THE IMPORTANCE OF ECONOMIC ANALYSIS WHEN ASSESSING VERTICAL AGREEMENTS

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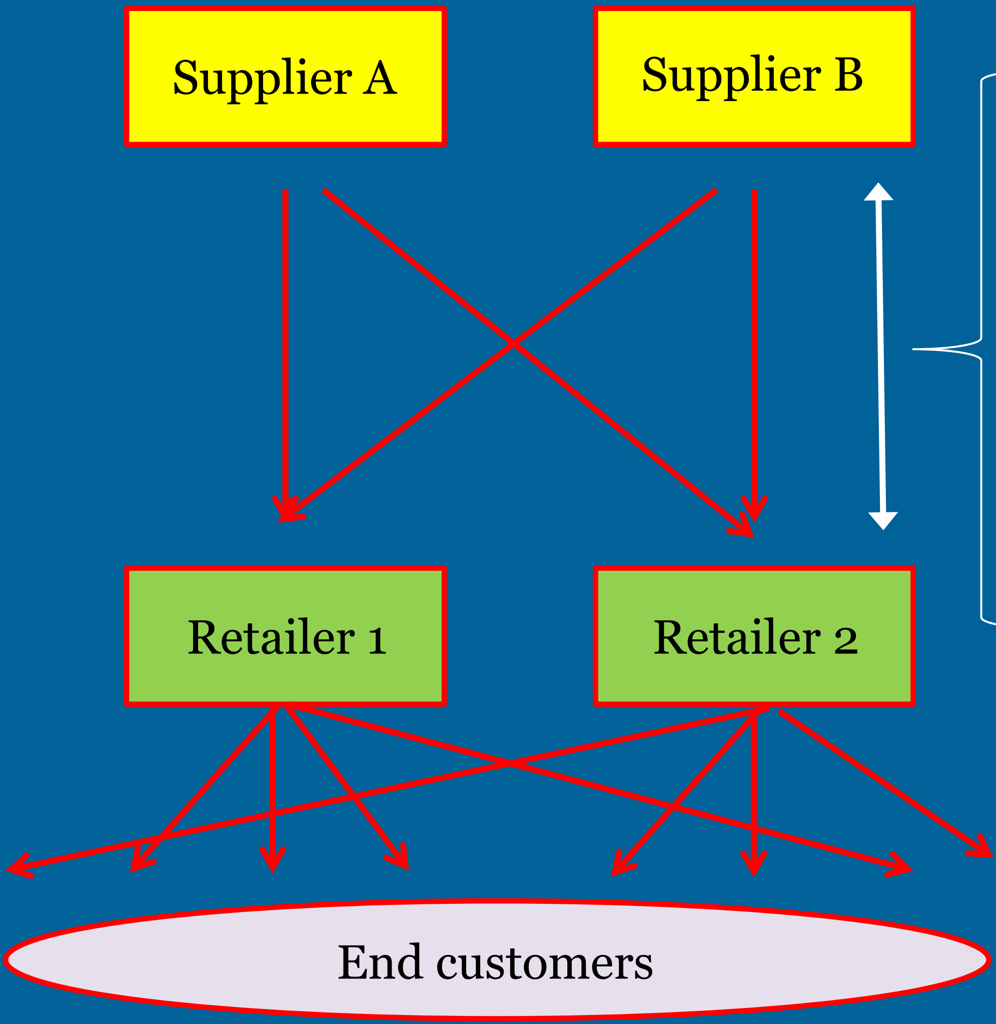
DES POLITIQUES MEILLEURES POUR UNE VIE MEILLEURE

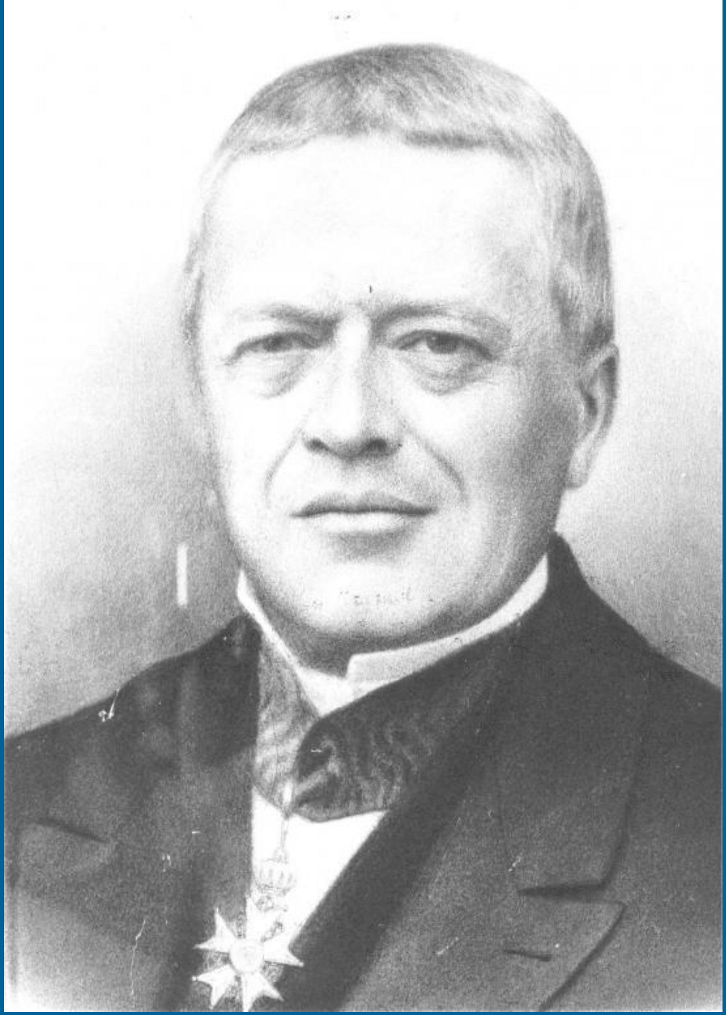
Vertical restraints



Vertical restraint: a contract specifying conditions of sale other than spot price:

- Exclusive dealing
- Exclusive territory
- Tying or bundling
- Resale price maintenance (min, max or both)
- Others…

It all starts with Cournot



Antoine Augustin Cournot
(1801 - 1877)

Independent decision-making between firms with some market power producing substitutes lowers prices:

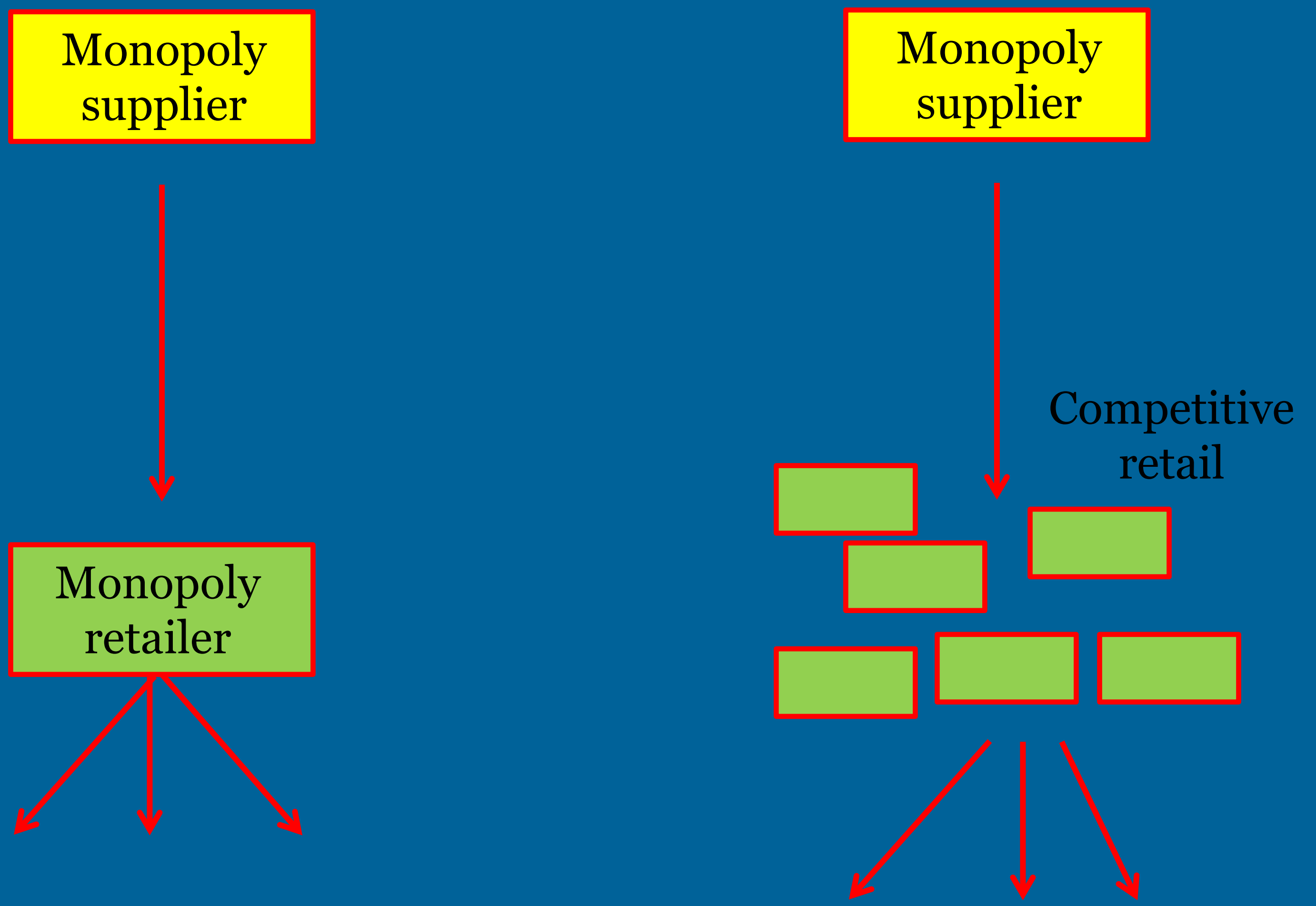
$(p-c)/p = HHI/\varepsilon$

So mergers or agreements bad for consumers.

Independent decision-making between firms with some market power producing complements raises prices

So mergers or agreements good for consumers.

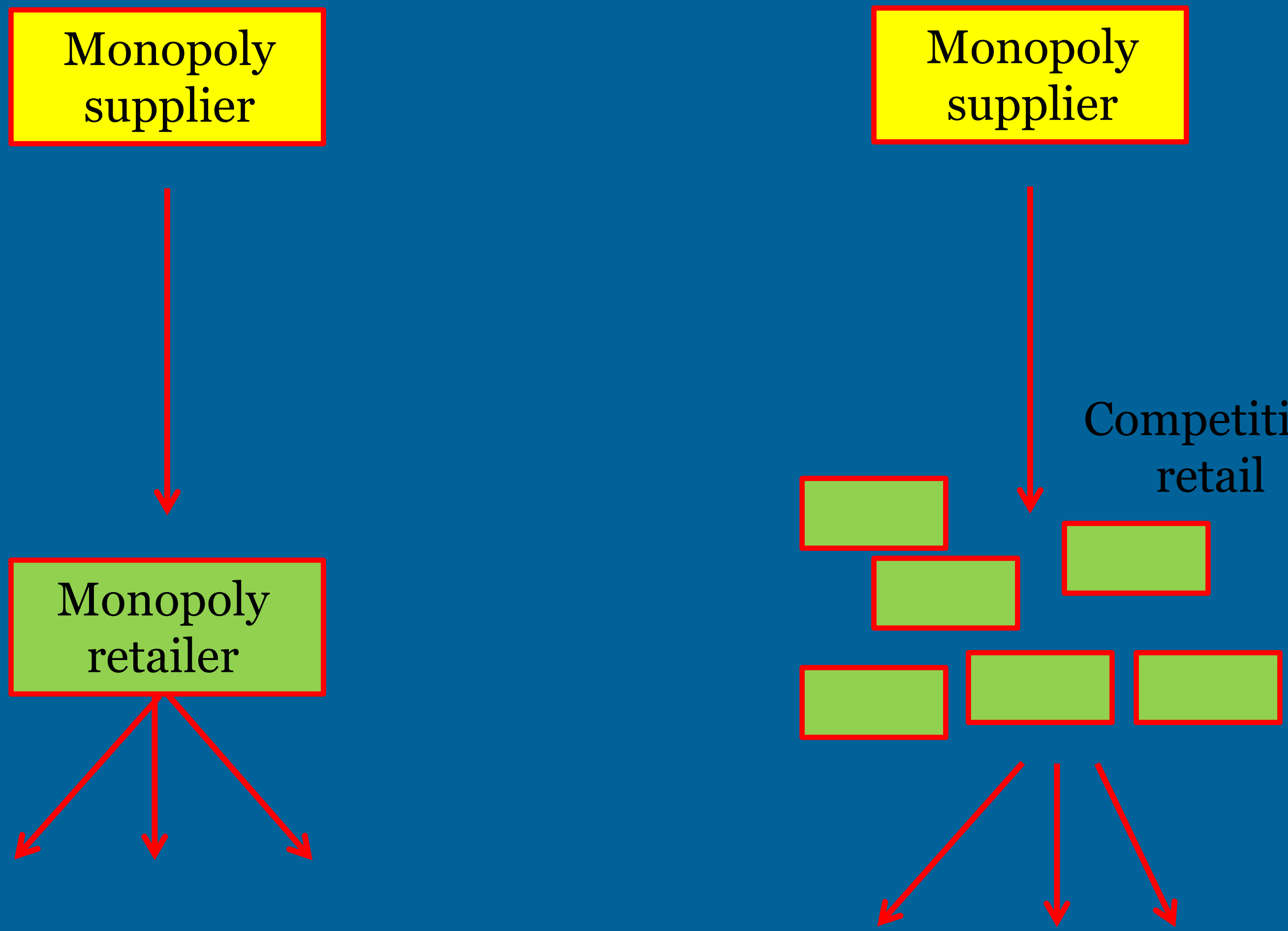
Successive steps in a vertical supply chain are *complements*



Price > supplier's monopoly price

Price = Supplier's monopoly price (maximises supplier's profit)

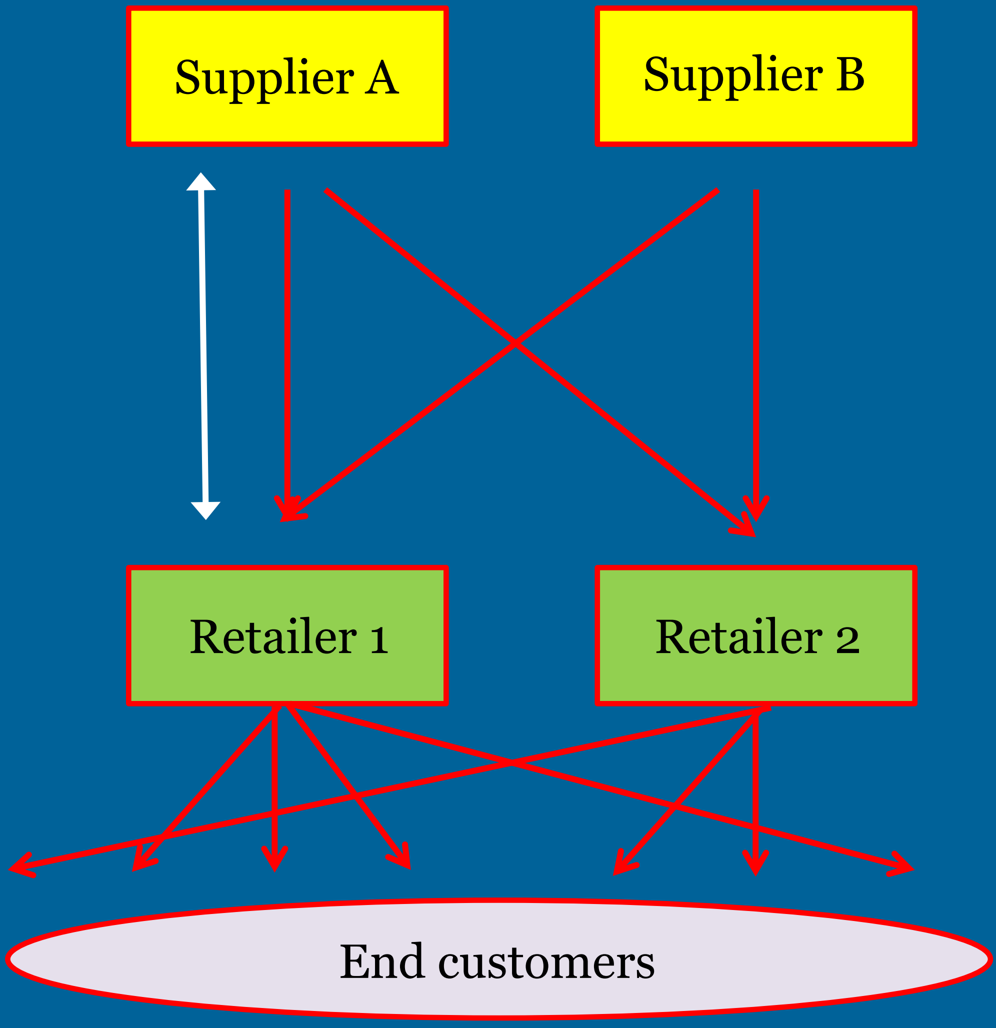
…and if retailers need to provide services, more externalities can arise



Retailer investment in services insufficient (because also benefits supplier)

…and with multiple retailers, some can free ride on the service investments of others – so even worse

Main concern historically has been with *exclusion*



Vertical restraint Supplier A – Retailer 1

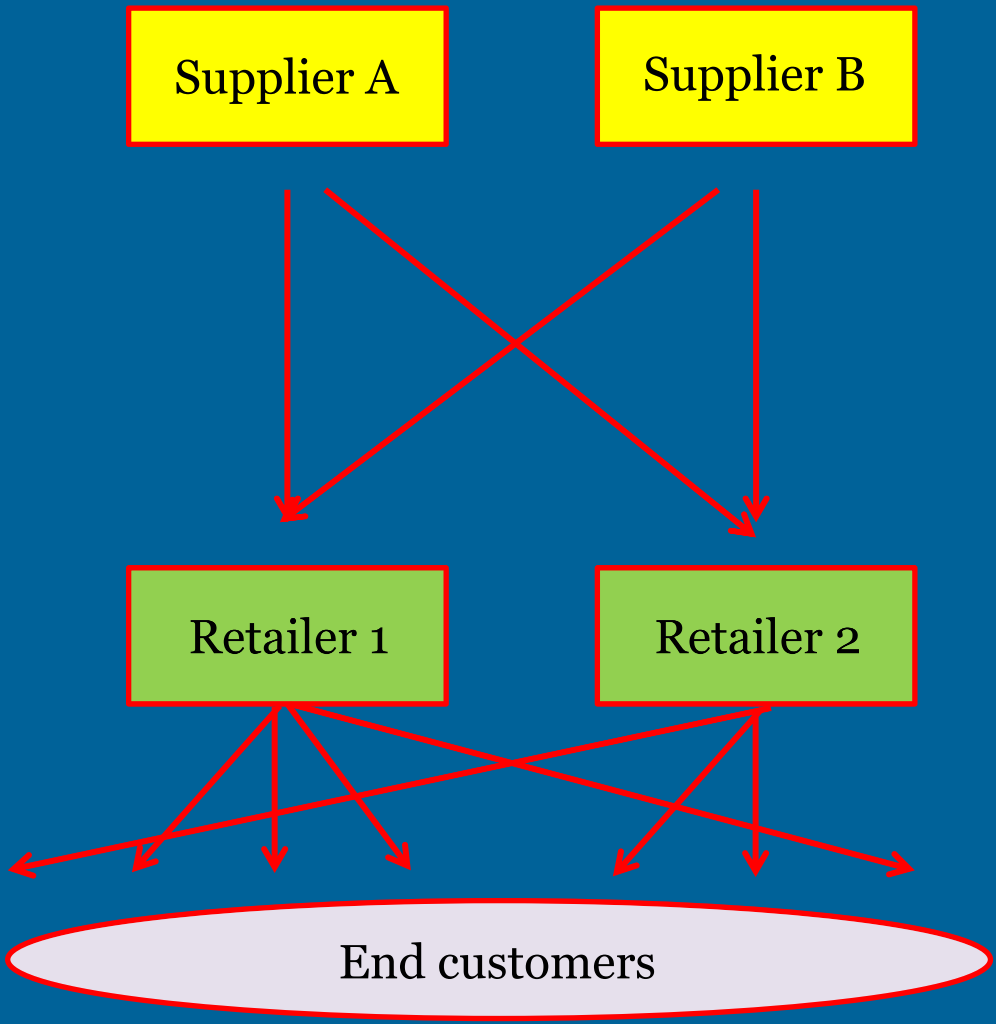
Foreclosure of part of market for Supplier B

If reduces likely sales below minimum efficiency scale, may create monopoly for Supplier A

Requires good understanding of the economics of potential harm:

- Foreclosure effects of restraint (if not absolute)
- Viability of B if partially foreclosed
- Sustainability of monopoly after exit
- Incentives of retailers to sign!

…but more recently more interest in collusion (including less explicit forms)



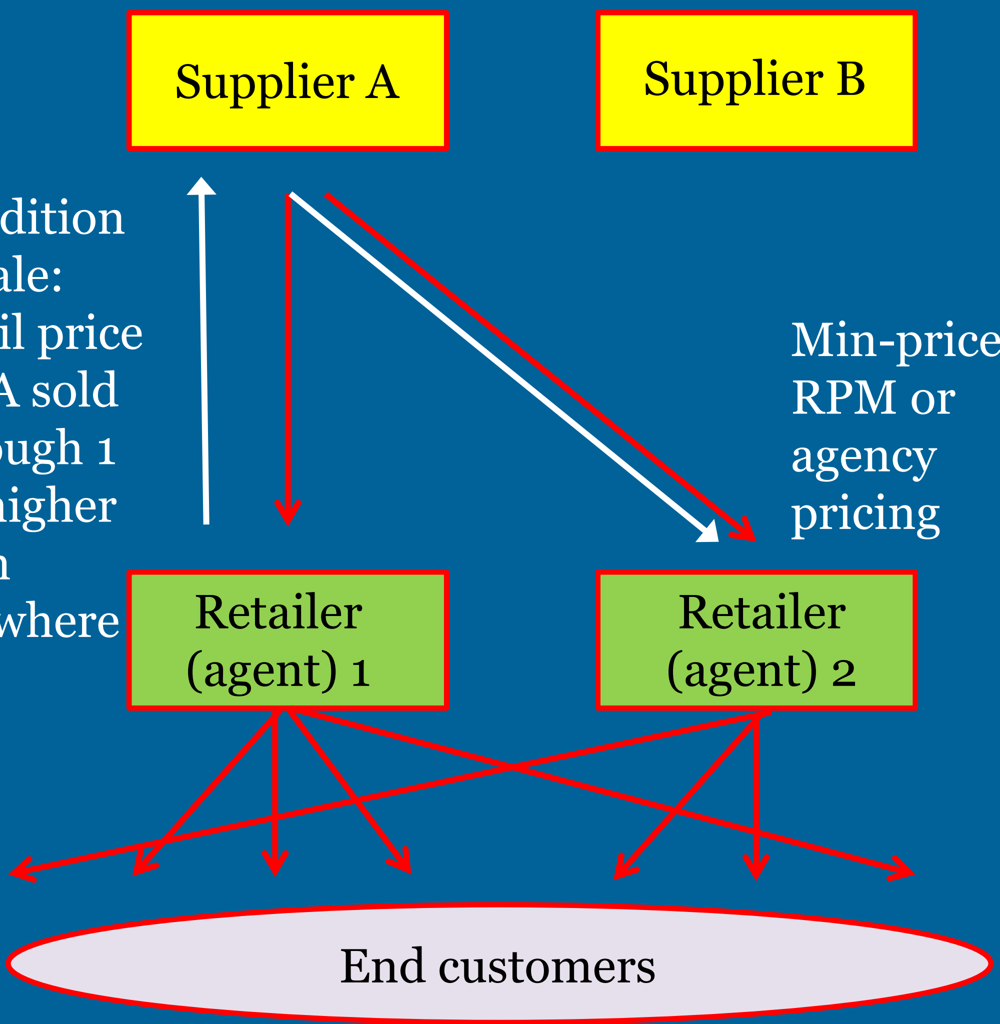
Many different mechanisms, eg:

1. RPM facilitates upstream collusion by making supplier prices more transparent
2. ‘Common agency’ arrangements to combine competing supplies into single distributor monopoly
3. Industry-wide RPM or exclusive territories as ‘sham’ agreements to enable retailers to collude.

Again, always worth asking why the other party would agree.

MFN clauses with agency pricing, especially for online sales

Condition of sale: retail price for A sold through 1 no higher than anywhere else



Theories of harm:

1. Eliminates price competition among retailers (even if some do not take part), equivalent to industry-wide RPM
2. Softening competition among retailers on margins to suppliers
3. Exclusive effects (by denying new entrants opportunity to build market share through low prices).

Theories of benefit: Mainly to eliminate free-rider problem

What (ideally) would we like?

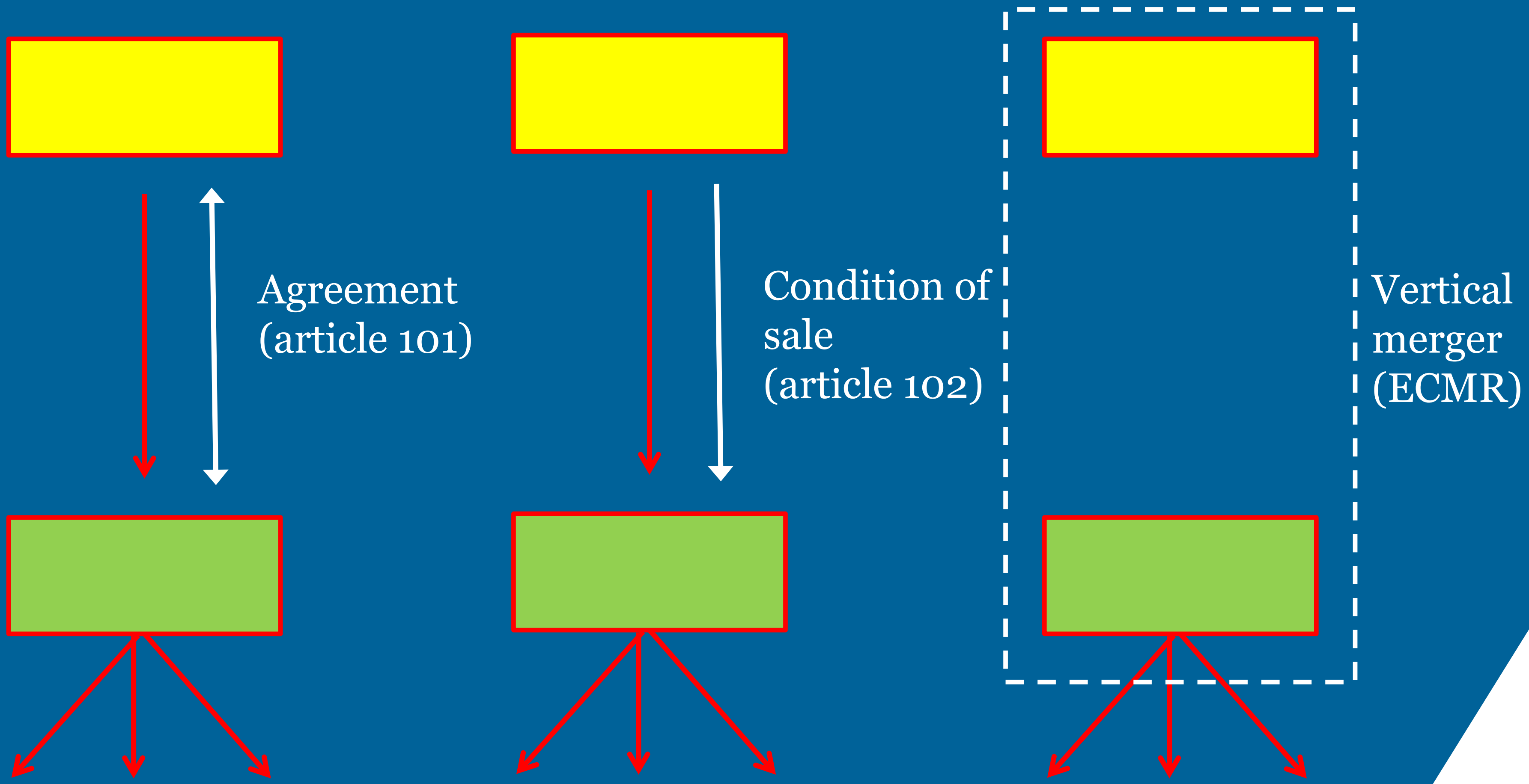
- Ways of determining:
  - No effect or pro-competitive effect
  - Any or all of the following anti-competitive effects:
    - Exclusionary abuse
    - Exploitative abuse
    - Facilitation of collusion (explicit or tacit)

… and the role of efficiencies

Best (drawn) amicus brief ever: http://www.abajournal.com/files/AppleAmicusBrief.pdf

Some consistency would be nice (but full consistency may be impractical)

- Identical effects under different legal tools?



What's the evidence (1)?

- Lafontaine and Slade (2008):
  - Summarize results of studies looking at effects of private and public vertical restraints
  - Ideally, using studies that look at variations in legal environment across regions and over time
  - Measuring benefit to consumers, ideally through quantity effects

  - Overall, results (of about 22 studies):
    - Private restrictions usually benefit consumer welfare
    - Public restrictions usually harm consumer welfare
- Cooper et al (2005) review similar results: little anticompetitive harm

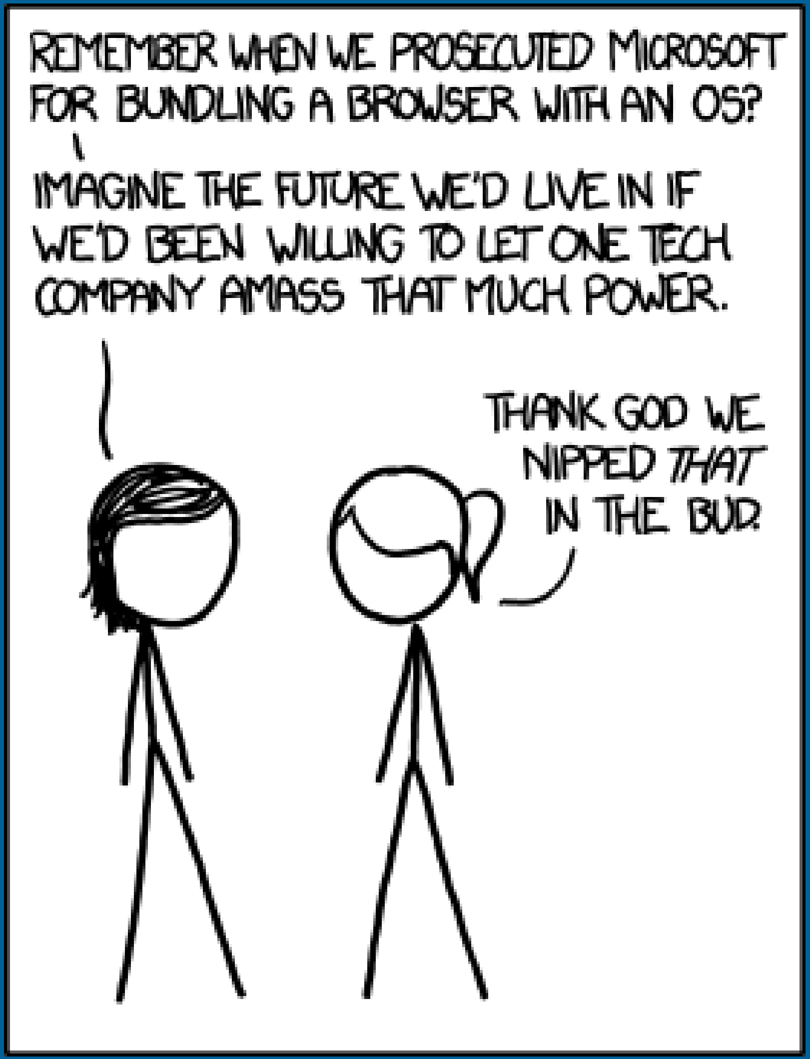
What's the evidence (2): RPM ?

- Over-enforcement by US authorities in 1970s and 80s: Overstreet (1983), Ippolito (1991):
- BUT - quite a wide variety of evidence finding anti-competitive effect of minimum price RPM, through weakened competition (especially collusion), eg:
  - OFT (2008) study on end of resale price maintenance for books (study concludes benefit arose from new business models)
  - Santos and Wildenbeest (2014) on e-books case, price reductions of 8 – 18% following settlements
  - Biscourp, Boutin and Vergé (2008): price-concentration correlation broken following effective legalisation of min-price RPM in France, implying collusion
  - Bonnet & Dubois: same French measure increased retail prices of bottled water about 7%

What’s the evidence (3): RPM ?

- MacKay and Smith (2013):
  - Natural experiment, comparing US states that adopted rule-of-reason for min-price RPM post-Leegin and those retaining per-se illegality
  - Significant price increases, and decreased output, in ‘rule of reason’ states
  - HOWEVER - price increases not always associated with quantity decreases (see Harris (2013)) so could reflect quality improvement
  - Debate continues…

But it's hard to determine long term effects even in retrospect



…and still harder to make predictions (especially about the future)

Antoine Augustin Cournot
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"But in reality, the economic system is an assembly of which all parts stand and react to each other. This would surpass the forces of mathematical analysis and our practical methods of calculation, even if all the values of the constants could be assigned numerically."

Some rather unsupported final thoughts

- Per se legality or illegality makes little sense – so we need economics
- Foreclosure analysis (as set out in Commission priorities paper) for *exclusive* effects. More empirical analysis (and ex post studies) can help develop rules of thumb…at least for short term effects

- Relatively little guidance on *collusive* effects:
  - Economists less interested because less tractable?
  - Lawyers less interested because 'real' collusion can be dealt with using existing cartel tools?
- But case practice and empirical studies seem to suggest this might be at least as important as foreclosure…
- …implying at least a strong *presumption* against minimum-price RPM? Especially if applied across all retailers (whether through supplier-imposed RPM or retailer-imposed MFN clause).

Thank you