Vertical restraints –
An economist‘s perspective

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Starting point

- Restrictions by object vs. the more economic approach
  - Effects-based enforcement of Article 101 TFEU: the “object paradox” (Damien Gerard, 2012)
- Discussion after Leegin 2007 vs. current activities/positions of European antitrust authorities (AAs)
  - BWB RPM Conference September 2008 – BKartA RPM Guidelines grocery retail industry (2017)
- Coty decision, and subsequent EC brief
- Economist’s take on vertical restraints, in particular RPM
  - Why RPM: Many other practices (platform and internet sale bans) are work arounds to achieve the same goal

Agenda and message

- Ingredients and background of economic thinking about VR
- Efficiencies and anticompetitive effects associated with VR
  - RPM, implemented by manufacturers
    - Platform and internet bans, dual pricing strategies
  - RPM, „enforced“ by retailers
    - Price parity clauses
  - Exclusive content vs. exclusionary practices
    - Vertical mergers

Message:

If no (significant) market power (Posner’s ‘monopoly power’), no competition policy problem. Otherwise: Rule of reason!

Ingredients of the economic approach

- Firms are profit maximizing and (more or less) rational
  - ⇒No one voluntarily accepts smaller share of pie than 'necessary'
  - ⇒C.p. supplier rather has low cost retailer distribute its product
- Questions / Problems:
  - ⇒What is (consumer) welfare effect of certain behavior/ practices?
  - ⇒Potential long run effects: dynamic rather than static view
- Problem: 'Imperfect' world
  - Economies of scale
  - Uncertainty, asymmetric information, and externalities

⇒ 'Perfect' competition is not a proper benchmark

Horizontal and vertical externalities in vertical structures

- Double marginalization [if upstream and downstream market power exists]
- horizontal externalities of service provision (Telser 1960), certification of quality (Marvel und McCafferty 1984), …

  ⇒Consumer (and ‘discounter’) free riding
- Vertical externality with complementary investments, sales efforts (reputation), public goods character of retailer

  ⇒Retailer and manufacturer free riding, resp.

⇒Institutions (‘Agreements’; VRs) beyond arms-length trading necessary to provide efficient distribution system

⇒EU Block exemption regulation

How RPM and other VRs solve externality problem and enhance efficiency - Examples

- Double marginalization [if upstream and downstream market power exists]
  - ⇒Classic problem: Everyone wants to have his margin (Brewers, wholesalers, retailers)
  - ⇒Prices too high from industry perspective, demand too low
  - ⇒Vertical integration, RPM ceiling, two part tariffs solve problem
  - ⇒VRs increase consumer welfare

⇒Vertical externality
  - ⇒Negative incentive on innovative activity
  - ⇒Only part of return from innovation accrues to innovator

The horizontal externality problem – Free riding

- ‘Service’ provision (Telser 1960)
  - Service provision argument 2.0: Showrooming vs. webrooming
  - Asics, Sennheiser, Denon & Marantz
  - BSH home appliances $\Rightarrow$ dual pricing
  - Corner bookstores $\Rightarrow$ ‘make’ fiction bestsellers
- Certification of ‘quality’ (Marvel und McCafferty 1984)
  - Amazon marketplace, HRS, Booking.com, [Pierre Fabre]

  $\Rightarrow$ Price parity clauses (narrow (+) and wide (-))
- Inventory (Krishnan und Winter 2007)
  - Books, Asics, Haribo, BSH, Sennheiser, Denon & Marantz

$\Rightarrow$ **Consumer (and ‘discounter’) free riding**

The *vertical* externality problem – Free riding

- Complementary 'investments'
  - Premium products: Coty
  - Distribution channel/price as signal of quality: Pierre Fabre
- Sales efforts/promotional services (reputation) (Klein and Murphy, 1988)

  ⇒No consumer free riding
  - Brand name apparel (Levi's)
  - Dornbracht, Pierre Fabre
- public goods character of retailer
  - Book stores (spontaneous purchases)

⇒**Retailer and manufacturer free riding, resp.**

Potential anticompetitive effects of VR (in particular of RPM)

- Manufacturer Cartel and softening of inter-brand competition, resp. (Guidelines on VR, 100,b)
- Upstream foreclosure (Guidelines on VR, 100,a)
- Dealer cartel and softening of intra-brand competition, resp.(Guidelines on VR, 100,c)
- Downstream foreclosure (Guidelines on VR, 100,a)

$\Rightarrow$ Downstream foreclosure (‘forced’ RPM and exclusivity, rsp. by dominant retailer) arguably most relevant

$\Rightarrow$ Where are the anticompetitive effects in the recent EC and BKartA – RPM cases??

The effect of VRs: Preliminary weighing up

- Conclusion from theory:

  Motta (2004): „Vertical restraints and vertical mergers are **anticompetitive only if** they involve firms endowed with **significant market power**. … An **efficient policy** […] would **grant exemption to *all* the vertical restraints of firms** which do not have large market power. [A] **rule of reason** should be adopted, and one should balance possible efficiency effects with possible anti-competitive effects [**if firms with significant market power involved**].

- Empirical results:

  Lafontaine/Slade (2008): Despite ambiguous theoretical results, **empirical evidence „surprisingly consistent“:** Restraints imposed **by manufacturers** typically increase consumer welfare.

Exclusivity (preliminary thoughts)

- Foreclosure by platforms and retailers
  - Radius restrictions (ED) (Brühn/Götz 2018), Toys “R” Us (RPM)
- But: **Exclusivity** might be important procompetitive device if introduced by upstream firms:
  - Video games industry (Lee 2013) $\Rightarrow$ **Facilitates entry**,
  - Brewers and pubs (Lafontaine/Slade 2008) $\Rightarrow$ **ensures efficient investment**
  - Apple iPhone and mobile network operator $\Rightarrow$ **disrupts** (?) **collective dominance/tacit collusion** [Countervailing power]
  - AT&T/Time Warner (DirecTV) $\Rightarrow$ dto (?)

$\Rightarrow$ Reinvigorates competition and gives consumers better deal

(Tentative) Conclusions

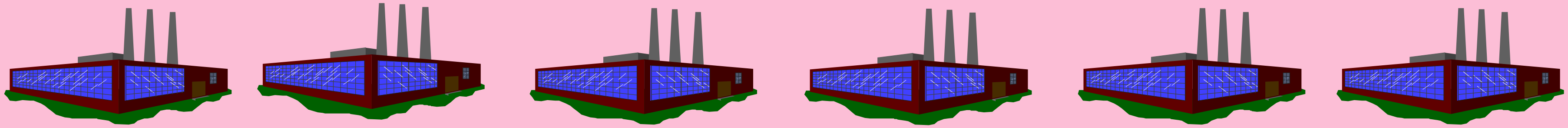
- Not covered above:
  - What is significant market power? **30% market share in BER**

    ⇒Market definition critical (SSNIP in two-sided platforms)
  - CTS Eventim [Leniency as Industrial Policy??]
- Lessons:
  - **Freedom to compete** not equal to **license to free ride**
  - With externalities efficiency [often] requires restraints
  - Given powerful retailers and platforms VRs (introduced by manufacturers) provide welcome countervailing power

⇔ (Over-) Enforcement has long run effects on market structure and innovation ⇒ **more powerful retailers and platforms**?

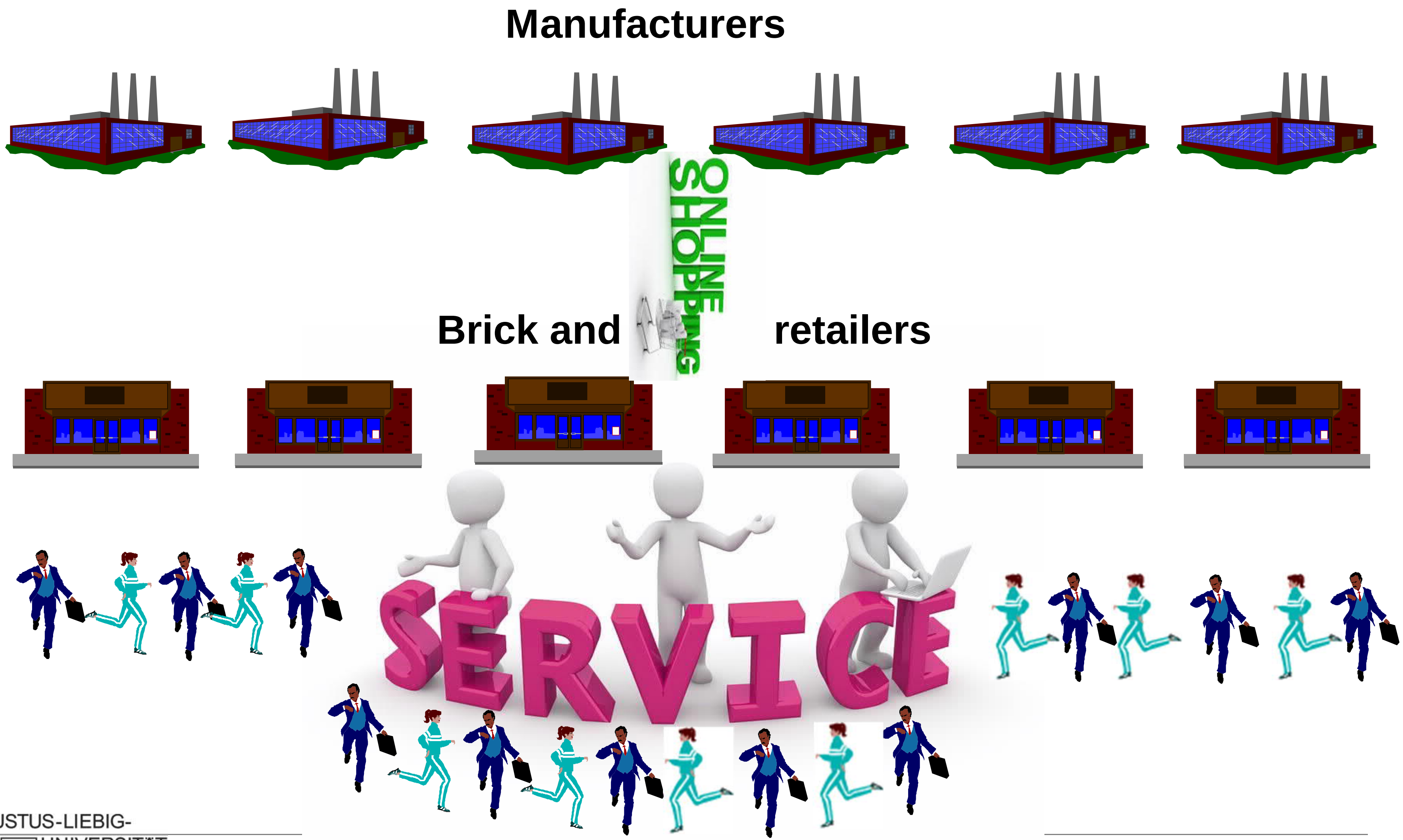
The rosy past

Manufacturers



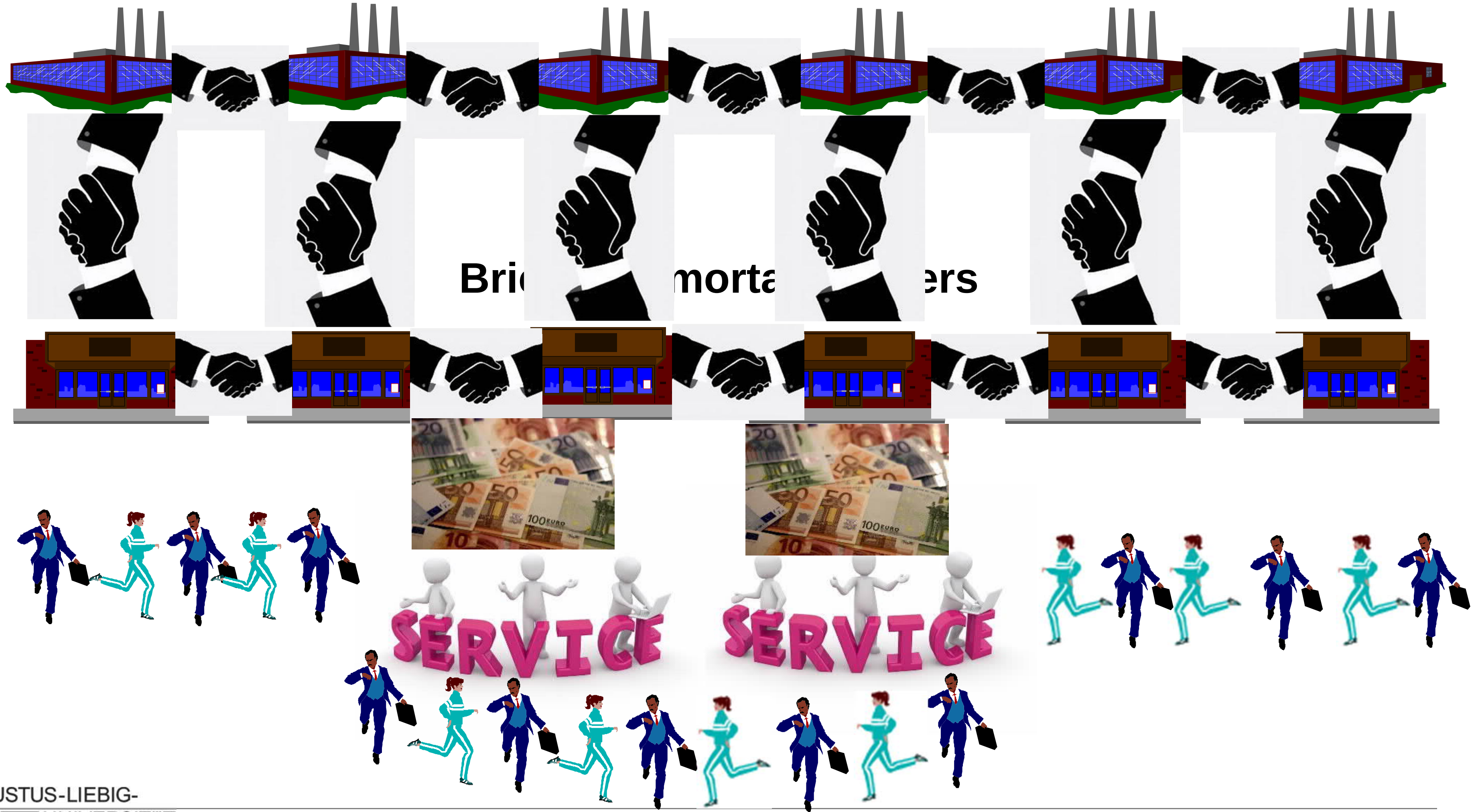
Brick and mortar retailers

The future without RPM: MF & B&M-R view



The future with RPM: the enforcers' view

Manufacturers



Final thoughts for enforcers

- The end is **not** near in a world with RPM
  - See US after Leegin (Marvel 2017, Contact lenses??)
- Important: Don't beleaguer ‘small’ companies!
- Fine (= tax) large companies (the big business: GAFA), but don't distract them from there core business

  ⇒No second Microsoft Windows Vista �
- **Never** enforce a '**no single buyer**' rule for UEFA Champions League and German Bundesliga
- And don’t interfere with exclusive dealings between brewers and pubs

QUESTIONS & REMARKS

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