Some new findings that are relevant to the VGL's approach to resale price maintenance

by *Dr. Melanie Ariane Schwaderer, LL.M. (LSE)*
EUI Florence/ Universität Erfurt
27.05.2019

The research summarized below is taken from Schwaderer, "Resale price maintenance in consumer good markets: an economic justification for the prohibition of RPM", unpublished Ph.D. thesis, defended 27.02.2019, EUI Florence (supervisor: Prof. Dr. Heike Schweitzer, Humboldt-Universität zu Berlin, internal advisor: Prof. Giorgio Monti, EUI Florence, Italy). **For the full argument and references see *Schwaderer 2019*.**

The cited literature can be found below in the short bibliography.

It relates to the following questions of the questionnaire:

- Do you consider that the VBER and the related guidance in the VGL provide a sufficient level of legal certainty for the purpose of assessing whether vertical agreements and/or specific clauses are exempted from the application of Article 101 of the Treaty and thus compliant with this provision (i.e. are the rules clear and comprehensible, and do they allow you to understand and predict the legal consequences)?
- Do you see the need for a revision of the VGL (including Section VI) in light of major trends and/or changes during the past 5 years (e.g. the increased importance of online sales and the emergence of new market players)?
- Is there any area for which the VBER and/or the VGL currently do not provide any guidance while it would be desirable?

The VGL need to be modified with regard to RPM. While the below summarized analyses support the EU's strict approach to RPM, in particular the Commission's reluctance to accept the service-based explanations of RPM as pro-competitive justifications under Art. 101 (3) TFEU, they also show that the Commission's guidance on RPM in the VGL needs to be modified. It is in particular necessary to move away from the VGL's focus on service-based RPM models (VGL, para. 223) towards a discussion of the so far largely ignored price-based RPM models, as these models are more likely to explain RPM, in particular in the cases where RPM is initiated by a non-dominant, non-colluding supplier. As long as the current focus is kept and the more likely price-based models are ignored, the VGL do not provide sufficient legal certainty (question 1 above); it would be desirable that guidance on the price-based explanations of RPM is added to the VGL (question 3 above); this has become – as shown below – particularly clear in light of the radically changed consumer behavior brought about by the emergence of the internet (question 2 above).

The research (*Schwaderer 2019*) relied upon in the questionnaire in particular shows:

I. Price-based, not service-based models explain the use of RPM in the absence of market power and collusion.

The above cited thesis shows – based on empirical analyses – that the inducement of pre-sale services is unlikely to be the motivation for the use of RPM and that RPM is rather used to secure a uniform (high) price level, which is used to create the perception of (high) quality, either as a credible quality signal, a component of the product or a mechanism to bias the consumer decision.

This claim is based on the following analyses:

1. An analysis of the empirical relevance of the service-based RPM shows that these models are unlikely to accurately describe the real world phenomenon of RPM for the following two reasons:

a) There is no evidence that RPM *is* frequently used to induce dealer services (*Schwaderer 2019: 33-66*).

An in-depth analysis of the existing empirical studies on RPM, which are often cited by proponents of a more lenient approach to RPM, shows that these studies – in contrast to what is often suggested (e.g. *Wright 2009: 22*) – do not provide convincing evidence that RPM is used to induce services. The often cited "incidence studies" (*Overstreet 1983; Ippolito 1988; id. 1991; Ornstein 1985)* and the "effects studies" *(Cooper et al. 2005a; id. 2005; Lafontaine and Slade 2008; Overstreet 1983*) suffer from methodological limitations and the use of outdated data, which has no relevance in the digitalized information environment of today; where the "apparent likelihood" for the service-based models' conditions to be fulfilled on real world markets is examined (*Klein (2009); Wright (2014)*), the analysis remains incomplete, considering only one condition of a model in isolation, thus not being able to provide strong evidence, as this would require an examination of all conditions of the particular model.

b) There is new evidence that RPM *is not* used to induce services (*Schwaderer 2019: 67-121*).

An analysis of new evidence – taken from current marketing research – shows that in the digitalized information environment of today, it is highly unlikely that RPM is used to induce services. It can be shown that in particular the service-based models' condition that pre-sale services must be crucial for demand is unlikely to be fulfilled in today's consumer good markets, in particular in view of the drastic changes in consumer behavior brought about by the emergence of the internet and described in the marketing literature. In addition it shows that, even if such services were crucial for demand, the supplier would be paying for the services directly, as RPM is unlikely to be the most efficient mechanism to induce services.

2. An analysis of three price-based explanations of RPM (*Schwaderer 2019: 123-214*) shows that there are plausible alternatives to the refuted service-based models that can fill the gap, which the negative models of RPM of collusion and exclusion cannot fill, as they are applicable only under very narrow circumstances. This is important, as it is not sufficient to refute the service-based models, as "it takes a theory to beat a theory" (*Stigler 1992: 62* as cited by *Wright 2009: 359*). As RPM is a cost to the supplier (who – in contrast to cartelists – does not directly benefit from the (horizontal) restriction of competition among its dealers), there must be an offsetting benefit that may (or may not) enhance interbrand competition on the supplier-level thereby outweighing the intrabrand restriction. The price-based explanations are able to account for this offsetting benefit and motivation of the supplier to incur the costs of RPM.

II. Of the three price-based RPM models, only the "price as quality signal model" should be accepted as pro-competitive justification under Art. 101 (3) TFEU.

An analysis of the three price-based models of RPM (*Schwaderer 2019: 123-211)* shows the following:

The "price as quality signal model" (= price model 1), based on *Inderst 2013*, is a fully-developed model, in which positive effects on welfare are predicted. In the model the supplier desires to control the retail price through RPM in order to be able to provide the consumer with information on the quality of the (physical) product; price is seen as an information tool that solves an information asymmetry between supplier and consumers that would lead to a "market for lemons" (*Akerlof 1970*) . With regard to the model's empirical relevance an analysis of the marketing literature shows that the model will rarely apply, as the required informational market failure is unlikely to occur in today's consumer good markets (*Schwaderer 2019: 139-150*).

If there is no informational market failure, the situation is more difficult. RPM is then used to either create a valued image component of the product ("price as utility model" = price model 2) or to bias the consumer decision ("consumer bias model" = price model 3). The "price as utility model" is based largely on *Orbach 2010*, the "consumer bias model" on *Kuenzler 2017*.

Which of the two models applies depends on whether the consumer is rational or not, whether she truly values the high price image independent from the product's intrinsic quality or is merely being misled by it. This is an empirical question that is difficult, if not impossible, to decide and that – at least at first sight – is crucial, as positive welfare effects are predicted only in one of the models, namely price model 2. Nevertheless, there may be an easy solution, as it may be possible to argue that price model 2 may never apply (as rational consumers always identify high price with high (intrinsic) quality, on this *Schwaderer 2019:163ff.*) or that its prediction of welfare effects is inaccurate for the following two reasons (*Schwaderer 2019: 161ff., 166ff.)*: First, as there is a lack of systematic economic research on the demand for the emotional component of the product there is no firm established basis for the prediction of welfare effects, where – as in price model 2 – increased sales are the result of psychological effects. Second, there is no market failure to be remedied by RPM in price model 2, as the demand for the psychological effects arising from the good's high price can be satisfied also by products that emanate the luxurious aura because of their inherent quality, i.e. by naturally, instead of artificially, scarce goods.

III. Concrete implications for the Commission's VGL

The VGL should reject as highly unlikely any justification of RPM which claims that RPM is used to induce services; this includes the free rider models, but also the *Klein*/contract enforcement model that currently is not mentioned in the VGL.

The "price as quality signal model" should be included into the VGL as a possible pro-competitive justification under Art. 101 (3) TFEU. Businesses should be cautioned that they must prove an informational market failure, which will rarely exist in the information environment of today.

The "price as utility model" should be rejected as possible pro-competitive justification.

Economic research on the welfare effects of RPM in the absence of an information market failure should be encouraged.

Bibliography

Akerlof (1970)	AKERLOF, GEORGE A. (1970) 'The Market for "Lemons": Uncertainty and the Market Mechanism' 84 (3) *The Quartely Journal of Economics* 488-500
Cooper et al. (2005a)	COOPER, JAMES C., LUKE M. FROEB, DAN O'BRIEN and MICHAEL G. VITA (2005a) 'Vertical antitrust policy as a problem of inference' 23 *International Journal of Industrial Organization* 639-664
Cooper et al. (2005)	COOPER, JAMES C., (2005), A Comparative Study of United States and European Union Approaches to Vertical Policy, 13 *George Mason Law Review* 289
Inderst (2013)	INDERST, ROMAN (2013) 'An Economic Analysis of 'Price Ownership' by Branded Goods Manufacturers' Study conducted for the German Markenverband (Association of Brand Manufacturers), Research & Consulting Services; available at http://www.markenverband.de/publikationen/studien/Branded%20Goods%20and%20Price%20Ownership%20Report%20-%20Roman%20Inderst.pdf (last accessed 30.06.2018)
Ippolito (1988)	IPPOLITO, PAULINE M. (1988) 'Resale Price Maintenance Economic Evidence From Litigation Bureau of Economics Staff Report Federal Trade Commission April 1988'; available at: https://pdfs.semanticscholar.org/5eae/347f747f141a3ec13696ec25e0b63d78b658.pdf (last accessed 30.06.2018)
Ippolito (1991)	IPPOLITO, PAULINE M. (1991) 'Resale Price Maintenance: Empirical Evidence from Litigation' 34 *The Journal of Law and Economics* 263-294
Klein (2009)	KLEIN, BENJAMIN (2009) 'Competitive Resale Price Maintenance in the Absence of Free-riding' 76 *Antitrust Law Journal* 431-481
Kuenzler (2017)	KUENZLER, ADRIAN (2017) 'Dilution Law, Vertical Agreements, and the Construction of Consumption´ 37 *Oxford Journal of Legal Studies* 75-104
Lafontaine and Slade (2008)	LAFONTAINE, FRANCINE, and MARGARET SLADE (2008) 'Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy' in: Buccirossi, Paolo (ed) *Handbook of Antitrust economics* (MIT Press) 391-414
Orbach (2010)	ORBACH, BARAK Y (2010) 'The image theory: RPM and the allure of high prices' 55 (2) *The Antitrust Bull* 277-307
Ornstein (1985)	ORNSTEIN, STANLEY I. (1985) ´Resale price maintenance and cartels´ 30 *Antitrust Bulletin* 401-432
Overstreet 1983	OVERSTREET, THOMAS R., JR. (1983) 'Resale Price Maintenance: Economic Theories and Empirical Evidence Bureau of Economics Staff Report to the Federal Trade Commission November 1983'; avialbee at: https://www.ftc.gov/sites/default/files/documents/reports/resale-price-maintenance-economic-theories-and-empirical-evidence/233105.pdf (last accessed 30.06.2018)
Schwaderer (2019)	SCHWADERER, MELANIE A. (2019), *Resale price maintenance in consumer good markets: an economic justification for the prohibition of RPM*, unpublished Ph.D. thesis, EUI Florence, supervisor: Heike Schweitzer, internal advisor: Giorgio Monti, further committee member: Rupprecht Podzun, Lorenzo Federico Pace.
Stigler (1992)	STIGLER, GEORGE (1992), Graduate School of Business, University of Chicago, Nobel Memorial Lecture: The Process and Progress of Economics (Dec. 8, 1982), in Mäler, Karl-Göran *Nobel Lectures, Economics 1981-1990* NOBEL LECTURES, ECONOMICS 1981-1990 (Singapore: World Scientific Publishing Co. 1992) 67
Wright (2009)	WRIGHT, JOSHUA D. (2009) 'Overshot the Mark? A Simple Explanation of the Chicago School's Influence on Antitrust' *George Mason University Law and Economics Research Paper Series 09-23*; available at http://ssrn.com/abstract=1370641 (last accessed 30.06.2018)
Wright (2014)	WRIGHT, JOSHUA D. (2014) 'The Economics of Resale Price Maintenance & Implications for Competition Law and Policy' Remarks of Joshua D. Wright Commissioner, Federal Trade Commission before the British Institute of International and Comparative Law London United Kingdom April 9, 2014';

available at https://www.ftc.gov/public-statements/2014/04/economics-resale-price-maintenance-implications-competition-law-policy-0 (last accessed: 30.06.2018)