TESTIMONY OF TOD COHEN, VICE PRESIDENT AND DEPUTY GENERAL COUNSEL, GOVERNMENT RELATIONS, EBAY
BEFORE
THE UNITED STATES HOUSE OF REPRESENTATIVES, COMMITTEE ON THE JUDICIARY, SUBCOMMITTEE ON COURTS AND COMPETITION POLICY

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Chairman Conyers, Ranking Member Smith, and Members of the Subcommittee, I am Tod Cohen, Vice President and Deputy General Counsel for Government Relations at eBay Inc. Thank you for the invitation to speak today about the impact of the Supreme Court's decision in *Leegin Creative Leather Products, Inc. v. PSKS.* I'd like to begin with acquainting you with eBay and more generally the business that we participate in -- Internet commerce.

Founded in 1995, eBay Inc. connects hundreds of millions of people around the world every day. The company's online platforms empower hundreds of millions of individuals and small businesses to meet and engage in open trade on a local, national and international basis. The eBay Marketplace has 88.3 million active users and there are 160 million live listings on any given day. While known for its auction format, eBay users can also buy and sell through standard pricing formats found within traditional retailers, both in stores and on-line. In 2008, eBay transacted $60 billion worth of goods, or an average $2,000 worth of goods every second. eBay is committed to fair and open competition with the view that it benefits eBay's participants and society overall.

At eBay, we believe that the Internet is a transformational technology platform for increasing business efficiency and effectiveness, enhancing the shopping and purchase experiences of consumers, and facilitating increased competition in trade. Businesses use the Internet in many ways to offer lower prices, greater choice and great values to consumers because of reduced operating costs and increased efficiencies provided by the Internet.

Consumers who use the Internet are able to easily find, compare and purchase products because of their convenient access to vast amounts of information. The Internet also enhances competition through effectively widening and deepening the market for goods and services. Because of the Internet, businesses and consumers are no longer bound by geography and may sell and trade with one another through local, national and global markets. Businesses are able to offer, and consumers are able to compare more products and brands, effectively increasing the depth of the market. These and other benefits inherent in Internet technologies have resulted in new and innovative retail business models and growing retail commerce that brings benefits to consumers, retailers and the overall economy.

Before I move to focus on some of the specific issues surrounding Retail Price Maintenance, commonly known as RPM, I want to note that the Internet is a transformational technology that is part of every serious 21^{st} Century retail strategy. The

Internet is used by every segment in the retail business – from massive "brick and click" retailers with national networks of big box stores integrated with popular web sites, to large "remote" Internet and catalogue retailers with nationally known brand names, to small businesses who are either building new businesses on the Internet or integrating the Internet into an existing small retail business in order to survive and grow in the highly competitive retail environment.

The Internet is also used by manufacturers, from the largest to the most specialized, to reach customers with information, and more and more with products. And the Internet is critical to more consumers every day, both as a retail marketplace and the greatest source of product information ever created. I mention these facts because sometimes people paint this issue, and other retail issues, as being about Internet retailers on one side and non-Internet retailers on the other. Nothing could be farther from the reality of 21st Century retail.

Everyone uses the Internet. But, there are big differences in how the Internet is used. The most important distinction to keep in mind is that on one side you have established networks of manufacturers and retailers who want to use technology to reinforce or enhance established retailing business models, without undermining those existing and highly profitable business models. They like the Internet when it is closed and structured to serve their interests, but they are threatened by the Internet when it is harnessed to offer consumers better deals and more information outside the established incumbent retail networks. On the other side are innovators with new business models, almost always small to mid-size businesses, using new technologies to offer consumers better deals, more information and new services. They are the "open Internet," the great force for innovation and change, and they threaten traditional retail networks.

Unfortunately, the recent decision in *Leegin* is beginning to undermine many of the consumer benefits delivered by innovators using the openness of the Internet. *Leegin* empowers those who want to curtail the ability of small and mid-size online retailers to communicate and offer lower prices to consumers. *Leegin* requires that henceforth antitrust challenges to minimum resale price maintenance (RPM) or agreements that fix the minimum price at which a retailer may sell a manufacturer's products are to be analyzed applying the *rule of reason* versus the prior and more strict *per se* standard.

At the time *Leegin* was decided by the Supreme Court, commentators predicted that the decision would lead to an increase in RPM programs and related practices that restrict intrabrand price competition. Anecdotal reports and other information corroborate that this has indeed been the result. These reports further identify Internet retailers as a particular target of the increasing use of RPM.

eBay's own experiences confirm this to be true. For example, a recent report in the Wall Street Journal details how some businesses limit price competition through continually scanning the eBay platform to identify sellers offering their products at a lower price. [1]

[1] Pereira, Joseph (2008), "Discounters, Monitors Face Battle on Minimum Pricing," Wall Street Journal, December 4, available at http://online.wsj.com/article/SB122835660256478297.html

They then use a plethora of tools to identify the seller and enforce their minimum prices. The tools used to enforce these minimum prices are varied and often depend on the circumstances of the seller and the relationship with the manufacturer. For these businesses, the *Leegin* decision has clearly been interpreted as a legal "green light" to more aggressively thwart low-price competition by legitimate sellers.

Small and mid-size Internet retailers have become the particular target of RPM because of the combination of two factors: they often offer lower prices to consumers, and the Internet enables consumers to find those great price deals much easier than ever before. These lower prices are alleged by traditional retailers to be the result of unfair competition. As reported this past year in the Wall Street Journal, "many traditional retailers favor minimum-pricing agreements because they help put a stop to what the stores view as unfair competition from online sellers, which can charge less because they have lower overhead costs."[2]

Traditional retailers contend that innovative Internet retailers are able to offer lower prices to consumers because they "free-ride" on the promotional investments of their traditional counterparts. The traditional "free-rider" argument contends that rather than providing consumers with pre-sale information through, for example product demonstrations and other methods, small and mid-size Internet retailers depend on competing brick-and-mortar retailers to do so. They then divert "educated" consumers away through offering them lower prices obtained through their cost savings. Traditional retailers threaten that unless protected by RPM from Internet retailers' lower prices eventually they will no longer provide pre-sale information; frustrating manufacturers' promotional efforts and harming consumers in the process.

From eBay's perspective there are many problems with this argument. The most significant of these problems is that, as previously described and subsequently elaborated upon, the realities of 21st Century retailing and the Internet turns the traditional free-rider justification for RPM on its head. Indeed, it does so to the point where in many cases it could be argued that the largest and most established retailers are free-riding on the tremendous consumer information tools created by Internet innovators.

With this central point in mind, we urge you to also consider the following more specific points in your deliberations:

1. A small or mid-size Internet retailers' ability to offer lower prices should not be attributed to free-riding. Instead, the Internet enables new and specialized retail business models that can have cost advantages related to distribution, consumer information and market penetration. These are substantial and far more likely to be the reasons behind a small or mid-size Internet retailer's lower prices.

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[2] Pereira, Joseph (2008), "Why Some Toys Don't get Discounted: Manufacturers Set Price Minimums That Retailers Must Follow or Risk Getting Cut Off; Shopping Around for 'Rock Band 2,'" Wall Street Journal, December 24, available at: http://online.wsj.com/article_email/SB123007559680631543-lMyQjAxMDI4MzIwNDAyNzQ1Wj.html

2. Internet retailers provide significant pre-sale information to their customers. In fact, the open Internet has completely revolutionized the consumer information experience. At its core, the Internet is a medium for the communication of information and its capabilities are enormous. Internet businesses including retailers can and do use the Internet to provide valuable pre-sale information to consumers. In fact, consumers are increasingly turning to the Internet to search for product information, make product comparisons and check prices *before* visiting and purchasing from traditional brick and mortar stores – raising the question of who is actually the free-rider.

3. You should also question the contention that an Internet retailer would adopt a strategy of relying on its competitors to generate customer demand for them. Relying on your competitor to generate customers through providing pre-sale information is not only a risky strategy, but is also contrary to the competitive advantage that fuels innovative Internet retailing. At its core this advantage is the ability to provide information that creates value for prospective customers. It is hard to imagine an Internet retailer forgoing the very advantage that is the basis of its business model, let alone relying on competitors who have adopted a different business model to do it for you.

4. Even in the event some consumers obtain the benefit of pre-sale information from one retailer and then continue to shop and eventually purchase from another competitor, it is hard to imagine that it would result in the outcomes predicted by traditional retailers and established manufacturers. For example, how much supposed free riding is necessary for established retailers to abandon a marketing strategy it presumably invested substantially in and one that ostensibly its customers find considerable value.

5. I understand that past real-world evidence regarding the use of RPM has not been explained based on free-riding, but by the motivation of incumbent retailers attempting to avoid the competitive threat of new and more innovative forms of retailing. I believe that this is even more true today in the Internet Age. The largest and most established retailers and manufacturers, who benefit economically from the status quo, are threatened by innovators using the Internet, not the Internet itself.

6. It is also noteworthy that established retailers' calls for RPM based upon free-riding arguments are not limited to innovative Internet retailers. I understand that the same justification has been advanced against value-based brick and mortar retailers who also offer lower prices to consumers. If true, RPM narrowly targeted at innovative Internet retailers will not cure free riding by these lower-priced retailers.

7. The fact that many manufacturers have found value in the Internet is also contrary to the free-rider argument. Increasingly manufacturers are using the Internet distributing their products through both brick and mortar stores and online sites in what is termed multi-channel distribution. If free riding is a significant problem it

is unlikely these manufacturers would see value in a strategy that ostensibly encourages its very occurrence.

8. At the same time, it should be acknowledged that many manufacturers continue to avoid the open Internet. A fair question is whether this is because they view, as some traditional retailers, that free-riding by innovative Internet retailers is a problem or because of other reasons. When considering this question, one important reason that should not be overlooked stems from the Internet's ability to effectively widen and deepen the market for goods. Some manufacturers may wish to avoid the increased competition and ensuing pressure on their upstream prices that results from these effects. By extension, rather than being motivated by concerns for free-riding, manufacturers who do distribute over the Internet may see the uniform prices that result from RPM as a way to reduce these upstream effects. This prospect should not be overlooked.

9. It may also be the case that differences observed in the prices and pre-sale information of the biggest established retailers and innovative Internet retailers are merely the result of efficient market processes rather than free-riding. It is well-known that consumers differ in their information needs and price preferences even for the same product. If established retailers are providing more information and charging higher prices and smaller innovative Internet retailers are providing less information and charging lower prices, this may simply be an efficient response by each to the demands of different customer segments. Marketers call this "target marketing" or the customization of information and price offerings to different customer segments. Unless free-riding can be proven, forcing all consumers to pay the same through RPM actually risks a misallocation of promotional resources rather than increasing it.

These and other problems with the free rider explanation should be considered and adequately explained prior to accepting any justification for Internet retailers being the particular target of RPM.

Finally, I understand that a recent study involving Internet retailing and examining the abolition of RPM in the UK book industry found that it increased industry productivity.[3] According to the study, abolishing RPM resulted in strong growth in new retail channels of distribution for books including through Internet retailers with both the total industry sales volume as well as the number of titles published increasing. A key finding of the study was that the new retail channels of distribution had different business models typically based on lower costs and innovation. Evidence of this kind should be especially helpful to this Committee in better understanding Internet retailing and RPM.

Thank you Mr. Chairman and members of the Subcommittee.

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[3] Office of Fair Trading (2007), "An Evaluation of The Impact Upon Productivity of Ending Resale Price Maintenance on Books."