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Resale Price Maintenance and Other Vertical Restraints: The Evidence

Francine Lafontaine

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Vertical Restraints

- Restrictions that one firm in a vertical chain (upstream/downstream) imposes on another, usually via contract
- Most common:
  - ~ Resale price maintenance (RPM)
    - – Minimum
    - – Maximum
  - ~ Exclusive dealing (ED)
  - ~ Exclusive territories (ET)
  - ~ Tying, etc.
- Often seen as forms of partial vertical integration
- => Vertical integration/merger (VI) as a benchmark

Facts about Vertical Restraints

- Empirically, vertical restraints are common
- Most often in distribution, especially exclusive dealing
  - ~ Traditional franchising (autos, gasoline) and
  - ~ Business format (e.g. fast food)
  - ~ Often include other constraints beside ED (e.g. ET)
- Little agreement in theory about their consequences – need evidence
- But empirical models and analyses of vertical restraints are much less common, and very descriptive, compared to
  - ~ models of horizontal competition
  - ~ auctions

Public Policy Towards VR

- Price and non-price restraints have been and still are treated differently in most jurisdictions
  - ~ even though price and non-price restraints are often substitutes for one another
- Also VRs can be used to mimic vertically integration results – yet not treated same as VI
- And once vertically integrated, firms can do things (e.g. set prices, or use exclusive territories) that would not be allowed between separate entities

=>Changing rules on any VR affects decisions on use of other (complementary or substitute) VRs, and/or vertical integration decisions, in ways may not foresee/want

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Public Policy toward RPM

- In most jurisdictions, minimum and maximum RPM have been/are treated differently
- In the US, not so for most of recent history
  - ~ In 1911 Dr Miles decision, Supreme Court declares RPM illegal per se
  - ~ In Albrecht, in 1968, confirms that maximum RPM illegal per se as well
- Of course, subject to:
  - ~ Colgate doctrine (1919)
  - ~ fair trade laws passed during Great Depression, fully eliminated in 1975

Public Policy toward RPM

- But from theory, reasons to impose maximum (double margins, positive demand externalities, and so on) and minimum prices are very different
  - ~ Clearly cannot presume that prices are higher when firms impose maximum prices, on the contrary
  - ~ Need to treat maximum and minimum RPM as two separate types of VRs (perhaps use different terminology?)
  - ~ Otherwise risk making maximum RPM illegal by “confusion” or “association”

Public Policy toward RPM

- State Oil v. Khan decision in 1997 did put maximum RPM under rule of reason
  - ~ and since no consumer harm, legal?
- With Leegin, now minimum RPM is under rule of reason in US
  - ~ But here prices are higher presumably, so there are some scenarios under which one might find consumer harm
- In EU, 1999 vertical guidelines (expiring May 2010?) – now treat minimum RPM (and territorial restrictions) more harshly than US
- Maximum, like suggested, prices are legal

Handbook of Antitrust Economics(2008) chapter with Slade

- Assess what we can learn from empirical studies of the consequences of vertical restraints and vertical integration
  - ~ when privately adopted
  - ~ when imposed (forbidden) by government agencies
- Attempt to extract empirical regularities
- Point out some of the difficulties
- Discuss potentially promising questions/avenues

Table 10.1
Empirical assessment of effects of vertical contracts by method of assessment

Analysis type	Author	Year	Industry	Restraint
Descriptive	Jordan and Jaffee	1987	Beer distribution	Exclusive territories
	Hanssen	2000	Movie distribution	Block booking
Cross sectional	Smith II	1982	Auto distribution	Various
	Hass–Wilson	1987	Contact lenses	Tying
	Brickley, Dark, and Weisbach	1991	Several	Termination restrictions
	Azoulay and Shane	2001	Several	Exclusive territories
	Blass and Carlton	2001	Gasoline retailing	Divorcement (I)
	Sass	2004	Beer distribution	Exclusive dealing
Time series	Sass and Saurman	1996	Beer distribution	Exclusive territories

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Table 10.1
Empirical assessment of effects of vertical contracts by method of assessment

Analysis type	Author	Year	Industry	Restraint
Panel	Ornstein and Hanssens	1987	Distilled spirits	Min Resale price maintenance
	Culbertson and Bradford	1991	Beer distribution	Exclusive territories
	Sass and Saurman	1993	Beer distribution	Exclusive territories
	Slade	2000	Beer distribution	Exclusive dealing
	Vita	2000	Gasoline retailing	Divorcement (I)
	Barron, Taylor, and Umbeck	2004	Gasoline retailing	Sourcing restrictions
Natural experiment	Barron and Umbeck	1984	Gasoline retailing	Divorcement (I)
	Ippolito and Overstreet	1996	Glassware	Min Resale price maintenance
	Slade	1998	Beer retailing	Divorcement (II)
Event study	Gilligan	1986	Many	Mixed Resale price maintenance
	Brickley, Dark, and Weisbach	1991	Many	Termination restrictions
	Ippolito and Overstreet	1996	Glassware	Min Resale price maintenance
Structural	Asker	2004	Beer distribution	Exclusive dealing
	Brenkers and Verboven	2004	Auto distribution	Exclusive territories

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What we learn:

- Very few papers on effects
  - ~ even if we looked broadly, and over time
  - ~ even if we include studies of divorcement
- A few cross-industry studies, but most focus on single industries, with gasoline, beer and car distribution as front runners
- Different approaches – runs the gamut from descriptive, case study type analyses to structural, with intermediate reduced form/event study type analyses

Why so little evidence …

- Studies of effects are rare for a reason:
  - ~ Decision to implement any VR is endogenous in such studies
  - ~ Often several VRs at once
  - ~ Good instruments are rare (though I would argue that combination of geography/other firms in markets offers some promise)
  - ~ Makes structural approach desirable, but then
    - – need strong assumptions about market equilibrium and the upstream (horizontal) game, the downstream (horizontal) game, and the vertical interactions within the chain
    - – Also, modeling cost changes arising from VR is difficult, as these changes relate to incentive and information effects
- Given data and other constraints, need thoughtful empirical work using various approaches in different industries to generate body of evidence required to inform policy

Table 10.2
Empirical assessment of effects of voluntary vertical restraints

Author	Year	Industry	Variable (Y)	Effect (Y)	Effect (W)
Exclusive dealing					
Slade	2000	Beer retailing	Price	+	−
Asker	2004	Beer distribution	Cost	−	+
Sass	2004	Beer distribution	Price	+	+
			Consumption	+	
Exclusive territories					
Jordan and Jaffee	1987	Beer distribution	Price	+	−
Sass and Saurman	1993	Beer distribution	Price	+	+
			Consumption	+	
Sass and Saurman	1996	Beer distribution	Consumption	+	+
Azoulay and Shane	2001	Several	Survival	+	+
Brenkers and Verboven	2004	Auto distribution	Price	+	−
Tying					
Hanssen	2000	Movie distribution	Consumption	+	+
RPM					
Gilligan	1986	Many	Stock returns	Mixed	Ambiguous
Ippolito and Overstreet	1996	Glassware	Consumption	+	+
			Stock returns	+	
Sourcing restrictions					
Barron, Taylor, and Umbeck	2004	Gasoline	Price	−	+

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Table 10.3
Empirical assessment of effects of mandated vertical restraints

Author	Year	Industry	Variable (Y)	Effect (Y)	Effect (W)
Exclusive territories					
Smith II	1982	Auto distribution	Number of dealerships	−	Ambiguous
Culbertson and Bradford	1991	Beer distribution	Price	+	−
Tying					
Hass-Wilson	1987	Contact lenses	Price	+	−
RPM					
Ornstein and Hanssens	1987	Spirits	Price	+	−
			License values	+	
			Consumption	−	
Termination restrictions					
Smith II	1982	Auto distribution	Number of dealerships	+	Ambiguous
Brickley et al.	1991	Several	Stock returns	−	−
Dealer licensing					
Smith II	1982	Auto distribution	Price	+	−
			Consumption	−	
			Number of dealerships	−	
Divorcement					
Barron and Umbeck	1984	Gasoline	Price	+	−
			Hours	−	
Slade	1998	Beer retailing	Price	+	−
Vita	2000	Gasoline	Price	+	−
Blass and Carlton	2001	Gasoline	Cost	+	−

What we learn:

- First, most empirical analyses of VR are simple, so one must interpret with caution
- Also, not sufficient to look at price effects to draw welfare conclusions
  - ~ Effect on welfare can be positive even with increased prices (e.g. Sass, 2004: quantity going up says that consumers are better off despite the higher prices)
- The evidence, in the end, is quite consistent:
  - ~ Privately adopted restraints (price or non-price) tend to increase welfare, not reduce it
  - ~ Publicly mandated vertical restraints have negative welfare consequences

Also, Evidence from Incidence

- Lafontaine and Slade (2008) focused on studies of effects of VRs
- But can also learn about motives for VRs, whether pro or anticompetitive, from some studies of incidence
- Ippolito (1991) looks at population of 203 reported cases of resale price maintenance (min and max) in the US between 1975 and 1982 (post fair trade laws, pre Monsanto). Shows that
  - ~ Most private cases are initiated by dealers (often terminated dealers)
  - ~ RPM often used with other VRs, most frequently territorial, tying, or customer restrictions
  - ~ About half of cases involve other non-vertical charges (e.g. horizontal price fixing in 30, and refusal to deal in 40 of the cases)

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Evidence from Incidence

- Ippolito (1991) also finds
  - ~ 65% of private, and 68% of public cases in her data are for products that are complex, new, or infrequently purchased - where the special services theory for RPM is most likely to hold
  - ~ overlapping segment of cases where dealers can influence the quality of the final good or customer experience in important ways – here also RPM is efficiency enhancing
  - ~ A last set of (mostly franchising) cases seems well explained by concerns over vertical sales effort
- She concludes that collusion is not the primary explanation for the RPM practices that were prosecuted during this period
- Heide et al. (1998) focus on exclusive dealing. Through survey, find use of ED if manufacturers worry their support of dealers will benefit other manufacturers – again efficiency motive
- (Note: Lafontaine and Slade (2011))

Possible lessons/conclusions

- Many of the markets where VRs are used and studied are fairly competitive, especially downstream
- Entry into these markets is fairly easy
- In such contexts, upstream firm and customer needs are more likely to be aligned – both want downstream not to earn more returns than necessary to encourage right level of effort/investments

Questions for future consideration

- Has maximum RPM increased since Khan (1997)? Perhaps no need to consider?
- So far, since Kahn:
  - ~ Anecdotal – car manufacturers "slow" to adopt
  - ~ McD's statement about prices varying across restaurants disappears from US web site, but remains in UK…
  - ~ (Ater and Rigbi, 2007) : paper on McD prices in 1999-2006. No maximum imposed directly, but dollar menu reduces price differences
- But even before Kahn – different corporate policies for corporately-owned and operated restaurants of chains (Lafontaine, JBV, 1995)

Questions for future consideration

- Can franchisees within a chain "collude" on prices? If franchised network of outlets, allowed? But if independent dealers, cannot?
- Can we see which firms/industries are likely to benefit from new minimum RPM rules by looking at stock prices after Leegin ? I.e. was there any stock market reaction to Leegin decision? If so, where? If not, does this mean firms and investors do not "value" the change in regime?
- Terminated dealers brought most of the prior private cases. For VRs, contract disputes often brought under antitrust due to treble damages. Perhaps worth reconsidering application of treble damages for these?

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Thank you

EU policy on Max RPM and ET

- The exemption provided for in Article 2 shall not apply to vertical agreements which, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object:
  - (a) the restriction of the buyer's ability to determine its sale price, without prejudice to the possibility of the supplier's imposing a maximum sale price or recommending a sale price, provided that they do not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties;
  - (b) the restriction of the territory into which, or of the customers to whom, the buyer may sell the contract goods or services, except…:

	Prices in corporate restaurants are:			
Chain:	Identical across all restaurants nationally	Identical within regions, but variable across regions	Allowed to vary completely	No answer /Don't know
Arby's	√			
Baskin Robbins				√
Burger King		√		
Chi-Chi's			√	
Dairy Queen/Brazier			√	
Denny's		√		
Domino's			√	
Dunkin Donuts				√
Eat N Park	√			
KFC				√
Little Caesar's Pizza				√
Long John Silver's		√		
McDonald's			√	
Pizza Hut			√	
Ponderosa		√		
Roy Rogers				√
Subway				√
Taco Bell	√			
Wendy's		√		