CRA Competition Memo

When do retail price communications between retailers and manufacturers become RPM? *

Introduction

Commercial negotiations between manufacturers and retailers necessarily involve a discussion of wholesale prices, but they may also involve a discussion of potential *retail* prices, including recommendations of retail prices by manufacturers (RRPs). Retail prices not only determine how much money a retailer will make, but also how much product the manufacturer will sell. Furthermore large retailers may have little idea of how to price specialist products, something on which manufacturers have often undertaken significant amounts of research.

While these communications are generally beneficial and efficient, there are two main concerns with price communications between retailers and manufacturers. First, the possibility that these price communications may be passed onto a competitor thus facilitating coordination. Second, the possibility that pricing communications may mask a Retail Price Maintenance (RPM) agreement by the retailer to implement a price required by the manufacturer.

The first of these concerns is now well-established within the case law and has a clear legal test – the 'A2B2C' test or 'hub and spoke' test. However the second of these concerns is both less developed and arguably more contentious, given the treatment of RPM as anti-competitive by object. Using evidence of RRPs and its subsequent implementation as evidence of RPM implies that implementation of RRPs de-facto becomes an object infringement. This short memo sets out the main issues behind such cases and explains the role that economic evidence can play in informing whether discussions on retail prices were in fact supporting the existence of an RPM agreement.

When are Vertical Communications harmful?

Communications of prices between suppliers and manufacturers are generally unlikely to be harmful and are often integral parts of the negotiation process. Discussions on wholesale price are a strictly necessary part of the negotiation process for retailers. Furthermore, retailers may even communicate a rival manufacturer's price to the manufacturer it is negotiating with, in order to try to secure a better deal. As such it is notable that, to date, there have been no cases concerning wholesale price communications, even if firms' wholesale prices may sometimes be communicated to rivals during the negotiation process.[1] Any attempt to block such communications runs a real risk of dampening retailers' ability to negotiate and could end up increasing manufacturer – and therefore retailer – prices.

Communications on *retail* price between retailers and manufacturers have attracted greater regulatory scrutiny. In the past, cases on retail price communications have centred on the concern that a manufacturer may act as a conduit or 'hub' for price communications between retailers – thereby facilitating the possibility of coordination. Nonetheless, UK Courts have also been mindful of the fact that a blanket ban on discussions between a retailer and manufacturer regarding retail price is likely to dampen competition. To square the issue the UK Courts have focussed only on cases where communications on retail prices have been knowingly passed onto a rival – with purely bilateral communications not considered as problematic.[2]

In the recent *Sports Bras* case however, the OFT took the view that the *bilateral* communications of retail prices between manufacturer DBA and certain retailers were problematic – even absent any allegation that DBA was passing retail prices on to rival retailers.[3] This raises the question of how one should treat communications of retail prices and when such communications should be considered evidence of RPM.

How to differentiate between normal retail price communications and RPM?

In trying to differentiate between normal, benign retail price communications between a manufacturer and a retailer (of the type discussed in the Court of Appeals), and RPM, there are three main questions that should be asked.

Question One: Is there a pro-competitive explanation?

Is there a clear pro-competitive explanation for the communications, consistent with the evidence? If there is, then any authority must be especially careful in what it considers sufficient evidence of an RPM agreement.

The economic literature is clear that manufacturers have a strong interest in what price retailers charge: the higher the retail price, the lower the manufacturer's sales will be. Indeed manufacturers are often willing to finance retailer promotions on the specific condition that retailers' prices will, and actually do, fall.

Furthermore, in the case of communications of RRPs, the literature suggests an additional reason for both manufacturers and retailers to discuss retail prices. Retailers that sell tens of thousands of product lines may not have the time or knowledge to research the appropriate price for a given new product. In contrast, manufacturers often spend significant amounts of time researching where their product should be positioned within the market. The result is that manufacturers often have better information on the correct level of market price than retailers.[4] Buehler and Gartner (2013) showed that sharing this better information can lead to both lower consumer prices and higher firm profits. Manufacturers will recommend a lower RRP in order to encourage the retailer to sell more, and retailers will listen to this because the manufacturer has

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∗ The views expressed in this memo are those of the author, and do not reflect the opinions of other CRA experts or CRA's clients.

1 The OFT stated that "*Retailers regularly go back and forth in negotiations between competing suppliers in order to get the best possible terms. In negotiation, they may quote prices to one supplier available from that supplier's competitor in order to negotiate a lower price from the first supplier. In some circumstances, this may be an important way in which they are able to exploit their bargaining position, which may result in benefits to consumers in terms of lower prices and greater choice in the downstream markets*." UK submission to OECD roundtable on Unilateral Information Disclosures, page 168, 2012.

2 The Court of Appeal in Argos vs OFT stated: "It is one thing for a manufacturer to ask its distributors, as a matter of routine, to inform it of the prices at which and the terms on which they sell its products, which it may wish or need to be aware of for its own commercial purposes and in the context of the ongoing relationship with each distributor separately. It is quite another (as it was found to be in the Hasselblad case itself) where the information is obtained in order to be shared with other customers of the same manufacturer." Argos, Case Nos 2005/1071, 1074 & 1623 Argos Ltd and Littlewoods Ltd v Office of Fair Trading and JJB Sports Plc v Office of Fair Trading [2006] EWCA Civ 1318, ¶99.

3 See https://www.gov.uk/cma-cases/sports-bras-rpm-investigation.

4 The CAT in Tesco stated that one of the key efficiencies pf RRPs is: "suppliers may be better informed about the suitability of a particular retail price point, both in absolute terms and relative to the products of other suppliers, than a retailer."

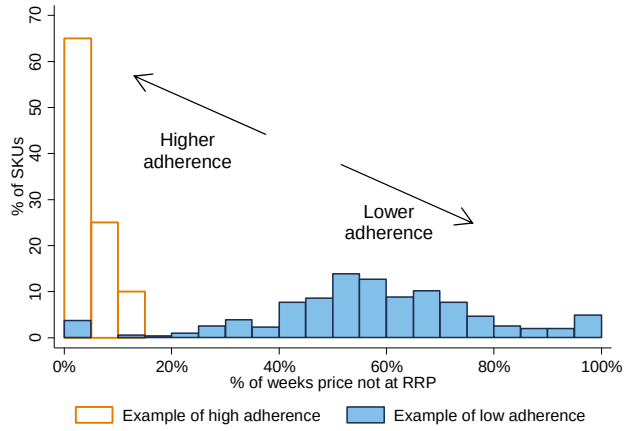
better information about the product and the retailer wishes to avoid shortages or unsold inventory.

In the context of *Sports Bras* this explanation fitted the facts of the case closely. Sports bras are speciality garments for which the large department stores in question did not have 'own brand' products. DBA put out new products regularly and had much better information on how those products were likely to sell and at what price. Furthermore, choosing too low a price initially was costly for retailers as prices were directly ticketed on the garment. An increased price could not be simply pasted over the original price without leading to customer complaints – increasing prices required the department store to remove all the clothes from the rack and re-ticket them. This meant information from manufacturer RRPs had a real benefit for the retailers.

Question Two: Is the economic evidence consistent with RPM?

RPM delegates responsibility for setting retail price from the retailer to the manufacturer. In RPM any changes in retail price are logically derived from an order issued by the manufacturer to the retailer. This suggests a simple economic test to determine if any communications are hiding an RPM agreement: any price change that occurs should have a corresponding communication from the manufacturer.[5] The more that retail price deviates from the level discussed between the manufacturer and the retailer, the clearer it is that the retailer is acting independently and therefore there is no RPM agreement.

Figure 1: Consistency of pricing with RPM



When there are multiple products, it is likely to be too simplistic to simply test whether the *average* price across these products was equal to the RRPs – in fact, this will be biased towards not finding RPM because the average price will depend on the mix of products. In these cases one should therefore consider individual SKUs – to determine whether price was equal to the RRP at the SKU level. One may also want to build in some degree of 'tolerance', so that a very small deviation from RRP – which might be driven by a one-off discount for damaged goods, for example – is not erroneously claimed as evidence of a lack of RPM.

In the *Sports Bras* case, we looked at deviations of up to 5% and 10% away from RRP before counting a SKU as inconsistent with RPM. However even allowing for this, the vast majority of SKUs were priced away from the relevant RRP for the majority of their product life time – i.e. there was low adherence of RRPs (see Figure 1). In addition, we also examined whether actual pricing was significantly closer to RRP during the period of alleged infringement (as one would expect if the RRP was RPM) compared to outside the alleged infringement. Once again there was no evidence that this was the case.

These two pieces of economic analysis fundamentally questioned the interpretation of the communications of RRP as evidence of an RPM agreement.

Question Three: Is there a plausible theory of harm that fits with the market context?

Finally, is there a plausible theory of RPM in which the manufacturer benefits from instigating higher retail prices? If not, one must question whether communications relating to RRPs are evidence of an RPM agreement. In particular, if both the upstream manufacturer and the downstream retailer have low market shares, then it is unlikely that either of them would find it profitable to increase price above the competitive level. A higher retail price would simply result in customers either diverting to other retailers or other manufacturers' products within the same retailer.

A 2013 OFT research paper by Professor Greg Shaffer examined this specific question: is RPM less likely to harm consumers if there is no market power upstream or downstream? Shaffer concluded that "*where not all firms in the market are engaged in RPM, the ability of suppliers to use RPM to support supra-competitive retail prices would be expected to be more difficult the more fragmented is the downstream industry*."[6] This makes an easy 'no plausible theory' test for an authority or a court: if there is no market power upstream, no market power downstream, and no network of RPM agreements, then it is highly unlikely that the supplier or retailer could use RPM to support anti-competitive prices. In such circumstances vertical RRP communications are highly unlikely to mask an RPM agreement.

In *Sports Bras,* DBA had less than 15% market share of the sports bra market, while the retailers (both separately and together) had a nominal share of the retail market for Sports Bras. Furthermore the OFT made no allegation of RPM agreements relating to any other sports bra manufacturers or retailers. This indicated that a theory of harm that postulated higher than competitive retail prices was inherently implausible, given the market context.

Conclusion

After the Oral Hearings the CMA concluded that there was insufficient evidence to conclude the existence of an RPM agreement.[7] In our view this was the correct decision given the clear pro-competitive rationale, lack of economic evidence consistent with RPM, and the lack of any coherent theory of harm given the market context.

Whilst one cannot rule out the possibility that purely bilateral discussions between manufacturers and retailers on retail price *may* constitute an RPM agreement, an authority must be extremely careful in pursuing such cases. There are clear pro-competitive reasons for discussing retail prices bilaterally, and any presumption that implementation of RRPs constitutes RPM would be likely to result to harm consumers.

Just as we have a clear legal test to differentiate between potentially beneficial and potential harmful A2B2C cases, we need a clear legal test to differentiate between beneficial bilateral price discussions and RPM. The three questions outlined in this memo may provide the basis for such a test.

Dr Matthew Bennett, Dr Cristina Caffarra, Dr Jenny Haydock and Dr Oliver Latham advised John Lewis on the Sports Bras *case.*

[5] In JCB the CFI stated that mere influence on retail prices is not sufficient to constitute RPM. CFI, 13/01/2004, JCB Service v. Commission, Case T-67/01.

[6] February 2013, G Shaffer, Report for OFT (para 1.24), Anti- Competitive Effects of RPM (Resale Price Maintenance) Agreements in Fragmented Markets.

[7] June 13 2014, CMA Case Closure Decision.

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