Summary of Discussion Points

Presented by the Business and Industry Advisory Committee (BIAC) to the OECD at the OECD Competition Committee
Roundtable on Resale Below Cost Laws*

October 20, 2005

BIAC welcomes the opportunity to provide the business community’s views on the topic of resale below cost laws (“RBC” laws).

I. RBC LAWS ARE NOT IN CONSUMERS’ INTERESTS

1. RBC laws generally prohibit retailers and other resellers from selling products at a price below some appropriate measure of cost to the reseller.

2. RBC laws are distinct from prohibitions of predatory pricing in that RBC laws generally do not require evidence of harm to competition. In contrast, a competitor engaging in predatory pricing must have a market position that would enable that competitor to effectively use predatory pricing as a tool to force other competitors from the market and eventually raise prices.

3. While the concept of predation is not applied homogeneously throughout the world, there is widespread consensus that a prohibition of predatory pricing by dominant undertakings in general provides an adequate means to prevent consumers from being harmed by abusive low pricing strategies. Outside these circumstances, low prices can be expected to deliver benefits for consumers. RBC laws are designed to prevent businesses from offering consumers the lowest prices they can possibly offer. Not surprisingly, therefore, the Secretariat’s background note on RBC laws comes to the conclusion that RBC laws are more likely to harm consumers than to benefit them. BIAC agrees with this conclusion. While RBC laws may protect inefficient competitors in the short run by sheltering them

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1 See October 2004 Roundtable on Predatory Foreclosure, http://www.oecd.org/dataoecd/26/53/34646189.pdf. For instance, the EU concept does not require evidence of recoupment while the US concept does, in Canada it is a self standing criminal offence under Section 50(1)(c) of the Canadian Competition Act.
from more efficient competition, they do so at the expense of higher short-term prices for consumers, and are unlikely to offer long-term benefits to consumers or to enhance the competitiveness of the industry which is regulated by such laws.

4. The Irish Competition Authority has recently estimated, for example, that removing the RBC restrictions imposed by the Groceries Order would have saved Irish consumers “up to €577 million over the 12 months between June 2004 and June 2005”.2 The United States Federal Trade Commission similarly has noted that minimum mark-up laws likely deter pro-competitive price cutting and ultimately can lead to higher prices for consumers.

II. LOW PRICES ARE NEARLY ALWAYS GOOD FOR CONSUMERS

5. Consumers almost always benefit from low prices. In most cases, low prices are the result of vigorous, effective and efficient competition.

6. Consequently, low pricing by a firm should raise competition concerns only when it is a temporary phenomenon, designed, as part of a longer-term strategy, to allow the firm in question to increase prices above competitive levels in the future. For this to occur, the low pricing must cause the exit or substantial weakening of existing competitors and/or deter the entry of new competitors in the future, such that the on-going competitive constraints faced by the firm are rendered ineffective. Evidence that some competitors are harmed by low pricing is not evidence that the competitive process is harmed.

7. EU Competition law recognises the dangers from abusive low pricing. Predation is well established as a form of conduct that may be an abuse of dominance under provisions such as the provisions of Article 82 and analogous national laws. The United States federal antitrust laws similarly prohibit predatory pricing, below-cost pricing that has a reasonable prospect or dangerous probability of leading to monopoly. The United States Supreme Court has defined predatory pricing as “pricing below an appropriate measure of cost for the purpose of eliminating competitors in the short run and reducing competition in the long run.”3 Under U.S. law, two criteria must be satisfied to establish predatory pricing: 1) that the prices complained of are below an appropriate measure of the defendant’s costs, and 2) that the defendant had a reasonable prospect or a dangerous probability of recouping its investment in below-cost prices.4

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8. In contrast, RBC laws frequently extend the constraints imposed on low pricing beyond these legitimate boundaries by:
   a. applying controls to (non-dominant) firms that would not be caught by the abuse of dominance standard;
   b. raising the floor on the pricing that a dominant firm can undertake above the predation standard; and
   c. simply preventing firms from offering low prices without requiring any evidence of a negative impact on competition or consumers.

9. Laws that incorporate these characteristics are likely to impair legitimate competition and deprive consumers of the benefits of genuine price competition.

III. RBC LAWS AFFECT COMPETITIVE FIRMS AND MARKETS

10. The theory of predatory pricing holds that unless firms possess significant market power – as measured by the concept of dominance, for instance – they will be subject to effective competitive constraints. In these circumstances, low pricing should not be a concern.

11. However, RBC laws often apply to non-dominant firms.
   a. In Germany, for instance, RBC laws apply to undertakings with ‘superior market power’. This is a much lower standard than dominance. It is sufficient to show that the undertaking in question is larger, in terms of size, resources and/or product portfolio, than its small and medium-sized competitors.
   b. In Belgium and France, RBC laws apply to all undertakings regardless of size or market position.

12. As such, these laws apply in circumstances where competition is effective and to firms who face vigorous competitive constraints. Indeed, firms operating in highly competitive environments, where the downward pressures on prices are considerable, are liable to be especially exposed to the operation of RBC laws.

13. In the discussions preceding the recent modification of RBC laws in France it was acknowledged that resale below cost is not per se harmful to competition. The Canivet Report which prepared the reform underlined that in the absence of RBC laws RBC practices would undoubtedly restore price competition among retailers, and would still fall under Article 82 EC in appropriate cases.\(^5\) While the French legislator considered that a return to free competition (that is by allowing RBC practices) could only be achieved

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progressively in order not to disrupt economic stability, the reform is seen as a first step towards the abolition of RBC laws in France.\(^6\)

14. When faced with interest groups’ requests for protection against low prices offered by competitors, legislators have reason to assess with great care the impact of such strategies on consumers and on the competitiveness of the economy as a whole. Concerns that the imposition of RBC laws would unnecessarily deter resellers from lowering prices, and thus deprive consumers of the benefits of lower prices, have caused several countries in the world to reject the adoption of RBC laws. These nations either have not considered it necessary or advisable to enact specific RBC laws, or have abolished this kind of law. Indeed, a law preventing competitive firms from offering consumers the lowest prices would be regarded as counter-productive in numerous jurisdictions. In the United States, for example, even though several states have enacted RBC laws in an effort to level the competitive playing field among participants in their respective regional markets, there is no national law prohibiting below-cost sales or mandating minimum mark-ups. Such jurisdictions recognize that, other than the narrowly defined prohibitions against predation, economies do not benefit from restricting price competition.

IV. RBC LAWS HINDER THE NORMAL PROCESS OF COMPETITION

15. As noted above, a number of states in the United States have introduced laws that either impose retailer minimum mark-up requirements or prohibit retail sales below cost. The United States Federal Trade Commission, in providing comments to state regulators on laws and proposed laws that would regulate the price at which retailers could sell gasoline to consumers, consistently has taken the position that such regulations hinder the normal process of competition by deterring pro-competitive price cutting. Commenting on proposed laws introduced by state legislators in Michigan, Wisconsin and Kansas, the Federal Trade Commission indicated that such laws are likely to discourage competitive pricing by subjecting vendors to civil liability for cutting prices even if there is no likelihood of harm to competition. In order to forestall the possibility of litigation, vendors avoid pro-competitive price cutting and may, in order to deter complaints from competitors, choose to set prices well above the minimum set by state regulation.

16. Some RBC laws, such as those in Germany, effectively prohibit vigorous competition even between larger firms. As such they impose arbitrary and undesirable constraints on the process of competition itself. For example, in 2000 Walmart lowered its price for long-life milk in Germany below the price of its two most powerful competitors, Lidl and Aldi. Those two companies reacted by lowering their own prices below the respective purchase prices. At this point Walmart’s milk supplier increased its prices, but Walmart left its resale

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\(^6\) As a result, the new legislation has maintained RBC laws but has lowered the RBC threshold. See Act n°2005-882 of 2 August 2005, Loi en faveur des petites et moyennes entreprises, Of of 3 August 2005. One may question the real risk of economic instability in case of a potential abolition of RBC laws in France, as well as the efficiency of the regime in force which provides for complicated calculations in order to determine the RBC threshold.
price unchanged and sold below purchase price. While this might be judged to be a consequence of strong and effective competition, the German Federal Supreme Court regarded it as irrelevant, under the provisions of the RBC laws, that WalMart was a relatively new entrant and was only reacting to RBC practices by its larger competitors.7

17. As illustrated by the example above, RBC laws may have a disproportionate negative impact on certain categories of market participants, including new entrants to the market, small firms and firms benefiting from annual rebates and volume discounts. RBC laws that apply to all firms risk a particularly severe impact on the development of competition from new entrants. In many instances, entrants must overcome the ‘first mover’ advantages of incumbents, such as the consequences of customer switching costs and brand awareness, in order to establish themselves. A prohibition on RBC will limit the instruments with which entrants can begin to compete. The effect on small firms also may be pronounced, especially where economies of scale arise in purchasing. An RBC regime that required all firms to price above their own purchase costs would then tend to prevent such firms from competing on level terms with larger, established competitors, thereby denying them the opportunity to attain viable scale. Finally, the negative impact of RBC laws to consumers can be exacerbated if the relevant measure of purchase price does not include annual bonuses and rebates, advertising subsidies and similar factors which effectively lower the reseller’s costs of obtaining the product. In such cases, the reseller will be prevented from pricing at a level that reflects its actual purchase costs. For example, the Irish Groceries Order prohibits retailers from “passing on to their customers, discounts that they receive from their suppliers in the form of an end-of-year off-invoice discount”.8

18. In these circumstances, RBC laws actively neutralise the desirable competitive pressures which ensure that prices reflect costs.

V. PROTECTING INEFFICIENT COMPETITORS IS RARELY DESIRABLE

19. RBC laws, particularly when they require low-cost firms to price above their true costs, offer protection to inefficient competitors. The circumstances in which such protection is desirable are exceptional. They do not apply where effective competition is established.

20. Such temporary protection arguably may be warranted, however, in special settings where competition has the potential to develop but has yet to do so. Liberalised utility industries provide a potential example. In these cases, when incumbents benefit from significant ‘first-mover’ advantages, such as economies of scale and large customer switching costs, it is possible to identify circumstances in which long-run efficiency and consumer welfare can be enhanced by allowing inefficient ‘infant’ competitors some protection for a period to allow them to reach viable scale, if this protection opens up an industry that would

8 The Competition Authority: Submission to the Minister for Enterprise, Trade and Employment on the Groceries Order’, July 2005, Appendix A.
otherwise be entrenched. This possibility is sometimes summarised by the comment that “inefficient competitors may be better than no competitors at all.”

21. Crafting a statutory regime to provide temporary protection to infant competitors presents significant challenges. It is one thing to sketch a theoretical possibility along these lines, and another to identify regulatory action that can confidently predict that it will do more good than harm. The dangers that well-meaning intervention on protecting competitors can lead to adverse outcomes, and the risk that regulators become ‘captured’ by competitors and special interest groups, argue against intervention of this nature [in other than very unusual circumstances].

22. Regulators also should be mindful of the fact that while some justification arguably exists for protecting inefficient competitors in an uncompetitive market, there is no competition, efficiency or consumer welfare justification for protecting inefficient competitors when competition is effective. Indeed, such protection serves to harm the competitive process and should therefore be regarded as anti-competitive itself. The prospect of failure is an important source of dynamic pressure on firms. Offering protection for inefficient firms merely serves to ossify markets and destroy dynamic incentives.

VI. RBC LAWS ARE NOT A MEANS TO ELIMINATE INEFFICIENCIES

23. Considered in simple isolation, below cost pricing is liable to be inefficient. When the price of a good is set below the true resource costs involved in consumption, consumers will tend to consume too much of the good in question. These inefficiencies will be made worse if the prices of other goods are raised above cost to provide an effective cross-subsidy.

24. However, as the Secretariat’s background note identifies, there are many reasons why RBC pricing can deliver efficiencies in practice. For example, the UK Competition Commission recognised such possibilities in its 2000 report on supermarket retailing. Leading supermarket chains were found to price some items below cost to encourage shoppers to visit their stores. Such a (loss leading) strategy can be profitable for multi-product retailers if the losses made on the RBC items are offset by an increase in overall sales, e.g. because of the complementarities created by the attractions of ‘one-stop’ shopping. Even efficient small or specialist retailers may find it difficult to compete on price in such circumstances.

25. It is far from clear that prohibiting RBC would result in a more efficient outcome, or would benefit consumers in any way. Given the existence of informational imperfections which prevent consumers from observing and processing an extensive list of product prices, supermarkets will have little incentive to refocus price reductions on other items if RBC is prohibited. Indeed, the Competition Commission cited research from Ireland which

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9 See Competition Commission (2000): Supermarkets – A report on the supply of groceries from multiple stores in the UK, pages 83-87, for example.
suggested that such re-balancing had not occurred there in response to the introduction of RBC laws.10

26. In this case, prohibiting RBC simply may relax the intensity with which supermarkets compete against one another, causing prices to rise and consumers to lose out. Measures to provide greater price information to consumers might then provide a more effective mechanism for intervention to overcome the original imperfections.

27. The UK Competition Commission rejected the imposition of RBC curbs in its supermarkets report.

VII. EXTRANEOUS SOCIAL OBJECTIVES IMPOSE REAL COSTS ON CONSUMERS

28. It might be argued that RBC laws serve useful purposes that have nothing to do with competition. For example, they may serve to preserve a particularly valued institutional and social structure in a country. The pressure imposed by industry or interest groups to impose RBCs to achieve social or economic objectives can be intense. The case of the United States is illustrative of these pressures. As noted previously, the United States has no national law prohibiting below cost sales or mandating a minimum mark-up. According to the United States’ note, however, twenty five states currently have RBC laws of general application, i.e. the laws apply to all retail merchandise; and thirty-one states have laws that cover the sale of specific items, such as fuel and petroleum products, farm and dairy products, cigarettes, alcoholic beverages and prescription drugs. These statutes have been enacted largely to level the playing field by protecting small, independent stores from competition by chain and big-box stores and to protect consumers that might conclude erroneously that the margin of discount applied to loss leaders is representative of the discount applied to all or most other products carried by that retailer. We cannot judge the merits of these claims, save to note that RBC laws cannot be seen as in some way distinct from restraints of competition since they have direct anti-competitive effects.

29. Moreover, it is essential that the full costs of maintaining RBC laws, which are borne by consumers, are recognised. As noted above, the Irish Competition Authority, for example, recently estimated that maintaining the RBC provision of the Groceries Order cost consumers approximately €577 million in one year.

VIII. CONCLUSION

30. In conclusion, because RBC laws tend to deter retailers from engaging in legitimate price competition, protect inefficient resellers by sheltering them from competition and inhibit market participation by new entrants, smaller competitors and firms whose expenditures are offset by supplier incentives or year-end rebates, BIAC believes that the adoption of such

10 CC Supermarkets report, para 2.560.
laws generally is not in the best interest of consumers or the economy as a whole. To the extent that RBC laws may provide some limited utility, as in the case of infant industries, such laws must be carefully tailored to minimize anti-competitive effects.