

Non-Technical Summary

The attitude of competition authorities and courts towards vertical restraints varies significantly from one country to another or from one period to another. Still, it emerges a consensus against resale price maintenance (RPM), a particular restraint according to which the manufacturer sets the final price that distributors charge to consumers. This restriction has some variants, including price ceilings, price floors, recommended or advertised prices; competition authorities are more tolerant towards some of those variants but, in its strictest form, resale price maintenance is usually illegal *per se*. For example, the European Commission recently adopted a more open attitude towards nonprice restrictions but maintained RPM on a black list –with only one other restraint. In France, price floors are *per se* illegal under article 34 of the 1986 Ordinance; and in *Lypobar vs. La Croissanterie* (1989), the Paris Court of Appeal ruled that RPM was an abuse of franchisees' economic dependence, and insisted that franchisees had to be free to choose their retail prices.

In contrast with the consensus of the jurisprudence against resale price maintenance, the economic analysis of vertical restraints is more ambiguous: it is not straightforward that RPM has a more negative impact on the welfare than other vertical restraints which limit intrabrand competition; instead, both price (e.g. RPM) and non-price restraints (e.g. exclusive territories) have positive and negative effects on economic welfare, depending on the context in which they are used (The arguments that courts have given to justify territorial restraints could actually often be used as well in favor of RPM). Moreover, a comparison of the welfare effects of exclusive territories, RPM and exclusive dealing shows that the balance is not clearly in favor of nonprice restrictions (see Caballero-Sanz and Rey, 1997).

It is clear that minimum prices (a variant of RPM) may be sponsored by distributors to maintain a retail cartel: that is, an illegal horizontal agreement can be disguised as vertical arrangements that restrict prices; that would amount to an horizontal agreement, which is usually *per se* illegal. Less clear is the case of purely vertical contracts, where producers and distributors bilaterally negotiate their own wholesale and retail prices.

A few papers have stressed that RPM can help a manufacturer to better exert its market power. Hart and Tirole (1990) show for example that a producer is tempted to free-ride on its retailers when vertical contracts are privately negotiated and not publicly observed; as a result, downstream competition percolates to the upstream level and prevents the producer from fully exerting its market power. In this context, an industry wide price-floor would prevent the risk of opportunistic behavior and help the manufacturer to exert its market power. O'Brien and Shaffer (1992) further show that bilaterally negotiated price ceilings, too, can prevent opportunism.

Those papers thus stress that RPM can help restore pre-existing market power. Dobson and Waterson (1997) study instead a bilateral duopoly with interlocking relationships. Assuming that manufacturers use (inefficient) linear wholesale prices, they show that the welfare effects of RPM depend on the relative degree of upstream and downstream differentiation as well as on retailers' and manufacturers' bargaining powers; RPM can be socially preferable when retailers are in a weak bargaining position, because the double-marginalization problems generated by the restriction to linear wholesale prices is more severe in such circumstances.

However, one argument often mentioned against RPM, and not yet much formally analyzed, is that RPM can facilitate horizontal agreements – interbrand collusion. A first step in that direction is provided by Jullien and Rey (2000), who stress that, by making retail prices less responsive to local shocks on retail cost or demand, RPM yields more uniform prices that facilitate tacit collusion –by making deviations easier to detect. In contrast, we will focus here on a static bilateral duopoly with interlocking relationships, as in Dobson and Waterson, but will allow for efficient (two-part) wholesale tariffs, in order to eliminate double marginalization problems and focus instead on the impact of RPM on interbrand and intrabrand competition. Our analysis suggests that RPM can prevent **any** effective competition –at the interbrand level as well as at the intrabrand level– and yield instead the monopoly outcome.

This paper provides a basis for competition authorities' tough attitude towards RPM. In a context of interlocking relationships where competing retailers carry several competing brands, and as long as competition among retailers eliminates their rents, RPM allows firms to maintain monopoly prices and thus defeat both upstream and downstream competition. This is the case even when retail prices are set independently for each retailer, and vertical contracts are negotiated bilaterally and independently from each other (purely “vertical” RPM).

The situation is however more complex when imperfect competition among retailers generate rents downstream. First, equilibria where competing retailers carry competing brands may no longer exist, even if demand conditions would make this outcome desirable; RPM may still allow firms to generate prices closer to the monopoly level – as well as lower than without RPM. Second, which price level will prevail may depend on the relative bargaining power of retailers and manufacturers, with retailers favoring high levels but manufacturers favoring low levels in order to minimize retail rents.