medicines intended for sale to wholesalers, who could be interested in exporting them primarily to the UK and other Member States, providing two different prices for home sale and export. The wholesalers were required to sign copies of the Conditions and return them to GW as proof of acceptance. Seventy-five wholesalers with sales accounting for more than 90% of the total GW sales in Spain signed the Conditions.⁴⁰²

The Commission’s decision stated that GW’s agreement infringed Article 101(1) by charging higher prices if the medicines were exported to other Member States.⁴⁰³

1) Relevant Market

The relevant market was divided into national markets due to different legislative conditions.⁴⁰⁴ The Commission did not determine the relevant market in details, as it believed that the mere existence of an anti-competitive object is enough to state that competition was restricted.⁴⁰⁵ The relevant product market was the medicine concerned and the medicines from other producers used for the same therapeutic purposes.⁴⁰⁶

2) Agreement

The Commission found that signed copies of the Conditions constituted an agreement between GW and the signed wholesalers.⁴⁰⁷ GW disagreed, arguing that this did not

⁴⁰¹ GSK appeal, paragraph 4; GSK, paragraphs 8-9.

⁴⁰² GSK appeal, paragraphs 5-8; GSK, paragraphs 10-14.

⁴⁰³ GSK appeal, paragraph 2; GSK, paragraphs 18-20.

⁴⁰⁴ GSK, paragraphs 148-151.

⁴⁰⁵ Ibid., paragraph 154.

⁴⁰⁶ Ibid., paragraph 159.

⁴⁰⁷ Ibid., paragraph 60.

constitute an agreement because a concurrence of wills to restrict competition was not manifested.⁴⁰⁸

The General Court examined the existence of the constitution of independent will and of a concurrence of will on the wholesale price of medicines.⁴⁰⁹ The Court stated that Spanish legislation did not maintain wholesale prices of medicines, thus setting wholesale prices outside the Spanish sickness scheme was within the scope of the undertakings.⁴¹⁰

With regards to the concurrence of wills, the General Court argued that the case file showed GW had adopted the Conditions as well as a system of setting prices. Seventy-five from eighty-nine wholesalers signed copies of the Conditions as requested by GW. In doing so they accepted the offer and an agreement with GW was formed.⁴¹¹

The General Court also observed that some wholesalers who signed the Conditions, “expressed doubts as to the legality of those conditions”; however, they did not withdraw from the agreement.⁴¹² Some wholesalers who signed the Conditions were members of associations who complained to the Commission about the Conditions. However, the General Court stated that this did not prove that all or some of the wholesalers did not intend to collude with GW.⁴¹³ Therefore, the concurrence of wills was manifested.⁴¹⁴

3) Restriction of Competition, Including Interbrand Competition and Consumer Welfare

The Commission argued that the Conditions had both the effect and the object of restricting competition in the form of limiting parallel trade.⁴¹⁵ However, the General Court analysed both interbrand and intrabrand competition. It observed that despite the allowed restriction on price competition based on national and EU legislations, there was competition among the producers of medicine, between producers and their distributors

⁴⁰⁸ Ibid., paragraphs 61-64.

⁴⁰⁹ Ibid., paragraph 65.

⁴¹⁰ Ibid., paragraphs 67, 72-73.

⁴¹¹ Ibid., paragraph 79.

⁴¹² Ibid., paragraph 87.

⁴¹³ Ibid., paragraph 88.

⁴¹⁴ Ibid., paragraph 89.

⁴¹⁵ Ibid., paragraphs 91-98.

and between parallel traders and national distributors. Therefore, GSK had no capability to eliminate competition altogether but it was able to restrict competition.⁴¹⁶

This was an obvious shift in the importance of interbrand competition when compared to the ruling in *Consten & Grundig*, where the CJEU simply stated that it was enough to show that intrabrand competition was restricted without surveying interbrand competition.⁴¹⁷ Although this shift more reflects the policy of the US, this current EU policy appears to be more accurate as it is not satisfied simply with an opinion that restrictions of intrabrand competition automatically increase interbrand competition, which is typified by the US case of *Sylvania* and repeated in the recent case of *Leegin*.⁴¹⁸

The General Court confirmed that GSK intended to limit the parallel trade between Spain and other Member States. The General Court argued that an action which intended to differentiate prices and restrict parallel trade had a restrictive object.⁴¹⁹ However, according to the General Court, the restriction on parallel trade on its own did not have its object in restricting competition. Even the existence of illegal object must be proved by analysis.⁴²⁰

The General Court criticised the Commission for not analysing the market in detail,⁴²¹ and for a random economic examination.⁴²² The General Court analysed the effect on competition and stated that Member States controlled the prices of medicines in different ways. This and the exchange rate caused the existence of different medicine prices in different Member States. These price differentiations caused parallel imports of medicines.⁴²³ Therefore, the General Court argued that the fact that exporting distributors were making less profit because of double pricing did not prove the restriction of competition.⁴²⁴ Nevertheless, it is true that the freedom of Spanish distributors was

⁴¹⁶ Ibid., paragraphs 104-108.

⁴¹⁷ *Consten & Grundig*, p. 342.

⁴¹⁸ Compare with *Leegin*, at 890; *Business Cards Tomorrow*, at 1205; *Sylvania*, at 51-52, 65.

⁴¹⁹ *GSK*, paragraphs 114-116.

⁴²⁰ Ibid., paragraphs 117-119.

⁴²¹ Ibid., paragraphs 133, 138.

⁴²² Ibid., paragraphs 275-277.

⁴²³ Ibid., paragraphs 125-129.

⁴²⁴ Ibid., paragraph 168.

affected.⁴²⁵ However, the restriction on the freedom of action of the undertakings, or of one of them, was not on its own prohibited under Article 101(1).⁴²⁶

The General Court stated that the objective of EU competition law is to protect consumer welfare, which could be decreased by the restrictive actions of undertakings. Therefore, for an action to be illegal, it must be proved that the restriction negatively affected final consumers.⁴²⁷

Although the Commission confirmed several times in its decision that the Conditions affected the welfare of consumers in terms of the supply of price by restricting parallel trade,⁴²⁸ the General Court concluded that the Conditions themselves and their object did not decrease the welfare of consumers. Thus, the text itself did not prove a restriction of competition. However, this does not mean that the welfare of consumers did not decrease in its effect. For that reason, the Court found it essential, when analysing the existence of an anti-competitive effect, to determine whether competition was restricted.⁴²⁹

The Commission applied Article 101(1)(d). The General Court stated that this Article prohibits agreements that apply dissimilar conditions to parties to equivalent transactions and, therefore, place them at a competitive disadvantage.⁴³⁰ As the Commission itself confirmed, the geographic market was each Member State as each Member State had different conditions based on its national rules.⁴³¹ The General Court argued that different prices applied because different markets already existed. Hence, GSK did not establish the different markets.⁴³²

The CJEU criticised the General Court's statements regarding the existence of the restrictive object.⁴³³ The CJEU disagreed with the General Court that an agreement can have the object of restricting competition only when the agreement was likely to lead to negative effects for consumers and it concluded that the case concerned, including the

⁴²⁵ *Ibid.*, paragraph 170.

⁴²⁶ *GSK*, paragraph 171; quoting *C-309/99 Wouters and Others* [2002] ECR I1557, paragraph 97; and *T-112/99 M6 and Others v Commission* [2001] ECR II2459, paragraph 76.

⁴²⁷ *GSK*, paragraphs 171-172.

⁴²⁸ *Ibid.*, paragraphs 118, 121.

⁴²⁹ *Ibid.*, paragraph 147.

⁴³⁰ *Ibid.*, paragraphs 174-175.

⁴³¹ *Ibid.*, paragraph 178.

⁴³² *Ibid.*, paragraph 179.

⁴³³ *GSK* appeal, paragraphs 41-43.

parallel trade, had its object in restricting competition.⁴³⁴ The aim of Article 101 TFEU was not just to protect consumers but to protect effective competition, which includes the protection of market structure.⁴³⁵

On the other hand, the General Court confirmed the Commission's finding of anti-competitive effects when the Commission stated that the Conditions also reduced the welfare of final consumers as they could not take advantage of the reduced cost and prices.⁴³⁶ The Commission found that in some Member States the patients paid for some medicines. In other Member States and when purchasing other medicines, however, the final consumer was part of the "the national sickness insurance scheme". The CJEU had already ruled that such social security institutions substituted the final consumers because they paid for medicines.⁴³⁷ The Commission also observed that some national sickness insurance schemes reflected in different ways whether the cost of medicines had decreased.⁴³⁸ The Conditions deprived consumers of advantages that would have existed if parallel export had not been limited and, thus, had an impact on intrabrand competition.⁴³⁹

4) Intrabrand v Interbrand Competition and Article 101(3) Analysis

The General Court argued that intrabrand loss must be compared with interbrand gain in competition, highlighting the leading role of interbrand competition rather than that of intrabrand competition.⁴⁴⁰ Competition increased with an increase in GSK's innovation.⁴⁴¹ Hence, the Court disagreed with the Commission's mere rejection of GSK's argument that parallel trade had prevented it from making profits, which were essential for innovation.⁴⁴² The Court missed a proper examination of this issue in the Commission's decision, which should have been based on balancing the advantages against the disadvantages of examined conduct.⁴⁴³

⁴³⁴ *GSK* appeal, paragraphs 55-64.

⁴³⁵ *GSK* appeal, paragraph 63, citing *C-8/08 T-Mobile Netherlands BV v Raad van bestuur van de Nederlandse Mededingingsautoriteit* [2009] 5 CMLR 11, paragraphs 38-39.

⁴³⁶ *GSK*, paragraph 182.

⁴³⁷ *GSK*, paragraph 184, citing *Case 238/82 Duphar and Others* [1984] ECR 523, paragraph 20.

⁴³⁸ *GSK*, paragraph 188.

⁴³⁹ *Ibid.*, paragraph 189.

⁴⁴⁰ *Ibid.*, paragraph 296.

⁴⁴¹ *Ibid.*, paragraph 297.

⁴⁴² *Ibid.*, paragraphs 300-301.

⁴⁴³ *Ibid.*, paragraphs 303-304, 306.

Therefore, the General Court concluded that the Commission could not rule that GSK did not demonstrate the promotion of technical progress under Article 101(3).⁴⁴⁴ Furthermore, as confirmed by the Commission, the real market power of GSK had not been estimated.⁴⁴⁵ Thus, the Commission could not conclude “that competition would be eliminated for a substantial part of the relevant products”.⁴⁴⁶ The Court annulled the part of the decision that stated that the Conditions did not fulfil the conditions for granting an exemption.⁴⁴⁷

The CJEU endorsed the General Court’s ruling on Article 101(3).⁴⁴⁸ Although the applicants had the burden of proof, the Commission did not evaluate the applicant’s arguments satisfactorily as the Commission rejected evidence without explanation or justification.⁴⁴⁹

GSK argued that parallel trade would lead to a loss of efficiency in the form of reduction of innovation.⁴⁵⁰ Furthermore, GSK claimed that the distribution system was improved by a reduction of delays in placing products on the market in some Member States and by a better allocation of GSK’s medicines for sale.⁴⁵¹

GSK based its argument on improvements in innovation and, thus, on an increase in efficiency.⁴⁵² The General Court explained that innovation was paid for by the final consumers who were prepared to pay more due to different prices in different states.⁴⁵³ The patent protected the prices of patented products; however, the price of medicines that were reimbursed by the national sickness insurance schemes were maintained by a price control or by a control of benefits. Therefore, the UK was more profitable for GSK and allowed innovation to be recuperated globally not just locally.⁴⁵⁴

The General Court ruled that it was enough for applicants to prove the likelihood of “appreciable objective advantages” which could compensate for the resulted

⁴⁴⁴ Ibid., paragraphs 308, 310.

⁴⁴⁵ Ibid., paragraph 312.

⁴⁴⁶ Ibid., paragraph 313.

⁴⁴⁷ *GSK*, paragraphs 316-317.

⁴⁴⁸ See *GSK* appeal, paragraphs 69-168.

⁴⁴⁹ *GSK* appeal, paragraphs 81-83.

⁴⁵⁰ *GSK*, paragraph 220.

⁴⁵¹ Ibid., paragraph 221.

⁴⁵² Ibid., paragraph 258-259.

⁴⁵³ Ibid., paragraph 271.

⁴⁵⁴ Ibid., paragraph 272.

disadvantages.⁴⁵⁵ The test showed whether the conduct in question made it possible to obtain appreciable advantages or not.⁴⁵⁶ This must be demonstrated with “a sufficient degree of probability” that the possibility of obtaining an appreciable objective advantage existed.⁴⁵⁷

The Commission criticised the General Court’s ruling that the advantage of the conduct in question was higher profits which promote innovation. It stated that there was no causal link between this advantage and the conduct itself, explaining that the conduct must promote technical progress such as innovation and not simply increase profits.⁴⁵⁸ However, the CJEU rejected this argument and affirmed the General Court’s conclusion that the advantage was that the increased profit could be dedicated to incremental innovation.⁴⁵⁹

5) Free Riding

The General Court further stated that free riding did not concern competition law when the profit was transferred from the producer to an intermediary. It would be of interest to competition law only if the free riding caused a decrease in consumer welfare. Moreover, as far as the intermediary participants in competition go, parallel trade was in the interest of competition law and its restrictions can have an anti-competitive effect.⁴⁶⁰

The importance of parallel trade in general was confirmed by the CJEU.⁴⁶¹ The approach to free riding in US antitrust law was different. In general, the US Federal Courts found free riding to be anti-competitive when it occurred in both VTR and RPM.⁴⁶²

6) Summary

The CJEU summarised the balancing test of Article 101(3) as established by the General Court as follows. Firstly, it must be shown that there was an appreciable objective advantage. Secondly, the Commission must analyse whether the conduct in question decreased efficiency. Thirdly, if efficiency was reduced, the Commission must analyse the

⁴⁵⁵ *GSK* appeal, paragraphs 92-95.

⁴⁵⁶ *Ibid.*, paragraph 94.

⁴⁵⁷ *Ibid.*, paragraph 95.

⁴⁵⁸ *Ibid.*, paragraph 112.

⁴⁵⁹ *Ibid.*, paragraphs 118-119.

⁴⁶⁰ *GSK*, paragraph 273.

⁴⁶¹ *GSK* appeal, paragraphs 59, 61.

⁴⁶² *Leegin*, at 890, 894; *Business Electronics*, at 721, 727-728; *Sylvania*, at 55-56; *Park & Sons* at 45.

extent to which it was reduced. And, lastly, the gain in efficiency must be analysed.⁴⁶³ The CJEU agreed with the General Court that the Commission erred when it did not consider the gain in efficiency of the conduct in question.⁴⁶⁴

As Kallaugher and Witbrecht conclude, the CJEU gave a clear message that parallel trade was also restrictive by its object; however, this does not necessarily establish any real economic harm. Article 101(3), with the analytical balance, applied in such cases.⁴⁶⁵

5.7. Application of Competition Law in RPM and VTR Cases

5.7.1. Application of Block Exemption

Article 101(1) of the TFEU explicitly prohibits forms of RPM in point (a) when it states that multilateral conducts are illegal if: “directly or indirectly fix purchase or selling prices or any other trading conditions”. It partly mentions territorial restrictions in point (c): “share markets or sources of supply”. When applying the legal positivism approach⁴⁶⁶ to this matter and considering the legal power of the TFEU, which is the primary source of EU law, it must be concluded that RPM is illegal unless the conduct concerned fulfils the terms and conditions of Article 101(3), in which case the conduct can be exempted and is considered to be legal.

In accordance with Article 101, the current Block Exemption Regulation, which is the secondary source of EU law, does not exempt sale (retail) price fixing, including minimum price fixing,⁴⁶⁷ and some forms of territorial restrictions, such as passive sales,⁴⁶⁸ which restrict competition in object.⁴⁶⁹ Having as their direct or indirect object such restraints, these forms of vertical restraints are so called “hard core restrictions” under Article 4 of Regulation, which assumes that hard core restrictions have actual or potential negative results to such an extent that fulfilment of the conditions of Article 101(3) is highly

⁴⁶³ *GSK*, paragraphs 263-303; *GSK* appeal, paragraph 128.

⁴⁶⁴ *GSK*, paragraphs 261-262; *GSK* appeal, paragraph 118, 131, 133, 156.

⁴⁶⁵ J. Kallaugher, A. Witbrecht, “Development under the Treaty on the Functioning of the European Union, Articles 101 and 102, in 2008/2009” (2010) Issue 8 *ECLR* p. 313.

⁴⁶⁶ EU law is based on *lex scripta* (written law); EU Courts do not have the power to change the rules of valid EU Treaties.

⁴⁶⁷ Regulation, Article 4(a).

⁴⁶⁸ Regulation, Article 4(b); but also see Regulation Articles 4(c), 4(d) and 4(e); Guidelines, paragraphs 48-64.

⁴⁶⁹ See cases *Volkswagen* appeal; *GSK* appeal, *Nintendo*; *Minière v. Maschinenbau*.

unlikely.⁴⁷⁰ Therefore, these restrictions remain on the “hard core” list.⁴⁷¹ Nevertheless, Article 101(3) of the TFEU applies in such cases too. Theoretically, hard core, as well as any other restrictions, can be exempted under this Article.⁴⁷²

Market power plays an important role in the EU law of vertical restraints.⁴⁷³ In cases other than hard core restrictions, the block exemption does not apply if the market share of one of the parties, a seller or a buyer, is higher than 30% as it is assumed that efficiency-enhancing effects outweigh any restrictive effects in such cases.⁴⁷⁴ If there is a decision by an association of retailers of goods, then the total annual turnover of each member must exceed € 50 million in order not to apply the block exemption.⁴⁷⁵ Market power below the aforementioned threshold and turnover create a so-called “safe harbour”.⁴⁷⁶ Although the law of vertical restraints should be focused on bargaining power rather than horizontal market power, as discussed in Chapter 3 “Vertical Competition and Structure”, EU policy leaves some space for such arguments as different market power on competition can prove its legality or illegality in individual cases.⁴⁷⁷ Additionally, the Commission or a national competition authority can decide that the block exemption does not apply in individual cases if the conditions of Article 101(1) are fulfilled but conditions of the Article 101(3) are not.⁴⁷⁸

As discussed previously, the block exemption does not apply to minimum price fixing and price fixing or to passive and other territorial restrictions.⁴⁷⁹ However, the block exemption still applies to maximum price setting, price recommendations and some forms of territorial restriction.⁴⁸⁰ VTR is a hard core restriction; however, the block exemption still applies in the case of:

1. Exclusive territory or customer policy, restrictions of active sales which do not include restrictions of customers;⁴⁸¹

⁴⁷⁰ Regulation, Preamble, paragraph 10; Guidelines, paragraphs 47, 223.

⁴⁷¹ “Antitrust: Commission adopts revised competition rules for vertical agreements: frequently asked questions”, MEMO/138, Brussels, 20 April 2010.

⁴⁷² Guidelines, paragraphs 47, 106-109, 223, 229; compare with Jones, “Left Behind?” 649-676; for further discussion see below.

⁴⁷³ Regulation, Preamble, paragraph 7; Guidelines, paragraphs 6, 23, 97, 99, 106, 110-111.

⁴⁷⁴ Regulation, Articles 3, 7, Preamble, paragraphs 7-9; Guidelines, paragraphs 23, 87-92, 110.

⁴⁷⁵ Regulation, Articles 2(2), Article 8.

⁴⁷⁶ Guidelines, paragraph 23.

⁴⁷⁷ See Guidelines, paragraphs 87-92.

⁴⁷⁸ Regulation, Preamble, paragraphs 13-16.

⁴⁷⁹ Regulation, Article 4; Guidelines, paragraphs 47-64.

⁴⁸⁰ Regulation, Articles 4(a), 4(b); Guidelines, paragraphs 4, 50-63.

⁴⁸¹ Regulation 4(b)(i); Guidelines, paragraph 55.

2. Restrictions of sales to end users by a buyer operating at the wholesale level of trade to keep the two levels of trade, wholesale and retail, separate;⁴⁸²
3. Selective distribution systems, restrictions of sales to unauthorised distributors within the territory where the selective distribution system operates;⁴⁸³ and
4. Restrictions which aim to avoid imitations of the same types of goods by potential competitors to avoid selling components to undertakings who would use them to manufacture the same type of goods as those produced by the supplier.⁴⁸⁴

However, some examples, including the last one, could be classified as customer allocations rather than territorial restraints.

Under the Guidelines, a general exemption from the prohibition of territorial restrictions exists in cases when a product is penetrating a new market or a new brand is introduced into a new market. In such cases, not only vertical agreements protecting new territories but also RPM are usually allowed for up to two years; in RPM, the period is only two weeks.⁴⁸⁵

With respect to some forms of customer allocations and territorial restraints, the block exemption also does not apply to active and passive sales to “end users by members of a selective distribution system operating at the retailer level of trade”⁴⁸⁶ because distributors within their selective distribution system should be free to sell the product concerned and the system cannot be combined with an exclusive distribution system. It also does not apply to “the restriction of cross-supplies between distributors within a selective distribution system, including distributors operating at different level of trade”⁴⁸⁷ because selective distributors must remain free to purchase the product concerned from another distributor in the selective distribution system and they cannot be obliged to purchase the product only from the manufacturer. Finally, it does not apply to

the restriction, agreed between a supplier of components and a buyer who incorporates those components, of supplier’s ability to sell the components such as spare parts to end-users or to repairers or other service providers not entrusted by the buyer with the repair or servicing of its goods.⁴⁸⁸

⁴⁸² Regulation 4(b)(ii); Guidelines, paragraph 55.

⁴⁸³ Regulation 4(b)(iii); Guidelines, paragraph 55.

⁴⁸⁴ Regulation, Article 4(b)(iv); Guidelines, paragraph 55.

⁴⁸⁵ Guidelines, paragraphs 61, 107(b)-(c), 225.

⁴⁸⁶ Regulation Article 4(c), see Guidelines, paragraph 57.

⁴⁸⁷ Regulation Article 4(d); see Guidelines, paragraph 58.

⁴⁸⁸ Regulation Article 4(e); see Guidelines, paragraph 59.

There are different forms of VTR with different approaches in EU competition law. Generally, VTR is based on an area within which distributors' sales may be restricted. Exclusive distribution is a form of distribution that may see a distributor granted an exclusive territory where it is allowed to sell a product or provide a service but it is not usually allowed to sell to other territories.⁴⁸⁹ Selective distribution, among others, limits the number of distributors; the possibilities for resale are based on qualitative criteria and/or includes a prohibition to sell to unauthorised distributors within a certain territory. Anything which restricts sales beyond this and which introduces quantitative criteria could be part of hard core restrictions.⁴⁹⁰

Dethmers and Posthuma de Boer criticise the Commission for the Guidelines being too extensive and both the Guidelines and Regulation for being too complicated and theoretical without providing any legal certainty for their practical application.⁴⁹¹ Colino adds to this criticism claiming that the market share threshold is somewhat arbitrary and the approach to the relevant market and the market share is excessively formalistic and far from adequate.⁴⁹²

Furthermore, the question remains as to whether the differentiated approach to VTR is not too complicated and unnecessary and whether this could be replaced with a simpler approach. For instance, it would be easier to differentiate between absolute territorial and other territorial restrictions, including any restriction on passive sales, as hard core restrictions and others, if differentiation was agreed to be necessary regarding the different impacts on competition.

Monti, Jones and Sufrin argue that the Commission and the EU Courts have applied strict policy against restrictions which directly or indirectly divide the EU market into territories.⁴⁹³ However, it is arguable whether the policy of territorial restraints is in reality so strict, as the Commission differentiates among territorial restraints in its approach. For

⁴⁸⁹ Guidelines, paragraph 151, also see 152-167; *Novalliance / Systemform*, paragraph 60.

⁴⁹⁰ Regulation, Preamble, Articles 1(e), 4(b)(iii), 4(c); Guidelines, paragraphs 174-188.

⁴⁹¹ Dethmers, Posthuma de Boer, "Ten Years on:" pp. 425, 439-439; although this article discusses previous Guidelines 1999 and Regulation 1999, the few changes to the current Regulation and Guidelines mean that the same could be stated regarding the current system.

⁴⁹² S. Marco Colino, *Vertical Agreements and Competition Law, a Comparative Study of the EU and US Regimes* (Hart Publishing, Oxford and Portland, Oregon, 2010), 100-104; for further analysis see Chapter 3 "Vertical Competition and Structure".

⁴⁹³ Jones, Sufrin, *EU Competition Law*, 655; Monti, "Article 81", 1065-1066.

instance, the strict approach involves the restriction of passive sales and absolute territorial restrictions, which are restrictions in object.⁴⁹⁴ In general, the Commission does not apply the same strict approach to some forms of active sales, such as exclusive territorial restrictions, as it does to price fixing and minimum price fixing. However, as this thesis analyses, in some cases, the negative impact of territorial restraints can be even greater than that of RPM.⁴⁹⁵

In comparison, the US approach to VTR is arguably more liberal, as the practical effect of the rule of reason in VTR has caused the non-existence of cases in this matter in the US. This means the legalisation of VTR in practice, although the possibility of violation of the Sherman Act exists in theory and under the rule of reason.⁴⁹⁶

In all EU vertical restraint cases, parties are allowed to apply Article 101(3) to justify their restrictions. Therefore, the *per se* rule does not exist in EU competition law. The US *per se* rule, which applied to RPM before *Leegin*, was stricter than the EU approach to RPM as the *per se* rule did not allow any possibility for justification. The authorities and courts applying EU competition law must take into account any justification. Nevertheless, although Article 101(3) can apply in RPM, under new and also older Vertical Restraints Block Exemption Regulations and Guidelines, the EU Commission assumes that RPM and some forms of VTR, in the form of multilateral conduct, have “actual or likely negative effects” with no positive effects, or that RPM is not indispensable for creating positive effects on competition.⁴⁹⁷ As Jones highlights, such an approach is extremely hard for accused entities of RPM to challenge in practice.⁴⁹⁸ The existing cases do not indicate the existence of the successful application of Article 101(3) by the entities concerned. Simultaneously, it is difficult to determine how often the Commission’s investigation has been stopped because of the proven existence of a justification prevailing the negative effects on competition under Article 101(3) in hard core restrictions. However, it can be observed that even in the latest cases on hard core restrictions, the Commission did not analyse the pro-competitive justifications under Article 101(3) in detail. Both EU courts

⁴⁹⁴ *Nintendo*, 2.2.7., paragraph 331; *Consten & Grundig*, pp. 346, 344; (and any restriction on parallel import – *GSK* appeal, paragraphs 62-64).

⁴⁹⁵ See Chapter 6 “Theories of Pro-Competitiveness v. Anti-Competitiveness”.

⁴⁹⁶ For further discussion see Chapter 4 “Development of the US Law of Vertical Territorial and Price Restraints”.

⁴⁹⁷ Guidelines, paragraph 223; L. Peeperkorn, “Resale Price Maintenance and Its Alleged Efficiencies” (2008) June *European Competition Journal* 202-204.

⁴⁹⁸ Jones, “Left Behind?” 655-656.

criticised this in the case of *GSK*,⁴⁹⁹ which will hopefully lead to positive changes in the practical application of Article 101(3) on vertical hard core restrictions and its detailed analysis of justifications in future decisions of the Commission.

5.7.2. RPM and VTR – Application of Article 101

Block exemptions do not apply to hard core restrictions. Therefore, hard core restrictions, as well as other vertical restrictions, must be analysed under the Article 101 test which involves four general steps.

Article 101(1):

1. It applies to multilateral or bilateral conducts (agreements, concerted practices, decisions of associations) which do not include agency agreements.
2. It must appreciably affect competition and trade between Member States (indicators are market shares and turnover).
3. There must be a restriction in a) object, or b) effect.
4. If there is a restriction under Article 101(1), Article 101(3) can apply and then a balancing test of effects must be used.

1. First, it must be proved that the restriction in question is formed by multilateral conduct not by unilateral conduct,⁵⁰⁰ which also includes agency agreements.⁵⁰¹ Some conditions of subcontracting agreements are also exempted.⁵⁰² If one of the parties is a manufacturer or a distributor with a dominant position, Article 102 can apply on its own or in parallel with Article 101, and only on its own if there is no multilateral conduct.⁵⁰³

2. Second, there must be an appreciable effect on both competition and trade between Member States.⁵⁰⁴ There is a presumption that there is no appreciable effect on trade between Member States and on competition when the market share is below *de minimis*

⁴⁹⁹ *GSK*, paragraph 294; *GSK* appeal, paragraphs 69-168; also see *Nintendo*, 341; COMP/C3/37.980, *Souris-Topps*, paragraph 130; *Novalliance/Systemorm*, paragraphs 70-72, 74-75; Callery, “Leegin’s ‘Rule of Reason’” 43.

⁵⁰⁰ Guidelines, paragraphs 24-30; see the discussion above regarding the *Volkswagen* appeal and *Bayer*.

⁵⁰¹ Guidelines, paragraphs 12-21.

⁵⁰² Guidelines, paragraph 22; Commission Notice of 18 December 1978 concerning assessment of certain subcontracting agreements in relation to Article 85(1) of the EEC Treaty, OJ C 1, 3.1.1979, p.2.

⁵⁰³ Guidelines, paragraph 1; *Minière v. Maschinenbau*, pp. 248-249; *Bayer* appeal, paragraphs 47 and 174.

⁵⁰⁴ *Bayer* appeal, paragraphs 47 and 174; *Novalliance / Systemform*, paragraphs 63-65; *Minière v. Maschinenbau*, pp. 248-249; Guidelines, paragraphs 2(5), 8-11, 97; Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty establishing the European Community (“*de minimis* Notice”), OJ C 368, 22.12.2001, p.13.

15% threshold.⁵⁰⁵ It is also presumed that vertical agreements among small and medium-sized undertakings rarely affect trade between the Member States appreciably.⁵⁰⁶ However, in individual cases, and primarily in hard core restrictions, Article 101(1) applies sometimes even when the market share is below the 15% threshold.⁵⁰⁷ Similarly, there does not have to be an appreciable effect even if the market share is above *de minimis* 15% threshold in a particular case.⁵⁰⁸

3. Third, the restriction must restrict competition directly or indirectly⁵⁰⁹ in its object or effect. The conduct in question must have actual or likely restrictive effects.⁵¹⁰ A particular form of restrictions is restricting competition by its object if competition is “almost” always restricted, irrespective of economic circumstances.⁵¹¹ Agreed and/or enforced minimum and price fixing and VTR and “any” restriction of parallel import restrict competition in their object.⁵¹² Moreover, when the restriction by object applies, there does not have to be a direct link between the conduct in question and the restrictive consequence, such as the increase of consumer prices.⁵¹³ Intention is not essential but the potential to have a negative impact on competition is;⁵¹⁴ at least, such potential must be determined. Such impacts should be measured to assess the seriousness of the infringement in question.⁵¹⁵

When a restriction by object is present, it is not necessary to analyse the restrictive effect as it is presumed that such a restriction restricts competition.⁵¹⁶ As Loozen explains, both restrictions by effect and object require a restrictive object. However, the restrictive object is restrictive *per se* being restrictive in its nature; therefore, it is assumed that it causes an “increase of allocative inefficiency” and it is obvious from the object itself that it will

⁵⁰⁵ Guidelines, paragraph 9.

⁵⁰⁶ Guidelines, paragraph 11; see Annex to Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, OJ L 124, 20.5.2003, p. 36.

⁵⁰⁷ C-306/96 *Javico v Yves Saint Laurent* [1998] ECR I-1983, paragraphs 16-17; T-7/93 *Langnese-Iglo v Commission* [1995] ECR II-1533, paragraph 98; 22/71, *Béguelin Import Company v. GL Import-Export SA* [1971] ECR 949, [1972] CMLR 81; 5/69, *Völk v. Vervaecke* [1969] ECR 295, 302, [1969] CMLR 273, 282; Guidelines, paragraphs 9-10; *De Minimis* Notice, p. 13-15.

⁵⁰⁸ *Ibid.*

⁵⁰⁹ See Regulation, Articles 4-5.

⁵¹⁰ *Minière v. Maschinenbau*, p. 249; Guidelines, paragraph 97.

⁵¹¹ C-8/08 *T-Mobile Netherlands BV v Raad van Bestuur van de Nederlandse Mededingingsautoriteit* [2009] 5 CMLR 11, paragraph 20.

⁵¹² *Novalliance / Systemform*, paragraphs 60-61; parallel import: *GSK* appeal, paragraphs 62-64.

⁵¹³ *T-Mobile Netherlands*, paragraph 43.

⁵¹⁴ *GSK* appeal, paragraph 58; *T-Mobile Netherlands*, paragraphs 27, 31; *Peugeot Nederland*, paragraphs 55-56; C. Callery, “Should the European Union Embrace or Exorcise *Leegin*’s ‘Rule of Reason’?” (2011) 32(1) *ECLR* 44.

⁵¹⁵ *Peugeot Nederland*, paragraphs 22, 43-141.

⁵¹⁶ See, e.g., Guidelines, paragraph 21; Jones, “Left Behind?”, 656.

trigger deadweight loss.⁵¹⁷ On the other hand, restriction by effect requires further analysis which will lead to the conclusion of deadweight loss to prove a restriction of competition.⁵¹⁸ Nevertheless, both forms of restrictions can be exempted under Article 101(3).

The aim of restriction by object is to increase competitive constraints, such as price increases. On the other hand, a restriction by effect does not necessarily aim to lessen competition; however, it leads to such results by its effect.⁵¹⁹ Restriction by effect means that competition has been restricted or there is a potential for a restriction, which is expected with a reasonable degree of probability and to an appreciable extent.⁵²⁰

Horizontal restriction by object, or even by effect, can appear to be simpler than a vertical restriction as the strengthening of market power of the participants of a cartel indicates the existence of a restriction by object.⁵²¹ On the other hand, the enhanced market power of participants of a particular vertical conduct can be caused by aspects other than the restriction itself. Therefore, the whole situation in the market should be considered.

Even the existence of a threat, direct or indirect, actual or potential, to restrict trade between Member States could be enough to apply Article 101(1).⁵²² If the restrictive object is proved, such as an absolute territorial protection, the effect does not have to be analysed.⁵²³ However, even the existence of an illegal object must be determined based on an analysis.⁵²⁴ For instance, the CJEU ruled that a sole distributorship, including granting an exclusive right to sell, could have a restrictive effect.⁵²⁵ It introduced a test which determines whether the effect is restrictive:

[I]t must be possible to foresee with a sufficient degree of probability on the basis of a set of objective factors of law or of fact that the agreement in question may have an influence, direct or indirect, actual or potential, on the pattern of trade between the Member States.⁵²⁶

⁵¹⁷ Loozen, “The Application” 148-149.

⁵¹⁸ *Minière v. Maschinenbau*, p. 249; Loozen, “The Application” 149.

⁵¹⁹ E. Loozen, “The Application of more Economic Approach to Restrictions by Object: no Revolution after all (T-Mobile Netherlands (C-8/08))” 4 (2010) *ECLR* 148.

⁵²⁰ *T-Mobile Netherlands*, paragraph 28; Guidelines, paragraph 97.

⁵²¹ Loozen, “The Application”, 147-148; also see Guidelines, paragraph 98.

⁵²² *Consten & Grundig*, p. 341.

⁵²³ *Nintendo*, chapter 2.2.7. (332); *Minière v. Maschinenbau*, p. 249; *Consten & Grundig*, p. 342.

⁵²⁴ *GSK*, paragraphs 117-119.

⁵²⁵ *Minière v. Maschinenbau*, p. 248.

⁵²⁶ *Minière v. Maschinenbau*, p. 249.

The question remains open as to whether the conducts that restrict competition in their effect have the same approach as the US rule of reason in vertical restraints.⁵²⁷ Firstly, it must be highlighted that the US rule of reason has different forms and is not absolutely unified for different restrictions. Moreover, its form is not definitely settled for RPM yet. Secondly, the EU approach under Article 101 differs from the US rule of reason. Briefly, under Article 101(1) the Commission must prove that the conduct in question restricted competition in fact. If there is restriction under object, certain forms of conducts, such as RPM, must be proved. If the restriction in effect is proved, the party that restricted competition can show that pro-competitive benefits outweighed the anti-competitive restriction under Article 101(3). In contrast, the rule of reason applies the aspects from both 101(1) and 101(3) at once and focuses on interbrand competition.

4. Fourth, the Commission or a national competition authority must examine the available evidence to determine whether there is a justification under Article 101(3). The evidence must show in a convincing manner that the restrictive action in question caused “appreciable objective advantages”, either actual or potential.⁵²⁸

The application of Article 101(3) is based on an economic evaluation of the available evidence, which must determine an improvement of competition in distribution and production and/or whether the conduct in question promotes technical and or economic progress, showing “appreciable objective advantages” that outweigh the disadvantages of the restriction concerned.⁵²⁹ Therefore, the principle of proportionality must apply, meaning that the restriction cannot go beyond what is necessary to use a certain positive effect in the market under Article 101(3).⁵³⁰ Moreover, for Article 101(3) to apply, the vertical restriction in question should not eliminate a substantial part of competition.⁵³¹

In contrast with US antitrust policy and in conformity with Steiner’s theory,⁵³² the Commission must examine both intrabrand and interbrand competition.⁵³³ Usually in

⁵²⁷ For general discussion see Callery, “*Leegin’s ‘Rule of Reason’*” 42-49.

⁵²⁸ *GSK*, paragraph 248; 294; Guidelines, paragraph 122.

⁵²⁹ *Novalliance / Systemform*, paragraphs 70-72, 74-75; *Nungesser & Eisele*, paragraph 76; *AEG-Telefunken*, paragraphs 41, 42; *Consten & Grundig*, p. 347-348; Guidelines, paragraph 125.

⁵³⁰ *Nungesser & Eisele*, paragraphs 76-77.

⁵³¹ Guidelines, paragraph 127.

⁵³² See Chapter 4 “Development of the US Law of Vertical Territorial and Price Restraints”; Chapter 3 “Vertical Competition and Structure”.

⁵³³ *GSK*, paragraphs 104-108.

vertical restraints, the intrabrand loss must be compared with interbrand gain, with the interbrand competition taking the leading role rather than intrabrand competition.⁵³⁴

It is enough for applicants to prove the likelihood of “appreciable objective advantages”, which can compensate for the resultant disadvantages.⁵³⁵ The test should show whether the conduct in question makes it possible to obtain appreciable advantages or not.⁵³⁶ This must be demonstrated with “a sufficient degree of probability” that the possibility of obtaining an appreciable objective advantage exists.⁵³⁷

To summarise, the balancing test of Article 101(3) contains the following. Firstly, it must be shown that there was an appreciable objective advantage. Secondly, the Commission must analyse whether the conduct in question decreased efficiency. Thirdly, if so, it must decide the extent to which efficiency was decreased. Lastly, the gain in efficiency must be analysed.⁵³⁸ If the gain is greater than the loss of efficiency, then the conduct will be justified under Article 101(3).

Consumer welfare is a determining, essential, efficiency factor of the appreciable objective advantages and of the restrictions under the Commission’s Guidelines on the application of Article 101(3), which states that Article 101(3) applies if the conduct enhances consumer welfare.⁵³⁹ However, the CJEU ruled rightly only a few years after the Guidelines had been issued that Article 101 protected effective competition.⁵⁴⁰ Therefore, the enhancement of consumer welfare is only one aspect. The second aspect is the positive effects on the competitive market structure. Similarly, Article 101(1) applies when effective competition is restricted and not just when consumer welfare decreases.⁵⁴¹ The question is whether the Commission will apply the second aspect in practice, although it should under this recent judgement and under law. It can be assumed that the Commission will continue to analyse vertical restraints from the perspective of consumer welfare as this approach appears in the recently issued Guidelines on vertical restraints.⁵⁴²

⁵³⁴ *Ibid.*, paragraph 296.

⁵³⁵ *GSK appeal*, paragraphs 92-95.

⁵³⁶ *Ibid.*, paragraph 94.

⁵³⁷ *GSK appeal*, paragraph 95.

⁵³⁸ *GSK*, paragraphs 263-303; *GSK appeal*, paragraph 128.

⁵³⁹ Guidelines on the application of Article 81(3), paragraph 13.

⁵⁴⁰ *GSK appeal*, paragraphs 55-64; see discussion in Chapter 3 “Vertical Competition and Structure”.

⁵⁴¹ *GSK appeal*, paragraph 63.

⁵⁴² Guidelines, paragraphs 7, 101-102, 122.

5.8. Conclusion

In comparison to the US development, the EU approach to vertical territorial and price restraints seems to be more consistent, and has been without sudden fluctuations. However, this is well-founded and logical considering the differences in the two legal systems. The US legal system involves precedents and private litigations, as well as certain circumstances that influenced its development, including the fact that the US Sherman Act was already issued at the end of 19th century.

In line with the development in the US, although not in the same way, the EU law of vertical territorial and price restraints has gradually shifted from a strict approach with theoretical and economical considerations, when the mere threat of restriction on intrabrand competition would infringe Article 101(1), to a more balanced test based on concrete economic and factual evaluations, when intrabrand and interbrand competition could be analysed under both Article 101(1) and Article 101(3). Although, it can be observed that justifications under Article 101(3) have not been analysed sufficiently enough by the Commission, this can improve in the future.

It can be concluded from an observation of the current approaches, that the US and the EU laws of vertical territorial and price restraints have followed their own paths. This message is clear when the EU Guidelines on Vertical Restraints and the US case of *Leegin* are compared.

The objective of EU competition law has also been changing and developing. In the early days, *Consten & Grundig* showed that the creation of a single market had been essential and, thus, it was also the aim of competition law. Although, in practice, the Commission still concentrates on the protection of an integrated market, in analysis of the effects in individual cases, the focus has been shifting to consumer welfare, as is obvious in *Metro*, which ended with the Commission's conclusion that the objective of competition law was consumer welfare. However, in 2009, the CJEU stated in *GSK* that the main aim was the protection of competition, explaining that consumer welfare was only one aspect of such an objective.

Although the courts and the Commission have not found it necessary to analyse the motivations for introducing vertical restraints in most of the cases discussed, it can be observed that it has been manufacturers who, on their own initiatives or together with their distributors, have introduced vertical restrictions on competition. In comparison with the previous chapter, which discussed US cases, the EU cases do not include situations where distributors or distributors and their manufacturer pressured by the distributors would restrict competition. In contrast to the US, the EU cases are typical of parallel-trade restrictions and of using vertical restrictions to penetrate the new markets of other Member States.

In the cases of *Consten & Grundig*, *Minière v. Maschinenbau* and *Nungesser & Eisele*, it was the manufacturer who wished to penetrate a new market, and to do so it had to offer something “special” to find a new distributor. Although, the distributors had some bargaining advantage, the manufacturers, the distributors, their consumers and competition in general profited from the vertical territorial restraints in question.

Interestingly, in the case of *Consten & Grundig*, the parties introduced a one-off explanation for the application of the absolute territorial restraint. This explanation was that vertical restraints could be used as business tools to assist the distributor in planning its business in advance. Although the Court rightly refused such a justification and it has not appeared in cases on such restraints since, it can explain the introduction of vertical restraints when this cannot be logically determined or proved based on the evidence. The same explanation could be used at the supplier level. Such an explanation could have applied in *AEG Telefunken*, *Pronuptia*, *Novalliance/Systemform* and *Volkswagen*. Although, *AEG Telefunken* and *Pronuptia* also had another and more obvious explanation: the improvement of distribution systems. However, can RPM and strict territorial restraints be justified simply by improving distribution? Clearly, in these cases, it was the complete franchising and selective systems that involved such a justification. However, if these systems included RPM and strict territorial restraints with a restriction of passive sales, these elements would likely not have been justified under the explanation that it improves distribution.

Selling under different prices occurs in the EU, particularly this is common conduct in the pharmaceutical market where producers sell their products at different prices in different Member States. Therefore, a producer can have a higher profit per unit in one Member

State than it has in others. Territorial restrictions which avoid parallel trade, such as the cases of *GSK*, *Bayer* and *Sandoz*, are usually in the producers' interests, although, this can be in the interest of some distributors also. In all probability, the same motivations played their role in the case of *Nintendo*. Therefore, some EU cases clearly show that the vertical restraints in question are in the interest and for the benefit of manufacturers and suppliers.

The analysis of both the US and the EU cases raises questions of liability and punishment. In other words, should we punish distributors who act under economic duress and against their interests? It is arguable whether the first sense of injustice of such liability was not an aspect of morality for establishing the US *Colgate* doctrine. However, determining the boundaries of unilateral and multilateral conducts and basing vertical restrictions on multilateral conducts does not tackle the problem and are not necessarily the best approaches.

Vertical restraints differ from horizontal restraints not only in their impact on competition but also in their nature. Vertical relationships are essential on the market and are based on different forms of distribution agreements. Parties usually need one another to do their business or, in other words, to exist; however, the bargaining power of parties differs. Trying to determine the existence of multilateral conducts and then make liable and punish all parties of such conducts could be the wrong approach. The following chapter discusses the anti-competitiveness and/or pro-competitiveness of RPM and VTR and thus assists with the determination of whether such restrictions should be illegal and, if they should be, when and in what forms.

Chapter 6: Theories of Pro-Competitiveness v. Anti-Competitiveness

6.1. Introduction

This chapter tests existing theories against the nature of vertical interactions as surveyed in Chapter 3 and the objective of competition law as set in Chapter 2. It further shows whether the theories applied in case law and policy are sufficient and are the right ones and whether the criticism of the existing law and policy as discussed in Chapters 4 and 5 is well-founded.

Economic theories have always influenced antitrust policy and law. Nevertheless, the understanding of different aspects of the law of vertical restraints, such as its objective, is not the same under economic theories, law and policy. Williamson observed in the late 1980s that even economists themselves did not share the same basic opinion on vertical restraints.¹ As this chapter will partially show, this still remains an issue. Indeed, not only law and policy but also antitrust economic theories have been changing and this has had an impact, not necessarily immediately, on the law of vertical restraints.

This chapter analyses pro-competitive and anti-competitive explanations of the law of vertical territorial and price restraints. Throughout the existence of US antitrust law and EU competition law, different pro-competitive and anti-competitive theories, mostly relating to RPM, have been introduced, but there has been a lack of deep and sustained analysis of both forms of restraints. This chapter shows that some theories and ideas which apply to RPM can be used for the analysis of territorial restraints. It introduces new explanations, analyses old theories and finds new counterarguments to identify weaknesses in each theory and to determine which ideas are closest to the realities of RPM and VTR.

¹ O. Williamson, *Antitrust Economics: Mergers, Contracting, and Strategic Behaviour*, (Basil Blackwell, New York, 1987), 123; also see M. Bennett, A. Fletcher, E. Giovannetti, D. Stallibrass, “Resale Price Maintenance: Explaining the Controversy, and Small Steps Towards a More Nuanced Policy” (2010) MPRA Paper No. 21121, posted 4 March 2010/18:02, (at <http://mpa.ub.uni-muenchen.de/21121/>), p. 1; T.R. Sass, D.S. Saurman, “Mandated Exclusive Territories and Economic Efficiency: An Empirical Analysis of the Malt-Beverage Industry” (1993) 36 *J.L. & Econ.* 153-154; F.H. Easterbrook, “Vertical Arrangements and the Rule of Reason”, (1984) 53 *Antitrust L.J.* 145.

6.2. Schools and Theories

The roots of pro-competitive theories can be found in the Chicago School, which originated in the early 1950s. The central argument of the Chicago School was that the free market has the ability to regulate itself and maintain competition² and that vertical restraints, including RPM and territorial restraints, have a positive impact on competition, in particular acting as the strategic tools of manufacturers to create the best conditions for manufacturers, their distributors and consumers.³

In contrast, exponents of the Harvard School argued that vertical restraints result in restrictions of competition. The Harvard School theory is based on the relationship between structure, conduct and performance. The market structure influences firms' conduct, which determines market performance thus explaining how certain markets lead to certain types of conduct and performance. The founder of the Harvard School, Mason, along with others, studied industrial organisations. According to them, profit-making is at the centre of organisations and it is the market structure that determines price behaviour.⁴

An economic perspective from the New Institutional Economics, represented by, for example, Coase⁵ or Williamson,⁶ widens this understanding of competition into transaction costs, including social and legal rules in the relevant economic analysis and reasoning. As Williamson points out, a transaction cost aspect is a missing piece in the Harvard approach: "if transaction cost economies are unimportant, the suspicion that novel business practices are motivated by anticompetitive purposes is easy ..."⁷

² W.A. Cann, "Vertical Restraints and the 'Efficiency' Influence – Does any Room Remain for More Traditional Antitrust Values and More Innovative Antitrust Policies?" 24 *American Business Law Journal* (1986) 487; R.A. Posner, "The Chicago School of Antitrust" (1979) 127 *University of Pennsylvania Law Review*, 928; also see H. Hovenkamp, "Harvard, Chicago, and Transaction Cost Economics in Antitrust Analysis" (2010) 55 *Antitrust Bulletin* 631.

³ Hovenkamp, "Harvard, Chicago, and Transaction Cost" 617; N. Vettas, "Developments in Vertical Agreements" (2010) 55(4) *Antitrust Bulletin* 858; B. Durand, "On the Efficiency of VTR" (thesis, Boston College, The Department of Economics, U.S.A., May 2000), pp. 3-4; J.W. Burns, "Vertical Restraints, Efficiency, and the Real World" (1993) 62 *Ford. L. Rev.* 597, 597-598; Easterbrook, "Vertical Arrangements" 135.

⁴ See, e.g., Hovenkamp, "Harvard, Chicago, and Transaction Cost" 615-616; A. Jones, B. Sufrin, *EU Competition Law: Text, Cases, and Materials*, Fourth Edition (Oxford University Press, 2011) 22-23; J.S. Bain, *Essays on Price Theory and Industrial Organization* (Little, Brown and Company, Boston, 1972); H.M. Mann, "Seller Concentration, Barriers to Entry, and Rates to Return in Thirty Industries, 1950-1960" (1966) 48 *Rev. Econ. & Stat.* 296.

⁵ R. Coase, "The Problem of Social Cost" (1960) 3 *Journal of Law and Economics* 1; R. Coase, "The Nature of the Firm" (1937) 4(16) *Economica*, 386-405.

⁶ Williamson, *Antitrust Economics*.

⁷ *Ibid.*, p. 156.

In continental Europe, a new competition theory was introduced at the beginning of, and even before, the existence of competition law and unfair competition law as found today in several continental European countries, such as Germany, the Czech Republic, Austria and Slovakia. The idea of using the law to protect and enhance competition was propagated by Carl Menger and Eugen Bohm-Bawerk in Austria in the 19th century.⁸ In the 1930s, the economist Walter Eucken and two lawyers, Franz Böhm and Hans Großmann-Doerth, established the Freiburg School, which expounded the ordoliberalism approach. This theory was based on the idea that an economic constitution promoting the common interest would achieve a desirable economic order protecting, watching over and giving order to individual economic freedom.⁹

The schools and theories are still evolving and include other general theories and approaches.¹⁰ Posner sees the existence of the Chicago School as opposing the older Harvard School.¹¹ However, this understanding does not consider the ongoing formulation of new ideas and theories on anti-competitive effects that originated from both the Harvard and the Chicago School and also from Williamson's theory on transaction cost economics and others.¹² Indeed, the previously discussed schools have been influencing scholars and policies since their establishment.

6.3. Pro-Competitive Theories

Several theories that offer reasons for the legality of RPM exist; however, these theories are also applicable, sometimes partially or in different forms, to VTR. Indeed, Justice White stated that price and non-price vertical restraints have essentially the same economic effects.¹³

⁸ D.J. Gerber, "Europe and the Globalization of Antitrust Law" (1999) 14 *Connecticut Journal of International Law*, 15, 26.

⁹ M. Vattero, "The Ordoliberal Notion of Market Power: An Institutional Reassessment" (2010) 6 *European Competition Journal* 690; R. Van den Bergh, P. Camesasca, *European Competition Law and Economics, A Comparative Perspective* 2nd Ed. (Sweet & Maxwell, London 2006) 65f; W. Eucken, *The Foundations of Economics, History and Theory in the Analysis of Economic Reality* (William Hodge, London, Edinburgh, Glasgow, 1950); see also H. Großmann-Doerth, *Selbstgeschaffenes Recht der Wirtschaft und Staatliches Recht* (Wagner'sche Universitätsbuchhandlung, Freiburg, 1933).

¹⁰ For example see: <http://www.antitrustinstitute.org/content/philosophies>; see Chapter 2 "Objective of the Law of Vertical Territorial and Price Restraints".

¹¹ Posner, "Chicago School" 925.

¹² Hovenkamp, "Harvard, Chicago, and Transaction Cost" 613, 617-618; R.P. Nelson, "Comments on a Paper by Posner" (1979) 127 *University of Penn. L.R.* 949; see below.

¹³ *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977), at 69-70.

Silcock was arguably the first economist to discuss the pro-competitive explanation of RPM in 1938. He expressed the idea that RPM increased consumer services.¹⁴ In the UK, it was Yamey who discussed the pro-competitive effects of RPM in his book in 1954, although he did not use the term “free riding”.¹⁵ However, it could be argued that the free riding theory was first introduced by the Court of Appeals in the RPM case of *Park & Sons* in 1907.¹⁶ The theory of services was discussed in the cases of *Leegin*,¹⁷ *Business Electronics*,¹⁸ *Sylvania*,¹⁹ *Schwinn*,²⁰ *White Motor*,²¹ *Albrecht*,²² and in the EU cases of *AEG-Telefunken*²³ and *Consten & Grundig*.²⁴ Nevertheless, it could be argued that there is no real evidence that RPM or VTR have been used to provide services in practice.²⁵

6.3.1. Theory of Services, Quality Certification and Product Differentiation

6.3.1.1. Theory of Services

An American theorist from the University of Chicago, Telser, discussed the pre-sale services theory in 1960 to justify the existence of RPM for products unfamiliar to consumers, such as new products or products that are purchased infrequently. He stated that RPM encourages retailers to promote manufacturers’ products and protects them from free riders who benefit from the promotional services of other retailers while charging low prices. If RPM sets the minimum price at such a level that includes the manufacturer’s price, retailers’ profits and services’ expense, then no retailer can benefit from the services of other retailers while charging low prices.²⁶ In general, it can be said that discounting retailers or distributors free ride, in other words, steal profits from the manufacturer and other dealers or distributors.²⁷

¹⁴ T.H. Silcock, “Some Problems of Price Maintenance” (1938) 48 *Econ. J.* 42.

¹⁵ B.S. Yamey, *The Economics of Resale Price Maintenance* (1954, Sir Isaac Pitman, London), 52-56.

¹⁶ *Park & Sons*, at 45.

¹⁷ *Leegin*, at 890-892.

¹⁸ *Business Electronics*, at 727-728.

¹⁹ *Sylvania*, at 55.

²⁰ *Schwinn*, 370-371.

²¹ *White Motor*, at 269.

²² *Albrecht*, at 152-153.

²³ Case 107/82 *Allgemeine Elektrizitäts-Gesellschaft AEG-Telefunken AG v Commission of the EC* [1983] ECR 3151, paragraphs 33-34, 41-42, 75.

²⁴ C-56/64 *Établissements Consten S.à.R.L. and Grundig-Verkaufs-GmbH v EEC Commission* [1966] ECR 299, p. 349.

²⁵ See Chapter 4 “Development of the US Law of Vertical Territorial and Price Restraints”; D.F. Shores, “Vertical Price-Fixing and the Contract Conundrum: Beyond Monsanto” (1985) 54 *Ford. L. Rev.* 377, 402.

²⁶ L.G. Telser, “Why Should Manufacturers Want Fair Trade?” (1960) 6 *Journal of Law & Economics* 86.

²⁷ K. Kelly, “The Role of the Free Rider in Resale Price Maintenance: The Loch Ness Monster of Antitrust Captured” (1988) 10 *Geo. Mason U.L.Rev.* 327, 338.

The theory of services can apply only if the pre-sale services are necessary and if there are retailers free riding on this promotional cost. Similarly, it can be stated that guaranteeing exclusive territories to retailers prevents free riding and helps promote manufacturers' products or services.²⁸

Free riders can take advantage not just of others' investments into pre-sale services, but also into after-sale services and innovation. Following this reasoning, other theorists have developed pre-sale services, after-sale services, quality certification, and the output and consumer welfare theories.²⁹ These theories discuss the same process but from different perspectives and angles.

6.3.1.2. Quality Certification, Product Differentiation

The quality certification theory is based on the idea that RPM assists a manufacturer to create and maintain brand image and, hence, differentiate its product from others.³⁰ Retailers who hold quality certifications, sell the most fashionable and the highest quality products (or services), which are usually new in the market. If a free rider sells the same product or products, it can benefit from the reputation established by retailers with quality certifications.³¹

This theory can be used with respect to VTR, which can also protect retailers with quality certifications against free riders. In general, pro-exclusive territory explanations claim that exclusive territories are an important part of providing incentives for creating and maintaining reputation.³² This is typical of franchises.

²⁸ H.P. Marvel, "Resale Price Maintenance and Resale Prices: Paying to Support Competition in the Market for Heavy Trucks" (2010) 55 *Antitrust Bulletin* 79-99; H. Hovenkamp, *The Antitrust Enterprise: Principle and Execution* (Harvard University Press, London, 2005), 184; P.E. Areeda, H. Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application*, 2nd Edition, Volume VIII (Aspen Publishers, 2004), 247, 407, 418-422; E. Gellhorn, W.E. Kovacic, S. Calkins, *Antitrust Law and Economics* 5th Edition (Thomson West, St. Paul, 2004), 360; *Sylvania*, at 55.

²⁹ See below.

³⁰ W.F. Baxter, "Vertical Practices – Half Slave, Half Free" (1983) 52 *Antitrust L.J.* 743, 748; see the US case of *Leegin*, at 882.

³¹ M. Kneepkens, "Resale Price Maintenance: Economics Call for a More Balanced Approach" (2007) 12 *E.C.L.R.* 657-658; Areeda, Hovenkamp, *Antitrust Law*, 12-13; Gellhorn, Kovacic, Calkins, *Antitrust Law and Economics*, 344-345; H.P. Marvel, S. McCafferty, "Resale Price Maintenance and Quality Certification" (1984) 15 *Rand Journal of Economics* 347; see also the US case of *Bausch & Lomb*, at 728.

³² P. Rey, J. Stiglitz, "The Role of Exclusive Territories in Producers' Competition" (1995) 26 *Rand Journal of Economics* 446.

However, in order to apply the theory, some conditions must be fulfilled. Firstly, consumers must link the product with retailers who have quality certifications and the quality certification must matter to the consumers. It must be noted here that price is not the only motivating factor for consumers to buy a particular product from a particular seller. In this case, it is the quality.³³ Secondly, there are free riders who do not have the same certifications.³⁴

In other words, this theory is based on an assumption that a high quality certification creates useful and essential information for consumers who will buy this product based on this information, but from a dealer with the lowest price: a free rider. Elzigna, Peritz, Pitovsky, Posner and Telser offer two possibilities as to how to prevent free riders from selling the product. The first is to refuse to sell to discounters and the second involves imposing RPM, which guarantees that dealers receive compensation for the quality certifications.³⁵

Naturally, there are obvious and important drawbacks to the discussed theories. Firstly, the theories can apply only if all conditions are fulfilled, as is the necessity for services, and it can apply only to some products and only in some markets. Secondly, RPM is not the only way to protect and/or ensure the provision of services, innovation and the maintenance of reputation. The obvious question is whether there exists a more efficient and pro-competitive mechanism, one that is less restrictive, and is, thus, legal, to guarantee the same aims on which these theories, including the quality certification theory, are based.

6.3.1.3. RPM: Product Differentiation – Image Theory

When analysing RPM, the question must be asked as to whether high retail prices can be of benefit to manufacturers and consumers, and potentially to competition. Orbach argues that they can. He explains that some manufacturers are motivated to maintain and initiate high resale prices for their products to create and maintain an image of an exclusive product, which is appealing for some consumers. Therefore, high prices are a product feature that

³³ Besanko, D. ... [et al.], *Economics of Strategy* Fifth Edition (John Wiley & Sons, 2010), 25-27; Bain *Essays on Price Theory* 3.

³⁴ Marvel, McCafferty, "RPM and Quality Certification" 355; Commission Notice, Guidelines on Vertical Restraints, Official Journal C 130, 19.05.2010, SEC(2010) 411 ("Guidelines"), paragraphs 107(c), 107(i).

³⁵ Marvel, McCafferty, "RPM and Quality Certification" 348-350.

should be protected by competition policy in the form of RPM, rather than made illegal.³⁶ Such an explanation could apply to several cases regarding RPM.³⁷

Although this theory is similar to the theories of services and quality certification, it misses one feature – an extra aspect which would have the potential to enhance competition because it is the high price itself without anything else that creates the wanted image and potentially attracts certain consumers. In such a case, discounting itself cannot bear the title “free riding” as discounters cannot free ride on any positive aspect but would rather discount as part of their own promotion; however, if this occurs frequently, it could destroy the image that the manufacturer is aiming for.

The interest of certain consumers is the reason why Orbach argues that RPM should be protected by competition and he groups this “justification” among pro-competitive theories.³⁸ However, considering that such conduct creates ancillary monopolistic prices and restricts price intrabrand competition without enhancing any other aspect of competition and welfare and, moreover, it has the potential to motivate only a minority of consumers depending on the nature of the market, it is in contradiction to the protection of effective competition.

Furthermore, manufacturers have a more direct tool to increase prices: their own wholesale prices. Although this does not ensure that retailers will not offer discounts on their products, it does not restrict competition, distributors or retailers. Nevertheless, the image theory offers a valuable, although rather anti-competitive, reason for a manufacturer to use RPM.

6.3.1.4. Free Riding

Peritz, Pitofsky or Telser see the benefit of RPM in preventing competing retailers from free riding on the promotional services of retailers, such as product demonstrations and consultations.³⁹ Such an advantage also appears in the case of using territorial restraints.⁴⁰

³⁶ B.Y. Orbach, “The Image Theory: RPM and Allure of High Prices” (2010) 55 *Antitrust Bulletin* 277-307; also see G.R. Ackert, “An Argument for Exempting Prestige Goods from the *Per Se* Ban on Resale Price Maintenance” (1995) 73 *Texas Law Review* 1185; F.W. Taussig, “Price Maintenance” (1916) 6 *Am.Econ.Rev.*, 172.

³⁷ See US cases *Leegin*; *Bausch & Lomb*; *Parke, Davis*; *Colgate*; *Park & Sons*; *Dr. Miles*.

³⁸ Orbach, “The Image Theory” 306-307.

³⁹ R.J. Peritz, “A Genealogy of Vertical Restraints Doctrine” (1988-1989) 40 *Hastings Law J.* 511; Easterbrook, “Vertical Arrangements” 152-153; R. Pitofsky, “In Defense of Discounters: The No-Frills Case

Retailers who do not invest in promotional services (or after-sale services or quality certification) can free ride on these services by avoiding the extra cost of services. Therefore, they have an advantage over other retailers.⁴¹ Logically, the services need to be linked to the product not to the retailers' business in general. They must also be provided before sale without the possibility of charging a separate fee for them and consumers must seek these services, otherwise, such an attempt would not be efficient. Hence, as Kneepkens observes, the argument that free riding on promotional and pre-sale services has a potential to be anti-competitive applies only to a limited group of services.⁴²

These theories, and most notably the theory of services, were used in several US cases to justify the existence of both RPM and VTR.⁴³ On the other hand, the EU Courts and the Commission chose a different approach at their inception, promoting free riding as a legal and pro-competitive activity primarily to protect competition and the free market.⁴⁴ Currently, the Commission considers free riding as part of a justification for applying vertical restrictions. However, EU competition policy recognises free riding justifications only in the case of pre-sales services and promotional activities, and not in the case of after-sale services, and only with the condition that the product in question is relatively new and/or technically complex and/or where reputation plays an essential role. The product must also have a high value and it must not be practical for the producer or other suppliers to include a requirement of promotion and/or pre-sales services in the distribution contract with all distributors.⁴⁵

for a *Per Se* Rule Against Vertical Price Fixing" (1983) 71 *Geo.L.J.* 1487, 1494; Posner, "Chicago School" 926-927; Telser "Why Free Trade?", 86, 91.

⁴⁰ Marvel, "Heavy Trucks" (2010) 55 *Antitrust Bulletin* 79, 83-84.

⁴¹ P.M. Ippolito, "RPM Myths that Muddy the Discussion" (2010) 55 *Antitrust Bulletin* 157-158; K.G. Elzinga, D.E. Mills, "The Economics of Resale Price Maintenance", in *Competition Law and Policy*, Collin W., (2008) *American Bar Association*, Chapter XX, pp. 2-3; Peritz, "Genealogy" 511; Easterbrook, "Vertical Arrangements" 152-153; Pitofsky, "In Defense of Discounters" 1487, 1494; Posner, "Chicago School" 926-927; Telser "Why Free Trade?", 86, 91.

⁴² Kneepkens, "Resale Price Maintenance" 657; Shores, "Contract Conundrum", 377, 400-402.

⁴³ See for RPM: *Leegin Creative Leather Products, Inc. v. PSKS, Inc., DBA Kay's Kloset...Kays' Shoes*, 551 U.S. 877 (2007), at 890-892; *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988), at 721; 728; 731; *Bausch & Lomb*, at 728; *John D. Park & Sons Co. v. Hartman*, 153 Fed. Rep. 24 (Sixth Circuit, 1907), at 45; for Territorial Restraints: *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977), at 55-56.

⁴⁴ See e.g. Case 56/64, 58/64 *Établissements Consten S.à.R.L. and Grundig-Verkaufs-GmbH v. Commission of the European Economic Community*, [1966] ECR 299; Case 258/78, *L.C. Nungesser KG and Kurt Eisele v. Commission* [1982] ECR 2015; Case 161/84, *Pronuptia de Paris GmbH v. Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 353.

⁴⁵ Case 107/82 *Allgemeine Elektrizitäts-Gesellschaft AEG-Telefunken AG v Commission of the EC* [1983] ECR 3151, paragraphs 33-34, 41-42, 75; Guidelines, paragraph 107.

Consumer Focus refuses to accept the free-riding theory. The organisation argues that free riding should be protected as it reflects consumer demand and the nature of markets. Free riding not only decreases prices, it also increases innovation as suppliers must find different ways to sell their products and fulfil consumer needs.⁴⁶

For some services, such as free maintenance, it is more reasonable that customers who decide to buy a product because of the offer of extra services will buy it from retailers who offer those services. A customer can buy a service with the product; if she/he buys the product without the service, she/he must pay for it later if she/he ever needs such a service. One can state that, firstly, this applies to services whose purpose is not providing information. Secondly, if a customer buys from a retailer who does not offer services but sells the product more cheaply than competitors, the customer is interested in the product itself and not in the services. Allowing free pricing policy in such circumstances enriches competition.

Furthermore, even though it can be true in some cases that RPM (or territorial restraints) increases distributors' interest in offering services and quality, free price policy does not stop retailers from developing business strategies based on services and quality rather than on prices. On the contrary, free price policy means that the different needs of different consumers will be met. Simply, some retailers focus on consumers searching for the lowest price; other retailers may offer extra services to other consumers if there is this demand. Hence, free price policy opens more possibilities for retailers to compete and covers different consumer needs.

Lao also argues that the existence of free riding is positive for competition and the relationship among retailers with different preferences is complementary as it increases total sales and thus enhances competition.⁴⁷ Gundlach, Cannon, Kenneth and Manning conclude in their marketing study summarising findings across marketing scholarly work,

⁴⁶ Consumer Focus (the statutory organization for consumers across England, Wales, Scotland and Northern Ireland) "Consumer Focus Response to Vertical Restraints Block Exemption Regulation" (September 2009) pp. 11-12; Daniel J. Schuler' statement, *Consumer Protection Against Price Fixing*, hearings on S. 429 before the Subcommittee on Antitrust, Monopolies and Business Rights of the Senate Commission on the Judiciary, 102d Cong., 1st Sess. 66 (1991); *Retail Competition Enforcement Act*, hearing before Senate Commission on the Judiciary, 100th Cong., 1st Sess. 281 (1987); also see M. Lao, "Resale Price Maintenance: The Internet Phenomenon and Free Rider Issues" (2010) 55 *Antitrust Bulletin* 473-512; P.J. Harbour, L.A. Price, "RPM and the Rule of Reason: Ready or Not, Here We Come?" (2010) 55 *Antitrust Bulletin* 229; R.L. Steiner, "The Leegin Factors – a Mixed Bag" (2010) 55 *Antitrust Bulletin* 55.

⁴⁷ M. Lao, "Resale Price Maintenance: The Internet Phenomenon and Free Rider Issues" (2010) 55 *Antitrust Bulletin* 492-494; also see S. Van Baal, Ch. Dach "Free Riding and Customer Retention across Retailers' Channels" (2005) 19 *J. Interactive Marketing* 76.

including those based on empirical data, that some manufacturers encourage the existence of free riding to increase their intrabrand competition. In cases where manufacturers introduce RPM, such conduct tends to increase the free riding phenomenon and, aside from a unified price or price range, it also results in the same or similar non-price strategies; thus, RPM tends to have adverse effects restricting choice and diversity.⁴⁸

Innovation and competition have introduced new methods for shopping, such as the internet. Consumers seek available information and compare not just prices, but also services and quality. Such consumer behaviour promotes fair and effective competition, as discussed in Chapter 3 “Vertical Competition and Structure”. These aspects result in multi-channel consumers and multi-channel distributions. Indeed, this enhances competition and total welfare and reflects the diversity of consumer demand.⁴⁹

Allowing the free riding argument as a reasonable justification for vertical restraints can prevent the natural development of, and innovation in, different markets. It can also restrict consumer choice and the efficiency of distributors and/or retailers. In contrast, refusing to allow such justifications has led to innovative ideas. For example, perfume manufacturers provide samples in magazines which means that consumers are not as driven by visiting brick shops as they would be without this promotional method. Books and music markets include reviews and online samples.⁵⁰

Allowing the existence of RPM and potentially VTR disturbs effective competition, including innovation and the natural advantage of the most efficient distributors,

If [consumers] wish to seek advice from ‘official’ suppliers and then shop online to get a better price then they are simply expressing their preference for price over information. This choice will then drive change in the marketplace. Existing suppliers will either have to rebalance their offer, lowering prices or offering some other innovation (such as in-house coffee shops in bookstores) or exit the market. This is the normal operation of the marketplace. Every product or service is a combination of item and information. If there is a market for both parts of the offer the suppliers, assuming a degree of efficiency in both elements, will find alternative ways to supply consumer demand.⁵¹

⁴⁸ G.T. Gundlach, J.P. Cannon, K.C. Manning, “Free Riding and Resale Price Maintenance: Insights from Marketing Research and Practice” (2010) 55 *Antitrust Bulletin* 384, 412-418.

⁴⁹ Gundlach, Cannon, Manning, “Marketing Research” 391-401, 403-410, 412-413; Harbour, Price, “RPM” 225-244; also see Chapter 3 “Vertical Competition and Structure”, pp. 39-40.

⁵⁰ Consumer Focus “Focus Response”, 11; for instance, see the book section on Amazon.com.

⁵¹ Consumer Focus “Focus Response”, 12.

The US Supreme Court was right when it stated that antitrust law could not accept a defence that competition itself, for instance price competition, is unreasonable.⁵² As Pitofsky highlights, trying to prevent free riding would be against the US free market ideology and thus against democracy. He further states that a competitive market should not give manufacturers the authority to decide which retailers will stay in the market, whether the retailers are offering services or whether they are charging lower prices.⁵³ Each retailer has its own responsibility for its business decisions and its marketing strategy.

Finally, Peeperkorn correctly highlights that, even if RPM is imposed, it does not eliminate the free riding issue as retailers or distributors can still use the “dominant strategy”, which applies in game theory, to pocket the higher margin instead of using it for promotion.⁵⁴

6.3.1.5. Interbrand Competition

The US and EU approaches both prefer interbrand competition over intrabrand competition.⁵⁵ Therefore, the effect of the pro-competitive theories on interbrand competition must be analysed. This includes consumer demand, market structure and the nature of the product as these aspects may determine whether pro-competitive theories can apply in reality. For instance, Comanor argues that if the market is competitive at the interbrand level and products are relatively homogenous, then RPM does not solve the problem of free riding because there will be free riders distributing for other competing manufacturers.⁵⁶ However, when applying game theory, the legalisation of both RPM and VTR can lead to situations when all or almost all manufacturers use such restrictions. This cumulative effect at the interbrand level must lead to the restriction of interbrand competition as price competition will be restricted at this level in the case of RPM, or competition in general will be restricted at the interbrand level in the case of absolute territorial restrictions.

⁵² See *National Society of Professional Engineers v. United States*, 435 U.S. 679 (1978).

⁵³ Pitofsky, “In Defense of Discounters” 1493.

⁵⁴ L. Peeperkorn, “Resale Price Maintenance and Its Alleged Efficiencies” (2008) June *European Competition Journal* 201, 206.

⁵⁵ US: *Mack Trucks*, at 225; *Leegin*, at 889-890, 895-897; *State Oil v. Khan*, at 15; *Business Cards Tomorrow*, at 1205; *Business Electronic*, at 725-726; *Sylvania*, at 51-65; EU: *GSK*, paragraphs 114-296.

⁵⁶ W.S. Comanor, “Vertical Price-Fixing-Vertical Market Restrictions, And the New Antitrust Policy” (1985) 98 *Harv.L.Rev.* 1000.

6.3.1.6. Pre-Sale Services Theory - Advertising as Entrance Barrier

It is questionable whether advertising and other promotional tools can be classified as “services”. One could argue that promotion forms part of a business marketing strategy and therefore does not have to, as its first aim, assist consumers. Rather, it assists manufacturers and potentially their distributors and retailers. Nonetheless, advertising may be beneficial for competition as it can increase it, in particular by better disseminating the flow of information.⁵⁷

However, Posner, when discussing pre-sale services, proposes that advertising is desirable for consumers because it delivers information that is important to them.⁵⁸ This is contentious, given that there are advertisements that concentrate on impressions rather than factual information about the quality and price of the products.⁵⁹ Many products are not advertised, yet consumers are able to obtain information about them, for example from their packaging.

Furthermore, according to Posner, the Chicago School supposes that promotional cost creates a barrier to entry for new competitors who want to penetrate the market, as the promotional cost is an extra expenditure that might discourage a new competitor from entering the market. Therefore, imposing RPM can be essential business strategy for new competitors. It can be used as a tool to assist new competitors to overcome this entrance barrier by securing the retail price to retailers and, thus, securing a return of their promotional investment.⁶⁰

Klein argues even further by defending the use of RPM, claiming that it is the manufacturer’s tool to resolve the incentive differential and, thus, this “restriction” motivates distributors to promote a manufacturer’s products by guaranteeing a margin for

⁵⁷ See, for example, Ippolito, “RPM Myths” 154; S.I. Ornstein, D.M. Hanssens, “Resale Price Maintenance: Output Increasing or Restricting? The Case of Distilled Spirits in the United States” (1987) 36 *J. Industrial Economics* 11; J.E. Kwoka, “Advertising and the Price and Quality of Optometric Services” (1984) 74 *Am.Economic Review* 211; L. Benham, “The Effect of Advertising on the Price of Eyeglasses” (1972) 15 *J.L. & Econ.* 337.

⁵⁸ Posner, “Chicago School” 925.

⁵⁹ See Nelson, “Comments” 949, 950.

⁶⁰ Posner, “Chicago School” 930; see also G. Shaffer, “Slotting Allowances and Resale Price Maintenance: A Comparison of Facilitating Practices” (1991) 22 *Rand Journal of Economics* 120-135; Elzinga, Mills, “The Economics of RPM” 1-15.

its distributors.⁶¹ However, as Grimes points out, this does not lead to pro-competitive results if there are other and less restrictive options.⁶² The question is moot as to whether the same distributors would be motivated to promote these products if all manufacturers used RPM. Moreover, as mentioned previously, the direct objective of RPM is not the promotion of products. Finally, the desired margin depends on market structure elements such as interbrand competition.

The same reasoning can be used with respect to territorial restraints.⁶³ In particular, exclusive territories avoid free riding and allow dealers to invest money in promotion for new competitors. Having distributor intrabrand monopolies allows the manufacturer and its distributors to set prices high enough to cover promotional costs.

If interbrand competition is anti-competitive because of a monopoly or oligopoly, then there is a high possibility that Rey's and Stiglitz's assumption will apply in an exclusive territories system. They claim that a barrier to entry exists because there are no other distributors in the market who would invest in advertising to penetrate the market, and not because advertising is itself a barrier to entry.⁶⁴ On the contrary, if the interbrand distributor competition is highly competitive, then distributors can be highly motivated to invest in pre-sales services, if required by consumer demand. RPM or territorial restraints are therefore not necessary; the most efficient distributors will naturally benefit and competition will be balanced without these vertical restraints.

It is an important fact in the nature of business that each new competitor must prepare its business strategy and consider why it wants to enter the market, whether it will make a profit after a certain amount of time and whether it has enough capital.

6.3.1.7. Theory of Services - Direct Compensation

Peritz and Comanor suggest that manufacturers can offer retailers financial compensation for their services to ensure the same conditions for retailers who promote products and free riders who may be advantaged by not carrying promotional costs. This compensation could

⁶¹ B. Klein, "Competitive Resale Price Maintenance in the Absence of Free-Riding" (2009) 76 *Antitrust L.J.* 437.

⁶² W.S. Grimes, "A Dynamic Analysis of Resale Price Maintenance: Inefficient Brand Promotion, Higher Margins, Distorted Choices, and Retarded Retailer Innovation" (2010) 55 *Antitrust Bulletin* 101.

⁶³ See Areeda, Hovenkamp, *Antitrust Law*, 418-422.

⁶⁴ Rey, Stiglitz, "Exclusive Territories" 446.

be reflected in the wholesale price for the distributors or retailers.⁶⁵ Telser argues that it is difficult to set prices for services because it is difficult to predict how many customers of a particular retailer will be interested in the promotional services. Moreover, he presumes that it can be very expensive, including the cost of negotiating and concluding such contracts.⁶⁶

One could argue that if a manufacturer invests its time and money to introduce RPM, then it is difficult to imagine that it would be less expensive than agreeing on direct coverage of services' expenses. It is also difficult to set the minimum price or price in RPM because different distributors will have different promotional and general costs; in other words, their efficiency differs. RPM or territorial restraints conceal efficiency and effective competition and can discourage more efficient distributors.

Furthermore, if the minimum cost is too low, the services theory cannot apply. Or, at least, there will be distributors who would like to invest more money into promotion. If it is too high, distributor efficiency is restrained. This could also set excessive prices for customers and increase profits, similar to a monopoly, depending on the market structure and its nature.

These arguments, supported by Mathewson's and Winter's economic study that shows that a simple uniform price maintenance is not efficient in the competitive market,⁶⁷ contradict the reasoning by Gould and Preston. They claim that RPM is a useful tool for a manufacturer to set up efficient, in other word profitable, outlets, and avoid less efficient retailers staying in business.⁶⁸

Finally, RPM or VTR do not directly oblige or motivate distributors to invest in services. On the other hand, if a manufacturer compensates retailers for the costs of promotional services directly, it can directly motivate its retailers to promote its products. Areeda and Hovenkamp argue that the competitive alternatives may fail to offer optimal services.⁶⁹ However, it is questionable as to how RPM and/or territorial restraints can offer optimal

⁶⁵ Peritz, "Genealogy" 571; Comanor, "Vertical Price-Fixing" 987.

⁶⁶ Telser "Why Free Trade?" 92-94; also see Ippolito, "RPM Myths" 161.

⁶⁷ G.F. Mathewson, R.A. Winter, "An Economic Theory of Vertical Restraints" (1984) 15 *Rand Journal of Economics* 27.

⁶⁸ J.R. Gould, L.E. Preston, "Resale Price Maintenance and Retail Outlets" (1965) 32 *Economica* 302

⁶⁹ Areeda, Hovenkamp, *Antitrust Law*, 24.

services if the manufacturer does not control services or their volume and does not directly influence its distributors to use services.

Easterbrook claims that if RPM is imposed, it is easy to observe if services are used: if the price drops then services also drop.⁷⁰ However, there are several factors which influence price aside from the cost of services. A retailer can sell below price to clear its stock or as part of a promotion. Furthermore, as previously discussed, RPM does not ensure the use of services. Additionally, Steiner argues that services and other previously-described objectives are usually better achieved through other marketing strategies.⁷¹

6.3.1.8. Direct Obligation or Imposing Services – Selective System

Pro-competitive effects can be achieved through means that do not restrict competition, that is without using RPM, and that protect competitiveness and the more efficient competitors.⁷² One such means, direct compensation, was discussed previously.

Bailey and Leonard argue in their economic study that, instead of using RPM, a manufacturer can use other tools, such as minimum advertised pricing policy, to achieve the same retail pricing practices but without decreasing total welfare, as is the case in RPM.⁷³ Steiner explains that such competitive means are more effective than RPM, which does not monitor the performance of the pro-competitive activities in question.⁷⁴

As Brunell rightly observes:

these other activities raise demand directly, and only indirectly raise prices, while resale price maintenance raises prices directly and only indirectly may lead to the hoped-for benefits.⁷⁵

Pitofsky argues that there is no guarantee that retailers know what the manufacturer wants and, even if they do, that they will follow its instruction when RPM or even territorial

⁷⁰ Easterbrook, “Vertical Arrangements” 156.

⁷¹ R.L. Steiner, “How Manufacturers Deal with the Price-Cutting Retailer: When Are Vertical Restraints Efficient?” (1997) 65 *Antitrust LJ* 443.

⁷² Brief of Amici Curiae Economists in Support of Petitioner, *Leegin*, 2007 WL 173681, at 9 in the article: R.M. Brunell, “Overruling *Dr. Miles*: The Supreme Trade Commission in Action” (2007) 52 *Antitrust Bulletin* 511-512.

⁷³ E.M. Bailey, G.K. Leonard, “Minimum Resale Price Maintenance: Some Empirical Evidence from Maryland” (2010) 10 *The B.E. Journal of Economic Analysis & Policy* 1-6; also see Gundlach, Cannon, Manning, “Marketing Research” 410-411.

⁷⁴ Steiner, “The Leegin Factors” 52-55.

⁷⁵ Brunell, “Overruling *Dr. Miles*” 513.

restraints are used.⁷⁶ This applies to both services and quality certification. There is no direct empirical evidence to support that applying vertical restraints increases services or the quality of a product. On the contrary, cases discussed in previous chapters and some studies, such as the study of the US music industry, indicate that not only do RPM and VTR not increase services and quality, but they also lead to welfare losses.⁷⁷ Moreover, parties base their arguments on free riding, services and quality theories in situations when their intention was not to improve services and/or quality. For example, the party in the case of *Golf Sales* mentioned this; however, RPM applied also to authorised online dealers who did not offer any consulting services.⁷⁸

In certain cases, it is possible for a manufacturer to impose services itself. Comanor points out that if it does so, distributors are not jeopardised by free riders and the manufacturer's profit increases, as does the price charged to distributors. It is important to understand that this only applies to certain markets where consumer demand increases with services.⁷⁹ However, some services cannot be performed by the manufacturer, in particular shop assisting. This kind of promotional service also establishes a retailer's reputation and becomes a part of its ability to compete.

Another possible way to avoid free riding and ensure services, quality and the reputation of products is the manufacturer's refusal to deal with non-suitable retailers. The manufacturer can specify the exact standards required from its distributors, including services. It can

⁷⁶ Pitofsky, "In Defense of Discounters" 1493.

⁷⁷ Press Release, FTC, Record Companies Settle FTC Charges of Restraining Competition in CD Music Market (May 10, 2000), <http://www.ftc.gov/opa/2000/05/cdpres.shtm>; Grimes, "Dynamic Analysis" 134-142; Press Release, FTC, Record Companies Settle FTC Charges of Restraining Competition in CD Music Market (May 10, 2000), <http://www.ftc.gov/opa/2000/05/cdpres.shtm>; Ornstein, Hanssens, "RPM: Output Increasing or Restricting?" 1-16; Hearings on S. 408 before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, 94th Cong., 1st Sess., 173 (1975); Hearings on H.R. 2384 before the Subcommittee on Monopolies and Commercial Law of the House Committee on the Judiciary, 94th Cong., 1st Sess., 122 (1975) – Statement of Keith I. Clearwaters, Deputy Assistant Attorney General, Antitrust Division; Overstreet's and Ippolito's studies as discussed in the case of *Leegin* are based on assumptions and do not offer direct evidence that RPM would increase services and quality; even the latest publication which summarises existing empirical studies on RPM is based on assumption in regards with precompetitive effects of RPM and not on direct at least economic evidence – see F. Lafontaine, M. Slade, *Exclusive Contracts and Vertical Relationships: Empirical Evidence and Public Policy* (2008, Cambridge: MIT Press); Territorial Restraints; Durand, "On the Efficiency"; W.F. Mueller, F.E. Gaithman, "An Empirical Test of the Free Rider and Market Power Hypothesis (April 12, 1989) (unpublished manuscript, on file with the University of Wisconsin) in W.S. Comanor, "The Two Economics of Vertical Restraints" (1992) 21 *Sw.U.L. Rev.* 1281; W.P. Culbertson, D. Bradford, "The Price of Beer: Some Evidence from Interstate Comparisons" (1991) 9 *Int. J. Indus. Org.* 275; W.P. Culbertson, "Beer-Cash Laws: Their Economic Impact and Antitrust Implications" (1989) 34 *Antitrust Bulletin* 209; W.J. Jordan, B.L. Jaffee, "The Use of Exclusive Territories in the Distribution of Beer: Theoretical and Empirical Observations" (1987) 32 *Antitrust Bulletin*, 137.

⁷⁸ *MD Products v. Callaway Golf Sales Co.*, 459 F. Supp. 2d 434 (W.D.N.C.2006) – this case is based on a successful unilateral-conduct defense; Grimes, "Dynamic Analysis" 137-142; also see Chapter 4 "Development of the US Law of Vertical Territorial and Price Restraints".

⁷⁹ Comanor, "Vertical Price-Fixing" 994-997; also see Steiner, "How Manufacturers Deal?" 416.

offer its product only to those retailers or distributors who have a quality certification. However, this can be difficult for a new competitor who must be able to attract distributors and offer them reassurance.

Therefore, the manufacturer can base its distributive system on a selective system and create objective selective criteria, including particular services and/or quality, when choosing its retailers. If the retailers do not obey with the distributive agreement, then the manufacturer can terminate their agreement. This means that all retailers have to use services directly; nonetheless, they are free in price competition and, thus, efficiency remains.⁸⁰

6.3.1.9. Increasing Non-Price Competition

Both the theory of services and the theory of quality certification presume in a certain way that RPM increases non-price competition as it motivates distributors to compete in different areas than just price, such as competing in services, innovation, quality and reputation.⁸¹ This presumption does not apply to absolute VTR as distributors in absolute territories do not have to increase non-price competition within one brand. Arguably, they are not motivated to compete at all. However, if the product is not significantly differentiated in such aspects as brand reputation, the more competitive the interbrand market is, the more the distributors are motivated to compete, as discussed in Chapter 3 “Vertical Competition and Structure”.

Moreover, market structure, consumer demand and the nature of products, amongst other factors, play important roles. For instance, while sophisticated products, such as computers, or more complex products, such as houses, may involve the need for services, this is not true when selling simple products, such as fruit, sheets and drinks. Therefore, a general claim that RPM increases non-price competition and is, thus, justified cannot apply in all cases.

⁸⁰ For instance, see *AEG-Telefunken*, paragraphs 33-34.

⁸¹ See Kneepkens, “Resale Price Maintenance” 658; Telser “Why Free Trade?” 86.

6.3.2. Theory of Welfare Effects

The theory of welfare effects explains that RPM is beneficial for consumers because it increases their welfare. Welfare can be improved by increased services, innovation and other factors based on the use of RPM. The previous theories focused on the manufacturer's choice; however, this theory is based on consumer interests. Nonetheless, the theory also presumes that manufacturer interests are the same as consumer interests. Bork and Brief claim that RPM increases competition in services, which subsequently increases consumer demand and, hence, RPM is “highly pro-competitive and enhance[s] consumer welfare by stimulating interbrand rivalry”.⁸²

Pitofsky disagrees with Bork and Easterbrook that manufacturer interests are the same as consumer interests. He also does not believe that manufacturers and their dealers share interests either. Dealers do not want the best profit for manufacturers but for themselves and, understandably, consumers do not want the highest profit for the manufacturers and retailers but the best price, quality and services for themselves.⁸³ Although, manufacturers must attract consumers (and also distributors) to profit, the highest profit for a manufacturer does not exactly mirror the best interest for a consumer.

This is well demonstrated in the *Leegin* example: Mr. James Donahau had bought Leegin's belt at a discount of \$20 and not at the full price of \$60. He asked sarcastically whether he would have been better off if he had bought it for \$60 after RPM was used. He said that he would not as there were no other advantages or services for him as a consumer than the price.⁸⁴

The theory of welfare effects is based on an assumption that consumers make their choice merely in relation to non-price aspects, such as extra services – the more services offered, the more products consumers buy or the more consumers that are interested in buying the products – and that RPM increases the choice of such aspects (services). As explained

⁸² R. H. Bork, “The Rule of Reason and the *Per Se* Concept: Price Fixing and Market Division” (1966) 75 *Yale L.J.* 373, 403 (quotation); Brief for the United States as Amicus Curiae in Support of Petitioner at 6, *Spray-Rite* (No.82-914); also see *Leegin*, at 889; *GSK*, paragraphs 171-172; Kneepkens, “Resale Price Maintenance” 658.

⁸³ Pitofsky, “In Defense of Discounters” 1491; compare with Easterbrook, “Vertical Arrangements” 135, 147; Bork, “Price Fixing and Market Division” 373; Adam Smith already recognised that producers were driven only by their own interests (mainly profit making) – see A. Smith, *The Wealth of Nations*, Books I-III edited by A. Skinner (Penguin Group, London, 1999), Book I, Chapter II.

⁸⁴ The American Bar Association, Section of Antitrust Law, “The Antitrust Fall Forum” (November 12-13, 2009) Washington D.C. (Mr. James Donahau – November, the 13th).

above, in reality, this does not motivate all consumers. As Durand demonstrates in his economic thesis when analysing pre-sale services, consumer welfare is only positive if the elasticity of pre-sales services of demand is high.⁸⁵

Furthermore, there are other important factors for consumers when making their choice. These factors are linked to the product, the brand and the market. As explained by Spence, this theory supposes that there are only marginal consumers who are sensitive to any product improvements and services.⁸⁶ Hence, even though the price increases, they will be more interested in the product if it is improved or offered with additional services. However, there are also other consumers, or only other consumers, in the market who are not interested in price at all and will continue buying the same amount of a product; these are called infra-marginal consumers.⁸⁷ Schulz's economic model proves that the efficiency of RPM depends on the characteristics of consumers, comparing those consumers who buy spontaneously and those who search for different information.⁸⁸

Types of consumers other than marginal and infra-marginal consumers exist in the market. For example, there are also consumers whose preference is only price. As Comanor points out, to claim that vertical restraints have a pro-competitive effect by increasing consumer welfare, leads to the assumption that it must be true that all consumers value new services. However, if only one half of consumers are marginal and value services, with consumer surplus declining, services will not increase profit and vertical restraints will be not efficient.⁸⁹

Rey and Stiglitz argue in their economic study that the standard theory of consumer behaviour or Posner's test of the presence of "efficiency-enhancing" costs causing a shift in the demand curve does not exactly apply in reality because the structure of different markets is more complicated and includes a number of different aspects.⁹⁰ Nonetheless, in the competitive market, as Mathewson and Winter calculated, a simple uniform price

⁸⁵ Durand, "On the Efficiency".

⁸⁶ A.M. Spence, "Monopoly, Quality, and Regulation" (1975) 6 *Bell J. Econ.* 417 – 419.

⁸⁷ Comanor, "Vertical Price-Fixing" 991; see also Elzinga, Mills, "The Economics of RPM" 7-8.

⁸⁸ N. Schulz, *Resale Price Maintenance and the Service Argument: Efficiency Effects* (2005) Wuerzburg Economic Working Paper No. 53, 1-23.

⁸⁹ Comanor, "Vertical Price-Fixing" 997-998.

⁹⁰ Rey, Stiglitz, "Exclusive Territories" 431.

maintenance was not efficient.⁹¹ However, economists Fisher and Overstreet obtained the opposite results in their economic study.⁹²

Conversely, Ippolito argues that consumer prices could decrease if RPM is introduced, if RPM motivates distributors to promote and/or introduce services; thus, the manufacturer can decrease its own activities in this sense.⁹³ However, this statement is based merely on an assumption without any practical evidence and without considering the basic aspects of RPM and competition. This thesis shows the opposite. Firstly, manufacturers are driven by high profits and, therefore, unless they are pressured by circumstances or the bargaining power of vertical competitors, they simply would not decrease their wholesale prices. Secondly, with the same motivation, distributors would not decrease retail prices primarily when RPM is used.

Generally, the structure and the nature of a particular market, as well as aspects such as the rightly-set objective of antitrust/competition law, should play an essential role in theories. The protection of consumers does not necessarily mean the same as economic efficiency or the protection of competition. However, consumer demand is an important factor for competition as it should determine which competitors remain in the market.

Comanor summarises that to say that vertical restraints increase consumer welfare is too general and is not based on any economic analysis.⁹⁴ Bork refutes Comanor's arguments as "thoroughly inadequate", claiming that Comanor suggests that promotion, advertising and other sales efforts should be illegal *per se*.⁹⁵ However, as is obvious from Comanor's article, he explains that vertical restraints are not necessarily used for promotional or other services but more probably restrict competition to increase profit. He also stresses that there are other, more direct methods to promote a product or avoid the benefits for free riders.⁹⁶ As Williamson summarises, Bork presumes that there is almost no friction on the vertical chain, which grossly suppresses the importance of one of the main aspects of business: the operation of strategic considerations, including transaction costs.⁹⁷

⁹¹ Mathewson, Winter, "Economic Theory" 27; see also G.F. Mathewson, R.A. Winter, "The Law and Economics of Resale Price Maintenance", (1998) 13 *Rev. Ind. Org.*, 57, 67.

⁹² A.A. Fisher, T.R. Overstreet, "Resale Price Maintenance and Distributional Efficiency: Some Lessons from the Past" (1985) 3 *Contemp. Policy Issues* 49-50.

⁹³ Ippolito, "RPM Myths" 155.

⁹⁴ Comanor, "Vertical Price-Fixing" 1001-1002.

⁹⁵ R.H. Bork, *The Antitrust Paradox: A Policy at War with Itself* (The Free Press, New York, 1978) 291.

⁹⁶ Comanor, "Vertical Price-Fixing" 1001-1002.

⁹⁷ Williamson, *Antitrust Economics*, 157-158.

6.3.2.1. Interbrand Competition

Cases discussed in previous chapters include an argument that RPM and VTR increase interbrand competition.⁹⁸ However, RPM and territorial restraints can also restrict interbrand competition in certain markets, as has also been discussed in previous chapters and was argued by Durand in his economic research. Durand studied car distribution systems in the US, which are based on franchise agreements containing exclusive territories.⁹⁹

The vehicle industry includes various types of customers. Some pre-sale services are essential for selling cars, such as showrooms and test-drives. This is in the nature of a product that is expensive and technically complex and complicated. The results of Durand's study show that reducing the number of dealers by imposing exclusive territories had an anti-competitive effect in the US vehicle market. The consumer welfare effect was low, if at all, because the pre-sales service elasticity of demand was not statistically significant (almost equal to zero) and thus the exclusive territorial restraints raised the price-cost margin and allowed producers to exercise a higher degree of market power. Restricting intrabrand competition also reduced interbrand competition.¹⁰⁰ Therefore, the territorial restraints in this market were inefficient and restrictive towards competition and general welfare.¹⁰¹

6.3.3. Theory of Output

The theory of output discusses the same reasoning as previous theories, but from the opposite angle, concentrating on production rather than consumer welfare.

Bork believes that anti-competitive theories of vertical restraints result in a restriction of output.¹⁰² He claims that output increases when imposing RPM (as well as any other

⁹⁸ US cases: *Leegin*, at 890-896; *Business Cards Tomorrow*, at 1205; *Sylvania*, at 51-54, 65; EU cases: *GSK*, paragraphs 91-98, 104-108, 296; *Novalliance / Systemform*; paragraph 76; *Consten & Grundig*; p. 342.

⁹⁹ Durand, "On the Efficiency".

¹⁰⁰ *Ibid.*

¹⁰¹ *Ibid.*, pp. 110-111.

¹⁰² Bork, *The Antitrust Paradox*, 295.

vertical restraint) because additional services increase the interest of consumers to buy the product concerned. Therefore, vertical restraints are pro-competitive.¹⁰³

This could apply only if the market structure allowed for such a result; that is, if the market included only mere marginal consumers and not any other groups. If it does, then increasing the price will decrease output because consumers whose preference is price will seek a cheaper alternative, as explained in previously mentioned theories.

For instance, suppose that a manufacturer produces luxury products and, therefore, wishes to maintain an image of luxury products. It applies RPM or a vertical territorial restraint to obtain such a result. If there are both consumers who are motivated by price and consumers who shop only in luxury shops, then the manufacturer's output will not increase when applying RPM or a vertical territorial restraint because consumers motivated by price will stop buying the product, or they will start to buy less, while other consumers will continue to go to luxurious shops. However, if there are only consumers who buy the product because it is luxurious, not everybody can afford it and the product is only sold in expensive fashionable stores, then their interest will remain the same, or potentially increase after the use of RPM.¹⁰⁴

6.3.4. Facilitating Entry by New Entities

RPM and VTR can assist a new company to penetrate the market or a company to penetrate a new market by motivating distributors and retailers to get involved and sell its products. In general, the risks of unknown profit are reduced if RPM or absolute territories are introduced.¹⁰⁵ RPM used by a penetrating company could also eliminate or minimise slotting allowances, in other words, fees paid for the retailer's shelf space, in the case of a producer seeking large retail stores. Slotting allowances can be very high if a producer is new to the market.¹⁰⁶

¹⁰³Bork, *The Antitrust Paradox*, 295-297; Bork, "Price Fixing and Market Division" 403; also see the discussion in P.E. Areeda, H. Hovenkamp, *2009 Supplement to Antitrust Law: An Analysis of Antitrust Principles and Their Application*, (Aspen Publishers, Frederick, 2009), 238-239, 243.

¹⁰⁴ For further explanation and discussion, see Chapter 4 "Development of the US Law of Vertical Territorial and Price Restraints", mainly the discussion on the case of *Leegin*.

¹⁰⁵ Van den Bergh, Camesasca, *European Competition*, 222; Steiner, "How Manufacturers Deal?" 430, 446; P. Rey, J. Tirole, "The Logic of Vertical Restraints" (1986) 76 *AER* 921; Yamey, *The Economics*, 52-56.

¹⁰⁶ See Organisation for Economic Co-operation and Development, "Buying Power of Multiproduct Retailers" 7 OECD (Policy Roundtables), (1998) DAFPE/CLP(99)21, pp. 38-39 at <http://www.oecd.org/dataoecd/1/18/2379299.pdf> (9/11/2009).

RPM offers some certainty for distributors that their investment in the new product will be profitable while lowering distribution costs. In such a situation a distributor can better predict risks and returnability of investment. Depending on the time period, this seems to be beneficial for the market as it increases interbrand competition at the beginning because the market is enriched with a new product.

This theory is well-established in both EU and US cases.¹⁰⁷ However, according to the EU approach, it is illegal to maintain the vertical restriction after the product is no longer new. It is based on the understanding that, after a certain time, maintaining such a restriction would restrict free competition.¹⁰⁸

Comanor proposes two different approaches: one for products which are new to the market and where the increase of consumer welfare is probable, and another one for older products where promotion or other information services are not likely to increase the interest of consumers.¹⁰⁹ If competition policy allows and legalises vertical restraints in general, this could lead to a contra-effect. In particular, using exclusive territories can establish oligopolies and, thus, “implements to entry”.¹¹⁰ This restricts potential distributors from entering the market and even potential sellers could be restricted as they would have no distributors to choose from. On the contrary, if RPM and territorial restraints are used for new competitors to enter the market, this would lead to the promotion rather than restriction of competition.

Paldor argues that manufacturers initiate RPM not only to penetrate the market but an established manufacturer may use RPM to assure or establish downstream-level exclusivity; in other words, as a motivation for its distributors to sell only its products or to

¹⁰⁷ Territorial Restraints: EU: C-56/65 *Société Technique Minière v. Maschinenbau Ulm GmbH* [1966] ECR 235, p. 250; *Nungesser & Eisele*, paragraphs 44 - 68; Guidelines, paragraphs 61, 107(b)-(c); Green Paper 1996, point 12; US: *Sylvania*, at 55; *White Motor*, at 269; Areeda, Hovenkamp, *Antitrust Law*, 16, 424-426, 430-432; Gellhorn, Kovacic, Calkins, *Antitrust Law and Economics*, 360-361; RPM: Areeda, Hovenkamp, *Antitrust Law*, 17-18; 308; Gellhorn, Kovacic, Calkins, *Antitrust Law and Economics*, 333-334; see *Leegin*, at 891; Guidelines, paragraph 225; Regulation 772/2004 on technology transfer agreements [2004] O.J. L123/11, pp. 11-17, article 4(2)(b)(ii); Guidelines on the application of Article 81 to technology transfer agreements, [2004] O.J. C101/27, pp. 2-42, paragraph 101; see discussions in previous Chapters.

¹⁰⁸ For example, C-234/89, *Delimitis (Stergios) v. Henninger Bräu*, 28 February 1991, [1991] ECR I-935, [1992] 5 CMLR 210, [1992] 2 CEC 530; Case 258/78 *Nungesser (LC) KG v Commission* [1982] ECR 2015; [1983] 1 CMLR 278; Case 161/84 *Pronuptia de Paris GmbH v Pronuptia de Paris Ismgard Schillgalis* [1986] ECR 353; [1986] 1 CMLR 414; Case 56/64, 58/64 *Établissements Consten S.à.R.L. and Grundig-Verkaufs-GmbH v. Commission of the European Economic Community*, [1966] ECR 299; Guidelines, paragraphs 61, 107(b)-(c), 225; see Peeperkorn, “Resale Price Maintenance” 201, 211-212.

¹⁰⁹ Comanor, “Vertical Price-Fixing” 1001-1002.

¹¹⁰ Williamson, *Antitrust Economics*, 130-137.

display them exclusively.¹¹¹ Although this is a logical reason for initiating RPM by a manufacturer, it is also conditional. Firstly, this can be of benefit to the manufacturer in question if its competitors do not also use RPM. Secondly, this does not offer any certainty that the distributors will comply, as it is in their interest to sell as many different products as possible and thus receive the highest profit. RPM does not ensure exclusivity in contrast with, for instance, exclusive territorial restraints.

6.3.5. The Reduction of Distribution Costs; Efficiency

Some market structures are such that territorial restraints can minimise distribution costs and create the most efficient method for distribution. For instance, this can be true in the personally delivered newspaper market.¹¹² This justification was confirmed in the US cases of *McDaniel*¹¹³ and *Newberry*.¹¹⁴ However, the negative, anti-competitive effects of absolute territorial restraints could prevail over distribution efficiency.

Areeda and Hovenkamp claim that, although it is possible that vertical restraints have alternatives which do not restrict competition,¹¹⁵ this does not mean that vertical restraints should automatically be illegal. They believe that the fact that vertical restraints, in particular RPM, have been used in practice (even though some forms of vertical restraints are illegal and RPM has been illegal *per se* for a long time) means that, in some cases, these restraints are more effective than their alternatives, or the alternatives are not always available.¹¹⁶ This can also have other explanations, for instance, the manufacturer and its distributors were not aware of the illegality of RPM or the territorial restraint was used simply for anti-competitive reasons.

Areeda and Hovenkamp continue with their argument stating that the transaction costs may be excessive, for instance, if the manufacturer offers to pay for services separately.¹¹⁷ This can be true if RPM or territorial restraints do not include any financial loss and cost or the financial loss is smaller than the cost of separating the services. On the contrary, allowing free riding can lead to lower costs and higher total welfare.¹¹⁸ However, as further

¹¹¹ I. Paldor, "RPM as an Exclusionary Practice" (2010) 55 *Antitrust Bulletin* 309-342.

¹¹² Areeda, Hovenkamp, *Antitrust Law*, 406, 422-424.

¹¹³ *McDaniel v. Greensboro News Co.*, 1984-1 Trade Cas. ¶65,792 at 67,286 (M.D.N.C. 1983).

¹¹⁴ *Newberry v. Washington Post. Co.*, 438 F. Supp. 470, 475 (D.D.C. 1977).

¹¹⁵ See above.

¹¹⁶ Areeda, Hovenkamp, *Antitrust Law*, 22-23.

¹¹⁷ Areeda, Hovenkamp, *Antitrust Law*, 24; also see Williamson, *Antitrust Economics*, 123-160.

¹¹⁸ Gundlach, Cannon, Manning, "Marketing Research" 420-421.

discussed in this chapter, RPM and/or VTR do not guarantee any pro-competitive aims, such as providing services: their first objective is restrictive. Therefore, how would a manufacturer calculate the cost of RPM if it wants to use it for a pro-competitive reason when it does not even have the certainty of such an effect? And why would it use such vertical restraints for pro-competitive reasons if it cannot assume such results?

The manufacturer has means other than direct compensation, for example, a selective distribution system where it can specify that it would sell its products only to distributors who will offer specific services (what kind, how often etc.). Maintaining and announcing RPM and/or territorial restraints have arguably similar costs to selective systems; however, the manufacturer can be sure of its pro-competitive result.

However, if the manufacturer is hoping to create a luxury brand with high prices without offering anything else, the RPM or territorial restraints could possibly create artificial luxury products without reflecting the reality of the product concerned. This is certainly in contrary to welfare and efficiency.

6.4. Anti-Competitive Theories

The anti-competitiveness of RPM is not as obvious as the anti-competitiveness of horizontal price fixing, which usually raises prices and strengthens the market power of manufacturers involved in the horizontal conduct. Moreover, as Bennett, Fletcher, Giovannetti and Stallibrass claim and as it is observed in this thesis, the number of economic studies analysing possible anti-competitive effects of RPM and VTR is much smaller than those analysing the possible economic explanations of pro-competitive effects.¹¹⁹ Therefore, in addition, this section introduces some further anti-competitive explanations aside from analysing existing anti-competitive theories.

6.4.1. Retailer Cartels

¹¹⁹ Bennett, Fletcher, Giovannetti, Stallibrass, “Resale Price Maintenance”, pp. 17, 20; further see Chapter “Introduction”.

In general, it can be stated that RPM or VTR can have the same effects as a cartel.¹²⁰ Comanor explains that RPM, if initiated by retailers, will have an anti-competitive intention and also probably an anti-competitive effect, as powerful retailers may fear intrabrand competition, particularly if they are less efficient, and may thus pressure their manufacturer to use RPM.¹²¹ Rey and Stiglitz highlight that exclusive territories limit the number of retailers, which may enable them to engage in tacit collusion. This is less possible and likely in a competitive retailer market.¹²²

A retailer cartel based on vertical arrangements is likely to be more stable than a horizontal agreement because the cartel is managed by a manufacturer and followed by its retailers.¹²³ Retailers or a retailer with significant bargaining power based on a monopsony or oligopsony can pressure their manufacturer to impose a vertical restriction, such as setting prices above the competitive level.¹²⁴ Shaffer explains that retailers are interested in softening competition to keep higher profits and to stop more efficient retailers and other price cutters, including more efficient competitors, from “stealing” the profit from them.¹²⁵

There are several factors, such as products, the market and competitors, which always need to be considered when claiming that RPM or territorial restraints have the same effect as cartels. Moreover, vertical restraints are not the same as horizontal restraints. A horizontal cartel restrains interbrand competition. A restriction where a manufacturer and its distributors agree to fix a price primarily affects the manufacturer’s products at the intrabrand level. This can have a negative or even a positive effect on interbrand competition. If the market is highly competitive with a number of competitors and the product is homogenous, then price fixing can increase the output of other competitors. Therefore, interbrand competition will not be restricted and such vertical restraints will not have the same effect as interbrand cartels.

¹²⁰ Kneepkens, “Resale Price Maintenance” 660-661; F.M. Scherer, D. Ross, *Industrial Market Structure and Economic Performance* 3rd Edition (Houghton Mifflin, 1990) p. 550; see Guidelines, paragraphs 100(c), 223.

¹²¹ W.S. Comanor, “Antitrust Policy toward Resale Price Maintenance Following *Leegin*” (2010) 55 *Antitrust Bulletin* 60-63, 67-69, 75-77.

¹²² Rey, Stiglitz, “Exclusive Territories” 446.

¹²³ Bennett, Fletcher, Giovannetti, Stallibrass, “Resale Price Maintenance”, pp. 21-22; Gellhorn, Kovacic, Calkins, *Antitrust Law and Economics*, 342; Pitofsky, “In Defense of Discounters” 1490.

¹²⁴ Comanor, “Antitrust Policy” 60-63, 67-69, 75-77; Peeperkorn, “Resale Price Maintenance” 201, 206; Areeda, Hovenkamp, *Antitrust Law*, 20; Elzinga, Mills, “The Economics of RPM” 5; Williamson, *Antitrust Economics*, 123-160.

¹²⁵ Shaffer, “Slotting Allowances” 120-136.

Bork, paying particular attention to interbrand competition, recognises vertical restraints as instruments that “would not eliminate the rivalry of resellers of other manufacturers’ products”.¹²⁶ However, there would be a significant restriction of competition limiting consumers’ choice of a cheaper substitute if competition is oligopolistic and other competitors “follow the leader”, or if the brand is monopolistic or significant in other ways.¹²⁷

Durand shows that restricting intrabrand competition through the use of territorial restraints in the vehicle industry in the US had negative effects on interbrand competition. Moreover, it had no positive impact on consumer demand but, instead, allowed car manufacturers to raise their prices above the competitive levels.¹²⁸ As Rey and Stiglitz highlight, exclusive territories can significantly affect prices and profits, and it is not only the retailers who can benefit from the lack of competition but also the manufacturers, primarily in the form of a franchise fee.¹²⁹

6.4.2. Manufacturer Cartels

RPM helps to maintain manufacturer cartels by ensuring that not only wholesale prices remain the same or in the same range, but also retail prices by maintaining the price at the retailers’ level and, simultaneously, by preventing cheating. Manufacturers might introduce RPM as part of their cartel to assist them to monitor and enforce collusion and enhance price transparency.¹³⁰ VTR can also be used to maintain manufacturer cartels as territorial restrictions make transparency obvious.¹³¹

Such vertical arrangements restrict interbrand competition, strengthen the manufacturer cartels and prevent manufacturers from cheating.¹³² Similarly, when imposing territorial

¹²⁶ Bork, *The Antitrust Paradox*, 292; see also Elzinga, Mills, “The Economics of RPM” 5-6.

¹²⁷ See Chapter 3 “Vertical Competition and Structure”.

¹²⁸ Durand, “On the Efficiency”; also see Chapter 3 “Vertical Competition and Structure”.

¹²⁹ Rey, Stiglitz, “Exclusive Territories” 446.

¹³⁰ Guidelines, paragraph 224; Bennett, Fletcher, Giovannetti, Stallibrass, “Resale Price Maintenance”, p. 21; Peepkorn, “Resale Price Maintenance” 201, 206; Kneepkens, “Resale Price Maintenance” 661; Elzinga, Mills, “The Economics of RPM” p. 6; Scherer, Ross, *Industrial Market*, 550; P.M. Ippolito, “Resale Price Maintenance: Empirical Evidence from Litigation” (1991) 34 *The Journal of Law & Econ.* 281; also see Press Release, FTC, Record Companies Settle FTC Charges of Restraining Competition in CD Music Market (May 10, 2000), <http://www.ftc.gov/opa/2000/05/cdpres.shtml>; Grimes, “Dynamic Analysis” 134-142.

¹³¹ Guidelines, paragraph 151; Areeda, Hovenkamp, *Antitrust Law*, 439-441.

¹³² Areeda, Hovenkamp, *Antitrust Law*, 19-20, 321; Shores, “Contract Conundrum” 377, 402-403; see Guidelines, paragraph 100(b).

restraints, it would also strengthen the manufacturers' and retailers' power if a cartel divides the market not just among manufacturers, but also among retailers.

Bork refutes this theory, arguing that RPM is totally unnecessary for manufacturer cartels, considering the outlet reports and opportunities and the reasons for cheating inside the cartels. Moreover, RPM attracts government attention and, therefore, RPM would be used as part of cartel collusion only very rarely.¹³³ Although, these arguments are valid, it can be observed that even a horizontal cartel attracts suspicion from a government; it occurs frequently in reality, even though the competition authorities generally focus on horizontal rather than vertical restrictions to protect interbrand competition. Finally, the market structure and amount of participants need to be considered when claiming the presumption that a participant is cheating. A cartel consisting of manufacturers and retailers would, logically, have more members; therefore, the assumption that parties could have more opportunities to cheat is correct. However, the cartel is also more transparent as using vertical restraints in a horizontal cartel makes it easier to determine whether somebody has cheated.

6.4.3. Restrictive Effects

The above explanations of the reasons for keeping RPM and VTR illegal are based on an assumption that cartels are illegal. This could, therefore, lead to the conclusion that the form itself is illegal. However, such a form, primarily in vertical restraints, does not have to restrict effective competition by reducing efficiency. Therefore, this sub-chapter discusses the possible restrictive effects of RPM and VTR.

6.4.3.1. Price Increase, Output Decrease and Restriction on Growth of Efficient Distributors

Vertical restraints can have several restrictive effects. RPM, and sometimes VTR, increase prices at the vertical level at least.¹³⁴ The scarce empirical studies from France, the UK and

¹³³ Bork, *The Antitrust Paradox*, 293-295; see also Elzinga, Mills, "The Economics of RPM" 6.

¹³⁴ Guidelines, paragraph 224; Peeperkorn, "Resale Price Maintenance" 201, 207; Pitofsky, R., "Are Retailers Who Offer Discounts Really 'Knaves'?": The Coming Change to the *Dr. Miles* Rule" (Spring 2007) *Antitrust* 61-64; Burns, "Vertical Restraints, Efficiency" 597.

the US show that RPM and VTR increase prices.¹³⁵ On the other hand, free price policy can increase competition, decrease prices and increase demand.

Ornstein and Hanssens show in their study based on economic data and focusing on output that RPM in the US market of alcoholic beverages did not have any pro-competitive effects but simply lessened competition as it decreased output.¹³⁶ Saas and Saurman analysed territorial restrictions in the US beer market. Contrary to the previous study, they argue that such restrictions had pro-competitive effects because, although it increased retail prices, output remained the same.¹³⁷ However, such a conclusion would indicate that there was a welfare loss rather than a gain. Even if VTR increased promotion, the output did not increase, in fact it remained the same despite the fact that retail prices increased. This could be explained by the popularity of beer consumption. As the beer industry does not offer special services to consumers and as promotion without other benefits cannot be seen as completely welfare enhancing, there was a consumer welfare loss. It is possible that distribution improved and the output remained the same but this did not necessarily enhance total welfare, as retail prices increased reflecting higher profits for both breweries and their distributors.

Generally, anti-competitive conduct is that which increases prices and/or decreases output. Brunell, Peeperkorn and Steiner argue that among other anti-competitive explanations and theories, RPM should be illegal because (and if) it increases prices and prevents efficient distributors from growing. In other words, it reduces dynamism and innovation at the distribution level.¹³⁸ More efficient distributors benefit from free competition and with

¹³⁵ RPM: Press Release, FTC, Record Companies Settle FTC Charges of Restraining Competition in CD Music Market (May 10, 2000), <http://www.ftc.gov/opa/2000/05/cdpres.shtm>; Ornstein, Hanssens, "RPM: Output Increasing or Restricting?" 1-16; Hearings on S. 408 before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, 94th Cong., 1st Sess., 173 (1975); Hearings on H.R. 2384 before the Subcommittee on Monopolies and Commercial Law of the House Committee on the Judiciary, 94th Cong., 1st Sess., 122 (1975) – Statement of Keith I. Clearwaters, Deputy Assistant Attorney General, Antitrust Division; also see Grimes, "Dynamic Analysis" 134-142; Release, FTC, Record Companies Settle FTC Charges of Restraining Competition in CD Music Market (May 10, 2000), <http://www.ftc.gov/opa/2000/05/cdpres.shtm>; VTR in US market with malt beverages: T.R. Saas, D.S. Saurman, "Mandated Exclusive Territories and Economic Efficiency: An Empirical Analysis of the Malt-Beverage Industry" (1993) 36 *Journal of Law and Economics*, 153-177; Culbertson, Bradford, "The Price of Beer" 275; Culbertson, "Beer-Cash Laws" 209; Jordan, Jaffee, "Exclusive Territories" 137; US car market: Durand, "On the Efficiency"; US mattresses market – VTR reduced output and increased prices: Mueller, Gaithman, "An Empirical Test" in Comanor, "Two Economics" 1281.

¹³⁶ Ornstein, Hanssens, "RPM: Output Increasing or Restricting?" 1-16.

¹³⁷ Saas, Saurman, "Mandated Exclusive Territories" 174.

¹³⁸ Peeperkorn, "Resale Price Maintenance" 201, 208; Brunell, "Overruling *Dr. Miles*" 475-529; Steiner, "How Manufacturers Deal?" 407; also see Grimes, "Dynamic Analysis" 101-149.

them consumers, competition and the economy is better off because this promotes competitive efficiency.

Steiner argues that in the Japanese market, aside from barriers to entry, RPM has prevented more efficient distributors from performing at the distribution level as highly and efficiently as in the US.¹³⁹ He claims that when vertical restraints prevent more efficient distributors from being rewarded for their capacity to be efficient, several restrictive results occur on the vertical stage. Firstly, distribution costs are higher because less efficient distributors benefit from such conduct. Secondly, the total costs in the vertical system remain higher because of eliminating the option of allocating functions between manufacturers and more efficient distributors. Thirdly, advertising has a tendency to be lower as the cost of distribution is higher, which has a negative impact on output. And, finally, innovation, product quality and consumer choice are restricted.¹⁴⁰

Obviously, RPM prevents price decreases because distributors of a certain brand are prevented from lowering their sale prices. This can lead to a general price increase as argued above. In VTR, a distributor of a certain brand who does not compete with other distributors due to territorial restrictions is not motivated to decrease the price if, for example, the demand curve for this product has the tendency to be inelastic. When imposing such restraints, distributors do not have to be as motivated to compete, nor do they have to be as effective and have as efficient a distribution system as they would need without the existence of such restraints.

6.4.3.2. Influencing Retailers' and Consumers' Choice - Foreclosure

As previously discussed, RPM restricts consumers' choice of potentially cheaper products or services and territorial restraints can lead to the same restriction as RPM. In addition to what has been said in the previous sub-chapter, they can also restrict consumers' choice of products that are more innovative or improved because, most notably, absolute territorial restrictions foreclose the whole intrabrand competition; however, the foreclosure of price intrabrand competition in RPM can also restrict innovation as effective distributors are not

¹³⁹ Steiner, "How Manufacturers Deal?" 439.

¹⁴⁰ *Ibid.*, pp. 439-440.

rewarded accordingly. Such results are contra-motivating factors for retailers to be as efficient and as innovative as possible.¹⁴¹

RPM and/or VTR can influence retailers to promote or choose manufacturer's products at the expense of the manufacturer's competitors. Moreover, they reduce consumers' choice due to the excessive concentration on brands, including promotion and high prices.¹⁴² This statement would not apply when fixing maximum prices or when fixing prices at a lower level. However, when the price is fixed high, the minimum price is set high or the product market is divided into territories, retailers may receive a higher profit. A retailer can set prices high without RPM or territorial restraints but they would risk a loss of profit if other retailers (competitors) maintained lower prices. RPM assures retailers that all will sell for the same price or the same minimum price. Therefore, it is profitable to favour this product at the expense of the manufacturer's competitors or even decide to sell only this product, depending on the position of the other retailers. The existence of territorial restraints can influence retailers' choice in the same way as RPM.¹⁴³

Bork claims that this discrimination is very rare. He assumes, without further explanation, that such a situation can even be beneficial for consumers.¹⁴⁴ It is difficult to prove beyond a doubt whether the previously-described situations are or are not real threats, particularly because empirical studies are lacking and the restraints in question have not been completely legal. However, it is very difficult to imagine that consumers could benefit from a form of discrimination that restricts competition, when retailers "refuse" to distribute competitors' products preferring a manufacturer with RPM or with a territorial restraint. Moreover, such behaviour restricts competition because it decreases distributors' choice of other competitors. On the other hand, it does not directly make distributors refuse to distribute competitors' products. This is rather a side-effect because it can be still profitable for retailers to sell other products. Therefore, knowledge of the market is essential when making this assumption in a particular case.

¹⁴¹ Steiner, "How Manufacturers Deal?" 407; Consumer Focus "Focus Response" pp. 11-12; also see Daniel J. Schuler' statement, *Consumer Protection Against Price Fixing*: hearings on S. 429 before the Subcommittee on Antitrust, Monopolies and Business Rights of the Senate Commission on the Judiciary, 102d Cong., 1st Sess. 66 (1991); Retail Competition Enforcement Act: Hearing before Senate Commission on the Judiciary, 100th Cong., 1st Sess. 281 (1987).

¹⁴² Guidelines, paragraph 224; Kneepkens, "Resale Price Maintenance" 661-662; Elzinga, Mills, "The Economics of RPM" 7; Areeda, Hovenkamp, *Antitrust Law*, 436-437; R.L. Steiner, "Exclusive Dealing + Resale Price Maintenance: A Powerful Anticompetitive Combination" (2004) 33 *Sw.U.L.Rev.* 447-476.

¹⁴³ Also see Chapter 3 "Vertical Competition and Structure" and Chapter 4 "Development of the US Law of Vertical Territorial and Price Restraints".

¹⁴⁴ Bork, *The Antitrust Paradox*, 295.

6.4.3.3. Manufacturers' Margin and Profits

Steiner discusses situations in different markets when a manufacturer is forced by retailers or the situation on the vertical stage to introduce vertical restraints.¹⁴⁵ Peeperkorn argues that in some RPM cases a manufacturer may introduce RPM because

the manufacturer generally prefers [intra-brand] competition not to be so fierce that it also starts to put pressure on its own margins, in other words that the downstream competition means that important buyers demand lower purchase prices.¹⁴⁶

Although this argument is highly valid, it would not apply to all market situations in practice. This is only possible if the manufacturer does not have a strong bargaining power. If it did, it could more or less dictate the conditions of the market. A competitive intra-brand situation is usually of benefit to the manufacturer and retailers generally have no power to pressure it to lower selling prices as there are no other strong manufacturers to buy from. Therefore, to apply Peeperkorn's argument, power must be on the side of retailers, as this presumes that retailers can choose from various manufacturers.

6.4.3.4. Manufacturers' Business Profit Strategies

Manufacturers can be motivated to introduce RPM or even VTR as part of the process of making the right and most efficient business decisions for themselves. A similar "justification" was discussed previously in the case of *Consten & Grunding*, where the applicants claimed that the vertical territorial restraint in question assisted the distributor to plan its business. The Court of Justice rightly stated that this was not a reasonable justification because risks are a part of business and the restriction of competition to eliminate potential risks is not on its own legal justification.¹⁴⁷ Since this case, parties have not used this or similar explanations.

Excluding situations discussed in the pro-competitive theories, introducing vertical restraints by a manufacturer could be illogical at first glance as this could contradict its interests and cause potentially fewer sales and, therefore, less profit. However, this is not always the case. Firstly, a manufacturer can introduce a vertical restraint to persuade its

¹⁴⁵ Steiner, "How Manufacturers Deal?" 407-448.

¹⁴⁶ Peeperkorn, "Resale Price Maintenance" 207; also see Grimes, "Dynamic Analysis" 148.

¹⁴⁷ *Consten & Grunding*, p. 348; also see the US case of *National Society of Professional Engineers*.

distributors into another restraint, such as a tie-in.¹⁴⁸ Secondly, VTR and/or RPM can be a useful business tool to assist a manufacturer in maximising production and profit. If the manufacturer knows or sets the retail price, and/or if it knows the number of products it is going to sell in a certain period, it can determine its profit and plan and adjust its future production accordingly. RPM and/or setting vertical territories are useful tools in this sense for assisting the manufacturer to set the most effective production and price to maximise its profit.

However, the obvious question arises as to whether this form of motivation for using VTR and RPM is anti-competitive and illegal.¹⁴⁹ The aforementioned pro-competitive theorists claim that RPM (or VTR) are manufacturers' tools, which they use to introduce and/or maintain pro-competitive purposes. However, it is argued in this sub-chapter that a manufacturer introduces RPM or a vertical territorial restraint for its own benefit, without including any extra benefit for consumers. It introduces it merely to increase its profit based on the ability to make better judgments of future situations in the market if it uses one of the restraints in question.

Williamson argues that vertical restraints promote the strategic purposes of a manufacturer; however, Williamson does not specify what these strategic purposes are. He explains that a manufacturer considers different transaction costs in its business strategy. Williamson also claims that a manufacturer's strategic decisions are usually more effective as they save rather than increase transaction costs, unless they lead to dependent oligopolies or monopolies, or such "restraints", most notably exclusive dealing such as exclusive territories, are used in monopolistic or oligopolistic markets.¹⁵⁰

In summary, Williamson argues that, aside from the aforementioned situations, vertical restraints could restrict competition only seemingly, as such "restrictions" can save transaction costs and subsequently lead to more effective competition, which is pro-competitive rather than anti-competitive. Hence, each situation must be economically analysed based on the transaction costs to determine whether it is pro- or anti-competitive.¹⁵¹ Although Steiner agrees with the conclusion that each situation must be economically analysed he illustrates in several examples why vertical restraints, in

¹⁴⁸ Areeda, Hovenkamp, *Antitrust Law*, 19, 32, 319.

¹⁴⁹ Easterbrook, "Vertical Arrangements" 140-145.

¹⁵⁰ Williamson, *Antitrust Economics*, 123-160.

¹⁵¹ *Ibid.*

particular RPM but also territorial restraints, lead to less rather than more efficient competition and higher transaction costs.¹⁵² Also, Gundlach, Cannon and Manning argue in their marketing study that the existence of free riding and thus unrestricted competition leads to lower costs.¹⁵³ Nevertheless, as Hovenkamp highlights, manufacturers use vertical restraints to control the vertical market because they believe that they will save their own transaction costs and increase profits.¹⁵⁴

There are other, different points raised in this sub-chapter that are not necessarily in contradiction with Williamson's arguments, and are in addition to Steiner's reasoning. Neither of these scholars openly considers the manufacturer's business plan as a reason for using vertical restraints.

Steiner highlights several reasons as to why manufacturers introduce vertical restraints:

More often than not, leading brands benefit from retail price cutting even when the off-price retailing sector has a relatively low share of market. Why is it, then, that many leading brands have adopted vertical restraints before and since the end of fair trading? ... [T]he fear of having their goods appear on the shelves of unprestigious stores was probably a decisive factor in the manufacturer's decision to restrict competition. ... Some leading brands seem to have been mistaken in adopting vertical restraints in the first place, or to have retained the restrictions well after they should have been abandoned. Still other brands may have had a "mutually dependent" relationship with larger market share retailers.¹⁵⁵

A manufacturer only considers its own transaction cost saving. As observed by Williamson, such a decision is based on bounded rationality. Additionally, opportunism could lead against competitive benefits. If a manufacturer makes an error, it is already punished by the less profitable results.¹⁵⁶ If such a restriction is used for the purposes described in this sub-chapter, then the manufacturer's intention is to save transaction costs and find the most efficient way to obtain the highest profit for itself. However, this does not necessarily result in the most efficient intrabrand, interbrand and vertical competition, which can be described as the saving of transaction costs for every player in the chain or within the market and the most effective competition and results for consumers based on fully functioning competition within the nature of that market. Grimes argues and shows in

¹⁵² Steiner, "How Manufacturers Deal?" 407-448; also see Grimes, "Dynamic Analysis" 101; for further discussion see Chapter 3 "Vertical Competition and Structure".

¹⁵³ Gundlach, Cannon, Manning, "Marketing Research" 420-421.

¹⁵⁴ Hovenkamp, "Harvard, Chicago, and Transaction Cost" 649.

¹⁵⁵ Steiner, "How Manufacturers Deal?" 447-448.

¹⁵⁶ Areeda, Hovenkamp, *Antitrust Law*, 105-106; Williamson, *Antitrust Economics*, 123-160.

several cases that RPM decreases social welfare and is anti-competitive because this cost-saving concerns only the manufacturer and, for that reason, it is interested in RPM.¹⁵⁷

In such a situation, retailers/distributors are restricted when making strategic business decisions and must find their own, most efficient strategies, which means a restriction of competition in price or territories. This does not necessarily result in efficient intrabrand or even interbrand competition. Moreover, the manufacturer does not necessarily choose the most effective business strategy for itself as its decision-making process is based on bounded rationality, which is restricted to the information that the manufacturer possesses.¹⁵⁸ Even if the purpose for using the vertical restraints in question is pro-competitive, as discussed in the pro-competitive theories, the transaction costs of such a restriction are not necessarily lower in comparison with the legal, “pro-competitive” alternatives discussed.

If such behaviour leads to transaction cost savings at least at the intrabrand, but mainly at the interbrand, level, it could increase the efficiency of competition and if it does, economically, it is right for such a conduct to be legal. However, the question arises as to whether procedural law in the form of private proceedings has the capacity to accurately determine this. And, thus, whether such an approach would be applicable in reality and whether it could ensure legal certainty and the aim of the law of vertical restraints, which is the protection of effective competition.

There are other business decisions, such as lowering production, which restrict competition but are also legal. Easterbrook includes vertical restraints, including RPM and territorial restrictions, with this group of manufacturers’ business tools and argues that they only form “a way by which one manufacturer competes with others”.¹⁵⁹ Generally, if the manufacturer does not hold dominant power, unilateral conduct is not illegal under the TFEU or the Sherman Act. Changing its own wholesale prices and lowering production, among other actions, can simply mean that a manufacturer is adjusting to different conditions in the market but, mainly, it is making its own strategic business decisions

¹⁵⁷ Grimes, “Dynamic Analysis” 101-149.

¹⁵⁸ In the case of *Schwinn*, the manufacturer’s shares rapidly decreased after introducing a restricted, so-called “franchising” system (although, the production increased). One could assume that such a new system did not lead to the most efficient competition and business strategy.

¹⁵⁹ Easterbrook, “Vertical Arrangements” 135; also see K.G. Elzinga, D.E. Mills “Leegin and Procompetitive Resale Price Maintenance” (2010) 55 *Antitrust Bulletin* 349-379; Ippolito, “RPM Myths” 156; D. Gilo, “Private Labels, Dual Distribution, and Vertical Restraints – An Analysis of the Competitive Effects” in *Private Labels, Brands, and Competition Policy* (2009, Oxford University Press), p. 141.

which are within its scope and which do not interfere with the rights of others. However, the difference between legal, potentially restrictive, unilateral conducts and RPM and VTR come down to two factors. First is the primary purpose, which is restriction, as discussed previously (and the effect is also presumably restrictive). Second, such vertical restraints directly change matters which would be based on the business decisions of the distributors/retailers if competition was not restricted and if the theory of ownership was incorporated into the law of vertical restraints. Even from an economic perspective, both vertical territorial and price restraints do not allow the best rewards for the most efficient distributors. This contradicts the principle of effective and free competition.

6.5. Theory of Ownership

Although the theory of ownership is not an established and existing theory in either EU competition law or US antitrust law, supposition of such an understanding in the law of vertical restraints was obvious in US case law at the beginning of the application of the Sherman Act.¹⁶⁰ The freedom of distributors was also protected in the EU case of *Novalliance/Systemform*.¹⁶¹ Furthermore, the freedom of the individual was a core aspect in English “competition” law in the Middle Ages (although not in the same way as described in this sub-chapter),¹⁶² and this aspect is also reflected in the ordoliberalistic protection of individual economic freedom. Finally, economic freedom and fairness is at the centre of attention of the current US antitrust policy.¹⁶³

The theory of ownership, as recognised and discussed in this thesis, is not a direct anti-competitive or pro-competitive theory, but is based on the participants’ rights and their freedom to make business decisions. In antitrust/competition law, the theory of ownership used to partially, and could, play an essential role in determining who is responsible for a particular anti-competitive behaviour and whose rights were violated.

The US case of *Dr. Miles* introduced ownership rights in RPM cases. The Supreme Court explained that only the owner of a product had the right to determine its price.¹⁶⁴ A few

¹⁶⁰ *Sylvania*, at 45-46; *Schwinn*, at 377-387; *Simpson v. Union Oil*, at 16, 20; *Colgate*, 307; *Dr Miles*, 404-406.

¹⁶¹ Paragraphs 60-61.

¹⁶² See *Magna Carta*; *Dyer* (1414) YB 2 Hen V, Vol. 5; *Tailors of Ipswich*, 77 E.R. 1218; (1614) 11 Co. Rep. 53: “... no man could be prohibited from working in any lawful trade ...”

¹⁶³ <http://www.justice.gov/atr/public/speeches/272536.pdf> (DOJ WebPages: Ch.A. Varney, “Vigorously Enforcing the Antitrust Laws: Developments at the Division,” Washington, DC, 24/6/2001, pp. 15, 1).

¹⁶⁴ *Dr Miles*, 404-406.

years later, the same Court partially reversed its ruling stating that the manufacturer could announce in advance its price policy, setting retail prices, and was free to terminate a contract with a dealer who did not follow the set prices.¹⁶⁵

The question is moot as to where the boundaries are. If a manufacturer announces its policy regarding retail prices and the retailer agrees with the policy, then the retailer has exercised its right of ownership. However, in such a scenario, the manufacturer did not act unilaterally when setting the prices but, rather, in collusion with the retailer. If setting prices is illegal, or should be illegal because it restricts competition in the market, then they are both responsible for this action.

On the other hand, the retailer does not have to agree with the manufacturer's price setting and can determine its own retail prices. This should be its right. Additionally, it is the right of the manufacturer to choose with whom it will deal and to refuse to deal with anybody else. However, the retailer would not be in a position to exercise this right if it acted under the threat (arguably duress) that its contract would be terminated or that a contract will not be concluded in the first place. In this situation, the retailer would not be free to determine its retail prices. Moreover, the termination of a contract with a dealer who did not agree with a manufacturer's policy should be illegal as the reason for the termination of the contract is anti-competitive.¹⁶⁶ (This also applies *via versa* in situations when a manufacturer has little or no bargaining power.) Unfortunately, the Sherman Act and the TFEU do not cover this kind of issue. Thus, if RPM restricts competition without any benefit, the European Commission tries to prove the existence of an agreement.¹⁶⁷

Areeda and Hovenkamp, and in some part Williamson, argue that manufacturers are the right persons to decide whether to use RPM or VTR as part of their business. They know the market and their business and they are better placed than the courts to recover any mistakes they make if they enforce a vertical practice that is inefficient for their business.¹⁶⁸ However, if the manufacturer decides not to invest in its own distribution but

¹⁶⁵ *Colgate*, 307.

¹⁶⁶ Acting under economic duress has not been applied in competition/antitrust law. Moreover, some national legislations have even reversed their position towards economic duress, claiming that such an action is fully legal – for instance, the Czech Republic: *Obchodni zakonik, zakon c. 513/1991 Sb.* (Commercial Code), §267(2); [Compare with Art. 3.9 (*Threat*) and Art. 3.10 UNIDROIT Principles 2010; UK doctrine of economic duress, for instance - *Universe Tankships of Monrovia* (1983)].

¹⁶⁷ See B. Jedlickova McCabe, "Boundaries between Unilateral and Multilateral Conducts in Vertical Restraints" (2008) 10 *ECLR* 600.

¹⁶⁸ Areeda, Hovenkamp, *Antitrust Law*, 30-31; Williamson, *Antitrust Economics*, 123-160.

sells to distributors and retailers, it determines that its business will not be vertically integrated and passes certain risks to independent entities – its distributors/retailers – who should be free to do their own business. The manufacturer should not make decisions on behalf of the retailers or distributors. Moreover, they know their local customers better than the manufacturer to determine their own prices and other conditions.¹⁶⁹

The European Commission observes:

The retailer is the closest of all the institutions in the distribution chain to the consumer and is increasingly using the knowledge derived from this position to develop activities more suited to consumer demand.¹⁷⁰

As well as in current US policy, in the EU, the freedom of distributors/buyers, to determine their selling territories and retail or other prices is not protected and such “freedoms” are not recognised as distributor rights. Moreover, restrictions of such “freedoms” do not necessarily restrict competition.¹⁷¹ However, the question is open now as to whether the law of vertical restraints should be changed and partially based on the theory of ownership. Nonetheless, the theory of ownership arguably already applies in the determination between agency and non-agency agreements in both US antitrust law and EU competition law.¹⁷²

6.5.1. Basic Freedoms

Free and effective competition should be based on freedom and rights; companies incorporate human beings and should, therefore, have some of the rights of human beings. Similar to basic human rights, such rights should be inalienable if legal persons are truly

¹⁶⁹ A good example that shows that retailers know their final customers well is the large retailer stores in Europe – see R. Herbert, “Private Labels – What Drives Them Forward?” in *Private Labels, Brands, and Competition Policy* (2009, Oxford University Press), p. 19.

¹⁷⁰ Green Paper on Vertical Restraints in EC Competition Policy, Economic Analysis, COM (96) 721, point 31.

¹⁷¹ See T-168/01 *GlaxoSmithKline Services Unlimited v Commission of the EC* [2006] ERC II-02969, paragraphs 167-168, 170-171; C-309/99 *Wouters and Others* [2002] ECR II557, paragraph 97, and Case T-112/99 *M6 and Others v Commission* [2001] ECR II2459, paragraph 76.

¹⁷² For instance, see EU: Case 311/85, *ASBL Vereniging van Vlaamse Reishureaus v. ASBL Sociale Dienst van de Plaatselijke en Gewestelijke Overheidsdiensten* [1985] E.C.R. I-3801; Case 15/74, *Centrafarm BV and Adnaan De Peijper v. Sterling Drug Inc* [1974] ECR 1183, [1974] 2 CMLR 480; T-325/01 *Daimler Chrysler AG v. Commission*, [2007] 4 C.M.L.R. 15; T-66/99 *Minoan Lines SA v. Commission* [2003] ECR T-66/99; US: *Ryko*, 823 F.2d; *Morrison*, 797 F.2d; *Ill. Corp. Travel*, 889 F.2d; *Mesirow*, 703 F.2d; *Hardwick v. Nu-Way Oil Co.*, 589 F.2d 806, 808 (5th Cir. 1979); *Ozark Heartland Electronics Inc. v. Radio Shack*, 278 F.3d 759 (8th Cir. 2002); *Hardwick*, 589 F.2d; *Call Carl, Inc. v. BP Oil Corp.*, 554 F.2d 623,627-28 (4th Cir. 1977); *Miller v. W.H. Bristow Inc.*, 739 F. Supp. 1044, 1052-54 (D.S.C. 1990).

independent entities and not dependant, such as agents. The inalienability prevents possible abuse such as giving up ownership rights for the benefit of the party possessing a significantly stronger bargaining power.¹⁷³

The theory of ownership of competition law is based on three basic freedoms:

- 1) *what* to sell or offer;
- 2) for *how much*;
- 3) to *whom* (which includes *where, when*).

Each seller should have some legal certainty that the law will protect the basic freedoms of their business decisions, based on the ownership of a product/service. Indeed, the issue is more complicated as manufacturers and other participants may wish to sell, as part of their products or services, certain services and trademarks and build specific reputations. However, this does not contradict the freedoms, as buyers will buy the products with these other attributes. Certain boundaries and rules can be or are already determined which can assist to classify what is and what is not part of one product as, for instance, a tied product is not part of the main product. The cases on tying give some idea of such boundaries and rules.

Price is arguably one of the most important aspects for profit making. Therefore, this would lead to the conclusion that the buyer should be free to determine its price once it buys the product and should not be restricted by the manufacturer who already exercised its right when it sold the product to the buyer and, thus, determined its wholesale price.

Similar to RPM, in relation to vertical territories, determining territories while drafting distribution agreements, provided they are not forced upon one party, could simply be recognised as a business deal. However, and on the contrary, if a legislator allows parties to restrict and divide their territories, this could potentially lead not only to intrabrand restriction, but also to a “network effect”, which is a situation based on game theory when several or all distributors are driven to have a market just for themselves and can lead not only to intrabrand but also to interbrand restrictions.¹⁷⁴

¹⁷³ The situation based on giving up of ownership rights occurred in the light bulb market in the US at the beginning of the 20th century as a result of the Consent Decree from 1911 preventing RPM – see R.P. Rogers, “Staff Report on the Development and Structure of the US Electric Lamp Industry” (2/1980) Bureau of Economics, FTC, at 95-100.

¹⁷⁴ Such situations occurred in the US after the *per se* rule had been changed to the rule of reason for territorial restraints. See *Coca-Cola Company, PepsiCo. Inc. v. Federal Trade Commission*, 642 F.2d 1387

It was argued in Chapter 2 “Objective of the Law of Vertical Territorial and Price Restraints” that effective competition should be protected by the law of vertical territorial and price restraints. The objective of protecting effective competition is enhanced by protecting fair and free competition.

For competition to be effective, fair and free, the law must clearly set the rights, in other words freedoms and responsibilities, of participants. This means that although, and on the contrary to the deontological approach, this law is primarily based on the consequentialist or teleological approach, which focuses on the harmful effects, or in other words the outcomes and effects, arising from conduct, the law should go even further as it should precisely determining the participants’ rights and responsibilities. This determination would involve applied natural law based on a deontological approach, as rights and ethics are considered in such a suggested approach. Therefore, by recognising and applying the theory of ownership as discussed above, the law of vertical territorial and price restraints would ensure economic freedom and fairness. In other words, this would ensure that competitors are free to compete without being forced to apply VTR or RPM. Simultaneously, entities introducing and even forcing other, mainly vertical competitors, to apply VTR or RPM would be liable for such behaviour. Such a situation would assist with fair allocation of profits based on efficiency of each entity involved in vertical arrangements between suppliers and buyers; and thus, in general, with maximising efficiency.

6.6. Conclusion

Economic theories offer various explanations for the existence of RPM and VTR. These explanations are either pro-competitive or anti-competitive. Although RPM and VTR are different forms of vertical restrictions, the reasons for their use are almost the same.

The traditional anti-competitive theories are based on forms rather than on anti-competitive effects. Such a formalistic approach does not fully respect the objective of the relevant law as set out in this thesis: the protection of effective competition. It is time to move away

(1981); *First Beverages, Inc. of Las Vegas and Will Norton v. Royal Crown Cola Co. and H & M Sales Co.*, 612 F. 2d 1164 (1980); also see Comanor, “Antitrust Policy” 77; Saas, Saurman, “Mandated Exclusive Territories” 153-177; Culbertson, Bradford, “The Price of Beer” 275; Culbertson, “ Beer-Cash Laws” 209; Jordan, Jaffee, “Exclusive Territories” 137; see Chapter 3 “Vertical Competition and Structure”.

completely from this approach, and consider the different nature of vertical restraints as explained in Chapter 3 and concentrate on the main element of effective competition: effects and efficiency, particularly when the primary effects of the discussed restraints are usually in the form of a restriction of intrabrand, and potentially also interbrand, competition and consumer choice.

Although there are several possible pro-competitive explanations for the usage of RPM or VTR, the arguments are not strong enough to support the *per se* legalisation of RPM and VTR. Even horizontal price fixing or minimum price setting and territorial restraints can have possible positive effects on competition in some markets. However, this does not call for a radical change in competition legislation and policy, which would legalise such conducts. Horizontal cartels can have some forms of efficiency and economic advantages, for instance, the members of cartels stop competing among themselves and, thus, they save money which they can use for innovation. Nonetheless, such a potential positive side to cartels does not lead to the final conclusion that these should be legal.

Arguably, the most pro-competitive usage of both RPM and VTR when considering effective competition as the objective of this law includes situations where new competitors wish to enter a market. RPM or territorial restraints can assist a new competitor in attracting distributors, making the necessary investments and saving advertising costs and, thus, improves their ability to penetrate the market.

Nonetheless, the reasoning behind most pro-competitive theories is fragile and not applicable to all markets in general. The majority of the existing pro-competitive theories are based on similar reasoning, where the essential aspect is free riding. However, it is arguable whether free riding harms or promotes competition. Generally, free competition, which includes free pricing competition, should be protected rather than lessened. As the US Supreme Court stated, antitrust law cannot accept a defence that competition itself, for instance price competition, is unreasonable.¹⁷⁵

Although the economy and economic theories are pivotal in competition, the law itself must be based on other, more legal aspects such as the rights, freedoms and responsibilities of parties. It has been observed that commentators generally forget that not only manufacturers, but also distributors, should have the same ownership rights and freedoms

¹⁷⁵ See *National Society of Professional Engineers*.

to make business decisions. The owner of a product should have the right to set prices and choose its customers, and it should be free to make such decisions without being placed under duress. Each player must be free to make its own business decisions and take full responsibility for these.

Moreover, law which is easily applicable and which protects legal certainty cannot be overcomplicated or over-technical. This could occur in the law of vertical territorial and price restraints if policy shifted focus merely to technically-complicated economic analysis and collecting data in each case. Such an approach would miss the legal aspect based on rights and responsibilities, and would not support legal certainty and transparency, which are two of the main principles of the law in general.

To summarise, pro-competitive or anticompetitive theories are justified if they serve the purpose of protecting effective competition in the sense that in reality, within the real markets, vertical arrangements and their mutual interactions, it is shown that competition in general including its all forms has led to increased efficiency. Without this, hindered competition is not justified. With the assistance of the theory of ownership, effective competition will also honour economic freedom and fairness. The competitors will be free to make their own business decisions without being forced to apply restrictions such as RPM and VTR and may take responsibility for their business decisions. This will lead to fair rewards to entities for increasing their efficiencies which will motivate them to compete and be as efficient as possible. Entities with stronger bargaining power genuinely introducing restrictions such as VTR and RPM will be responsible for such behaviour. Such a balance does not only serve the purpose of protecting effective competition, but it also supports free and fair competition.

Chapter 7: Conclusion

“If vertical competition gets no respect in antitrust analysis, surely the ultimate insult is to deny that it exists at all.”¹ (Robert Steiner)

7.1. Summary

This thesis argues against some existing competition policies and principles, such as the objective of the law of vertical territorial and price restraints. Chapter 2 explains that the principal objective of the law of vertical territorial and price restraints should be the protection of effective competition and not any other values where the effective competition is based on maximising economic efficiency. Efficiency is maximised if competition and competition law respects the nature of the relevant product and geographic market including aspects establishing the nature of the market. Chapter 3 investigated these aspects in the framework of the vertical chain as VTR and RPM are based on vertical and not (only) horizontal relationships and interactions. Chapter 2 indicates and Chapter 3 further confirms the complexity of establishing the exact impact of RPM or VTR on efficiency in particular situations which include consideration of all aspects of vertical interactions: vertical markets and vertical competition. However, this must be simplified when enforcing relevant law.

Chapter 3 revealed the existence of vertical competition as it showed that entities at the vertical level not only compliment each other, but they also compete as they are able to take profit from each other. Unfortunately, vertical competition has not been officially recognised and acknowledged by EU competition law and US antitrust law and the courts and competition authorities applying them as it is obvious in Chapter 4 and Chapter 5. These Chapters also prove the lack of acknowledgement of bargaining power. Bargaining power plays an essential role in RPM and VTR and thus should have played in the law of vertical territorial and price restraints as analysed in Chapter 3. The lack of this recognition is reflected in the fact that relevant law and its application is focused on horizontal market analysis rather than addressing the vertical competitive interactions and the fact that an

¹ R.L. Steiner, “Vertical Competition, Horizontal Competition and Market Power” (2008) 53 *Antitrust Bulletin* 252.

entity or entities with significant bargaining power, which is not necessarily entity or entities with a strong horizontal market position, at one level of vertical chain can abuse such position and vertically restrict competition. The relationship between intrabrand competition and interbrand competition is simplified and the importance of intrabrand competition especially in certain cases is not recognised most notably in the US.²

Chapters 3 and 6 explain and reveal possible motivations for using RPM and VTR which are not always obvious in the case law as discussed in Chapters 4 and 5. Chapter 6 further surveys these intentions in its analysis of the existing pro-competitive and anti-competitive theories, and unveils loopholes in these theories. It criticises the formalistic approach within the traditional anti-competitive theories and the demagogical approach within the majority of pro-competitive theories, which do not prove impacts on efficiency, offering new suggestions and points of view.

Chapter 6 further discusses the issue introduced in Chapter 2: the importance of economic freedom and fairness which assists the principal objective of competition law as set in Chapter 2. Generally, any area of law is best enforced if it respects fairness. This is determined by rights and responsibilities which follow from the theory of ownership and should play an important role in the law of vertical territorial and price restraints as discussed in Chapter 6. In competition law, when protecting effective competition, it is fair allocation of profits which means more profit for more efficient entities. Such fairness is only possible if competitors are free to compete without restricting effective competition. An example of such a restriction is a situation when a retailer with significant bargaining power forces a supplier and other retailers to introduce RPM. If RPM or VTR is forced upon others by a competitor with strong bargaining power, it must be this competitor who should be liable for such behaviour. This reflects the nature of vertical interactions as discussed in Chapter 3; however, such approach is not recognised by the current EU and US antitrust/competition policies which are rather focused on formalistic approach suitable for horizontal cartels as discussed in Chapters 4, 5 and 6.

Chapter 4 and Chapter 5 critically surveyed the development of the laws of vertical territorial and price restraints and included an analysis of the relevant and significant cases in both the EU and the US within the broader historical framework, showing some inconsistencies, simplified explanations of anti-competitiveness and/or pro-

² See, e.g., *Leegin 2, Leegin, Sylvania*.

competitiveness and uncertainties. For example, these cases reveal that the intentions of parties to use RPM or VTR are not always clear, as they have been initiated for the most part by suppliers. Such intentions do not always fit within the current, most notably US, understanding of the reasons for the existence of vertical territorial and price restraints which is based on the presumption that suppliers introduce RPM or VTR for rather pro-competitive reasons. However, the thesis shows that, although there is a potential for pro-competitive intentions of suppliers introducing RPM or VTR, the survey in the thesis reveals that the suppliers can be motivated to introduce RPM or VTR to restrict competition. For instance, Chapter 5 discusses cases where producers in their own interests used RPM or VTR to restrict parallel-trade competition. This is typical for the pharmaceutical market.

The other supplier's reasons for introducing RPM or VTR which are anticompetitive and have the potential to restrict effective competition are:

- **Increasing Output:** If RPM means that there are more retailers interested in selling manufacturer's products, which increases manufacturer's output and therefore profit.
- **The Loss of Retailers (an important retailer):** The first quick consequence of losing a main retailer leads to decrease of outlets for the manufacturer. At least before it finds a new one if consumers do not switch to competing products.
- **A Business Strategic Tool:** Producers use vertical restraints to control the vertical market and adjust its future business strategy because they believe that they will save their own transaction costs and increase profits. However, it rather decreases social welfare because this cost-saving concerns only the manufacturer.
- **Maintaining High Wholesale Prices:** Producers use RPM or VTR to more easily maintain higher wholesale prices as they guarantee retail margins through RPM.
- **Maintaining Distributors' Loyalty.**
- **Maintaining its Reputation for a Premium, Expensive Brand.**
- **Lobbying; Improving its Position and Increasing Bargaining Power:** for example, a smaller producer may fear even being considered by a large retailer and/or it needs to lobby for better shelf position. Therefore, introducing RPM can give it some benefit in the bargaining process.
- **Persuading its Distributors into Another Restraint, such as a tie-in.**

As Chapter 6 discusses, the theories based on the presumption that free riding is anti-competitive are not necessarily pro-competitive explanations of the application of RPM or potentially VTR as free riding can rather enhance than restrict economic efficiency and thus effective competition. The thesis reveals that there is only one clearly pro-competitive and effective competition enhancing explanation for a supplier as to why it would introduce RPM or VTR: penetrating a new market. This is usually based on balanced bargaining power rather than abuse of such power because the supplier must offer some certainty to its buyer to persuade it to take certain risks of selling a new product, or a product new in the particular geographic market.

Chapters 4 and 5 among others discuss the current EU and the US approaches to VTR and RPM. Chapter 4 shows that the US approach to VTR and RPM has been significantly changing. Although the current approach is the rule of reason in both cases, the approach differs from one another. While in VTR introducing the traditional rule of reason in the case of *Sylvania* lead to *de facto* legalisation of VTR, which is not necessarily based on real impacts of VTR in different markets as further discussed in Chapters 3 and 6, RPM's rule of reason is not soundly based. The recent cases on RPM, *Mack Trucks* and *Leegin 2*, do not reveal whether the traditional rule of reason or its modification will apply to this form of vertical restrictions. Moreover, it is not clear from the case law as to what is included and what is not included in the group of vertical price restrictions.³ Even the case of *Leegin* which introduced the rule of reason to all form of RPM does not offer clearly persuasive arguments for this change, simplifying the nature of RPM when it generalises, for example, that the restriction of intrabrand competition increases interbrand competition which is proved false in discussions in Chapters 3, 6 and 4 too. This leads to significant legal uncertainty and lack of consideration of nature of vertical restraints including the existence of vertical competition.

The EU approach to RPM and VTR differs and is more consistent than the US approach as discussed in Chapter 5 protecting among others a significant aim of the EU: the common market. Nevertheless, one of the issues identified in Chapter 5 is that the pro-competitive justifications are not always truly considered by the Commission and that the Commission aims to protect consumer welfare when it applies relevant competition law and not total welfare and thus effective competition as it is defined in Chapter 2. Despite all, the current

³ See *Mack Trucks*, *Euromodas*, *Business Electronics*.

approaches are based on legislative/Treaty provisions which were drafted to tackle horizontal rather than vertical restrictions, and as this thesis shows, they do not fully consider the nature of such restrictions including the existence of vertical competition.

7.2. Main Findings for an Argument against Legalisation

Although this thesis included numerous findings, in terms of the future EU and US policies and suggestions of legal changes, the following findings are the most crucial:

Generally speaking, RPM and absolute territorial restrictions should not be legalised because:

1. The potential for restricting effective competition is significant. Even if in particular cases, RPM and/or VTR have pro-competitive effects, general and absolute legalisation of these restraints could eventually lead to the restriction of effective competition without enhancing any efficiencies. Based on, for instance, game theory, they will be utilised:
 - a. To eliminate more efficient distributors. This occurs most notably when the less efficient distributors have bargaining power and pressure the seller to introduce a vertical restraint. Without using such a restraint, the most efficient distributors will benefit more from the functions of free competition.
 - b. To restrict interbrand competition across the whole industry, as anybody would be free to introduce such a restraint.
 - c. To restrict intrabrand competition in individual, single cases. Even restricting intrabrand competition contradicts the objective of the protection of free and effective competition and can have more restrictive consequences than those so far assigned to RPM and VTR most notably by the courts in the US.
2. RPM and/or VTR dishonour and restrain basic freedoms of vertically competing participants if such conduct is forced upon a party because, in such situations, ownership rights are not respected and participants are not free to determine their business within their ownership-rights framework.

The reason for not legalising as explained in point 2, which is based on legal rights rather than on economic effects, leads to the same final conclusion as point 1., which involves the economic debate, and that is that the legalisation of RPM and VTR would contradict the genuine objective of the law of vertical restraints by restricting effective competition.

Nevertheless, the possible and real pro-competitiveness of VTR and RPM in individual cases must be protected. Most notably, VTR and RPM assist companies and have significant pro-competitive benefits in situations where they are attempting to penetrate a market. However, such situations do not justify the absolute legalisation of RPM and VTR for the reasons previously discussed.

7.3. Current Approach and Suggested Approach

The law must be transparent and certain, and its enforcement must be established within a workable time and cost framework. As this thesis has revealed, these basic principles have been suppressed in the law of vertical territorial and price restraints in both the EU and the US. In the US system, and partially in the EU system, not just is the approach to RPM and VTR uncertain, with only little guidance for lawyers who are left in doubt as to how to advise their clients, it is also overcomplicated, over-technical and expensive. It has been advocated in both jurisdictions that the right economic analysis should apply to cases tackling RPM and/or VTR; however, this advocacy has not assisted legal certainty and transparency, as such an approach can be significantly complicated. Furthermore, it is not clear what the correct economic analysis is, as there does not exist a mutual consensus or clear understanding of the effects of the vertical restrictions in question within vertical competition. Moreover, vertical competition is not recognised in the existing EU and US antitrust/competition policies, rather these policies are based on an understanding of the term “competition” which is suitable more for horizontal restraints, a point criticised by Steiner. Nevertheless, it must be noted that the EU approach is more soundly-based and more appropriate to this matter.⁴

However, due to economic crises, the recent EU competition and US antitrust policies have highlighted the importance of legal certainty and transparency in competition/antitrust law.⁵ Furthermore, considering the intensive discussion, most notably on RPM in the US, it is the right time to begin the process of serious and appropriate changes to the law and policy to honour the legal principles of transparency and certainty. Generally, the current

⁴ Compare the existing approach as discussed in Chapter 5 “Development of the EU Law of Vertical Territorial and Price Restraints” with the legislative suggestions as discussed below.

⁵ US: Ch. A. Varney, “Vigorously Enforcing the Antitrust Laws: Developments at the Division,” (Washington, DC, 24/6/2011), pp. 15, 1, <http://www.justice.gov/atr/public/speeches/272536.pdf>; EU: A. Italianer “EU Priorities and Competition Enforcement”, Dublin, 25/3/2011, p. 10, http://ec.europa.eu/competition/speeches/text/sp2011_03_en.pdf.

approach to vertical territorial and price restraints includes two issues: firstly, the objective of the law of vertical territorial and price restraints and secondly, the nature of vertical arrangements and the real effect of RPM and VTR on effective competition.

7.3.1. Objective

The current approach to vertical territorial restraints in the USA and in the EU has not always respected the protection of effective competition based on efficiency enhancing total welfare but it has rather focused on one of the aspects of competition such as the protection of consumer welfare which does not necessarily lead to maximising total welfare. The principal objective of the law of vertical territorial and price restraints is to protect effective competition based on efficiency as discussed in Chapter 2. However, for competition/antitrust law to be easily enforced and respected by the society based on legal certainty and for competition law to be efficient, an aspect of law: fairness; and an aspect of competition: economic freedom must be protected and honoured. This means following:

- **Effective Competition Based on Efficiency:** Competition law protecting effective competition and thus competitive process motivates undertakings to be as efficient as possible. Only efficient undertakings remain in the market and less efficient undertakings will receive less or will be even driven to exit the market if they do not increase their efficiency.
- **Fair:** Fairness has two aspects while protecting effective competition: A fair reward for undertakings which means that the more efficient competitors having their efficiency based on competitive and legal conducts should be rewarded more than less efficient competitors. Secondly, only competitors who make business decisions in the form of VTR or RPM should be liable and should be punished for such behaviour. This includes competitors with stronger bargaining power who are forcing others to apply RPM or VTR and not the forced parties.
- **Free:** Competitors are free to compete on fair bases and thus increase their efficiencies without being restricted by e.g. vertical restrictions. Competition law must play a role of a referee or a watchdog making such restrictions, which hinder effective competition, illegal and punishable.

7.3.2. The Nature of Vertical Arrangements

As the development of the legal regimes outlined in and Chapter 4 and 5 have revealed, at the beginning of the existence of the Sherman Act in the US and EU competition law, vertical restrictions were not at the centre of attention when the main legislation was drafted. Therefore, the existing primary legislation in both the EU and the US do not respect the differences between vertical competition and horizontal competition and the nature of vertical arrangements, including vertical restraints. Attempts to tackle RPM and VTR within the existing legislative framework have proved to be formalistic, mostly incorrect and insufficient.

Most notably, focusing on the determination of the existence of multilateral conducts rather than purely on the effects of certain behaviours in competition in the form of increasing or decreasing efficiency is not sufficient as some conducts are defined as multilateral, although it could be argued that they are unilateral, and simultaneously, some anticompetitive behaviour hindering effective competition remains legal as multilateral conducts are not proved. The new approach should be based on the understanding that vertical competition exists. Therefore, even vertical entities compete among themselves trying to take profit from one another. The competitors with better position on the vertical chain are the competitors who have stronger bargaining power in vertical arrangements.

Therefore, the new approach to vertical territorial and price restraints must be based on bargaining power rather than horizontal market power. Bargaining power is power which occurs between participants on vertical chain when negotiating their business arrangements. When their arrangement is not well balanced but rather inclines to be one sided and thus offers more benefits to one party, this one party has stronger bargaining power. In general bargaining power is the ability to negotiate better conditions in bilateral/multilateral arrangements including contracts and agreements.

7.3.3. Legislative Suggestions

Considering the above arguments, it must be concluded that the most suitable way of changing the approach to VTR and RPM is to amend the existing primary legislation: the TFEU and the Sherman Act. This amendment must reflect the nature of vertical restraints based on the existence of vertical competition and, hence, its final wording should include

two aspects. Firstly, the existence and the significance of bargaining power in vertical arrangements; and, secondly, the fact that effective competition must be restricted with Member States in the EU or within states in the US to reflect the ineffective results of such vertical arrangements without punishing entities for using vertical arrangements that have pro-competitive effects, such as penetrating a new market.

The existing provisions are not sufficient enough to be applied to tackle vertical restraints in particular RPM and VTR. Firstly, Article 101 of the TFEU and Section 1 of the Sherman Act presume the existence of some form of meeting of minds; however, as the thesis shows, the majority of analysed cases are based on situations when one party with stronger bargaining power forces the other party to comply.

Secondly, Article 102 of the TFEU when it states "...a dominant position within the internal market..." and partly Section 2 of the Sherman Act require monopolistic or dominant horizontal market power which is not equivalent to bargaining power, although it influences bargaining power as further explained in Chapter 3. Thus these provisions focus on the determination of dominating/monopolising a particular horizontal market which does not show whether bargaining power was abused at the vertical level in certain cases dealing with RPM and or VTR but rather whether an undertaking/person or undertakings/persons abused their horizontal market power in the horizontal market.

Despite this, Section 2 of the Sherman Act has a potential to be interpreted to include bargaining power as it states that "[e]very person shall... monopolize any part of the trade or commerce..." if the words "the trade or commerce" could be interpreted as to include vertical chain; in other words, arrangements between a buyer (buyers) and a supplier (suppliers). This could include situations when a buyer with bargaining power forces a supplier to terminate a contract with another buyer who is more efficient to sell for less. That they the buyer with bargaining power monopolises the trade in relation to the product/service of the supplier at the buyer level. Nevertheless, the US courts have applied this provision to horizontal market power in situations when a person or persons have monopolised (or have attempted to monopolise) relevant, horizontal market. It is difficult to imagine that such practice of applying Section 2 could be changed without introducing any legislative changes.

The wording of the new provisions, in addition to existing articles/sections and completely respecting the existing versions of the Sherman Act and the TFEU, could be as follows:

The TFEU:

Any abuse by one or more undertakings of bargaining power which have, as their object or effect, the prevention, restriction or distortion of competition within the internal market shall be prohibited as incompatible with the internal market insofar as it may affect trade between Member States.

This provision tackling vertical restraints must further include the application of Article 101(3).

The Sherman Act:

Every person who shall abuse or attempt to abuse or combine or conspire with another person to abuse bargaining power in any part of the trade or commerce among several States, or with foreign nations, and thus restrain trade shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine...

In both legal systems and presumably in the competition law systems of all developed countries, the abuse of bargaining power in the form of RPM or VTR, such as forcing another party to use RPM/VTR, should be presumed to restrict competition for reasons discussed previously, unless proven otherwise by the party abusing the power. If that party wishes to justify its conduct and prove the pro-competitive effects, it would have the burden of proof. Logically, power would not be abused if, for instance, RPM or VTR is used by an entity penetrating a new market as it does not possess significant bargaining power. However, this situation would change the moment it had established its position and become a powerful competitor. Such an approach is well-balanced, making liable that party or parties who have the power to enforce RPM and/or VTR upon others, avoiding unnecessary formalism and, importantly, respecting the nature of vertical arrangements, including the effects of RPM and VTR as discussed in this thesis.

Contrary to horizontal market power when applying Article 102 of the TFEU and Section 2 of the Sherman Act, bargaining power does not have to be precisely measured and therefore, this is a less technical approach. It is not complicated and technical to determine who has stronger bargaining power in a particular relationship between a supplier and a

buyer or in a particular range of relationships including several buyers and/or suppliers. Simply, by analysing the arrangements between them, it can be determined whether a particular vertical restraint such as RPM or VTR was forced upon the other party as it was one way aim and it served the benefit of the first party without offering any reciprocal conduct.

Articles 101 and 102 of the TFEU and Sections 1 and 2 of the Sherman Act remain; therefore, other aspects of vertical arrangements could be tackled using the existing provisions. Article 101 of the TFEU and Section 1 of the Sherman Act would still apply in situations based on the existence of a mutual agreement between parties on the vertical chain when bargaining power is not abused. For example, this includes cases when two parties of an agreement agree to apply two forms of vertical restraints for the benefits of each party as described by Steiner and discussed in Chapter 3. European Commission should improve its application of Article 101(3) as discussed in the Chapter 5. The US courts should introduce a structured rule of reason to RPM and VTR which would balance the burden of proof between parties and simplify the procedure and serve the legal certainty. Such a structured rule of reason could reflect the EU practice: at the first stage, the petitioner should prove the existence of RPM or VTR, and then the respondent could introduce pro-competitive explanations and effects. In that case, the petitioner would have to prove that any anticompetitive effects outweigh such pro-competitive effects to win the case.

This approach to vertical territorial and price restraints ensures that all subjects of competition benefit from the legal system appropriately and fairly. It is based on the protection of free and effective competition respecting “fair-play” in competition and across industries. Only in fair-play can players compete to their maximum abilities without unfairly obtaining profit; this is competition at its most efficient.

7.4. Final Remark

I would like to conclude this thesis in a personal manner as I have built a very personal relationship with my PhD thesis over these past four years of intensive research. Hence, I believe that readers will forgive me for my final, personal lines:

I believe in justice, humanity and fairness, including fair-play and fair and efficient productivity in business. These are the principles that should be reflected in any area of life, such as personal, working, inter-states and business and, thus, in any area of the law. Therefore, these principles play a central role in this thesis which shows that not only the law of vertical territorial and price restraints, but also the complete law of vertical restraints should be changed, based on knowledge and a better understanding of vertical competition with a soundly-based approach that protects free and effective competition and ensures fairness for everybody.

APPENDIX

TABLE 1: STRUCTURE OF MARKETS¹

DEMAND FORM	SIDE	SUPPLY SIDE FORM		
		MANY	FEW	ONE
MANY		Perfect Competition	Oligopoly	Monopoly
		Oligopsony	Bilateral oligopoly	Monopoly – oligopsony
FEW		Monopsony	Oligopoly –	Bilateral monopoly
ONE			monopsony	


¹ H. von Stackelberg, *Marktform und Gleichgewicht* (1934, Julius Springer, Berlin) in P. Dobson, M. Waterson, A. Chu, "The Welfare Consequences of Exercise of Buyer Power" 16 (Sept. 1998) Office of Fair Trading, Research Paper 8.


TABLE 2: VERTICAL CHAIN (MARKET STRUCTURE and MARKET POWER)

Raw Materials Producers	Monopoly	Oligopoly	Monopoly + possible bargaining power	Oligopoly + possible bargaining power	Perfect Competition		
Raw Materials Distributors	Monopsony (double marginalisation if bargaining power is rather balanced)	Oligopsony (double marginalisation if bargaining power is rather balanced)	Monopoly	Oligopoly	Monopoly/Monopsony + possible bargaining power	Oligopoly/Oligopsony + possible bargaining power	Perfect Competition
Manufacturers	Monopsony (double or triple marginalisation if bargaining power is rather balanced)	Oligopsony (double or triple marginalisation) if bargaining power is rather balanced	Monopoly	Oligopoly	Monopoly/Monopsony + possible bargaining power	Oligopoly/oligopsony + possible bargaining power	Perfect Competition
Distributors	Monopsony (double or triple or multiple marginalisation if bargaining power is rather balanced)	Oligopsony (double or triple or multiple marginalisation if bargaining power is rather balanced)	Monopoly	Oligopoly	Monopoly/Monopsony + possible bargaining power	Oligopoly/Oligopsony + possible bargaining power	Perfect Competition
Retailers	Monopsony (double or triple or multiple marginalisation if bargain power is rather balanced)	Oligopsony (double or triple or multiple marginalisation if bargain power is rather balanced)	Monopoly	Oligopoly	Monopoly/Monopsony + possible bargain power	Oligopoly/Oligopsony + possible bargain power	Perfect Competition

Table 2: Explanation

This table shows the basic relationships between contractual parties at the vertical level. It determines bargaining power only from the perspective of market structure and related market power. It manifests that it is complicated and probably almost impossible to correctly determine the impacts of certain conduct on the entire vertical chain and thus it is difficult to precisely analyse relevant vertical competition. However, it is important to note that market structure and market power are only two aspects of bargaining power. Other aspects can influence bargaining power in such a way that the results could be in contradiction with this table. It would be more complicated to draw a table showing this as it would include more options if other aspects influencing bargaining power, such as brand reputation and transparent information, were included.

Vertical Relationship: 

Vertical Relationship/Interaction - Ideal Situation: 

The European Union

Article 101 of the TFEU

(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) Any agreements or decisions prohibited pursuant to this Article shall be automatically void.

(3) The provisions of paragraph 1 may, however, be declared inapplicable in the case of:

- any agreement or category of agreements between undertakings,
- any decision or category of decisions by associations of undertakings,
- any concerted practice or category of concerted practices, which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

- (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
- (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

Article 102 of the TFEU

Any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States.

Such abuse may, in particular, consist in:

- (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
- (b) limiting production, markets or technical development to the prejudice of consumers;
- (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
- (d) making 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.

The United States

Section 1 of the Sherman Antitrust Act

Trusts, etc., in restraint of trade illegal; penalty

Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding \$10,000,000 if a corporation, or, if any other person, \$350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

Section 2 of the Sherman Antitrust Act

Monopolizing trade a felony; penalty

Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding \$10,000,000 if a corporation, or, if any other person, \$350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

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