Federal Trade Commission

The Economics of Resale Price Maintenance & Implications for Competition Law and Policy

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before the

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Good evening. Thank you for the kind introduction and warm welcome. I am delighted to be here today. I would like to thank the British Institute of International and Comparative Law, and especially Professor Philip Marsden, for the generous invitation to share my views with you this evening. I also would like to thank former FTC Commissioner and acting Chairman, Terry Calvani, for helping organize today's trans-Atlantic discussion, and to Freshfields for hosting this event. I very much look

* The views stated here are my own and do not necessarily reflect the views of the Commission or any other Commissioner. I am grateful to my attorney advisor, Jan M. Rybnicek, for his invaluable assistance in preparing this speech.

forward to what I hope will be an open exchange of ideas about how competition law and policy can best maximize consumer welfare. Before I begin, however, I am obligated to provide a short disclaimer familiar to many of you: the views I express today are my own and not necessarily those of the Commission or any of the other Commissioners. With that bit of business out of the way, let us jump right in.

I. INTRODUCTION

Today I would like to talk about the appropriate legal treatment of minimum resale price maintenance ("RPM") agreements under the antitrust laws.[1] Identifying the appropriate legal rule to govern RPM is a challenging issue and one that has a long history in the United States. Indeed, for a vast majority of the United States experience, vertical restraints like RPM were treated as *per se* violations of the antitrust laws. Then, a watershed moment for antitrust generally and vertical restraints specifically came in 1977 in the form of the Supreme Court's decision in *Continental T.V. v. GTE Sylvania, Inc*. Based upon new and emerging economic learning and a broader movement toward a consumer welfare-based antitrust regime, the United States Supreme Court began to abandon *per se* treatment of vertical restraints in favor of applying a rule of reason analysis that assesses the competitive effects of such agreements on a case-by-case

[1] For additional discussion of the appropriate legal treatment of resale price maintenance agreements under the antitrust laws, see Joshua D. Wright, *Overshot the Mark? A Simple Explanation of the Chicago School's Influence on Antitrust*, 5 COMPETITION POL'Y INT'l 179 (2009), *available at* https://www.competitionpolicyinternational.com/file/view/5930.

basis.[2] The shift occurred more quickly for some restraints than others. It was not until 1997 that the Supreme Court began to apply the rule of reason to maximum RPM agreements.[3] As you all are well aware, it was not until 2007 that the Supreme Court in its landmark decision in *Leegin* overturned a nearly century-old rule that treated minimum RPM as *per se* violations of the antitrust laws to hold that such business arrangements instead are appropriately analyzed under the rule of reason.[4] In my opinion, this was a positive development in U.S. competition law and policy.

But despite the Supreme Court's decision in *Leegin*, considerable debate remains concerning the appropriate legal treatment of minimum RPM in the United States. Whereas the shift toward rule of reason treatment for other vertical restraints is now seen as uncontroversial in the United States—including maximum RPM—there remains significant support for the view that minimum RPM should be either *per se* unlawful or subject to a rebuttable presumption of illegality under which such contracts are deemed "inherently suspect."[5] Indeed, it is fair to say that the bulk of the remaining debate in

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[2] *See* Cont'l T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977) (applying the rule of reason to analyze the legality of vertical non-price restraints); Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717 (1988) (observing that vertical non-price restraints are more often procompetitive than anticompetitive).

[3] State Oil Co. v. Kahn, 522 U.S. 3 (1997).

[4] Dr. Miles Med. Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911), *overruled by* Leegin Creative Leather Prods. v. PSKS, Inc., 551 U.S. 877 (2007).

[5] *See, e.g.*, *Interview with J. Thomas Rosch, Commissioner, Federal Trade Commission*, ANTITRUST (Spring 2009), *available at* http://www.ftc.gov/sites/default/files/documents/public_statements/interview-j.thomas-rosch-commissioner-federal-trade-commission/090126abainterview.pdf; Marina Lao, *Free-Riding: An Overstated, and Unconvincing, Explanation for Resale Price Maintenance*, *in* HOW THE CHICAGO SCHOOL OVERSHOT THE MARK: THE EFFECT OF CONSERVATIVE ECONOMIC ANALYSIS ON U.S. ANTITRUST (Robert Pitofsky ed. 2008);

the United States concerns how lower courts should shape the rule of reason. There are many available options ranging from a full-blown rule of reason analysis, to the weighting of the various factors enumerated in *Leegin*, to a so-called "structured" rule of reason test that would impose a rebuttable presumption of illegality. Even within the last category of "structured" rules, the devil is in the details with respect to the precise burden of proof imposed upon RPM users to discharge the presumption. Moreover, minimum RPM agreements remain *per se* unlawful in many states—including some states that have shifted to *per se* illegality in response to *Leegin*.[6] Lastly, it also is worth noting that some in Congress have sought to respond to the *Leegin* decision by proposing legislation to undo the shift to the rule of reason for minimum RPM in the United States in favor of returning to the *per se* standard.[7]

A quick survey of jurisdictions around the world reveals that the debate over the appropriate legal treatment of minimum RPM is not limited to the United States. In many jurisdictions outside the United States, minimum RPM agreements are regarded as serious competition law violations. For example, here in the United Kingdom, there

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Warren S. Grimes, *The Path Forward After* Leegin*: Seeking Consensus Reform of the Antitrust Laws of Vertical Restraints*, 75 ANTITRUST L.J. 467 (2008).

[6] *See, e.g.*, Michael Lindsey, *Overview of State RPM (Complete)*, ANTITRUST (Fall 2007), *available at* http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/LindsayFullChart11_29.authcheckdam.pdf (cataloguing state RPM laws); Michael, Lindsey, *State Resale Price Maintenance Laws after* Leegin, ANTITRUST SOURCE (Oct. 2009), *available at* http://www.dorsey.com/files/upload/lindsay_eupdate_antitrust_oct09.pdf (discussing developments in state RPM laws).

[7] *See* Discount Pricing Consumer Protection Act, S. 148, 111th Cong. (2009).

is a relatively strict prohibition on minimum RPM arrangements.[8] It also appears that the competition authority in the United Kingdom has taken a strong stance in prosecuting RPM cases. Indeed, just last fall, the Office of Fair Trading issued "statements of objections" in two separate cases alleging anticompetitive RPM agreements.[9] Similarly, in the European Union, minimum RPM agreements are considered "hardcore restrictions" and typically cannot make use of the benefits of the block exemption.[10] However, the European Commission does not apply a *per se* rule to minimum RPM agreements, and thus efficiencies resulting from such agreements theoretically can be shown to outweigh any anticompetitive effects.[11] In practice,

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[8] *See, e.g.*, OECD Competition Committee, Policy Roundtables: Resale Price Maintenance 2008, DAF/COMP (2008)37, 52-55 (2009) [hereinafter OECD Report], *available at* http://www.oecd.org/daf/competition/43835526.pdf. A recommendation of a resale price generally is permitted in the United Kingdom, but if the resale price recommendation is tied to any financial inducement or penalty, the arrangement becomes a mandatory resale price and is considered a hard-core infringement of the competition laws.

[9] Press Release, Office of Fair Trading, OFT Issues Statement of Objections to Sports Bra Supplier and Three UK Department Stores (Sept. 20, 2013), *available at* http://www.oft.gov.uk/news-and-updates/press/2013/64-13#.U0Kp9MfoVEo; Press Release, Office of Fair Trading, OFT Issues Statement of Objections in Mobility Scooters Sector (Sept. 24, 2013), *available at* http://www.oft.gov.uk/news-and-updates/press/2013/66-13#.U0bimxDgzTo.

[10] *See* Commission Regulation on the Application of Article 81(3) of the Treaty on the Functioning of the European Union to Categories of Vertical Agreements and Concerted Practices, No. 330/210, 2010 O.J. L. 102/1 [hereinafter VRBER Regulations]; OECD Report, *supra* note 8, at 225-31. For additional discussion about the legal framework for RPM in the European Union, see Andres Font-Galarza, Frank P. Maier-Riguad & Pablo Figueroa, *RPM Under EU Competition Law: Some Considerations From a Business and Economic Perspective*, CPI ANTITRUST CHRON. (Nov. 2013), *available at* https://www.competitionpolicyinternational.com/file/view/7015; and Amelia Fletcher, Emanuele Giovannetti, & David Stallibras, *Resale Price Maintenance: Explaining the Controversy, and Small Steps Towards a More Nuanced Policy*, 33 FORDHAM INT'L L. REV. 1278 (2011), *available at* http://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=2204&context=ilj.

[11] *See* VRBER Regulations, *supra* note 10; OECD Report, *supra* note 8.

however, there appears to be a heavy presumption against minimum RPM and procompetitive justifications are often viewed skeptically.[12]

The appropriate treatment of minimum RPM agreements also is an issue in emerging markets in the ever-growing global antitrust community. For instance, Article 14 of China's Antimonopoly Law appears to prohibit minimum RPM.[13] Although the National Development and Reform Commission ("NDRC") has endorsed something close to *per se* illegality for RPM, the courts appear to apply an analytical framework more similar to the rule of reason.[14] In 2013, in two separate cases, the NDRC imposed fines on six milk powder producers and two distilleries for entering into minimum RPM agreements.[15] These cases suggest that the NDRC will take an active role in identifying and vigorously prosecuting RPM arrangements in China. Minimum RPM agreements also have come under scrutiny recently in Taiwan. Taiwan's competition authority late last year imposed a significant fine against Apple for entering into distribution agreements with telecommunications companies that

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[12] *See id.*; Font-Galarza et al., *supra* note 10; Luc Peeperkorn, *Resale Price Maintenance and its Alleged Efficiencies,* 4 EUR. COMP. L. J. 201 (2008).

[13] ANTI-MONOPOLY LAW OF THE PEOPLE'S REP. OF CHINA (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 30, 2006, effective Aug. 1, 2008).

[14] Beijing Ruibang Yonghe Tech. & Trade Co. Ltd., v. Johnson & Johnson Med. (Shanghai) Ltd. and Johnson & Johnson Med. (China) Ltd., Judgment of Shanghai High People's Court (Aug. 1, 2013).

[15] Faaez Samadi, *China Fines Milk Companies*, Global Competition Review (Aug. 7, 2013), *available at* http://globalcompetitionreview.com/news/article/33967/china-fines-milk-companies/; Faaez Samadi, *China Hits State-owned Distillers with Record Fine*, Global Competition Review (Feb. 19, 2013), *available at* http://www.globalcompetitionreview.com/news/article/33075/china-hits-state-owned-distillers-record-fine/.

allowed Apple to approve iPhone pricing decisions.[16] Under existing law, minimum RPM is *per se* unlawful in Taiwan, but proposals have been introduced in Congress to employ a rule of reason standard.[17]

The wide-range of approaches for analyzing minimum RPM under the antitrust laws naturally raises the question of which approach is the most appropriate. In my view, the key question is not whether a *per se* rule or rule of reason standard should apply. As Professor Areeda's famous reference to the application of the rule of reason with the "twinkling of an eye" reminds us, the term "rule of reason" alone includes tests which vary not only in the quality of burdens of proof and production but their assignment as between the parties. A better question, in my view, is to ask: "what does economic theory and our body of empirical evidence about the competitive effects of such arrangements tell us about which RPM rule is most likely to maximize consumer welfare?"

With that question front of mind, I would like to use the remainder of my time to discuss: (1) the economics of developing appropriate antitrust rules; (2) the pro- and anti-competitive theories associated with minimum RPM; (3) the existing empirical evidence on RPM and other vertical restraints; and lastly, (4) what the theoretical and

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[16] Faaez Samadi, *Apple Hit with RPM Fine*, Global Competition Review (Dec. 30, 2013), *available at* http://www.globalcompetitionreview.com/news/article/34943/apple-hit-rpm-fine/; Tim Worstall, *Apple Fined $670,000 In Taiwan for Price-Fixing,* Forbes (Dec. 25, 2013), *available at* http://www.forbes.com/sites/timworstall/2013/12/25/apple-fined-670000-in-taiwan-for-price-fixing/.

[17] Samadi, *supra* note 16.

empirical evidence teaches us about the appropriate rule for the treatment of minimum RPM under the antitrust laws.

II. THE ECONOMICS OF ANTITRUST LIABILITY RULES

Any legal rule governing liability determinations under competition policy must focus upon maximizing consumer welfare. In order to construct a rule that maximizes consumer welfare it is necessary to employ a framework that considers three key factors. First, the framework must consider the probability that the challenged business arrangement is anticompetitive. Second, the framework must evaluate the magnitude of the social cost created by any errors in assessing antitrust liability because any legal rule inevitably will lead to some errors. There are two types of errors possible: false positives in which procompetitive conduct is mistakenly condemned, and false negatives in which we fail to condemn conduct that is actually anticompetitive. Third, the framework must acknowledge the administrative costs of implementing alternative legal rules. For instance, a bright-line prohibition is less costly to administer than a standard requiring a case-by-case assessment of the competitive effects.

The framework I have described above is, of course, the standard "decision-theory" or "error-cost" approach to legal rules. The error-cost approach is well suited for designing appropriate legal rules for assessing liability under the antitrust laws. Pioneered by Judge Frank Easterbrook of the U.S. Court of Appeals for the Seventh Circuit, the error-cost approach is an uncontroversial application of decision theory that

makes it possible to channel available economic information through an analytical framework to help identify the optimal enforcement approach and has been applied fruitfully in a variety of antitrust settings.[18]

Key to the error-cost framework is its use of theoretical and empirical economic evidence to inform thinking about the procompetitive or anticompetitive nature of a specific business practice as our understanding of the practice evolves over time or with case-specific information. This economic evidence offers an assessment of the probability that the underlying conduct is anticompetitive, and in turn informs our understanding of the probability of false positives and false negatives.

Applying the error-cost framework, a *per se* prohibition or presumption of illegality is appropriate only when the business practice in question is overwhelmingly, but not necessarily always, likely to cause competitive harm and the ability to engage in a more fact-intensive inquiry to identify instances of procompetitive arrangements provides a sufficiently small marginal benefit to consumers.[19] Accordingly, for a *per se* or "inherently suspect" approach—the latter defined as an approach which begins by

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[18] Frank Easterbrook, *The Limits of Antitrust*, 65 TEX. L. REV. 1 (1984); *see also* David Evans & Jorge Padilla, *Designing Antitrust Roles for Assessing unilateral practices: A Neo-Chicago Approach*, 72 U. CHI. L. REV. 73 (2005); Luke Froeb et al., *Vertical Antitrust Policy as a Problem of Inference*, 23 INT'L J. INDUS. ORG. 639 (2005); Keith Hylton & Michael Salinger, *Tying Law and Policy: A Decision-Theoretic Approach*, 69 ANTITRUST L.J. 469 (2001); C. Frederick Beckner III & Steven C. Salop, *Decision Theory and Antitrust Rules*, 67 ANTITRUST L.J. 41 (1999). *But see* Jonathan Baker, *Talking the Error Out of "Error Cost" Analysis: What's Wrong with Antitrust's Right*, ANTITRUST L.J. (forthcoming 2014), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2333736.

[19] Andrew I. Gavil et al., ANTITRUST LAW IN PERSPECTIVE: CASES, CONCEPTS, AND PROBLEMS IN COMPETITION POLICY 103-06 (2d ed. 2008).

assigning the burden of proof to the defendant rather than the plaintiff to establish anticompetitive effects—for assessing the antitrust liability of vertical contracts such as RPM agreements to generate consumer welfare gains relative to the rule of reason, it must be the case that there is a substantial basis in the economic literature and empirical evidence upon which to conclude that such agreements in practice are nearly always anticompetitive. So what does economic theory and empirical evidence tell us about the likelihood that minimum RPM nearly or always is anticompetitive?

III. THE ECONOMICS OF RESALE PRICE MAINTENANCE

Economic literature has long recognized, and the Supreme Court has endorsed the view, that minimum RPM, like nearly all forms of horizontal restraints, vertical restraints, pricing practices, and mergers under the domain of the antitrust laws, can have both anticompetitive and procompetitive effects.[20] The anticompetitive theories of harm from minimum RPM are well known and I will only briefly review them here. The anticompetitive theories of minimum RPM generally can be lumped into two categories: collusion and exclusion.[21] With respect to collusion, minimum RPM agreements potentially can help facilitate dealer-level cartels by using manufacturers to establish and police pricing behavior that leads to price-fixing at the dealer level. Separately, minimum RPM agreements also potentially can be used by manufacturers

[20] *See Leegin*, 551 U.S. at 889-94; Thomas A. Lambert & Michael Sykuta, *Why the New Evidence on Minimum Resale Price Maintenance Does not Justify a* Per Se *or "Quick Look" Approach*, CPI ANTITRUST CHRON. (Nov. 2013), *available at* https://www.competitionpolicyinternational.com/file/view/7019 (cataloguing the pro- and anti-competitive theories associated with RPM).

[21] *See Leegin*, 551 U.S. at 892-94.

to structure and police manufacturer-level collusion by stabilizing retail prices and reducing the likelihood of cheating.

With respect to exclusionary theories of harm, minimum RPM agreements potentially can be used by a dominant dealer to request a price floor in order to avoid competition from more efficient rival dealers. Minimum RPM agreements also potentially can be used by a dominant manufacturer to guarantee retail mark-ups in order to convince dealers to disfavor the manufacturer's rival. Although several conditions must hold true for minimum RPM to raise anticompetitive concerns, it is well accepted in the literature that such agreements can harm competition.[22]

The economic literature also is replete with examples of procompetitive justifications for minimum RPM agreements. Much of the discussion about procompetitive justifications in the minimum RPM context has revolved around the economic concept of free-riding. Maybe the most common procompetitive justification cited is the use of minimum RPM to facilitate dealer point-of-sale services by ensuring dealers that furnish no or lesser promotional services cannot free-ride upon the investment of dealers who provide the full complement of promotional services and then offer products to consumers at discounted rates.[23] Point-of-sale services include offerings such as consumer education and product testing, and can require a

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[22] *See* Lambert & Sykuta, *supra* note 20, at 4 (identifying the necessary conditions for anticompetitive harm from minimum RPM).

[23] *See GTE Sylvania*, 433 U.S. at 55 (observing "discounting retailers can free-ride on retailers who furnish services and then recapture some of the increased demand those services generate").

considerable investment on the part of the dealer. Discount dealer free-riding takes place when consumers first visit the full-service retailer to obtain valuable promotional services before purchasing the product from a "discount dealer" who does not provide those services and, therefore, can sell at a lower retail price. A related concern can arise when a pioneering dealer that invests in developing a brand is undercut by later rivals that discount the product once the brand is established.[24] Minimum RPM can be an important means for preventing these problems by eliminating retail discounting.[25]

As many have pointed out, the "discount dealer" story alone is insufficient to explain the prevalence of minimum RPM.[26] Critically, however, minimum RPM agreements also can play an important role in facilitating the provision of efficient promotional services even in the absence of free-riding concerns. Indeed, relying upon a seminal article by Benjamin Klein and Kevin Murphy on the economics of vertical restraints, the Supreme Court in *Leegin* observed that vertical restraints such as minimum RPM can help align manufacturer and dealer incentives even where there is no free-riding.[27]

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[24] *See Leegin*, 551 U.S. at 913.

[25] *See* Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86 (1990).

[26] *See, e.g.*, Benjamin Klein, *Competitive Resale Price Maintenance in the Absence of Free-Riding* (Feb. 10, 2009) (draft for FTC Hearings on Resale Price Maintenance, Feb. 17, 2009), *available at* http://www.ftc.gov/sites/default/files/documents/publicevents/resale_price_maintenance_under_sherman_act_and_federal_trade_commission_act/bklein0217.pdf ("The attempt by defendants to place all cases of resale price maintenance within the prevention of free-riding framework has led to absurd, clearly pretextual explanations.").

[27] *Leegin*, 551 U.S. at 892 (citing Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J. L. & ECON. 265 (1988)).

This efficiency rationale for RPM and other vertical restraints recognized by the Supreme Court has been well known in the antitrust literature for over 25 years. In their 1988 article, Klein and Murphy demonstrate that retailers will undersupply promotional services because manufacturers do not take into account the incremental profit margin earned by the manufacturer on promotional sales when some, but not all, consumers value the promotional service. Klein and Murphy identify an important incentive conflict between manufacturers and retailers with respect to retailer supply of point-of-sale promotional effort. The conflict derives from two economic factors common in differentiated product markets where RPM is observed. The first is that the manufacturer's profit margin—or the difference between wholesale price and marginal cost of production—on an incremental sale induced by retailer promotion generally is much larger than the retailer's profit margin—or the difference between retail price and wholesale price paid. This is highly likely to be the case where manufacturers produce branded, differentiated goods and face substantially less elastic demand than retailers. Because retailers do not take into account the additional profit margin earned by the manufacturer on promotional sales, they generally will have an insufficient incentive to provide promotional services from the manufacturer's point of view.[28]

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[28] This is not the case where the services desired have significant inter-retailer demand effects and consumers shift their purchase from one retailer to another in response to the retailer's supply of the service. However, these large inter-retailer demand effects are not likely to be present from many desired services, such as the provision of premium shelf space. For a more complete economic analysis of the incentive conflict based inter-retailer demand effects, see Ralph Winter, *Vertical Control and Price Versus*

The second economic factor is that the manufacturer's incremental sales produced by the retailer's manufacturer-specific efforts are often greater than the retailer's overall incremental sales. When a retailer provides incremental services to promote a specific manufacturer's product, there is not a larger retail increase in total sales that is capable of offsetting the lower retail profit margin. In fact, when a multi-product retailer supplies promotional services for a specific brand, for example Coca-Cola, the primary effect is demand-shifting among manufacturers.[29] In other words, promotion-induced sales of Coca-Cola are likely to be at least partially offset by a decrease in the sales of other soda products.

Given these general economic conditions—manufacturer profit margins that exceed retailer profit margins on promotional incremental sales, the absence of significant inter-retailer demand effects from supply of promotional effort, and promotion that results primarily in manufacturer "brand-shifting"—retailers will not have an adequate incentive to supply manufacturer-specific promotion efforts. Crucially, these conditions are pervasive in the modern economy of differentiated products, firm-specific downward sloping demand curves, and competitive retail industries. Under these conditions, whether or not there is also "discount dealer" free-riding, manufacturers and retailers are strongly motivated to solve this incentive

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Nonprice Competition, 108 Q.J. ECON. 61 (1993) and Benjamin Klein & Joshua D. Wright, *The Economics of Slotting Contracts*, 50 J.L. & ECON. 473 (2007).

[29] *See* Joshua D. Wright, *Slotting Contracts and Consumer Welfare*, 74 ANTITRUST L.J. 439 (2007).

conflict by devising contractual arrangements assuring that the jointly profit maximizing level of promotional services is supplied.

While these conditions provide the incentive for manufacturers to compensate retailers for the supply of promotion services, there are a number of possible contractual arrangements firms might adopt. For example, manufacturers might compensate retailers with a per unit time slotting payment, a wholesale price reduction, or RPM. The fundamental objective of these payments is to provide a premium stream to retailers for the provision of promotional services. This premium stream facilitates performance and is self-enforcing in the economic sense.[30]

Understanding the economic role minimum RPM agreements play in remedying "discount dealer" free-riding or in resolving incentive conflicts between manufacturers and retailers in the absence of dealer free-riding of course does not imply that minimum RPM is generally procompetitive or tell us what legal rule should apply. To identify the appropriate legal rule for minimum RPM we must understand whether the procompetitive or anticompetitive models associated with RPM has greater predictive power. For that we must examine the existing empirical evidence on the subject.

IV. EMPIRCICAL EVIDENCE ON RESALE PRICE MAINTENANCE

A variety of methodologies have been employed to measure the welfare effects of minimum RPM agreements and other vertical contracts. A particular challenge of

[30] *See* Benjamin Klein & Keith B. Leffler, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. POL. ECON. 615 (1981).

measuring the welfare effects of minimum RPM is that researchers need to assess both price and output effects. From a consumer welfare perspective, measuring the impact of minimum RPM on price alone tells us little about the competitive effects of minimum RPM because both procompetitive and anticompetitive theories predict higher prices, all else equal. Analyzing the impact of minimum RPM on output, where the theories offer predictions in opposing directions, resolves this problem. Despite the difficulties of measuring the welfare effects of minimum RPM, over the past 30 years there has been a concerted effort to add empirical knowledge to our rich menu of theoretical models.

As I have already discussed, in order to determine whether *per se* or "inherently suspect" treatment of minimum RPM is socially optimal as compared to the rule of reason, the existing evidence must demonstrate that such agreements are always, or almost always, anticompetitive. However, economists nearly universally agree that while minimum RPM can generate anticompetitive outcomes in some instances, the empirical evidence indicates such agreements are more often than not procompetitive.

As is the case with many vertical restraints, the empirical literature is relatively modest but growing. Among the early empirical evidence on RPM is a 1983 report prepared by Thomas Overstreet analyzing 68 FTC RPM cases from mid-1965 to 1982.[31] The report also summarizes the empirical studies on RPM available at the time.

[31] Thomas Overstreet, Bureau of Economics Staff Report to the FTC, RESALE PRICE MAINTENANCE: ECONOMIC THEORIES AND EMPIRICAL EVIDENCE (1983).

Overstreet observed that an overwhelming number of the RPM cases brought and resolved by the FTC occurred in markets that were not conducive to either dealer or manufacturer collusion, and therefore concluded that RPM agreements generally are procompetitive. Further, Overstreet's survey of the existing empirical work showed that although RPM can have both socially desirable and undesirable consequences, the studies did not support the conclusion that RPM agreements are more often than not anticompetitive.[32]

In a 1991 study, Pauline Ippolito reviewed 203 litigated RPM cases reported from 1975 through 1982, and concluded they were generally inconsistent with theories of dealer or manufacturer collusion.[33] In particular, Ippolito observed that allegations of horizontal price-fixing in these cases was exceedingly rare—appearing only 9.8 percent of the time in private cases and 13.1 percent of the time over all cases—even though such claims logically would have been included by plaintiffs if they had any evidence that the RPM arrangements in question facilitated dealer or manufacturer collusion.[34] Moreover, most of the cases offered facts suggesting procompetitive justifications for the use of RPM. This led Ippolito to conclude that "service and sales-enhancing

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[32] *See* Thomas A. Lambert, *A Decision-Theoretic Rule of Reason for Minimum Resale Price Maintenance*, 55 ANTITRUST BULL. 167 (2010) (discussing Overstreet's findings).

[33] Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & ECON. 263 (1991).

[34] *Id.* at 281; Lambert & Sykuta, *supra* note 20, at 5-6 (discussing Ippolito's findings).

theories, taken together, appear to have greater potential to explain the [RPM] practice" than do collusion-based explanations.[35]

Two more recent empirical surveys summarizing the empirical literature on vertical restraints since Overstreet and Ippolito offer additional evidence placing doubt on the proposition that minimum RPM is always or almost always anticompetitive. The first, authored by a group of FTC and Department of Justice ("DOJ") economists, reviews 24 papers published between 1984 and 2005 providing empirical effects of vertical integration and vertical restraints.[36] The study offers a careful synthesis of the evidence and observes that "empirical analyses of vertical integration and control have failed to find compelling evidence that these practices have harmed competition, and numerous studies find otherwise."[37] While only a handful of the selected studies directly involve RPM rather than other forms of vertical restraints, the authors go on to conclude that while "some studies find evidence consistent with both pro- and anti-competitive effects . . . *virtually no studies can claim to have identified instances where vertical practices were likely to have harmed competition*."[38]

The second empirical survey, by Francine Lafontaine and Margaret Slade, reviews 23 papers with some overlap with the study prepared by the DOJ and FTC

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[35] Ippolito, *supra* note 33, at 291-92; *see also* Lambert & Sykuta, *supra* note 20, at 17.
[36] James C. Cooper, Luke M Froeb, Dan P. O'Brien & Michael Vita, *Vertical Antitrust Policy as a Problem of Inference*, 23 INT'L J. INDUS. ORG. 639 (2005).
[37] *Id.* at 18.
[38] *Id.* (emphasis added).

economists.[39] Lafontaine and Slade reach a similar conclusion. Summarizing and synthesizing the evidence they reviewed, the authors conclude that: "it appears that when manufacturers choose to impose restraints, not only do they make themselves better off, but they also typically allow consumers to benefit from higher quality products and better service provision . . . the evidence thus supports the conclusion that in these markets, manufacturer and consumer interest are apt to be aligned."[40] In an even more recent analysis of the vertical restraints literature, FTC economist Dan O'Brien notes that three additions to the literature provide new evidence that vertical restraints mitigate double marginalization and promote retailer effort.[41] O'Brien goes on to conclude that, "with few exceptions, the literature does not support the view that these practices are used for anticompetitive reasons," and supports "a fairly strong prior belief that these practices are unlikely to be anticompetitive in most cases."[42]

Not to be outdone, skeptics of minimum RPM point to empirical work conducted since the Supreme Court's decision in *Leegin* as evidence that *per se* or "inherently suspect" treatment of such agreements is appropriate. Specifically, in a 2013 study,

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[39] Francine Lafontaine & Margaret Slade, *Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy* (Sept. 2005) (unpublished paper), *available at* http://www2.warwick.ac.uk/fac/soc/economics/staff/academic/slade/wp/ecsept2005.pdf

[40] *Id.* at 22.

[41] Daniel P. O'Brien, *The Antitrust Treatment of Vertical Restraints: Beyond the Possibility Theorems, in* REPORT: THE PROS AND CONS OF VERTICAL RESTRAINTS 40, Konkurrensverket, Swedish Competition Authority (Nov. 2008), *available at* http://www.konkurrensverket.se/upload/Filer/Trycksaker/Rapporter/Pros&Cons/rap_pros_and_cons_vertical_restraints.pdf.

[42] *Id.* at 82.

Alexander MacKay and David Aron Smith explore a natural experiment that compares the pre- and post-*Leegin* worlds by examining price and output levels in states that retained the *per se* rule against those in states that shifted to the rule of reason.[43] Mackay and Smith find statistically significant increases in price and decreases in quantity in states employing the rule of reason standard over states where minimum RPM is illegal *per se*.[44] Based upon these results, they conclude that because leniency towards minimum RPM is associated with higher prices and lower output, minimum RPM agreements are more likely to be anticompetitive than procompetitive.[45]

Although Mackay and Smith's study is methodologically superior in the econometric sense to some of the earlier empirical work, its results must be interpreted carefully. As others have pointed out, a close look at the study's findings demonstrate that it does not support a more restrictive policy towards minimum RPM.[46] First, although the study considers the impact of the legal environment for RPM on both price and quantity, the results are not consistent with the predictions of the anticompetitive theories of RPM – that is, a reduction in output and an increase in price for the product

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[43] Alexander MacKay & David Aron Smith, *The Empirical Effects of Minimum Resale Price Maintenance on Prices and Output* (Apr. 29, 2013), *available at* http://home.uchicago.edu/~davidsmith/research/Leegin_and_MRPM.pdf. For an empirical analysis showing increased prices post-*Leegin* but concluding legislative action to undo the Supreme Court's decision is not yet warranted because of uncertainty about output effects, see Nathaniel J. Harris, Leegin's *Effect on Price: An Empirical Analysis*, 9 J. OF L., ECON. & POL'Y 251 (2013).

[44] *Id.*

[45] *Id.*

[46] Lambert & Sykuta, *supra* note 20, at 7-8.

category.[47] It turns out that merely 1.6 percent of the product categories surveyed had both an increase in price *and* a decrease in quantity in states that shifted to the rule of reason.[48] Moreover, the study does not purport to actually present evidence that minimum RPM agreements were implemented for any of the product categories where price increases or output reductions were found.[49] This is particularly problematic because the study utilizes consumer product data for the grocery retail industry, where minimum RPM arrangements traditionally have not been employed and many products are distributed nationally so it is unlikely that manufacturers have entered into minimum RPM agreements on a state-by-state basis.

While one always desires more rather than less empirical evidence, the state of the existing empirical literature supports the conclusion that, at least in the United States, minimum RPM is more likely to be procompetitive than anticompetitive. Although the empirical evidence can change over time, the best evidence today suggests that there is insufficient basis upon which to conclude that minimum RPM agreements are always or nearly always anticompetitive.

V. IMPLICATIONS FOR DESIGNING THE APPROPRIATE LEGAL RULE FOR RESALE PRICE MAINTENANCE

In light of the existing economic evidence on RPM and other vertical restraints, it is hard to justify a *per se* or "inherently suspect" approach to analyzing minimum RPM

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[47] *Id*.
[48] *Id.*
[49] *Id*.

agreements in the United States. Recall that the key question is whether the evidence warrants imposition of an initial assignment of the burden of proof to the RPM user to demonstrate the procompetitive nature of the restraint. Both common sense and economic analysis suggest that question should be answered in the affirmative only in the presence of empirical evidence robustly demonstrating that minimum RPM is always or almost always anticompetitive. The appropriate antitrust rule for RPM is thus a rule of reason analysis that requires plaintiffs to proffer such evidence as part of their *prima facie* burden before requiring defendants to offer evidence of the restraint's efficiency. The rule of reason allows courts and antitrust enforcers to determine, on a case-by-case basis, whether a particular minimum RPM agreement is anticompetitive. In doing so, the rule of reason offers the best opportunity for consumers to realize the benefits of the vast majority of minimum RPM agreements that are procompetitive while also allowing a host of modern economic tools to be used to effectively identify and prosecute those minimum RPM arrangements that actually harm competition.

The most serious economic defense of *per se* or "inherently suspect" treatment of minimum RPM appears to be that minimum RPM agreements are just as likely to be anticompetitive as they are to be procompetitive, and therefore it is a close call on whether the rule of reason should be applied. A corollary of this argument is that in jurisdictions initially endowed with a hostile approach to RPM, the existing evidence is not sufficient to overcome the initial rule. But path dependence of legal institutions is

not an economic defense of the rule. Indeed, economists have been quite successful in changing the law over time as economic knowledge develops. Of course, even if it were true that minimum RPM arrangements are just as likely anticompetitive as they are procompetitive, such evidence would again suggest that a legal approach under which minimum RPM agreements are evaluated on a case-by-case approach would be appropriate. Remember, under a decision-theoretic approach, *per se* or "inherently suspect" standards are only appropriate where a business practice is always or nearly always anticompetitive. In addition, by permitting a case-by-case assessment, the rule of reason standard actually can allow courts and antitrust enforcers to obtain valuable experience about when minimum RPM is likely to result in anticompetitive effects. The rule of reason therefore has the added benefit of being a useful basis upon which to expand our existing understanding about the economics of minimum RPM and, as I will discuss in a moment, potentially to draw presumptions where case-specific evidence demonstrates doing so is appropriate.[50]

As discussed, the rule of reason can comes in a variety of sizes and flavors in the United States. Indeed, in *Leegin*, the Supreme Court counseled lower courts that as they "gain experience considering the effects of [minimum RPM] by applying the rule of

[50] *See, e.g.*, Ariz. v. Maricopa Country Med. Soc., 457 U.S. 332, 351 n.19 (1982) (referring to "the established position that a *new per se* rule is not justified until the judiciary obtains considerable rule-of-reason experience with the particular type of restraint challenged"); Polygram Holdings v. FTC, 416 F.3d 29 (D.C. Cir. 2005) (describing inherently suspect restraints as "those that judicial experience and economic learning have shown to be likely to harm consumers" and acknowledging "that as economic learning and market experience evolve, so too will the class of restraints subject to summary adjudication").

reason over the course of decisions, they can establish the litigation structure to ensure the rule operates to eliminate anticompetitive restraints from the market and to provide more guidance to business."[51] The Supreme Court further observed that lower courts can "devise rules over time for offering proof, or even presumptions where justified, to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints and to promote procompetitive ones."[52]

In my view, a structured rule of reason for minimum RPM may very well offer a superior legal rule.[53] However, critical to any decision to structure the rule of reason for minimum RPM is that the relevant analytical factors correctly match the economic evidence. For instance, some of the factors identified by the *Leegin* Court as relevant for identifying whether a particular minimum RPM agreement might be anticompetitive actual shed little light on competitive effects. For example, the *Leegin* Court noted that "the source of the constraint might also be an important consideration" and observed that retailer-initiated restraints are more likely to be anticompetitive than manufacturer-initiated restraints.[54] But economic evidence recognizes that because retailers in effect sell promotional services to manufacturers and benefit from such contracts, it is equally

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[51] *Leegin*, 551 U.S. at 898.
[52] *Id.* at 898-99.
[53] For a proposed structural rule of reason approach for RPM consistent with an error-cost framework, see Thomas A. Lambert, *Dr. Miles is Dead. Now What?: Structuring a Rule of Reason for Evaluating Minimum Resale Price Maintenance*, 50 WM. & MARY L. REV. 1937 (2009), *available at* http://scholarship.law.wm.edu/cgi/viewcontent.cgi?article=1092&context=wmlr.
[54] *Id.* at 897-98.

possible that retailers will initiate minimum RPM agreements as manufacturers.[55] Imposing a structured rule of reason standard that treats retailer-initiated minimum RPM more restrictively would thus undermine the benefits of the rule of reason.

But there may be other options for a structured rule of reason approach that are more consistent with the economic evidence. For instance, it might be possible to construct a regime that shifts the burden to the defendant upon a showing of direct evidence that a minimum RPM resulted in a reduction in output.[56] Whatever the approach, it is critical that the structure match the relevant economic theories.

VI. CONCLUSION

Resistance to minimum RPM appears to be considerably stronger than to other vertical restraints. The resistance to minimum RPM may result from the fact that such practices are often equated with or referred to as "price-fixing." Perhaps another reason minimum RPM faces strong opposition is because it interferes with a retailer's right to price on its own. But again, this view is difficult to square with the treatment of other vertical restraints that impose price and non-price terms.

What is clear is that minimum RPM remains a fruitful area for further study. It is important that we continue to accumulate evidence on the competitive effects of RPM, both in the United States and around the world, so that we can update and refine our

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[55] *See* Benjamin Klein, *The Evolving Law and Economics of Resale Price Maintenance*, J. L & ECON. (forthcoming 2014).

[56] *See* Lambert, *supra* 53, at 1997-98.

thinking about how to analyze such arrangements under competition law. It is my strong belief that economics can be an important force towards convergence in this task. A focus on economic evidence and a shared goal of selecting rules that maximize consumer welfare provides a common language and terms upon which to advance the discussion about the appropriate treatment of minimum RPM. It is my sincere hope that I have achieved the modest goal of contributing to that discussion today.

Thank you.