Fee Caps on Food Apps:
Exploring NYC Law Setting Maximum Restaurant Delivery Fees

Policy Analysis

Informed by the DCI Delivery Fee Cap Working Group

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Background

During the COVID-19 pandemic, several cities and states legislated fee caps on popular food delivery services such as Uber Eats, Grubhub, and DoorDash, limiting what these companies can charge food and beverage businesses. The Data Catalyst Institute (DCI) recently published a white paper by Prof. Liad Wagman, a former Federal Trade Commission economist, summarizing economic arguments for why government-imposed fee caps on delivery apps do not help - and likely harm - small food and beverage businesses that are policymakers' intended beneficiaries.

While there are many historic examples of fee caps not working as intended, rigorous data on the consequences of the delivery service fee caps during the pandemic is harder to come by. Recently, however, DoorDash reported that its order volume in Chicago dropped by 8.6% following imposition of the city's delivery fee cap, and that DoorDash delivery team members lost a collective $650,000 in earnings each month (or $7.8 million annually) as a result of fewer orders. In a separate blog post, DoorDash reported that driver earnings also plummeted in several more fee-cap jurisdictions that the company analyzed, including Philadelphia and St. Louis.

A recent Grubhub blog post noted similar effects in New York City, which also imposed fee caps. In that market, the company reports that small and medium-sized restaurants have lost orders at least in part because the fee cap reduces access to Grubhub integrated marketing services. In NYC, Grubhub restaurants that "benefitted" from lower fees due to the cap experienced dramatically less 2021 order growth on the platform, compared to restaurants that continued paying the pre-cap fees. Grubhub also note a related disparity in delivery driver tips, as tips for drivers delivering food from restaurants "helped" by fee caps did not grow during the pandemic, perhaps because Grubhub imposed customer delivery and service fees to offset the reduced restaurant fees and customers responded by reducing or not increasing tip amounts.

Notwithstanding historical and now recent data about fee cap failures, some jurisdictions have maintained and even made their caps permanent. Several months ago, the NYC Council made permanent a previously-enacted emergency ordinance that set maximum limits on restaurant delivery fees. The ordinance caps fees at:

- 15% of the amount of a delivery order,
- 5% of all other fees, including the fees paid by restaurants to market their restaurant, except payment processing fees which can be additional.

To consider whether the NYC fee cap ordinance would actually help restaurants as intended, or might instead trigger unanticipated and harmful effects, we gathered a discussion group of economists and other relevant experts (predominantly from New York City) and posed a series of questions. This Report is informed by their input.

It is notable that the discussion and Report are occurring against a backdrop of litigation, wherein the largest restaurant delivery firms are asking a court to invalidate the fee cap ordinance as an unconstitutional exercise of government power in the private market. This Report, however, does not delve into legal considerations.

Working Group Concerns, Key Findings and Conclusions

After much discussion, the Working Group consensus arrived as follows:

- Thousands of NYC restaurants chose to contract with delivery companies and pay fees before the fee caps were legislated, and without any expectation that a law would reduce their fees.

- When the fee cap was initially legislated, COVID-19 public health restrictions had essentially ended indoor dining at NYC restaurants. As a result, restaurants wishing to stay in business arguably had little choice except to hastily embrace one or more delivery services almost regardless of their perspective of the price/value being offered. In this environment, the government's concern about restaurant delivery services' market and pricing power was reasonable.

- Today, the environment has changed. Indoor dining restrictions have been lifted, there continue to be several strong competitors in the NYC restaurant delivery marketplace, and a low barrier to entry means that new delivery services can enter (and are entering) the market to offer low-priced options.

- The economics of restaurant delivery fee caps have triggered unintended effects that harm small, independent restaurants, consumers, and delivery workers.

- Restaurant delivery services have already responded to perceived price concerns by offering tiered fee and service options, and new competitors continue to come online.

- The law's inflexible fee cap and the definitions of "food service establishment" and "food delivery service" remove reasonable choices that restaurateurs might prefer, and exacerbate compliance, enforcement, and unintended consequences.

The NYC Restaurant Delivery Fee Cap Working Group

Working Group participants have expertise in economics, law, and retail:

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Findings and Discussion

Though the Working Group was presented with several questions and conversation-starters, the discussion was free-flowing and frequently returned to a relatively small set of themes. Below are summaries of the thematic discussions and perspectives.

Restaurants voluntarily contract with delivery companies

For restaurants, meal delivery is not a required offering, and third-party delivery services are optional. During the pandemic it was necessary for thousands of NYC restaurants to embrace delivery services in order to survive, and to policymakers it might have seemed reasonable to protect restaurants against potential pandemic profiteering by third-party delivery services. But that crisis and the city's associated policy justification for a fee cap ended several months ago when in-person capacity restrictions were substantially reduced and then eliminated.

Considering the broader pre- and post-pandemic context, restaurant delivery has long been a staple offering of many restaurants in New York City; for instance, Chinese and pizza restaurants have offered delivery for decades. It is also undoubtedly true that many NYC restaurants, blessed by loyal customers in high-density neighborhoods, survived the pandemic with a combination of takeout and outdoor dining. Thus, from a purely economic perspective, the NYC Council enacting delivery service fee caps to "help ensure the survival" of restaurants was worthy of consideration, but that circumstance no longer exists.

We also understand that restaurant contracts with food delivery services are short-term and easily terminated without penalty. If restaurants felt unable to negotiate lower fees with delivery services during the pandemic, perhaps 18 months of survival was so inextricably linked to participating with major delivery platforms that many restaurants have now chosen to stay on the platforms. This, however, is a choice that restaurants make rationally, based on their individual situation and judgment about costs and perceived benefits, e.g., the increased business that platform participation generates. For each restaurant this may be a dynamic situation, but changing circumstances are accommodated by short-term contracts with penalty-free termination provision.

It is also notable that delivery is only one of many services provided to restaurants by so-called "delivery services" or "delivery apps." Some additional services include (1) building and maintaining a restaurant's website; (2) email marketing; (3) splash-page promotions when a consumer opens the app; (4) paid placement, e.g., at the top of relevant ethnic or neighborhood categories. These marketing programs are additional services that restaurants choose to pay for, and are charged through increased percentage-of-revenue fees so there are no up-front or out-of-pocket costs. This payment option can be very attractive to small, independent restaurants that don't have (and often cannot afford) traditional marketing agencies that charge fees which must be paid regardless of whether the marketing produces additional revenue. The NYC law caps these fees at 5% of revenue (in addition to the 15% delivery fee cap).

Restaurant delivery competition is high and barriers to entry low

A traditional justification for price regulation is that a single business (often a utility) has monopoly pricing power, or a small group of businesses are acting as a cartel and not competing aggressively against each other. As there are at least three major nationwide delivery services operating in NYC - DoorDash, Grubhub and Uber Eats - there certainly is not a monopoly. However, the group discussed whether there is a NYC cartel in the restaurant delivery industry, or if there is a cartel effect because (a) barriers to entry are high, and (b) competitors' price/service offerings seem perfectly aligned and appear to change in tandem (as is frequently suggested with respect to the airline industry).

When the NYC Council debated whether to enact the fee cap law, there was a great deal of discussion about high prices demanded by powerful out-of-town and Silicon Valley-funded firms, and it was noted that Uber Eats had recently acquired another major competitor, Postmates. There was, however, no direct discussion about oligopolistic pricing in an economic or anti-competitive sense, and we have not read anything that suggests these competitors act uniformly or as a cartel.

The Working Group also was aware of and discussed the abundance of independent delivery service competitors operating in NYC, in several other cities nationwide. Among the competitors, some (e.g., Delivery.com) seem to charge a lower commission rate, and others are utilizing a creative subscription model that their founders (and substantial investors) hope will generate a profit and leave more money in restaurateurs' pockets. For example, NY-based Sesame has raised $3 million to build a restaurant-friendly delivery service that charges flat monthly fees to restaurants and delivery fees only to consumers.

The Restaurant Marketing and Delivery Association claims there are more than 550 restaurant delivery services operating in more than 700 U.S. cities. There are also services focused on niche markets, e.g., black-owned restaurants, local (mom-and-pop) Asian food restaurants and pizza. And of course there are still innumerable restaurants, e.g., Chinese restaurants, that employ their own delivery staff in NYC and nationwide.

With so many options available, the Working Group agreed that there is not an effective oligopoly and no basis for price regulation or an antitrust investigation in NYC or likely in any U.S. market. Restaurants have the freedom to choose from among different services and different business models, or to work with several services. When operating competitively and correctly - as it appears to be with food delivery services - free markets promote price and service competition and do not require price regulation.

The delivery service fee cap will motivate new behaviors and produce undesirable results

For an economist, there is no doubt that imposing a fee cap in a competitive market will tend to increase demand (because prices are lower), decrease supply (because capped services are less profitable), and produce some combination of a higher-priced black market and “shadow costs,” (e.g., wasted time waiting for a meal to be delivered by a service that has too many orders and too few drivers). Multi-sided markets, like those that service both sellers/restaurants and buyers/consumers, are even more complex, and are less likely to respond as anticipated to simple fixes like price caps.

There are a variety of ways that a permanent fee cap might impact restaurant delivery services:

- Reduce delivery services’ revenue and, in effect, subsidize NYC restaurants
- Force services to reduce costs, e.g., by paying drivers less or reducing marketing and overhead
- Force delivery services to reduce important non-delivery offerings, e.g., marketing programs.
- Prompt services to limit their exposure to regulated markets, e.g., by promoting Nassau County restaurants to Queens residents and Yonkers restaurants to Bronx residents
- Move to alternative revenue and operational pricing policies, e.g., by increasing consumer delivery fees, imposing minimum order amounts, eliminating long-distance deliveries, and turning down less lucrative deliveries.

Our participants are confident that eventually delivery services will reach their limit, and then the question is how they will react and which constituencies will bear the burden, e.g., of lower pay, minimum order sizes, or limited delivery areas? One Working Group economist asked: “How much revenue loss due to fee caps can restaurant delivery companies be expected to absorb? 50%? 80%?”

As noted earlier, DoorDash data shows that government fee caps (and subsequent additional fees imposed by DoorDash in reaction to the caps) resulted in lower order volume and delivery personnel earnings, and this pattern is seen broadly across jurisdictions that have imposed caps. This obviously cuts into delivery company revenue; indeed, in a November 2021 shareholder letter, DoorDash estimates that in Q3 2021 (most recent figure available), price controls had a net $23 million negative impact on revenue. And when DoorDash's platform becomes less affordable for customers, restaurant revenue and government sales tax (and likely income tax) revenue decreases.

We can particularly imagine an outcome where marketing programs, e.g., in-app advertising, and email or splash-page promotions, are no longer offered as an additional service. In an uncapped-fee market, small and independent restaurants that have no marketing budget or staff can pay delivery apps an additional percentage point or two of their revenue in exchange for in-app and email promotions, and can do this on an experimental basis without paying up-front agency costs, e.g., for creative or research. But in a fee-capped market, these extras likely will be awarded "for free" or as "bonuses" to the highest volume (and presumably highest margin) restaurants and chains - which already have substantial marketing budgets. In this example, small independent restaurants get hurt the most by an inflexible fee cap, and the NYC Council's effort to help small, local restaurants will backfire and instead help corporate restaurants.

All of these outcomes will harm drivers, restaurants and the eating public - but if key stakeholders don't blame their elected officials then those who created the warped incentives and changed behaviors will not suffer any consequences.

A more creative alternative raised by a Working Group participant would be if the delivery services vertically integrate by acquiring or investing in "ghost kitchens," and essentially create "store brands" akin to those of big-box retailers. Delivery-only ghost restaurant brands already exist, and entrepreneurs have raised hundreds of millions of dollars to build ghost kitchen facilities and new independent brands in a market estimated to be potentially valued at more than $1 trillion.

If major delivery services go this route, their ability to promote new brands to NYC residents could be astonishingly successful and could severely harm independent restaurants. It is likely that chain restaurants will be less impacted due to their own substantial advertising and marketing budgets. Of course, these moves could also trigger a flood of restaurants canceling their contracts with delivery services and (1) forging new deals with services that promise not to compete against their restaurant customers, or (2) creating a restaurant owned coop delivery service.

Regardless of how the delivery services react to NYC's permanent fee cap law, clearly they must respond, and there will be consequences. One Working Group participant was perplexed: "The price caps seem to have been implemented by posturing politicians without careful economic analysis. The set of things that may happen in reaction to these price caps are likely to disproportionately hurt restaurants and increase the failure rate of independent restaurants. This is probably not what the City Council intended."

Without permanent regulation, restaurant delivery fees have become flexible and negotiable

As delivery services mature, more competitors enter the industry, and restaurants become more sophisticated about their needs and fair value, market pricing has organically become more creative and competitive. Prior to NYC's fee cap law becoming permanent, DoorDash introduced Basic, Plus and Premier service levels with prices equaling 15-30% of each order. Grubhub offers restaurants a similar service tiers at similar prices.

Tiered fee models generally empower restaurants to choose which services they desire and which costs they wish to bear. If a restaurant wishes to pay all costs and offer consumers free delivery, it can make that choice and see if free delivery grows its business enough to make the cost worthwhile. Market-driven pricing is also more flexible than government pricing, because the market will adapt, e.g., to short-term challenges such as labor or supply chain shortages, more quickly than legislators can act.

Market pricing also promotes competition. When governments set maximum prices, the maximums often become minimums, and competition is based only on service delivery as providers try to cut corners and eke out profits. In contrast, when markets set prices the services can develop price and service offerings flexibly, and use consumer-side or restaurant-side discounts, promotions and specials to build brand loyalty while maintaining service quality. Price and service competition also encourages restaurants to try all the services at different times, and perhaps simultaneously. Multihoming allows restaurants to learn first-hand which services are best for their customers, neighborhood, and cuisine, and to make educated decisions about long-term delivery service relationships.

One Working Group participant noted the competitive environment and new entrants and said "The market is still evolving. I'm not sure the government should do anything here because there doesn't seem to be a market failure that justifies intervention."

The inflexible price cap and limitation to "prepared food" creates unfortunate and unintended challenges

The NYC ordinance defines a "food delivery service" as a mobile/digital/internet-based service that **both** (1) offers/arranges for the sale of prepared food, and (2) provides same-day delivery or pickup. By capping prices at 20 percent per order, and prohibiting flexible negotiated pricing above that level, the ordinance prohibits sophisticated restaurants and food preparation services from making educated value-based decisions to pay higher fees for higher levels of service. The definition also does not exclude multi-purpose services, and that creates unnecessary risk.

Imagine, for example, that a high-end steakhouse wants its meals to be delivered with "white glove" service. The delivery must be timed perfectly, using a vehicle that has a specific warming oven set at the correct temperature, delivery must include branded steak knives, and the accompanying wine should be opened professionally. This service is clearly worth more than 20 percent and goes well beyond delivery.

As a different example, imagine a food delivery app with a catering option. A customer needs a last-minute delivery of prepared food for a business meal or surprise family visit, and chooses to use a food delivery app instead of calling restaurants directly. The food delivery app identifies a restaurant with capacity and makes the magic work for the customer and the restaurant. Does this justify a fee that exceeds 20 percent? Is the wine delivery considered prepared food and its delivery prices regulated, or can that charge be higher?

Finally, how will the law treat deliveries from combination restaurants/markets or a corner deli with a hot food bar, when the delivery includes prepared food, packaged food and dry goods? Can this delivery be priced at only 20 percent of the order, or must the price be bifurcated so there is a regulated price for delivering prepared food and a market price for all other items?

Conclusions

The pandemic was extraordinarily challenging for many independent restaurants. But small restaurants have been "struggling for the last 5,000 years," in the words of one Working Group participant. If delivery service price caps were justified by the pandemic, then with restrictions on restaurant seating capacity ended, it seems past the point for government limits on delivery service prices to also end.

The delivery service fee cap ordinance begs the question of how far a government can go (legally), and should go (as a matter of policy and economics), to tilt any market in favor of select businesses or industries. Published data from more than one company show that both local order volume and driver revenue decreased after fee caps were imposed. And what does the NYC Council do when the regulated market reacts - in this instance when delivery price caps lead to longer wait times for people who order disfavored smaller meals, cuts in delivery personnel pay, delivery radius restrictions and minimum order requirements. Imagine if the local burger joint gets thrown off delivery service apps because their order size is consistently too small to support a fee that will fairly pay a delivery person? And relatedly, if restaurants continue to struggle, will the NYC Council limit the costs of restaurant cleaning services, outside linen providers, food and beverage supplies, or other inputs?

For our Working Group economists and other relevant experts, the first question is why the Council believed there was a pricing problem in a highly competitive and relatively easy-to-enter market. Coming out of the COVID-19 crisis, customers, restaurants, and delivery services are adapting to a new normal and trying to figure out if we will revert to past behaviors, or if pandemic habits, e.g., eating at home with prepared foods delivered, will continue apace.

Regardless of how consumers behave, the delivery service industry is still evolving and very competitive, and fees and offerings will continue to be best determined by market forces rather than government intervention.