

Recent EU fines for resale price maintenance are symptoms of broader challenges faced by today's consumer-goods manufacturers

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The European Commission (the “Commission”) issued four separate decisions on 24 July 2018, fining consumer electronics manufacturers Asus, Denon & Marantz, Philips and Pioneer a total of €111 million for imposing fixed or minimum resale prices on their online retailers in breach of EU antitrust rules (so-called “resale price maintenance” or “RPM”).

The decisions are significant in three respects:

- They mark the first time the Commission has imposed fines for RPM in 15 years. The last time was in 2003, when the Commission fined a musical instrument manufacturer, Yamaha, €2.56 million for imposing minimum resale prices on authorised dealers under a selective distribution system and on importer-distributors. In the past decade, the Commission had largely left the enforcement of RPM and other vertical restraints to national competition authorities such as the German Federal Cartel Office.

- These are also the first antitrust cases in which the Commission looked closely at the role of algorithms. The Commission’s statements indicate that two types of algorithms affected its analysis. First, the Commission noted that the manufacturers employed software to monitor online retail prices among the members of their respective distribution networks, thus making it easier to enforce the minimum resale price restraints. Secondly, the Commission indicated that the online retailers themselves used algorithms to automatically adjust prices to those of their rivals, thus broadening the market-wide impact of price increases.
- The decisions are also notable because, in assessing the fines, the Commission granted generous discounts to the consumer electronics manufacturers for providing evidence that added significant value to the investigation, and because they acknowledged liability for infringing EU antitrust rules. This is a significant development because the Commission’s leniency and settlement programs have traditionally been used in cartel enforcement, but not with respect to other types of infringements, such as the vertical restraints at issue here.

Nature of the conduct

The decisions have yet to be published. According to the Commission’s press release, however, during periods ranging from 2011 to 2015, the four consumer electronics manufacturers individually monitored online retail prices for their respective products, which included kitchen appliances, hairdryers, notebook computers, headphones and hi-fidelity audio devices. The Commission alleged that the manufacturers employed sophisticated price-monitoring software and swiftly intervened with retailers when resale prices were below certain levels.

According to the Commission, the manufacturers enforced minimum resale prices by imposing or threatening to impose sanctions, such as withholding supplies of the relevant products to the retailer. Subsequent price increases by individual retailers had a far-reaching impact on prices across the industry as a result of the algorithms the online retailers used to monitor and automatically adjust in real time their prices in response to prices charged by their competitors.

The official investigations were opened shortly before the Commission published the final findings of its e-commerce sector inquiry on 10 May 2017, which identified resale price restraints as one of the most prevalent business practices that may restrict competition in e-commerce sales. The 2017 report showed that such practices were widespread, with 42 per cent of the

respondents to the inquiry indicating that they had pricing limitations imposed on them. However, Competition Commissioner Margrethe Vestager indicated that the investigations were launched independently of the sector inquiry following complaints from retailers.

Possible incentives for such conduct

One might be tempted to ask why manufacturers would care that retailers are charging lower prices. Holding all else equal, lower resale prices should increase the quantity of product demanded by consumers and help the manufacturer compete with rival manufacturers, thus increasing the manufacturer's sales volume. While lower resale prices should be expected to increase the quantity of product demanded by consumers and help the manufacturer compete with its rivals, there are several reasons why manufacturers might instead prefer higher resale prices.

Harm to brand

The Commission found during its sector inquiry that one of the most important ways for modern manufacturers to compete is on brand image, and that price competition can be of lesser importance to manufacturers. Higher prices can signal quality to consumers, and investments by manufacturers to create a brand that consumers associate with a certain level of quality can be undermined by low resale prices. Even within a brand, manufacturers may offer products at different levels of quality to cater to different consumer preferences such as those seeking an entry level product versus those seeking a more fully featured product. Retailer pricing may disrupt that product architecture, causing confusion for consumers as to the value proposition of different products in the line.

Reduced investments and sales efforts by retailers

Demand for a manufacturer's products can be influenced by the quality of service and shopping experience that the retailer provides and the sales associate's ability to describe the merits of the manufacturer's products. These services require investments by the retailer, which can be discouraged if the retailer must charge lower prices to sell the manufacturer's products in competition with price cutters that do not provide such services. A manufacturer's ability to protect such investments can produce useful services for consumers, drive demand for the manufacturer's products, and help the manufacturer compete with rivals.

Reduced points of distribution

Instead of reducing service in response to lower resale prices, some retailers may choose to drop the manufacturer's products and allocate shelf space to an alternative product that provides the retailer with a better return. A manufacturer's inability to offer retailers a

competitive return on resales of a product can thus harm a manufacturer's distribution reach and limit its ability to compete for sales.

Lowered wholesale pricing

A retailer may alternatively respond to lower resale prices by demanding that a manufacturer lower its wholesale prices so that the retailer's margins are preserved at the lower resale price point. A manufacturer seeking to avoid losing an important distribution partner may acquiesce and be less profitable as a result of the lower resale pricing.

Impact of price algorithms and e-commerce technology on manufacturer incentives

Although the Commission's press release focused on the impact of algorithms on the manufacturer's ability to monitor retailers' pricing and the market-wide impact of retailers charging higher prices, such algorithms can also affect the incentive for manufacturers to seek influence over reseller pricing in the first instance. Prior to the emergence of online sales, low prices charged by small bricks-and-mortar retailers were unlikely to lead to significant price declines as customers needed to spend significant time to compare prices between offline shops, and low pricing by a small competitor with limited storefront presence, limited service or limited inventory was unlikely to have much impact on larger retailers. In the digital era, by contrast, price comparison and price aggregation websites allow consumers to compare online prices instantaneously, and online marketplaces like those offered by Amazon or eBay can give small, and even unauthorised, retailers broad reach and prominent placement in search results. The use of algorithms by larger retailers to match price can result in these small retailers having large impacts on market-wide pricing in ways that would not have been possible prior to the emergence of this technology.

For example, a small unauthorised reseller working from her kitchen table can potentially affect market prices long after she has sold out the limited inventory stored in her garage. And while this may temporarily benefit consumers through lower prices than would otherwise be available, the long-term result may be that retailers cut back on services, stop carrying the manufacturer's products, or demand lower wholesale prices that can cause the manufacturer to reduce output. These dynamics thus increase the incentives for manufacturers to control their distribution networks, prevent unauthorised resales, and obtain more influence over resale pricing.

EU rules on RPM

In general, companies are free in how they organise the distribution of their products in the EU. EU antitrust rules however take a hard stance against RPM that is viewed as a so-called "hardcore restriction". Where RPM is

included in an agreement, that agreement is presumed to restrict competition and thus fall within the scope of art.101(1) TFEU, which prohibits agreements that have as their object or effect the restriction of competition.

The Commission's Guidelines on Vertical Restraints¹ define RPM as

“agreements or concerted practices having as their direct or indirect object the establishment of a fixed or minimum resale price or a fixed or minimum price level to be observed by the buyer.”

In the case of contractual provisions that directly establish a fixed or minimum (re)sale price, the restriction is clear cut. However, RPM can also be achieved through indirect means. The Guidelines on Vertical Restraints provide a non-exhaustive list of examples such as fixing the distribution margin, fixing the maximum level of discount the distributor can grant from a prescribed price level, making the grant of rebates or reimbursement of promotional costs by the supplier subject to the observance of a given price level, linking the prescribed resale price to the resale prices of competitors, threats, intimidation, warnings, penalties, delay or suspension of deliveries or contract terminations in relation to observance of a given price level.²

The Guidelines further indicate that direct or indirect means of achieving price fixing can be made more effective when combined with measures to identify price-cutting distributors, such as the implementation of a price-monitoring system, or the obligation on retailers to report other members of the distribution network that deviate from the standard price level. They subsequently clarify, however, that the use of such a supportive measure is not considered in itself as leading to RPM.³

As an exception to the prohibition set out in art.101(1) TFEU, art.101(3) TFEU provides that the prohibition contained in art.101(1) may be declared inapplicable under certain conditions where the agreement at issue leads to countervailing competitive benefits or efficiencies under art.101(3) TFEU. Although theoretically RPM can be justified under art.101(3) TFEU, in practice, convincing competition authorities that the pro-competitive effects of RPM outweigh the anti-competitive effects will typically be an uphill battle.

The Vertical Block Exemption⁴ recognises that RPM may produce pro-competitive effects where it is applied temporarily to introduce a new product or organise a franchise system or similar distribution system applying a uniform distribution format, or where it provides the means and the incentive to prevent free-riding on (additional) pre-sales services. The Vertical Block

Exemption however does not expressly recognise the protection of brand image, which is one of the key parameters of competition at the manufacturing level.

Contrasting the US approach to RPM

Although minimum RPM is analysed under the rule of reason under US federal law, and thus can be lawful, it remains per se unlawful in several US states. As a result, US manufacturers rarely seek to enter into RPM agreements with retailers. Instead, US manufacturers more commonly manage the challenges discussed further above through minimum advertised price (“MAP”) policies or through *Colgate* policies.

A MAP policy allows the retailer to charge any price it chooses at checkout, but prevents the retailer from *advertising* a price for the manufacturer's products below the MAP price. Under a *Colgate* or “unilateral pricing” policy, the retailer also retains discretion over how to price, but the manufacturer will choose not to sell to retailers that price inconsistently with the manufacturer's suggested resale prices. Although such policies can be difficult to execute in practice and require careful oversight by counsel, they are generally upheld as lawful under US law.

In the EU, there is no Commission case law on whether *Colgate* or MAP policies, on their own, constitute (indirect) RPM. *Colgate* policies may, however, be construed as (indirect) RPM because they attach penalties for retailers who do not follow the manufacturer's pricing policies. With respect to MAP policies, the Commission has indicated that they are likely also to amount to a restriction of competition by object without any credible pro-competitive effects.⁵

Outlook

The decisions signal a return to enforcement in vertical restraints at the EU level, and the Commission is sending a stark reminder that it views intervention by manufacturers in their retailers' freedom to set their own prices as a violation of EU antitrust rules. Following the Commission's e-commerce sector inquiry, several Commission investigations into online sales practices are currently pending. And this comes at a time when the incentives for manufacturers to influence resale pricing are as strong as ever, given the impact of e-commerce technology and price-matching algorithms.

As a result, manufacturers must be careful when seeking to manage and influence behaviour among EU resellers in their distribution network. While manufacturers may monitor and use monitoring software to track prices at the retail level, they should be careful

¹ Commission's Guidelines on the application of Article 101 TFEU to vertical restraints [2010] OJ C130/1.

² Guidelines on Vertical Restraints, para.48.

³ Cf. Guidelines on Vertical Restraints, para.48, last sentence.

⁴ Commission Regulation (EU) 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices [2010] OJ L102/1.

⁵ Commission Reply to Petition No.2383/2014 by Norbert Perstinger (Austrian), on the introduction of the Minimum Advertised Price (MAP) in the European Union dated 25 November 2015, available at <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+COMPARL+PE-572.975+01+DOC+PDF+V0//EN> [accessed 10 September 2018].

not to intervene with EU retailers in a way that would pressure or incentivise the retailers to follow a recommended price set by the manufacturer. It is important for manufacturers to seek advice from counsel when designing strategies to manage their distribution networks.

The decisions, however, do offer some good news for companies under investigation in the EU as they appear to confirm the shift in the Commission's policy to extend their leniency and settlement procedures to infringements other than cartels. This procedural development should allow the Commission to deal with non-cartel infringements more quickly and efficiently in the future.