

# Theories of harm from RPM: Exclusion, the equivalence principle, and *per se* rules

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# Topics

- Prepared prior to other presentations
- Supreme Court: “A manufacturer with market power, by comparison, might use resale price maintenance to give retailers an incentive not to sell the products of smaller rivals or new entrants”
- Direct exclusion as harm? Main focus
- Indirect exclusion? RPM as discouraging breach of exclusive dealing arrangements
- Equivalence principle: If X is legal and Y is no worse than X, should Y ever be illegal?
- Is rule-of-reason practical?

## RPM history, recent and ancient

- Usual arguments against RPM
  - Strips dealers of right of alienation
  - Equivalent result to intra-brand dealer cartel
  - Facilitating upstream manufacturer cartel
  - Manufacturer also a retailer: A horizontal agreement?
- Dr. Miles' lawyers: Decades ahead of their time?
  - Caused “confusion, trouble, and damage”
  - “Injuriously affected the reputation”
  - Retail druggists can't survive against discounters
  - Unwilling to keep drugs in stock
  - “if kept in stock, do not urge or favor sales thereof, but endeavor to foist off some similar remedy”
  - “‘cut’ from the established price [leads to] loss of reputation and becomes of inferior value and demand”

## Big change in 2007: *Leegin*, and a new RPM harm?

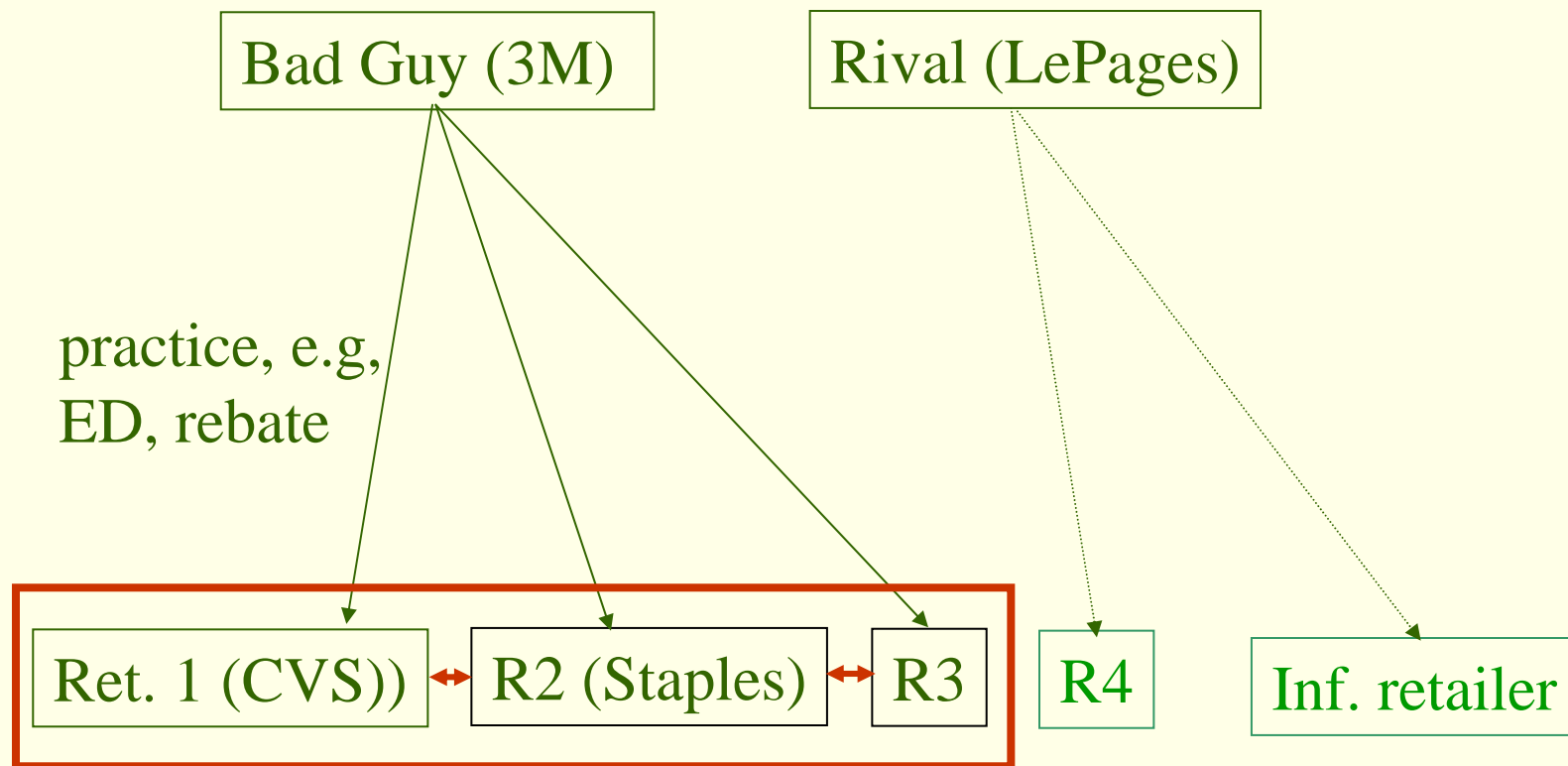
- The Supreme Court's limited justification:  
3 pages in *Marvel and McCafferty* (*JLE*, 1985)
- M&M: RPM employed by a sugar trust around 1900 would “secure at least some measure of loyalty from the wholesalers”
  - Used to enforce (implicit?) exclusive dealing
  - Exclusion would force trust's competitors to deal directly with (presumably more expensively) retailers
- Variation on *Klein and Murphy*, where the contract enforced is exclusive dealing
  - “Deny distribution to rivals ... the most plausible explanation”
  - Zerbe: RPM “bribe ... not to handle anyone else's sugar

## Characterizing exclusionary conduct

- To hurt rivals, must raise the cost of something they need
  - Upstream inputs (labor, materials)
  - Downstream services (distribution, retailing)
- Focus on these *complement* markets
  - Must substantially lessen competition in them to raise the price rivals pay
  - Suppression necessary, sufficient for SLC
- “Complement market monopolization” (CMM)

# Portraying exclusion through CMM

- Effective linkage horizontal across covered retailers
- SLC: inferior retailer margin, not price vs. bad guy cost



## Perspectives, tests

- Overall perspectives
  - Relevant market that of the complement
  - Dominance in primary market reduces “but for” SLC
  - Harm from creation of new monopoly
  - Exclusion not the same as predation: Non-strategic
- The two fundamental tests
  - First, does the practice cover a “dominant” share of a properly delineated complement market?
  - Second, what is the effect of the practice on the (quality-adjusted) price rivals pay for complement?
- Do these apply to RPM?

## First test: Covering a complement market

- **HMG like factors**
  - Ease of expansion?
  - Ease of entry (including self provision, e.g., distribution)?
- **RPM must be from a single entity in primary market**
  - From need to suppress competition within single set of complement providers
  - E.g., that turn-of-the-century US sugar trust
- **Differs from “facilitating collusion” story**
  - Allows multiple employers of RPM in primary market
  - Issue coordination among them, not unilateral effect
- **Could have to go beyond full-service providers**
  - Under typical RPM, discount houses available to rivals
  - Those who can use them not harmed



## Second question: Effect on rivals

- **Less apparent than first glance**
  - One firm using it does not necessarily discourage rivals
  - Full service or no service shelf space may be available
  - Again, dominance—does using uncovered providers raise price?
- **Need capacity limitation**
  - Can RPM inducements for X reduce complement supply to Y?
  - Does overpaying for shelf space reduce space available for rivals?
  - Hard to argue, at least for stores carrying multiple products
  - Perhaps capacity in sales staff capable of supplying effort
- **Issue not consumer ability to absorb X instead of Y**
  - Then retailer has market power
  - “But for” SLC case harder to make

## Summary – For RPM to be directly exclusionary

- A single upstream firm imposes it over a dominant share of a relevant retail market
- Covered retailers must have limited capacity to carry the type of product sold by the upstream firm
- Discount outlets are unlikely to be acceptable substitutes in that retail market, at least with regard to selling the upstream firms' rivals' products

## Indirect exclusion

- Best guess as to what *Leegin* court had in mind?
- Marvel and McCafferty (via Klein and Murphy)
  - Paldor (2008) elaborates on this theme
- But RPM is ancillary to exclusion, not the problem itself
  - Higher retail margins like any other contract enforcement mechanism
  - Recognize that exclusion need not be explicit (*U.S. v Dentsply*)
- The harm, if any, is in making RPM contingent reward for not carrying rivals' product
  - Isn't this bundled rebates? Oops, wrong panel ....
- Banning RPM like banning cash, contracts
  - Zerbe's "bribe"

## Leads to consider an “equivalence principle”

- Suppose X is legal, Y is no worse than X. Should Y ever be illegal?
- Numerous examples from RPM
- Why care about intrabrand cartels if vertical integration into retailing is legal?
  - Against the wishes of the manufacturer?
  - Why can't they police it?
- Why care about restrictions on price if exclusive territories are at least evaluated by “rule of reason”?
- Apparently persuasive to *Leegin* court
- Should an equivalence principle apply?

## *Per se* vs. rule of reason for RPM

- *Leegin* court allowed, invited “rule of reason” analysis
- Easy when obvious
  - Harm vs. no benefit, benefit vs. no harm
  - *Dentsply* trial court: No harm or benefit, tie goes to defendant
- But what if there are harms and benefits?
- Can there be a rule of reason without instruction on how to do the cost benefit test?
- Explain D. Ginsburg finding that non-price vertical restraints essentially *per se* legal following *Sylvania*
- Will this happen to RPM? Should it?
- “Discuss amongst yourselves”