

SUPERMARKET POWER: SERVING CONSUMERS OR HARMING COMPETITION

Javier Berasategi



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The Author

Javier Berasategi is a law professor and the founder of Berasategi & Abogados, a law firm based in Madrid (Spain). He is the former chairman of the Competition Authority of the Basque Country (Spain). Before joining the Basque Competition Authority, he was a competition lawyer with Stanbrook & Hooper and McDermott, Will & Emery in Brussels (Belgium). He has been involved in high profile competition cases before the European Commission and other competition authorities since 1997. While at the Basque Competition Authority, he authored the market study “*Retailing of consumer goods: Competition, Oligopoly and Tacit Collusion*” (2009) and has researched, written and lectured extensively on the enforcement of competition law and fair dealing regulations in the grocery retail sector. He holds a degree in law and economics by the University of Deusto (Spain), a postgraduate diploma in European economics by the European Institute of the same university and a LLM in European Law by the College of Europe (Belgium). He is a member of the Editorial Board of the two leading competition law publications in Spanish (Boletín Latinoamericano de Competencia and Gaceta Jurídica de la Unión Europea y de la Competencia), lectures on competition law in several post-graduate programmes and speaks regularly in conferences and seminars.

For more information about the author’s publications on this topic, please visit www.supermarketpower.eu.

The author can be contacted at: jb@berasategi.es.

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1 Introduction

This paper analyses the sources of supermarket power vis-à-vis shoppers and independent brands. This power transforms leading supermarkets into vertically-integrated competitive bottlenecks that are able to restrict competition between brands (including their own ones) and reduce consumer welfare. However, competition enforcement has failed to address their bottleneck role and the negative consequences of their practices on dynamic competition (i.e., a market where the competitive process fosters innovation, quality and variety), the ultimate goal of competition policy. This paper proposes complementary regulatory and competition remedies to ensure that access to supermarket platforms and competition within them promotes fair dealing, consumer welfare and economic growth. It draws inspiration from the remedies enforced in other competitive bottlenecks such as CRSs, mobile communication networks, internet service providers, internet search engines and credit card networks.

The new economic paradigm: supermarket platforms

Leading grocery retailers (herewith, “supermarkets”) have emerged as powerful platforms that dictate to a large extent how consumers and owners of grocery brands not affiliated with supermarkets (known colloquially as “suppliers”, “providers”, and “manufacturers’ brands”, herewith identified as “independent (grocery) brands”) interact. As the consumers’ loyalty to supermarkets grows at the expense of grocery brands and the purchase decisions of specific brands are predominantly adopted in the store, access to and competition within the store becomes a critical competitive variable under control of the supermarkets. As a consequence, supermarkets are no longer neutral traders that convey consumers’ demand to suppliers and make sure that this demand is satisfied in the most efficient way. Supermarkets have realised that they hold the power to influence and even prescribe what consumers demand and how suppliers reach consumers. The retailing literature has extensively analysed this new economic paradigm and described the extent of supermarkets’ power and reflected the common wisdom in a self-explanatory war cry: “whoever owns the shelf, owns the market”.

Conventional competition analysis of supermarkets: buyer power

Conventional competition analysis of supermarkets’ dealings with suppliers remains anchored in an old-fashioned view of supermarkets as merchants. This conventional analysis presents supermarkets as buyers of grocery products and equates buyer power with lower purchase prices. Not surprisingly, competition law guidelines identify buyers/retailers as consumers. Moreover, for many years, competition policy has been designed to protect and increase retailers’ business freedom and buyer power at the expense of their suppliers. Most notably, the EU competition rules on vertical restraints

are designed to increase intra-brand competition, a term coined to limit suppliers' business freedom (bargaining power) at the expense of other operators downstream, without much regard for the status of inter-brand competition between the suppliers. For example, the prohibition of resale price maintenance, a cardinal sin in practically all competition jurisdictions, is one of the factors that led to the emergence of powerful grocery retailers that can dictate freely the retail prices of the independent brands that compete with supermarket brands. All in all, conventional competition analysis negates as a matter of principle that "buyer power" can lead to anticompetitive effects or consumer harm. At most, some competition authorities concede that some of the supermarkets' practices should be addressed under fair competition rules but this solution offers little, if any, comfort to independent brands, since unfair competition rules are non-existent, not readily applicable to the supermarkets' practices or not enforced by the victims of the abuses for fear of commercial retaliation.

Evolutionary competition analysis: danger of risk transfer and horizontal dimension

A few competition authorities have abandoned the conventional competition analysis in favour of an evolutionary analysis. This new approach still emphasises supermarkets' buyer role but identifies specific practices, which transfer excessive and/or unjustified risks to suppliers and may undermine the competitiveness of the independent grocery brands. Furthermore, it reckons that supermarket brands introduce a horizontal competition dimension vis-à-vis brands that has not been addressed so far. However, the evolutionary approach falls short of advancing competition law remedies because its competition analysis is heavily formalistic: First, it assumes a distinction between the procurement market (where supermarkets procure from independent brands) and retail markets (where supermarkets compete against each other). Therefore, the supermarket practices that discriminate against independent brands, especially in-store, seem to fall into a legal limbo. Second, single firm dominance in the national grocery procurement market is exceptionally rare because it requires very high market shares (e.g., +40-50%) and a significant gap with competitors in terms of market-share and competitive advantages. Third, competition authorities have never enforced the single firm dominance rules in retail markets of a local/regional dimension outside the merger control area and, even if they did it, it remains to be seen whether they would link retail dominance to the abuse of such dominance vis-à-vis independent brands (i.e., the procurement market). Fourth, the concept of "collective dominance" is a dead-letter outside the merger control arena, so the trading practices that could be considered abusive if undertaken by a supermarket held to be dominant under a formalistic analysis (e.g., a 45% market share with no other competitor reaching a 10% market share) can be freely undertaken by two supermarkets with a 45% market share each or even three supermarkets with a 30% market share each. Aware of this legal gap in the conventional competition analysis, the evolutionary analysis does not close the door to a regulatory remedy.

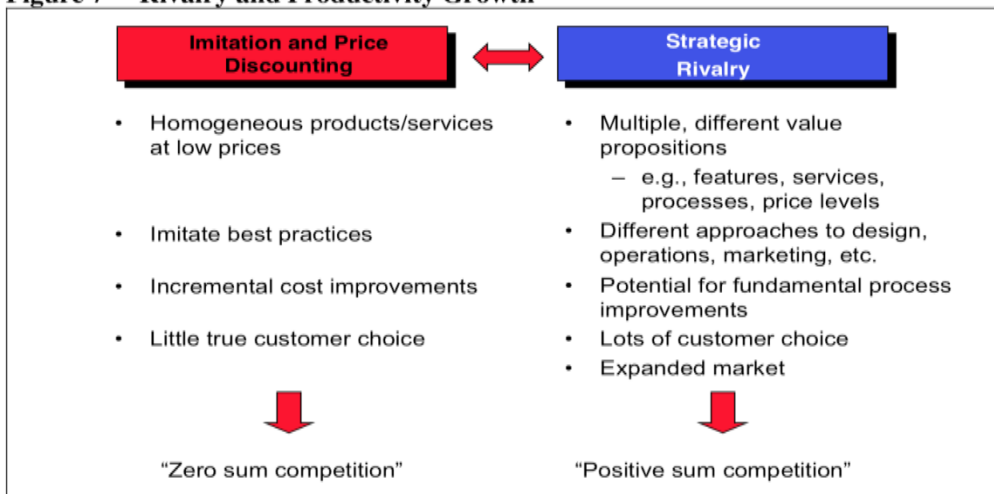
Proposed competition analysis: identifying competitive bottlenecks and addressing the practices that distort the competitive process and consumer sovereignty/choice/freedom

Departing from the conventional competition analysis, this Report proposes a new competition analysis that revisits the goals of competition policy, identifies the real sources of supermarkets' power and the dynamic effects of their practices in the grocery supply chain and proposes effective remedies that could be implemented under competition law and specific regulatory measures. Whereas the conventional analysis tries to fit the new supermarket reality into traditional analytical tools, the new vision proposes a mindset change to reinterpret existing rules to take account of the role of supermarkets as competitive bottlenecks.

A. The goal of competition policy: reconciling economic growth, competition and consumer welfare

Economic theory has evidenced for a long time that innovation and productivity are the drivers of economic growth. Michael Porter argues that those markets and economies where competition is based on the Strategic Rivalry model flourish, whereas markets and economies where competition is based on the Imitation and Price Discounting model enter a self-destructing spiral.

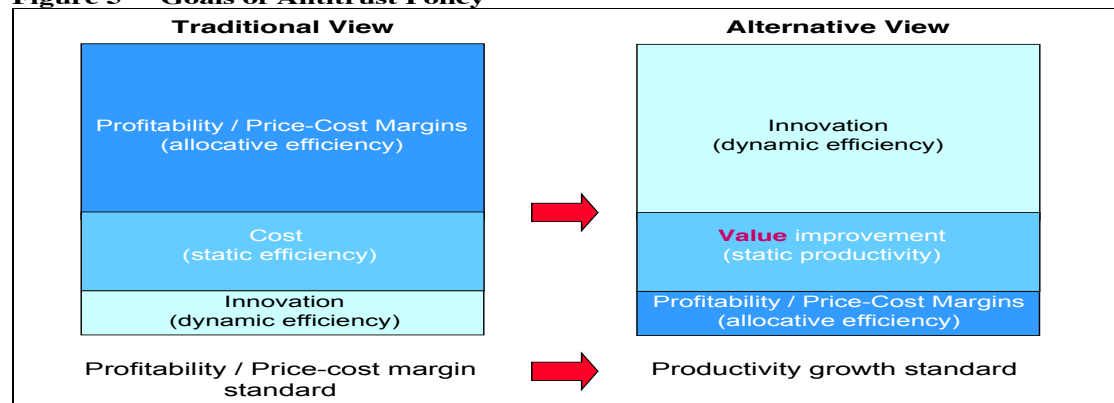
Figure 7 Rivalry and Productivity Growth



Source: Porter 2002, p. 16

Therefore, mainstream economic theory has advocated that competition policy should focus on the main drivers of economic growth. For example, Michael Porter has proposed a ranking of the primary goals of competition law and placed much more importance on innovation (dynamic efficiency) and value improvement (static productivity) than on profitability/price-cost margins (allocative efficiency).

Figure 5 Goals of Antitrust Policy



Source: Porter 2002.

However, competition authorities have always focused on allocative efficiency considerations (profitability and price/cost margins). This contradiction between economic theory and competition policy was understandable when competition analysis was essentially a formalistic exercise, but the recent trend towards an effects-based competition analysis has not improved anything either. Competition economists (disciples of the price/cost econometric analysis with little or no knowledge in the field of business strategy and economic growth) have developed tools to assess price effects only and the static short-term price analysis has ignored any dynamic consideration on innovation, variety, quality and choice.

The proposed competition analysis reconciles the goals of competition policy with the drivers of economic growth, Porter's model of Strategic Rivalry and modern definitions of consumer welfare such as the "competitive process" (EU competition law), "economic freedom" (German competition law); "consumer choice" (Neil Averitt, FTC and Robert Lande, American Antitrust Institute); "consumer freedom" (Thomas Leary, FTC) and "econodiversity" (Joseph Farrell, FTC). It abandons the preconceived view of supermarkets as merchants and the faulty analysis of their market power. It places less emphasis on formalistic considerations and more on the competitive process. It transcends the artificial distinction between seller and buyer, procurement and retail and tries instead to explain why leading and even not so leading supermarkets are able to exercise a seemingly unconstrained bargaining power vis-à-vis all their suppliers and to identify the practices that distort the competitive process between grocery brands and between supermarkets themselves. For example, the right focus on the drivers of economic growth leads to the conclusion that a leading supermarket fundamentally distorts the competitive process and innovation whenever it misuses the commercial secrets of independent brands and copycats, whereas a conventional analysis would simply focus on the static low-price competition brought about by the imitator.

B. Leading supermarkets: narrow group of competitive bottlenecks controlling interaction of brands and consumers

This modern analysis concludes that leading supermarkets enjoy market power in the grocery retail markets, as a result of the market concentration, the barriers to entry, the

consumers' loyalty to their preferred supermarkets and the information asymmetries that benefit supermarkets at the expense of consumers.

Furthermore, leading supermarkets adopt the role of competitive bottlenecks for independent brands, which depend on access to each of the leading supermarkets if they are to remain viable economic players. Mark Armstrong, the economist who advanced the economic theory of "competitive bottlenecks", developed a model for supermarkets that showed that the exploitation of suppliers exceeded the potential gains to consumers, even under intense supermarket competition. Thus, exploitation of suppliers reduced social welfare and, unless supermarket competition was intense, consumer welfare as well. Furthermore, harm to social welfare intensified if retail competition was not sufficient. Basically, the determinant of supermarkets' power rests on the ever-diminishing substitutability between them from a supplier's perspective. On the one hand, suppliers' operations reflect existing turnover and, as the European Commission attested in the Rewe/Meinl merger decision and other sources show, a 5-10% drop in turnover may force a supplier into losses and a 20% drop of business may drive him out of the market. On the other hand, consumers' loyalty to supermarkets prevails over their loyalty to specific grocery brands and this means that an independent brand's loss of access to a given supermarket cannot be compensated with higher sales in other supermarkets. This essentially confers each of the leading supermarkets a significant bargaining power over all suppliers, which is a much more accurate manifestation of market power than a given market share (e.g., a 40% market share, the so-called dominance threshold, reveals that 60% of the suppliers/customers do not even trade with the "dominant" company). For example, supermarkets have delisted Coca-Cola, possibly the grocery brand that commands the highest consumer loyalty in the world, in order to obtain satisfactory commercial terms. Furthermore, this reality underlies the critical importance attached by independent grocery brands to their weighted distribution and the achievement of the break-even threshold, that experts place at 70% of the modern retail market. This means that the cumulative effects of the unilateral decisions by a few supermarkets to refuse access to an innovation may have a devastating effect on consumer welfare and economic growth. Against this reality, conventional competition analysis worldwide sticks to a simplistic theoretical assessment of supermarket dominance or brand dominance based on high market shares that overlooks the real sources of supermarkets' bargaining power over their suppliers. Sometimes, the misfocus goes as far as the comparison of the independent brands' market shares in given product categories with the market share of a given supermarket in the grocery retail market. Another example is the definition of different product markets for the leading independent brands and the competing supermarket brands as a result of the application of a price test (the Significant and Non-transitory Increase in Price (SNIP) Test) that penalises premium pricing of independent brands (largely explained by retailers' practices) with a narrow market definition conferring an undeserved dominance status. Indeed, the *Rewe/Meinl* and *Carrefour/Promodès* merger decisions of the European Commission (*de facto* reversed by subsequent merger decisions of the European Commission), the *Kerry/Breeo* Judgment of the Irish High

Court (the merging parties provided all kind of evidence of the supermarkets' power and abuses over suppliers that led the Court to criticise sharply the Irish Competition Authority's decision against the merger), the *Kerry/Headlands* Decision of the Office of Fair Trading (a consummated merger of two suppliers whose competitive effects were observable), and the *FTC v. H.J. Heinz Co. and Milnot Holding Corporation* Judgment of the US District Court (a judgment siding with the merging parties against an FTC order against a merger, reversed on appeal but vindicated by later market developments) are possibly the only competition cases where the real-life bargaining power of supermarkets over all their suppliers has been uncovered.

C. Abuse of bargaining power and anticompetitive effects

Leading supermarkets have exploited their power vis-à-vis their suppliers in two stages:

Firstly, they have managed to transfer more and more of the risks of their retailing operations to suppliers by means of remunerated service agreements, manifestly unbalanced purchase agreements and unilateral practices that disregard contractual terms and legal provisions. For example, supermarkets and their alliances may impose access fees for the right to enter or be part of the supermarkets' product listing. On top of that, independent grocery brands may be contractually forced to bear the cost of: (1) delivery in pallets and crates of third parties (imposed by the supermarkets) to the individual stores or the provision by the supermarket of centralised delivery & warehousing services; (2) in-store replenishment; (3) in-store promotions and marketing activities; (4) product shrinkage; (5) consumer complaints; (6) guaranteed margins or wrong margin forecasts; (6) unsold items; and (7) positive credit terms enjoyed by supermarkets. If, despite all the risk-transferring activities put in place contractually, supermarkets do not meet internal profit forecasts or want to exceed them, there is always scope for unilateral practices that extract rents from suppliers under threat of delisting. Basically, supermarkets are progressively transforming themselves into service providers to independent grocery brands and they seek to maximise profits from access to and competition within their platforms.

Secondly, at some point in time, supermarkets have realised that it is more profitable to exclude independent grocery brands from the market than to trade with them. Therefore, they have integrated vertically by launching supermarket grocery brands (manufactured or not by them). Market foreclosure takes place through a set of restrictive practices that are aimed at competing independent grocery brands and can coexist with the risk-transferring practices: (a) the misuse of the business secrets provided by independent brands to supermarkets in favour of the supermarket brands; (b) access fees that prevent distribution of independent brands; (c) an abrupt termination of access that undermines the economic viability of the operations of independent brands; and (d) an upfront access refusal of the independent brands that compete with supermarket brands. Market foreclosure may also take place through pricing and non-pricing practices that distort in-store competition between brands. Even though supermarkets are able to transfer most, if not all, retail risks to suppliers and often operate *de facto* as providers of remunerated

distribution services to them as much as marketplaces do (e.g., shopping centres, Ebay, Amazon), they have not formally foregone their “retailer” or “merchant” role (i.e., supermarkets still purchase independent grocery brands for resale to consumers), as far as it affords them competitive advantages such as the control of the retail price of independent grocery brands. And this pricing power may undermine an independent brand’s value proposition to consumers through an artificial price gap between the targeted independent brand and the supermarket brand; a loss-leading price of the independent brand that undermines its quality perception; a refusal to pass-through promotional wholesale prices of independent brands to their retail prices; and a prohibition of the on-pack promotions of the independent brands. On the other hand, non-pricing practices may also be used to distort the consumer’s in-store choice through degradation of the in-store services provided to independent brands; switch marketing techniques in favour of supermarket brands; better positioning of the supermarket brands; and copycat packaging by supermarket brands of targeted competitors.

All in all, real-life evidence reveals that several commercial practices, where applied by the leading supermarkets, distort competition between supermarkets and between brands. They may restrict output by independent brands, as predicted by the economic theory on competitive bottlenecks (the theory assumes demand withholding by supermarkets but, in reality, demand withholding becomes a demand distortion in favour of supermarket brands); they may exploit independent brands and reduce retail competition, as predicted by the economic theory on anticompetitive access fees (access fees increase the costs of independent brands and their prices for all retailers whereas access fees only benefit the recipient); and, most notably, they may foreclose independent brands and reduce competition in the grocery retail market, as predicted by the economic theory on vertical foreclosure/collusion (vertical integration promotes monopoly rent preservation/expansion by supermarkets, raises independent brands’ costs and facilitates collusion between supermarkets).

Olbrich and Buhr have described how supermarkets distort competition between independent grocery brands and their own brands on four competitive dimensions and its consequences: a market where vertically integrated supermarkets eliminate or distort competition on all four competitive dimensions.

		Competition between products in retailing	
		Intrabrand	Interbrand
Competition between retailers	Intrastore	Branded articles over time are subject to a market appearance controlled by the retailers (in particular through changing marketing strategies of the retailers)	Branded articles compete with each other and with private labels (in particular through competition for shelf space and misuse as a price umbrella for private labels)
	Interstore	Branded articles are subject to pricing competition between retailing systems (in particular through price promotions and loss leaders)	Branded articles compete with each other and with private labels (in particular through profiling strategies of the retailers and as a price umbrella for private labels)

Fig. 3: Competition fields of branded articles in the consumer goods sector

		Competition between products in retailing	
		Intrabrand	Interbrand
Competition between retailers	Intrastore	No competition at the level of private labels	No competition between different private labels Increasing sealing off through delisting branded articles
	Interstore	No competition because private labels are only represented in one retailer's outlets	Increasing sealing off through business concentration (private labels are merged) Increasing sealing off through delisting branded articles

Fig. 2: Competition fields of private labels in the consumer goods sector

Source: Olbrich 2004, pp. 19-20

This outcome is the antithesis of the Strategic Rivalry economic model praised by Michael Porter or the “competitive process” that competition rules seek to protect. As a result, the leading supermarkets’ practices undermine grocery innovation, variety and quality to an extent unheard of in any other unregulated economic sector, without leading to lower retail prices. Indeed, the harm on innovation, variety and quality increases the quality-adjusted retail prices. Furthermore, a recent study by two economists of the Italian Central Bank analysed the relationship between market concentration at the buying group, parent company and regional level and price dynamics in the grocery retail sector of six Member States of the EU (Germany, Spain, Finland, Italy, Austria and Portugal) and found a positive association between retail market concentration and price growth in food and beverages, alcohol and tobacco and miscellaneous goods in the time span 2003-2010. Likewise, a landmark report by The Brattle Group has found that if leading Spanish supermarkets matched the higher margins (the retail price less the procurement price) they earn on independent brands with the lower margins they earn on their own competing supermarket brands, the prices of independent brands would fall between 4% and 41%, depending on the product, which would mean an average price decrease of 20%. This would lower the

price differential between the independent brand and the supermarket brand by nearly 48%.

D. Designing adequate competition law and regulatory remedies

It is imperative to enforce *ex ante* regulatory and *ex post* competition law remedies in order to address supermarkets' unfair/exclusionary practices and to ensure vigorous and efficient competition between grocery brands and between supermarkets.

Several factors point towards the need to supplement competition policy enforcement with economic regulation of supermarket platforms: First, in the developed economies, the retail market structure is not likely to become more competitive in the foreseeable future. To the contrary, the retail market concentration is growing and the room left for new entry or growth of small players is vanishing. Second, the European Commission and other public authorities have acknowledged that competition bottlenecks are better dealt with under an *ex ante* regulatory regime than under competition rules. Likewise, competition authorities have also considered that buyer power is better addressed through regulation. Third, the supermarkets' anticompetitive practices are widespread, simultaneous and multifaceted, evidencing a structural market failure. Fourth, the supermarkets' vertical integration and foreclosure practices place the old vertical relationships between grocery brands and supermarkets in a new horizontal dimension: a non-reciprocal commercialisation agreement with a competitor, whose brand competes head-on with independent brands in the store. Fifth, for many years, competition policy enforcement has been biased against manufacturers (sellers) and in favour of retailers. Supermarkets have benefited from an asymmetric competition regime (e.g., prohibition of resale price maintenance) for many years and it is only fair that their anticompetitive practices are banned upfront and expeditiously through economic regulation. Sixth, public intervention in other competitive bottlenecks suggests that economic regulation is a necessary complement to competition rules. Indeed, preventive regulatory intervention against the threat of anticompetitive practices, despite the absence of single-firm dominance, has been the remedy chosen in the field of Computer Reservation Systems, interconnection between mobile telecommunications networks, provision of Internet access, and Internet domain name registration. Seventh, supermarkets' power has enabled them to bundle two business models in order to profit from their respective advantages: they *de facto* behave as service providers vis-à-vis independent grocery brands whilst controlling retail competition through their formal role of merchants. Conversely, independent grocery brands are forced to shoulder the disadvantages of both models: they have to bear supermarkets' access fees, terms and risks whilst not being able to control the retail commercialisation of their products. This market failure may call for a regulatory clarification of the boundaries of supermarkets' business model. Last, but not least, economic regulation may also take into account other public policies worth of protection. The supermarkets' anticompetitive practices and their Imitation and Price Discounting business model may have a profound impact on producers of agricultural

products and the agrifood industry. Producers of agricultural products can be impacted by the supermarkets' practices in different ways. If producers supply directly to supermarkets branded or unbranded goods, they can be subject to abuses regarding the access fees and terms. If producers integrate vertically forward into industrial processing and develop commercial brands, they may also be prey to the practices described herewith. Producers will also suffer indirectly as input suppliers of the agrifood industry. The Imitation and Price Discounting model mostly adopted by supermarkets, however profitable may be for them, leads to zero sum competition. The producer and industrial levels do not make enough profits to foster innovation and productivity growth (value), leading to the supply of homogeneous products at infracompetitive wholesale prices. All in all, there is a sustained destruction of economic value in the agricultural chain. As in many other countries, the Common Agricultural Policy is a pillar of the EU policies and it has been afforded a special status from a competition law perspective. However, any initiative confined to increasing concentration and seller power at the production level will do nothing to offset the supermarkets' market power vis-à-vis suppliers, their incentive and capacity to abuse their power and, ultimately, the suppression of the Competitive Rivalry model in favour of the Imitation and Price Discounting model. If the EU and other developed economies want a healthy and competitive agricultural sector, they must address supermarkets' competitive bottleneck in the food chain.

Turning to the specific regulatory remedies, it is critical to put in place a legal demarcation of the business model of supermarkets coupled with other structural and behavioural remedies. As far as the legal demarcation of the service provision and the retail operations, supermarkets should opt between the provision of distribution services to grocery brands or the naked purchase and resale model without the ever growing transfer of risks/costs to the brands. The distribution service would guarantee supermarkets an income/fee, either fixed or variable, and let brands compete freely for these distribution services and regain control of their retail placement and prices. The retailer/merchant model would let supermarkets control retail competition between brands but would force them to bear the ensuing business risks as well, which are currently transferred to brands in a myriad of ways (i.e., formal/informal and contractually/unilaterally). Furthermore, other regulatory remedies would comprise (i) FRAND ("fair, reasonable and non-discriminatory") terms regarding access to and competition within their platforms; (ii) a separation of the supermarket grocery brand activities from the distribution services or the retailer function; (iii) an independent enforcement of the regulatory obligations with *ex officio* investigatory powers; and (iv) the control of retail concentration. The suggested remedies are coherent with those adopted by the EU and third countries in the field of Computer Reservation Systems.

On the competition side, the specific features of the grocery retailing and its economic and social importance call for a holistic oversight of the access to and competition within the stores of the leading supermarkets. This justifies a sector-specific block exemption regulation and/or guidelines under Article 101 TFEU and a creative

approach to market definition (e.g., each supermarket's platform?), dominance (e.g., +20-30% market share?) and/or abuse (e.g., can dominance in a given retail market be abused in the procurement market?), instead of the current unduly formalistic and patchwork approach that benefits supermarkets. Indeed, the European Commission has favoured this creative approach and sector-specific rules in other business sectors of less economic and social relevance (e.g., the motor vehicle distribution, where repair and spare-part markets for each car manufacturer's network have been found and sector-specific block exemption regulations and guidelines have been approved). All in all, other competitive bottlenecks such as Computer Reservation Systems, call termination in mobile communication networks, Internet Service Providers, media platforms, aftermarkets and credit card payment networks have seen proactive regulatory and/or competition law intervention to address anticompetitive practices by two-sided platforms that were only latent or incipient. Supermarkets' anticompetitive practices are widespread and a combined regulatory and competition law intervention to address them is legitimate, coherent and justified.

2 Modern retailing: a new economic paradigm

Amongst all areas of retailing, food retailing stands out as having experienced the most significant changes in market structure in the last 20-30 years: supermarkets have emerged as the grocery retail channel of choice for consumers, as grocery demand has evolved towards a one-stop-shop model¹. Furthermore, supermarkets' pre-eminence over traditional and specialised grocery shops has radically altered the balance of power in the grocery supply chain and it is likely to impact significantly on suppliers and consumers².

Independent experts unanimously agree that this new economic paradigm is one characterized by supermarket domination up to a point that supermarkets' listing decisions may affect the financial viability of their suppliers³. Even those suppliers who are fortunate enough to be listed must adhere to the supermarkets' terms⁴ and live under the "Damocles sword" of a delisting with immediate effect⁵. These terms often include substantial payments and other compensations that turn upside down the traditional

¹ See a general discussion of this new economic paradigm in Clarke, Davies, Dobson and Waterson, *Buyer Power and Competition in European Food Retailing*, Published by Edward Elgar Publishing, 2002.

² Weiss and Wittkopp, "Buyer Power and Product Innovation: Empirical Evidence from the German Food Sector", Working Paper FE 0303, University of Kiel, June 2003, p. 3.

³ Thomassen, Lincoln and Aconis, *Retailization – Brand survival in the age of retailer power*, Kogan Page, 2006, Preface xi-xii: "We face a new era that will not go away – a new era called 'the era of retail power'. When the largest retailer in the world is now several hundred times larger than an individual brand it is clear where the power of the business world is residing. When only a few retailers control 75 per cent of an individual market and the biggest brands control less than 1 per cent, it is clear where the power lies. Where a few buyers at a few major retailers determine total effective consumer choice, it is clear where the real power lies. We used to live in a world where brand power was everything, but slowly and inexorably it is being replaced by retail power...The mountain here is the shelf: a shelf in the supermarket, a shelf in a concept store or a shelf on the internet. Once the shelf was the place we proudly displayed our brands. Now it's the place we fight to stay on. Now it's the place we can be evicted from on the smallest whim...we believe this squeeze has taken us to a new type of world. It's clear that this new world has some big fish and some little fish. The biggest fish of them all is the global retailer. This new breed of super retailer increasingly gets its own way. It can decide to swim with the small fish or simply gobble them up and spit them out. The little fish are of course the brands."

⁴ Blythman, *Shopped: the shocking power of Britain's supermarkets*, Harper Perennial, 2007, pp. 150-151: "The concentration of power that has taken place in the food retailing in recent years...has not just given our large supermarket chains a stranglehold on the nation's food shopping. It has effectively assigned them the role of gatekeepers whom farmers, growers and manufacturers must get pass if they want to supply that market, with extraordinary negotiating power. If they are to let suppliers through, supermarkets expect to be kept sweet. If you are a supplier you are expected to play by the rules of the supermarket game – rules that are drawn up by the supermarket themselves, and are effectively non-negotiable. It is not like a game of Monopoly where the ultimate penalty is going to jail. With losers getting delisted, which could mean you go out of business, the stakes are high".

⁵ Seth and Randall, *The Grocers: the rise and rise of the supermarket chains*, Kogan Page, 1999, p. 278: "If consumers are the biggest group affected by what supermarkets do, suppliers are also intimately involved. For some, the decisions of a few buyers may make the difference between profit and loss – in extreme cases, the difference between survival and closure. When four buyers between them control the majority of the market – up to 60 or 80 per cent, depending on the category – then the threat of de-listing is a serious one, and the negotiating power brought to bear is enormous."

concepts of supplier/seller and retailer/buyer⁶. Furthermore, large supermarkets have become the fiercest competitors of their suppliers and often misuse the business secrets of their suppliers in favour of their own brands up to the point of copycatting the same packaging and presentation. In summary, supermarkets' terms force independent suppliers to 'feed' competing supermarket brands in a slow but fatal *hara-kiri* process⁷. However, legal complaints are almost non-existent, as suppliers are afraid of upsetting their largest customers and losing them⁸.

Economic power and related competition problems have been traditionally considered to be abstract concepts managed by businesses and economists concerned respectively about profits and economic efficiency, but the retail grocery sector deals with the most basic human need (i.e, food) and its social implications are huge⁹. Indeed, social

⁶ Blythman 2007, p. 150: "You would think that if a product was wholesome, safe and reliably supplied at a price that, as well as sustaining the supplier, offered a decent margin to the retailer, supermarkets might be interested in purchasing it. But these days in the lord-and-vassal world of grocery retailing, that proposition is not necessarily sufficiently enticing. If suppliers want to deal with supermarkets, it is a lot more complicated than that. They may have to approach the supermarket buyer not only armed with something the consumer might like to buy, but also, like the ancient Greeks, bearing gifts"

⁷ Kumar and Steenkamp, *Private label strategy – How to meet the store brand challenge*, Harvard Business School Press, 2007, book cover: "As retailers have grabbed power around the globe, they've transformed private labels from price purchases into powerful brands with their own cachet. As a result, once powerful brand manufacturers like Nestlé and Procter & Gamble now find themselves competing for shelf space with their biggest customers, like Tesco and Walt-Mart."

⁸ Bevan, *"Trolley wars: the battle of the supermarkets"*, Profile Books, 2006, pp. 174-175: "Although farmers are the most vocal of supermarket suppliers, many others are dissatisfied with their lot. Of the branded manufacturers, the ones that have been most squeezed in the past ten years own the second-tier brands. Yet in Britain's competitive business climate, few will complain publicly or officially because their continuation in business so often depends on the goodwill of their customers. According to one former head of a bakery company, 'nobody ever tells the real story to the competition authorities; they have too much to lose'". See, also, Blythman 2007, pp. 138-140: "In the past decade, supermarkets have established a near feudal relationship with their suppliers, tightening their control over them, effectively dictating what they produce and screwing down prices, yet offering no security in return...It is a one-way trade, not a dialogue, and no criticism or grumbling is permitted. 'As soon as you put your head above the parapet [complain] that's a nail in your coffin', is how one supplier summed up the predicament...Fear? An exaggeration perhaps? Not according to the Competition Commission, when in 2000 this independent body reported the conclusions of its inquiry into supermarkets. 'We received many allegations from suppliers about the behaviour of the main parties [supermarket chains] in the course of their trading relationships. Most suppliers were unwilling to be named, or to name the main party that was the subject of the allegation. There appeared to us to be a climate of apprehension among many suppliers in their relationships with the main parties'".

⁹ Simms, *Tescopoly: How one shop came out on top and why it matters*, Constable, 2007, p. 180: "Just thirty retailers already have captured one-third of the global food market, and their control is increasing. The biggest stores are growing faster than the market as a whole...So why does this matter? To ensure that everyone's needs are met, every marketplace needs checks and balances. The lopsided accumulation of power tends to mean bad news for the powerless. Arguably, this might not matter if the goods in question were, for example, luxury hi-fi equipment or balloons. But this market concerns our most basic need: food. Just as importantly, it concerns the people who grow it." See also Ganesh, "The Right to Food and Buyer Power", *German Law Journal* Vol. 11, N° 11, 2010, Abstract: "Modern global food supply chains are characterized by extremely high levels of concentration in the middle of those chains. This paper argues that such concentration leads to excessive buyer power, which harms the consumers and food producers at the ends of the supply chains. It also argues that the harms suffered by farmers are serious enough a to constitute violations of the international human right to food, as expressed in the Universal Declaration of Human Rights and more specifically, in the International Covenant on

concerns have led different social groups, including NGOs, to call actively for the control of the supermarkets' power and abuses, a social uprising hardly seen in any other economic sector¹⁰.

Therefore, it is critical for the economy and society to assess whether the emerging power of grocery retail giants is improving consumer welfare or rather harming competition¹¹.

In order to answer this question, this Report presents the conventional analysis of supermarket power by mainstream competition authorities and contrasts it with the evolutionary approach adopted by a minority of competition authorities. Furthermore, it builds on the evolutionary analysis and proposes a new (modern) approach to supermarket power under competition policy. This new approach refreshes the conventional tools developed by competition authorities in order to define the relevant markets, ascertain supermarket market power and verify the existence of

Economic, Social and Cultural Rights. World competition law regimes cannot ignore these human rights imperatives.”

¹⁰ See, for example, *Tescopoly*: “The Tescopoly Alliance was launched in June 2005 to highlight and challenge the negative impacts of Tesco’s behaviour along its supply chains both in the UK and internationally, on small businesses, on communities and the environment. The campaign also advocates national and international legislation needed to curb the market power of all the major British supermarkets. The Tescopoly Alliance represents a diverse group of organisations from large international NGOs to unions and small pressure groups, embracing a range of issues from worker’s rights to the decline in small independent retailers. Members are Banana Link, Friends of the Earth, GMB London, Labour Behind the Label, nef and War on Want” (www.tescopoly.org); *SupermarktMatch*: “Die Supermarkt-Initiative ist ein Zusammenschluss von 23 Nichtregierungsorganisationen und Gewerkschaften, die sich mit aller Kraft dafür einsetzen, dass der Missbrauch von Einkaufsmacht aufgedeckt und begrenzt wird. Eine umfassende Untersuchung des Lebensmitteleinzelhandels durch das Kartellamt soll die Misstände ans Tageslicht bringen. Zudem fordert die Initiative die Einhaltung sozialer und ökologischer Standards in der gesamten Lieferkette. Dabei geht es vor allem darum, strukturell etwas zu verändern, d.h. bessere Sozial- und Umweltstandards in der gesamten Lieferkette der Supermärkte durchzusetzen, in Deutschland, innerhalb der EU und in Produktionsländern” (www.supermarktmatch.de); Vander Stichele (SOMO) and Young (Europe Economics), *The Abuse of Supermarket Buyer Power in the EU Food Retail Sector Preliminary Survey of Evidence*, AAI-Agribusiness Accountability Initiative, March 2009; and Consumers International, *The relationship between supermarkets and suppliers: What are the implications for consumers?*, July 2012, pp. 22-23: “Effective measures to prevent unfair B2B commercial practices and the resulting detriments to both small-scale producers and consumers are urgently needed. For too long, and despite numerous initiatives, national and EU authorities have failed to solve the problems. Remedies should be based on a fundamental principle of fair dealing. To be effective, they also need to be binding and enforceable. Further, the global nature of supply to leading supermarkets must be recognised in order to ensure that all suppliers (regardless of geographical location) have effective recourse to protection. With a mandate to inform consumers and act in their interests, consumer organisations have a vital role to play in preventing the negative effects of buyer power. CI will support the work of its members in raising consumer awareness of relevant issues; will hold supermarkets to account for the conditions in their food supply chains and the integrity of their purchasing practices. Further, CI will support binding and enforceable action to prevent abuses of buyer power and subsequent detriment to consumers and suppliers alike”. Consumers International (CI) is the world federation of consumer groups, with over 240 member organisations in 120 countries.

¹¹ The title of this Report is inspired by the title of the US Senate antitrust hearing on Google’s practices, “*The Power of Google: Serving Consumers or Threatening Competition*” (21.09.2011). The analogy with Google is highly relevant, because Google and supermarkets have become competitive bottlenecks vis-à-vis Internet content providers and grocery brands, respectively.

anticompetitive effects/consumer harm¹². Finally, it proposes competition and regulatory remedies to address the supermarket practices that are considered to harm consumers and competition alike.

¹² Conventional competition analysis under Article 101 (ex-Article 81 TEC) and Article 102 (ex-Article 82 TEC) of the Treaty on the Functioning of the European Union (“TFEU”) first proceeds with market definition, then assesses dominance/market power and finally estimates the competitive effects of the conduct/agreement. See, for example, Communication from the Commission - Guidelines on the application of Article 81(3) of the Treaty (“EU Guidelines on Article 101(3) TFEU”), OJ C 101, 27.4.2004, par. 27: “For the purposes of analysing the restrictive effects of an agreement it is normally necessary to define the relevant market. It is normally also necessary to examine and assess, inter alia, the nature of the products, the market position of the parties, the market position of competitors, the market position of buyers, the existence of potential competitors and the level of entry barriers. In some cases, however, it may be possible to show anti-competitive effects directly by analysing the conduct of the parties to the agreement on the market. It may for example be possible to ascertain that an agreement has led to price increases. The guidelines on horizontal cooperation agreements and on vertical restraints set out a detailed framework for analysing the competitive impact of various types of horizontal and vertical agreements under Article 81(1)”. This methodology admits exceptions when assessing objective restrictions such as price-fixing cartels, but otherwise, it is entirely relevant to the analysis of the supplier-supermarkets relationships.

3 Conventional competition analysis

Modern competition policy is a century old institution that was born to address the market power of manufacturers of goods (sellers) at a time where retailers were considered to be neutral transmitters of customer demand and, therefore, agents/representatives of consumers.

As a tribute to this origin, competition authorities all over the world consistently promote not only inter-brand competition, but also competition within the distribution network of each brand (intra-brand competition)¹³. Indeed, the EU Guidelines on Article 101(3) still associate the term ‘consumer’ with the term ‘distributor’ (i.e., wholesaler/retailer)¹⁴ and the EU Vertical Guidelines refer to retailers as distributors of goods¹⁵. As a consequence of this pro-retailer bias, non-dominant suppliers, and even those without any significant measure of market power, have seen competition laws interfere with their freedom to manage their distribution networks in the name of free competition and consumer welfare¹⁶. Furthermore, several restraints imposed by

¹³ EU Guidelines on Article 101(3) TFEU, par. 17: “The assessment of whether an agreement is restrictive of competition must be made within the actual context in which competition would occur in the absence of the agreement with its alleged restrictions. In making this assessment it is necessary to take account of the likely impact of the agreement on inter-brand competition (i.e. competition between suppliers of competing brands) and on intra-brand competition (i.e. competition between distributors of the same brand). Article 81(1) prohibits restrictions of both inter-brand competition and intra-brand competition [footnote: See in this respect e.g. Joined Cases 56/64 and 58/66, Consten and Grundig, [1966] ECR 429].

¹⁴ *Id.*, par. 84: “The concept of “consumers” encompasses all direct or indirect users of the products covered by the agreement, including producers that use the products as an input, wholesalers, retailers and final consumers, i.e. natural persons who are acting for purposes which can be regarded as outside their trade or profession. In other words, consumers within the meaning of Article 81(3) are the customers of the parties to the agreement and subsequent purchasers. These customers can be undertakings as in the case of buyers of industrial machinery or an input for further processing or final consumers as for instance in the case of buyers of impulse ice-cream or bicycles.”

¹⁵ See Commission notice - Guidelines on Vertical Restraints (“EU Vertical Guidelines”), OJ C 291, 13.10.2000. The par. 2 lays down the principle that these rules apply to both goods and services supplied and purchased at all levels of trade. However, all along the text of these Guidelines, the production (manufacturer) and distribution (wholesaler/retailer) levels are distinguished in a top-bottom framework. See, for example, par. 25, c): “The agreement or concerted practice is between undertakings each operating, for the purposes of the agreement, at a different level of the production or distribution chain. This means for instance that one undertaking produces a raw material which the other undertaking uses as an input, or that the first is a manufacturer, the second a wholesaler and the third a retailer. This does not preclude an undertaking from being active at more than one level of the production or distribution chain”. Furthermore, the three sections that touch directly on grocery supermarkets categorize them as retailers of goods. Section III.2.3 (Association retailers) considers that “retailers are distributors reselling goods to final consumers” (par. 29). Section VI.2.7 (Upfront access payments) and 2.8 (Category management) also considers supermarkets as buyers and distributors of goods purchased from suppliers (sellers).

¹⁶ EU Guidelines on Article 101(3) TFEU, par. 18: “For the purpose of assessing whether an agreement or its individual parts may restrict inter-brand competition and/or intra-brand competition it needs to be considered how and to what extent the agreement affects or is likely to affect competition on the market. The following two questions provide a useful framework for making this assessment. The first question relates to the impact of the agreement on inter-brand competition while the second question

suppliers on retailers are considered to be objective restrictions of intra-brand competition and almost automatically found to be anticompetitive¹⁷.

This institutional framework and the underlying mindset explain the different treatment accorded by competition authorities to seller power and buyer power, despite the fact that the economic theory and the guidelines issued by competition authorities assume that market power is a uniform concept irrespective of the market or practice being assessed¹⁸. Indeed, the dual bias against seller power and in favour of buyer power can be discerned in the terminology used. On the one hand, when competition authorities assess market power of manufacturers (sellers) of products they simply refer to market power and not to seller power. However, this is not the case when competition authorities assess the market power of retailers in their dealings with manufacturers. In this case, they avoid the term market power and refer to either buyer power or bargaining power, terms that implicitly suggest opposition to seller power

relates to the impact of the agreement on intra-brand competition. As restraints may be capable of affecting both inter-brand competition and intra-brand competition at the same time, it may be necessary to analyse a restraint in light of both questions before it can be concluded whether or not competition is restricted within the meaning of Article 81(1): (1) Does the agreement restrict actual or potential competition that would have existed without the agreement? If so, the agreement may be caught by Article 81(1). In making this assessment it is necessary to take into account competition between the parties and competition from third parties. (...). (2) Does the agreement restrict actual or potential competition that would have existed in the absence of the contractual restraint(s)? If so, the agreement may be caught by Article 81(1). For instance, where a supplier restricts its distributors from competing with each other, (potential) competition that could have existed between the distributors absent the restraints is restricted. Such restrictions include resale price maintenance and territorial or customer sales restrictions between distributors. However, certain restraints may in certain cases not be caught by Article 81(1) when the restraint is objectively necessary for the existence of an agreement of that type or that nature. Such exclusion of the application of Article 81(1) can only be made on the basis of objective factors external to the parties themselves and not the subjective views and characteristics of the parties. The question is not whether the parties in their particular situation would not have accepted to conclude a less restrictive agreement, but whether given the nature of the agreement and the characteristics of the market a less restrictive agreement would not have been concluded by undertakings in a similar setting. For instance, territorial restraints in an agreement between a supplier and a distributor may for a certain period of time fall outside Article 81(1), if the restraints are objectively necessary in order for the distributor to penetrate a new market. Similarly, a prohibition imposed on all distributors not to sell to certain categories of end users may not be restrictive of competition if such restraint is objectively necessary for reasons of safety or health related to the dangerous nature of the product in question. Claims that in the absence of a restraint the supplier would have resorted to vertical integration are not sufficient. Decisions on whether or not to vertically integrate depend on a broad range of complex economic factors, a number of which are internal to the undertaking concerned.”

¹⁷ *Id.*, par. 19: “In the application of the analytical framework set out in the previous paragraph it must be taken into account that Article 81(1) distinguishes between those agreements that have a restriction of competition as their object and those agreements that have a restriction of competition as their effect. An agreement or contractual restraint is only prohibited by Article 81(1) if its object or effect is to restrict inter-brand competition and/or intra-brand competition”; and par. 23: “Non-exhaustive guidance on what constitutes restrictions by object can be found in Commission block exemption regulations, guidelines and notices. Restrictions that are black-listed in block exemptions or identified as hardcore restrictions in guidelines and notices are generally considered by the Commission to constitute restrictions by object. In the case of horizontal agreements restrictions of competition by object include price fixing, output limitation and sharing of markets and customers. As regards vertical agreements the category of restrictions by object includes, in particular, fixed and minimum resale price maintenance and restrictions providing absolute territorial protection, including restrictions on passive sales”. See the discussion of resale price maintenance in Section 5.7.2.

¹⁸ See the introductory discussion of the concept of “market power” in Section 5.3.

(countervailing power). In a similar vein, several competition authorities gathered at the OECD Roundtable on Monopsony and Buyer Power, tried to distinguish bargaining power (pro-competitive) from monopsony power (anti-competitive)¹⁹. The views of the competition authorities openly or implicitly conceded that the concept of monopsony power is confined to the theoretical world of economic textbooks and plays no meaningful role in competition policy enforcement²⁰.

This bias in favour of distributors/retailers seems to underlie the superficial assessment of the supermarkets' power. On the one hand, competition authorities assume that any abuse in the grocery procurement market can only take the shape of infra-competitive purchase prices, as predicted by the neoclassic monopsony model. On the other hand, competition authorities assume, without much supporting evidence, that grocery retail markets are competitive in terms of overall prices. Therefore, it is taken for granted that a virtuous low-price/high output circle is in place along these lines: (1) buyer power leads to lower procurement prices without restricting input; (2) low purchase prices are passed-on to low retail prices, thereby increasing end-consumer demand; and (3) increased demand reinforces buyer power and leads to lower procurement prices without ever restricting input. All in all, the end-conclusion is that supermarkets either do not hold market power over suppliers or that they exploit it for the benefit of end-consumers.

Accordingly, the theories of harm developed in this field fail to show harm almost by definition²¹.

¹⁹ OECD, "Roundtable on Monopsony and Buyer Power", Competition Committee, DAF/COMP (2008)38, 17.12.2009 [OECD 2009a]. See, in particular, the Executive Summary. Both monopsony power and bargaining power imply the ability of a strong purchaser to lower the input prices, however, their effects on competition and consumers are considered to be different. The monopsonist lowers input prices by purchasing less quantities of input up to a non-competitive level, thereby harming input suppliers but also consumers. The purchaser with bargaining power threatens to reduce purchases in order to extract surplus from the input supplier and this outcome is either neutral (if the purchaser holds seller power in the output market it will keep the surplus for itself) or beneficial (if the output market is competitive it will pass-on the surplus to consumers) from a consumer welfare perspective.

²⁰ See, for example, OECD 2009a Note by Canada, p. 142: "To date, there have been no abuse investigations involving bargaining power that have involved lower input prices. It is unlikely that lower input prices would, in isolation, meet the requirement of a practice of anti-competitive acts."

²¹ Some competition authorities have openly admitted that their approach to buyer power confers on supermarkets a free rein in the grocery procurement market. Other competition authorities have subtly relied on theories of harm (e.g., retailer foreclosure through low prices) that *de facto* exclude the application of competition rules. See, for example, OECD 2009a, Note by the European Commission, pp. 255-256: "*Section 2. Should the Commission address buyer power?* Much of the current interest in buyer power highlights the plight and problems faced by small suppliers. It is clear that some of these concerns relate to issues that are not a matter of competition law but rather highlight social or political concerns. In terms of competition policy, the first question is whether competition between purchasers on the procurement side is to be protected to the same extent as competition between suppliers on the sales side. European Commission policy is that the ultimate end user of any product - the consumer - should be at the centre of competition law. This means that ultimate focus should be on the demand side. It is competition that brings about low prices and better choice for consumers and guarantees that companies' offers adapt to the preferences of the demand side. It is also this process that drives efficiency, innovation and productivity benefits. Nevertheless, there are certain potential situations where buyer power can lead to a competition problem if it has an effect on competition on the sales market - either in terms of higher

In the output (retail) market, it is considered that negative effects on consumer welfare can only arise in the long term under very stringent conditions: (i) the lower wholesale prices obtained from this conduct lead to lower downstream market prices that decrease the profitability of a buyer's competitors, leading to their market exit; and/or (ii) the lower wholesale prices obtained from this conduct by a buyer with market power results in an increase in the wholesale price to other buyers. These two scenarios are almost impossible to distinguish from competition on the merits and, therefore, this analysis leads to a dead-end as far as competition authorities are concerned²².

In the input (procurement) market, it is considered that negative effects on consumer welfare can only arise if suppliers exit the market or reduce their investments up to a point where input prices go up and materially affect output (retail) prices and, "perhaps, variety". However, the short-term benefits of price competition are accorded preference over the long-term restriction of competition. Therefore, the analysis hits a dead-end again²³.

Finally, the vertical integration of supermarkets into grocery products (brands) is either absent in the competition/harm analysis²⁴ or considered to be a countervailing force to seller power and, therefore, pro-competitive²⁵. To be fair, the new EU Vertical Guidelines do mention in passing the potential foreclosure of independent brands by supermarkets' access (assortment) decisions in the section devoted to category

prices or loss of choice or quality (for instance if there is significant supplier exit). These would lead to direct disadvantages for the consumer which should be addressed by competition law."

²² OECD 2009a, Executive Summary, Point 6: "In scenario (i), intervention based on competition laws is problematic since it involves foregoing immediate and certain gains for consumers for the purpose of averting potential harm in the future. In scenario (ii), the increase in the price to other buyers raises their costs, leading either to their exit or giving them an incentive to raise their downstream price. However, there may not be a waterbed effect. Indeed, the price to buyers with less bargaining power might also decrease. Alternatively, other buyers may be able to implement counterstrategies that eliminate or narrow any asymmetries of buying power, thereby obtaining access to matching wholesale prices and benefiting consumers. Furthermore, even if there is a waterbed effect, prices to consumers in the downstream market might still decrease."

²³ *Id.*, Executive Summary, Point 7: "In the long run, hold up of suppliers by buyers with bargaining power may have negative ramifications for competition upstream: less investment and higher input prices if sellers exit the market as a result. These effects, if material, would eventually lead to harm in the downstream market in the form of higher prices and, perhaps, a loss in variety. The actual results will typically be difficult to predict with confidence. They are long-run effects that will require an assessment of how the transaction and the increase in buyer power will affect industry structure upstream. Moreover, these long-run costs, if any, may be offset in part by gains to consumers in downstream markets in the short run, depending on the extent of competition downstream. To avoid over-enforcement and false positives, the evidentiary threshold should therefore likely be relatively high."

²⁴ See, for example, OECD 2009a and OECD, "Roundtable on Competition and Regulation in Agriculture", DAF/COMP(2005)44, 21.12.2005.

²⁵ The EU Vertical Guidelines, par. 116: "The market position of the parties' customers provides an indication of whether or not one or more of those customers possess buyer power. The first indicator of buyer power is the market share of the customer on the purchase market. That share reflects the importance of its demand for possible suppliers. Other indicators focus on the position of the customer on its resale market, including characteristics such as a wide geographic spread of its outlets, own brands including private labels and its brand image amongst final consumers. In some circumstances, buyer power may prevent the parties from exercising market power and thereby solve a competition problem that would otherwise have existed...."

management practices²⁶. However, these Guidelines hold that the assessment of potential foreclosure of independent brands is to be done by analogy with the assessment of single branding obligations²⁷. This is also a dead-end because the remedies contemplated for single branding restraints by manufacturers (i.e., termination of exclusivities) cannot be replicated in supermarkets' relationships with their suppliers. Furthermore, they neglect "access degradation" practices (creeping foreclosure), including discriminatory access payments and/or the discriminatory in-store practices against listed independent grocery brands. Finally, the pro-retailer bias inherent in the conventional competition policy extends also to supermarket brands. First, retailers are not considered to be 'manufacturers' when they subcontract the production of goods under their own brands²⁸. Second, the competitive assessment of upfront access payments focuses on foreclosure practices by independent brands despite the existence of retailer brands that do not face these payments²⁹. Not surprisingly, no competition proceedings have ever been instituted in the EU and beyond regarding the foreclosure of independent brands by supermarkets.

All in all, the conventional approach to buyer power leads to the non-application of competition rules in the grocery procurement market³⁰. This hands-off approach in the procurement market has not been compensated by a proactive intervention in the

²⁶ As evidenced by the EU concept of inter-brand and intra-brand competition, competition in the markets takes place between brands, not between suppliers or sellers. For example, whereas grocery brands of suppliers and supermarkets compete in the market, manufacturers/suppliers of supermarket brands do not compete against manufacturers/suppliers of independent brands. Indeed, an independent grocery brand may also rely on third party manufacturers/suppliers through subcontracting agreements."

²⁷ The EU Vertical Guidelines, par. 210: "...While in most cases the distributor may not have an interest in limiting its choice of products, when the distributor also sells competing products under its own brand (private labels), the distributor may also have incentives to exclude certain suppliers, in particular intermediate range products. The assessment of such upstream foreclosure effect is made by analogy to the assessment of single branding obligations (in particular paragraphs (132) to (141)) by addressing issues like the market coverage of these agreements, the market position of competing suppliers and the possible cumulative use of such agreements".

²⁸ *Id.*, par. 27: "...A distributor that provides specifications to a manufacturer to produce particular goods under the distributor's brand name is not to be considered a manufacturer of such own-brand goods."

²⁹ *Id.*, par. 205: "Exceptionally, upfront access payments may also result in anticompetitive foreclosure of other suppliers, where the widespread use of upfront access payments increases barriers to entry for small entrants. The assessment of that possible negative effect is made by analogy to the assessment of single branding obligations (in particular paragraphs (132) to (141))."

³⁰ See, for example, OECD 2009a, Note by European Commission, pp. 255-256. See also the views of the Commission and the competition authorities of the Member States in the European Competition Network (ECN), "Report on competition law enforcement and market monitoring activities by European competition authorities in the food sector", May 2012, pars. 253-254: "253. The analysis of the exercise of buyer power by retailers and its effects on competition in procurement and sales markets is also an issue which has been a priority by many NCAs in their market monitoring investigations...NCAs also agree that the exercise of buyer power can bring positive effects if competition among retailers exists in downstream markets and the lower purchasing costs achieved in procurement markets are passed to consumers in terms of lower prices. 254. However, it has also been pointed out that in certain cases the imbalances of bargaining power between retailers and suppliers can lead to situations of contractual conflicts and tensions, resulting in the transfer of excessive risks or costs or the imposition of unfair trading practices to suppliers. To tackle these situations, which do not involve anti-competitive practices implying harm for consumers and, consequently, do not fall under the scope of EU and most of the national competition rules of Member States, some NCAs have proposed alternative solutions..."

retailing market either. Competition authorities have considered that retail markets are generally competitive based on a comparison of grocery price indexes and supermarket net operating margins with general and third-sector indexes, overlooking a raft of indirect (structural) evidence and even direct evidence suggesting the existence and exercise of retail market power. Therefore, conventional competition policy has been limited to merger control (i.e., ensuring that single dominant positions, measured by high market shares, do not emerge in local markets) and competition advocacy (i.e. removal of legal barriers to entry and expansion)³¹.

The conceptual and methodological distinction between seller power and buyer power/bargaining power (i.e., demand competition v. procurement competition) is an exceptional departure from the underlying economic foundations of competition policy. Moreover, the assessment of competition in the grocery retail market on the basis of industry-wide accounting ratios and price indexes is close to a paranormal event³². As a rule, competition authorities reject the use of profitability ratios and pricing information in the assessment of seller dominance/significant market power in favour of indirect (structural) evidence. The grocery retail sector is probably the only economic sector where this rule is reversed. This raises a dilemma: either the competition analysis conducted for many years in all the economic sectors has been utterly flawed or the *ad hoc* competition analysis applied in the field of grocery retailing is out of touch with reality and standard competition policy.

³¹ It seems difficult to reconcile a finding of intense retail competition with a call to remove legal barriers to entry and expansion.

³² See Appendix 8.1.

4 Evolutionary competition analysis

In a recent development, some competition authorities have questioned some of the conclusions of the mainstream conventional competition analysis regarding supermarket power, while respecting its foundations.

The UK Competition Commission has been the precursor of this evolutionary movement. Its UK Grocery Reports 2000 and 2008, elaborated under pseudo-regulatory powers, called for remedies in the procurement and retail markets and have marked the way for other competition reports and regulatory initiatives³³. In line with the conventional analysis, the UK Competition Commission has considered that the one-stop grocery shop market is broadly competitive and that, overall, excessive prices are not being charged, nor excessive profits earned³⁴. In any event, it has found high and persistent concentration in some local markets for one-stop grocery retailing, calling for structural and behavioural remedies in the retail markets³⁵. Furthermore, the UK

³³ Competition Commission, “Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom”, 10.10.2000 and “The supply of groceries in the UK market investigation”, 30.04.2008. The UK Competition Report 2000 found that the leading supermarkets formed a complex monopoly. Under section 6(1)(c) and (2) of the Fair Trading Act (FTA) 1973 was taken to exist when at least one-quarter of all the goods of a particular description which are supplied in the UK are supplied by or to members of one and the same group consisting of two or more persons (not being a group of interconnected bodies corporate) who, whether voluntarily or not and whether by agreement or not, so conduct their respective affairs as in any way to prevent, restrict or distort competition. The Enterprise Act 2002 replaced the scale and complex monopoly provisions of the FTA 1973 with a new regime for market investigations. Such investigations are likely to focus on competition problems arising from un-coordinated parallel conduct by several firms or industry wide features of a market in cases where the Office of Fair Trading (OFT) does not have a reasonable suspicion of breach of the Competition Act. The UK Grocery Report 2008 was conducted under the new regime.

³⁴ The UK Grocery Report 2008, Final Report, Summary, par. 2: “We found that, in many important respects, competition in the UK groceries industry is effective and delivers good outcomes for consumers, but not all is well”. See, also, the UK Grocery Report 2000, Summary and Conclusions, par. 1.13: “Taking all the above matters into consideration, we are satisfied that the industry is currently broadly competitive and that, overall, excessive prices are not being charged, nor excessive profits earned.”

³⁵ See, for example, the UK Grocery Report 2008, Final Report, Summary, par. 2: “We have concerns in two principal areas. First, we found that several grocery retailers have strong positions in a number of local markets. Barriers faced by competing grocery retailers that could otherwise enter these markets mean that consumers get a poorer retail offer in terms of prices, quality and service than would otherwise be the case, while those grocery retailers with strong local market positions earn additional profits due to weak competition in those markets”; and par. 4: “We are taking a number of steps to address the problems that we identified. We are recommending to Government and the devolved administrations that a competition test be applied, as part of the planning process, to proposed new stores (and proposed extensions to existing stores). The competition test will favour new entrants and grocery retailers other than those which already have a significant local market share. We will also require grocery retailers to relinquish control over landsites in highly-concentrated markets that we have identified as inhibiting entry by competing retailers. Further, we will be limiting the ability of grocery retailers to prevent land being used by their competitors in the future”. See also, UK Grocery Report 2000, pars. 1.13-1.15. On 2 October 2009, the Competition Commission announced its new decision on the Competition Test following further work undertaken after an appeal launched by Tesco in July 2008

Competition Commission has verified that the three market conditions (high concentration and monitoring of deviations, a punishment mechanism and absence of outside constraints) that facilitate tacit collusion are present in the UK grocery retailing market, even though it considered that retailers would have to focus their parallel behaviour on a narrow set of products and no evidence has been found of it actually happening³⁶. However, the most significant departure from the conventional analysis refers to the so-called procurement market. In its UK Grocery Report 2000, the Competition Commission found that the five leading supermarkets (i.e., Asda, Safeway, Sainsbury, Somerfield and Tesco), each having at least an 8 per cent share of grocery purchases for resale from their stores, had sufficient buyer power that 30 of their practices adversely affected the competitiveness of some of their suppliers and distorted competition in the supplier market—and in some cases in the retail market—for the supply of groceries³⁷. As a remedy, the UK Competition Commission considered that any supermarket meeting the 8 per cent criterion should be required to give undertakings to comply with a Code of Practice addressing the anticompetitive practices identified in the Report and providing for independent dispute resolution. The Competition Commission trusted the retailers and representatives of suppliers with the drafting of the Code, subject to the approval of the OFT. As a corollary, the Supermarket Code of Practice entered into force in 2002. The UK Grocery Report 2008 has gone further than its predecessor. Despite stating that buyer power in principle benefits consumers, it has singled out the dangers for the competitive process and, ultimately, consumers, of an excessive transfer of risks from supermarkets to suppliers³⁸. Therefore, the UK Competition Commission has expanded the scope³⁹ and

and a remittal by the Competition Appeals Tribunal to undertake further analysis. The Government has not taken further action yet.

³⁶ The UK Grocery Report 2008, Final Report, pars. 8.20-8.41. In particular, par. 8.40: “Our review of the conditions necessary for tacit coordination to arise and be sustainable suggested that these conditions may be present in UK grocery retailing. However, it may be that sustaining coordinated conduct over thousands of differentiated products or choosing a smaller group of products on which to coordinate would be sufficiently complex to prevent the emergence of tacit coordination. Further, we have not seen evidence of large grocery retailers engaging in parallel behaviour with respect to prices. As a result, we did not find that grocery retailers were engaged in tacit coordination. However, we are concerned that, given the structure of the grocery retailing market, such behaviour could occur in the future.”

³⁷ The UK Grocery Report 2000, Summary and Conclusions, pars. 1.10.-1.11.

³⁸ The UK Grocery Report 2008, Final Report, Summary, pars. 36-37: “36. Grocery retailers’ buyer power is of benefit to consumers since part of the lower supplier prices arising from this buyer power will be passed on to consumers in the form of lower retail prices. We did not find that the financial viability of food and drink manufacturers was under threat as a result of the exercise of buyer power by grocery retailers. However, the transfer of excessive risks or unexpected costs by grocery retailers to their suppliers is likely to lessen suppliers’ incentives to invest in new capacity, products and production processes. We concluded that, if unchecked, these practices would ultimately have a detrimental effect on consumers. 37. We concluded that the principal manner in which excessive risks or unexpected costs could be transferred from grocery retailers to suppliers was through retailers making retrospective adjustments to the terms of supply. We also concluded that there were circumstances where allocations of risk may be agreed up-front between a retailer and supplier, but that the extent of risk transferred to the supplier was excessive. We also have concerns regarding the transfer of risk from grocery retailers to suppliers where, as a result, the retailer has less incentive to minimize that risk”.

³⁹ There is a £1 billion turnover threshold that covers in practice all supermarkets that exceed the 2% market share threshold.

the substance of the re-named Grocery Supply Code of Practice (“GSCOP”), and proposed a regulator with enforcement and fining powers (i.e., the “Ombudsman”, now called “Adjudicator”)⁴⁰. The improved rules cover all the stages in the supply contract and can be summarized as follows:

- (1) Overarching principle: fair dealing⁴¹.
- (2) Access Terms:
 - a. Form: agreements and amendments must be in written⁴² and retrospective adjustments to supply terms are forbidden⁴³.
 - b. Delivery: changes to supply procedures in the course of a supply contract will follow a reasonable notice and give rise to compensation⁴⁴ and suppliers will be compensated for supermarkets’ forecasting errors⁴⁵.
 - c. Contracting with third parties: contracting with third parties can only be imposed on suppliers subject to strict conditions that exclude financial payments from third parties to retailers⁴⁶.
 - d. Wholesale promotional prices: supermarkets must calculate on a transparent basis the quantities ordered at promotional prices and cannot over-order with the purpose of selling at higher retail prices⁴⁷.
 - e. Payment: supermarkets must pay within a reasonable time⁴⁸.
 - f. Termination: delisting must follow a reasonable notice and a legitimate business purpose⁴⁹.
- (3) Access Fees
 - a. Listing fees are forbidden except for the launch of innovations and yet subject to stringent conditions⁵⁰.
 - b. Supermarkets cannot impose payment for marketing costs⁵¹.

⁴⁰ The UK Grocery Report 2008, Final Report, Summary, par. 5: “We will be tightening the provisions of the Supermarkets Code of Practice and broadening its application such that more grocery retailers will be required to abide by its terms. We will also be seeking legally binding commitments from grocery retailers to establish an Ombudsman to oversee the revised Code. If we cannot secure suitable undertakings from these grocery retailers, we recommend that Government takes the necessary steps to facilitate the establishment of the Ombudsman.” Supermarkets did not accept the creation of the Ombudsman and the Government published a draft Groceries Adjudicator Bill on 24 May 2011. Following a Parliamentary discussion, the Groceries Code Adjudicator Act entered into effect on 25 April 2013. The relevant features of the Groceries Code Adjudicator Bill are discussed in Section 7.1.5.

⁴¹ UK GSCOP, Schedule 1, Part 2.2 (*Principle of fair dealing*).

⁴² *Id.*, Part 1.6 (*Duty to provide information to Suppliers*).

⁴³ *Id.*, Schedule 1, Part 3.3 (*Variation of Supply Agreements and terms of supply*).

⁴⁴ *Id.*, Schedule 1, Part 3.4 (*Changes to supply chain procedures*).

⁴⁵ *Id.*, Schedule 1, Part 4.10 (*Compensation for forecasting errors*).

⁴⁶ *Id.*, Schedule 1, Part 4.11 (*No tying of third party goods and services for Payment*).

⁴⁷ *Id.*, Schedule 1, Part 4.14 (*Due care to be taken when ordering for Promotions*).

⁴⁸ *Id.*, Schedule 1, Part 4.5 (*No delay in Payments*).

⁴⁹ *Id.*, Schedule 1, Part 4.16 (*Duties in relation to De-listing*). It is not clear whether delisting of an independent grocery brand in favour of a supermarket brand qualifies as a genuine commercial reason.

⁵⁰ *Id.*, Schedule 1, Part 4.7 (*Limited circumstances for Payments as a condition of being a Supplier*). Payments will only relate to “Grocery products which have not been stocked, displayed or listed by that Retailer during the preceding 365 days in 25 per cent or more of its stores, and reflects a reasonable estimate by that Retailer of the risk run by that Retailer in stocking, displaying or listing such new Grocery products”.

- c. Supermarkets cannot seek payments for better shelf positioning⁵².
- d. Supermarkets cannot force suppliers to finance predominantly retailers' promotions⁵³.
- e. Supermarkets cannot impose payments/deductions for such things as shrinkage⁵⁴ or wastage⁵⁵.
- f. Supermarkets can only claim compensation for justified customer complaints and following a specified procedure⁵⁶.

Overall, the GSCOP is a rigorous and sound attempt to reconcile supermarkets' power with economic efficiency and free competition in the grocery supply chain. However, it still suffers some loopholes (e.g., the clear title "no contribution to marketing costs" is developed with a confusing wording and the issues surrounding delivery terms and disputes are not addressed). Furthermore, it is surprising that the UK Competition Commission did not consider that supermarkets' buyer power and ability to transfer excessive risks to suppliers affects their incentives to guarantee competition on the merits between independent brands and their own brands⁵⁷.

Following the trail blazed by the UK Competition Commission, the Spanish Competition Authority adopted a Grocery Report ("the Spanish Grocery Report") in October 2011⁵⁸. The Report distinguished monopsonistic buyer power from bargaining power (relative strength of the parties), and identified buyer power with the latter: whereas the analysis of buyer power is appropriate in commodity markets with a single price, the analysis of bargaining power is more appropriate for the grocery market, where a limited number of suppliers and retailers bilaterally negotiate and contract with

⁵¹ *Id.*, Schedule 1, Part 4.6 (*No obligation to contribute to marketing costs*). The clear-cut title is developed with a confusing text. Supermarkets may argue that the prohibition of marketing fees does not apply as long as they are provided for in the original supply contract. This interpretation would conflict with the spirit of the provision.

⁵² *Id.*, Schedule 1, Part 4.12 (*No Payments for better positioning of goods unless in relation to Promotions*).

⁵³ *Id.*, Schedule 1, Part 4.13 (*Promotions*).

⁵⁴ *Id.*, Schedule 1, Part 4.7 (*No Payments for shrinkage*).

⁵⁵ *Id.*, Schedule 1, Part 4.8 (*Payments for wastage*).

⁵⁶ *Id.*, Schedule 1, Part 4.15 (*No unjustified payment for consumer complaints*).

⁵⁷ The UK Grocery Report 2008, Final Report, par. 5: "9.73 It was suggested to us that, in occupying both these roles, grocery retailers enjoyed significant competitive advantages in their capacity as suppliers of own-label ranges, through their ability to control branded product manufacturers' access to market, the prices at which those branded goods were sold and their rates of sale (through shelf position and size), as well as the availability of opportunities for in-store communications and promotions. In addition, it was suggested that retailers were in a position to demand access to commercially-sensitive marketing and product information ahead of a product's launch, which could then be used by those retailers in the development of their own-label products. The exploitation by retailers of such a position could, in theory, reduce the ability of brand owners to realize a return on product innovation, and might lead to lower levels of investment into new products in the future"; and "9.81 We concluded that the sale of own-label products by grocery retailers does not give rise to an AEC". If the Competition Commission had applied the standard of proof to the effects of the excessive transfer of risks as the one applied to the effects of the discrimination of independent brands, no remedy would have been imposed at all.

⁵⁸ Comisión Nacional de la Competencia (now, Comisión Nacional de los Mercados y la Competencia), "Informe sobre las relaciones entre fabricantes y distribuidores en el sector alimentario", 5.10.2011 (hereinafter, "The Spanish Grocery Report").

each other⁵⁹. It also identified the factors that determine supermarkets' bargaining power over suppliers: (1) the size of the supermarket; (2) its gatekeeper role in respect of local markets; (3) the relative (economic) dependence of the supplier; (4) the supermarket's brand; (5) the competition between suppliers; and (6) consumers' loyalty to the store (as opposed to the grocery brand)⁶⁰. As far as the Spanish grocery retailing is concerned, the Report concluded that the presence of the six factors, plus the structure of retailing (i.e., prevalence of supermarkets with limited assortments) and the barriers to entry, afforded considerable bargaining power to the Spanish grocery retailers⁶¹. The Report also assessed the potential effects of this bargaining power and expressed several concerns⁶². First, in line with the conventional analysis, it acknowledged that the improvement of the purchasing terms obtained by the supermarkets is pro-competitive if "effective and sufficient" retail competition exists to guarantee that these improved terms are passed-on to consumers. However, based on the evolution of the net operating profits in grocery retailing, it suggested that the pass-on rate might be decreasing⁶³. Second, it noted that although the emergence of the supermarkets' brands may lead to cost savings and lower retail prices, it might also be accompanied by an artificial increase of the retail prices of competing independent brands, the net effect being uncertain⁶⁴. Third, it warned against the foreclosure of the non-leading brands in the medium-term and the risks of an explicit or tacit collusion between supermarket brands and leading brands⁶⁵. Fourth, it envisioned a reduction of retail competition in the longer term as a consequence of the waterbed effect⁶⁶. Fifth, it reckoned the reduction of independent brands' incentives and capacity to invest and innovate in the longer-term⁶⁷.

Then the Spanish Grocery Report focused on some widespread supermarket practices, which were unrelated to purchase prices and distorted competition in the grocery brands and retail markets⁶⁸. The Report assessed the competitive effects of the most notorious practices, among which: access payments, long credit terms, discriminatory category management, copycats and misuse of commercially sensitive information of independent brands, absence of written contracts, retroactive amendment of contracts, termination of contracts without due notice, most favoured customer clauses, mandatory contracting with third parties, and loss leading⁶⁹. Finally, the Report concluded that, in light of the market structure, the anticompetitive effects of the increased bargaining power of retailers were likely to outweigh any positive effects in the Spanish grocery

⁵⁹ The Spanish Grocery Report, Section II.4.1 ("Buyer power as bargaining power").

⁶⁰ *Id.*, Section II.4.2 ("Factors that influence bargaining power").

⁶¹ *Id.*, Section II.4.3 ("Bargaining power in Spain").

⁶² *Id.*, Section II.4.4 ("Consequences of the increased bargaining power of retailers").

⁶³ *Id.*, Section II.4.4.1 ("Improvement of retailers' purchasing terms").

⁶⁴ *Id.*, Section II.4.4.2 ("Saving in production costs").

⁶⁵ *Id.*, Section II.4.4.3 ("Reduction in inter-brand competition due to the foreclosure of some manufacturers in the medium-term").

⁶⁶ *Id.*, Section II.4.4.4 ("Reduction in intra-brand competition due to the significant advantages of large retailers vis-à-vis other retailers in the longer-term").

⁶⁷ *Id.*, Section II.4.4.5 ("Reduction of the manufacturers' incentives and capacity to invest and innovate in the longer term").

⁶⁸ *Id.*, pars. 176-179.

⁶⁹ *Id.*, Section III.3.

retailing⁷⁰. Therefore, it made specific recommendations in respect of the most problematic practices⁷¹.

More recently, in January 2012, the Finnish Competition Authority published a Grocery Report (“the Finnish Grocery Report”) along the lines of the Spanish Grocery Report⁷². The Report exposed that several practices by retailers may be questionable for sound and effective competition and cited as examples, (1) the use of gratuitous marketing allowances⁷³, (2) the transfer of risks to suppliers⁷⁴ and (3) the discrimination in favour of retailers' own brands, facilitated by their control of category management⁷⁵.

A Report by the French Competition Authority on the grocery retailing market in the Paris town (hereinafter, “the Paris Grocery Report”) should also be added to this list of

⁷⁰ *Id.*, Section III.3.

⁷¹ *Id.*, Section V. (Conclusions), par. 379: “In Spain, several factors increase the risk of a net negative effect on competition and consumer welfare in the long-term as a result of the increased retailer power. The research conducted suggests that, as well as the growth of retailer brands at the expense of second and third manufacturer brands (which has also occurred in other countries), intra-brand competition may be weakening and the rate of innovation in the food industry also appears to have slowed down in recent years. Additionally, the survey conducted for the purposes of this Report indicates that large retailers are applying generally and simultaneously certain commercial practices. The above factors, combined with the competition restriction brought about by the persistence of legal barriers to entry and expansion of certain store formats, that constitute a barrier for the development of effective competition in this market, increases the said risk.”

⁷² See press release of the Finnish Competition Authority (FCA), “FCA study shows that daily consumer goods trade uses its buying power in several ways that are questionable for competition”, 10.01.2012.

⁷³ Press release of the Finnish Competition Authority (FCA), 10.01.2012: “The majority of the suppliers who responded to the FCA’s questionnaire do not feel that they obtain any value for the marketing allowance they have paid other than the opportunity to be included in the retailer’s product categories. It is the view of the industry representatives that, frequently, the value offered in return for the marketing allowance is not agreed upon. Gratuitous marketing allowances may induce price increases because suppliers seek to pass on all their cost increases to purchase prices. The practice is particularly harmful for the entry of new businesses and hence the competitive situation in the entire field. In addition, gratuitous allowances may have a wider impact on the weakening of price competition in the field.”

⁷⁴ *Id.*: “The study explored several ways in which retailers transfer their own risk to suppliers. Repurchase requirements for unsold products are the most common way. For example, of the respondents in the bakery and pet food industries, three-thirds announced that they had met with repurchase requirements from the retailers. With such a transfer of risk, the increased uncertainty typically results in production cuts and pressure to increase prices. The suppliers’ willingness to innovate may also decrease. In addition to suppliers, the transfer of risk may also have an impact on those competing actors at the retail level who are in a weaker position: if one retailer succeeds in transferring risks to the supplier, this may result in the supplier seeking to obtain better conditions when negotiating with relatively weaker retailers. This may have impacts which further undermine the position of the weaker actors (so-called waterbed effect).”

⁷⁵ *Id.*: “The increase in the number of private label products benefits consumers because it increases product variety and lowers prices. However, problems may occur in the long run, as the retailers have such a strong position in category management and pricing. Moreover, as a manufacturer of private label products, a retailer is able to obtain better information about new brand products, in addition to which they have better information than before about the cost structure of products. All this further reinforces the strong position of retail in relation to suppliers. According to the suppliers’ responses, retailers often price brand products above private label products. According to the study, this phenomenon and the possible competition distortions created by it could possibly be prevented by the suppliers’ maximum resale price maintenance. However, it is difficult to present tenable estimates about the possibilities and incentives of the supplier level to include conditions on maximum resale price maintenance into the agreements.”

reports by competition authorities that offer a fresh re-appraisal of supermarkets' power⁷⁶. The Paris Grocery Report found that Casino, the leading supermarket in the Paris town⁷⁷, was able to distort competition in that local market, even though its market share nationwide was modest. The Report noted that (1) Casino was able to charge more for independent brands, while ensuring a competitive pricing for its own brands⁷⁸; and (2) increased competition in local areas reduced Casino's net margins⁷⁹, but was not reflected in lower retail prices by Casino⁸⁰; and (3) the present net margins of the buying organizations and retailers of the Casino group made retail price reductions possible, were the Casino group to face increased retail competition⁸¹. The Report highlighted that the legal and economic barriers made entry and expansion of large supermarkets very difficult, whereas the growth of the smaller formats has been led by Casino itself. In light of the above the Report made three recommendations: (1) the suppression of legal barriers to large supermarkets⁸²; (2) the limitation of the franchising agreements (i.e., 5-year maximum periods) of the Casino network as well as the suppression of non-compete post-contractual clauses⁸³; and (3) the adoption of laws

⁷⁶ Autorité de la Concurrence, Avis n° 12-A-01 du 11 janvier 2012 relatif à la situation concurrentielle dans le secteur de la distribution alimentaire à Paris.

⁷⁷ According to the Paris Grocery Report, Casino's market share in the Paris town exceeded 50% and it was significantly higher in many of the town's administrative areas ("quartiers").

⁷⁸ The Paris Grocery Report, pp. 38-40 ("*a*) *Des prix élevés pour les produits de marque nationale, des prix compétitifs pour les produits à marque de distributeur*"). The Report noted that this pricing strategy responds to a profit maximization strategy that sidesteps consumers' preferences. See par. 136: "Ensuite, les marques de distributeur peuvent représenter une part importante du chiffre d'affaires des magasins *Franprix*, non du fait de la préférence intrinsèque des consommateurs pour ces produits, mais parce que les prix élevés des produits de marque nationale dans les magasins *Franprix* contraignent les consommateurs à acheter des marques de distributeur. De fait, le positionnement commercial choisi par Casino peut répondre à son propre objectif de maximisation des profits – les marges des distributeurs sont fréquemment plus élevées sur les produits à marque de distributeur que sur les produits de marque nationale – et non aux souhaits des consommateurs: la concurrence étant structurellement limitée sur le marché parisien du fait du poids important des magasins du groupe Casino, celui-ci est en effet en mesure de s'abstraire des préférences des consommateurs et de la concurrence. A l'inverse, une concurrence plus forte pourrait contraindre le groupe Casino à réduire les prix de ses produits de marque nationale."

⁷⁹ The Paris Grocery Report, pp. 42-43 ("*b*) *Une plus grande concurrence locale diminue les résultats nets des magasins *Franprix**").

⁸⁰ The Paris Grocery Report, pp. 38-40 ("*a*) *Une plus grande concurrence locale n'a, à ce jour, qu'un effet très limité sur les prix de détail des magasins *Franprix**").

⁸¹ The Paris Grocery Report, pp. 40-41 ("*b*) *Des niveaux de marge qui rendraient possible une diminution des prix si la concurrence était plus intense*"). The Report noted that the incentives to lower prices are undermined by demand (i.e., consumers favour proximity over price savings) and offer considerations (i.e., high concentration increases the risks of cannibalisation between stores of the same Group. See par. 144: "L'impact limité, à ce jour, de la concurrence sur les prix des magasins *Franprix* provient plus vraisemblablement de la faible étendue des zones de chalandise et de l'omniprésence du groupe Casino dans les quartiers parisiens. En effet, compte tenu des paniers d'achat limités des consommateurs parisiens, une part significative de la clientèle choisit son magasin moins en fonction du différentiel de prix avec les magasins concurrents (faible en valeur absolue) qu'en fonction de la distance à parcourir. Par conséquent, une baisse des prix pour contrer la présence d'un magasin ou de plusieurs magasins concurrents pourrait n'attirer que peu de clients supplémentaires, alors qu'elle réduirait la marge réalisée auprès des clients qui fréquentaient déjà le magasin. De plus, compte tenu du maillage des quartiers parisiens, l'incitation des magasins du groupe Casino à réduire les prix pour attirer de nouveaux clients est naturellement faible : vraisemblablement, une forte proportion des clients qui seraient attirés par les prix bas d'un magasin *Franprix* proviendrait d'un autre magasin du groupe Casino."

⁸² The Paris Grocery Report, Recommendations, pars. 172-178.

⁸³ The Paris Grocery Report, Recommendations, pars. 179-184.

conferring new powers on the French Competition Authority to enforce *ex post* structural remedies (i.e., non authorisation of new stores or divestitures of existing stores in highly concentrated areas)⁸⁴. The Report considered that the first two recommendations, as well as the merger control regime, would only have a limited impact on the structure of the grocery retail market. Therefore, it concluded that only pseudo-regulatory powers aimed at increasing retail competition through store divestitures would ensure that supermarkets competed on prices and chose a product range that truly responded to consumer preferences.

Finally, a Report by the Italian Competition Authority has concluded that large retailers and their alliances enjoy increased market power over their suppliers and this market power is leading to practices such as trade spending (i.e., the amounts paid by suppliers to the large-scale retail channels so as to remunerate the promotional, distributive and sale services) that may undermining price competition at the retail level. This market structure and its performance call for a new consumer-welfare analysis based on middle-long term considerations and the enforcement of new regulatory remedies based on the concept of economic dependence: “Taking into consideration the increased market power of the large-scale retail channel as regards the buyer power, the Antitrust Authority will make use of all the intervention tools provided for by competition protection laws, evaluating possible anticompetitive effects on the consumer’s wellbeing not only from the viewpoint of a short-term period of time but also from the viewpoint of a middle-long term period. As regards the transfer of agricultural and agri-foodstuff products, besides the traditional tools (preventive assessment of concentrations, ascertainment and sanctioning of agreements and abuses), the Antitrust Authority has a new tool of intervention constituted by article 62 of law no. 27/2012, which enables it to sanction conducts which represent an illegal execution of contractual power on behalf of the demand detrimental to suppliers. Owing to this new power, complementary compared to those already provided for by antitrust laws, the Authority will be able to intervene in order to protect public interest represented by the correct competition structure of the market when commercial relationships of vertical nature (not quantifiable as vertical agreements or as abuses of dominant position) between large-scale retail channels and suppliers produce indirectly “relevant” negative effects on said structure.”⁸⁵

⁸⁴ The Paris Grocery Report, Recommendations, pars. 185-195. So far, the French Competition Authority has not applied competition laws, including the stricter provisions on unilateral conduct (i.e., abuse of economic dependence), to supermarkets’ access and in-store practices vis-à-vis independent grocery brands. However, the Authority has investigated a supermarket group’s contractual provisions with their retail franchisees under the abuse of economic dependence provision (Décision n° 11-D-20 du 16 décembre 2011 relative à des pratiques mises en œuvre par Carrefour dans le secteur de la distribution alimentaire, which accepted commitments by Carrefour regarding its contractual provisions with franchisees). Again, the conventional competition analysis seems to be deeply ingrained even in the “evolutionary” mindset of the French Competition Authority.

⁸⁵ Autorità Garante della Concorrenza e del Mercato, “Indagine conoscitiva sul settore della Grande Distribuzione Organizzata”, 24.07.2013 and the press-release, “Agri-foodstuffs: the Antitrust Authority reports the strengthening of market power of the large-scale retail channel, conflictual relationships with suppliers and uncertain effects on consumers”. As a follow up to its report, the Italian

The Reports by the UK Competition Commission, the Spanish Competition Authority, the Finnish Competition Authority, the French Competition Authority and the Italian Competition Authority share some underlying principles. They concede that conventional behavioural competition rules (Articles 101 and 102 TFEU and/or their national counterparts) are not applicable to the supermarkets' practices vis-à-vis their suppliers, even though some of them may distort competition between grocery brands and between supermarkets in grocery retail markets characterised by high concentration and entry barriers and leave the door open to the application of general or sector-specific fair dealing rules against these practices⁸⁶.

Competition Authority announced the opening of infringement proceedings against a buying alliance on 12.12.2013: "GDO: Antitrust avvia istruttoria nei confronti della supercentrale d'acquisto 'Centrale italiana' e delle 5 catene distributive concorrenti per verificare l'esistenza di una possibile intesa, con potenziali effetti sia sui fornitori che sui consumatori". In particular, the Authority is concerned that the buying alliance is undermining its suppliers' competitiveness, forcing them to reduce product variety and quality, as well as innovation and investments. Furthermore, the Authority is concerned that the buying alliance reduces the incentives of its members to compete in the grocery retail markets.

⁸⁶ See ECN 2012, pars. 256-257: "256. Many NCAs have also focused on vertical relations between suppliers and retailers. Practices occurring in the framework of such relationships have in many instances not been considered to raise competition problems in the short term, but rather fall under the rules applicable to unfair trading practices. However, a few NCAs have also pointed out that in the long term certain commercial practices, if largely applied by retailers, may undermine the competitiveness of the food supply chain and have a negative impact in competition terms. In other cases, some NCAs have warned against the anti-competitive behaviours that may result from or be facilitated by certain practices and agreements in the retail sector. 257. In this context, practices such as commercial payments, category management agreements, most favourite client clauses, exchanges of sensitive commercial information, or own-label products have been subject to close consideration." The ECN 2012 reports the market studies that have expressed concerns regarding some of the supermarkets practices and would adhere to the evolutionary analysis. See, for example, the Grocery Report by the Portuguese Competition Authority ("Final Report on Commercial Relations Between the Large Retail Groups and their Suppliers" (Abridged English Version), October 2010), which suggested a Code of Conduct and the consideration of specific regulatory remedies, or the Grocery Report by the Austrian Competition Authority (2007), discussed below in note 424.

5 Modern competition analysis

Building on the evolutionary analysis of the supermarkets' practices advanced by some competition authorities, this Report proposes a fresh competition analysis that should fill the perceived gap between competition policy and supermarket power. Based on this new analysis, both regulatory and competition law remedies are explored.

5.1 The competitive impact of the new economic paradigm

As discussed in Section 2, the emergence of the one-stop model for grocery shopping has radically altered the balance of power in the grocery supply chain. This Section proposes a fresh analysis of the competition and consumer welfare implications of this new economic paradigm.

5.1.1 Supermarkets control access to/competition in their platforms

Supermarkets are no longer, if they ever were, neutral traders that convey consumer demand for a product to manufacturers. They offer services both to consumers and to grocery brands. On the one hand, they offer grocery shoppers a one-stop shop service under a distinctive brand⁸⁷. This differentiated service dilutes the relevance of the individual products purchased in consumers' store selection decisions⁸⁸. On the other hand, supermarkets offer access to their platforms to grocery brands and influence in-store competition between grocery brands for shoppers' preferences. Access to and competition within supermarket platforms are competitive variables under their control. These variables may be influenced by shopper demand but, increasingly, by supermarkets' own strategy and the demand for distribution services of grocery brands. Indeed, grocery brands compete to influence supermarkets' assortment and in-store

⁸⁷ Likewise, retailers claim that they have also transcended the role of "outlet" to become service providers to end-consumers. See, for example, Commission staff working document, "Competition in the food supply chain", accompanying document to the European Commission "A better functioning food supply chain in Europe", SEC(2009) 1449, 28.10.2009, p. 13: "In light of an often exacerbated political debate, the retail sector has frequently been under the spotlight as the sector where the profit margins are allegedly highest, and where the most substantial amount is added to the formation of the final consumer price [footnote: According to representatives of retail sector, it should be recalled however that modern retailers are more than simple outlets in the sense that they add value as service providers through promotional and marketing activities, information to consumers, investment in customer proximity services, and innovation on new products. Such services incur costs and it is understandable, from a business perspective, that these costs are reflected to a certain extent in consumer prices. For example waste and shrinkage costs are often high in modern retail outlets.]"

⁸⁸ Pine and Guilmore, *The Experience Economy*, Harvard Business School Press, Boston, 1999. The book presents an imaginative view of the way in which a society matures. The authors explain that economies evolve from reliance on the production and marketing of commodities to the sale of differentiated products, then to the sale of services, and ultimately to the sale of experiences (including those that transform customers). At each stage, there is a dramatic increase in the value, and hence the price, of what is offered.

competition strategies, evidencing that supermarkets may influence shopper demand for their products even more than the other way round.

As a consequence, the traditional view of supermarkets as traders leaves room to a new economic paradigm in which the services offered by supermarkets to grocery brands transcend and are more important than the trading relationship. These services may be very different in nature and scope, and the formal transfer of ownership of the grocery product is becoming less and less relevant:

First, supermarkets may rent shelf space and other distribution services to suppliers without performing a retail function (i.e., taking up property of their goods)⁸⁹. Independent online supermarkets such as “Alice” or “Amazon” predominantly follow this “wholesale access” (market-place) model, also prevailing in brick and mortar shopping malls/centres, leaving grocery brands free to contract directly with online grocery shoppers⁹⁰. In this market-place scenario, supermarkets operate exclusively as ‘sellers’ of services to consumers and grocery brands.

Second, supermarkets may tender supplies of both own-brands and independent brands in many categories⁹¹, prices being only one of the several factors considered⁹². These

⁸⁹ Hagiu, “Merchant or Two-sided Platform”, Harvard Business School Working Paper 07-093, 2007, p.13: “It is interesting to note a straightforward parallel between the third-party, digital storefronts on Amazon.com in the online world and the Wal-Mart’s practise of renting out shelf space to some of its suppliers in the brick and mortar world. Indeed, instead of buying all products and reselling them, thus effectively taking ownership, Wal-Mart rents shelf-space to some suppliers such as Kellogg and Coca-Cola. These suppliers are responsible for stocking, displaying, pricing and advertising their merchandise, within the space allocated by Wal-Mart. The efficiency gains come from providing suppliers with incentives to use price, advertising, and display to maximize profits, part of which Wal-Mart can extract through higher rents. On the other hand, some efficiency is lost because suppliers do not fully internalize the effects of their in-store actions on other suppliers (cf. section 4). And Kellogg, Coke and others are more than a little interested in the traffic Wal-Mart generates, since this determines how many consumers are likely to stop by their stands and eventually buy their products. It makes sense to think of them as “on board” the Wal-Mart two-sided platform.”

⁹⁰ In the remedies section of this Report it is suggested that public authorities should clarify the boundaries between the provision of distribution services to independent brands and retail activities (Section 7.1.1).

⁹¹ UK Competition Commission, “Completed acquisition of the frozen ready meals business of Headland Foods Limited by Kerry Foods Limited”, Provisional Findings, 25.10.2011, p. 19: “7.4 FRM suppliers tend to win business through tender processes. The evidence we received from customers suggested that the degree of formality of tender processes varied considerably and that resulting agreements to supply were also of varying degrees of formality; in some cases, fixed-term multi-year contracts were agreed for supply of FRM, whilst at the other extreme the large supermarkets entered agreements for ongoing supply for which notice—typically of around 13 weeks— could be given by either side”.

⁹² *Id.*, footnote 3 (summary of a conference call with Tesco), p. 7: “4. Tesco said it took account of many factors in deciding which companies to invite to tender to supply FRMs. Tesco said it was a volume operator and FRM suppliers had to have the potential to be able to supply high volumes consistently over time. [%]. 5. It said that tenders tended to be [%] where a comparison was made on quality and cost as well as other factors such as service provision, geographical location, scale, and financial viability. [%]. Tesco said that it had some knowledge of providers, but it would sometimes be contacted by new prospective suppliers, including from over- seas; these tended to be European because of supply chain considerations. Tesco said it had a preference to maintain existing relationships; it said that there was always a cost to moving business, and it tended to encourage long-term relationships in its supply base”. Indeed, sourcing functions (procurement and all other functions associated with it), are supermarket-driven as evidenced by WorldWide Retail Exchange (WWRE) and GlobalNetXchange (GNX), two firms

auction markets are under control of the supermarkets and the latter provide access to their platform through auctions. Therefore, supermarkets essentially allow access to their platform only to the successful bidders.

Third, even if supermarkets formally purchase the grocery product of their choice at the end of a bilateral negotiation with the supplier of a grocery brand, they may also offer a wide array of remunerated services to the supplier, up to a point where the purchase price is considered to be ancillary to the remunerated distribution services provided by the supermarket⁹³. These services, identified under different and ever changing names (e.g., “logistic services”, “listing services” and “in-store services”)⁹⁴, form part of the supermarkets’ general terms and conditions of access to the supermarket platform⁹⁵, and

founded by retailers (e.g., Tesco and Ahold) which merged into Agentrics in 2005 (www.agentrics.com). This firm claims to represent more than half of the world’s top 25 retailers and provides retail label, sourcing (including auctions) and supply chain services. See, regarding Carrefour’s and Metro’s online marketplace sourcing strategies, Kyvik, Geloso and Pinali, “Market structure in the distribution sector and merchandise trade”, Working Party of the Trade Committee, OECD, TAD/TC/WP(2007)16/FINAL, 1.02.2008, p. 42: “Contracts with suppliers at the global level are assigned transparently through electronic marketplaces like Argentrics, where in 2005 Carrefour conducted 10,000 auctions in 18 countries with a base of 24,000 suppliers. Carrefour’s sourcing strategy aims to strengthen its commercial dynamics through price roll backs to leverage economic scale. The auction system combined with non-food sourcing in China and the other buying offices is designed to cluster consumer needs through store segmentation according to the local purchasing power”; and p. 46: “Metro is also a member of the Argentrics online B2B group in which suppliers are invited to compete in online auctions for procurement contracts. In 2004, €1.45 billion of Metro’s €46 billion procurement spending was through Argentrics and continues to rise.⁵² These strategies have the potential to decrease the number of suppliers in the system, and offer increased market access opportunities for those suppliers that are able to perform.”

⁹³ For a dramatic example of the day-to-day operation of access fees, the reader is referred to the wealth of evidence uncovered by the French Competition Authority in the *Décision n° 07-D-50 du 20 décembre 2007* relative à des pratiques mises en œuvre dans le secteur de la distribution de jouets (“the Toys Decision”), and the growing number of judgments by French courts against payments demanded by supermarkets from suppliers, which do not remunerate any service or are disproportionate with regards to the service provided. See, for example, Judgment of 14.10.2009 of the Tribunal de Commerce d’Evry, *Ministre de l’Economie, de l’Industrie et de l’Emploi c. Carrefour Hypermarchés* (“the Carrefour Judgment I, 2009”); and, on appeal, Judgment of 2.2.2012 of the Cour d’Appel de Paris, *Carrefour Hypermarchés c. Ministre de l’Economie, des Finances et de l’Industrie* (“the Carrefour Judgment II, 2012”); Judgment of 7.09.2011 of the Tribunal de Commerce de Lille, *Ministre de l’Economie, de l’Industrie et de l’Emploi c. Eurauchan* (“the Auchan Judgment 2011”); Judgment of 29.10.2009 of the Cour d’Appel de Versailles, *Leclerc – Galec c. Ministre de l’Economie, des Finances et de l’Industrie* (“the Leclerc Judgment 2009”); Judgment of 24.10.2006 of the Tribunal de Commerce de Creteil, *Ministre d’Etat, Ministre de l’Economie, des Finances et de l’Industrie c. Système U* (“the Système U Judgment 2006”).

⁹⁴ See the different concepts mentioned in the Toys Decision (e.g., par. 64: “Les conditions régissant les marges arrière résultent de l’application, d’une part des contrats de coopération commerciale élaborés par les distributeurs, comprenant notamment des prestations de logistique, des services de centralisation et des services de mise en linéaire”). See also the judgments quoted in the previous footnote and, in particular, the Carrefour Judgment II, 2012 (“accords de partenariat”, including the following services: “plan de action par famille des produits”, plan de développement des performances” and “communication d’un plan d’implantation des produits par type de magasin”) and the Système U Judgment 2006 (“Action de construction et de diffusion du Tronc d’Assortiment Commun”).

⁹⁵ The use by supermarkets of general terms & conditions applicable to all suppliers, supplemented by individually negotiated agreements, is a practice common to all wholesale platforms (e.g., Internet operators such as Google, Amazon and eBay and media operators; and credit card networks). See the Toys Decision, pars. 65-118 and, in particular, par. 65: “Les GSA (Leclerc, Carrefour, Auchan, Cora et Casino), chez lesquels la plupart des fournisseurs sont référencés (à l’exception de Clementoni, Vulli et de Lego qui ne sont pas référencés par le mouvement Leclerc) disposent de contrats de coopération commerciale types applicables à tous leurs fournisseurs, qu’ils soient alimentaires ou non alimentaires.

the purchase of these services is a pre-condition to the supply agreement⁹⁶. Furthermore, even though supermarkets may break down these services into endless categories and create new ones if and when necessary, they can be grouped under the general umbrella of “access services” (i.e., access to the supermarket’s platform/customers)⁹⁷. Very

Ces contrats standardisés proposent un ensemble prédéterminé de prestations commerciales. Les changements de dénomination d’une année sur l’autre sont fréquents, de même que l’ajout de nouvelles dénominations”. See also above, footnote 93 and, in particular, the Carrefour Judgment II, 2012, p. 6: “D’ailleurs, la SAS Carrefour Hypermarchés met à disposition le modèle de contrat unique utilisé lors des négociations commerciales, des sorte que les actions sont engagées pour le compte de Carrefour Hypermarchés...”

⁹⁶ See, for example, the Carrefour Judgment II, 2012, p. 13: “Le dernier paragraphe de l’accord-type de partenariat précise que «les parties sont liées par le présent accord de partenariat et l’accord commercial. Ces deux contrats forment un ensemble indivisible». L’article 3-3 de l’accord de partenariat-type précise que “...sauf décision contraire et expresse de Carrefour la résiliation de l’accord commercial signé entre les parties entraînera automatiquement et simultanément la résiliation du présent accord de partenariat. De même la résiliation du présent contrat entraînera automatiquement et simultanément la résiliation de l’accord commercial”. The mechanics of the access fees imposed by supermarkets were comprehensively described in the Toys Decision. See, for example, pars. 71-74: “71. Les représentants de MegaBrands confirment que «ces contrats de coopération commerciale sont des contrats d’adhésion établis par les GSA. Avec les GSS, les négociations sont plus souples Il y a de nouveaux intitulés, à services constants. Nous sommes obligés d’accepter les contrats tels qu’ils sont. Les pourcentages globaux sont stables ». (procès-verbal d’audition établi le 5 mars 2007 – Cotes Pégase 36277 à 36289). 72. Les représentants du groupe Smoby soulignent : «nous souhaitons préciser que les contrats proposés par les grandes enseignes constituent pour les fournisseurs des contrats d’adhésion très difficilement modifiables » (procès-verbal d’audition établi le 12 février 2007 – Cotes Pégase 30129 à 30164). 73. Le représentant de Tomy déclare que si beaucoup de services changent ou sont créés tous les ans (surtout en 2004), « c’est le fait du distributeur prestataire de services. Nous cherchons à optimiser notre collaboration avec notre client et à vérifier que les services sont effectivement réalisés par le distributeur. Par ailleurs, certains services qui ne sont plus facturés, sont parfois encore rendus ». « Nous ne pouvons pas identifier précisément où sont les autres services car il y a eu de nombreux changements de noms de service en 2004 » (procès-verbal d’audition établi le 14 février 2007 – Cotes Pégase 37301 à 37316). 74. Les représentants de Vulli ont indiqué que «chaque distributeur propose un contrat type. Ils définissent leur budget puis le font par l’intermédiaire des services de coopération commerciale. Les dénominations varient mais l’objet est le même, améliorer leurs conditions d’achat. Parfois, le distributeur peut vous demander des conditions supplémentaires, même si votre chiffre d’affaires diminue, pour financer des promotions ou des publicités complémentaires ou des tickets promotionnels ». Ils ont ajouté: «il est inutile de reprendre distributeur par distributeur toute les remises car le fonctionnement général est identique quelque soit le distributeur : chaque année les contrats types sont ré-écrits par les distributeurs, spécialisés ou non, qui s’ingénient à trouver des services supplémentaires qui ne viennent jamais en diminution mais toujours en augmentation. Ils veulent améliorer leurs conditions d’achat par rapport à l’année d’avant, quel que soit le volume d’affaires et peu importe la dénomination des services. Même si légalement nous devrions vérifier la réalité des services rendus, nous ne pourrions pas nous opposer à la rémunération du service du fait de notre vulnérabilité dans les rapports de forces avec les distributeurs » (procès-verbal d’audition établi le 8 janvier 2007 – Cotes Pégase 27898 à 27903).” To be fair, a few powerful retailers known for their “everyday low price” strategy (e.g., Wal-Mart in the US and Mercadona in Spain) may forego listing fees. However, no one would question that they are able to dictate the terms under which suppliers may access their stores to reach their customers. For example, Mercadona delisted without prior notice more than 800 references in February 2009. These references included products in high demand and market leaders. In no case did Mercadona argue that the delisting responded to disagreement on the wholesale price.

⁹⁷ Independent grocery brands will tend to allocate a budget per supermarket to these access services. See, for example, the Toys Decision and, in particular, par. 68: “Les représentants de Goliath ont fait valoir, comme l’ensemble des fabricants de jouets, que la variable fondamentale était le montant global des prestations, dès lors que les services dont ils ont besoin en fonction de leur stratégie propre, sont effectivement rendus: « en fait, on a une enveloppe globale pour les conditions commerciales et on adapte les typologies de services et les rémunérations sous la contrainte de l’enveloppe globale. L’essentiel c’est que notre stratégie annuelle soit bien mise en place, quel que soit le taux individuel des

often, the access fees corresponding to these access services are not reflected in a reduction of the invoiced wholesale price, but charged separately by the supermarket or unilaterally deducted from the payments due to the supplier.

In short, access fees amount to a considerable portion of the suppliers' sales to each supermarket⁹⁸ and these fees may become more important than the retail competition and ensuing margins (i.e., retail margin = retail price - purchase price)⁹⁹.

Supermarkets' statements and practices evidence their new central role in today's economic relations with suppliers. A good testimony can be found in the letter of complaint sent to the European Commission's Directorate General for the Internal Market by the Slovak Trade and Tourism Association (member of Eurocommerce) against the draft Slovakian "Bill on Inappropriate Conditions in Commercial Relationships" among suppliers and trade companies¹⁰⁰. Even though the Bill, now in force, regulated as many as 12 retailer practices considered to be abusive per se¹⁰¹, the

prestations ou leur dénomination précise individuelle, en optimisant les outils offerts par le distributeur » (procès-verbal d'audition établi le 17 janvier 2007 – Cotes Pégase 28134 à 28148)."

⁹⁸ See, for example, OECD, "Roundtable on two-sided markets", Competition Committee, DAF/COMP/WD(2009)69, 28.05.2009, Note by the Delegation of the Russian Federation, p. 202: "During inspections conducted by the FAS Russia there was exposed that the retail price for products was formed not only basing on production cost and mark-ups at the distribution levels (producer's mark-ups, distributor's mark-ups, retail chain's mark-ups) but also substantially bears supplier's expenses related to additional payments in favour of retail networks and expenses for providing credit on goods to the retail networks (postponements of payments). Taking into account that the network trade mark-up for products constitute to minimum 10-15% (for many products a middle mark-up constitute to 30-40%), even at the minimum level of trade mark-up, total pressure to the final product price of all mark-ups and payments formed in retail networks, constitute from 20 to 60%, about half of the cost of goods. It should be noted that this practice is peculiar to the retail networks even with a share of the market less than 5%. It proves existence of substantial market power for relatively small-scale retail networks that is enough to influence the terms of product circulation on the neighbouring markets". See also OECD 2009a, Note by the Delegation of France, p.163: "Parallèlement, le niveau des «marges arrière», c'est-à-dire les différentes ristournes octroyées aux distributeurs et la coopération commerciale facturée aux fournisseurs, a également cru de manière rapide [note en bas de page: De 22% du prix des produits en 1999, elles passent à 33,5% en 2005 et 37% en 2006 (source : ILEC)], témoignant de l'échec de ces lois à encadrer l'exercice de la puissance d'achat".

⁹⁹ According to the French industry association ILEC, hidden margins (payments and deductions off-invoice) had increased up to 88% of the supermarkets' total grocery margins in 1999, the remaining 12% accounted for by "observable margins" (rebates on the invoice), in line with the growth of supermarkets' power (see *infra*, note 573). Likewise, the French Competition Authority's Toys Decision (cited *supra*, note 93) found that grocery retailers made almost no retail margin on sales of toys but imposed considerable access fees (hidden margins or "marge arrières") on toy suppliers.

¹⁰⁰ Letter dated 9.01.2008 from Pavol Konštiak (President of the Slovak Trade and Tourism Association) to Jean Bergevin, Head of Unit, Services II, Internal Market and Services Directorate-General, European Commission, reference "Slovakian Draft Act – Compliance with EU Laws, in particular Article 43 EC", available at the website of the Slovak Trade and Tourism Association, <http://www.biznis.sk/zakon-o-neprimeranych-podmienkach-v-obchodnych-vztahoch/> (visited on 25.10.2011).

¹⁰¹ Slovak Law 172/2008 on Inappropriate Conditions in Commercial relationships and on Supplementation of the Slovak National Council Act No. 30/1992 Coll. on the Slovak Chamber of Agriculture and Food Industry as amended, Article 1, Section 3 (2): "As an inappropriate condition in a the commercial relationship is also considered:

- a) the carrying out of controls of the premises of the producer or the supplier by the customer, including the demand of analyses and tests of goods when the validity of the document in respect of an official control issued by the competent state control authority, or by a licensed person, with the exception

complaint targeted primarily the statutory limitation of access fees paid by suppliers to retailers to a maximum threshold of 3% of their turnover with each retailer¹⁰², whilst at the time access fees ranged between 4 and 19% according to observers¹⁰³. The Association argued that these payments from suppliers were required by large retailers across the EU and reflected the modern economic relations between them:

“The Slovakian Government states in its Memo that supply relations “are characterized by a situation where hypermarkets and supermarkets, based on their independent market position, make a contract subject to terms that are clearly unfavourable for the other party, i.e. the supplier (...).” It becomes very clear from this very first page of the Memo that the Slovakian Government has a very determined view on the operations of trade companies. It also appears that the Government does not appreciate the modern and highly complex and sophisticated trade relationships among suppliers and modern traders.

However, modern supply relationships are the key to establishing modern supply chains, diversifying the offer of products for consumers and ultimately increasing quality and reducing prices for the consumer. The supply conditions referred to under Section 3 of the Draft Act

such case when he continues to sell the goods to the end consumer under his own brand name and assumes the obligations of the producer,

- b) the return of goods by the customer to the supplier at the supplier’s expense, without a legal reason,
- c) the obligation of an unjustified exchange of delivered goods at the supplier’s expense,
- d) the setting, in respect of delivered goods with minimum expiration date of shelf life or consumption, of the period for the performance of monetary obligation longer than 30 days after the day of service of the invoice for the delivered goods, issued according to a special regulation,
- e) the reduction in the agreed-upon price of goods in return for the payment of the monetary obligation prior to the period of maturity,
- f) the demand of an additional non-monetary performance to the participant in the commercial relationship after the handover and takeover of goods,
- g) the transfer of sanctions imposed by the control authorities on the participants in the commercial relationship to the other participant in this relation, without a legal reason,
- h) an immediate termination of a contract on recurrent performance, without a notice period and without a reason,
- i) the conditioning of the possibility to assign a receivable without a written substantiation of the debtor,
- j) the exclusion of the claim for default interests in case of the late performance of monetary obligation,
- k) the sale, at the supplier’s expense, of goods to the end consumer at a price that is lower than its production cost, or than the price agreed upon between the supplier and the customer, without agreement between the supplier and the customer,
- l) an additional reduction by the customer of the price agreed upon of delivered goods, without agreement with the supplier about the reason for the reduction of the price agreed upon.”

¹⁰² Slovak Law 172/2008 on Inappropriate Conditions in Commercial relationships and on Supplementation of the Slovak National Council Act No. 30/1992 Coll. on the Slovak Chamber of Agriculture and Food Industry as amended, Section 3, (1): “An inappropriate condition in the commercial relationship is the monetary performance

- a) for the inclusion of the supplier in the register of suppliers with the customer,
- b) for the inclusion of goods in the record of products sold by the customers, and the payment for operation of electronic equipment,
- c) for the use of the customer’s distribution network,
- d) for the placement of the supplier’s goods in a certain location in the customer’s the place of business without the supplier’s having asked for any certain placement of the goods, or
- e) of the supplier for the customer’s commercial activities,

if the total amount of money accounts for more than 3% of the supplier’s annual takings for the goods sold to an individual customer in a calendar year, if such monetary performance took place.”

¹⁰³ The Slovak Spectator, “New law tackles retail chains”, 21.04.2008, available at http://spectator.sme.sk/articles/view/31480/3/new_law_tackles_retail_chains.html (visited on 24.10.2011).

stipulate fees for services rendered by the trader to the supplier and/or commercially provide for cost and risk sharing required to develop new products and markets. Such income of modern traders is essential for modern supply structures and the respective income conditions are standard practise in Europe. Consequently, we are not trying to defend or establish a “Lex Slovakia” when protecting such income conditions as such supply relations are a commercial fact holding true internationally, i.e. standard international practice even in very regulated markets like France.

The creation of such income is part of the business model of modern trade both on the side of the trader and the side of respective suppliers. For modern trade such income is a material part of the total income, i.e. material for the total gross profit. No such trade company can afford to simply waive the claim for the income portion generated from such conditions as this accounts for a material portion of the overall margin and therefore is a factor for surviving.”

The European Commission itself has recognised this new economic paradigm in the framework of the retail market monitoring report and referred to retailers as providers of services to two types of customers: end-consumers and suppliers¹⁰⁴.

Fourth, if the services provided and charged to grocery brands are not sufficiently indicative of the supermarkets’ new role as service providers, one has to factor in supermarkets’ unilateral transfer of risks to grocery brands, to an extent that supermarkets *de facto* act as providers of (distribution) services to independent brands rather than as traders in grocery products:

(1) they demand non-agreed and/or retroactive payments and discounts from suppliers, including late payments that generate a positive cash flow (finance), thereby unilaterally amending their ongoing business relations with grocery brands according to retail market performance (or their own economic projections); and

(2) they transfer trading risks to their suppliers as if the latter were contracting directly with customers (e.g., shrinkage and wastage payments, customer complaints and in-store promotions).

¹⁰⁴ See Commission staff working document, “On Retail Services in the Internal Market”, accompanying document to the European Commission Report on Retail Market Monitoring: “Towards more efficient and fairer retail services in the Internal Market for 2020”, SEC(2010) 807, 5.7.2010, p. 6: “Retail services are provided to two different kinds of customers i.e. downstream customers who are final consumers of retail products and upstream customers who are suppliers of products. Whilst monitoring the retail service market, one has therefore to take into consideration these two distinct markets i.e. one market where retailers and consumers interact and another market where retailers and suppliers interact. [...]. In the upstream market, retailers provide suppliers with access to the consumer market. This access is provided and/or further facilitated through different services whether remunerated or not, depending on the business model involved. To the extent that these services are being provided by the retailer, they would include logistics i.e. transport and stocking (retailers also increasingly integrate the wholesale function), product display (real or virtual depending on the sales channel concerned) and product merchandising which may include different advertising and promotion (commercial communication) activities. The retailer may also offer market research services which aim to provide the supplier with information on the profiles of consumers purchasing his/her product in order to maximise promotional and advertising efficiency [footnote: The market intelligence that suppliers can collect via these channels is extensive. The monitoring of how consumers react to in-store promotions and the testing of differing types of promotions in differing local markets is common. Moreover, through the development of loyalty cards retailers can assist suppliers in targeting promotions to the particular categories of consumers that are of interest to them]”. The paper devotes substantial attention to grocery retailing.

Two practices are worth highlighting for they actually eliminate all trading risks: guaranteed margins¹⁰⁵ and return of unsold items or equivalent practices (e.g., supplier compensates the supermarket for taking care of unsold perishable items)¹⁰⁶.

All in all, nowadays, access to and competition within the supermarket is the decisive factor for independent grocery brands as opposed to the importance of the procurement price in a one-off supply agreement¹⁰⁷. Not even the brands traditionally thought to be must stock items are immune to this market reality¹⁰⁸.

¹⁰⁵ A guaranteed margin, a widespread requirement by retailers that up to know competition authorities associated with supplier-induced resale price maintenance, takes away all the trading risk in respect of fast moving consumer goods. See, for a highly illustrative example of the supermarkets' demands, increasingly focused on margins, note 671 (the Kerry/Breeo Judgment) and the Toys Decision, par. 218: "Un accord de coopération en date du 16 avril 2002 est rédigé comme suit (cotes Pégase 13170 à 13200): «les sociétés Carrefour et Lego ont décidé d'entamer en 2002 une nouvelle collaboration commerciale, intégrant les politiques commerciales des deux sociétés, basée sur les principes du category management, en vue d'un développement commun et profitable du chiffres d'affaires Carrefour-Lego. Objectifs 2002 : Carrefour et Lego se fixent ; un objectif de CAHT net facturé de 63000000FF pour l'année 2002 ; un objectif de marge avant brute de 27 % ; cette marge avant de 27 % étant calculée sur le CA HT net facturé 2002, hors produits soldés (c'est-à-dire à marge négative).... Prestations de service 2002 : pour une marge brute annuelle égale à 27 %, la société Lego rémunérera mes prestations des services (mentionnées ci-dessous) à hauteur de 7 % du CA net facturé 2002. Ce qui permet de répondre à la demande de rentabilité globale de 34 %. 2002 étant une première année d'apprentissage pour les deux sociétés, Carrefour et Lego conviennent d'une rémunération flottante, calculée en fonction de la marge avant atteinte et destinée à répondre à un objectif de rentabilité globale maximale de 34 %.... Ainsi par exemple, pour une marge avant de 25 %, les prestations de services seront rémunérées à hauteur de 9 % ; Pour une marge avant de 26 %, les prestations de services seront rémunérées à hauteur de 8 % ; pour une marge avant de 27 %, les prestations de services seront rémunérées à hauteur de 7 % ; pour une marge avant de 28 %, les prestations de services seront rémunérées à hauteur de 6 % ; pour une marge avant de 29 %, les prestations de services seront rémunérées à hauteur de 5 % ; et ainsi de suite...»."

¹⁰⁶ Kyvik 2008, p. 17: "The finished goods inventory risk has to a significant extent been transferred to the suppliers. For instance contracts between suppliers and retailers where retailers may return unsold units are not uncommon (Dobson et al, 2003)". See also Press release of the Finnish Competition Authority (FCA), 10.01.2012: "The study explored several ways in which retailers transfer their own risk to suppliers. Repurchase requirements for unsold products are the most common way. For example, of the respondents in the bakery and pet food industries, three-thirds announced that they had met with repurchase requirements from the retailers. With such a transfer of risk, the increased uncertainty typically results in production cuts and pressure to increase prices. The suppliers' willingness to innovate may also decrease." Even though the buy-back obligations have been associated with supermarkets' dealings with producers of agricultural products, even large multinationals supplying groceries and other goods to supermarkets may be subject to this obligation (see the Toys Decision, par. 265: "Les démarches sont aussi confirmées par Lego: «Dans le cas de demande de remboursements de la part d'un client suite à la campagne publicitaire de Carrefour, le magasin Carrefour ou la centrale contacte son interlocuteur chez Lego afin de faire le nécessaire auprès du concurrent qui pratique des prix moins élevés que chez Carrefour, soit nous menace de nous faire financer les remboursements. Faire le nécessaire signifie : s'assurer que nos recommandations ont été communiquées » (procès-verbal d'audition établi le 13 juillet 2004 – Cotes Pégase 11789 à 11794). Dans certains cas, Carrefour a obtenu de Lego qu'il rachète des produits en rayon. C'est ce que l'on peut constater dans l'historique du suivi des relations entre Carrefour et Lego en 2002 (Cotes Pégase 1806 à 1809 et 1833 à 1836).").

¹⁰⁷ Today, access to the supermarket and the competitive implications associated with it are much more important than the analysis of wholesale prices. Indeed, there is a growing body of economic literature assessing the pro- and anti-competitive effects of slotting fees, attesting the two-sided platform behaviour of supermarkets (see Appendix 8.3). See, for example, Shaffer, "Slotting Allowances and Optimal Product Variety", *Advances in Economic Analysis and Policy*, Volume 5, Issue 1, Article 3, 2005, p. 1: "The pace of new-product launches in recent years has contributed to making retail shelf space scarce, especially in the grocery industry. According to one industry analyst, "The typical supermarket

In summary, in the new economic paradigm, supermarkets can and do operate contractually or *de facto* as providers of distribution services (i.e., providers of wholesale-access or market-place services) to independent brands. They can impose on the latter the cost of: (1) delivery in pallets and crates of third parties (imposed by the supermarkets) to the individual stores or the provision by the supermarket of centralised delivery & warehousing services; (2) in-store replenishment¹⁰⁹; (3) in-store promotions and marketing activities; (4) product shrinkage; (5) consumer complaints; (6) guaranteed margins or wrong margin forecasts; (6) unsold items; and (7) positive credit terms.

In this new economic paradigm, the neoclassic model of buyer power with linear contracts collapses. Supermarkets now exploit strategically two competitive variables for independent grocery brands, i.e., access to and competition within their stores. Therefore, any competition analysis based on the classic supplier-merchant model with linear contracts (i.e., purchase price) is no longer valid¹¹⁰.

has room for fewer than 25,000 products. Yet there are some 100,000 available, and between 10,000 and 25,000 items are introduced each year". Retailers must choose among more product categories and more products per category than at any time in the past. This proliferation of new products has intensified competition among manufacturers for the limited store space. The scarcity of shelf space affects new and established products alike. In many instances, manufacturers are opting to pay retailers for their patronage with lump- sum money. Manufacturers of new products typically pay 'slotting fees' to secure a spot on a retailer's shelf and in its warehouse, while manufacturers of established products pay 'facing allowances' ostensibly to buy improved shelf positioning. End-aisle displays are paid for with 'street money,' and contributions to 'market development funds' help subsidize retailer advertising and promotional programs" and p. 3: "Manufacturers often compete to secure retailer patronage for the purpose of having their products distributed to final consumers. Obtaining access to retail shelf space is imperative in many consumer-goods industries, especially when the technology of distribution is such that it is prohibitively costly for a manufacturer to enter the downstream market to sell only its product. Shelf space is typically limited, however, and thus some manufacturers' products may be excluded. When this happens, two important questions are: will the 'right' products be excluded, and what effect will slotting allowances have on the retailers' choices? That is, do slotting allowances enhance social welfare by providing retailers with an efficient means of allocating scarce retail-shelf space (as some theories imply), or are there circumstances in which slotting allowances facilitate the 'wrong' products being sold? If the latter, what factors contribute to making this more or less likely?"

¹⁰⁸ For example, the media has reported temporary delisting of Coca Cola products by a US retailer and Unilever products by a Belgian retailer following commercial disputes. In Spain, Carrefour delisted the leading supplier of olive and vegetal oil for many years following a pricing dispute that sparked the intervention of the Spanish Competition Authority, who fined the supplier and other supermarkets for retail price maintenance. This and other evidence of supermarket power over leading grocery bands is discussed in Section 5.3.2.3.

¹⁰⁹ See Decision of 23.04.2010 of the Spanish Competition Authority, Case S/0161/09 *Empresas Reponedoras de Productos en Grandes Superficies*. The investigation found that shelf-replenishment may be carried out by a specialised company, by the supermarket or, rarely, by the independent grocery brand itself, but the cost of this service is always born by the latter. Furthermore, supermarkets are the ones who select these specialised companies, even though independent brands pay for their services. The case concerned a complaint by the Spanish food and drink industry against these specialised companies for parallel price increases to their customers (i.e., the independent grocery brands) but the Spanish Competition Authority considered that there was insufficient evidence to substantiate an infringement decision.

¹¹⁰ Marx and Shaffer, "Upfront payments and exclusion in downstream markets", RAND Journal of Economics Vol. 38-3, 2007, pp. 832-833: "We also contribute in this article to the literature on countervailing buyer power. Although this literature has had a long history (e.g., Galbraith, 1954; Stigler, 1954), there has been little formal modelling of the effects on competition when retailers have buyer

5.1.2 Supermarket brands compete with independent grocery brands

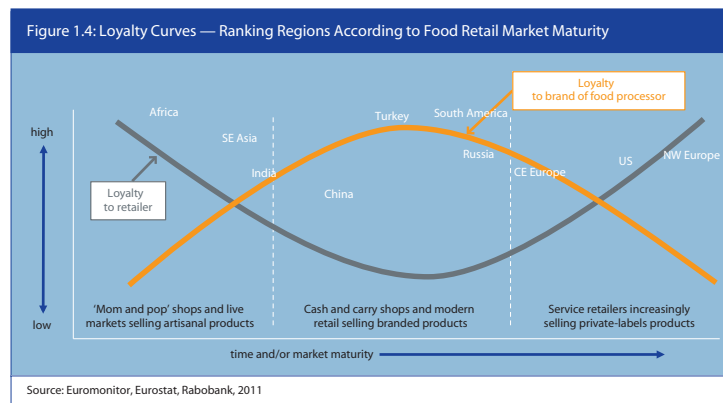
Supermarkets' control over access to and competition within their platforms have led them to promote their own grocery brands in order to compete head-on with independent grocery brands. Generally, supermarkets merely own the brand and the marketing assets and sub-contract production. The virtual nature of this vertical integration suggests that the goal of supermarkets is not so much to reduce transaction costs (since they have to sub-contract the production of their own brand and negotiate all the procurement prices and terms with manufacturers) but to exploit to the full extent their power over independent brands.

Accordingly, industry analysts see supermarket brands as a “push” market as opposed to a “pull” market¹¹¹. This means that the growth of these brands has more to do with mature concentrated markets (the prevailing market structure in developed economies) and the strategy of leading supermarkets within them, than with consumer demand for supermarket brands.

In mature markets, modern grocery retailing through one-stop shops is the prevailing retail channel for fast moving consumer goods. In these markets, one-stop grocery shoppers trust their supermarket of choice for their grocery shopping and are thus more loyal to the supermarket than to individual grocery brands.

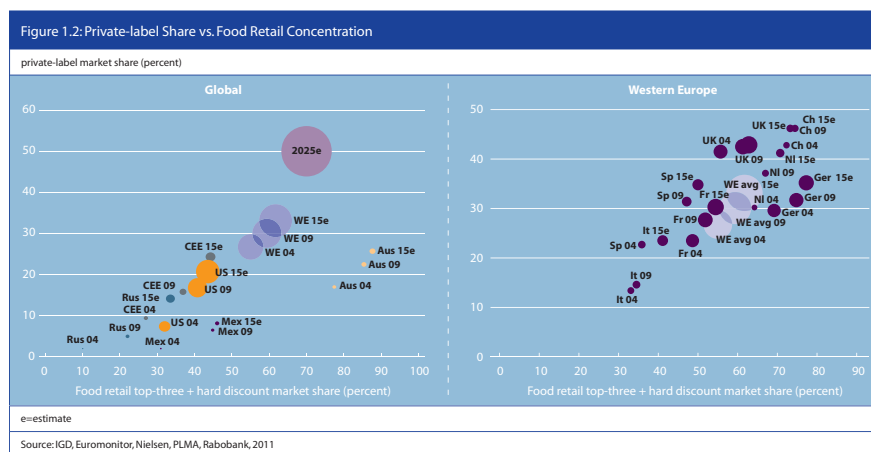
power. Early attempts such as Horn and Wolinsky (1988), Von Ungern-Sternberg (1996), and Dobson and Waterson (1997) restrict attention to linear contracts, where manufacturers always want higher per-unit prices and retailers always want lower per-unit prices. However, when nonlinear contracts are feasible, we find that retailers do not necessarily want lower per-unit prices. Instead, they may prefer to use their buyer power to negotiate upfront payments, which can be exclusionary”; and p. 830: “The fact that the overall joint payoff is not maximized when the downstream firms make the offers is not necessarily bad for consumer welfare if the failure arises because the retailers have used their buyer power to obtain lower wholesale prices (which would then likely be passed on to consumers in the form of lower retail prices). Indeed, pressure by “strong” buyers to keep upstream margins to a minimum is typically thought to be one of the main benefits to consumers of retailer buyer power. But this reasoning presumes that competition downstream is otherwise healthy, and that exit and entry in the downstream market is independent of the contract negotiations in the input market. When retailers make the contract offers, however, this presumption does not hold. Although this is not entirely surprising given that each retailer would prefer to be a monopolist, the “surprise” here is the helplessness of the manufacturer in preventing exclusion, the ease with which the “dominant” retailer can use its buyer power to induce exclusion, and the notable lack of any non-exclusionary equilibria.”

¹¹¹ See for a thorough analysis, Rabobank, “Private Labels v. Brands”, Rabobank International Food & Agribusiness Research and Advisory, 2011 (“Rabobank 2011”) and, in particular, p. 5: “The prime beneficiary of growth in private label is the food retailer. The private-label market is a ‘push’ market, meaning that the width and depth of the private-label offering is largely determined by the food retailer.”



Source: Rabobank 2011, p. 8.

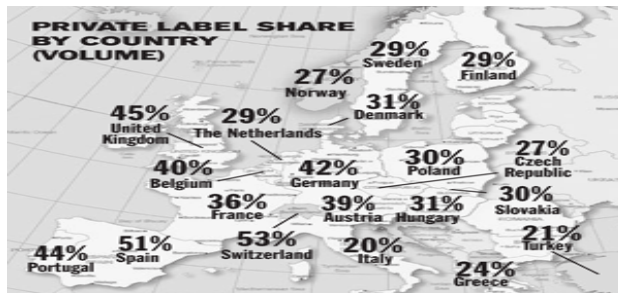
These mature markets are increasingly concentrated as the leading supermarkets exploit economies of scale and scope and are protected by entry and expansion barriers. These leading supermarkets are the main drivers in the expansion of supermarket brands¹¹².



Source: Rabobank 2011, p. 7.

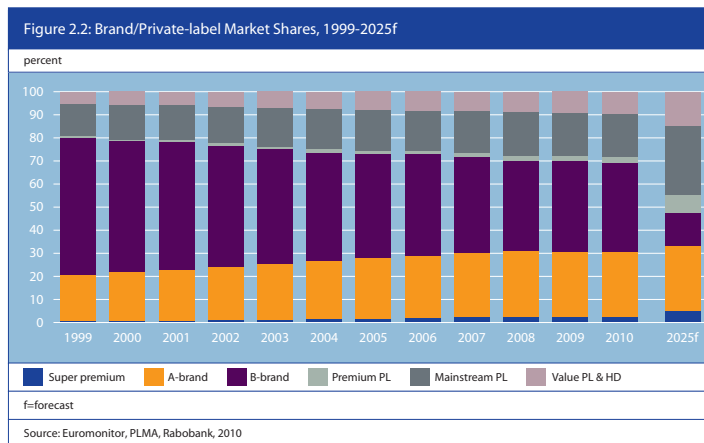
In Western Europe, the market share of retailer grocery brands is already in the 30%-50% range and growing steadily.

¹¹² Rabobank 2011, pp. 5-6: “To overcome consumers’ negative perception of quality, private-label products are priced at a significant discount compared to branded alternatives. However, the sales potential of a private-label product is much smaller than for branded alternatives, as the prospective market is capped to the consumers that frequent the retailer’s outlets. To source the private-label product at a competitive price and make production economically viable, retailers’ sales volumes must meet a minimal threshold. This means that the size and diversity of a retailer’s private-label offering is a function of its market share. Consolidation in food retail is therefore the prime driver of private-label growth”.



Source: Private Label Manufacturers Association 2013 Yearbook.

Furthermore, as the structure of the modern grocery retailing market becomes more concentrated around the world, the growth of supermarkets brands is expected to reach 50% of global food retail sales by 2025¹¹³.



Source: Rabobank 2011, p. 12.

The growth of supermarket brands has mainly come at the expense of B-brands, i.e., the grocery brands that are not the leading brand(s) in a category. This trend is expected to continue in the future as part of a supermarket strategy known as “ROB+1” (i.e., the leading supermarkets only stock an A-brand alongside their own brand in each category)¹¹⁴. Furthermore, hybrid production of B-brands and supermarket brands, even

¹¹³ Rabobank 2011 links the growth of supermarkets brands to the concentrated structure of retail markets: “Our estimate of overall private-label adoption by 2025 is closely linked to forecasts for developments in the food retail structure over the coming 15 years. Looking at the market structure in mature countries in western Europe, and the ongoing consolidation trend, the top-three are expected to account for an approximate share of between 60 percent and 70 percent in each country by 2025. The share of hard discount is expected to grow to about 10 percent to 15 percent — leaving a 20 percent to 25 percent share for the second-tier supermarkets. The weighted average of private-label penetration by market segment and the anticipated food retail structure point to a private-label share of at least 50 percent of global food retail sales by 2025, which is double the current share of 25 percent (see Figure 2.2)” (p. 11).

¹¹⁴ Rabobank 2011, p. 17: “With fewer metres available for brands, retailers will be inclined to reduce the number of brands and simplify their offering. A process referred to as ROB+1 (the offering will be reduced to retailers’ own brands, i.e., private label, + 1 strong A-brand). In mature product categories, such as frozen vegetables or frozen snacks, ROB+1 is pretty much common practice already”. See also Seth 1999, p. 281: “This is where the problem may lie. The major retailers’ policy has been increasingly to stock, within a given category, the brand leader, possibly a strong second, and their own

though they may be a last line of defence, may be counterproductive for the company and for consumer welfare (e.g., convergence of product quality and product innovation and cross-subsidisation of private label by the B-brand)¹¹⁵.

On the other hand, analysts think, perhaps naively, that A-brands will resist the push of supermarket brands because of the me-too nature of the supermarket brands in terms of quality/innovation and pricing: A-brands serve as a quality anchor for the category¹¹⁶ and supermarket brands are priced by reference to A-brands (umbrella-pricing strategy)¹¹⁷. Indeed, it is widely accepted, even by supermarkets themselves, that the pricing of their own brands does not respond to cost factors traditionally associated with intensely competitive markets, but with the retail price of a competing independent grocery brand¹¹⁸. All in all, it is thought that without a leading brand that provides a quality/price anchor, supermarkets would engage in a “negative quality/price spiral”¹¹⁹.

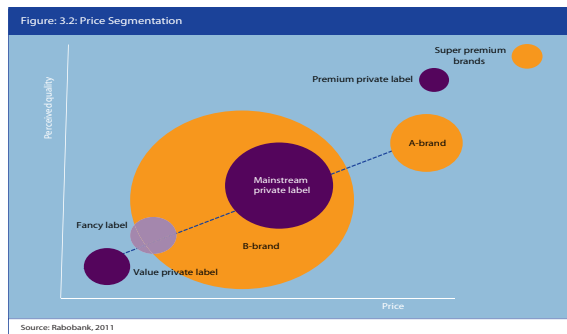
label. Brands lower than no. 2 in the market, and sometimes no. 1, have been de-listed (ie effectively killed off), unless they have a strong niche appeal. For a practical example of the ROB+1 strategy, see the analysis of the Heinz/Beech-Nut merger case, below at Section 5.7.1.

¹¹⁵ Rabobank 2011, p. 20: “It is debatable whether scale advantages can be achieved by combining B-brand and private-label production. The business models of brands and private-label suppliers differ greatly. Unlike private-label supply, brand production is about product, image, differentiation and market share. The brand supplier assumes more risk by investing in innovation and marketing. This higher risk needs to be rewarded by a price premium. The main risk of combining the two business models is that the price premium is forfeited. The ability to demand a price premium can be lost on both the consumer and the food retailer’s side. Once the consumer comes to believe that both the brand and the private-label alternative are produced in the same factory and there is no longer any perceived quality difference, the price premium fades overnight. In-house availability of a private-label alternative also undermines the negotiation position of the brand towards the food retailer. The pressure of the retailer may result in: (1) Convergence of product quality – eliminating any product differential of the B-brand; (2) Convergence of product innovation – reducing time to recoup R&D investments; (3) Convergence of accounting – cross subsidising private-label production with brand premium. Hybrid production is often used as a last line of defence. If the private-label business cannot survive on a stand-alone basis, it is likely to accelerate the deterioration of the B-brand”. Kumar 2007 also refer to this phenomenon as the “vicious circle of dual strategy” (pp. 140-141).

¹¹⁶ Kumar 2007, p. 57: “Despite all the claims by retailers that they are developing more than copycat products, the truth still remains that most of this is ambition rather than reality. It is true that retailers today are frequently developing packaging that helps position the store instead of just trying to mimic the manufacturer brands. There are also instances where the retailer brand has unique features or higher quality than manufacturers’ brands. But this is more the exception than the rule. The retailer’s private label proposition continues for the most part to be close to the quality of manufacturer brands, and therefore of acceptable quality, while being cheaper.”

¹¹⁷ Rabobank 2011, p. 14: “As mainstream private-label products are marketed primarily as the budget alternative to A-brands, their retail price tends to be tied to the pricing of their branded counterparts (see Figure 3.2). (...). Mainstream private-label retail prices are often directly linked to the prices of the A-brand. This means that the A-brand price level is a key factor in the retailers’ profit margins on their private-label offering. Given the interdependency of the two, any price adjustment in the A-brand (upward or downward) is likely to filter down into the private-label price as well. Consequently, retailers will not be inclined to undermine the position of the A-brand completely, as this will cut into their own profitability.”

¹¹⁸ See, for example, European Commission Decision of 9.11.2007, Case COMP/M.4824 - Kraft/Danone Biscuits, par. 32. “To contest the existence of any significant market power, the notifying party also claims that most retailers have private label products. Although procurement processes for private label products differs from branded products, there is a clear interaction between private label and branded products at the upstream level. Data submitted show that private label sales increase systematically to the detriment of branded products. However, more than 75% of the market still consists of branded products. Although retailers confirmed during the market investigation that they sell biscuits



Furthermore, experts claim that A-brands and independent brands in general also offer consumers choice and familiarity as well as a price benchmark to compare supermarkets on price attractiveness¹²⁰.

However, market reality shows that supermarkets do not focus on all product categories at the same time. They take a category-by-category approach that may be influenced by the importance of the category and its anchor role. As a consequence, in mature retail markets, supermarket brands already exceed the 50% market share threshold in many categories whilst in others they are less present. For example, data from IRI indicates that Spanish supermarket grocery brands held 50%-75% of the market in 11.17% of the main 298 categories surveyed in 2007 and more than 75% in 2.36% of them, whereas these percentages had increased respectively to 23.98% and 3.71% in June 2009¹²¹.

under their own respective name, many of them indicated that they set prices by reference to branded products (i.e. act as price followers rather than as competitive constraint). Therefore any potential price increase on the wholesale market for branded biscuits is likely to lead to price increase for private label biscuits. Indeed, the majority of respondents fear price increases following the transaction". See also the Kerry/Breeo Judgment, below at note 456, par. 9.25: "It is to be noted that the evidence available to the Authority included the fact that retailers do not price their private label products (at least primarily) by reference to the cost to them of the product plus a margin, but by fixing both the retail price of those products and of the branded products so as to create a differential which optimises the overall return from both lines. The Court considers that in assessing prospectively the potential constraining effect of private label sales by themselves and independently of the other mechanisms of influence available to retailers against the merged entity, the Authority was correct to assume that the current business models including the maintenance of the average price differential would be maintained."

¹¹⁹ Rabobank 2011, p. 15: "Last but not least, an A-brand often serves as the quality benchmark of the category. The quality of the A-brand product and the marketing around it determine the absolute price level that the consumer is willing to pay. Without the A-brand and the associated marketing, the price premium of the category would fade and competition could draw the retailers into a negative quality/price spiral. The absence of a strong A-brand can be detrimental to the overall profit pool in the category, including the retailer's share."

¹²⁰ Rabobank 2011, p. 15: "The availability of A-brands provides consumers with a sense of familiarity and choice. (...) The A-brand is also the price benchmark for the consumer. It allows the consumer to compare supermarkets on price attractiveness. By definition, a private-label product of one supermarket will not be found on the shelves of its largest competitor. That makes fair comparisons much more difficult. On the other hand, A-brand stock keeping units (SKUs) tend to be similar from one supermarket to the next."

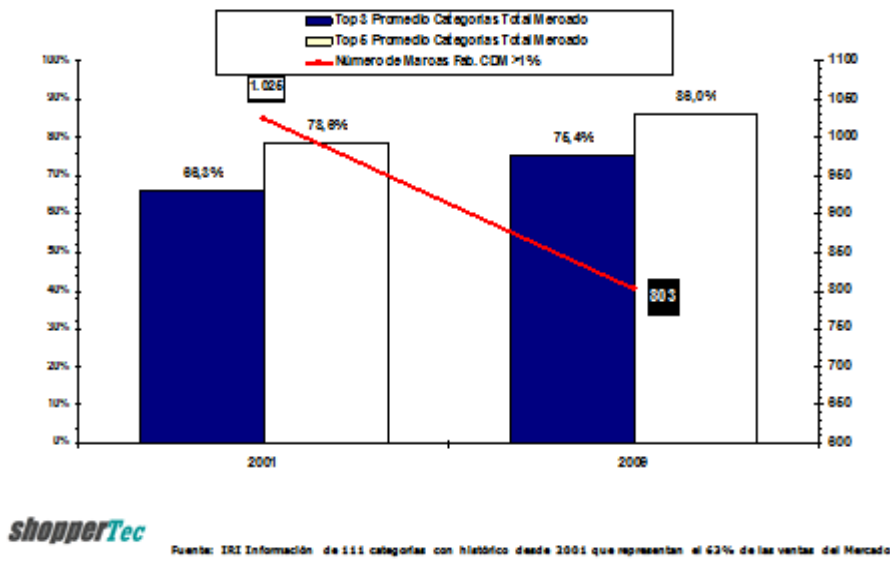
¹²¹ In light of the significant growth of the Spanish supermarket brands in 2010 and 2011, it is likely that their combined market share today has exceeded the 50% and 75% thresholds in several other categories.

Market share PL	Categories		Difference June 09 v. Year 07
	Year 2007	June 2009	
> 75%	7	11	+4
50% - 75%	51	71	+20
25% - 50%	115	126	+11
> 0% - 25%	116	84	-32
= 0%	9	6	-3

Source: IRI-InfoScan, 2009

The push strategy of the Spanish supermarkets in favour of their own brands seems to be the main factor behind the massive disappearance of independent grocery brands from the market and the growing concentration in many categories. According to IRI data regarding 101 grocery categories representing 65% of the modern grocery sales in Spain, the number of independent grocery brands went down from 1,025 to 803 (-21.3%) between 2001 and 2009. However, a simple look at the Spanish retail market reveals that the number of new supermarket brands in the 2001-2009 period was far below this figure¹²².

El mercado ha aumentado su concentración Análisis concentración: Top 3 y Top 5 Marcas



¹²² See, for a similar conclusion regarding the ready meal category in Germany, Olbrich and Grewe, "Effects of the proliferation of private labels in consumer goods retailing", Department of Business Administration and Economics, FernUniversität Hagen, Research Paper 6, 2009, discussed below in Section 5.6.

In light of the “push” strategy adopted by supermarkets, analysts recommend independent grocery brands to focus on their functional (satisfying consumer needs) and emotional (reputation and recognition) roles. On the functional level, they will have to innovate and protect their innovations from copying by supermarket brands¹²³. However, analysts fail to gauge that supermarkets’ power enables them to abuse their dual role of distributors-competitors in order to copy third-party innovations and foreclose them¹²⁴.

5.1.3 Conclusion: vertically integrated two-sided platforms

In the context of supermarket mergers, competition authorities have defined two separate, albeit interconnected, markets. On the one hand, there is a national procurement market for food retailing¹²⁵, which can be subdivided in different product categories¹²⁶. On the other hand, there is a market for modern grocery shopping in a one-stop shop format (supermarkets and hypermarkets, possibly including discounters)¹²⁷, whose geographic scope is in principle local, but may be broader if the local areas overlap and the competitive conditions are sufficiently homogeneous¹²⁸.

¹²³ Rabobank 2011, p. 16: “The competition with private label is fought out at the product level through: Innovation — developing taste, texture, ingredients or packaging to improve convenience, indulgence or health perception among consumers; [and] Patents/trade marks — impose structural barriers to prevent copying and defend this competitive advantage in court if necessary”.

¹²⁴ See, below Sections 5.5.1.1 (“Misuse of sensitive commercial information”), 5.5.1.4 (“Refusal of access”) and 5.5.2.2.4. (“Copycats”).

¹²⁵ The Rewe/Meinl Decision, par. 80: “It must be borne in mind that from the producer’s point of view different sales channels are not readily interchangeable. Different container sizes, get-up and packaging (for which special machines or other production requisites may be needed), different sales strategies (as in the food-retailing trade and in delicatessens), the need for variety of knowledge and contacts for different distribution channels and different logistics make it difficult to switch between sales channels. The Commission has information in its possession which indicates that entry into a new sales channel is sometimes possible only after lengthy canvassing of the market. Numerous products (in particular impulse and branded goods) are expressly designed for direct sale to final consumers. For such products, there are, outside the food-retailing trade, few marketing alternatives (as a rule the specialised trade, for non-food products the drugstore trade, cash-and-carry stores). The Commission’s investigations have disclosed that an immediate, smooth substitution of a lost food-retailing trade customer by selling through other sales channels is impossible in most product categories. A change of sales channel would instead, where it is at all possible, require considerable investment and adaptation of the firm’s production and sales organisation and cost structure. This points to there being, at least in certain product categories, a pure food-retailing procurement market.”

¹²⁶ In the Rewe/Meinl Decision, the Commission listed the following product categories (par. 77): meat and sausages, poultry and eggs, bread and pastries (fresh and packaged bakers’ wares, excluding frozen ones), dairy products (milk, butter, yoghurt, puddings, fresh milk-based desserts, all types of cheese), fresh fruit and vegetables, beer, wines and spirits, soft drinks (including mineral water), hot beverages (coffee and tea), confectionery, basic foodstuffs (including flour, sugar, noodles, rice and spices), preserved foods (non-perishable foodstuffs in tins or other packaging, with the exception of frozen foods), frozen foods (including ice cream), baby foods, pet foods, body-care products (creams, lotions, etc., the purpose of which is primarily preventive) and cosmetics (make-up and perfumes), detergents, polishes, cleaning products, other drugstore products (apart from the above, medicinal products available over the counter, health foods, personal hygiene products, and so on), other non-food products normally found in supermarkets (for example, clothing, newspapers and magazines, entertainment).

¹²⁷ The Rewe/Meinl Decision, par. 10: “There are, within the food-retailing trade, various forms of distribution which differ according to, among other things, the width and depth of the range carried and the size of the sales outlet (such as supermarkets with 5.000 to 10.000 articles, a fresh-food department

The interaction between these two markets can give rise to mutually reinforcing positive or negative competitive effects. The European Commission and other competition authorities have emphasized the links between the procurement and retail markets. On the positive side, buyer power in the procurement market may benefit consumers when retail competition is effective¹²⁹. On the negative side, a “snowball effect” can unleash when a dominant position arises in one of the two markets¹³⁰.

and a sales area of 400 to 1000 m², and hypermarkets with a sales area of at least 1000 m²). Owing to the existing competitive relationships between these different forms of distribution, it will be assumed below, however, as in previous Commission decisions, that there is a separate market in food retailing which embraces all retailers, and in particular supermarkets and hypermarkets, carrying a range of food and non-food products which is typical of the food-retailing trade (excluding, that is, specialised outlets such as butchers and bakers).” The Commission has left open the question whether discount stores are part of the relevant market (Carrefour/Promodès, par. 12 and Rewe/Meinl, par. 17). In Tesco/Carrefour, the market investigation confirmed that with regard to the pricing policy hypermarkets seem to be closer to discount stores than supermarkets, par. 12.

¹²⁸ When defining the isochrones (catchment areas) that make up geographic local markets in merger control decisions, the Commission and other competition authorities have been carrying forward drive times used in the first merger decisions: a 20-30-minute drive (see, for example, Commission Decision of 9.07.2007, Louis Delhaize/ Magyar Hipermarket KFT, 09.07.2007, par. 15). However, the use of a 20 to 30-minute drive time seems to be out of touch with modern grocery demand patterns in most countries. Empirical studies have confirmed that grocery demand is very localised, that the driving time to the supermarket is 10 minutes in urban areas and that a large proportion of customers walk to the supermarket in towns. See, for examples of geographic market definitions confined to 10-15 minute-drive, Commission Decision of 29.09.2005, DIA/Penny Market, at par. 6; Commission Decision of 25.01.2010, Schuitema/Super de Boer Assets, p. 5; and the UK Grocery Report 2008. For a critique of the unduly broad geographic market definition of grocery retail markets, see the Portsmouth Study II, cited below, note 233, at p. 65: “The broad travel-to-work-area units of analysis that are currently used for judging concentration are inadequate for this purpose”.

¹²⁹ The Rewe/Meinl Decision, par. 71: “The exercise of buyer power which leads to the securing of a more favourable purchase deal is not to be considered per se detrimental to the economy as a whole. Especially where the supplier side is itself highly concentrated and powerful, buyers are faced with effective competition in their own selling market and hence are compelled to pass on any savings to their own customers, buyer power can prevent monopoly or oligopoly profits from being earned on the supply side. However, if the powerful buyer himself occupies in his selling market a strong position which is no longer kept sufficiently in check by the competition, any savings can no longer be expected to be passed on to customers.”

¹³⁰ The Rewe/Meinl Decision, pars. 72-74: “(72) In the retail trade there is a close interdependence between the distribution market and the procurement market. Retailers' shares of the distribution market determine their procurement volume: the bigger the retailer's share of the distribution market, the larger the procurement volume. And the larger the procurement volume, the more favourable as a rule are the buying conditions which the trader obtains from his suppliers. Favourable buying conditions can in turn be used in various ways to improve one's position in the distribution market (sometimes through internal or external growth, but also through low-price strategies targeted at competitors). The improved position in the distribution market is itself reflected in a further improvement in buying conditions, and so on. (73) The spiral described above leads to ever-higher concentration both in distribution markets and in procurement markets. In the short term, final consumers may benefit from the process, as there may be a period of intense (predatory) competition in the distribution market during which the powerful buyer/trader is forced to pass on his savings to consumers. But this will last only until such time as a structure (as in this case, an individual dominant position) is arrived at in the distribution market which leads to a clear reduction in competitive intensity. At this stage, any consideration for the final consumer goes by the board, as he is left with few alternatives. (74) Buyer power also gives a trader considerable influence over the choice of products which come to market and hence are obtainable by consumers. Products which are not bought by a dominant buyer have practically no chance of reaching the final consumer as the supplier lacks alternative outlets. Lastly, the dominant buyer determines the success or otherwise of product innovations.”

As discussed in Section 3, competition authorities have traditionally assessed the grocery procurement market under the traditional seller power-countervailing buyer power approach (“demand competition or “top-bottom”)¹³¹. The categorisation of supermarkets as “buyers” has distorted the conventional competition analysis of their practices vis-à-vis grocery brands. This analysis has not assessed the effects of each practice on grocery brands (the procurement market). Instead, it has focused on the overall competitive status of the retail market, measured by the level of prices and supermarket profits. Curiously, this analysis conforms to the analysis of two-sided platforms advocated by some economists, which the European Commission has rejected in other sectors. Indeed, there is ample evidence that the modern supermarkets operate as platforms in a two-sided market (i.e., one-stop shopping services provided to grocery shoppers and distribution services provided to independent grocery brands) or, by the European Commission’s own terminology, as “two-sided platforms”¹³².

A new strand of industrial economics has identified a diverse set of industries where firms (platforms) display two-sided features that have important economic implications¹³³. According to Evans, two-sided platforms exhibit three features¹³⁴:

- (1) A two-sided platform provides goods or services simultaneously to two distinct groups of consumers who need each other in some way and who rely on the platform to intermediate transactions between them.
- (2) There are indirect externalities across groups of consumers (i.e., the value that a customer on one side realizes from the platform increases with the number of customers on the other side)¹³⁵.
- (3) The price structure of the platform affects the level of transactions (i.e., it is non-neutral)¹³⁶.

¹³¹ The Rewe/Meinl Decision, par. 71.

¹³² OECD 2009b, Note by the European Commission, p. 157, footnote 1: “In a recent paper Ordoover (2007) argued that to the uninitiated, the concept of a two-sided platform is probably confusing and offers little additional analytical insight, at best. After all, is it not the case that all markets have two sides, namely buyers and sellers? Ordoover suggests to use a more informative description, namely: markets with two-sided platforms. In this paper we follow this proposal and refer consistently to two-sided platforms, as opposed to two-sided markets.”

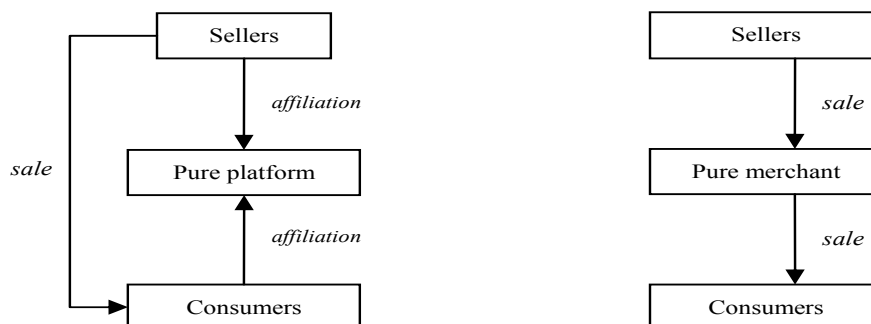
¹³³ *Id.*, Background Note by David Evans, p. 23: “The theory on two-sided platforms was initiated by the seminal article Rochet and Tirole (2003), and their subsequent article (2006). Other important contributions to the early literature include Armstrong (2006), Caillaud and Jullien (2003), Evans (2003a, b), Parker and Van Alstyne (2005)”

¹³⁴ *Id.*, Executive Summary by the OECD Secretariat, p. 11.

¹³⁵ For example, a search platform is more valuable to advertisers if it is more likely that it will reach a larger number of potential buyers. At the same time, it is more valuable to potential buyers if the platform has more advertisers because that makes it more likely that a buyer will see a relevant advertisement.

¹³⁶ The price structure is the way prices are distributed between consumers on the two sides of the market. The platform can affect the volume of transactions by charging more to one side of the market and reducing the price paid by the other side by an equal amount. Since the price structure matters, the platform must design it so as to induce both sides to join the platform.

The difference between one-sided and two-sided platforms is a matter of degree in a continuum between a pure one-sided platform and a pure two-sided platform model¹³⁷.



Source: Hagiu 2007.

However, some activities such as computer operating systems (software developers and computer users); credit cards (cardholders and merchants); real estate brokerage (renters and landlords), internet portals and search engines (sites, Internet surfers); magazines (readers and writers); yellow page directories (readers and businesses); night clubs (men and women); shopping malls (shoppers and shops), publication software (authors, readers), videogame consoles (gamers and developers), as well as various types of intermediation services such as matching and employment agencies, auction houses, service vouchers networks, payment systems, some telecommunication systems, scientific journals, are consistently rated as two-sided platforms by competition authorities¹³⁸.

Indeed, supermarkets fulfill the three requirements associated with two-sided platforms:

(1) They provide services simultaneously to two distinct groups of consumers (i.e., shoppers and grocery suppliers) who need each other in some way and who rely on the platform to intermediate transactions between them. Normally shoppers buy the goods from the supermarket but risk-transfer strategies (e.g., a guaranteed retail margin) and related in-store services (e.g., shelf-placement) position supermarkets as intermediaries between grocery brands and customers as opposed to merchants.

¹³⁷ OECD 2009b, Background Note by David Evans, p. 25: "Some businesses have a two-sided nature. They service simultaneously two interdependent groups of customers, which need the intermediation of the platform to internalize the indirect network externalities across groups. Two-sidedness is a matter of degree. Sometimes the two-sided nature of the business is critical for the analysis, other times it is irrelevant." See also contributions from OECD members and, in particular, Note by the Spanish Competition Authority (Spain), p. 121: "The views of the CNC regarding two-sided markets are not dogmatic, in the sense of establishing a dichotomy between two-sided markets and other of markets. In fact, the two-sided character of a market is a matter of degree: while some markets, such as payment cards, are clearly two-sided, others such as standard-setting organizations are multisided and others might have some elements of two-sided markets. Moreover, the degree to which firms can exploit the two-sided character of a market in order to maximise their profits also differs from market to market depending on the type of interaction between the two sides and on the market power at each side of the market".

¹³⁸ OECD 2009b, Note by the European Commission, p. 157.

(2) There are indirect externalities across shoppers and suppliers (i.e., shoppers value the one-stop offering of all their groceries and suppliers value the availability of as many shoppers as possible at a single location).

(3) The price structure of supermarkets is not neutral and affects the level of transactions: in highly competitive retail markets, supermarkets may favour lower retail prices to shoppers whilst charging higher access fees to suppliers (furthermore, the dynamic effects of higher access fees may reduce retail price competition).

Mark Armstrong, one of the first economists to analyse two-sided platforms and the first one to highlight the “competitive bottleneck” problem generated by consumers’ homing patterns, concluded that supermarkets are two-sided platforms exhibiting competitive bottleneck features¹³⁹. Stefano Vannini, member of the Chief Economist Team of the European Commission’s Directorate General for Competition, cited supermarkets as two-sided platforms in the first ever article on two-sided platforms by a member of that Directorate General¹⁴⁰.

Competition authorities have relied heavily on Armstrong’s seminal articles to build their policy approach to two-sided platforms. Furthermore, they have noted the interaction between the procurement and retail grocery markets in the merger control arena. However, surprisingly, none of them has analysed supermarkets as two-sided platforms but as traders in a one-sided market. For example, even though Vannini included supermarkets in a list of five two-sided platforms, the Commission has never referred to them as two-sided markets¹⁴¹. Likewise, the German Bundeskartellamt seems to equate supermarkets with traders, as opposed to two-sided platforms¹⁴², in line

¹³⁹ Armstrong, “Competition in two-sided markets”, *The RAND Journal of Economics*, 37(3), 2006, p. 678: “Other examples of this competitive bottleneck framework include: most people might read a single newspaper (perhaps due to time constraints), but advertisers might place ads in all relevant newspapers; consumers might choose to visit a single shopping mall (perhaps because of transport costs), but the same retailer might choose to open a branch in several malls; consumers might visit a single supermarket, but suppliers might wish to place their products on the shelves of several supermarkets; or a travel agent might use just one computerized airline reservation system, while airlines are forced to deal with all such platforms in order to gain access to each travel agent’s customers. After analyzing a fairly general model of competitive bottlenecks, I shall present specific applications to newspapers and supermarkets.”

¹⁴⁰ Vannini, “Bargaining and two-sided markets: the case of Global Distribution Systems (GDS) in Travelport’s acquisition of Worldspan”, *Competition Policy Newsletter*, Number 2-2008, p. 43: “Indirect network externalities (or cross-group externalities) arise when the value of a platform for users on one side is affected by the size of the users’ network on the other side. The willingness of customers on one side of the platform to pay in order to subscribe to a specific platform’s provider then depends on the size of the network of users covered by that same provider on the other side of the platform. For example, (i) the number of readers of a newspaper or magazine (or the audience of a TV broadcast) tends to attract advertisers, (ii) the number of customers of a supermarket chain (or shopping mall) tends to attract suppliers of products to be sold there, (iii) the number of holders of a given credit card increases the incentive for shops to accept the card.”

¹⁴¹ Vannini 2008, p.43: “For example, (i) the number of readers of a newspaper or magazine (or the audience of a TV broadcast) tends to attract advertisers, (ii) the number of customers of a supermarket chain (or shopping mall) tends to attract suppliers of products to be sold there, (iii) the number of holders of a given credit card increases the incentive for shops to accept the card.”

¹⁴² OECD 2009b, Note by Germany, pp. 97-98: “Defining what a two-sided market is and – related to that – which markets are two-sided and which markets are not, is far from trivial. A definition that

with the one-off supply model advanced by Rysman in favour of the one-sidedness of supermarkets¹⁴³. However, the one-off supply model in which the supplier is indifferent to the retail demand for his product does not conform to today's supermarket reality, if it ever did. Indeed, in the continuum between a one-sided and a two-sided platform, nowadays supermarkets operate much closer to a two-sided platform than a one-sided platform¹⁴⁴. As the Russian Competition Authority put it:

focuses on the fact that there are two different customer groups and that there are externalities between these two turns out to be too general. Basically, any undertaking that is active on an upstream market and a downstream market can be seen as the supplier of a platform, because demand on both the upstream and the downstream market depends on the turnover of the other market. An often-cited example is supermarkets. On the upstream market, supermarkets offer shelf-space. On the downstream market, they offer goods placed on these shelves to the final consumer. Obviously, network effects are crucial in order to understand the functioning of a trading platform. The more sellers there are, the more attractive the platform for (potential) buyers, the more buyers there are, the more attractive the platform for (potential) sellers. However, these effects stem exclusively from direct network externalities because the role of a trader (whether he/she is a buyer or a seller) is not predetermined and may change for each transaction. Against this background it seems appropriate to stick to a more narrow definition of a two-sided market such as the one brought up by Rochet and Tirole. Accordingly a market should only be considered to be —two-sided if the volume of transactions generated on both sides markets of the platform depends not only on the level of prices on both sides but also on the price structure. According to this definition, pure trading platforms would not be considered as two-sided markets.”

¹⁴³ Rysman, “The Economics of Two-sided Markets”, *Journal of Economic Perspectives*—Volume 23, Number 3, Summer 2009, p. 126: “Of course, one-sided markets have intermediaries, too. For example, consider a farmer that sells a product to a grocery store once and does not otherwise interact with the grocer. The grocer then picks a retail price based on inventory and demand. In this one-sided market, the farmer collects the wholesale price and is then indifferent to the success of the grocer in actually selling the good. The distinguishing feature in this case is whether the seller is paid based on the success of the platform with the buying side [Footnote 1: Or should a grocery store be considered a two-sided market? Armstrong (2006, Section 5) provides a formal model of grocery stores as a two-sided market. In his model, the grocery store sets the price per consumer, and the wholesaler is paid based on how many consumers show up. That contrasts with my characterization of a grocery store, in which a wholesaler sells a product for a known sum, the retailer takes possession of the product and sells the product as it wishes, and the wholesaler has no concern for how many units the retailer is able to sell. In my view, a grocery store is in a one-sided market, but Armstrong would disagree.”

¹⁴⁴ Supermarkets would qualify as two-sided platforms even under the restrictive criteria proposed by Hagiu 2007: “More importantly, we show that there is in fact a continuum of intermediary types between a pure merchant and a pure two-sided platform, depending on the extent of control over buyer-seller interactions left to sellers. “Control” can be thought of as encompassing three important dimensions: control over strategic variables (pricing, advertising, distribution, etc.); sharing of economic risk (is the risk borne by the sellers or by the intermediary?) and “ownership” of buyers (how salient are individual sellers’ “brands” relative to the intermediary’s “brand” when buyers make their affiliation decisions?). A pure two-sided platform leaves control to sellers, whereas a merchant takes over full control. As a consequence, our framework suggests an implicit definition of “two-sidedness”, relying on the division of control between sellers and intermediaries, rather than on the effects of the pricing structure chosen by the intermediary, as is the case with the definition proposed by Rochet and Tirole (2006)”. On the one hand, control of the shopper is increasingly in the hands of supermarkets (note, however, that media platforms also control end-customers and yet they are considered to be two-sided platforms). On the other hand, supermarkets increasingly transfer economic risks to independent grocery brands. As regards strategic variables of retail competition, even though the last word rests with the supermarket, independent grocery brands can exercise some control over their retail sales by purchasing in-store services and setting recommended retail prices. In any event, mainstream two-sided platform economics is not as restrictive as Hagiu and accepts that two-sided platforms may operate with or without direct transactions between end-users, the most well-know example of the latter being media operators that intermediate between viewers/readers/listeners and media advertisers. See, for example, Argentesi and Filistrucchi, “Market Definition in Two-Sided Markets: the Case of Daily Newspapers in Italy”,

“The retail networks are one of the best examples of «two-sided platforms» that allow members of two different groups (suppliers, producers and retail consumers) to interact with each other. Thus retail networks provide for a platform, a sort of infrastructure which allows facilitating access for consumers to the product ensuring a wide range of products and comfort buying facilities, but at the same time they provide suppliers with the access to distribution channels securing volumes of purchases under the adjusted schedules.”¹⁴⁵

Furthermore, some economists specialising in the food chain claim that it is precisely the two-sided platform externalities what explains the global emergence of supermarkets¹⁴⁶.

5.2 The Goals of Competition Policy

The German Bundeskartellamt has rightly argued that it is impossible to assess buyer power or, to be precise, supermarket power, without outlining one’s vision of the goals of competition policy¹⁴⁷. Indeed, this Report claims that the conventional competition analysis of buyer power reveals a misguided vision of the goals of competition policy.

Power Point Presentation in CRESSE, 2.07.2010. They wonder whether supermarkets are two-sided platforms and answer this question affirmatively:

“Two-Sided markets: a clarification

Not all firms are two-sided platforms Because firms buy inputs and sell output

This implies:

- they do not offer a service to input producers

- the input producers do not care about demand for their product by consumers once they are paid by the firm (note: it depends on the contract!)

e.g. Is a supermarket a two-sided platform?

Yes, but only to the extent it is able to make the wine producer pay (though a discount?) to have its wine on the right shelf (then it offers a service to them...)

Only then the wine producer will care about how many clients the supermarket has...”

¹⁴⁵ OECD, Roundtable on two-sided markets, Competition Committee, DAF/COMP/WD(2009)69, 28.05.2009, Note by the Delegation of the Russian Federation, p. 201.

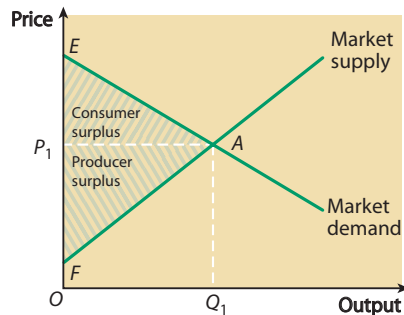
¹⁴⁶ Richards, Pofahl and Hamilton, “Network Externalities in Supermarket Retailing”, Working Paper, 2007, pp. 2-3: “In the 1990s and early 2000s, retail consolidation and the expansion of “big box” retailers in the food industry changed the way consumers buy food in most urban markets (Martinez). Most explanations for this phenomenon focused on scale economies and supply chain efficiencies achieved by retailers such as Wal Mart and Target in the U.S. and Tesco and Carrefour abroad. However, empirical estimates of production-side scale economies in food retailing are small, likely too small to generate the type of industry dominance now in place (Cotterill, 1986). Rather, we argue that much of the advantage is likely due to demand-side scale economies, in particular, to a form of indirect network effect generated by a two-sided demand for retail shelf space. Retailers are platforms that exist only to connect consumers and manufacturers. Consumers prefer a variety of products, so they value platforms that are able to attract a larger number of manufacturers. On the other side, manufacturers benefit by selling through a platform that is able to attract the greatest number of consumers. Both consumers and manufacturers pay a price for access – the retail price for consumers, and either access fees (slotting fees, promotional allowances, etc.) or comparatively low wholesale prices for retailers who do not charge slotting (Hamilton, 2004; Rao, 2004). In this study, we describe a general model wherein retail supermarkets serve as platforms in a two-sided market that consists of consumers on one side and manufacturers on the other. Because consumers are assumed to demand variety (Draganska and Jain, 2005; Richards and Hamilton, 2006) and manufacturers prefer more shelf-space, the price retailers charge to both sides must take the demand from the other into account. Recognizing the two-sided nature of retail markets explains many of the trends toward consolidation and off-invoice pricing activity, or lack thereof, in the supermarket industry over the last decade”.

¹⁴⁷ OECD 2009a, Note by Germany, p. 175: “The assessment of buyer power under competition law is substantially influenced by the general competition policy concept. Depending on this concept’s

5.2.1 Dynamic and static efficiency

Competition policy is heavily influenced by neo-classic economics. The static competitive model of economic welfare serves as the theoretical basis for competition analysis.

Static model of perfect competition



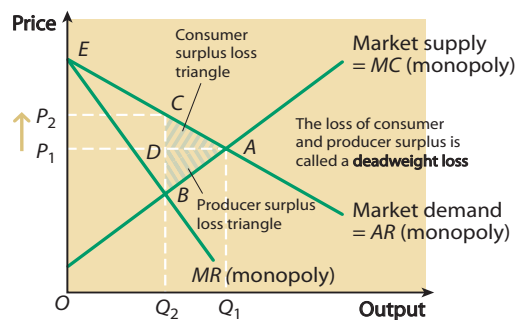
Market equilibrium in perfect competition is determined at point A (output is Q_1 and price is P_1). At that point, the combined consumer surplus and producer surplus (economic welfare) is maximized¹⁴⁸. At the equilibrium price and quantity in perfectly competitive markets, marginal benefit equals marginal cost, maximum willingness to pay equals minimum acceptable price, and the total of consumer surplus and producer surplus is maximized¹⁴⁹. This equilibrium point reflects economic efficiency, which consists of productive efficiency and allocative efficiency. Productive efficiency is achieved because competition forces producers to use the best techniques and combinations of resources to produce Q_1 at the minimum cost. Allocative efficiency is achieved because Q_1 is the optimum amount of output desired by consumers.

“strategic approach”, buyer competition appears to be more or less worthy of protection. Beyond its theoretical definition and the practical approach to it, buyer power must therefore also be discussed in terms of the basic objectives of competition law”.

¹⁴⁸ Consumer surplus is a measure of the economic welfare enjoyed by consumers: surplus utility received over and above the price paid for a good. Producer surplus is a measure of the economic welfare enjoyed by firms or producers: the difference between the price a firm succeeds in charging and the minimum price it would be prepared to accept.

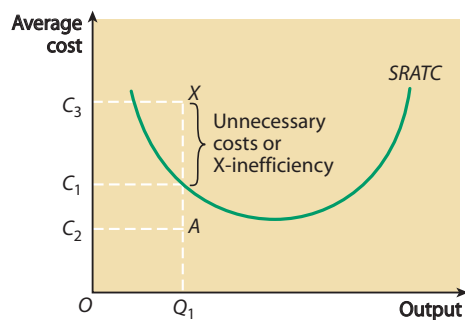
¹⁴⁹ In perfect competitive equilibrium, price equals marginal cost ($P=MC$). The price of a good, P , is a measure of the value in consumption placed by buyers on the last unit consumed. P indicates the utility or welfare obtained at the margin in consumption. This is the good’s opportunity cost in consumption. For example, a consumer spending 1 euro on a coffee cannot spend the euro on other goods. At the same time, MC measures the good’s opportunity cost of production; i.e. the value of the resources which go into the production of the last unit, in their best alternative uses.

Static model of monopoly



Compared to perfect competition, a monopolist restricts output (to Q_2) and raises price (to P_2) and the monopoly equilibrium is determined at point B where $MR = MC$. If a monopoly raises the price from P_1 to P_2 it gains the consumer surplus equal to the rectangular area $P_1 P_2 CD$. This means that producer surplus (in the form of monopoly profit) increases at the expense of consumer surplus. Over and above this transfer however, there is a net loss of economic welfare caused by the fact that the amount bought and sold falls to Q_2 . The welfare loss or deadweight loss is shown by the two shaded triangular areas, which respectively depict the loss of consumer surplus (the top triangle) and the loss of producer surplus (the bottom triangle). A monopoly may cause a welfare loss not just by increasing its price, but also by its own inefficiency due to the absence of competitive constraints.

A monopoly's X-inefficiency



According to the short-run average total cost curve of the monopoly, which shows the lowest possible unit costs of producing various levels of output, it is impossible for the firm to produce output Q_1 at a level of unit costs or average costs below C_1 , e.g., point A. Conversely, if unnecessary production costs are incurred, e.g., C_3 , unit costs greater than C_1 would be incurred when producing output Q_1 . In this case, the firm would be producing off its cost curve. Indeed any point above the average cost curve, is said to be X-inefficient.

Even though, theoretically, the neo-classic perfect competition model is more welfare enhancing efficient than the monopoly model, its assumptions are never present in real markets and it is doubtful whether it would actually benefit the economy and consumers at all. In perfect competition, all producers are passive price-takers, able to sell all their

commodity-like output at the ruling market price determined in the market as a whole. In this situation, firms cannot gain sales or market share by price-cutting or product differentiation. So the only form of competition is cost-cutting competition but it is also unlikely to develop as perfect information allows competing firms to replicate immediately the cost cutting strategy adopted by a given firm. Even more interestingly, it is likely that consumers would disfavour a perfect competition outcome, as each producer would supply an identical good or service at exactly the same price. Therefore, consumers would have no choice at all in perfect competition.

In any event, for many years, competition economists and lawyers have debated over whether competition policy should be aimed at protecting the economic efficiency (total welfare) or the consumer surplus identified in the neo-classic model of perfect competition¹⁵⁰.

Whereas the neo-classic models of perfect competition and monopoly (the oligopoly model lying somewhere in-between) refer to static competition (i.e., efficiency measured at a particular point in time), dynamic efficiency measures instead improvements in technical and productive efficiency that occur over time. Improvements in dynamic efficiency result from the introduction of better methods of producing existing products, including firms' ability to benefit to a greater extent from economies of scale and also from developing and marketing completely new products. In both cases, invention, innovation and research and development (R&D) improve dynamic efficiency. Its evolutionary and uncertain nature did not make it fit for the neo-classic economic modelling. As opposed to the neoclassic model of static quantity/price equilibrium, the dynamic view of competition in the market proffers that competition is not only about driving prices down to the cost level and bringing about allocative (static) efficiency. More importantly, it is about developing and spreading of new production technologies and new products and services (innovations). It is about finding out what the current (but also latent/future) problems of consumers are and how they can be solved better than before.

¹⁵⁰ From a purely economic perspective, total welfare is preferable to consumer surplus; therefore, competition scholars and private practitioners have favoured the adoption of the total welfare standard in competition policy. Even relevant members of competition authorities have expressed their personal views in favour of the total welfare approach. See, for example, articles from Heyer (at the time Director of Economics and currently Chief of the Competition Policy Section of the Antitrust Division of the Department of Justice), "Welfare Standards and Merger Analysis: Why Not the Best?", *Competition Policy International* 2, 2006; and Carlton (at the time Deputy Assistant Attorney General for Economic Analysis of the Antitrust Division of the Department of Justice), "Does Antitrust Need to be Modernized?", *Economic Analysis Group of the Antitrust Division of the Department of Justice, Economic Discussion Papers, EAG 07-3*, 2007. Among those supporting consumer surplus as the relevant standard for competition policy, see Areeda, "Introduction to Antitrust Economics", *Antitrust Law Journal* 52, 1983; Lande, "Proving the Obvious: The Antitrust Laws Were Passed to Protect Consumers (not Just to Increase Efficiency)", *Hastings Law Journal* 50, 1999, (citing over twenty scholars who support the consumer surplus goal); and Salop, "Question: What is the Real and Proper Antitrust Welfare Standard? Answer: The True Consumer Welfare Standard", *Loyola Consumer Law Review* 22-3, 2010.

The adoption of dynamic efficiency considerations in economic analysis reflects the real-world situation of dynamic competition and must be credited to the seminal works of Schumpeter¹⁵¹ and Hayek¹⁵². Schumpeter described competition as a rivalrous process of innovation and imitation¹⁵³. Hayek understood competition as a discovery process, where firms strive to find out in a trial and error dynamic what the best products and production technologies are¹⁵⁴.

Dynamic efficiency is critical for the economy. Economic development is inextricably linked to productivity growth and the latter can only be sustained through innovation¹⁵⁵.

¹⁵¹ Schumpeter, *Theorie der wirtschaftlichen Entwicklung* (transl. 1934, *The Theory of Economic Development: An inquiry into profits, capital, credit, interest and the business cycle*), 1911.

¹⁵² Hayek, *Individualism and Economic Order*, University of Chicago Press, 1948, pp. 92-106 ("The Meaning of Competition") and *New Studies in Philosophy, Politics, Economics and the History of Ideas*, University of Chicago Press, 1978, pp. 179-190 ("Competition as a Discovery Procedure").

¹⁵³ Kerber, "Competition, Innovation, and Maintaining Diversity through Competition Law", in *Economic approaches to competition law: foundations and limitations*, J. Drexler, W. Kerber, R. Podszun, eds., Edward Elgar, 2010, (the quoted text and page numbering relate to an online version available at Ideas), pp. 4-5: "In his famous book 'Theory of Economic Development' (1912/1934), Schumpeter sketched an alternative paradigm to mainstream equilibrium economics, which views technological progress as the central endogenous driving-force for economic development, propelled by pioneering entrepreneurs and imitators, who introduce and spread new products and production methods. From that Schumpeterian perspective, competition as an innovation-imitation process is seen as more important than price competition for the long-term growth of wealth. This Schumpeterian view of competition was the starting-point for concepts of dynamic competition, which attempted to analyze competition as a rivalrous process of innovation and imitation between competing firms, consisting of advancing, following, and overtaking action and reactions (Clark 1961, Arndt 1952, Heuss 1965, Hoppmann 1977)."

¹⁵⁴ Kerber 2010, pp. 5-6: "Only through experience and the feedback from the market can be determined what the best products for the current preferences or the most cost-efficient technologies are (market test). Therefore competition is a method for solving knowledge problems through a trial and error process. From this perspective also his critique of the traditional neoclassical concept of competition (as used in the model of perfect competition and still present in modern industrial economics) can be understood best: It is seriously flawed, because it already assumes the existence of the knowledge which - from an Hayekian point of view - can only be generated through the competitive process. An analysis of this epistemological argument about competition implies that competition can be viewed as a process, in which previously unknown knowledge is being generated and spread."

¹⁵⁵ Porter, "Competition and Antitrust: A Productivity-Based Approach", essay, revised 30.05.2002, pp. 3-4: "The goal of economic development is to achieve long term, sustainable improvement in a nation's standard of living, which can be approximated by per capita national income (GDP per capita). Per capita income is determined by the productivity of a nation's economy, where productivity is defined as the total value of the goods and services (products) produced per unit of the nation's human, capital and physical resources. A nation's overall productivity is composed of the productivity of its firms, both those involved in traded industries and those involved in purely local commerce. The crucial issue, then, is how to create the conditions for rapid and sustained productivity growth in a nation's firms. Since the seminal contributions of Schumpeter (1943), Solow (1956) and Abramovitz (1956), it is widely understood that the only means of achieving sustained productivity growth in an economy is through innovation. Innovation provides products and services of ever-increasing consumer value, as well as ways of producing products more efficiently, both of which contribute directly to productivity". Porter cites Schumpeter, *Capitalism, Socialism, and Democracy*, 2nd. ed., 1943; Solow, "A Contribution to the Theory of Economic Growth", *Quarterly Journal of Economics* 70, 1956; and Abramovitz, "Resource and output trends in the US since 1870", *The American Economic Review* 46-2, 1956. See also later articles by Solow, "Technical Change and the Aggregate Production Function", *Review of Economics and Statistics* 39, 1957; Mansfield, "Contribution of Research and Development to Economic Growth of the United States", *Papers and Proceedings of a Colloquium on Research and Development and Economic Growth Productivity*, National Science Foundation, 1972; Romer, "Increasing Returns and Long Run Growth", *Journal of Political Economy* 94, 1986; Nadiri, "Innovations and Technological Spillovers", National Bureau of Economic Research, Working Paper 423, 1993. From an economic policy perspective,

Since productivity and innovation flourish in competitive environments the unavoidable conclusion is that competition policy should be primarily devoted at promoting a competitive market conducive to growth and innovation.

Not surprisingly, leading economic experts have advocated the abandonment of the sterile neo-classic debate over total welfare and consumer surplus and a realignment of the competition policy goals with the real drivers of economic development¹⁵⁶. Furthermore, since the benefits to society of innovation largely outweigh the short-term benefits of low prices, it is argued that the protection of dynamic competition should always take precedence over the protection of static competition (low prices)¹⁵⁷. For

see at the OECD level, Rosenberg, “Innovation and economic growth”, OECD, 2004 and OECD, “Innovation and Growth: rational for an innovation strategy”, 2007, p. 3 (Preface): “Undoubtedly the capability to innovate and to bring innovation successfully to market will be a crucial determinant of the global competitiveness of nations over the coming decade. There is growing awareness among policymakers that innovative activity is the main driver of economic progress and well-being as well as a potential factor in meeting global challenges in domains such as the environment and health. Not only has innovation moved to centre-stage in economic policymaking, but there is a realisation that a co-ordinated, coherent, “whole-of-government” approach is required. Many OECD member countries have adopted national strategic road-maps to foster innovation and enhance its economic impact.”

¹⁵⁶ See, for example, Porter 2002, p. 4: “Innovation, in this broad sense, is driven by competition. While technological innovation is the result of a variety of factors, there is no doubt that healthy competition is an essential part. (...). Productivity growth, then, is the missing, unstated link between competition and national standard of living. This provides the soundest explanation for why antitrust must protect competition: it is the key to a nation’s economic prosperity. Productivity growth thinking also makes it clear that the focus of antitrust thinking should be on the long-term trajectory of product value and price, not just current consumer welfare measured by short-run prices”; and Sidak and Teece, “Dynamic Competition in Antitrust Law”, *Journal of Competition Law & Economics* 5-4, 2009, p. 600: “We attempt to give some substance to Schumpeter’s intuition. Unfortunately, antitrust economists often unwittingly favor static competition. They are often unaware that there are many ways to conceptualize competition. Dynamic competition is a style of competition that relies on innovation to produce new products and processes and concomitant price reductions of substantial magnitude. Such competition improves productivity, the availability of new goods and services, and, more generally, consumer welfare. Promoting dynamic competition may well mean recognizing that competitive conduct may involve holding short-run price competition in abeyance. For example, the argument against generic “me-too” drugs may be of this kind; generics may lower prices for existing drugs, but they may slow the development of new drugs, yielding a classic tradeoff between static efficiency and dynamic efficiency. Put succinctly, competition policy rooted in static economic analysis sees the policy goal as minimizing the Harberger (deadweight loss) triangles from monopoly. A new competition policy, recognizing the special power of dynamic competition, would advance the availability of new products and the co-creation of new markets that allows latent demand (and hence new amounts of consumer surplus associated with new demand curves) to be realized by consumers. It would also recognize cost savings flowing from innovation as an indicator of likely future consumer welfare gains. Put differently, the focus of a revised competition policy and merger-guideline framework would still very much be on the consumer, but it would be future-oriented and would recognize that certain business practices might lead to market creation (or at least co-creation) that would yield new demand curves with large gains in consumer surplus (because demand for new products could be satisfied). The minimization of Harberger deadweight loss triangles would be a secondary focus. Where minimizing Harberger triangles today stands in the way of creating new and significant future demand curves, a new competition policy would likely favor the future and recognize the welfare benefits associated with creating or co-creating new markets.”

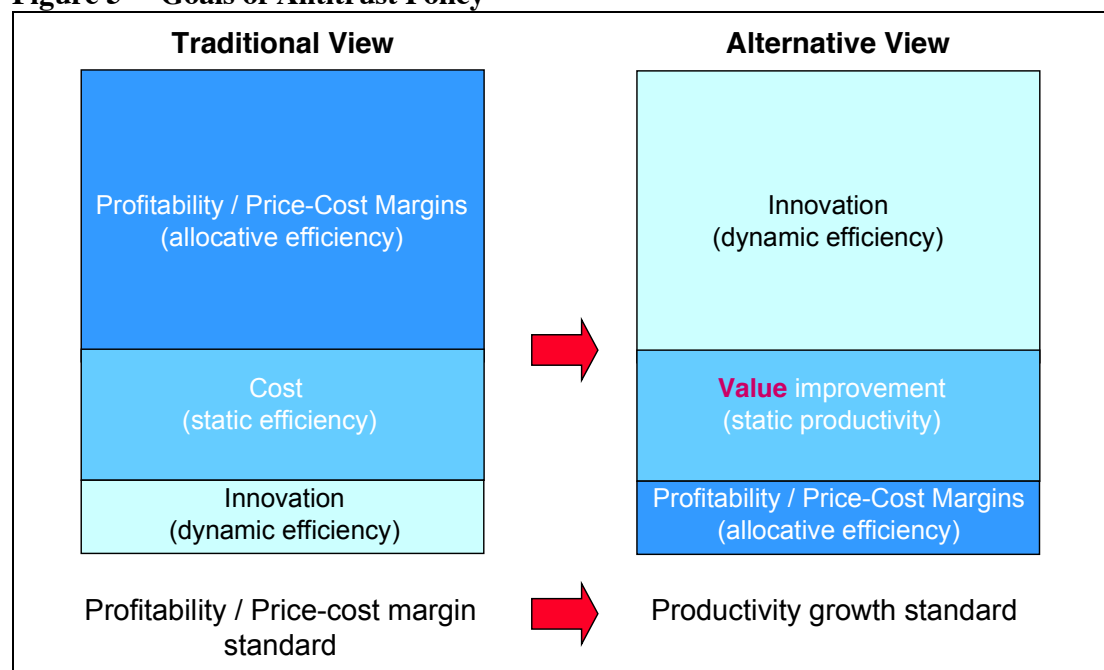
¹⁵⁷ See, prior note and, for a general survey of academic literature, OECD, “Application of Competition Policy to High Tech Markets”, OCDE/GD(97)44, 1997, Background Note prepared by the Office of Policy Planning of the FTC, pp. 7-8: “Contemporary economists and antitrust scholars have acknowledged the primary significance of technological progress. From a static viewpoint, a reduction in price is typically less welfare-enhancing than an equal reduction in cost, although the effects are closer if

example, Porter and Brodley have proposed turning the traditional hierarchy of competition policy goals upside down¹⁵⁸. The table proposed by Porter is self-explanatory:

concern is focused on consumer welfare alone. The lower price increases total economic welfare (as opposed to transferring wealth from producers to consumers) only to the extent that it increases output, whereas the reduction in cost has the added benefit of freeing resources that can be used elsewhere in the economy [footnote: Gilbert & Sunshine, "Incorporating Dynamic Efficiency Concerns in Merger Analysis: The Use of Innovation Markets," 63 *Antitrust L. J.* 569, 573 (1995)]. More significantly, "over the long run the gains to society from continuing innovation are vastly greater than those associated with competitive pricing." [footnote: Ordoover & Willig, "Antitrust for High-Technology Industries: Assessing Research Joint Ventures and Mergers," 28 *J. Law & Econ.* 311, 311-12 (1985) ("Ordoover & Willig 1985"), quoting, Nelson & Winter, "The Schumpeterian Tradeoff Revisited," 72 *Am. Econ. Rev.* 114 (1982). Thomas Jorde and David Teece, leading contemporary exponents of the Schumpeterian view agree: "it is dynamic competition propelled by the introduction of new products and processes that really counts." T. Jorde and D. Teece, *Antitrust, Innovation, and Competitiveness* 5 (1992)]. For example, if market power reduced gross national product ten percent below the competitive level but allowed growth at an annual rate of 3.5 per cent rather than 2.5 per cent, the compound effects of the higher growth rate would cause the monopolised economy to surpass the competitive economy in under eleven years. Allocative efficiency losses at the considerably lower levels typically suggested by empirical studies are correspondingly less significant [footnote: F. M. Scherer & D. Ross, *Industrial Market Structure and Economic Performance*, 613, 667 (3d ed. 1990) (estimating the deadweight welfare loss attributable to monopolistic resource misallocation in the United States at between 0.5 and 2 percent of gross national product). Wesley Cohen and Richard Levin observe that although empirical estimates of the costs of resource misallocation attributable to market power range from "miniscule" (0.7 per cent) to "substantial" (4-13 per cent), even the largest of the estimated costs "might be worth incurring in return for modest improvements in the rate of technological progress." Cohen & Levin, "Empirical Studies of Innovation and Market Structure," printed in 2 *Handbook of Industrial Organization* 1059, 1060, 1078-79 (R. Schmalensee & R. Willig ed. 1989). See W. Shepherd, *Market Power and Economic Welfare* 196-98 (1970) (estimating losses from monopolistic resource misallocations of 2.5 per cent of national income). See generally, E. Denison, *Trends in American Economic Growth, 1929-1982* 31 (1985) (finding advances in knowledge "much the largest source of growth" in the non-residential business sector)]. Considerations of this nature, coupled with evidence suggesting that private markets may provide less than optimal incentives to innovate [footnote: See Baker, "Fringe Firms and Incentives to Innovate," 63 *Antitrust L.J.* 621, 622 n.5 (1995) ("Studies of the return to investment in research and development invariably find that the return to society is more than double the return to the firms making the investment, suggesting that private markets provide less than the optimal incentive to innovate.")] and a belief that the rapidity of innovation is likely to prevent or diminish any competitive harm, have led many analysts to conclude that in making assessments of market power and the likelihood of anticompetitive effects enforcers should err on the side of promoting innovation [See, e.g., Hruska, "A Broad Market Approach to Antitrust Product Market Definition in Innovative Industries," 102 *Yale L.J.* 305, 310-11 (1992) (broad market definition justified in context of high-technology innovation); Jorde & Teece 1992, *supra* note 2, at 5 ("when the promotion of static consumer welfare and innovation are in conflict, the courts should favor the future impact"); Jorde & Teece, "Innovation and Cooperation: Implications for Competition and Antitrust," 4 *J. of Econ. Perspectives* 75, 91 (1990) ("Jorde & Teece 1990") ("if antitrust policy is going to err, it ought to do so by facilitating innovation, rather than inhibiting it")]. However, the European Commission delegate in the Roundtable did not see a conflict between price-competition and innovation: See Aide-Memoire of the Discussion, prepared by the OECD Secretariat, p. 105: "The Delegate from the Commission of the European Union raised firstly the fundamental question, whether competition authorities have always been wrong by concentrating on price competition instead of innovation. Is there a contraction between innovation and competition? The delegate, while recognising that innovation is the main source of increases in economic welfare, did not subscribe to the view that such a contraction exists. The economic literature does not seem to support the view that concentration or restriction of competition leads to more innovation. On the contrary, in general it seems that competition and open markets are an incentive for innovation, thereby taking away a possible conflict between competition policy and the protection of innovative activity."

¹⁵⁸ Porter 2002, and Brodley, "The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress", *N.Y.U. L. REV.* 62, 1987.

Figure 5 Goals of Antitrust Policy



Source: Porter 2002, p. 11.

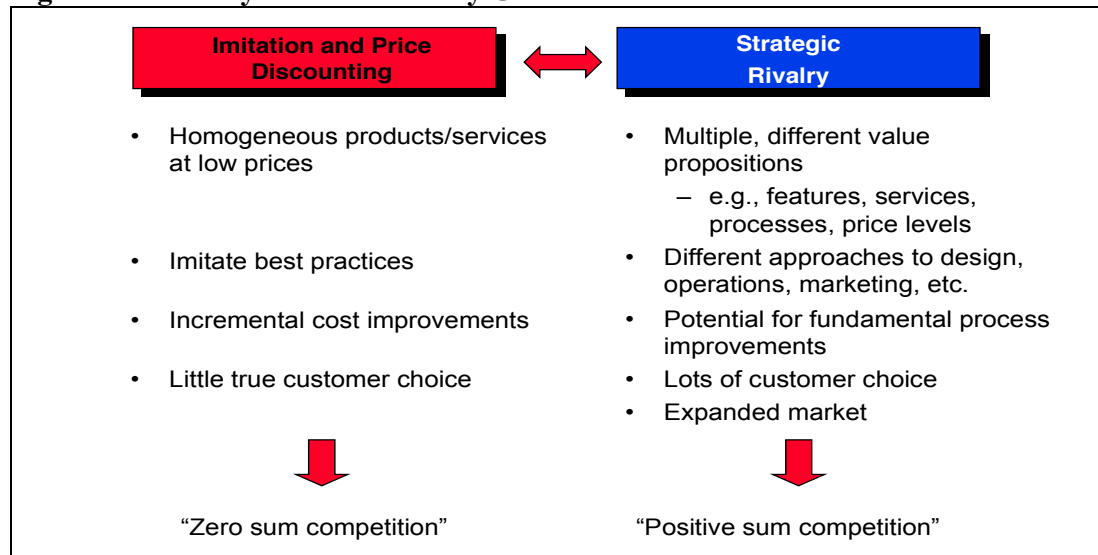
Porter holds that because of its direct effect on productivity growth, the most important goal for society is a healthy process of dynamic improvement, which requires innovations in products, processes, or ways of managing¹⁵⁹. A productivity growth standard suggests that technical (static) efficiency should be the second most important goal, but that it must be assessed with more subtlety. Productivity is enhanced not just by efficiency (cost) improvements, but also by improvements in product quality, features, and services. Product variety is also an essential component of value, giving customers more choices to better meet their particular needs. High-value products provide the consumer with superior performance and features, and therefore justify higher prices. With a focus on price/cost margins, however, high prices are often seen as inherently undesirable for consumers. Higher prices should be a danger sign in antitrust analysis only if they are not justified by rising customer value. Finally, limiting short-term price/cost margins or profitability is a dubious goal for antitrust. Firm profitability is a good thing if it reflects truly superior products or significant advantages in process technology or operating efficiency. It is a bad thing if it occurs in the absence of a healthy rate of dynamic improvement. In a typical industry, average price-cost margins and profitability will vary significantly among competitors, reflecting varying levels of fundamental competitiveness. Short-term consumer welfare measured by price, then, is a dubious goal on two levels. First, it fails to measure true consumer welfare by ignoring product value. Second, we care much more about the long-term trajectory of value, prices, and costs than we do about consumer welfare in the short run or immediately after a merger.

¹⁵⁹

Porter 2002, pp. 11-13.

Furthermore, not all forms of rivalry/competition are the same. Some forms of rivalry are more productivity-enhancing than others and, thus, more socially valuable. Porter differentiates between competition based on imitation/price discounting (“the Imitation and Price Discounting model”) and competition based on strategic rivalry (“the Strategic Rivalry model”)¹⁶⁰.

Figure 7 Rivalry and Productivity Growth



Source: Porter 2002, p. 16.

If price/cost margins are used as the metric of social benefit, then imitation and price discounting seem ideal. Customers get the benefit of low prices, and the ability to play one company against others. From a productivity growth standpoint, however, this form of zero sum competition leads to slower dynamic improvement. Competition on strategic positioning can foster increased variety and greater choices for customers in terms of the product that best meets their needs, not to mention more innovation in products and processes. In strategic competition, markets often expand as new needs are met and new customers are drawn into the market.

In line with Porter, Brodley holds that the economic goals of antitrust are innovation, productive efficiency, and allocative efficiency, in that order¹⁶¹. He also emphasizes the critical importance of the competitive process (inter-firm rivalry) to achieve these goals and coins the term “antitrust welfare”¹⁶².

¹⁶⁰ Porter 2002, pp. 16-17: “Assessing the two according to the productivity growth standard gives very different results. Imitation-based competition leads to similar products among rivals and strong pressures for price discounting. Strategic competition occurs when rivals pursue different value propositions: some firms offer low prices producing stripped down products, others have higher prices but provide better service, while still others concentrate on various segments of the market, tailoring their products and value chains accordingly.”

¹⁶¹ Brodley 1987.

¹⁶² Fox, ““Antitrust Welfare” – The Brodley Synthesis”, Boston University Law Review 90, 2010, p. 1377: “It is: “[T]he economic goal of antitrust policy is to increase the material welfare of society through the instrument of interfirm rivalry.” This is accomplished by a blending of economic efficiency and consumer welfare, pursued in a long-run time frame, concentrating on long-run structural factors such

Even those economists and lawyers traditionally associated with the neo-classic economic model have had to adapt their views on the goals of competition policy in order to capture the critical importance of dynamic efficiency¹⁶³.

Some have proposed to consider the protection of dynamic rivalry/competition as a different goal than the narrowly construed concepts of “consumer welfare” and “consumer surplus”¹⁶⁴. The term “economic freedom”, inspired by Ordoliberalism and seemingly influential in German and EU Competition Law¹⁶⁵, could also be reconciled with this approach¹⁶⁶.

An influential economist of the Federal Trade Commission (“FTC”), Joseph Farrell, has exposed that competition policy should protect competition sources (diversity) where the complexity is too high for having reliable information about the right solutions. This “econodiversity” is another crucial benefit of competition, which he calls the “dark matter of competition”, because it is hard to pin down and prove¹⁶⁷. The negative effects

as concentration and entry and exit barriers, and driven by rivalry. This unique blend of efficiency and consumer welfare achieved through the instrument of rivalry might be called, Brodley says, “antitrust welfare”.”

¹⁶³ Yet, none of these theories has articulated as comprehensively as Porter the link between the goals of competition policy and economic growth.

¹⁶⁴ See, for example, Grandy, “Original Intent and the Sherman Antitrust Act: A Re-examination of the Consumer-Welfare Hypothesis”, *Journal of Economic History*, 1993; and Farrell and Katz, “The Economics of Welfare Standards in Antitrust”, Mimeo, Competition Policy Center, UC Berkeley, 2006, pp. 4-5: “Those who claim that U.S. antitrust policy imposes a consumer or total welfare (or any welfarist) standard are omitting a crucial element of antitrust: that it examines not only consequences (the change in consumer or total welfare) but also the process (the nature of the acts) that generates the consequences. Specifically, antitrust prohibits firms from harming consumers and/or efficiency *through anticompetitive actions*”, and p. 7: “Thus, in antitrust as it is practiced both consequences and process count: it never answers only the question “does this practice reduce some measure of surplus?” It is incomplete and potentially misleading to say that antitrust protects consumer surplus, total surplus, or rivals’ profits. Rather, conduct can violate the antitrust laws only if it harms “competition.” As many have noted, the concept of harming competition is often hard to interpret, and too naïve an interpretation would prohibit many beneficial agreements. Thus, the law has evolved toward prohibiting only acts that *both* (a) hurt competition in an ordinary (if sometimes vague) sense *and* (b) hurt efficiency and/or consumer surplus. The debate over “the standard” is the debate over the standard applied in the second prong. We think that the debate is clarified by keeping this two-pronged criterion explicit, and not seeking to have the second prong redefine the word “competition” or claiming that antitrust is straightforwardly welfarist.”

¹⁶⁵ See Peacock and Willgerodt (editors), *German neo-Liberals and the Social Market Economy*, Macmillan, 1989 and Gerber, *Law and Competition in Twentieth-Century Europe*, Oxford University Press, 2001, chapter VII.

¹⁶⁶ For a practical overview of the Bundeskartellamt’s position, see Engelsing, Marsden and Möller, “A Bundeskartellamt/Competition Law Forum debate on reform of article 82: a “dialectic” on competing approaches”, *Competition Law Journal* 2, Special Issue “A Debate on Reform of Article 82”, July 2006. The potential conflicts between economic freedom and the narrowly construed notion of consumer welfare are highlighted in Lovdahl, “The conflict between economic freedom and consumer welfare in the modernisation of article 82 EC”, *European Competition Journal* 3-2, December 2007.

¹⁶⁷ Farrell, “Complexity, Diversity, and Antitrust”, *Antitrust Bulletin* 51, 2006, pp. 165-173.

of the loss of independent sources of innovation and of fewer experiences on dynamic efficiency would also be detrimental for consumer welfare.¹⁶⁸

Even one of the leading proponents of the consumer surplus approach (Robert Lande) and a relevant FTC official (Neil Averitt) have jointly proposed to interpret consumer welfare as meaning consumer choice, in order to take into account other non-price factors (including innovation) that shape consumer preferences¹⁶⁹. Long ago, an FTC Commissioner, Michael Leary, proposed a similar concept, i.e., consumer freedom/sovereignty¹⁷⁰.

¹⁶⁸ Kerber 2010, p. 22: "Here the problem of less decentralization are the negative effects of the loss of independent sources of innovation and of fewer experiences through less experiments on the evolution of the pool of knowledge in the entire industry, from which all can learn. However, also these effects can fit well into the established antitrust framework: Such negative effects on dynamic efficiency would be detrimental for consumer welfare, and therefore can be seen as a "significant impediment to effective competition" (in European merger cases) or a "significant lessening of competition" (in US antitrust law)."

¹⁶⁹ Averitt and Lande, "Using the 'Consumer Choice' Approach to Antitrust Law", *Antitrust Law Journal* Vol. 74, 2007, p. 175: "In this article we suggest replacing the older paradigms with the somewhat broader approach of "consumer choice". The choice framework has several advantages. It takes full account of all the things that are actually important to consumers— price, of course, but also variety, innovation, quality, and other forms of nonprice competition"; p. 178: "Although making only moderate changes in practice, our proposed choice model is also broadly and essentially new in principle. It represents nothing less than a new paradigm of the antitrust laws, one that will be helpful throughout the antitrust field. The consumer choice approach is fundamentally superior to the price and efficiency paradigms because it asks the right question. It recognizes that consumers do not just want competitive prices—they want options [footnote: Consumers want books that reflect their interests, not just cheap books; and they want pharmaceuticals that will cure their illness, not just cheap pharmaceuticals]. Framing the issue in this way starts the analysis on the right foot, presents the questions in a desirably transparent way, ensures that important long-term factors like innovation receive their full due [footnote: Innovation is the key to having future choices. The choice formulation thus brings to antitrust analysis an increased emphasis on two related elements: the short-term importance of nonprice options and the long-term importance of innovation. This can work either for or against an enforcement action. Sometimes the greater emphasis on innovation might make an innovation defence more likely to prevail, so that the new model could result in certain cases not being brought. In any event, we would see a somewhat different menu of cases], and helps to guard against circumstances in which enforcers inadvertently neglect important choice factors that are simply hard to translate into terms of price [footnote: This may be a more frequent shortcoming than is commonly realized. The price or efficiency approach typically defines "price" as price that is adjusted, somehow, for quality, variety, and innovation. See *infra* note 28. It is not clear how often these adjustments are actually made in reality]. Competitive prices will then become just one of the choices that are relevant to consumers—the controlling choice and the focus of analysis in the vast majority of cases, to be sure, but conceptually still a subset of choice."

¹⁷⁰ Leary, "Freedom as the core value of antitrust in the new millennium", ABA Antitrust Section 48th Annual Spring Meeting, Washington, D.C., April 6, 2000: "Consumer sovereignty or "buyer freedom" means that consumers are generally free to buy whatever they want and can afford, whether other people think it is good for them or not. Like seller freedom, buyer freedom does not flourish in the abstract. As we have seen, seller freedom implies the ability to have access to needed inputs or channels of distribution, and recognizes that sellers must be free to make efficient choices. Similarly, consumer freedom implies the right to buy in open markets from sellers who can be trusted. These ancillary rights become increasingly important as trade expands and transactions become more anonymous. Personal trust and confidence in fair dealing have been supplemented by competition and consumer protection law as guarantors of key elements of buyer freedom. Moreover, traditional consumer welfare economics, with its emphasis on producers' price and output decisions, things that can be quantified and manipulated in equations, has not had much to say about the infinite varieties of consumer taste. Not everyone patronizes the movie theater with the cheapest tickets or the restaurant that advertises "all you can eat." Attention to individual tastes will become more and more important as exploding technology provides the means to satisfy them in ways heretofore unknown. Recognition of a "buyer freedom" as an active value may

The unanimous consensus among enforcers and academia that dynamic competition should be at the forefront of competition policy does not call for a hands-off approach by competition authorities, but a refocus of their enforcement priorities from short-term static competition towards long-term dynamic competition¹⁷¹. For example, Brodley supports competition enforcement against practices that may distort innovation without leading necessarily to downstream price increases¹⁷².

In light of the foregoing, one would expect that competition authorities aligned their policy and enforcement with the drivers of innovation and economic growth. Indeed, the public declarations of the current President and several Competition Commissioners of the European Commission point to dynamic efficiency (productivity and innovation) as the most important goal of EU competition policy¹⁷³. Likewise, the European

therefore stimulate more attention to qualitative concerns. Impacts on product variety, for example, may be viewed as analogous to impacts on product quality”; and “The Significance of Variety in Antitrust Analysis”, *Antitrust Law Journal* 67, 2001, p. 1021: “If it is true that matters other than price are of prime importance to consumers, in ever-growing sectors of the economy, an intelligent antitrust policy should respond accordingly”. Thomas Leary has practised competition law for more than 50 years, both in private practice and at the FTC, where he served as Commissioner. He has received the Miles W. Kirkpatrick Award for Lifetime FTC Achievement and an award for Lifetime Contributions to Antitrust and Regulatory Policy from The American Antitrust Institute.

¹⁷¹ Kerber 2010, pp. 21-22: It should be emphasized that the current notion in the U.S. discussion that Schumpeterian competition would lead to a more permissive competition policy with less enforcement is not necessarily true. In their broad over- view article, in which they advocate strongly for more consideration of long-term innovation effects in merger policy, Katz/Shelanski (2007) demonstrate very clearly that this can lead both to the recommendation of being more or less restrictive in regard to the clearance of mergers.”

¹⁷² Brodley, “Post-Chicago Economics and Workable Legal Policy”, *Antitrust Law Journal* 63, 1995 and Fox 2010, p. 1377: “[I]s a price increase in the downstream consumer market the necessary condition for an antitrust violation...?” Brodley says no. The short-term view requiring price rise, he argues, “ignores the source of the heaviest penalty on economic welfare – loss of productive and innovation efficiencies. Indeed, these losses are apt to far outdistance those from static or allocative inefficiency.” For this example, Brodley uses *Eastman Kodak Co. v. Image Technical Services, Inc.*, assuming counterfactually that the price of aftermarket service had not risen. (...). Brodley concludes: “exclusionary conduct that undermines competitive conditions by destroying investment incentives, and which at the same time fails to produce any positive benefit for consumers, should be unlawful even in the absence of a predictable price increase in the impacted market.””

¹⁷³ Keynote speech by President Barroso, “European Union Competition policy – a building block for growth and renewal”, European Competition Forum Brussels, 2.02.2012: “Healthy and competitive markets stimulate entrepreneurship and encourage companies to be innovative – to create new products and services that meet demand. In turn, this helps to create jobs among successful players, triggers more competitive prices and gives consumers a wider choice of products and services. That is why innovation is a cornerstone of our growth agenda - because it is about more than product development. It is about the way our society changes and improves. It is about the way we do business. It is about turning new ideas into growth for our companies, jobs for our citizens and well-being for our societies. And that is why competition policy is a foundation for our growth and innovation strategy – precisely because it creates the right conditions”; Almunia, Vice President of the European Commission responsible for Competition Policy, “Fuelling growth in Romania: The role of competition policy”, Conference on competition in sensitive sectors of the Romanian economy, Bucharest, 21.10.2011: “The facts are all here: Europe badly needs to boost growth. We need our people to be equipped with the right skills and knowledge to make it happen. And growth will only come if our companies can innovate, become more efficient and develop a stronger entrepreneurial initiative. Competition is the main ingredient of this recipe. Because healthy competition stimulates entrepreneurship, improves efficiency and creates the best conditions for innovation. In turn, this helps create jobs, triggers more competitive prices and gives a wider choice of

Commission Guidelines have emphasized a healthy competitive process/dynamic as the best instrument to promote consumer welfare in its multiple manifestations, including innovation¹⁷⁴.

products and services to consumers”; and “Competition v Regulation: where do the roles of sector specific and competition regulators begin and end?”, Center on Regulation in Europe, 23.03.2010: “For markets to work well, we need effective competition. This is where competition policy comes into play. We can prevent mergers that will significantly reduce competition on the market, put an end to cartels or stop companies from abusing positions of dominance to the detriment of consumers. Or indeed, we can ensure that Member States do not distort competition on the market through state aid. Competition also drives companies to be more efficient and encourages them to innovate. This enhances their competitiveness at home, in Europe, and worldwide. In turn it will boost productivity and growth, and create jobs. For this reason, competition policy is fundamental to the Commission's new Europe 2020 strategy for achieving a new period of growth and dynamism in Europe”; Kroes, European Commissioner for Competition Policy, “Consumer welfare: more than a slogan”, Competition and Consumers in the 21st Century, Brussels, 21.10.2009: “For the Commission's part, competition policy is about more than lowering prices for consumers. Our effect on choice and quality is just as important. We must also consider the benefits of more dynamic efficiencies associated with innovation and increased productivity. This is not to say that our work delivers these benefits directly. We are not a one-stop-shop for consumer demands - that should be the job of companies. But we do occupy an important space: we enable a functioning market”; and “In defence of competition policy”, Competition policy, growth and consumer purchasing power, Brussels, 13.10.2008: “What worked for Japan and FIAT has been working the world over: competition encouraged by competition policy has fostered economies of scale and innovation. This is crucial for Europe's future competitiveness. Competition drives total factor productivity growth – the productivity that comes from technical progress and organisational innovation, which in turn is where the money is. Greater competition can improve this sort of productivity growth by 4 percent. What does that really mean in an everyday workplace? It means managers learn to work for their profits instead of being handed them on a plate – and they are offered a way to grow and maintain sustainable profits. (...). But let no one believe that the benefits of competition policy are felt only on the factory floor or on the company balance sheet. Where the Commission intervenes, we make sure there is a positive difference for final consumers.”

¹⁷⁴ The emphasis on the instrument/means (competitive process) over the final outcome (consumer welfare) can be discerned in many provisions. See, for example, Communication from the Commission — Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings (“EU Guidelines on Article 102 TFEU”), OJ C 45, 24.02.2009, pars. 5-6: “(5) In applying Article 82 to exclusionary conduct by dominant undertakings, the Commission will focus on those types of conduct that are most harmful to consumers. Consumers benefit from competition through lower prices, better quality and a wider choice of new or improved goods and services. The Commission, therefore, will direct its enforcement to ensuring that markets function properly and that consumers benefit from the efficiency and productivity which result from effective competition between undertakings. (6) The emphasis of the Commission's enforcement activity in relation to exclusionary conduct is on safeguarding the competitive process in the internal market and ensuring that undertakings which hold a dominant position do not exclude their competitors by other means than competing on the merits of the products or services they provide. In doing so the Commission is mindful that what really matters is protecting an effective competitive process and not simply protecting competitors. This may well mean that competitors who deliver less to consumers in terms of price, choice, quality and innovation will leave the market”; Commission Guidelines on Article 101(3) TFEU, par. 16: “Agreements between undertakings are caught by the prohibition rule of Article 81(1) when they are likely to have an appreciable adverse impact on the parameters of competition on the market, such as price, output, product quality, product variety and innovation. Agreements can have this effect by appreciably reducing rivalry between the parties to the agreement or between them and third parties”; and par. 24: “For an agreement to be restrictive by effect it must affect actual or potential competition to such an extent that on the relevant market negative effects on prices, output, innovation or the variety or quality of goods and services can be expected with a reasonable degree of probability”; Commission Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements (“EU Horizontal Guidelines”), OJ C 11, 14.1.2011, par. 27: “For an agreement to have restrictive effects on competition within the meaning of Article 101(1) it must have, or be likely to have, an appreciable adverse impact on at least one of the parameters of competition on the market, such as price, output, product quality, product variety or

However, the day-to-day enforcement of competition rules by competition authorities stands in stark contrast with their self-declared goals and tends to rely exclusively on static price analysis/competition at the expense of dynamic competition¹⁷⁵. Curiously, competition authorities' drive towards a more "effects based" approach may lead to a static price analysis (more easy to measure than other non-price variables, more so in a dynamic context) and do more harm than good from a policy perspective¹⁷⁶.

innovation. Agreements can have such effects [on the different parameters of competition] by appreciably reducing competition between the parties to the agreement or between any one of them and third parties. This means that the agreement must reduce the parties' decision-making independence, either due to obligations contained in the agreement which regulate the market conduct of at least one of the parties or by influencing the market conduct of at least one of the parties by causing a change in its incentives"; and par. 28: "Restrictive effects on competition within the relevant market are likely to occur where it can be expected with a reasonable degree of probability that, due to the agreement, the parties would be able to profitably raise prices or reduce output, product quality, product variety or innovation."

¹⁷⁵ Fox 2010, p. 1378: "Yet static efficiency has consumed the enforcement agencies. The striking result, says Brodley, is that antitrust misallocates enforcement resources by directing most of its resources to practices that "injure pricing efficiency in output markets" (cartels) while ignoring exclusionary conduct that disincentivizes innovation"; and Foer, "The Goals of Antitrust: Thoughts on Consumer Welfare in the U.S.", The American Antitrust Institute Working Paper 05-09, 2005, pp. 27-28: "Also questioned is why competition policy should focus exclusively on prices. The microeconomic focus on price is the result of a definition of efficiency that is based on exchange, in that exchange is carried out by a universal medium of value, i.e. monetary price. Price is the one value that can easily be quantified, hence made susceptible to scientific measurement and manipulation. When you ask consumers why they want competition to play a large role in the economy, it is true that they will likely point to competitive prices as being advantageous. (It is also possible that they will say that competition is desirable because it drives out waste.) But, if they take a moment to think about it, they will likely mention other effects that they desire from competition: a reasonably wide range of products and services to choose from (and the empowerment of leverage that this suggests) and the progressivity and growth of a system that encourages improvements and innovations. Competition that brings low prices will often also engender the other desiderata of variety and innovation. But not always. If a competitive system that delivers only competitive prices is not likely to be entirely satisfactory, why should we accept price as if it were a proxy for all the desiderata?"

¹⁷⁶ See, for example, Kerber 2010, p. 21: "The recent developments of using more economics in European competition law as well as in US antitrust law have led to an increasing tendency of focussing primarily on short-term effects of mergers and other business practices on prices and quantities (as indicators for consumer welfare). Long-term effects and, in particular, effects on innovation only play a role in a small number of cases, primarily in high technology markets. In many merger cases, it is not even discussed whether such mergers might have negative effects on the long-term development of new products or technologies"; Leary 2001: "Traditional antitrust analysis relies on economic models that generally assume commodity-like products. Perfect competition, monopoly, and even many oligopoly models rely on the simplifying assumption that products are homogeneous. The critical variables are cost, price and output. For many markets, these models have enabled us to make predictions at least about the likely direction, and perhaps the magnitude, of the changes likely to result from various business strategies -- even if the realities of the particular market did not precisely match the models' assumptions. However, as the assumption of homogeneous commodity products becomes progressively less realistic in the real world, we need to ask the question whether the traditional models will continue to be so useful. What can be said about non-homogeneous products, services, and experiences, which exist in bewildering 'variety'"; and Leary 2000: "Product quality is currently recognized as a positive consequence of competition, but it is not measured by most economic models that rely on the simplifying assumption of product homogeneity. For another thing, as we have seen, facts cannot be ignored simply because present methods do not permit them to be described and measured with full scientific rigor. Qualitative factors become progressively more important as people move further away from a subsistence standard of living. Measures of output and price do not capture the total economics of consumer welfare - - much less the economic welfare of the other actors in the system, which can have an ultimate effect on consumer welfare"; and Averitt 2007, p. 174: "The current paradigms of antitrust law—price and efficiency—do not work well enough. True, they were an immense improvement over their predecessors, and they have

As a consequence, the conventional competition analysis of supermarkets tends to associate supermarkets' welfare (surplus) with consumer welfare (surplus), measured by low purchase (and retail) prices (i.e., prices close to cost).

Therefore, the first and fundamental criticism of the conventional competition analysis of supermarkets' power is that it focuses exclusively on static price/margin considerations, overlooking other competitive variables (e.g., innovation, quality and variety) that are much more important from an economic perspective. The second criticism is that an isolated analysis of retail prices disregards the links between retail and procurement markets. For example, all the payments and costs imposed on grocery brands may increase the purchase prices and, accordingly, the retail prices.

5.2.2 Consumer welfare is not corporate buyers' welfare

The influence of the neo-classic model of static competition can be identified in the association of corporate buyers/retailers with consumers for the purposes of the welfare analysis. According to the European Commission Guidelines, the term 'consumer' refers not only to end-consumers, but also to buyers of the products/services down the distribution chain¹⁷⁷. This association of corporate buyers with end-consumers responds to the simplifying assumptions of the neo-classic model, where only producer-consumer relationships were considered and intermediate buyers were excluded¹⁷⁸.

served the field competently for a generation, producing reasonably accurate results in most circumstances. Accumulated experience has also revealed their shortcomings, however. The price and efficiency paradigms are hard to fully understand and are not particularly transparent in their application. Moreover, in a disturbingly large number of circumstances they are unable to handle the important issue of nonprice competition."

¹⁷⁷ See, for example, the EU Guidelines on Article 101(3) TFEU, par. 17.

¹⁷⁸ See, for example, Salop 2010, pp. 336-337, footnote 3: "Most analysis of competing welfare goals takes place in a simple framework in which there are firms selling products to final consumers. In this case, the consumers are the buyers and the firms are the sellers. Much economic conduct involves producers at one level selling products that are used as inputs by intermediate sellers, who produce their own products. In those instances, the analysis of welfare standards generally involves a partial equilibrium analysis that treats the purchasers as the "consumers" and the sellers as the "producers." Antitrust sometimes goes beyond the immediate level and evaluates the welfare of final consumers, as in the case of manufacturers' vertical distribution restraints. However, to keep the analysis simple, this article generally will focus on products sold to final purchasers. It will refer to the buyers as the "consumers" and the seller as the "firm"; and Cseres, "The Controversies of the Consumer Welfare Standard", *Competition Law Journal* 3-2, 2006, p. 132: "As has been illustrated above most welfare standard analysis takes place in a simple framework where firms are selling products to final consumers and where the firms are the sellers and consumers are the buyers. However, economic conduct often takes place between producers on one level selling inputs for intermediate sellers who produce their own products and then sell on the retail market. When intermediate firms have some market power and thus competition is not strong they may decide not to pass on efficiencies in the form of lower prices but keep these savings as rents. Pass-through of efficiencies to final consumers depends on demand side conditions and the oligopoly game firms are playing. Thus there are situations where final consumers would be left worse off, even as some (or even all) intermediate good producers benefit. The investigation competition authorities conduct today pay no attention to these differences except in cases where the retail market is the relevant market where the parties set off their products."

The influence of the static neo-classic analysis based on prices and the association of buyer welfare with consumer welfare has biased competition rules in favour of buyers in vertical relationships. For example, for more than 50 years, EU competition policy has interfered with sellers' freedom to manage their distribution networks in order to promote distributors' freedoms and, in particular, price competition within these networks. If the general regime on vertical restraints was not considered protective enough of distributors, the European Commission did not hesitate to reinforce it for specific sectors such as beer, gasoline and motor vehicles¹⁷⁹. All these sectors were considered to be highly concentrated even though no company held a dominant position in any given geographic market. In particular, the motor vehicle sector is a paradigm of competition law intervention to undermine the perceived market power of car manufacturers. Starting in 1995 and still ongoing, the EU has protected car dealers, producers/distributors or spare parts and independent providers of repair/maintenance services from the "abuses" of car manufacturers that have never been found to enjoy a single or collective dominant position. In particular, until the current Regulation 461/2010, in addition to the safeguards against conventional vertical restraints, dealers were free to sell competing brands (multi-brand dealerships) against the will of manufacturers¹⁸⁰, and benefitted from additional contractual guarantees: the right to oppose sales targets and stock requirements; the right of the dealer or authorised repairer to sell his business and all the associated rights and obligations to another member of the brand network; the obligation to state the reasons for terminating an agreement; the right to arbitration in the event of a dispute relating to the agreement; the obligation to conclude agreements of limited duration for a minimum period and to require a period of notice in the event of non-renewal or termination of the agreement¹⁸¹. On the other hand, Regulation 461/2010 has guaranteed and even

¹⁷⁹ Regulation 1984/83 contained specific provisions for beer and gasoline distribution agreements. The distribution of car vehicles has been successively regulated since 1985, most notably in Regulations 1475/95, 1400/2002 and, currently, 461/2010.

¹⁸⁰ Yet, Regulation 461/2010 contemplates a transitional phase until the end of 2013, to allow sufficient time for dealers, who invested in multi-branding, to amortize their investments.

¹⁸¹ The Commission has suppressed these safeguards because, in the absence of a dominant position, they are considered to fall outside the realm of competition rules. However, the "fierce competition" between car manufacturers has not prevented the Commission from imposing on them obligations regarding spare parts producers/distributors and independent providers of repair/maintenance services. See, Almunia, "Introductory remarks to European Parliament on review of Motor Vehicle Block Exemption Regulation", European Parliament Plenary Session, SPEECH/10/214, 5.05.2010: "Concerning the reason why we are proposing to do away with clauses granting contractual protection to the dealers, it is simply because competition law is not the appropriate instrument to address eventual imbalances between contractual parties. These issues belong to the sphere of commercial law. In a competitive market such as the car market, competition law should not interfere with the balance of powers between the different contracting parties. To do so would be intrusive. And we have to be proportionate when we interfere in how markets work(...).My main priority is to increase competition in the after-sales market, in repair and servicing, where it is most lacking. Although vehicle manufacturers may be in a strong commercial position vis-à-vis dealers, they compete fiercely with each other, and today there is no need to deviate from the Block Exemption Regulation for Vertical agreements, adopted recently and that will come into force also at the end of this month. "

increased the protection of independent providers of spare-parts and repair/service services that compete with those provided by the car manufacturers' networks¹⁸².

However, if competition policy is about protecting competition in the market and not competitors and rents, manufacturers and retailers should be treated alike, irrespective of the welfare standard supported, when their individual practices are analysed.

Indeed, in the British Airways case, the European courts established the legal principle that seller power and buyer power are to be treated alike under European competition rules¹⁸³.

¹⁸² European Commission Press release, "Commission adopts revised competition rules for the motor vehicle sector: frequently asked questions", MEMO/10/217, 27. 05.2010: 2. *How do you increase competition in the markets for repair, maintenance and spare parts?* The new block exemption regulation will apply as from 1 June 2010. The main change is that agreements between vehicle manufacturers and their networks of authorised repairers and spare part distributors will no longer benefit from the automatic exemption. This is because these networks usually have a market share of over 30%. This in turn will make it easier to deal directly with refusals to release technical information or the misuse of warranty terms aimed at excluding independent repairers or with new types of restrictions that may arise. Similarly, agreements obliging authorised repairers to purchase spare parts from car manufacturers are unlikely to be block exempted, as vehicle manufacturers also tend to have a market share exceeding 30% in the spare parts markets. This new Regulation also lists three hardcore clauses describing restrictions of competition rules on the spare parts market. 3. *How will access to technical information for independent repairers be ensured under the new legal framework?* These concern restrictions placed by car manufacturers on a) the sale of original spare parts by authorised repairers to independent garages, b) the ability of independent manufacturers of spare parts to supply to authorised or independent repairers, and c) spare parts' manufacturers' ability to put their trade mark or logo on their products. Independent repairers are important because they increase choice for consumers and keep the price of repairs competitive by putting pressure on car manufacturers' authorised repair networks. But for this to happen it is essential that they can get the technical information necessary to do the repairs on increasingly sophisticated cars. Withholding "technical information" will be dealt with directly under Treaty rules on restrictive business practices (Article 101) since, as said previously, the manufacturers, their spare parts and repair shops generally have a market share in excess of 30%. In addition, Guidelines also being adopted contain detailed clarifications as to the notion of technical information, cross-referring to Regulation 715/2007 on type approval of certain cars and all subsequent implementing regulations."

¹⁸³ Judgment of the Court of First Instance of 17.12.2003, Case T-219/99, *British Airways v. Commission*, (Commission Decision of 14 July 1999, IV/D-2/34.780 - *Virgin/British Airways*, OJ 2000 L 30), pars. 101-102: "101. With regard to the fact that the restrictions on competition which the Commission imputes to BA's performance reward schemes arise from the position which BA holds in its capacity not as supplier but as purchaser of air travel agency services, this is irrelevant having regard to the definition of the market in question. Article 82 EC applies both to undertakings whose possible dominant position is established, as in this case, in relation to their suppliers and to those which are capable of being in the same position in relation to their customers. 102. BA itself acknowledged at the hearing, moreover, that it is possible both for a seller and for a purchaser to hold a dominant position within the meaning of Article 82 EC". See also, on appeal, Judgment of the European Court of 15.03.2007, C-95/04, *British Airways v. Commission*, pars. 143-144: "The specific prohibition of discrimination in subparagraph (c) of the second paragraph of Article 82 EC forms part of the system for ensuring, in accordance with Article 3(1)(g) EC, that competition is not distorted in the internal market. The commercial behaviour of the undertaking in a dominant position may not distort competition on an upstream or a downstream market, in other words between suppliers or customers of that undertaking. Co-contractors of that undertaking must not be favoured or disfavoured in the area of the competition which they practise amongst themselves. 144 Therefore, in order for the conditions for applying subparagraph (c) of the second paragraph of Article 82 EC to be met, there must be a finding not only that the behaviour of an undertaking in a dominant market position is discriminatory, but also that it tends to distort that competitive relationship, in other words to hinder the competitive position of some of the business partners of that undertaking in relation to the others (see, to that effect, *Suiker Unie*, paragraphs 523 and 524)."

This outcome respects economic theory and legal precedents, but more importantly, it is a matter of common sense, as the categorization of a company as seller or buyer is more often than not a semantic choice to reflect the same economic reality. The false dilemma between buyer and seller power has been illustrated by two of the most prominent experts in competition law and economics.

Marius Schwartz has pointed out that “economically, it is not always clear which party is the ‘buyer’ and which is the ‘seller’, and provides various examples to illustrate the arbitrariness of the distinction (e.g., barter transactions and financial institutions). Furthermore, in the context of the commercial relationship between a manufacturer and a retailer, a mere reformulation of the traditional supply for resale agreement into a commission agreement may transform the retailer into a provider of distribution services (seller) to the manufacturer (buyer)¹⁸⁴. For example, in the British Airways case, under a traditional analysis, the European Commission could have concluded that the airline was a provider of transportation services (seller) that travel agents and global travel distribution systems aim to distribute (buyers)¹⁸⁵. However, it focused on the critical role of travel agents as intermediaries between airlines and passengers and held

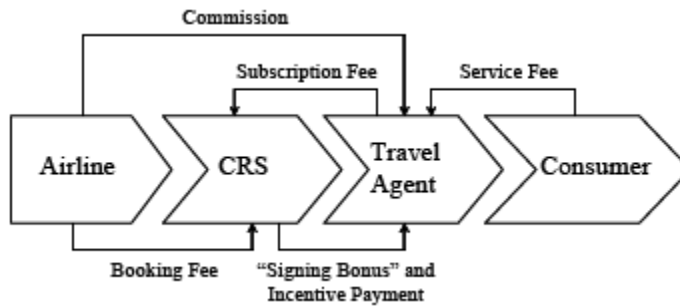
¹⁸⁴ Schwartz, “Should Antitrust Assess Buyer Market Power Differently than Seller Market Power?”, DOJ/FTC Workshop on Merger Enforcement, 17.02.2004, pp. 4-5: “Economically, it is not always clear which party is the ‘buyer’ and which is the ‘seller’. Barter transactions provide an obvious illustration [footnote: For example, consider a content provider supplying programming and a television broadcaster supplying distribution, with the advertising revenue split between the parties. There is no obvious sense in which one party is the buyer rather than the seller]. A second example involves financial intermediaries. In dealing with depositors, an intermediary buys current dollars and sells future dollars. When dealing with borrowers, it sells current dollars and buys future ones. It is arbitrary whether the intermediary should be designated the ‘buyer’ in its role as the borrower or as the lender. Even where the designation of the buyer is seemingly clear, as the party that pays ‘money’ (generalized purchasing power) in exchange for a specific good or service, a simple reformulation of the transaction can switch the identities. For example, suppose that a manufacturer initially sells its good to a distributor. Now it moves to retain ownership of the goods until they are sold to final consumers, and pays the distributor a percentage of the final price – thereby purchasing distribution services. A merger of distributors that increased their market power versus manufacturers creates buyer power in the first case and seller power in the second, with no economically relevant difference between the two cases. The point of these examples is to convey that the nature of the economic analysis in antitrust cases or the criteria for making decisions cannot turn on the labels ‘buyer’ or ‘seller’.” Professor Schwartz served from September 1998 through April 2000 at the Antitrust Division of the U.S. Department of Justice (DOJ) as the Economics Director of Enforcement, and for six months also as the Acting Deputy Assistant Attorney General for Economics (chief economist). From April 1995 through June 1996 he served at the President’s Council of Economic Advisers as the senior economist for industrial organization matters.

¹⁸⁵ See, to that effect, British Airways’ allegations in Case T-219/99, *British Airways v. Commission*, paras. 76-77: “76. BA submits that the Commission imputed restrictions on competition found in the disputed performance reward schemes to the position held by BA in its capacity of purchaser of the services provided by travel agents established in the United Kingdom. By so doing, the Commission departed, first, from its normal method of defining the market in question, thereby prejudging the finding of dominance and ultimately of abuse, and, second, (from the approach set out) in its Notice on the definition of relevant market for the purposes of Community competition law (OJ 1997 C 372, p. 5). 77. Travel agents represent a distribution channel allowing airlines to sell seats on their flights and providing a retail function. However, in markets for branded products, the nature of competition is assessed by taking the markets for the products in question as relevant, rather than those for the purchase of retail services supplied by the points of sale used by manufacturers to market their products.”

that the airline was a buyer of distribution services provided by travel agents (sellers)¹⁸⁶. On the other hand, Computer Reservation Systems (CRSs) have been considered two-sided platforms (sellers) providing services to both airlines and travel agents (buyers). However, large travel agents command sign-in bonuses and incentive payments from CRSs that may outweigh the service fees charged by the latter¹⁸⁷. Therefore, these travel agents are providing services to CRSs rather than buying them from the latter.

¹⁸⁶ Case T-219/99, *British Airways v. Commission*, pars. 92-100: “92. It is clear from BA’s pleadings that it itself acknowledges the existence of an independent market for air travel agency services, since it states in paragraph 11.34 of its application that travel agents themselves operate in a competitive market, competing with each other to provide the best possible service to their customers. 93. In that regard, although travel agents act on behalf of the airlines, which assume all the risks and advantages connected with the transport service itself and which conclude contracts for transport directly with travellers, they nevertheless constitute independent intermediaries carrying on an independent business of providing services (see, to that effect, the judgment in *VVR*, cited in paragraph 84 above, at paragraph 20). 94. As the Commission states in recital 31 of the contested decision, that specific business of travel agents consists, on the one hand, in advising potential travellers, reserving and issuing airline tickets, (and) collecting the price of the transport and remitting it to the airlines, and, on the other hand, in providing those airlines with advertising and commercial promotion services. 95. In that regard, BA itself states that travel agents are and will remain, in the short term at least, a vital distribution channel for airlines, allowing them efficiently to sell seats on the flights they offer, and that there is a mutual dependence between travel agents and airlines which are not in themselves in a position to market their air transport services effectively. 96. As BA has also stated, travel agents offer a wider range of air routes, departure times and arrival times than any airline could. Travel agents filter information concerning various flights for the benefit of travellers faced with the proliferation of different air transport fare structures, which arise from the real-time pricing systems operated by airlines. 97. BA has further recognised that the role which travel agents play in the distribution of airline tickets explains why airlines seek to offer them advantages so that they sell seats on their flights. The irreplaceable nature of the services which travel agents provide to airlines is thus borne out by all the payments which the airlines make to them. 98. Finally, BA has itself emphasised that major travel agents individually negotiate agreements for the distribution of air tickets and that they are thus in a position to set the airlines in competition. 99. That specific nature of the services provided to airlines by travel agents, without any serious possibility of the airlines substituting themselves for the agents in order to carry out the same services themselves, is corroborated by the fact that, at the time of the events of which complaint is made, 85% of air tickets sold in the territory of the United Kingdom were sold through the intermediary of travel agents. 100. The Court therefore considers that the services of air travel agencies represent an economic activity for which, at the time of the contested decision, airlines could not substitute another form of distribution of their tickets, and that they therefore constitute a market for services distinct from the air transport market.”

¹⁸⁷ European Commission Consultation paper on the possible revision of Regulation 2299/1989 on a Code of Conduct for computerised reservation Systems, 23.02.2007, par. 19: “As travel agencies avoid the subscription to several CRSs, the CRS providers compete to attract the travel agencies to their system. Therefore, CRS incentive payments to travel agencies had risen over the years. For smaller agencies, the incentive payments could offset at least partially the subscription fee. But for larger travel agencies, which can generate substantial booking fee revenue, the CRSs effectively paid the travel agency to subscribe. However, travel agents claim that, under the pressure of changing market forces, incentive payments have stopped their upward trend and even have started to decrease in the last three to four years.”



Source: Commission Consultation paper on the possible revision of Regulation 2299/1989

Likewise, Thomas Leary has criticised the artificial distinction between seller power and buyer power and the automatic linkage of dealer freedom with consumer welfare, which thereby introduces an unwarranted bias in favour of retailers in competition policy¹⁸⁸.

5.2.3 New competition policy on supermarkets

The consideration of supermarkets as “buyers” and the association of buyer welfare with end-consumer welfare have led competition authorities to focus their conventional analysis on the overall level of retail prices and supermarket profits as a benchmark for the assessment of the supermarkets’ practices in the procurement market.

This methodology calls for two critiques:

On a substantive level, the conventional analysis neglects the fact that supermarkets adopt the role of service providers (sellers) to grocery brands (buyers) and many of the supermarkets’ practices in the procurement market are not aimed at lowering wholesale prices, as noted by the market reports of the Competition Authorities of Spain and Italy. However, these practices may have a negative impact on retail prices and, even more importantly, on other competitive factors that shape consumer preferences (i.e., quality, variety and innovation).

¹⁸⁸ Leary 2000: “It could be argued that the trouble with pre-Sylvania [US Supreme Court judgment holding that vertical restraints may be pro-competitive] authorities is that they took too limited a view of freedom. They focused only on a dealer’s freedom to select the most effective means for distributing its products and failed to place any value on a manufacturer’s freedom to do the same thing. It was wrong to assume that a manufacturer has no legitimate interest in what happens once it has parted with formal title; it may, for example, have ongoing service responsibilities, concerns about the amenities available at the points of sale to ultimate consumers, and an interest in preserving the goodwill associated with products that bear its name [footnote: As an illustration of the difference that semantics can make, consider whether the law of vertical restraints would have evolved differently if, instead of viewing manufacturers as sellers of products to dealers, courts had earlier recognized that manufacturers are also purchasers of services from dealers. It might have been more obvious that the manufacturers have a legitimate interest in specifying the services that they want to buy and, in effect, establishing at least the maximum price that they are willing to pay. See *State Oil Co. v. Khan*, 118 S.Ct. 275 (1997). In addition, there probably would be less concern about possible facilitation of dealer cartels by manufacturers, because customers very rarely encourage collusion among their suppliers]. In other words, once again there are competing seller freedoms to be accommodated. Consumer welfare economics may be a useful tool for weighing the significance of these competing freedoms, but this most useful calibrating function can be performed without the further claim that consumer welfare is the sole concern”.

On a procedural level, the conventional analysis disregards the case-law and the Commission's practice on cross-market welfare effects¹⁸⁹. As a matter of principle, competition analysis does not taken into account cross-market effects and grocery retailing should not be an exception. Theoretically, the European Commission has conceded that, exceptionally, some two-sided platforms may allow a cross-market analysis¹⁹⁰. However, in practice, not even the card payment networks (often cited as the text-book example of two-sided platforms) have been able to benefit from a cross-market welfare analysis. The European Commission has concluded that there are two groups of consumers in the payment cards industry on an equal footing: "cardholders and merchants (as well as subsequent purchasers)"¹⁹¹. Interestingly, under a conventional consumer surplus analysis, one could conclude that competition policy should favour end-users (card-holders) over retailers. However, by placing retailers on an equal footing with card-holders, the Commission was able to conclude that the MIF adopted by MasterCard restricted competition in the acquiring banks market to the detriment of retailers¹⁹², regardless of their cross-benefits for card-holders¹⁹³. Certainly,

¹⁸⁹ OECD 2009b, Note by the European Commission, par. 52: "The characteristics of two-sided platforms increase the difficulty of analyzing the competitive effects of mergers and other conduct. For example, a merger of exchange or intermediation platforms may slightly reduce competition among vendors on one side of the market, but produce substantial pro-competitive gains from efficiencies for the customers on the other side of the market. Deciding how to balance these offsetting effects is not easy."

¹⁹⁰ *Id.*, Note by the European Commission, pars. 53 and 54: "(53) However both the merger guidelines as well as the guidelines on Article 81(3) leave open the possibility of taking cross market efficiencies into consideration in assessing the overall competitive effects of a merger or agreement. Paragraph 79 of the Horizontal Merger Guidelines states that *"The relevant benchmark in assessing efficiency claims is that consumers will not be worse off as a result of the merger. For that purpose, efficiencies should be substantial and timely, and should, in principle, benefit consumers in those relevant markets where it is otherwise likely that competition concerns would occur"*. Note that the wording clearly suggests that in some (possibly exceptional) circumstances the Commission would take into account efficiencies that benefit one set of consumers as partially offsetting harm to another group. Two-sided platforms may indeed be one of such circumstances. (54) The guidelines on Article 81.3 contain similar wording in paragraph 43: "The assessment under Article 81(3) of benefits flowing from restrictive agreements is in principle made within the confines of each relevant market to which the agreement relates". However, this paragraph further specifies "where two markets are related, efficiencies achieved on separate markets can be taken into account provided that the group of consumers affected by the restriction and benefiting from the efficiency gains are substantially the same". In the case of two-sided platforms, it is clear that the two sides are related. However, agents on each side are in general not substantially the same. Still, benefits on one side of the platform may lead, through the inter-group network effects to compensating benefits to agents on the other side."

¹⁹¹ See the full analysis of card payment networks in Appendix 8.2.7. Regarding the equal treatment of merchants and card-users, see the MasterCard Decision, cited at note 999, par. 258; and the Visa Decision 2010, cited at note 999, par. 82. For a general policy declaration, see the MasterCard Decision, par. 266: "MasterCard's concept of market definition is also inconsistent with the Commission's long standing case practice in defining product markets in industries with two-sided demand...". See also *US and several States v. Visa, MasterCard and American Express*, Civil Action No. CV-10-4496 (NGG)(RER), 12.21.2010 (*US v. Visa and others Civil Action*). "40. In addition to selling General Purpose Card network services to merchants, Defendants provide separate network services to a different group of customers: issuers, which provide General Purpose Cards to cardholders. Questions of market power and harm are distinct for the two separate customer groups. Sellers of General Purpose Card network services to merchants could exercise market power over merchants even in circumstances in which they could not exercise market power over issuers. Any benefits received by issuers are not necessarily shared with merchants, and would not offset anticompetitive harm imposed by networks on merchants."

¹⁹² The MasterCard Decision, par. 407.

the Commission also referred theoretically to potential harm inflicted to the retailers' customers, especially those not using cards¹⁹⁴, but this ancillary reasoning would also apply in the grocery sector, where customers of independent grocery brands would be harmed by the supermarkets' practices (e.g., access fees) not aimed at lowering wholesale prices.

All in all, a modern competition analysis would abandon the distinction between seller power and buyer power and the policy bias in favour of retailers. Indeed, this analysis would not even lose time trying to find out whether supermarkets are basically buyers of goods from suppliers or sellers of services to them. Instead, this modern analysis would rely on the fact that supermarkets operate contractually or *de facto* as two-sided platforms selling services to independent grocery brands¹⁹⁵ and retail one-stop shoppers¹⁹⁶.

Furthermore, competition policy vis-à-vis supermarkets should be aimed at promoting the Competitive Rivalry model proposed by Porter, which can be reconciled with the concepts of “competitive process” (EU competition law), “economic freedom” (German competition law); “consumer choice” (Lande); “consumer freedom” (Leary) and “econodiversity” (Farrell). This approach would focus on the protection of the innovative process and the competitive rivalry between grocery brands (i.e., consumer acceptance should determine a grocery brand's success, not whether the brand is vertically integrated or not) as well as between supermarkets, ensuring that quality and variety provide sufficient consumer choice in terms of value-for-money.

5.3 The concept of market power

The EU Guidelines on Article 101(3) TFUE define market power as follows:

“Market power is the ability to maintain prices above competitive levels for a significant period of time or to maintain output in terms of product quantities, product quality and variety or innovation below competitive levels for a significant period of time. In markets with high fixed costs undertakings must price significantly above their marginal costs of production in order to ensure a competitive return on their investment. The fact that undertakings price above their marginal costs is therefore not in itself a sign that competition in the market is not functioning well and that undertakings have market power that allows them to price above the competitive level. It is when competitive constraints are insufficient to maintain prices and output at

¹⁹³ The MasterCard Decision, pars. 453 and, in particular, 454: “That argument cannot be accepted. Under Article 81(1) of the Treaty there is no legally no reason why the negative effects of the MIF on prices in the acquiring markets to the detriment of merchants (and subsequent purchasers) should not constitute a restriction of competition because of potential benefits which a MIF may create for cardholders”.

¹⁹⁴ The MasterCard Decision, par. 411.

¹⁹⁵ Even the term “supplier” could be substituted for “buyer of supermarket services”. Indeed, this term would better reflect the differences between independent suppliers of branded FMCG and produce, and companies subcontracted to supply retailer brands.

¹⁹⁶ Even if supermarkets were considered to be buyers in a procurement market, the competition analysis should not be different to the analysis performed in respect of “sellers” in other markets, be they one-sided or two-sided. See above, Section 5.2.2.

competitive levels that undertakings have market power within the meaning of Article 81(1).”
[underlined by the Author]¹⁹⁷

These Guidelines also clarify that market power may exist without dominance:

“Market power is a question of degree. The degree of market power normally required for the finding of an infringement under Article 81(1) in the case of agreements that are restrictive of competition by effect is less than the degree of market power required for a finding of dominance under Article 82.”¹⁹⁸

In order to ascertain market power, i.e. the lack of competitive restraints facing companies, the Guidelines suggest looking at the following factors:

“It is normally also necessary to examine and assess, inter alia, the nature of the products, the market position of the parties, the market position of competitors, the market position of buyers, the existence of potential competitors and the level of entry barriers. In some cases, however, it may be possible to show anti-competitive effects directly by analysing the conduct of the parties to the agreement on the market. It may for example be possible to ascertain that an agreement has led to price increases.”¹⁹⁹

In addition to single-firm market power, competition rules also address collective market power. In particular, oligopolistic market structures may enable a few firms to adopt a common course of action in the market that restricts competition²⁰⁰. This outcome may be facilitated by three factors: (1) market transparency; (2) effective mechanisms of deterrence; and (3) lack of competitive constraints²⁰¹. The third factor

¹⁹⁷ EU Guidelines on Article 101(3) TFEU, par. 25. The Horizontal Guidelines replicate the same definition of market power in par. 39. The Guidelines on Article 102 TFEU use a similar wording to define dominance in par. 11.

¹⁹⁸ *Id.*, par. 26 and EU Horizontal Guidelines, par. 42.

¹⁹⁹ *Id.*, par. 27. The EU Horizontal Guidelines contain similar wording at pars. 43 and 45: “(43) The starting point for the analysis of market power is the position of the parties on the markets affected by the co-operation... (45) Depending on the market position of the parties and the concentration in the market, other factors such as the stability of market shares over time, entry barriers and the likelihood of market entry, and the countervailing power of buyers/suppliers also have to be considered.”

²⁰⁰ OECD, “Techniques and Evidentiary Issues in Proving Dominance/Monopoly Power”, DAF/COMP(2006)35, 9.10.2008, Note by the European Commission, p. 201: “Undertakings in oligopolistic markets may sometimes be able to raise prices substantially above the competitive level without having recourse to any explicit agreement or concerted practice. Coordination is more likely to emerge in markets where it is relatively simple to reach a common understanding on the terms of coordination. The simpler and more stable the economic environment, the easier it is for undertakings to reach a common understanding. Indeed, they may be able to co-ordinate their behaviour on the market by observing and reacting to each other’s behaviour. In other words, they may be able to adopt a common strategy that allows them to present themselves or act together as a collective entity. Coordination may take various forms”.

²⁰¹ OECD 2008, Note by the European Commission, p. 201: “The ability to arrive at and sustain such co-ordination depends on a number of factors, the presence of which must be carefully examined in each case. Firstly, each undertaking must be able to monitor whether or not the other undertakings are adhering to the common policy. [...]. There must, therefore, be sufficient market transparency for all undertakings concerned to be aware, sufficiently precisely and quickly, of the market conduct of the others. Secondly, the implementation of the common policy must be sustainable over time, which presupposes the existence of sufficient deterrent mechanisms, which are sufficiently severe to convince all the undertakings concerned that it is in their best interest to adhere to the common policy. Finally, it must be established that competitive constraints do not jeopardise the implementation of the common strategy. As in the case of single dominance, it must be analysed what is the market position and strength

covers the second and third factors considered under single-firm dominance. Therefore, collective dominance boils down to a common pattern of conduct by the market leaders in a concentrated and transparent market where they face negative incentives to depart from this conduct (effective deterrents) and positive incentives to pursue this strategy (absence of competitive constraints).

From the above, three conclusions emerge:

First, even though competition authorities, out of practical considerations, traditionally refer to market power as pricing power, all of them recognise that price is only one of several competitive variables (e.g., quality, variety and innovation) and, very often, not the most important one²⁰².

Second, even though market power can be described as power over pricing, this economic textbook definition does not help much in practice, because nowadays all markets exhibit imperfect competition (e.g., product differentiation, information asymmetries and switching costs) and it is not possible to ascertain the competitive market price and, by the same token, the supracompetitive price²⁰³. Therefore, competition authorities focus their analysis on identifying the roots of pricing power: the absence of competitive constraints faced by the relevant firm²⁰⁴. In that regard, the

of rivals that do not form part of the collective entity, what is the market position and strength of buyers and what is the potential for new entry as indicated by the height of entry barriers". The Commission quoted Case T-342/99, *Airtours plc v Commission* [2002] ECR II-2585, paragraph 62, and Case T-193/02, *Laurent Piau v Commission*, par. 111.

²⁰² EU Guidelines on Article 102 TFEU, par. 11: "The Commission considers that an undertaking which is capable of profitably increasing prices above the competitive level for a significant period of time does not face sufficiently effective competitive constraints and can thus generally be regarded as dominant [footnote: What is a significant period of time will depend on the product and on the circumstances of the market in question, but normally a period of two years will be sufficient]. In this Communication, the expression "increase prices" includes the power to maintain prices above the competitive level and is used as shorthand for the various ways in which the parameters of competition — such as prices, output, innovation, the variety or quality of goods or services — can be influenced to the advantage of the dominant undertaking and to the detriment of consumers [footnote: Accounting profitability may be a poor proxy for the exercise of market power. See to that effect Case 27/76 *United Brands Company and United Brands Continental v Commission* [1978] ECR 207, paragraph 126]".

²⁰³ OECD 2008, Background Note by the Secretariat, p. 17: "The economic concept of "market power" does not provide a precise standard to determine whether a firm should be subject to single firm conduct provision. But by highlighting that market power must be both substantial and durable to raise competition concerns in unilateral conduct cases, it can provide a good framework for the analysis. In this framework, evidence on entry barriers and barriers to expansion is considered most important because actual or potential entry or expansion can most effectively prevent a firm from exercising market power. Other important factors include competitive conditions in the market and buyer power". The Background Note examines the limitations of the economic concept of substantial market power in Section 2.1 (The Concept of Substantial Market Power), pp. 18-20.

²⁰⁴ EU Guidelines on Article 102 TFEU, par. 10: "Dominance has been defined under Community law as a position of economic strength enjoyed by an undertaking, which enables it to prevent effective competition being maintained on a relevant market, by affording it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of consumers. This notion of independence is related to the degree of competitive constraint exerted on the undertaking in question. Dominance entails that these competitive constraints are not sufficiently effective and hence that the undertaking in question enjoys substantial market power over a period of time. This means that the undertaking's decisions are largely insensitive to the actions and reactions of competitors, customers and, ultimately, consumers. The Commission may consider that effective competitive constraints are absent

three main factors considered in order to assess the existence of dominance or substantial market power are (1) the competitive strength of the relevant firm (constraints by existing competitors), (2) the barriers to entry and expansion (constraints by potential competitors) and (3) the countervailing power of its customers (constraints by customers)²⁰⁵. In some cases they may also complement this analysis with direct evidence of market power, flowing from the market conduct of the relevant company.

Third, in concentrated and transparent markets, even if single-firm dominance cannot be inferred, the leading firms may not be faced with sufficient competitive constraints that deter them from adopting a common pattern of conduct that restricts competition in the market as a single dominant firm could do.

Despite the internal warnings against the risks of over-reliance on market definition and market share measurements as indicators of market power, conventional competition analysis is still captured by this formalistic market-share-centric approach²⁰⁶. Many economists have argued against undue reliance on market power measurements based on market definition and market shares. For example, Porter has suggested a dynamic approach based on five competitive forces acting in an industry: threat of entry, threat of substitution, bargaining power of buyers, bargaining power of suppliers, and rivalry among current competitors²⁰⁷.

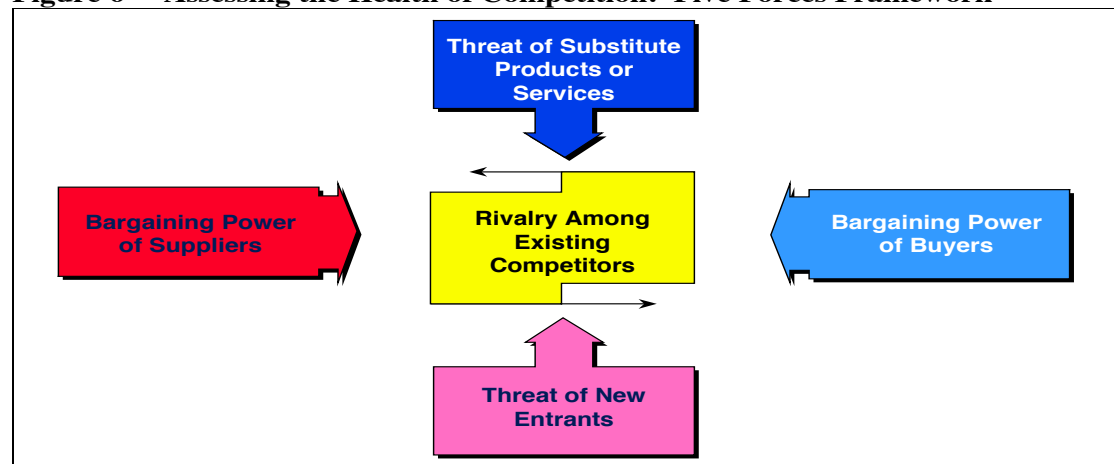
even if some actual or potential competition remains. In general, a dominant position derives from a combination of several factors which, taken separately, are not necessarily determinative”.

²⁰⁵ EU Guidelines on Article 102 TFEU, par. 12: “The assessment of dominance will take into account the competitive structure of the market, and in particular the following factors: (1) constraints imposed by the existing supplies from, and the position on the market of, actual competitors (the market position of the dominant undertaking and its competitors), (2) constraints imposed by the credible threat of future expansion by actual competitors or entry by potential competitors (expansion and entry), (3) constraints imposed by the bargaining strength of the undertaking's customers (countervailing buyer power).”

²⁰⁶ OECD 2008, Executive Summary by the Secretariat, Conclusions (5), p. 9: “There is also the risk that market share-based presumptions strongly influence any further analysis and that a decision-maker, once satisfied that market share-based presumptions have been triggered, analyzes remaining evidence selectively with a view to confirming the initial result. Conversely, market share-based presumptions with unreasonably high thresholds may create *de facto* “safe harbours” that benefit firms which may well possess substantial market power and therefore have the ability to engage in unilateral conduct that harms consumers.”

²⁰⁷ Porter 2002, p. 14: “It embodies the notion that competition is much broader than just rivalry, where seller concentration (HHI) analysis is focused. Any of the five forces can be significant in determining the health of competition, depending on the particular industry. For example, the power of customers to push down price or pressure improvements in service can be just as important to productivity growth as the number and size distribution of competitors in the market”; and p. 15: “Current antitrust analysis first determines the relevant geographic and product market, then uses its tools to analyze competitive effects. Current analysis starts with seller concentration as the principal metric. Other considerations are brought in, both only later and secondarily. Five forces analysis, on the other hand, avoids the first step by going straight to analyzing competitive effects in any and all submarkets deemed relevant by customers and competitors. It views seller concentration as only one and not the most important determinant of rivalry. It brings in all five forces as equally important. Finally, it does not rely heavily on price and quantity as the principal indicators of welfare.”

Figure 6 Assessing the Health of Competition: Five Forces Framework



Source: M.E. Porter, *Competitive Strategy: Techniques for Analyzing Industries and Competitors* 187 (1980).

His criticism of market definition seems highly relevant in the grocery procurement and retail markets²⁰⁸.

Rather than suppressing the market definition and market share measurement stages, Lande has advocated a flexible approach on market definition and market share thresholds when market failures are unrelated to competitive rivalry (e.g., lack of countervailing buyer power out of imperfect information and high transaction costs)²⁰⁹. These market failures can produce the same anticompetitive effects on consumer welfare and allocative efficiency even though they often go unnoticed²¹⁰. In order to respond to this market reality, Lande proposes that competition law enforcement explores these avenues: (1) Lower market share requirements for a finding of market

²⁰⁸ Porter 2002, pp. 15-16: “By assessing competition beyond existing rivals, the need is reduced for debates on where to draw industry boundaries, or the relevant market in antitrust terms. Any definition of a market is essentially a choice of where to draw the line between established competitors and substitute products, between existing firms and potential entrants, and between existing firms and suppliers and buyers. If these influences on competition are all recognized, and their relative impact assessed, as they are in five forces analysis, then where the lines are actually drawn becomes more or less irrelevant to strategy formulation and, I suggest, the antitrust analysis of competition. Latent sources of competition will not be overlooked, nor will key dimensions of competition. The need to determine *the* relevant market is eliminated. While there is a systematic approach to market definition defined in the Merger Guidelines, it begins with the questionable premise that a single market definition is a meaningful concept. Moreover, the approach to market definition relies heavily on price effects which are an incomplete measure of social benefit, not to mention a largely short-term and static one.” See also Kaplow, “Why (Ever) Define Markets?”, Harvard Law Review 124, 2010.

²⁰⁹ Lande, “Market Power Without a Large Market Share: The Role of Imperfect Information and Other ‘Consumer Protection’ Market Failures”, American Antitrust Institute Working Paper No. 07-06, 2007. He considers that these imperfections may affect both corporate executives and individual consumers.

²¹⁰ Lande 2007, p. 17: “It would be sound public policy to take the potential of this form of market power more seriously. Deception, imperfect information and other “consumer protection” problems, when they have marketwide effects, and are not likely to be prevented by competition in the relevant market, should give rise to antitrust violations. This is in part because they can cause harms to consumer welfare in addition to the higher prices they cause, including allocative inefficiency and umbrella effects.”

power²¹¹; (2) more narrowly defined product markets²¹²; and (3) a realistic assessment of barriers to entry that factors in information asymmetry²¹³.

These reflections are also relevant to the analysis of the supermarket platforms. Even if they competed intensely in the retail market, their market power and abuses vis-à-vis grocery brands may harm consumer welfare and allocative efficiency. This should prompt competition authorities to explore the existence of dominance/market power below the conventional market-share thresholds and narrowly defined markets that take into account supermarkets' grip over consumers and their in-store shopping behaviour²¹⁴.

5.3.1 Market power in the modern grocery retailing

Competition authorities and courts rely primarily on indirect evidence to assess market power. In particular, three main factors are taken into account: (1) market shares; (2) entry and expansion barriers; and (3) countervailing buyer power²¹⁵.

The structure of most national markets for grocery retailing indicates that leading supermarkets enjoy significant market power: market concentration is high, barriers to entry and expansion are enormous, market transparency is overwhelming and consumer lock-in and switching costs are much more critical than commonly thought.

²¹¹ *Id.*, p. 14: "Kodak had only 20-23% of its relevant market. In today's antitrust world, of course, it is almost inconceivable that a firm with *double* this market share would be found to have traditionally defined market power...When the market imperfections discussed in this Testimony are present, *ceteris paribus*, a lower market share should be required for a finding of market power or monopoly power. Another result is that we should be more cautious about establishing substantial market share based safe harbors in the Merger Guidelines or Joint Venture Guidelines, and consider using the existing market share screens more strictly".

²¹² *Id.*, pp. 14-15: "Imperfect information could create more narrowly defined relevant markets because it could effectively prevent customers from turning to certain potential substitutes...Moreover, some customers might not realize that a certain product is a cost effective option, and for other customers the transaction costs of finding another choice - or customers' beliefs as to the size of these transaction costs - might be so large that the firm in question has some degree of pricing freedom. To investigate these questions we should attempt to ascertain the information about the products in question that actually was in the minds of potential customers, rivals, and entrants. This will tell us whether other products effectively function as substitutes. It introduces consumer behavior and therefore marketing expertise into the antitrust equation. All this could lead to markets being defined more narrowly and to larger shares being imputed to certain firms within that market. This could have the effect of making it more likely that particular firms will be found to have market power."

²¹³ Lande 2007, p. 15: "Thus, the Merger Guidelines 'likely' test for entry could be affected, as well as its 'timely' test."

²¹⁴ See discussion of consumer lock-in in Section 5.3.1.4. and the proposed enforcement of Article 102 TFEU in Section 7.2.2.

²¹⁵ OECD 2008, Executive Summary by the Secretariat, Conclusions (2) and (3), pp. 7-8: "(2) Competition authorities and courts rely primarily on indirect evidence to determine whether a firm has substantial market power such as market shares, barriers to entry and expansion, buyer power and the nature of competition in the market. Typically there is no single factor that will provide conclusive answers. Entry barriers and barriers to expansion are widely considered the most important factors in determining whether a company's ability to exercise market power is effectively constrained. (3) There can be types of indirect evidence that allow competition authorities and courts to draw conclusions from structural market characteristics for the question of whether a firm's market power is substantial and durable [sic]. Other important types of indirect evidence include competitive conditions in the market and countervailing buyer power."

Furthermore, there is a growing amount of direct evidence that leading supermarkets are yielding significant market power vis-à-vis independent grocery brands and smaller competitors.

5.3.1.1 High Concentration

The use of market-shares as a proxy for market power faces many limitations and has to be used with great caution²¹⁶. However, market share thresholds are still widely used by competition authorities to establish market power presumptions or safe-harbours²¹⁷. In this regard, the European Commission and national competition authorities have highlighted the high degree of retail concentration prevailing in most EU Member States²¹⁸.

Concentration is usually more acute at the regional/local level than at the national level because retailers tend to follow an “oil stain” strategy out of efficiency (and possibly strategic pre-emption) considerations²¹⁹. This may confer market power on companies

²¹⁶ *Id.*, Executive Summary by the Secretariat, Conclusions (4), pp. 8: “Market share data continue to be the “high priest” in assessing whether a firm has substantial market power, although the limitations of market shares as proxy of market power are widely acknowledged.”

²¹⁷ *Id.*, Executive Summary by the Secretariat, Conclusions (5), pp. 8: “Although market share based presumptions of substantial market power might be a convenient tool for a decision maker, their use raises many of the same problems as the use of market shares in general. Market shares can fail to correctly predict whether a firm has substantial market power. Thus, market share-based presumptions must be used with great caution”. Guidelines on Article 102 TFEU, pars. 13-14: “13. Market shares provide a useful first indication for the Commission of the market structure and of the relative importance of the various undertakings active on the market. However, the Commission will interpret market shares in the light of the relevant market conditions, and in particular of the dynamics of the market and of the extent to which products are differentiated. The trend or development of market shares over time may also be taken into account in volatile or bidding markets. 14. The Commission considers that low market shares are generally a good proxy for the absence of substantial market power. The Commission's experience suggests that dominance is not likely if the undertaking's market share is below 40 % in the relevant market. However, there may be specific cases below that threshold where competitors are not in a position to constrain effectively the conduct of a dominant undertaking, for example where they face serious capacity limitations. Such cases may also deserve attention on the part of the Commission.” The safe harbour thresholds under Block Exemption Regulations do not imply that higher market shares lead to anticompetitive outcomes but call for a case by case analysis, thereby implying the existence of some degree of market power.

²¹⁸ Commission staff working document, “The functioning of the food supply chain and its effects on food prices”, Accompanying document to the Communication from the Commission Food prices in Europe - Including a roadmap to improve the functioning of the food supply chain, SEC(2008) 2972, 9.12.2008, p. 24: “Following a period of consolidation, the degree of concentration in the EU food retail sector is relatively high – in most Member States the five largest retailer chains account for over 50% of the market (see figure 10). It is higher in the old Member States, but the consolidation movement is stronger in the new Member States”. See also, Commission staff working document, “On Retail Services in the Internal Market”, accompanying document to the European Commission Report on Retail Market Monitoring: “Towards more efficient and fairer retail services in the Internal Market for 2020”, SEC(2010) 807, 5.7.2010, p. 9: “Today's retail markets in the EU are also characterised by a growing importance of large corporations. In most of the mature EU15 retail markets, the 8 biggest companies accounted for between 50% and 80% of the national grocery retail market in 2007 (figure 2).”

²¹⁹ See, for example, the UK Grocery Report 2000, Chapter 2 (Conclusions), p. 156: “ 2.611. Morrison told us that it was inevitable that each of the main parties would have particularly strong representation in those areas where they had started their businesses: Sainsbury and Tesco in London and the Home Counties; Asda in the North-East; Kwik Save in the North-West; Safeway in Scotland; and Morrison in West Yorkshire”.

both at the regional and national level in a way not reflected by market shares calculated on a national basis alone²²⁰. For example, both the UK Grocery Report 2008 and the Spanish Grocery Report have concluded that local market concentration is significantly higher than national concentration. The Spanish Grocery Report simply compared the degree of concentration, measured by floor space level, at the national and regional level. On the other hand, the UK Competition Commission has relied on a combination of two factors to infer market power at the local level: high market shares and a limited number of competitors²²¹. The analysis focused on larger stores alone and on mid-sized and larger stores combined:

Larger stores

Regarding the number of competitors in the local market²²², the analysis showed that 20%/7% of all larger grocery stores in the UK have no competing fascia within a 10/15-minute drive-time isochrone. Furthermore, 54%/81% have respectively one or fewer competing fascia (two or fewer fascias in total) and two or fewer competing fascias (three or fewer fascias in total) within a 10-minute drive-time. Using a 15-minute drive-time isochrone, the analysis found that 24%/46% have respectively one or fewer competing fascia (two or fewer fascias in total) and two or fewer competing fascias (three or fewer fascias in total).

Regarding the floor space share²²³, the analysis found that 59% of larger grocery stores are in local markets where the fascia operates more than 40% of relevant grocery floor

²²⁰ The UK Grocery Report 2008, p. 119: “6.67 In theory, two grocery retailers might each have 50 per cent of national sales. In one case, this might reflect an equal market share in each local market. In this case, each grocery retailer will be influenced by the actions of its competitor. However, in another case, a 50 per cent share of national sales might reflect a monopoly position for each of the two grocery retailers in half of the local markets across the country. In these circumstances, each grocery retailer would not face any constraint from the other (except in the border region where their stores face each other).”

²²¹ The UK Grocery Report 2008, p. 106: “6.8 There are a number of ways to measure market concentration. These include measuring the number of competitors in a market, the relative size of competitors as measured by sales shares (either by revenue or volume) and indices, such as concentration ratios or the Herfindahl-Hirschman Index, which reflect both the number of firms in a market and their relative size. For the purposes of assessing the extent of concentration in local markets for grocery retailing, we used two distinct measures: first, retailers’ shares of groceries sales area as a proxy for share of sales, and second, the number of competing fascias”; and p. 107: “6.11 The combination of these two criteria (ie the number of competitors and market share) allowed us to take both of these criteria into account in assessing the extent of local market concentration. In our view: (1) a retailer that operates a grocery store that faces a small number of competitor fascias and has a high local market share will enjoy local market power; (2) a retailer that operates a grocery store with only one or two competitor fascias (ie a duopoly or triopoly store) but has a small local market share (ie share of groceries sales area) is unlikely to enjoy a meaningful degree of market power; and (3) a retailer with a large local market share and a significant number of competitor fascias will have sufficient alternatives for its customers that it is unlikely to enjoy a meaningful degree of market power. (...). 6.13 In summary, to assess the extent of local market concentration, we focused on those local markets with three or fewer fascias in total where one of those fascias had a share of local grocery sales area that is greater than 60 per cent within a 10- or 15-minute drive-time. We defined these markets as ‘highly-concentrated local markets’.” The full analysis is provided in Appendix 6.1 (Extent of highly concentrated local markets for grocery retailing in the UK) of the UK Grocery Report 2008.

²²² The UK Grocery Report 2008, Appendix 6.1, par. 6.

²²³ The UK Grocery Report 2008, Appendix 6.1, par. 9.

space within 10 minutes and 27% of larger grocery stores are in local markets where the fascia operates more than 60% of relevant groceries floor space. Within 15 minutes, the analysis found that 36% of larger grocery stores are in local markets where the fascia operates more than 40% of relevant groceries floor space, and, of these, 12% of larger grocery stores operate more than 60% of relevant groceries floor space.

Mid-sized and larger stores

Regarding the number of competitors in the local market²²⁴, the analysis found that 18% of mid-sized and larger grocery stores with a grocery sales area greater than 280 sq metres have no competitors within 10 minutes and 8% within 15 minutes. Considering stores with one or fewer competing fascia (two or fewer fascias in total), the numbers were 44% within 10 minutes and 22% within 15 minutes. Considering stores with two or fewer competing fascias (three or fewer fascias in total), the numbers go up to 66% of mid-sized and larger grocery stores using a 10-minute drive-time and 39% of mid-sized and larger grocery stores using a 15-minute drive-time.

Regarding the floor space share²²⁵, the analysis found that 40% per cent of mid-sized and larger grocery stores are in local markets where the fascia operates more than 40% of relevant grocery floor space within 10-minutes, and 22% of mid-sized and larger grocery stores are in local markets where the fascia operates more than 60% of relevant groceries floor space. Within 15-minutes, 24% of mid-sized and larger grocery stores in local markets operate more than 40 per cent of relevant groceries floor space, and 10% of mid-sized and larger grocery stores operate more than 60% of relevant groceries floor space.

All in all, the Competition Commission found that, depending on the drive-time used (10 or 15 minutes), between 11% and 27% of larger grocery stores, and between 10% and 22% of mid-sized and larger grocery stores are in highly-concentrated local markets²²⁶. However, the percentages of locally concentrated markets would have been significantly higher if either the limited number of competitors or the 40% market-share threshold (usually considered to raise a presumption of single-firm dominance) had been taken into account.

5.3.1.2 Barriers to entry and expansion

Competition authorities, as well as outside observers, have denounced the enormous and quite unique regulatory barriers restricting entry and expansion in the grocery retail makets in all their market studies²²⁷. Furthermore, the exceptional and often

²²⁴ The UK Grocery Report 2008, Appendix 6.1, par. 23.

²²⁵ The UK Grocery Report 2008, Appendix 6.1, par. 24.

²²⁶ The UK Grocery Report 2008, paragraphs 6.14 to 6.26, pp. 108-114.

²²⁷ Commission staff working document, "Competition in the food supply chain", accompanying document to the European Commission "A better functioning food supply chain in Europe", SEC(2009) 1449, 28.10.2009, p. 13: "NCAs have also highlighted in a number of studies and advocacy initiatives the negative impact that certain regulatory restraints may have on competition (e.g. see repeal of the Royer –

insurmountable barriers to entry, let alone expansion, co-exist with economic and strategic barriers.

Economic barriers have traditionally been associated with corporate economies of scale. Certainly, large retailers enjoy substantial economies of scale on input costs, the most important cost element of grocery retailing. Furthermore, they are able to exploit other type of scale economies in these areas: management (increasing the specialization of managers), finance (obtaining lower-interest charges when borrowing from banks and having access to a greater range of financial instruments), marketing (spreading the cost of advertising over a greater range of output in media markets), and technology (taking advantage of returns to scale in the production function). However, market-wide economies of scale may even play a more important role in the configuration of highly concentrated local markets. In this regard, supermarkets may come close to natural monopolies/oligopolies. The most obvious example is when the scarcity of commercial land available for grocery retailing, even in the absence of planning restrictions, *de facto* restricts the number of competitors in a given local market. A less obvious but still common example flows from demand limitations: the number of residents in a given local market influences the number of supermarkets operating therein. Furthermore, the features of the local grocery retail market (high fixed costs of large stores; homogeneous fast moving consumer goods, often involving the same brand sold in different competing stores; price transparency and rapid adaptation to competitors' strategies; and significant customer lock-in) significantly reduce the target demand for new entrants and reinforce incumbents' strongholds²²⁸.

Retailers have realised that market leadership generates competitive advantages, short of market power, that are not available to other operators. Therefore, the market-entry strategy of international operators tends to be limited to the acquisition of leading incumbents and fast organic growth aimed at achieving a leadership status. Conversely, exit or a conservative (non-expansionist) strategy ensues as soon as it is assumed that market leadership cannot be secured²²⁹.

Raffarin laws in France, retail Planning System in Ireland, regional laws in Italy, urban planning and zoning laws in Belgium, Portugal and the UK, administrative authorisations in Spain)".

²²⁸ The UK Competition Commission claimed that the impact of successive entrants on incumbents' profits follows a descending path (the UK Grocery Report 2008, p. 116, note 2).

²²⁹ Kyvik 2008, p. 11: "As the case studies in Section 3 indicate, the major retailers appear to aim at being among the top three retailers in the markets they enter and if their market position objectives are not met within a reasonable time after entry, they exit. Thus, Ahold has recently left Poland and the Slovak republic, selling its operations in Poland to Carrefour in order to focus on the Czech market where it had gained a stronger position. By the same token, Carrefour sold its operations in the Czech Republic and Slovakia to Tesco in 2005 in order to focus on Poland where it has a stronger position. As these examples indicate, investment flows in the retail sector is largely in the form of mergers and acquisitions, while green field investments were more common in the early 1990s and still is in developing countries (Coe and Hess, 2005)."

Retail representatives themselves, especially the large format operators, have often argued that these regulatory barriers restrict competition, limit choice and increase retail prices²³⁰.

5.3.1.3 Market transparency

Transparency of supermarket services and prices facilitates rapid adaptation to competitors' strategic actions, especially in respect of Known Value Items ("KVI", basic items that are regularly bought and command higher price awareness), packaged goods and the representative basket of grocery products²³¹.

5.3.1.4 Consumer lock-in

One-stop grocery shopping exhibits some unique features that have not been apprehended by economic analysis. Reductionist price-sensitivity models, no matter how developed, do not correspond to observed consumer behaviour²³². Indeed, behavioural sciences may be much more relevant in order to explain retail grocery demand patterns²³³. For example, a comprehensive study of the evolution of grocery

²³⁰ Commission staff working document, "Competition in the food supply chain", accompanying document to the European Commission "A better functioning food supply chain in Europe", SEC(2009) 1449, 28.10.2009, p. 13: "The retail sector emphasised that overall price levels are heavily affected by regulatory and quasi-regulatory measures implemented at national level and which constitute a burden to free trade and an unnecessary fragmentation of the EU internal market (e.g. planning permissions, opening hours restrictions, codes of conduct, etc.)."

²³¹ For a highly illustrative example of the sophisticated price monitoring carried out by supermarkets, see the UK Grocery Report 2000, Appendix 7.4 (Competitor price monitoring). Each supermarket monitors its competitors intensely. For example: "Tesco: National basket of 4,000 products currently represents 49 per cent of turnover. From this, all products monitored weekly against Asda, Kwik Save, Morrison, Safeway, Sainsbury and Somerfield. Extended basket (no longer used as almost all of its products are now in the national basket)—it was a subset of general basket, 1,000 products representing 6 per cent turnover, monitored every four weeks, against Asda, Sainsbury and occasionally Safeway. Used to check on general basket and cost movements into national basket. General basket—everything not in National basket. Checked regularly against many other retailers. Value basket—200 value lines, 4 per cent turnover, must not be beaten within 1 mile. Monitored locally. Occasional check prices in general basket against Aldi, Budgens, Iceland, Lidl, M&S, Netto and Waitrose, and regular checking in non-food area. A quarterly check of all comparable products against Asda has been introduced". See the evidence of parallelism in retail pricing behaviour observed in the tables of grocery prices in Spain, discussed below, in Section 5.3.1.5.

²³² See, for an example of the efforts by the UK Competition Commission to build a model of consumer sensitivity to price, quality, range and service (PQRS), Appendix 4.2 of the UK Grocery Report 2008 (Model of consumer demand for grocery stores).

²³³ The role of behavioural economics in understanding consumer behaviour is gaining recognition. See, for example, the FTC Bureau of Economics, "Conference on Behavioural Economics and Consumer Policy", 20.04.2007, materials available at <http://www.ftc.gov/be/consumerbehavior/index.shtml>. See, also, Rosch (Commissioner of the FTC), "Behavioral Economics: Observations Regarding Issues That Lie Ahead", Vienna Competition Conference, 9.06.2010. See, in the grocery demand context, Clarke, Hallsworth, Jackson, de Kervenoael, Perez del Aguila and Kirkup, "Retail Restructuring and Consumer Choice 1: Long-term local changes in consumer behaviour: Portsmouth, 1980-2002", Environment & Planning A 2006, volume 38, pages 25-46 ("The Portsmouth Study I"), and "Retail restructuring and consumer choice 2. Understanding consumer choice at the household level", Environment and Planning A 2006, volume 38, pages 47-67 ("The Portsmouth Study II"). Regarding the distinction between behavioural science and economic theory, see The Portsmouth Study II, p. 50: "Consumer choice is a highly contested concept. Approaching it through theories of social practice, our research demonstrates that individual choice is highly constrained by social and spatial circumstances. Choice is experienced

shopping in a representative area of the UK (The Portsmouth Study I and II)²³⁴ has shown that the store selection process and the grocery selection process within the store respond to different competition/consumer dynamics²³⁵.

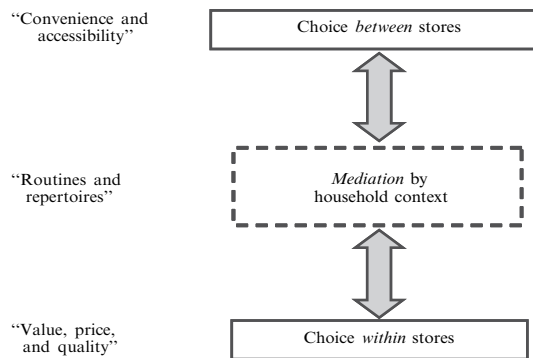


Figure 1. The mediation of consumer choice by household context.

Source: *The Portsmouth Study II*, p. 61

The comprehensive study of the UK grocery shopper's behaviour has evidenced that convenience/location is a key factor in the selection of the preferred/main store for grocery shopping²³⁶: car journey to the store has gone down on average to 10 minutes²³⁷

differently according to personal, household, and neighbourhood contexts... Our emphasis in approaching consumer choice through theories of social practice has several implications. It helps us avoid some of the more voluntaristic implications of choice as exercised by individual consumers, based on simplistic notions of price sensitivity. Instead, it sees the expression of choice as a more complex and socially embedded practice, the understanding of which requires a greater understanding of the variety of (family and household) contexts within which consumers choose. We also draw out the importance of choice between and within stores”.

²³⁴ Regarding the representativeness of the Portsmouth area in terms of the UK grocery retailing, see *The Portsmouth Study I*, p. 13: “These data show, too, that Portsmouth is not only fairly typical, in demographic and lifestyle terms, of the UK as a whole, but that the study area also exhibits many of the major *differences* in situation experienced among contrasting social groups... In respect of retail development, over twenty years ago, southern England was facing a retail watershed as food superstores – well established in the north – began to be developed... This proposition does not hold in the Portsmouth area – it has long had a full range of major national store fascias – another reason why it is an excellent study area”. See also, p.14: “Whilst these changes in retail provision within our study locality represented a very significant overall increase in the number of large stores for local residents to choose from, this broad pattern and increase was far from exceptional – in many respects it was typical of trends in the UK. Market data from the Competition Commission Report of 2000, for example, shows that the current Portsmouth concentration of market within the superstore sector equates roughly to the average in UK terms. In terms of relative market share concentration measured by the Herfindahl-Hirschmann Index for the Portsmouth postcode region is 1845, only slightly less than the UK weighted average for all postcodes of 2135”.

²³⁵ *The Portsmouth Study II*, p. 61: “Bearing in mind our earlier discussion of theories of practice and the need to distinguish between different dimensions of ‘choice’, we conclude that consumer choice between stores can best be understood by carefully unpacking notions of convenience and accessibility; choice within store relates to socially constructed notions of value, price, and quality; while choice between and within stores is closely related to people's domestic routines and repertoires, strongly mediated by their household context (see figure 1)”.

²³⁶ *The Portsmouth Study I*, p. 19: “Arguably the most important finding of this phase of our study was that convenience/location was the most important driver for shopping at any given store. Whilst retailers will probably say that they do not find this surprising, what is striking is the remarkable increase from 10 per cent of respondents liking their chosen store because of its ‘convenient location’ in 1980, to 20.5 per cent liking the store of their choice for the same reason in 2002. These results lead us to conclude that, rather than suggesting a significant increase in loyalty from customers, the increasingly capricious

and more consumers reach their store other than by car, most notably by foot²³⁸. Furthermore, customers' perceived "loyalty" to the main store has grown from 58% to 65%²³⁹. This suggests that grocery shoppers are locked-into a deterministic (constrained) demand pattern/routine²⁴⁰, driven primarily by the geographical proximity of the store²⁴¹, and the rare changes in their shopping behaviour respond to changes in the household context rather than changes in the parameters of competition between existing stores²⁴².

behaviour of shoppers, albeit still around one 'main shop', suggests that retailers seem to be relying on their stores' inherently local spatial monopolies, rather than providing a real differentiation of services to their customers".

²³⁷ The Portsmouth Study I, p. 16: "Comparing the results of the two surveys, what is striking is that there was a general decrease in journey times to stores for most shoppers. This is signified by the marked increase in the proportion of shoppers using a store within 10 minutes of where they live or work, which increased from 49.2 per cent to 71.6 per cent, and the consequent reduction in those shoppers travelling further a field. This finding reflects increased levels of car ownership and suggests that in Portsmouth a far higher proportion of food shopping is now carried out close to where people live or work because of the growth in the number of superstores – provision of new stores is effectively filling in 'gaps'. It implies, too, some degree of 'cannibalisation' of store catchments by new outlets, with the result that we can conclude that the catchment area of each store is inherently more local than it was in 1980, at least in terms of where the core proportions of trade are sourced". The Portsmouth Study I also unveiled that "more people shopped within 5 minutes travel time (up to 38.5% from 17% in 1980)" (as reported in Elms, Canning, de Kervenoael, Whysall and Hallsworth, "30 years of retail change: where (and how) do you shop?", *International Journal of Retail & Distribution Management*, Vol. 38-11/12, 2010, pp. 817 – 827).

²³⁸ The Portsmouth Study I, p. 16: "However, what is unexpected is that the proportion of shoppers travelling to the study stores by car fell from 95 per cent in 1980 to almost 90 per cent in 2003. Whilst this finding runs against the increase in car ownership figures, it reflects the fact that proportionally more people now arrive at the new stores by other means – walking, shopper buses and so on – arguably because there are more stores now closer to residents".

²³⁹ The Portsmouth Study I, p. 17: "Table 5, for example, shows that over 65 per cent of customers in the study area see the store at which they were questioned as their 'main store', compared to only 58 per cent in 1980". This data contrasts with the fact that the number of consumers buying all their needs in their preferred store has gone down from 46% to 31.2%, but the authors infer that this is not due to dissatisfaction with the preferred store but to complex working patterns/lifestyles and top-up shopping. They find support for their conclusion in the significant increase in the proportion of shoppers shopping alone (up from 42.5 per cent in 1980 to 71.9 per cent in 2002).

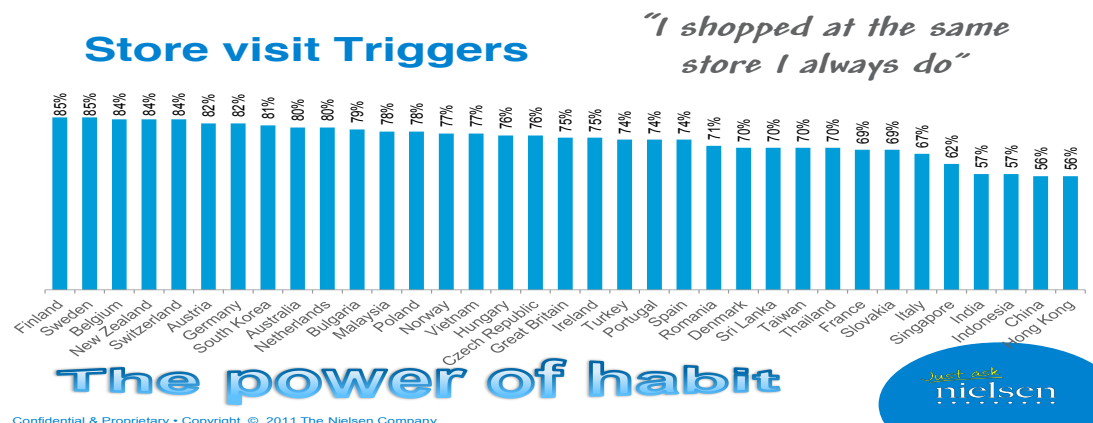
²⁴⁰ The study opposes constrained demand to the informed truly free choice of a consumer.

²⁴¹ The Portsmouth Study I, p. 21: "A critical reading of these findings might be that food shopping provision in the Portsmouth area has become more uniform and essentially more 'bland' to residents. By far the greatest tendency of residents is to use larger stores to obtain a single main shop, but then to use other large competing outlets to 'top up'. Rather than displaying 'free' choice – and the different attitude to retail provision in our local study sites bears this out – the impression that is created is one of consumers seemingly being 'locked into' patterns of behaviour driven by, for many, the increased geographic proximity of new outlets to where they live or work. Rather than suggesting customers as being 'loyal' to retailers – as the food retailers themselves would probably describe this – the sentiment that emerges from our findings is that local shopping behaviour is *fitted into* complex lifestyles rather than consumers exerting free choices, unhindered by such contexts". [emphasis added]

²⁴² See also The Portsmouth Study II, pp. 61-63: "Most people in our Portsmouth study used a relatively small repertoire of stores and found it hard to imagine the conditions that would lead them to change stores. When they do change, new routines become quickly embedded such that it is hard for people to recall their previous behaviour. The stores themselves encourage this kind of habitual practice through familiar store layouts and the use of 'loyalty' cards, for example" (p. 61); "Routines are, however, subject to change, and new practices often reflect changes in household context (as discussed above)... In general, however, our informants found it hard to imagine the conditions that would lead them to change stores. If a new store opened, most said that they would visit out of curiosity but few thought they would change for good" (p. 62); and "It is because people's shopping practices are so deeply

On the other hand, “socially constructed notions of value and the trade-off between price and quality” determine the selection by the shopper of grocery products²⁴³. Furthermore, it is also inferred that product selection within the store can also be constrained by domestic routines and/or retailers, a topic developed subsequently by the same authors and others²⁴⁴.

The conclusions of the Portsmouth Study can be extrapolated to other grocery markets in the EU and beyond. In particular, the importance of proximity/convenience in the selection of the main grocery store and the high degree of loyalty to the main store is almost a universal principle²⁴⁵. For example, Nielsen data reveals that store loyalty is a global phenomenon in the grocery retailing:



embedded within their specific social context and domestic routines that they are so resistant to change, underlining the stability of shopping behaviour reported in our previous paper (Clarke et al, 2005)” (p. 63). In a footnote, it is reported a case of customer switching following the opening of a new store. This example would suggest that only a new store opening encourages (limited) customer switching.

²⁴³ The Portsmouth Study II, p. 54.

²⁴⁴ See, for example, Hallsworth, de Kervenoael, Elms, and Canning, “The food superstore revolution: changing times, changing research agendas in the UK”, The International Review of Retail, Distribution and Consumer Research, 20-1, 2010, pp. 135-146, p. 139: “Conversely, academics are even questioning if purchase decisions are indeed free choices and asking to what degree consumers experience genuine choice once they are inside a store. Captive shoppers may purchase a wider range of goods than they perhaps intended. Furthermore, is it past purchasing history that determines what goes on the shelves or a complex and largely secret power play between retailers and their suppliers? (see the case study in The Grocer 2007).” [emphasis added]

²⁴⁵ The importance of physical location in the retail context has been highlighted in the economic literature since the early years of the XX century and the pioneer work of Hotelling, “Stability in competition”, The Economic Journal, Vol. 39, No. 153, 1929, pp. 41-57, advanced the argument that consumers tend to shop at the closest location. See, for example, Colomé and Serra, “Supermarket Key Attributes and Location Decisions: A Comparative Study between British and Spanish Consumers”, Universitat Pompeu Fabra Working Paper No. 469, June 2000, at p. 3: “While price, quality and variety can be changed to deal with competitors’ policies, the same cannot be said of location which, to all intents and purposes, represents a fixed one-time investment of a unique, unchangeable nature. In this environment, supermarket’s location could be the most important determinant of the supermarket’s success or failure. A well-known aphorism states, “the most important attributes of stores are location, location and location”. It is therefore not surprising that considerable study has been devoted to this point”. Retailers themselves acknowledge the strategic importance of location and closeness to customers: see Case Comp/M. 4686 – Louis Delhaize/Magyar Hipermarket KFT, 09.07.2007, par. 6: “In this respect, the notifying party submits that the proximity of the store is the most important criteria to Hungarian customers”. The strategic importance of store location in grocery retailing is also evidenced by retailers’ land-banks or even store-saturation strategies.

As far as the UK is concerned, the findings of the The Portsmouth Study are in line with the conclusions of the consumer survey made for the UK Grocery Report 2000²⁴⁶. It revealed that proximity and availability of car-parking space were the main determinants of store selection, alongside pricing considerations. Even more, a significant percentage of consumers (40%) declared that they were not able to shop at their first-choice of supermarket for locational reasons²⁴⁷. Loyalty to the preferred store was also found to be significant. At the time, 85% of shoppers had used the same store over the past year. 54% of shoppers claimed to almost always visit the same supermarket for their main grocery shopping, whilst 26% were semi-loyal and 14% regularly used two stores. The main reasons for not changing store were ease of access by car (36%), unfamiliar store layout (34%) and relative convenience of location (30%).

As far as the Spanish grocery retail market is concerned, several surveys highlight the critical importance of the proximity/loyalty to the main store. For example, a study from the Spanish Ministry for Agriculture reveals the evolution of consumer loyalty to the supermarkets. In 2010, 83% of the surveyed consumers revealed that they like to shop at the same stores and 79.9% of them expressed that they normally shop at the stores closest to their home. Asked if they like to buy in the stores of the same group, 58.4% responded affirmatively and 23.2% revealed that they switch stores with some frequency. These figures have been relatively constant since 2005²⁴⁸, despite the severe economic crisis faced by Spain in latest years.

DISTRIBUTOR BRAND/SHOP FIDELITY

Please tell me your degree of agreement for each of the following statements

	I like to buy in the same stores	I normally buy in the stores near my home	I normally like to buy in the same supermarket's stores	I frequently switch shop	Basis
TOTAL + QUITE AGREE 2010	83,0	79,9	58,4	23,2	1.202
TOTAL + QUITE AGREE 2008	81,4	78,1	58,8	26,1	4.012
TOTAL + QUITE AGREE 2007	84,2	78,3	56,4	22,1	3.007
TOTAL + QUITE AGREE 2006	83,2	79,2	58,6	27,2	4.006
TOTAL + QUITE AGREE 2005	85,9	79,7	55,8	20,7	6.000
TOTAL + QUITE AGREE 2004	89,8	82,9	57,4	16,1	8.000

Source: Agriculture Ministry (MARM) Market Research: - Food Consumption and Distribution Observatory – Historical Report – February 2010 Results

²⁴⁶ The UK Grocery Report 2000, Appendix 4.2 (Consumer survey – main report).

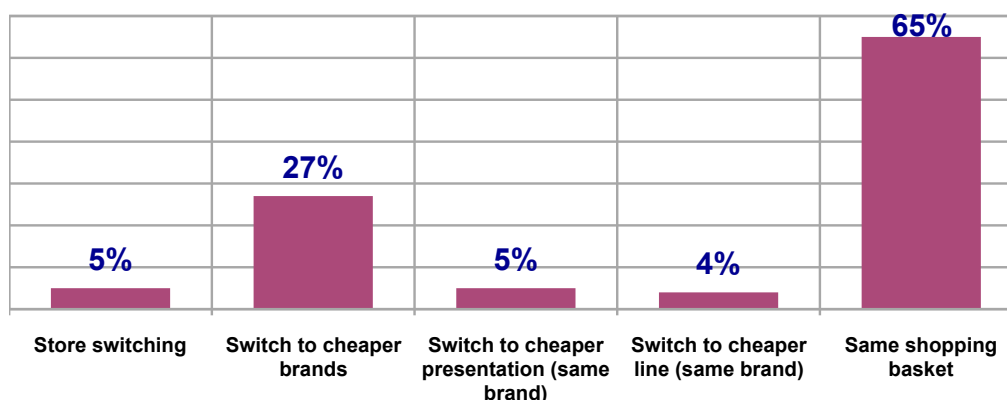
²⁴⁷ The UK Grocery Report 2000, Appendix 4.2, p. 36: “A sizeable 2 in 5 could [not] shop at their first choice of supermarket—almost 3 in 5 of these were of social class C2DE and less likely to utilize a car, therefore transport/distance from home were potentially the impeding factors. Asda (29 per cent), Tesco (22 per cent) and Sainsbury (21 per cent) are highlighted as the most unattainable stores.”

²⁴⁸ There is a significant variation from 2004 to 2005 but the cause is unknown.

Furthermore, a more recent survey by the Instituto Sondea revealed that 86% of consumers shop at the same store for their main weekly shopping and proximity is the main factor in selecting their store²⁴⁹.

Even the deep economic crisis and its impact on the household income have not precipitated store switching. According to a survey by IRI (2009), consumers have reacted to the economic crisis by changing their shopping habits in their preferred store and only 5% have turned to new stores:

Consumer response to the economic crisis



Source: IRI Spain, 2009

The European Commission has also noted consumer surveys that highlight proximity as the critical factor in the selection of a store in Belgium, France and Germany²⁵⁰.

The Belgian survey was conducted by Centre de Recherche et d'Information des Organisations de Consommateurs (CRIOC) and noted that proximity and parking space were the two most important factors in the selection of a grocery store, followed by pricing considerations:

Figure 3 Choice of retail outlet



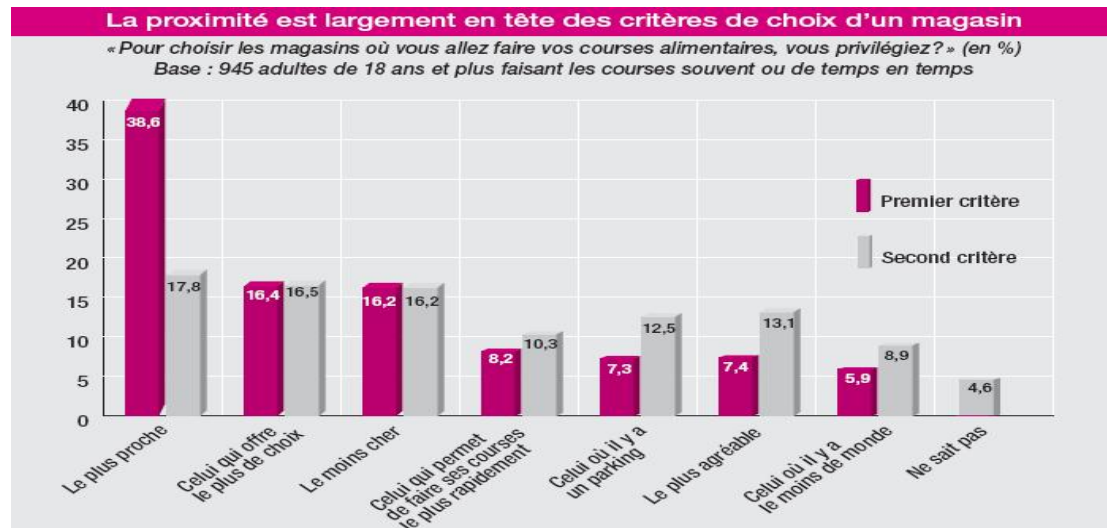
Source: CRIOC Belgique

²⁴⁹ Survey of 2,000 consumers by the Instituto Sondea for the Spanish Brands Association (Promarca), as reported in the magazine *Negocio y Estilo de Vida*, 7.07.2011. Interestingly, the survey reveals that only 50% of consumers use their car to do the weekly shopping: 48% reach the supermarket by foot and 2% rely on public transport.

²⁵⁰ Commission staff working document, "On Retail Services in the Internal Market", accompanying document to the European Commission Report on Retail Market Monitoring: "Towards more efficient and fairer retail services in the Internal Market for 2020", SEC(2010) 807, 5.7.2010, p. 13.

The French survey was conducted by the Centre de Recherche pour l'Étude et l'Observation des Conditions de Vie (CREDOC)²⁵¹ and reported that proximity was by far the most important factor in the selection of a hypermarket for grocery shopping²⁵².

Figure 1. Critères favorisés par les consommateurs dans leur choix d'un hypermarché



Source CREDOC, enquête Commerce, juin 2005.

The European Commission's reference to Germany was drawn from a survey of retailing in the Member States²⁵³.

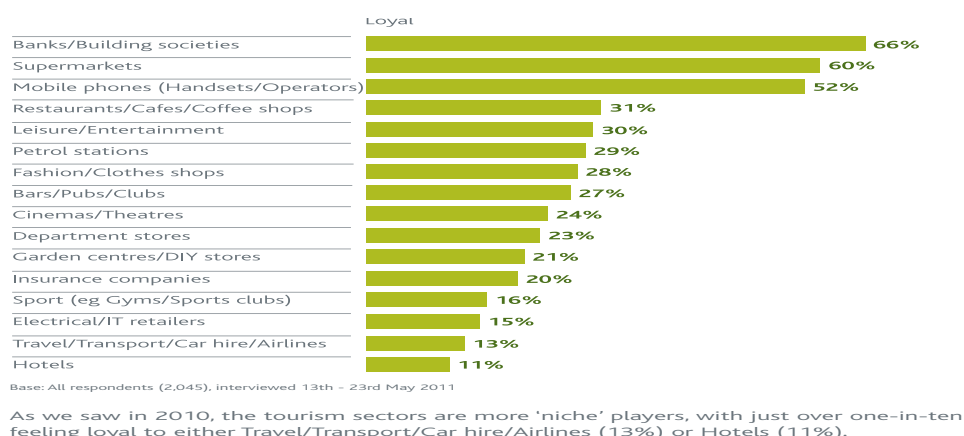
The significance of consumer loyalty to supermarkets, often ignored in competition analysis, is revealed when compared with the loyalty rate exhibited by other retail sectors. In this respect, the findings of the The Logic Group's survey of retail consumer loyalty in the UK and Spain are highly illustrative. Asked if they are a loyal customer to any company operating in several retail sectors, 60% of the surveyed in the UK

²⁵¹ Enquête commerce 2005. Commerce et attitudes des consommateurs à l'égard du commerce alimentaire, cahier de recherche n°211, novembre 2005.

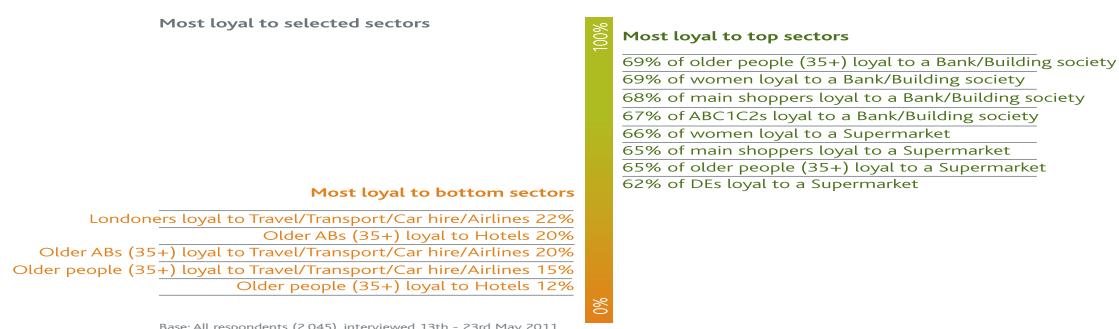
²⁵² See also UFC-Que choisir, "Concurrence locale sur les zones de chalandise et niveau de prix: quelle relation?", 3.04.2008, p. 4: "La zone de chalandise se définit comme la zone géographique habituelle de provenance des clients d'un point de vente. Concrètement, on sait qu'un consommateur fera ses achats dans un périmètre circonscrit pour des raisons de temps de transport ou de praticité. L'étude du Crédoc7, (cf. figure 1) soutient que la proximité est le principal critère retenu par les consommateurs pour sélectionner les quelques points de vente où ils feront leur courses. La localisation des achats induit que, dans la réalité, un hypermarché n'est en concurrence qu'avec un nombre limité de points de vente, ceux qui sont présents sur sa zone de chalandise."

²⁵³ French Presidency of the EU, "Caractéristiques essentielles et politiques de développement du commerce de détail dans les pays de l'Union Européenne", conference organised by the French Presidency on 23-24 October 2008, p. 33: "L'Allemagne souligne que l'évolution démographique influence les comportements en matière de consommation et relève en particulier le recul de la population totale, le nombre croissant des ménages composés d'une ou deux personnes et le vieillissement de la population - les personnes de plus de 59 ans représenteront 35 % de la population d'ici à 2030 - comme autant de nouveaux défis pour le commerce de détail. Les consommateurs privilégient les grandes surfaces facilement accessibles et dotées de parking, mais la proximité directe du domicile joue un rôle déterminant pour l'alimentaire et les petits points de vente perdurent, même s'ils pratiquent des prix plus élevés."

responded that they were loyal to a supermarket, second only to banks/building societies (66%)²⁵⁴.



The degree of loyalty to a supermarket increases if the respondent is a main shopper (65%), a woman (66%) or +35-year (65%), bringing the loyalty exhibited by supermarkets very close to that enjoyed by banks/building societies:



Likewise, the survey places Spanish supermarkets at the top of the loyalty ranking (71%), alongside mobile telephony operators, closely followed by the retail-banking sector (70%)²⁵⁵. Interestingly, the degree of loyalty to the supermarket was significantly up compared with the 2010 score (64%, yet the second highest after the 74% achieved by retail banks), despite the severe economic crisis²⁵⁶.

These findings suggest that consumer loyalty to the primary supermarket, as well as the unique entry and expansion barriers, are a distinctive feature of the grocery retailing that clearly distinguishes it from almost all other retail sectors²⁵⁷. Not surprisingly, the other

²⁵⁴ The Logic Group-Ipsos Mori, "The Imperatives for Customer Loyalty 2011", <http://www.the-logic-group.com/Product/Loyalty%20Report%202011>. The primary research was carried out through an online quantitative survey of 2,045 adults across Britain, aged 16-64 and from a range of social grades, between 13-23 May 2011. The survey data are weighted to be representative of the British population as a whole.

²⁵⁵ The Logic Group-Ipsos España, "Tendencias del consumidor y fidelización de clientes 2011".

²⁵⁶ The Logic Group-Ipsos España, "Tendencias del consumidor y los programas de fidelización 2010", 23.09.2010.

²⁵⁷ Other retail sectors may be as concentrated, but do not exhibit the features that facilitate the emergence and exercise of market power by supermarkets. This analysis is absent in the Commission staff working document, "On Retail Services in the Internal Market", p. 9: "The retail markets for durable

retail sectors, alongside modern grocery retailing, where customer loyalty (lock-in?) is significantly above the average (i.e., mobile telephony and banking), are regulated to a large extent.

The extraordinary role gained by consumer loyalty in grocery retailing can be attributed to several causes:

(1) Today's consumers consider grocery shopping as a routine: a low value and time-consuming activity. As a consequence, they concentrate their grocery purchases on the most convenient store, from a locational perspective, that fits with their household context (the preferred or primary store)²⁵⁸. Once a consumer has chosen his preferred store, routine will prevail over other economic considerations and competing stores will have to wait until this consumer elects to conduct a new store selection process, which may never happen again if his household context is not altered significantly (e.g., a change of residence). In short, grocery consumers are guided by routines and habits that constrain their behaviour and do not fit within the rational behaviour modelled by economic theories²⁵⁹. Nielsen has graphically defined this consumer lock-in as "the power of habit".

(2) Retail grocery competition is limited in many local markets due to the legal, economic and strategic barriers to entry and expansion²⁶⁰. Therefore, the choice of

goods (electronics and household appliance) within Europe are also characterised by relatively high concentration, with the 5 largest multinational retail operators accounting for one third of the market in 2008¹⁶. However, a very diverse market structure also exists in this sub-sector across Member States. In the clothing and fashion retail market, large corporations again play a major role, although with even more marked differences among Member States. In the UK and the Nordic countries the combined market share of large clothing retailers (both specialised and non-specialised) was well above 80% in 2007. In contrast, in the Mediterranean countries, this share stood at 40% (falling to even 27% in the case of Italy)".

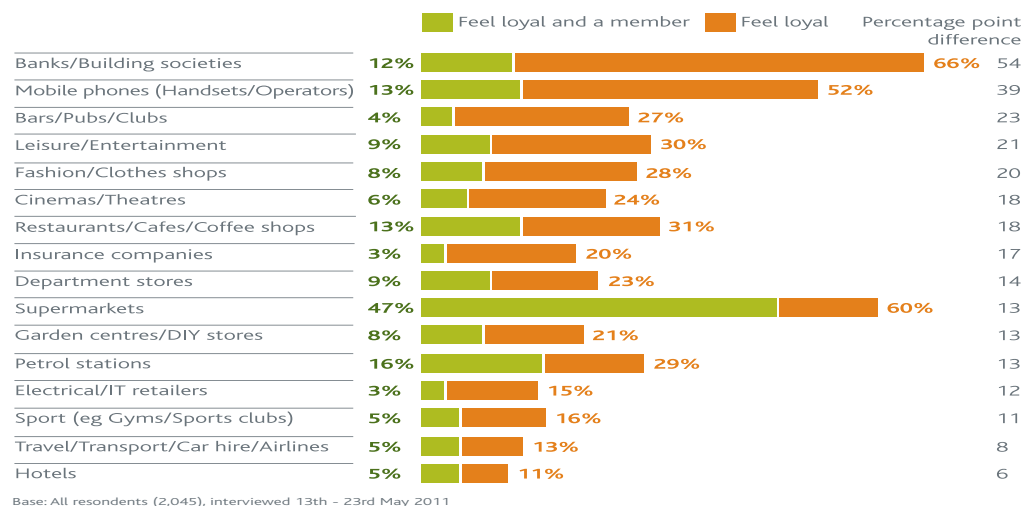
²⁵⁸ The one-stop-shop principle associated with modern distribution (e.g., purchase of all the required grocery and FMCG products in one trip/store) naturally leads to the preferred store demand model. Grocery shopping being an ordinary, low-priority and time-consuming activity for most consumers, the perceived information/transaction costs of repeated store choice far outweigh the prospective efficiencies. This also explains the importance of the proximity factor in the selection of the primary supermarket. See von Schlippenbach and Wey, "One-Stop Shopping Behavior and Upstream Merger Incentives", very preliminary version, February 2008, p. 2: "Time has become more and more scarce due to increasing requirements in professional life and a higher valuation of time-consuming spare-time activities. Therefore, consumers increasingly prefer to combine the purchase of different products in order to reduce the number of shopping trips or more generally their shopping time".

²⁵⁹ The Portsmouth Study I, p. 8: "Our research questions the unproblematic equating of shopping with buying – the exchange of money for goods – since there is now ample evidence to show that consumption is as much an habitual as a problem-solving activity (Hewer & Campbell, 1997). Indeed, recent work by Warde and others (Gronow & Warde, 2001; Shove & Warde, 1997) has highlighted the routine nature of 'ordinary' (as opposed to 'conspicuous') consumption. While their work focuses on the consumption of utilities (water, coal, gas and electricity), their argument can be extended to encompass the mundane nature of everyday food shopping. Warde argues that ordinary consumption practices are enmeshed in a network of related practices and habits, where notions of comfort, convenience, security and normality are governing concerns (Shove, 2003). From such a perspective, food shopping emerges as a routine practice, deeply embedded within other social practices, infrastructures and socio-technical systems."

²⁶⁰ See Sections 5.3.1.1 and 5.3.1.2.

stores available to consumers when they conduct the store selection process is very narrow.

(3) Supermarkets are the most effective of all retail actors in developing consumer retention strategies such as loyalty cards. According to The Logic Group, 47% of UK consumers who are loyal to a supermarket are members of the loyalty program, whereas the second retail sector in terms of loyalty program membership (petrol stations) only reaches 16% of consumers²⁶¹.



Furthermore, studies on membership of competing loyalty programs estimate that grocery consumers belong to one or two loyalty schemes at most and consider that it builds loyalty to the store, which reinforces the single-homing of consumers²⁶².

(4) Consumers get to know the parking and the store facilities of the preferred store and it takes several store visits to a new store to get used to its facilities (e.g., location of products in the shelves). This learning curve is time consuming and implies a switching cost for consumers²⁶³.

²⁶¹ The Logic Group-Ipsos Mori, "The Imperatives for Customer Loyalty 2011". The chart shows the difference between those who say they feel loyal to a sector versus those who say they feel loyal and have a loyalty scheme membership in that sector. The percentage point difference is calculated in the right hand column. This shows the gap between affective loyalty (feeling loyal) and effective loyalty (being a loyalty scheme member). Furthermore, similar conclusions are reached in Spain. According to The Logic Group-Ipsos España, "Tendencias del consumidor y fidelización de clientes 2011", supermarket loyalty programs reach 58% of the consumers, followed by mobile telephony operators (52%), banking (47%) and petrol stations (47%), and well ahead of the other retail sectors.

²⁶² The UK Grocery Report 2000, Appendix 4.2, pp. 37-38, pars. 42-45. More than 7 in 10 respondents held a store loyalty card and the average number held is approaching two. Of those who had at least one loyalty card, most (80%) said that they used it. 26% of customers agreed that to have a store card meant you were less likely to switch stores, suggesting it is probably not influential enough to initiate a move to another supermarket (in fact just 2% actually switched for a better loyalty scheme). Notwithstanding this, 1 in 4 shoppers actually claimed that the cards did create a sense of loyalty.

²⁶³ The UK Grocery Report 2000, Appendix 4.2, p. 36, par. 32: "The main reasons for not changing store were ease of access by car (36 per cent), unfamiliar store layout (34 per cent) and relative convenience of location (30 per cent)" [emphasis added].

(5) Whilst price monitoring by supermarkets is constant and effective, customers' price comparisons in/between supermarkets are difficult due to information asymmetries. If at all, consumers can remember the prices of some KVI or the overall price of the shopping basket, whose composition changes every now and then, making basket-to-basket price comparisons more difficult. In this regard, the consumer survey carried out for the UK Grocery Report 2000 is highly illustrative:

First, almost 50% of consumers did not check prices of essential items when visiting a supermarket nor across the same supermarket²⁶⁴.

Second, almost 60% never/rarely compared prices across supermarkets and less than 20% always or usually did so²⁶⁵. Furthermore, since those customers who check in-store prices and compare prices between supermarkets often belong to the lowest income category, their constraining power over supermarkets' pricing is very limited²⁶⁶.

Finally, the claimed price awareness did not even translate into real knowledge of supermarket prices: the survey results indicated significant deviation between the perceived and the real prices of grocery products, even for those stores applying Everyday Low Prices models²⁶⁷. Related to the consumers' price information asymmetry, several economic studies have showed that consumers' shopping habits may be the cause of the asymmetric price transmission prevailing in the food chain²⁶⁸.

²⁶⁴ The UK Grocery Report 2000, Appendix 4.2, p. 39, pars. 50-51: "50. The issue of price was apparent as a major consideration throughout this study. 55 per cent of respondents indicated that they usually or always checked prices of essential items typically bought on most visits to the supermarket, a figure that rose to 70 per cent when buying new products or untried brands. 51. Three out of ten of those interviewed stated that they usually or always sought to compare grocery prices week to week across the same supermarket, while just under half, 47 per cent, reported never or rarely doing so."

²⁶⁵ The UK Grocery Report 2000, Appendix 4.2, p. 39, par. 58: "When asked how frequently they sought to compare prices across different supermarkets/stores, a majority of respondents, 57 per cent, said that they never or rarely did so. Just under one-fifth, however, usually or always checked prices in this manner. For those who had at least sometimes sought to compare prices across different supermarkets, the most frequently used method was to compare prices of certain key items regularly purchased (mentioned by 61 per cent). Next most frequently reported methods were comparison of the overall cost of their groceries when shopping at other stores (mentioned by 41 per cent), and knowledge of the more expensive reputation of some stores in comparison with others (27 per cent). Just over a fifth reported using in-store signage as a price guide, while 16 per cent reported regularly checking press advertising for news of price reductions/discounts. (Note that percentages sum to more than 100 per cent, indicating that more than one method of price comparison was typically used.)"

²⁶⁶ The UK Grocery Report 2000, Appendix 4.2, p. 41, par. 58: "The above indicates that the subgroup of the population claiming to monitor prices week to week consists disproportionately of those on low incomes and falling into social class DE. While it may not be surprising that this group should actively seek to monitor prices week to week, their relatively low weekly household spend on groceries might mean that their actions have less influence on the price-setting behaviour of the multiples than would be the case if such monitoring were carried out by more affluent consumers. (...). Again, the evidence indicates that the group of main shoppers actively comparing prices across supermarkets consists disproportionately of lower-income consumers." [emphasized]

²⁶⁷ The UK Grocery Report 2000, Appendix 4.2, pp. 41-42, pars. 59-63.

²⁶⁸ Xia and Li, "Consumption Inertia and Asymmetric Price Transmission", *Journal of Agricultural and Resource Economics* 35(2), 2010, pp. 209-227. They review the extensive economic literature on asymmetric price transmission, mostly related to grocery markets. This literature concluded overall that the main driver of asymmetric price transmission is market power. The authors emphasize the importance of consumption inertia in the creation of retailer market power (p. 220): "Asymmetric price transmission

(6) The presence of supermarket brands makes product quality/price comparisons more difficult and, no surprisingly, the leading supermarkets are those most interested in advancing their own brands, as they increase consumer lock-in and loyalty to the store and reduce competitive pressure from smaller retailers.

(7) Habit prevents most consumers from switching stores on price considerations alone but the retail market structure also undermines price competition and reinforces consumer habit: the price transparency prevailing in the retail market and the favourable procurement terms enjoyed by leading supermarkets facilitate price-matching between them and even selective price-undercutting against smaller supermarkets, making price competition unprofitable for all supermarkets. As a result, despite the illusory sense of competition provided by selective and/or temporary price-promotions or low prices in some products, the overall prices of the supermarkets converge and evolve in parallel in an upward trend, limiting the scope for switching of price-sensitive consumers²⁶⁹. Interestingly, the consumer survey prepared for the UK Grocery Report 2000 revealed that price only motivated a third of the consumer switching behaviour and it merely involved 5% of consumers²⁷⁰, generally those that also compared prices between stores²⁷¹. Again, this data is highly illustrative because one would expect that

(APT) exists in many agricultural and food industries and can have significant welfare and policy implications. However, mechanisms driving this market phenomenon are not thoroughly understood. This paper suggests consumption inertia explains APT behavior. Consumption inertia makes instantly raising retail prices attractive for retailers with market power when wholesale prices increase because consumers will not significantly reduce their consumption levels in the short run. On the other hand, retailers are less willing to lower prices (and tend to lower them more slowly) in response to wholesale price decreases when consumption inertia exists because of relatively inelastic consumer responses in the short run. Therefore, consumption inertia leads to faster transmission of wholesale price increases to the retail level relative to wholesale price decreases". For a similar conclusion, based on consumer psychology, see Levy, Chen, Ray and Bergen, "Asymmetric Price Adjustment in the Small: An Implication of Rational Inattention." Discussion Paper Series 04-23, Tjalling C. Koopmans Research Institute, Utrecht School of Economics, 2004. They show that consumers may rationally ignore small retail price changes in order to avoid the costs of processing and reacting to new price information. Consumer inattention can explain why small price increases occur more frequently than small price decreases at the retail level.

²⁶⁹ The Paris Grocery Report concludes that convenience outweighs price considerations in grocery demand and, likewise, leading supermarkets are not willing to undercut prices of competitors in markets where they face competition: "144. L'impact limité, à ce jour, de la concurrence sur les prix des magasins *Franprix* provient plus vraisemblablement de la faible étendue des zones de chalandise et de l'omniprésence du groupe Casino dans les quartiers parisiens. En effet, compte tenu des paniers d'achat limités des consommateurs parisiens, une part significative de la clientèle choisit son magasin moins en fonction du différentiel de prix avec les magasins concurrents (faible en valeur absolue) qu'en fonction de la distance à parcourir. Par conséquent, une baisse des prix pour contrer la présence d'un magasin ou de plusieurs magasins concurrents pourrait n'attirer que peu de clients supplémentaires, alors qu'elle réduirait la marge réalisée auprès des clients qui fréquentaient déjà le magasin. De plus, compte tenu du maillage des quartiers parisiens, l'incitation des magasins du groupe Casino à réduire les prix pour attirer de nouveaux clients est naturellement faible: vraisemblablement, une forte proportion des clients qui seraient attirés par les prix bas d'un magasin *Franprix* proviendrait d'un autre magasin du groupe Casino".

²⁷⁰ The UK Grocery Report 2000, Appendix 4.2, p. 36-38, par. 31: "85 per cent of shoppers had used the same store over the past year. For those who had made a change to a 'new' store, a third did so for price-related reasons". Therefore, only 15% of the grocery customers had switched stores in the preceding 12 months and, of those 15%, only about 33% of the customers had switched stores for price-related reasons, which made up 5% of total grocery customers".

²⁷¹ The UK Grocery Report 2000, Appendix 4.2, p. 37, pars. 38: "One potentially important question of interest is whether those who checked prices, particularly across different supermarkets, were

consumers replying to a survey tend to overemphasize their rational behaviour and countervailing power (price sensitivity and store switching if the preferred store is not price responsive) over their real-life constrained behaviour.

All these factors make the supermarkets' proximity/loyalty proposition an unbeatable one. Certainly, there can be instances where some consumers are semi-loyal to a store or loyal to two stores²⁷². Likewise, in exceptional occasions they may switch their preferred store, mostly due to a change of their household context. As a corollary, grocery consumers tend to show a high level of satisfaction with their primary supermarket²⁷³. This result raises the question whether satisfaction drives habit or, rather, habit is the outcome of the *status quo bias*²⁷⁴.

Consumer loyalty to supermarkets being a natural development of modern grocery retailing, its consequences for independent grocery brands are nothing short of traumatic: customer loyalty to their primary supermarket undermines dramatically loyalty to grocery brands. The International Retailization Study 2005, by Nielsen, revealed that 70%-80% of customers would not change store if their primary supermarket ceased stocking their favourite brand²⁷⁵. More recent data from Spain confirms the rise of supermarket (brand) loyalty over grocery brand loyalty: only 29,9% of consumers would look for a missing grocery brand in another store, whereas 32,9% would settle for the alternative supermarket brand:

more likely to be switchers. To answer this question, in Table 7 we cross-tabulate switching behaviour and frequency of price comparison between different supermarkets. There does indeed appear to be a relationship between likelihood of having switched supermarket within the last 12 months and frequency of price comparison across different supermarkets/stores. 10 per cent of those who never compared prices had switched, a figure that rises steadily to 22 per cent of those who always compared prices."

²⁷² The UK Grocery Report 2000, Appendix 4.2, p. 36, par. 32: "54 per cent of shoppers claimed to almost always visit the same supermarket for their main grocery shopping, whilst 26 per cent were semi-loyal and 14 per cent regularly used two stores. The main reasons for not changing store were ease of access by car (36 per cent), unfamiliar store layout (34 per cent) and relative convenience of location (30 per cent)." The Portsmouth Study, see note 239, attributes this secondary sourcing behaviour to complex working patterns/lifestyles and top-up shopping.

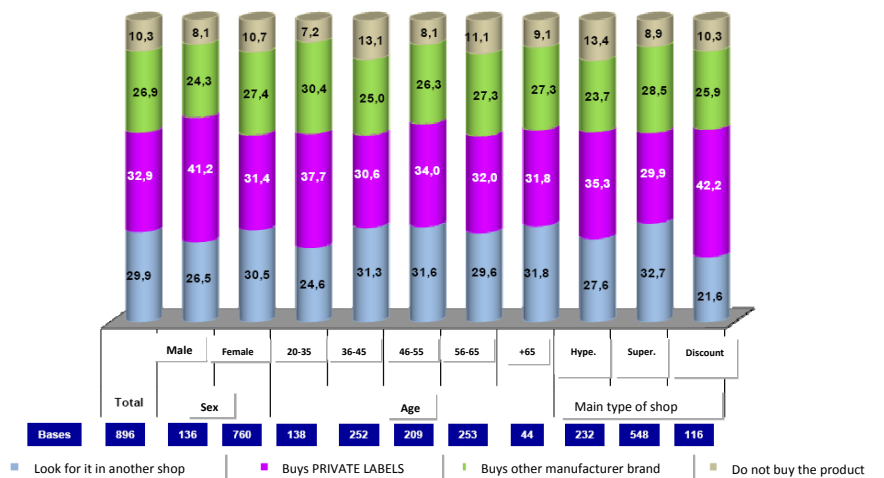
²⁷³ The UK Grocery Report 2000, Appendix 4.2, pp. 43-44, pars. 64-65. 89% of consumers rated "excellent" or "good" the value for money offering of their primary supermarket.

²⁷⁴ Rosch 2010, p. 4: "*Third*, behavioral economics recognizes that human beings are creatures of habit—we tend to stick with what we have even if that doesn't make sense. This tendency is often referred to as the status quo bias. This means that some people will make very conservative financial choices, such as keeping their deposits at one bank even when they are offered a better rate of interest by a bank which is essentially identical in all other respects".

²⁷⁵ The consumer survey was conducted in July 2005 among 3,000 shoppers in Denmark, Sweden, the United Kingdom, Germany, Spain and the United States. The results are discussed in Thomassen 2006, p. 33: "For the most part, people claim that they will not change store if their favourite brands cease to be stocked. It is difficult to conclude anything dramatic about brand loyalty based on this. It is also not the point. It is just interesting to note that people do not seem prepared to change shopping behaviour to maintain brand behaviour". Interestingly, the whole book is a dramatic warning call to brands to fight for survival in a new era of retailer market power.

What do you do when you cannot find a product of a manufacturer brand?

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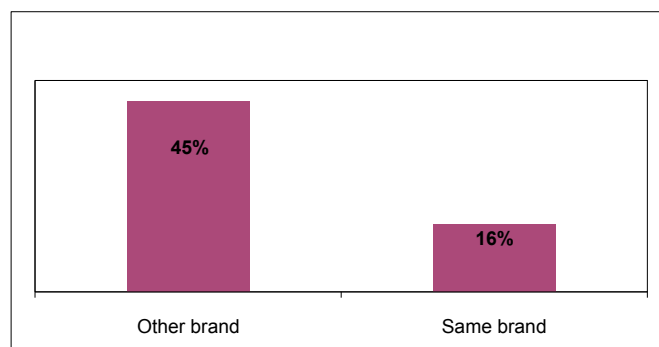
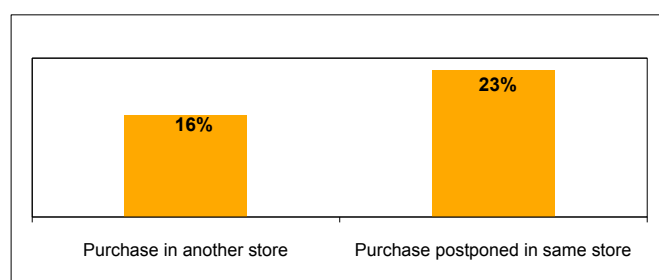
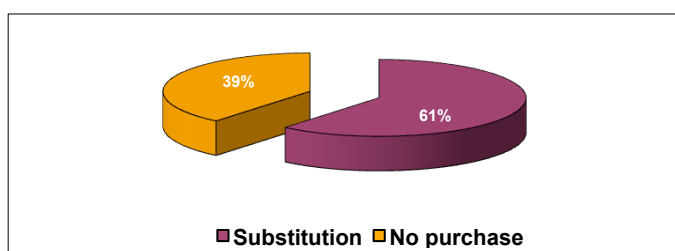


Food Consumption and Distribution Observatory

69

Source: Agriculture Ministry (MARM) Market Research: - Food Consumption and Distribution Observatory – Historical Report – February 2010 Results

Loyalty to the supermarkets feared even better in an IRI survey on Spanish consumers:



Source: IRI-Spain, 2009

According to the IRI results, only 16% of customers would look for the missing brand in another store, whereas 22% would wait until the brand becomes available again in their preferred store.

These results probably overestimate consumers' switching behaviour. The answers only show expressed preferences in a non-store setting. Therefore, consumers are likely to overestimate rational behaviour (change of store) over convenience/habit in a routine shopping scenario (revealed preference).

The routine, low value/priority nature of grocery shopping and the increased loyalty to the supermarket are also evidenced by the growth of in-store purchase decisions. Today, the large majority of the purchase decisions of specific brands are taken in the store and not before²⁷⁶. More and more consumers think in terms of 'wants' rather than specific brands when they write down or think through their shopping list and convenience rules over specific brand preference, up to a point where almost no grocery brand is irreplaceable: "whoever owns the shelf, owns the market!"²⁷⁷.

This reality highlights the importance of in-store dynamics and the critical role played by supermarkets in shaping consumer choice. Indeed, if rational choice depends on motivation, capacity and opportunity²⁷⁸, it is questionable whether grocery shopping is a rational choice and supermarkets are constrained by consumers in a free market.

²⁷⁶ According to an IRI presentation, in 2001, 67% of the brands were pre-selected by consumers and only 33% were selected in-store. In 2009, these figures had been reversed and 67% of the brands were selected in-store. See also Thomassen 2006, p. 20: "It dramatically increases the squeeze, especially if we think back to the question of whether shoppers write orange juice or Minute Maid on their shopping lists. In a 2004 report, retail experts POPAI described how more and more brand decisions are made in-store. In Europe, 75% of the purchase decisions are made after the shoppers enter the store. In the United States, the number is 70% (Liljenwall, 2004). Of course, it does not mean that brand and preference building are a waste of time outside the store. It does, however, mean that it all comes down to those critical seconds. Everything can happen once the shopper enters the store. A UK report from 2004 observes that 43% of shoppers claim that point of purchase (PoP) advertising can sway their purchase decision (*Marketing Week*, 2004)".

²⁷⁷ Thomassen 2006, pp. 25-26: "What does it all mean? First and foremost, it could mean that shoppers think in 'wants' rather than brands when they plan their shopping. What do they feel like? What do they want? They want orange juice, toothpaste, and a cool computer. Only when they hit the store do shoppers start making decisions between competing brand, between brands and private labels, and start making their choice between competing products, truly making the store the point of action. It also means the convenience rules. As shoppers our need for convenience trumps everything, and very quickly eliminates our immediate preference for a certain brand. For the most part, shoppers are not prepared to waste time going to another store to get that specific brand; in most cases a substitute will do just as well. Therefore, the research also suggests that in the short term no brand is irreplaceable. Now we can start to understand why some retailers cannot resist the temptation to deist some brands in order to teach them a lesson and simultaneously manifest their own power. The importance of owning the point of contact becomes very clear in our research. Whoever owns the place of purchase sets the agenda: that is, the retailer. Or like the previously mentioned quote from a retail CEO: 'Whoever own the shelf, owns the market.' This is squeeze!"

²⁷⁸ Poesz and Van Raaij, *Strategic Marketing and the Future of Consumer Behaviour: Introducing the Virtual Guardian Angel*, Edward Elgar, 2007, and "The Free Market Illusion: Psychological Limitations of Consumer Choice", *Tijdschrift voor Economie en Management*, Vol. XLIX, 2, 2004, pp. 309-338.

From a motivational perspective, grocery shopping is considered to be a routine and low value activity. Furthermore, the high sanitary standards applied to grocery products and the difficulty consumers face to ascertain functional differences, does not invite the consumer to spend much time, energy and/or money on functional property assessments. Supermarket themselves try to associate the quality of their brands with the quality of the leading brands and rely on more or less explicit claims suggesting “same quality, lower price”²⁷⁹. Therefore, consumer motivation to carefully judge and compare alternatives is reduced.

From a capacity perspective, consumers’ knowledge of the availability of grocery products in the market is limited as compared with many other sectors. For example, consumers may turn to the Internet for information and comparisons of mobile phones. The same information on all grocery products that are sold in a supermarket or, at least, go into an average shopping basket, either it is unmanageable or does not exist, or it is unreliable/subjective. Furthermore, consumers’ ability to integrate the large amount of grocery product information into rational evaluations, trade-offs, and decisions is severely limited.

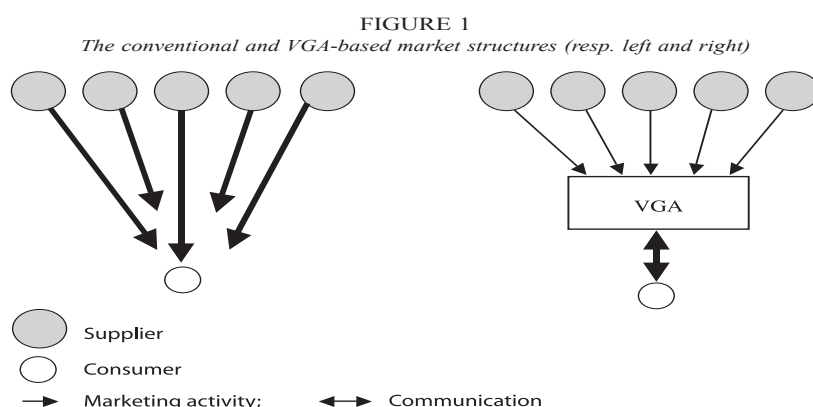
From an opportunity perspective, the mere observation of grocery buying in real life suggests that the conditions under which complex decisions need to be made are far from ideal. Consumers spend 3 to 6 seconds to evaluate a grocery product²⁸⁰. However, information acquisition, evaluation, and integration may be seriously disturbed by background noise, talking salespersons, the (noisy) presence of other customers, store music and auditory in-store announcements, in-store displays, and a limited amount of time available for the decision.

All in all, the evolution of grocery shopping into a loyal long-lasting relationship between the consumer and the supermarket comes very close to the trusted platforms or “virtual guardian angels” (VGAs), exposed by behavioural economics²⁸¹.

²⁷⁹ See, for example, the explicit claim on the website of the Private Label Manufacturers Association (PLMA), http://www.plmainternational.com/en/private_label_en.htm (visited 20.04.2012): “What are the advantages of private label? For the consumer, private label represents the choice and opportunity to regularly purchase quality food and non-food products at savings compared to manufacturer brands, without waiting for promotional pricing. Private label items consist of the same or better ingredients than the manufacturer brands, and because the retailer's name or symbol is on the package, the consumer is assured that the product meets the retailer's quality standards and specifications.” It is questionable whether this claim complies with the unfair competition and advertising rules of many EU Member States.

²⁸⁰ Thomassen 2006, p. 20: “Christopher Robert, the VP of retail marketing of Coca-Cola, put it this way: ‘When the consumer comes in like a shopper, there is a moment of consideration no matter what portfolio she is looking at. And it is a very quick pseudo-intellectual interaction made in 3 to 6 seconds’. Plenty of research backs these statements. The *Economist* (2005a) reports that shoppers waste no more than six seconds on average looking for a specific brand before they settle for an alternative. This is fascinating stuff. It dramatically increases the squeeze, especially if we think back to the question of whether shoppers write orange juice or Minute Maid on their shopping lists”.

²⁸¹ Poesz 2004, p. 329: “Under conditions of full trust (as the positive expectation regarding future performance based upon repeated positive experiences in the past), the consumer is likely to delegate, to the supplier, the purchases that are either uninteresting (motivation), too complex (capacity) and/or too time-consuming (opportunity – think of double income families). In turn, the supplier will honor the



Source: Poiesz 2004, p. 330.

In this new economic paradigm, the number of VGAs is considerably smaller than the number of brands available, as the VGAs adopt the function of meta-brands²⁸² or prescriptors. This limited number of VGAs serves as intermediaries between the consumer and a variety of grocery suppliers, and select (prescribe to consumers) the suppliers that are best capable of providing added value to the individualized package already formed²⁸³. Once a consumer is satisfied (or locked-in by habit) and trusts the VGA, price is no longer an issue, as long as the package is within the consumers' budget constraints²⁸⁴. As a corollary, notions like consumer choice, competition, and the notion of the free market must be placed at a more aggregate level. Consumers do not choose anymore between different brands or different products, but different multi-product systems. Consumer disciplining of markets can only take place at this level, but is seriously limited by long term relationships. In this sense, competition at the consumer level is strongly reduced, whereas competition will continue to exist between manufacturers supplying the VGAs²⁸⁵.

5.3.1.5 Direct evidence: pricing power and spatial competition

This Section provides direct evidence that the leading supermarkets in most grocery retail markets are able to enter into a virtuous growth cycle at the expense of independent grocery brands, consumers and smaller competitors. This market power corresponds to the snowball effect advanced by the European Commission in the Rewe/Meinl Decision²⁸⁶, which has since escaped the attention of conventional competition analysis, but not of some researchers²⁸⁷.

invested trust, and will select those products and services that are most likely to further increase satisfaction. Consumers will be unable to judge a package's price level. This seems to be a critical point in the argument. However, as the relationship is based upon trust and the intention to continue the relationship, neither party will exploit the situation unfairly".

²⁸² Poiesz 2004, p. 329.

²⁸³ *Id.*, p. 330.

²⁸⁴ *Id.*, p. 331.

²⁸⁵ *Id.*, p. 332.

²⁸⁶ The European Commission's analysis relied heavily on the virtuous growth potential of the merged company and the ensuing reduction of competitive rivalry. See the Rewe/Meinl Decision, par. 72-74. In particular, par. 72: "In the retail trade there is a close interdependence between the distribution

The market power of the leading supermarkets manifests itself in their ability to obtain better margins than their competitors. These better margins flow from two sources. On the one hand, leading supermarkets are able to extract better purchasing prices and terms than smaller supermarkets²⁸⁸. On the other hand, leading supermarkets benefit from the retail grocery pricing dynamics, either because prices are aligned across-supermarkets (thus, the lower wholesale prices paid by the leading supermarkets increase their relative margins vis-à-vis smaller supermarkets)²⁸⁹ or because leading supermarkets can command higher prices due to consumer loyalty and spatial monopolies (thus, leading supermarkets enjoy a double advantage: lower wholesale prices and higher retail prices). This conclusion should hold true whether the analysis is conducted at the aggregate national level or on a regional/local basis. For example, evidence regarding the UK and Spanish procurement and retail grocery markets confirms the privileged market status of the leading supermarkets.

With regards to the procurement terms, the UK Grocery Report 2000 found that the largest supermarket chains, and Tesco above all, enjoyed better purchasing terms than

market and the procurement market. Retailers' shares of the distribution market determine their procurement volume: the bigger the retailer's share of the distribution market, the larger the procurement volume. And the larger the procurement volume, the more favourable as a rule are the buying conditions which the trader obtains from his suppliers. Favourable buying conditions can in turn be used in various ways to improve one's position in the distribution market (sometimes through internal or external growth, but also through low-price strategies targeted at competitors). The improved position in the distribution market is itself reflected in a further improvement in buying conditions, and so on."

²⁸⁷ See, for example, Bell (powerpoint presentation), "Private Label: Their Role for Retailers & Their Impact Upon Competition", Presentation at the Conference *Trends in Retail Competition: Private Labels, Brands and Competition Policy*, Oxford, 09.05.2005: "Summary: -UK grocery retailing is characterised by vertically integrated oligopolists; -Control of the supply chain has facilitated the expansion of private label; -Private label facilitates differentiation and higher retail margins; -Retailers act as agents for their products and their suppliers brands; -Retailers control all of the in-store marketing variables and have advance notice of the brand plans of their suppliers; -Most product innovation is initiated by producer brands". Bell also mentions in his presentation that "Supply Chain Dominance" enables large retailers to grow through "Asset Investment". See also the UK Grocery Report 2000, Chapter 2 (Conclusions), p. 53: "2.207. In a situation where land and sites are scarce, incumbents with the largest shares of the grocery market are likely to be most favourably placed to defend their position against new entrants, particularly if they have a strong presence in specific local areas or larger regions."

²⁸⁸ The cost of goods sold by supermarkets is the largest cost category for supermarkets and, therefore, a critical competitive factor.

²⁸⁹ There is no need for supermarkets to equalise their prices on all grocery products on offer as long as consumer perceive them as competitive in the pricing of KVI and the standard grocery shopping basket, due account being taken of the pricing premium/discount attributed to the store format (hypermarket, large supermarket v. proximity supermarket) and the differentiated service offering level (e.g., store lay-out, product variety and consumer attention). The price convergence means that the price gap between KVI and the standard/average shopping basket of the supermarkets narrows to a point where relative prices cease to be a critical factor in consumer switching behaviour. Several factors facilitate the persistence of these price-gaps. First, when consumers select their primary store, they factor in its absolute/relative pricing. Second, as consumer loyalty to the primary store develops, the absolute/relative pricing-gap that will spur a change of store widens up. Third, consumers normally compare the cost of a shopping trip and this percentage difference translates into a small amount of money in absolute terms. Fourth, the price difference may depend on the shopping basket of each customer, which is not always constant.

the smaller supermarket chains²⁹⁰. Likewise, the leading Spanish supermarkets obtain better procurement terms than the smaller ones²⁹¹.

Regarding the trend towards convergence of national prices across supermarkets, the UK Grocery Report 2008 verified that all the leading supermarkets rely on national pricing strategies. Some years before, the UK Grocery Report 2000 had devoted a full chapter to the pricing practices of the leading supermarkets²⁹² and found that (1) grocery retail prices of the leading supermarkets were more or less within a 10% range²⁹³; (2) they constantly monitored each other's prices and took them into account when setting their own prices, in particular for core lines and KVI²⁹⁴; and (3) some price leadership-following existed²⁹⁵.

In Spain, the modern grocery retail price studies regularly published by the consumers' organisation OCU ("Estudio Supermercados") and, up to 2012, by the Government's "Observatorio de precios de alimentación y droguería en el comercio minorista en España" show a similar pattern of price convergence, more acute between the leading supermarkets, for different baskets of products and, in particular, for processed goods.

²⁹⁰ The UK Grocery Report 2008, Section 5.19-5.43, pp. 87-92. In particular, Section 5.41: "In conclusion, large grocery retailers, particularly the four largest, and especially Tesco, generally obtain lower prices from suppliers than wholesalers. This is likely to reflect a range of factors, including economies of scale and greater bargaining power for large retailers. We did not find these differences in supplier prices in and of themselves gave rise to an AEC for reasons that are discussed in relation to barriers to entry and expansion (see paragraphs 7.29 to 7.31)."

²⁹¹ Cruz-Roche, Yagüe, Rebollo and Oubiña, "Concentración y competencia en la distribución minorista en España", ICE 779, Julio-Agosto 1999.

²⁹² The UK Grocery Report 2000, Chapter 7 and related Appendices.

²⁹³ The UK Grocery Report 2000, Appendix 7.2 ("Relative price levels – evidence from the multiples' own surveys").

²⁹⁴ The UK Grocery Report 2000, Appendix 7.2 ("Competitor price monitoring") and Chapter 7, par. 7.107: "Given the acknowledgement of this phenomenon from the other parties and their descriptions of the circumstances and reasons for it, we conclude that price matching does occur. However, we accept that it may be confined to a relatively small number of products and may not occur continuously. This section does not consider whether prices are reasonable; common pricing can be consistent with intense competition or the wish to avoid self-defeating price cuts". Furthermore, in order to contest the existence of price leadership in the market, Tesco was able to assemble an impressive dataset of weekly prices of its competitors (the Grocery Report 2000, Chapter 7: "7.103. Tesco challenged the significance of such activity. It assembled a dataset of 850 product lines over a period of 68 weeks from the first week in March 1998 to the last week of June 1999. Prices were surveyed in Asda, Kwik Save, Morrison, Sainsbury, Safeway, Somerfield and Tesco.").

²⁹⁵ The UK Grocery Report 2000, Chapter 7, pars. 7.182: "The company pricing policies indicate that many price with regard to particular competitors, and in the case of budget own-label products, several parties all set their prices with regard to Tesco. If price leadership operates among the multiples then we should be able to discern that price changes tend to originate from one or two of the large companies and that other multiples tend to follow either very quickly or with a lag". The UK Competition Commission relied on a visual analysis of prices and a regression based analysis. See, respectively, pars. 7.189: "Despite the above limitations some tentative conclusions emerge from the graphs. The multiple most often identified leading a price change is Tesco, with Asda leading almost as often. Few price changes originated in Safeway and even fewer in Sainsbury. Morrison's prices often did not change when the other major multiples changed theirs. Aldi's price changes seem quite independent of those in the major supermarket chains"; and pars. 7.193-7.194: "7.193 Asda and Tesco were tested as potential price leaders for all eight items. Others were tested for items where a visual examination indicated a possibility that they acted as price leaders but were never found to be statistically significant. 7.194. No significant price leadership was found for prices of bread or coffee. Price leadership was identified in the other six items examined. Model results are reported in Appendix 7.12".

Interestingly, the national chain “El Corte Inglés”, traditionally associated with expensive prices and premium services, has publicly announced a policy of price-convergence with the market leaders²⁹⁶. The price convergence is much more acute in the processed independent brands basket. Almost all supermarket chains, national and local, are within the 10% range and the price convergence is much more visible across the national chains and, in particular, the leading supermarkets.

Despite the trend towards price convergence across-supermarkets, there is also some evidence that leading supermarkets are able to command supracompetitive prices either at the national or local level.

For example, the UK Grocery Report 2000 showed that the best purchasing terms obtained by the largest supermarkets (in particular, Tesco) did not translate into the lowest retail prices²⁹⁷. Indeed, the UK Grocery Report 2008 showed that the largest supermarkets have consistently monopolised for many years the stores present in highly concentrated local areas, thereby reaping supra-competitive profits²⁹⁸ and indirectly building supra-competitive national prices²⁹⁹.

In Spain, the price surveys of OCU reveal that the representative baskets of independent brands and supermarket brands are more expensive in the stores of the Spanish leader (Mercadona) than in the stores of other national and regional chains³⁰⁰. Furthermore, the

²⁹⁶ Interestingly, El Corte Inglés has announced a new pricing strategy that will see its prices aligned to those of Mercadona and Carrefour in a representative basket of 5,000 products (Expansión, “El Corte Inglés baja un 20% sus precios para competir con Mercadona y Carrefour”, 07.06.2012).

²⁹⁷ The UK Grocery Report 2000: “7.19. Price indices of the largest multiples, produced by the largest multiples, are reviewed in Appendix 7.2. The general picture that emerges from these exercises is that for the period to the end of 1999, the prices of the largest multiples can be divided into three groups. Kwik Save and Asda have the lowest prices with Morrison close behind. Secondly, Tesco prices have fallen such that it is approaching the first group, although according to Tesco its pricing is now at or below Asda’s. Thirdly, Safeway, Sainsbury and Somerfield define a separate, higher-priced group, although Safeway told us that it had embarked on a new strategy since early 2000, which might affect this picture.”

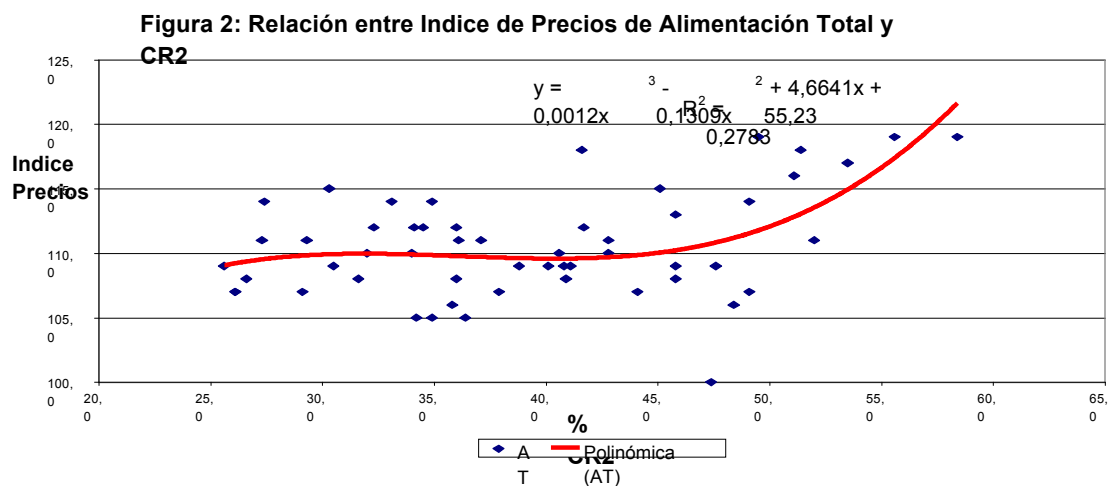
²⁹⁸ The UK Grocery Report 2008, pars. 6.62-6.63: “6.62 Our analysis of the extent to which store-level profit margins for larger grocery stores vary with the intensity of local competition shows that more intense local competition results in lower store-level profit margins. For example, we found that an additional competitor store within a 10-minute drive-time of a larger grocery store would reduce the store-level profit margin of the incumbent store by approximately 3.8 per cent. For an average larger grocery store, this would translate into a profit reduction of £300,000 to £350,000 a year. 6.63 We estimate that the cumulative effect of weak local competition on store-level profit margins allows grocery retailers to earn an additional £105–£125 million in profits per year at their larger grocery stores. This represents around 3 per cent of annual profits for the four largest grocery retailers. The additional store-level profits at mid-sized grocery stores as a result of weak local competition may be of a similar order.”

²⁹⁹ The UK Grocery Report 2008, pars. 6.64-6.73. See in particular, par. 6.72: “Nevertheless, had competition in more local markets been more intense, the decline in UK grocery prices that has been observed until recently (see paragraphs 3.40 to 3.41) may well have been greater. The scale of the impact on national price levels arising from weak local competition, while difficult to measure, is potentially very substantial. For example, for each 0.1 per cent increase in national price levels, consumer expenditure on groceries at the four largest grocery retailers increases by £80 million a year.”

³⁰⁰ See, for example, OCU, “Estudio Supermercados”, Compra Maestra, Octubre 2012. The study focuses on two baskets (the “standard basket”, comprising independent grocery brands and produce, and the “low-cost basket”, comprising supermarket brands). The study shows that the cheapest standard basket can be found in small operators without a national dimension whereas the cheapest national operators are Alcampo and Carrefour, ahead of Mercadona and Dia. With regards to the low-cost basket,

prices of the leading national chains (mainly, Mercadona, Dia, Eroski and Carrefour) are similar to the prices of the smaller national and regional chains, which enjoy less favourable wholesale prices. The price competitiveness of the smaller supermarkets *vis-à-vis* the leading ones and of the large supermarkets *vis-à-vis* the undisputed market leader (Mercadona) is even more surprising if one takes into account that Mercadona and other supermarkets pursue an aggressive vertical integration strategy. Overall, the price surveys lead to these conclusions: First, leading supermarkets and, especially, the undisputed leader (Mercadona) may not be competing aggressively at the retail level even though their purchasing terms with independent grocery brands are better than those enjoyed by small operators. Second, an open and non-discriminatory policy regarding access of independent grocery brands to the supermarket platform (i.e., more innovations, choice and quality) does not prevent supermarkets, even small ones, from offering representative baskets of independent brands and supermarket brands at similar or cheaper prices than those operators with a closed-shop strategy (Mercadona, Dia, Lidl and Aldi).

The close relationship between market power (size) and prices, inferred from the aggregated retail prices in Spain, seems to be vindicated by the price analysis of local/regional markets. Several studies have showed that there is a correlation between retail concentration in the Spanish market and higher prices³⁰¹. In particular, a recent study has found that retail prices in the main Spanish towns increase significantly once the C2 threshold exceeds 40% or the C3 threshold exceeds 50%³⁰².

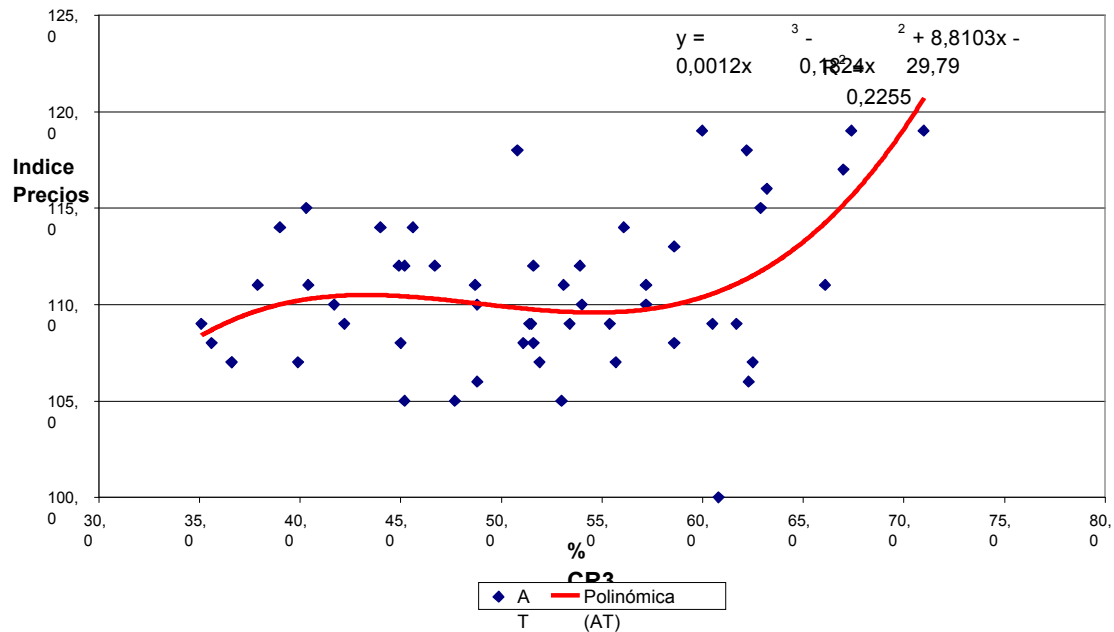


Alcampo is the cheapest operator, followed by a Lidl, Gadis Hiper, Carrefour, Aldi, Carrefour Market, Dia Market, MaxiDia, Eroski, Eroski Center and Mercadona). OCU noted that the overall price of the standard basket had gone up by 1%, whereas the price of the low-cost basket had gone up by 3.6. This trend, confirmed by subsequent studies, seems to be linked to the exponential growth experienced by supermarket brands in Spain and their increased market power (see Section 5.5.2.1.1).

³⁰¹ See, for an older example, Yagüe, “Relación entre concentración y precios en el comercio minorista”, Información Comercial Española 739, 1995, pp. 59-70.

³⁰² Oubiña and Yagüe, “Análisis de la concentración espacial y del poder de mercado de las enseñas comerciales y su efecto sobre la dispersion de precios minoristas”, 23.02.2011 (unpublished study made available to the author of this Report). The study analysed prices in the main 56 Spanish towns in the fourth-quarter of 2009. Concentration ratios were estimated based on retail grocery surface data provided by the publication “Alimarket”.

Figura 1: Relación entre Índice de Precios de Alimentación Total y CR3



Source: Oubiña and Yagüe, “Análisis de la concentración espacial y del poder de mercado de las enseñas comerciales y su efecto sobre la dispersión de precios minoristas”, 23.02.2011, p. 4.

Not surprisingly, those that stand to gain from local/regional supra-competitive prices are the leading national supermarkets, which rank amongst the three leaders in most regions of Spain³⁰³:

Autonomous Community (Region)	Top operator		Second operator		Third operator		Combined share of top three
	Operator	Share (%)	Operator	Share (%)	Operator	Share (%)	
Basque Country	Eroski	40.9%	Carrefour	16.6%	Uvesco	15.3%	71.8%
Balearic Isles	Eroski	37.8%	Spar	16.6%	Mercadona	13.8%	67.2%
Navarra	Eroski	37.4%	Carrefour	18.3%	Uvesco	11.4%	67.1%
La Rioja	Eroski	36.8%	Auchan	21.9%	Carrefour	17.7%	66.4%
Cantabria	Semark AC Group	34.9%	Carrefour	20.0%	Eroski	9.9%	64.8%
Valencia	Mercadona	25.0%	Consum	22.6%	Carrefour	14.2%	61.8%
Principality of Asturias	Alimarka	31.0%	El Árbol	15.2%	Carrefour	13.8%	60.0%
Galicia	Gadisa	21.3%	Eroski	20.7%	Carrefour	17.9%	59.9%
Canary Islands	Dinosol	24.8%	Agrucan	18.1%	Mercadona	15.7%	58.6%
Extremadura	Carrefour	25.6%	Lider Aliment.	19.1%	Mercadona	12.2%	56.9%
Murcia	Mercadona	24.3%	Carrefour	17.3%	Eroski	9.3%	50.9%
Aragón	El Árbol	19.3%	Auchan	16.6%	Eroski	14.5%	50.4%
Andalusia	Carrefour	19.9%	Mercadona	19.1%	Coop. Cowfan	11.1%	50.1%
Castilla-La Mancha	Mercadona	19.8%	Carrefour	19.4%	Eco Mora	9.9%	49.1%
Madrid	Carrefour	25.5%	Mercadona	12.2%	El Corte Inglés	10.5%	48.2%
Castilla y León	Carrefour	21.7%	El Árbol	12.1%	Mercadona	11.5%	45.3%
Catalonia	Carrefour	18.4%	Eroski	14.7%	Mercadona	11.0%	44.1%
National Level	Carrefour	17.6%	Mercadona	14.4%	Eroski	11.0%	43.3%

Note: Shares are calculated as a percentage of the total floor area as 31/12/2010.
Source: MITYC. Boletín de Información Comercial Española, August 2011.

Source: the Spanish Grocery Report, Table 5, p. 23

All in all, supra-competitive prices, facilitated by spatial monopolies and tacit collusion (even at the national level), may be the natural state of affairs in modern grocery retail markets. Both at the local level and, increasingly, at the national level, the three structural features that are associated with tacit collusion on prices seem to be present:

³⁰³ See the Spanish Grocery Report, Table 5, p. 23. The Carrefour data includes its former subsidiary Dia. Carrefour divested the Dia operations in July 2011. Now Dia is the second largest supermarket in Spain behind Mercadona and ahead of Carrefour and Eroski.

(1) a high degree of concentration and price transparency; (2) punishment mechanisms to ensure that no price undercutting occurs; and (3) the absence of competitive constraints by smaller players or new entrants³⁰⁴.

Furthermore, the trend towards uniform national pricing strategies reinforces this tacit collusion through: (a) a significant reduction of supermarkets' flexibility to compete against each other at the local markets (an incumbent and a new entrant in a highly concentrated market will enjoy limited scope for a price war)³⁰⁵; (b) an increase in price

³⁰⁴ See, for a practical assessment, the UK Grocery Report 2008, "Tacit Coordination", pars. 8.20-8.40. The Competition Commission somewhat contradictorily found that it had not seen evidence of parallel pricing despite finding that the three conditions for tacit collusion were present in the UK market and some price-leadership existed. Furthermore, it did not discard its occurrence in the future. See par. 8.40: "Our review of the conditions necessary for tacit coordination to arise and be sustainable suggested that these conditions may be present in UK grocery retailing. However, it may be that sustaining coordinated conduct over thousands of differentiated products or choosing a smaller group of products on which to coordinate would be sufficiently complex to prevent the emergence of tacit coordination. Further, we have not seen evidence of large grocery retailers engaging in parallel behaviour with respect to prices. As a result, we did not find that grocery retailers were engaged in tacit coordination. However, we are concerned that, given the structure of the grocery retailing market, such behaviour could occur in the future". See, however, recent economic Studies showing price leadership in the UK grocery market: Lloyd, "Price Leadership in UK Food Retailing: Time Series Representation and Evidence", paper presented at the 82nd Annual Conference, March 31 - April 2, 2008, Agricultural Economics Society. He analysed the price of a common basket of products sold in each of the UK's four largest retail chains to assess propositions regarding price leadership. Data used in the investigation represented weighted average prices of a large group of branded and non-branded products purchased nationally at weekly intervals over a three and half year period and covered purchases in 37 product categories. He concluded that Tesco, the largest of the retail chains, acted as price leader in both the strategic sense and the tactical sense. Likewise, Seaton and Waterson, "Identifying and characterising price leadership in British supermarkets", University of Warwick Economic Research Papers, number 987, draft April 2012, Abstract: "Price leadership is a concept that lacks precision. We propose a deliberately narrow, falsifiable, definition and illustrate its feasibility using the two leading British supermarket chains. We find both firms engaging in leadership behaviour over a range of products, with the larger being somewhat more dominant but the smaller increasing leadership activity over time. Surprisingly, more price leadership events are price reductions than price increases, but the increases are of larger monetary amounts (so average price increases over time) and the events appear not necessarily related to cost changes. Price leadership appears to play some role in price increases." In Spain, the recent move by El Corte Inglés to align its higher prices with those of its competitors (note 296) has been accompanied by public statements from the company and even competitors against a price war. See Europa Press (press agency), "El Corte Inglés registra un aumento 'significativo' de ventas tras bajar precios", 14.06.2012: "'Los resultados están siendo muy buenos', ha señalado el director de Compras de alimentación del grupo de distribución, Víctor del Pozo, en una entrevista en el canal '24 horas' de TVE recogida por Europa Press. Del Pozo se ha mostrado convencido de que 'no va a haber una guerra de precios' en la distribución comercial como consecuencia de esta decisión de El Corte Inglés, que tiene el objetivo de 'ser tan competitivo como los demás'"; and Europa Press, "Día descarta que la bajada de precios de El Corte Inglés lleve a una 'guerra de precios' al sector", 14.06.2012.

³⁰⁵ In light of their national pricing strategies, supermarkets can only adopt less visible/effective counter-strategies in response to a store opening, expansion or refurbishment by a competitor. See the UK Grocery Report 2008, pp. 113-114: "6.36 Grocery retailers provided us with a significant amount of evidence regarding the way in which they vary aspects of their retail offer, including pricing, food counters, store presentation and staffing according to local competitive conditions, and, in particular, in response to changes in local competitive conditions brought about through the opening of new stores by competing retailers. 6.37 Both CGL and Somerfield operate multiple price bands where the band to which a store is allocated takes into account local competitive conditions, while Asda, M&S, Morrisons, Sainsbury's, Tesco and Waitrose each told us that it used local vouchering, which allowed the average prices to be reduced at the store level (see paragraphs 5.73 to 5.81). For most of these retailers, vouchers are principally used at the time of new store openings or extensions or in response to a new opening, extension or store refurbishment by a competitor in the local area. 6.38 As we set out in paragraph 5.74,

transparency (a price change will be easily detected as opposed to a price change in one of the hundreds of local markets); (c) a facilitation of price monitoring (price-checking of a competitor can take place at any one of its stores); (d) a disincentive to launch a price war (i.e., price cheating among the oligopolists) as this move and the ensuing price-reprisal by other supermarkets will extend to all the stores in the country, including local markets where the instigator faces little competition or where its stores are not profitable at the war-price level; and (e) the possibility of factoring local market power into higher national prices³⁰⁶.

The above analysis provides a static snapshot of the market power of the leading supermarkets. This market power, in turn, sets in motion a virtuous surface growth dynamic³⁰⁷. Large supermarkets can benefit from their market power to expand their stores and open new ones at a pace that cannot be matched by smaller competitors. Expansions and, most notably, new openings are the most important drivers of market share growth, which in turn facilitates further growth through economies of scale and scope, better terms/payments from suppliers and more scope for monopolistic/oligopolistic retail services. Again, the evidence from the UK and Spain is highly illustrative of this virtuous growth dynamic and the ensuing reduction in competitive rivalry and, ultimately, consumer-welfare.

In the UK, the static picture of the retail market concentration indicated that the largest supermarket chains, and Tesco above all, held more stores in local concentrated markets than the smaller supermarket chains³⁰⁸. The dynamic analysis did not improve the competitive scenario either. The UK Competition Commission found that the opening of grocery stores had followed a slower but still positive trend over the 2000-2008

Tesco undertakes substantially more local vouchering than do other grocery retailers, spending nearly £[-] million on local vouchering between June 2003 and June 2006. Tesco, however, stressed what it considered to be the *de minimis* nature of its local vouchering. In contrast, M&S told us that its use of vouchering was very limited, but that it might respond to local entry by offering a special promotion on, for example, wine.”

³⁰⁶ In addition to the UK Grocery Report 2008, the European Commission’s Rewe/Adeg Decision also concluded that market power in local areas (even if the geographic scope of the retail market is considered to be national) affects the national retail pricing policy of a supermarket. See König, Simon, Terrasse and Kijewski, “Rewe/Adeg — Food for thought — Austrian markets for daily consumer goods”, European Competition Policy Newsletter, Number 3, 2008, p. 78: “Despite finding a national geographic market, the Commission assessed the competitive situation at the level of the 121 Austrian political districts in order to establish whether Rewe might be able to avoid substantial market share losses following a price increase due to local strength of the combined entity. The Commission considered that, in the districts in which Rewe and Adeg are particularly strong, influence on national price setting by Rewe could not be ruled out since Rewe might be able to compensate market share losses due to price increases by the higher revenues in regions where it is particularly strong.”

³⁰⁷ The importance of spatial competition in the grocery retailing market cannot be underestimated. According to real state experts worldwide, the three most important factors contributing to the value of a property are “location, location and location”. The business of grocery retailing closely follows this rule. Conventional competition analysis tends to focus on static price competition between supermarkets but neglects the most important element of competition between them: spatial competition.

³⁰⁸ The UK Grocery Report 2008, pars. 6.15-6.18. In particular, par. 6.16: “Of the total number of larger grocery stores in highly-concentrated local markets, Tesco accounts for the largest proportion (around 31 per cent), while Morrisons and Sainsbury’s each account for about 20 per cent and Asda accounts for a smaller proportion (14 per cent).”

period³⁰⁹ and noted that the leading retailers accounted for all the new larger stores providing one-stop shop services³¹⁰. It then adopted the proposition, in line with economic theory, that a highly concentrated market where supracompetitive profits have been found to exist would invite entry from competitors, unless barriers to entry protected incumbents' supracompetitive rents³¹¹. However, the data showed that 86% of the stores in a geographical monopoly/duopoly situation found to exist in 2000 kept that condition in 2006, which showed the existence of barriers to entry and the sustainability of supracompetitive profits³¹².

TABLE 7.1 Status of monopoly and duopoly stores that existed in 2000 by grocery retailer

<i>Fascia</i> (2000)	<i>Monopolies or duopolies in</i> 2000	<i>Fascia (2006)</i>	2006			
			<i>Monopoly</i>	<i>Duopoly</i>	<i>3 or more fascia</i>	<i>Closed</i>
Tesco	77	Tesco	32	38	6	1
Sainsbury's	16	Sainsbury's	3	7	5	1
Asda	7	Asda	1	4	2	0
Morrisons	4	Morrisons	0	3	0	0
		Sainsbury's	0	1	0	0
Safeway	82	Total former Safeway	43	28	6	5
		<i>Morrisons</i>	23	22	5	0
		<i>Somerfield</i>	17	5	0	0
		<i>Waitrose</i>	3	0	1	0
		<i>Sainsbury's</i>	0	1	0	0
Total stores	186		79	81	19	7

Source: CC analysis.

Source: *The UK Grocery Report 2008*, p. 124.

³⁰⁹ The UK Grocery Report 2008, Chapter 7 (Barriers to entry or expansion in grocery retailing), par. 7.5: "Between 1965 and 2000, the number of grocery stores increased by 3 per cent a year. From 2000, however, the rate of growth in the number of mid-sized and larger grocery stores slowed to approximately 1 per cent a year. Despite the overall slow-down since 2000, the rate of growth in the number of stores larger than 2,200 sq metres has been higher at around 3 per cent a year..."

³¹⁰ The UK Grocery Report 2008, Chapter 7 (Barriers to entry or expansion in grocery retailing), par. 7.6: "Each of the new larger stores which has opened since 2000 is, as far as we are aware, operated by one of Asda, Morrisons, Sainsbury's, Tesco or Waitrose. The lack of new store openings in the larger-stores product market by other grocery retailers indicates that they may face greater barriers to entry than these five retailers. We discuss this further in the context of planning as a barrier to new entrants (see paragraphs 7.65 to 7.68)."

³¹¹ The UK Grocery Report 2008, Chapter 7 (Barriers to entry or expansion in grocery retailing), par. 7.9: "We assessed whether highly-concentrated local markets for larger grocery stores and for mid-sized and larger grocery stores had persisted over time. Provided that there is sufficient demand to support an additional store, entry into highly-concentrated local markets should be attractive to retailers. This is due to the increased store-level profit margins in those markets (see paragraphs 6.52 to 6.63), and the ability conferred by these stores to set nationally determined aspects of the retail offer, such as prices, that are higher than would otherwise be the case (see paragraphs 6.64 to 6.73). Accordingly, the persistence of highly-concentrated markets is indicative of the presence of barriers to entry."

³¹² The UK Grocery Report 2008, Chapter 7 (Barriers to entry or expansion in grocery retailing), par. 7.10: "We examined the experience of new entry near stores that faced few local competitors to assess whether highly-concentrated local markets have persisted over time. In 2000, there were 186 stores larger than 600 sq metres in Great Britain belonging to Asda, Morrisons, Safeway, Sainsbury's and Tesco which faced no or only one competitor in the local market in which they operated (monopoly or duopoly stores). In 2006, 160 of these stores (or 86 per cent) continued to face no or only one competitor (see Table 7.1). The persistence of local concentration is indicative of the presence of barriers to entry in the markets in which these stores are located."

In Spain, the leading supermarkets have been able to grow, organically or through corporate acquisitions, faster than their smaller competitors. For example, the leading supermarket, Mercadona, has embarked on an organic growth race and has channelled significantly more financial resources on store openings than its competitors³¹³. Likewise, in 2007, Eroski, the third largest supermarket, spent 1,300 million euro to achieve a controlling stake in the supermarket chain Caprabo. Certainly, Carrefour divested its subsidiary Dia (mainly active in Spain) but this divestiture had no connection with the structure or performance of the Spanish retail market and the fact is that both Dia (now the second retailer in Spain) and Carrefour Spain (now the third retailer in Spain) have embarked on a growth strategy and Dia's stock market value has experienced significant growth.

Furthermore, the importance of spatial competition and the competitive advantage enjoyed by the leading retailers allows them to employ spatial foreclosure strategies, aided by the legal barriers to entry, that have gone largely unnoticed.

In the UK Grocery Report 2000, the UK Competition Commission found that the costs of land and of building supermarkets represented the bulk of the main parties' investments in fixed assets³¹⁴. Furthermore, the largest supermarkets paid, on average, higher prices for land than other grocery retailers in order to acquire prime sites, whereas others were content to pay lower amounts for secondary ones³¹⁵. In particular, Tesco had accumulated a large land bank over recent years, amounting to nearly one-half of the 214 assembled sites³¹⁶. Non-food sites had generally commanded only one-half to two-thirds the price of sites for food stores³¹⁷. Finally, the UK Competition Commission estimated the effect of these high land prices on prices, assuming a representative Return On Net Operating Assets (RONOA)³¹⁸.

³¹³ According to the Mercadona Annual Reports, the company invested 519 million euro in 2005, 565 million euro in 2006, 602 million euro in 2007, 572 million euro in 2008, 573 million euro in 2009 and 575 million euro in 2010. This massive investment fuelled a growth of its commercial surface from 1.2 to 1.7 million square meters (+41%).

³¹⁴ The UK Grocery Report 2000, Chapter 2 (Conclusions), par. 2.180.

³¹⁵ The UK Grocery Report 2000, par. 2.181.

³¹⁶ The UK Grocery Report 2000, par. 2.184. See also the daunting forecasts regarding new spatial competition, at par. 2.600: "We have seen (see paragraph 2.172) that, subject to planning permission being granted, there are no effective constraints on particular multiple retailers securing further sites for grocery retail development. In addition, the identity of the party seeking planning permission is not a factor currently taken into account by the planning authorities. Moreover, the largest main parties have been prepared to pay large sums to obtain sites. Tesco has over 40 per cent of the land held for new stores by the major parties and we do not think that at least three of the other four major parties currently have the size or financial resources to develop significant numbers of new stores in the foreseeable future."

³¹⁷ The UK Grocery Report 2000, par. 2.185.

³¹⁸ The UK Grocery Report 2000, par. 2.186: "We carried out a simulation, based on representative assumptions of costs and revenues for a large superstore including a land cost of £1,250,000 per hectare. This gave a return on net operating assets (RONOA) of 19.6 per cent. We then increased the cost of land to £2.5 million per hectare, leaving all other assumptions unchanged, and the return fell to 16.0 per cent of the increased net operating assets. We then calculated the price increase that would be required to restore RONOA to 19.6 per cent, with all other assumptions unchanged, and found that it was just under 1.4 per cent." Note that a 1.4 per cent price increase in a high volume business such as grocery retailing may amount to hundreds of millions of euro. See UK Grocery Report 2008, par. 6.72: "For example, for

Data on bidding behaviour for sites also indicated the existence of strategic considerations above the store area location and cost of development, which the UK Competition Commission linked to breaking into a new area³¹⁹. However, auction theory reveals that incumbents may corner the auctions and ultimately reduce competition in the market³²⁰. Not surprisingly, the UK Grocery Report 2008 dealt extensively with the leading supermarkets' practices that restricted spatial competition³²¹. It proposed a Competition Test to avoid the creation of highly concentrated areas through store openings by the same supermarket (organic growth)³²². It also adopted two remedies regarding controlled land-sites. First, it ordered supermarkets to terminate existing restrictive covenants³²³ in highly concentrated areas and to refrain from imposing new restrictive covenants³²⁴. Second, it limited to five years the duration of exclusive agreements with retail developers³²⁵. Finally, it considered but ultimately discarded potential remedies in respect of land banks³²⁶, leases and sub-leases to third parties³²⁷ and store-ownership in highly concentrated areas³²⁸.

each 0.1 per cent increase in national price levels, consumer expenditure on groceries at the four largest grocery retailers increases by £80 million a year.”

³¹⁹ The UK Grocery Report 2000, pars. 2.187-2.188: “2.187...The data showed that in about 25 per cent of cases the highest bid was more than 50 per cent above the second highest. However, we saw examples where the successful bidder bid twice as much as the second highest and three times the third highest. (...). 2.188. The differences in proposed store area or development costs do not appear sufficient to account for such a wide spread of bids. Multiples may differ in their views on a site's potential turnover and profitability (see, for example, the differences in turnover per sq metre in Table 12.22), but, again, the differences appear too great to be explained by this alone. Others may have strategic reasons for acquiring particular sites—such as breaking into a new area.”

³²⁰ Klemperer, “Bidding markets”, Occasional Paper No.1, UK Competition Commission, 2005. See, an empirical evidence regarding the US spectrum auctions, in Rose and Lloyd, “The failure of FCC spectrum auctions”, Center for American Progress, May 2006.

³²¹ The anticompetitive effects of restrictive practices regarding land-use have also been analysed by the OECD, “Land Use Restrictions as Barriers to Entry”, Competition Committee Policy Roundtables, DAF/COMP(2008)25, 28.11.2008, Executive summary by the Secretariat, Section 6 (Private land use restrictions).

³²² The UK Grocery Report 2008, pars. 11.12-11.135. The insights of the auction theory seem to be present in the rationale for the Competition Test. See, for example, par. 11.33: “We also assessed Tesco's comment that a competition test could have significant negative implications for developers. This argument is based on a number of assumptions. First, it assumes that a grocery retailer that would fail the competition test would also be the highest bidder among grocery retailers. This suggests that a grocery retailer with a strong local market position would bid more because there is value to the retailer in maintaining that position by preventing competitor entry. The competition test seeks to prevent that extra value being transferred from the consumer to the retailer. Secondly, it assumes that, in the absence of a particular retailer bidding, other grocery retailers would bid less than bidders for non-grocery uses. We do not see why this should be the case. Therefore, we do not agree that the exclusion of any particular grocery retailer would necessarily result in a site being used for other, non-grocery uses [footnote: Of course, the developer may receive lower bids because, with the competition test, the bids would not reflect the value of maintaining a concentrated position].”

³²³ A restrictive covenant is a restriction typically imposed on the sale of freehold land that limits the future use of the land. It is imposed on the sale of the freehold.

³²⁴ The UK Grocery Report 2008, pars. 11.137-11.182.

³²⁵ The UK Grocery Report 2008, pars. 11.183-11.230.

³²⁶ The UK Grocery Report 2008, pars. 11.232-11.243.

³²⁷ The UK Grocery Report 2008, pars. 11.244-11.249.

³²⁸ The UK Grocery Report 2008, pars. 11.256-11.268.

In Spain, even though the Spanish Grocery Report has not investigated retail practices of the leading supermarkets, the Spanish Competition Authority noted in its Carrefour/Promodès Decision that spatial pre-emption was a strategic barrier to entry erected by incumbent supermarkets and identified several instances of spatial pre-emption³²⁹. Furthermore, a Report by the Competition Authority of the Basque Country (Spain) noted that the leading supermarket in the Basque Country (Eroski) seemed to employ spatial saturation strategies in given areas of the Basque Country in order to preempt market entry and expansion by competitors³³⁰.

All in all, the virtuous cycle of growth experienced by the leading supermarkets at the expense of smaller ones seems evident in the UK and Spanish markets and it may be a common occurrence elsewhere. For example, the Paris Grocery Report reported similar findings in respect of the undisputed leader of the Paris grocery retail market, Casino. This supermarket claimed that, it being the fifth largest supermarket chain in France with a market share of just 10%, the relatively higher retail prices it charged for independent grocery brands responded to Casino's lower buyer power in comparison with the leading French supermarkets³³¹. However, the French Competition Authority found that Casino's retail prices for independent grocery brands were higher than the retail prices charged by other supermarkets with comparable buyer power³³². Furthermore, when faced with fresh competition in some local areas, Casino did not lower its prices³³³, even though its net margins were reduced, possibly due to lower

³²⁹ Decision of 4.05.2000 of the Tribunal de Defensa de la Competencia, Case C-52/00, Carrefour/Promodès, p. 61.

³³⁰ Basque Competition Tribunal, "Grocery retailing: Competition, Oligopoly and Tacit Collusion", 2009 ("the Basque Grocery Report", the English unofficial translation is available at the website of the Tribunal, now Autoridad Vasca de la Competencia), pp. 120-121 (spatial pre-emption in the Balmaseda area), p. 211 (spatial pre-emption in the Getxo area), and p. 212 (spatial pre-emption in the Barakaldo area). Incidentally, the OCU study, *supra* note 296, has identified Getxo and Barakaldo as two of the most expensive towns in Spain.

³³¹ The Paris Grocery Report, par. 137: "Afin d'expliquer les écarts de prix constatés sur les produits de marque nationale, le groupe Casino indique qu'il est, face à ses fournisseurs, dans une position de négociation moins favorable que les groupes réalisant un chiffre d'affaires total important sur l'ensemble du territoire français grâce à leur forte présence sur le segment des hypermarchés. Casino déclare ainsi avoir identifié, en mai et en octobre 2010, plus de 100 produits de grande consommation à très forte rotation pour lesquels ses prix d'achat (en triple net) étaient supérieurs aux prix de revente de ses principaux concurrents. Ce moindre pouvoir de négociation pourrait expliquer que Casino présente des prix supérieurs à ceux de ses concurrents pour les produits de marque nationale et qu'il ait choisi d'accroître, dans son assortiment, la part des produits MDD".

³³² The Paris Grocery Report, par. 138: "Cependant, la part du groupe Casino sur le marché amont de l'approvisionnement est comparable à celle d'Intermarché ou de Système U, et largement supérieure à celle de G20 ou de sa centrale d'achat, Francap, liée à la centrale Provera (Cora). Ces enseignes proposent pourtant, d'après les relevés de prix de l'Autorité, des prix significativement inférieurs à ceux de Casino pour les produits de marque nationale. De plus, ces différentiels de prix d'achat, à les supposer avérés, témoigneraient de la moindre efficacité du groupe Casino à l'achat. Si la concurrence sur le marché était aussi intense que le prétend ce dernier, les parts de marché de Casino devraient progressivement s'éroder – or, elles demeurent stables."

³³³ The Paris Grocery Report, par. 144: "L'impact limité, à ce jour, de la concurrence sur les prix des magasins *Franprix* provient plus vraisemblablement de la faible étendue des zones de chalandise et de l'omniprésence du groupe Casino dans les quartiers parisiens. En effet, compte tenu des paniers d'achat limités des consommateurs parisiens, une part significative de la clientèle choisit son magasin moins en fonction du différentiel de prix avec les magasins concurrents (faible en valeur absolue) qu'en fonction de la distance à parcourir. Par conséquent, une baisse des prix pour contrer la présence d'un magasin ou de

sales³³⁴. Finally, Casino's net operating net margins were seemingly higher than their comparable competitors, especially if the margins of Casino's buying group are taken into account³³⁵.

Most notably, a recent study by two economists of the Italian Central bank lend credit to the proposition that the virtuous growth cycle of the leading supermarkets through better purchase terms and supra-competitive prices is a universal phenomenon³³⁶. The study analysed the relationship between market concentration at the buying group, parent company and regional level and price dynamics in the grocery retail sector of six Member States of the EU (Germany, Spain, Finland, Italy, Austria and Portugal). Its results pointed to a positive association between retail market concentration and price growth in food and beverages, alcohol and tobacco and miscellaneous goods in the time span 2003-2010. Therefore, it suggested a more proactive competition policy intervention to address market concentration and supra-competitive prices in the grocery retail market³³⁷.

The leading supermarkets' growth strategy (at the expense of smaller supermarkets) has a corresponding effect on their superior profitability. A long-term profitability analysis would confirm that the leading supermarkets are also more profitable than smaller ones on a country-by-country comparison.

plusieurs magasins concurrents pourrait n'attirer que peu de clients supplémentaires, alors qu'elle réduirait la marge réalisée auprès des clients qui fréquentaient déjà le magasin. De plus, compte tenu du maillage des quartiers parisiens, l'incitation des magasins du groupe Casino à réduire les prix pour attirer de nouveaux clients est naturellement faible : vraisemblablement, une forte proportion des clients qui seraient attirés par les prix bas d'un magasin *Franprix* proviendrait d'un autre magasin du groupe Casino."

³³⁴ The Paris Grocery Report, par. 147: "Comme indiqué *supra*, cette diminution des résultats nets ne provient que pour une part très limitée d'efforts de réduction de prix. En revanche, les magasins confrontés à une plus forte concurrence doivent engager des coûts supplémentaires pour y faire face (horaires d'ouvertures étendus, rénovation plus fréquente du magasin, etc.). La diminution des résultats nets peut également provenir d'une diminution des volumes vendus du fait du départ de certains consommateurs vers les magasins concurrents. Les coûts fixes sont alors amortis sur un chiffre d'affaires plus faible, entraînant une diminution du résultat net.(...)"

³³⁵ The Paris Grocery Report, par. 139: "Les données de résultats nets des magasins de différentes enseignes exploités à Paris tendent à indiquer que les magasins indépendants *Franprix* ont des marges nettes similaires à celles des autres magasins indépendants de détail (G20, Système U, Intermarché). En revanche, les magasins *Franprix* «*Master franchisés*», qui représentent la majorité du parc de magasins *Franprix*, ont généralement une marge plus élevée. Les magasins *Franprix* intégrés au groupe Casino présentent à l'inverse une marge nette plus faible que les autres magasins indépendants. Aux marges de détail des magasins doivent également être ajoutées les marges nettes réalisées en amont, au niveau des centrales d'achats. Dans le cas du groupe Casino, la marge amont, réalisée au travers de Distribution *Franprix* et Sédifrais, s'élève à [3 – 7]%. Au final, le niveau de marge réalisé par les centrales d'achat du groupe Casino et les magasins *Franprix* autoriseraient donc ces opérateurs à diminuer leurs prix s'ils étaient soumis à une concurrence plus forte."

³³⁶ Ciapanna and Rondinelli, "Retail sector concentration and price dynamics in the euro area: a regional analysis", Bank of Italy, Questioni di Economia e Finanza (Occasional papers), Number 107 – October 2011.

³³⁷ Ciapanna 2011, p. 18: "A very important policy implication of the findings of this paper seems to be that there are important non-monetary determinants of price levels and short-run dynamics, which are not under direct control of the monetary authorities, but depend on how specific markets work (and on how far they are from the ideal benchmark of perfect competition). In a broader context, the study appears to suggest that, at least in the short run, appropriate competition-enhancing policies may facilitate the challenges posed to the monetary authorities in preserving price stability."

At the global level, the Deloitte ranking of the ten largest retailers (mostly grocery retailers) suggests that their average return on assets (“ROA”) ratio is better than the average of their competitors, even if their net profit margins are slightly lower³³⁸.

Economic concentration of top 10 retailers, 2010

Top 250 rank	Name of company	Country of origin	2010 retail sales (US \$mil)	2010 retail sales growth	2010 net profit margin	2010 return on assets	2010 asset turnover
1	Wal-Mart	U.S.	418,952	3.4%	4.0%	9.4%	2.3
2	Carrefour	France	119,642	4.8%	0.6%	1.1%	1.7
3	Tesco	U.K.	92,171*	6.7%	4.4%	5.7%	1.3
4	Metro	Germany	88,931	2.8%	1.4%	2.7%	1.9
5	Kroger	U.S.	82,189	7.1%	1.4%	4.8%	3.5
6	Schwarz	Germany	79,119*	9.4%	n/a	n/a	n/a
7	Costco	U.S.	76,255	9.1%	1.7%	5.6%	3.3
8	The Home Depot	U.S.	67,997	2.8%	4.9%	8.3%	1.7
9	Walgreen Co.	U.S.	67,420	6.4%	3.1%	8.0%	2.6
10	Aldi	Germany	67,112*	5.2%	n/a	n/a	n/a
Top 10*			\$1,159,788	5.0%	3.0%	6.4%	2.1
Top 250*			\$3,940,747	5.3%	3.8%	5.8%	1.5
Top 10 share of total			29.4%				

*Sales-weighted, currency-adjusted composite growth rate
Source: Published company data and Planet Retail

On a country level, the UK Grocery Report 2000 implicitly concluded that the leading supermarkets enjoyed higher gross margins, IRR and ROCE than the smaller ones and, overall, the sector could be considered to enjoy some degree of market power based on an IRR/WACC measurement. Likewise, it has been estimated that the leading Spanish supermarket (Mercadona) enjoys the highest ROA³³⁹ and its annual accounts show that its EBITDA and Own Capital figures have more than doubled and almost quadrupled respectively in the 2005-2012 period.

Year	Sales (m. Euro)	EBITDA	Own Capital	Investment (mEUR)
2005	10,338	521	811	519
2006	12,158	655	1,035	565
2007	13,986	850	1,350	602
2008	15,379	838	1,641	572
2009	15,505	725	1,885	573

³³⁸ Deloitte, “Global Powers of Retailing 2012”, January 2012, p. 19: “The eight Top 10 companies that disclosed their bottom-line profits generated a composite net profit margin of 3 percent, compared with 3.8 percent for the Top 250. Although Top 10 sales growth and profitability lagged the larger group, the retail leaders were more productive than the group as a whole, as reflected by the Top 10’s superior return on assets and asset turnover ratio”. Profitability ratios may be different across different retail sectors. Furthermore, company ratios may reflect different performances across-countries. However, the Deloitte results offer a first hint that the largest retailers achieve higher profitability ratios than the smaller ones.

³³⁹ See Rallo, “Nos roban los intermediarios?”, La Ilustración Liberal 42, Invierno 2009-2010. Rallo estimates that Mercadona’s ROA was 7.4 in 2008, well ahead of the ROA achieved by Carrefour and Eroski.

2010	16,485	1,000	2,255	575
2011	17,831	1,040	2,673	540
2012	19,077	1,082	3,019	650

Source: Mercadona Annual Reports 2005-2012

5.3.2 Market power in the grocery procurement

The leading supermarkets' market power in the grocery retail sector is reinforced by their market power in the grocery procurement market. Furthermore, the competitive bottleneck role played by supermarkets vis-à-vis independent grocery brands allows even supermarkets with seemingly modest market shares (e.g., 5-10%) to dictate their business terms to independent grocery brands.

5.3.2.1 The theory and practice on competitive bottlenecks

In his seminal paper on two-sided platforms serving two groups of consumers (e.g., group-1 and group-2), Armstrong developed a model of “competitive bottlenecks”. In the competitive bottleneck model, whereas group-1 agents join all platforms (“multi-home”), group-2 agents only join one platform (“single-home”). Multi-homing agents can only reach single-homing agents through a given platform, which therefore becomes a competitive bottleneck and can overcharge/exploit multi-homing agents to the benefit (or not) of the single-homing customers³⁴⁰.

Armstrong identified the mobile telephony market as a competitive bottleneck, where competition to attract subscribers (competitive subscription and outbound call fees) coexisted with lack of competition in the termination of calls from subscribers of a competitor (supracompetitive termination fees)³⁴¹. Furthermore, he identified other

³⁴⁰ Armstrong, “Competition in two-sided markets”, The RAND Journal of Economics, 37(3), 2006, (the first version of the article was distributed as early as 2002), pp. 669-670: “Here, if it wishes to interact with an agent on the single-homing side, the multi-homing side has no choice but to deal with that agent’s chosen platform. Thus, platforms have monopoly power over providing access to their single-homing customers for the multi-homing side. This monopoly power naturally leads to high prices being charged to the multi-homing side, and there will be too few agents on this side being served from a social point of view (Proposition 4). By contrast, platforms do have to compete for the single-homing agents, and high profits generated from the multi-homing side are to a large extent passed on to the single-homing side in the form of low prices (or even zero prices).”

³⁴¹ Armstrong 2006, p. 678: “The tariffs that mobile networks set in equilibrium have low charges for subscription and outbound calls and high charges for call termination. In particular, the models predict that high profits made from call termination are passed on to subscribers in the form of subsidized handsets or similar inducements. More precisely, the equilibrium call-termination charge is chosen to maximize the welfare of mobile subscribers and mobile networks combined, and the interests of those who call mobile networks are ignored. This feature—that the single-homing side is treated well and the multi-homing side’s interests are ignored in equilibrium—is a characteristic of the models presented below. A competitive bottleneck is present: even if the market for subscribers is highly competitive so that mobile networks have low equilibrium profits overall, there is no competition for providing communication services to these subscribers.”

competitive bottlenecks³⁴² and developed its general model into two stylized models: advertising on media platforms and supermarkets. In the supermarket model, whereas the prices paid to suppliers were always too low, the prices charged to shoppers depended on the retail market power enjoyed by the supermarket, and the overall effect was socially undesirable (i.e., the harm to suppliers exceeded any benefit that shoppers could gain)³⁴³.

Following a merger between two CRSs (now known as Global Distribution Systems or GDSs)³⁴⁴, the European Commission has formally accepted the relevance of the competitive bottleneck theory and its thinking has been outlined in an article published in the European Commission's Competition Policy Newsletter by an official of the DG Competition's Chief Economist Team³⁴⁵. The article admits that competition analysis should take into account two-sidedness if indirect network externalities are significant, otherwise, a one-side analysis of each side of the platform may be sufficient³⁴⁶.

³⁴² *Id.*, p. 678: "Other examples of this competitive bottleneck framework include: most people might read a single newspaper (perhaps due to time constraints), but advertisers might place ads in all relevant newspapers; consumers might choose to visit a single shopping mall (perhaps because of transport costs), but the same retailer might choose to open a branch in several malls; consumers might visit a single supermarket, but suppliers might wish to place their products on the shelves of several supermarkets; or a travel agent might use just one computerized airline reservation system, while airlines are forced to deal with all such platforms in order to gain access to each travel agent's customers." [emphasis added]

³⁴³ *Id.*, p. 685: "As with all the competitive bottleneck models, in equilibrium the joint surplus of the platforms and the single-homing group is maximized (supermarkets and consumers in this case, as given in expression (36)), and the interests of the multi-homing side (the suppliers) are ignored. The low level of compensation in (36) will exclude some relatively high-cost suppliers whose presence in the supermarkets is nevertheless efficient. (A supplier should supply if $\alpha_2 < \alpha_1 - c$, whereas the equilibrium price p_2 in expression (36) is strictly lower than $\alpha_1 - c$ and supply is inefficiently restricted.) In other words, payments to suppliers are too low from a social point of view and there are too few products on the shelves. How well consumers are treated depends on competitive conditions on their side."

³⁴⁴ European Commission Decision of 21.08.2007, Case COMP/M.4523-Travelport/Worldspan. This transaction was cleared after a 'Phase II' investigation. Both merging parties provide travel distribution services, in particular through their respective 'Global Distribution Systems' (GDS) Worldspan and Galileo (Travelport's brand). These technical platforms match travel content provided by airlines, hotel chains, car rental services, etc. on one side, and the demand for such content as conveyed by travel agents on the other side. The Commission considered that the two-sided GDS market contains a number of elements characteristic of the competitive bottleneck model: (1) The multi-homing (travel content providers) / single-homing (travel agents) configuration; (2) a limited degree of product differentiation; (3) asymmetries in indirect network effects, with indirect network externalities generated mainly if not exclusively on the travel agent side; and (4) a distribution of prices skewed towards the travel content side.

³⁴⁵ Vannini 2008. The author clarifies that the content of the article does not necessarily reflect the official position of the European Communities.

³⁴⁶ *Id.*, p. 43: "As emphasised in a series of recent articles, the two- (or multi-)sided nature of a market should explicitly be considered in evaluating the existence and magnitude of possible anti-competitive effects. However, the relevance of the two-sided nature of markets depends on at least two elements: (i) indirect network externalities and (ii) pattern of subscription ('homing') to the platform. Under specific circumstances, in particular when indirect network effects are negligible, the standard 'one-sided' analysis of each side of the platform in isolation provides a simpler analytical framework and a reliable proxy."

The article elaborates on the concept of “indirect network effects” and lists a few two-sided markets, among which supermarkets³⁴⁷. Then addresses subscription patterns and incentives³⁴⁸ and focuses on competitive bottlenecks³⁴⁹. Finally, the article implies that competition law should intervene to correct the competition problems caused by competitive bottlenecks unless the multi-homing side enjoys sufficient countervailing power³⁵⁰. This was the case in the *Travelport/Worldspan* merger, where the countervailing power of multi-homing travel content providers vis-à-vis GDS platforms led the Commission to conclude that the merger would not restrict competition despite the single-homing pattern of travel agents dealing with GDS platforms³⁵¹. The OECD Roundtable on two-sided markets provided the European Commission and other competition authorities a fresh opportunity to express their standpoint on two-sided markets. In its contribution, the European Commission downplayed its practical

³⁴⁷ *Id.*, p. 43: “Indirect network externalities (or cross-group externalities) arise when the value of a platform for users on one side is affected by the size of the users’ network on the other side. The willingness of customers on one side of the platform to pay in order to subscribe to a specific platform’s provider then depends on the size of the network of users covered by that same provider on the other side of the platform. For example, (i) the number of readers of a newspaper or magazine (or the audience of a TV broadcast) tends to attract advertisers, (ii) the number of customers of a supermarket chain (or shopping mall) tends to attract suppliers of products to be sold there, (iii) the number of holders of a given credit card increases the incentive for shops to accept the card.” [emphasis added]

³⁴⁸ *Id.*, p. 43: “As a general rule, multi-homing on one side of the market (say A) decreases incentives for multi-homing on the other side (say B). Assuming for a moment that users of group A choose full multi-homing, they are accessible by users of group B no matter what platform provider these users adopt. The marginal value, in terms of network externalities, for B users of subscribing to an additional provider is then limited or non-existent. Therefore, the incentive to multi-home on side B of the platform is correspondingly limited or non-existent. Reversing this reasoning, if single-homing is prevalent among B users, this represents an incentive for A users to multi-home, because network externalities would be positive and significant.”

³⁴⁹ *Id.*, pp. 43-44: “In other words, multi-homing prevailing on one side of the platform and single-homing on the other corresponds to a situation where indirect network effects are asymmetric and mostly arise on the single-homing side. This is the situation identified in economic literature as ‘competitive bottlenecks’, which, in its most stylised version, boils down to full multi-homing on one side and single-homing with no exceptions on the other. In this case, as soon as platform providers manage to get enough of both sides on board, they will be able to ‘tip’ the market in a way to allow them to extract rents from multi-homing A users. In this way, a platform provider can subsidise single-homing B users willing to join its platform, for whom providers have to compete fiercely. Single-homing on side B supports rent extraction on side A because providers appear to A users as gate-keepers to a number of B users.

³⁵⁰ *Id.*, p. 44: “Last but not least, customers on the multi-homing side A, for whom the platform’s provider represents a gatekeeper to single-homing customers on side B, may have some countervailing bargaining power. For instance, they can divert some of their traffic and circumvent the platform, thereby decreasing the total rent available for extraction by the platform provider. While remaining able to extract the same rent in relative terms, as compared to the total rent available, the platform provider will still see its rent decrease in absolute terms because of the diversion. Faced with this possibility, the platform provider may well decide to make concessions to multi-homing customers in order to limit diversion (and the related erosion of the total rent available for extraction)”.

³⁵¹ *Id.*, p. 50: “In situations where a ‘competitive bottleneck’ is identified, it has to be considered whether platform users have any countervailing bargaining power. If that is the case, the theoretical result of the ‘competitive bottleneck’ theory, stating that the platform provider can extract all rents to the detriment of multi-homing users, has to be adjusted. Travelport’s acquisition of Worldspan provides an interesting example in this regard, as it features (i) preliminary indications of possible unilateral effects on the basis of high market shares in a number of markets, (ii) a pattern of subscription to the platform broadly corresponding to the competitive bottleneck scenario and (iii) a dynamic aspect consisting of users on the multi-homing side developing bargaining tools to counteract the rent extraction predicted by theory in that scenario.”

experience in this field³⁵² and focused again on competitive bottlenecks. It argued that platforms would exploit their “monopoly power” over the multi-homing side³⁵³ provided three conditions are met³⁵⁴, and dealt with its practical implications from a competition law perspective³⁵⁵. In particular, the Commission recalled that, in exceptional cases, it might take into account efficiencies that benefit one set of consumers as partially offsetting harm to another group and suggests that two-sided platforms might qualify for this exceptional treatment³⁵⁶. Finally, the note relied again

³⁵² OECD 2009b, Note by the European Commission, pars. 9-11. See, in particular, par. 9: “At the outset, it is necessary to point out that the EU Commission, possibly like other competition authorities, has not yet acquired any significant experience on the assessment of competition cases involving two-sided platforms. As a result this OECD Roundtable contribution, unlike past contributions in other topics, does not provide a summary of the EU Commission’s case practice regarding the competitive assessment of two-sided platforms. (...) See also par. 10: “Thus it is still early for a competition authority to adopt any definite views, let alone concrete policies or assessment methodologies, concerning the application of competition policy in cases involving two-sided platforms. Hence, the views and comments put forward in this paper are intended to add to the on-going debate and cannot be read as providing guidance on the EU Commission’s past or future assessment of competition cases involving two-sided platforms”. One is bound to disagree with the Commission on this point. Competition authorities have dealt for a long time with two-sided markets and competitive bottlenecks even if under conventional one-sided methodologies.

³⁵³ *Id.*, Note by the European Commission, par. 33: “As explained by Rysman (2007) the presence of multi-homing on one side of competing platforms influences the degree of competition. Whether agents at both sides of a platform participate in multiple platforms or just one has important implications for market power. If one side of a market practices single-homing, then the only way for the other side to reach those agents is through their preferred platform. Thus, platforms have monopoly power over providing access to their single-homing customers for the multi-homing side. This monopoly power naturally leads to high prices being charged to the multi-homing side and typically there will be too few agents on this side being served from a social welfare point of view.” Theoretically, the exploitation of the multi-homing side occurs whether the multi-homing/single-homing outcome is assumed (see Armstrong 2006) or endogenously created (Note by the Delegation of the European Commission, par. 40: “In particular, Gabszewicz and Wauthy (2004) assume agents are heterogeneous and allow for an endogenous participation in each side of the market (i.e. registering to no platform is allowed, and is observed in equilibrium). However only registration fees are allowed in this model implying that it is best viewed as representing a situation where the agents in one side of the market have access to a set of transactions whose size is endogenously determined by the number of affiliated agents in the other side. In this model, one side multi-homes, whereas the other one single-homes. This equilibrium has similar features as identified by Armstrong (2004) with the multi-homing side being “exploited” and the other being targeted “aggressively”. A key-difference is that Armstrong assumes the homing structure (single-homing on one side, multi-homing in the other) whereas in Gabszewicz and Wauthy (2004) the unique equilibrium outcome emerges endogenously.”

³⁵⁴ *Id.*, Note by the European Commission, par. 35: “Vannini (2008) recalls that this extreme homing configuration (and related rent distribution pattern) is based on a series of assumptions: (i) that there is no differentiation among different platform providers, (ii) that customer preferences on the same side of the platform are sufficiently homogeneous and (iii) that customers on the multi-homing side have no bargaining power allowing them to limit rent extraction by the platform provider. Under these assumptions theoretical models such as Armstrong’s (2006) predict intense competition between platforms on the single-homing side of the market and almost non-existent competition on the multi-homing side”. Indeed, the first two conditions relate to the multihoming/singlehoming configuration, therefore only the third one (countervailing power on the multihoming side) is relevant once the multihoming/singlehoming configuration has been ascertained.”

³⁵⁵ *Id.*, Note by the European Commission, Sections 3 (Assessment of competition cases involving two-sided platforms) and 4 (Significance of two-sided platforms in selected merger cases).

³⁵⁶ *Id.*, Note by the European Commission, pars. 53 and 54: “(53) However both the merger guidelines as well as the guidelines on Article 81(3) leave open the possibility of taking cross market efficiencies into consideration in assessing the overall competitive effects of a merger or agreement. Paragraph 79 of the Horizontal Merger Guidelines states that “*The relevant benchmark in assessing efficiency claims is that consumers will not be worse off as a result of the merger. For that purpose, efficiencies should be substantial and timely, and should, in principle, benefit consumers in those relevant*

on Armstrong's model to argue that even in a highly competitive inter-platform market, the bottleneck single-home/multi-home model may lead to socially inefficient outcomes (exclusion of multi-homing agents) and, therefore, some sort of regulation may be pertinent³⁵⁷.

Even though the European Commission and other competition authorities suggested that the practical experience with two-sided platforms is very limited, economists have long argued that customer loyalty/lock-in (single-homing) and switching costs facilitate inefficient pricing structures and exploitation in a growing number of markets³⁵⁸. Furthermore, several two-sided markets have been subject to extensive regulatory and competition law remedies: (1) CRSs; (2) Mobile Communications Networks; (3)

markets where it is otherwise likely that competition concerns would occur". Note that the wording clearly suggests that in some (possibly exceptional) circumstances the Commission would take into account efficiencies that benefit one set of consumers as partially offsetting harm to another group. Two-sided platforms may indeed be one of such circumstances. (54) The guidelines on Article 81.3 contain similar wording in paragraph 43: "The assessment under Article 81(3) of benefits flowing from restrictive agreements is in principle made within the confines of each relevant market to which the agreement relates". However, this paragraph specifies "where two markets are related, efficiencies achieved on separate markets can be taken into account provided that the group of consumers affected by the restriction and benefiting from the efficiency gains are substantially the same". In the case of two-sided platforms, it is clear that the two sides are related. However, agents on each side are in general not substantially the same. Still, benefits on one side of the platform may lead, through the inter-group network effects to compensating benefits to agents on the other side."

³⁵⁷ *Id.*, Note by the European Commission, pars. 57: "Armstrong points out that even if the platforms do not make excessive profits overall, the multi-homing side faces too high a charge from the point of view of social welfare. Bolt and Tieman (2006) in a comparatively simple two-sided platform model, obtain a similar result. They show that in the social optimum, platform pricing leads to an inherent cost recovery problem... It follows that even adequate competition policy enforcement alone may not always lead to best outcomes. This suggests, at least in some instances regulation may be pertinent."

³⁵⁸ Armstrong and Wright, "Mobile Call Termination", Working Paper, September 2007, p. 1: "There is an important, and perhaps growing, set of markets in which monopoly prices emerge even when competition is intense. That is to say, while industry profit is not excessive overall, there is an inefficient balance of prices: too high for some services, too low for others. Familiar examples involve consumer "lock-in" of various kinds, including markets with switching costs. In these markets the typical pattern of prices involves "bargains-then-ripoffs", so that firms attract new consumers with generous deals up-front, consumers pay high (perhaps monopoly) prices once locked in. If competition is vigorous, the monopoly profits from locked-in consumers are transferred to new consumers, and the lifetime profitability of a consumer is approximately zero. In a sense, a new consumer's "future self" is exploited by the "present self". A related, but distinct, set of markets exhibit what might be termed "competitive bottlenecks". Here, firms compete to attract one group of consumers. For natural technological or geographical reasons, each consumer in this group wishes to deal with just one firm. A second group of consumers wishes to interact with the first group and, because each consumer in the first group deals exclusively with one firm, that firm can charge the second group high prices (or pay low input prices) for access to its captive customers. If competition is vigorous, the monopoly profits generated by the first group are passed back to these consumers in the form of subsidised service. Here, the first group may be said to exploit the second group. Examples of this kind of market include: newspaper advertising (where most readers tend to read a single newspaper due to time constraints, and so a newspaper can charge high fees to advertisers for access to its captive readers) and supermarkets (where a consumer tends to visit just one shop over the relevant time horizon, and so the supermarket can pay low wholesale prices to its suppliers for access to these captive shoppers). At the end of the paper we will discuss another possible application of this approach, to the contentious issue of "net neutrality" on the internet. However, perhaps the leading example of a competitive bottleneck involves call termination on mobile telephone networks. Despite the distinction made between competitive bottlenecks and aftermarket, the evidence in competitive bottlenecks shows, at least in the retail grocery market, that the exploitation of a set of customers ultimately leads to the exploitation of the other set of customers, as both groups are interrelated."

Internet Service Providers (ISPs); (4) Internet Search Engines; (5) Internet Domain Name Registration; (6) Media Platforms; (7) Card Payment Networks; and (8) Aftermarkets³⁵⁹.

(1) CRSs

In the EU, Council Regulation 2299/1989, of 24 July 1989, on a code of conduct for computerized reservation systems, was the first regulatory remedy adopted in this area³⁶⁰. It imposed several obligations aimed at safeguarding fair competition between airline carriers and between CRSs³⁶¹. These obligations related to the (1) open, fair and non-discriminatory terms of access by airline carriers and travel agents to the services of CRSs, subject to available capacity and technical constraints beyond control of CRSs³⁶²; (2) fair and non-discriminatory competition within the platform of each CRS³⁶³; (3)

³⁵⁹ A full discussion of each of these markets and their relevance in the analysis of the supermarkets' practices and potential regulatory and competition law remedies is provided in Appendix 8.2.

³⁶⁰ Official Journal L 220 of 29.07.1989. Regulation 2299/1989 was subsequently amended by Regulations 3089/1993 and 323/1999.

³⁶¹ See for an overview of the aims and substance of the Regulation 2299/1989, Commission Consultation paper on the possible revision of Regulation 2299/1989 on a Code of Conduct for computerised reservation Systems, 23.02.2007, par. 3: "The Code of Conduct recognised that Computerised Reservation Systems required a certain degree of regulation in order to ensure that all airlines enjoy the same level of access to travel agents and consumers. It was established with the aim of improving transparency and preventing discriminatory behaviour both by the system vendors themselves and also by airlines, especially those which have a stake in the ownership and control of a CRS. On the one hand, system vendors were required to deal in an even-handed manner with all carriers and travel agents, while, on the other, carriers with a financial stake in a CRS were required not to favour that system over the others. The code also imposed obligations in terms of neutral display in order to avoid discriminatory treatment of airlines on the system's principal display.

³⁶² See, for example, Article 3.2: "A system vendor shall allow any air carrier the opportunity to participate, on an equal and non-discriminatory basis, in its distribution facilities within the available capacity of the system concerned and subject to any technical constraints outside the control of the system vendor". The fairness and non-discrimination principles also extended to the fees charged by a CRS. See Article 10.1.a: "Any fee charged to a participating carrier by a system vendor shall be non-discriminatory, reasonably structured and reasonably related to the cost of the service provided and used and shall, in particular, be the same for the same level of service. The billing for the services of a CRS shall be sufficiently detailed to allow the participating carriers to see exactly which services have been used and the fees therefor; as a minimum, booking fee bills shall include the following information for each segment: [...]. The billing information shall be offered on magnetic media. The fee to be charged for the billing information provided in the form chosen by the carrier shall not exceed the cost of the medium itself together with its transportation costs. A participating air carrier shall be offered the facility of being informed when any booking or transaction is made for which a booking fee will be charged. Where a carrier elects to be so informed, it shall be offered the option of disallowing any such booking or transaction, unless the latter has already been accepted. In the event of such a disallowance, the air carrier shall not be charged for that booking or transaction."

³⁶³ The CRS services would correspond to the in-store management of independent brands by supermarkets. Regulation 2299/1989 imposed several obligations aimed at safeguarding competition between airline carriers within each CRS system: CRS shall not manipulate the material supplied by carriers in a manner that would lead to inaccurate, misleading or discriminatory information being provided to consumers (article 4.2); CRS shall load and process data provided by participating carriers with equal care and timeliness, subject to the constraints of the loading method selected by individual participating carriers and to the standard formats used by the CRS (article 4.3); CRS shall provide a principal display or displays for each individual transaction and shall include therein data provided by participating carriers on schedules, fares and seats available for individual purchase in a clear and comprehensive manner and without discrimination or bias, in particular as regards the order in which

legal and functional separation between CRSs and their parent airline carrier(s)³⁶⁴; (4) independent compliance audit³⁶⁵; and (5) the European Commission's powers of

information is presented (article 5.2.a); the criteria to be used for ranking information shall not be based on any factor directly or indirectly relating to carrier identity and shall be applied on a non-discriminatory basis to all participating carriers (article 5.2.c); where a system vendor provides information on fares, the display shall be neutral and non-discriminatory and shall contain at least the fares provided for all flights of participating carriers shown in the principal display. The source of such information shall be acceptable to the participating carrier(s) and system vendor concerned (article 5.3); CRS shall provide information, statistical or otherwise, other than that offered as an integral part of the distribution facilities, only as follows: (a) information concerning individual bookings shall be made available on an equal basis to the air carrier or air carriers participating in the service covered by the booking (article 6.1.a); (b) any marketing, booking and sales data made available shall be on the basis that (i) such data are offered with equal timeliness and on a non-discriminatory basis to all participating carriers, including parent carriers...".

³⁶⁴ See, for example, Regulation 2299/1989, article 3.1: "A system vendor shall have the capacity, in its own name as a separate entity from the parent carrier, to have rights and obligations of all kinds, to make contracts, inter alia with parent carriers, participating carriers and subscribers, or to accomplish other legal acts and to sue and be sued"; and article 4.a.3: "A system vendor shall ensure that its distribution facilities are separated, in a clear and verifiable manner, from any carrier's private inventory and management and marketing facilities. Separation may be established either logically by means of software or physically in such a way that any connection between the distribution facilities and the private facilities may be achieved by means of an application-to-application interface only. Irrespective of the method of separation adopted, any such interface shall be made available to all parent and participating carriers on a non-discriminatory basis and shall provide equality of treatment in respect of procedures, protocols, inputs and outputs. Where relevant and generally accepted air transport industry standards are available, system vendors shall offer interfaces compatible with them." This amendment was introduced by Regulation 3089/93. See Commission Report on the application of Council Regulation 2299/1989 on a code of conduct for computerised reservation systems (CRSs), COM(97) 246 final, 09.07.1997, p. 4: "The principal amendments included, firstly, the need to ensure that CRSs make equal functionality available to all participating carriers, and, in particular, by those CRSs which share common systems with their parent carriers. In this respect, the code requires that a system vendor's distribution facilities are clearly separated from the internal reservation system of its parent carriers. The effectiveness of the arrangements put in place to achieve the separation of the two functions is subject to verification by independent external audit. Associated with the technical requirements for the separation of the distribution facilities of a system vendor from the internal systems of its parent carriers, was a requirement for a system vendor to be established as a separate entity from its parent carrier for legal purposes".

³⁶⁵ Regulation 2299/1989, Article 21.a.: "1. The system vendor shall ensure that the technical compliance of its CRS with Articles 4a and 6 is monitored by an independent auditor on a calendar year basis. For that purpose, the auditor shall be granted access at all times to any programmes, procedures, operations and safeguards used on the computers or computer systems through which the system vendor provides its distribution facilities. Each system vendor shall submit its auditor's report on his inspection and findings to the Commission within four months of the end of the calendar year under review. The Commission shall examine those reports with a view to taking any action necessary in accordance with Article 11(1). 2. The system vendor shall inform participating carriers and the Commission of the identity of the auditor at least three months before confirmation of an appointment and at least three months before each annual reappointment. If, within one month of notification, any of the participating carriers objects to the capability of the auditor to carry out the tasks as required under this Article, the Commission shall, within a further two months and after consultation with the auditor, the system vendor and any other party claiming a legitimate interest, decide whether or not the auditor is to be replaced". See Commission Report on the application of Council Regulation 2299/1989 on a code of conduct for computerised reservation systems (CRSs), p. 7: "Article 21.a.1 of the code requires a system vendor to ensure that "the technical compliance of its CRS with Articles 4a and 6 is monitored by an independent auditor". It also requires a system vendor to submit a copy of the auditor's report on his inspection and findings to the Commission once a year. This provision of the code introduced in the review of 1993 represents the first time that the technical compliance of a CRS with any code of conduct in force throughout the world has been subject to statutory audit. In order to provide guidance to the system vendors' auditors on the nature and extent of the audit checks to be carried out, the Commission appointed a specialist consultant in the field of computer auditing and established a working group, to jointly

enforcement³⁶⁶ and guidance³⁶⁷. Regulation 2299/1989 was only recently repealed and replaced by Regulation 80/2009 of the European Parliament and of the Council of 14 January 2009 on a Code of Conduct for computerised reservation systems. The European Commission noted that this competitive bottleneck is gradually being eroded by the growth of commercial channels that bypass CRSs³⁶⁸. Furthermore, carriers had gradually divested or reduced their shareholdings in CRSs³⁶⁹. Therefore, Regulation 80/2009 puts in place a partial de-regulation aimed at suppressing some of the obligations that were considered no longer necessary or counterproductive. However, the new regulation still imposes several obligations on CRSs regarding access³⁷⁰, services³⁷¹, displays³⁷², commercial information³⁷³ and relations with parent carriers³⁷⁴.

develop a set of CRS audit guidelines. The audit guidelines defined the nature and scope of the audit checks to be carried out based on a series of defined control objectives. The guidelines were published in October 1994 and copies were also sent to all Member States directly. The guidelines were also used by the Commission's services as a standard against which the adequacy of the audit reports were to be judged. Although the use of the guidelines is not mandatory, the CRSs' auditors have generally used them as the basis for the audits they have carried out."

³⁶⁶ Commission Report on the application of Council Regulation 2299/1989 on a code of conduct for computerised reservation systems (CRSs), pp. 8-9: "Over the period since the adoption of the amended code, the Commission's services have given guidance on the application of a particular provision of the code on three points - advertising in the principal display, display of code share flights and the treatment of passive bookings. The background to the request for clarification and the Commission's services response is set out below. The Commission's services gave their guidance on interpretation without prejudice to any other future positions of the Commission; it is for the Court of Justice to give binding interpretations of Community law pursuant to Article 177 of the Treaty".

³⁶⁷ See Articles 11 to 16 of Regulation 2299/1989. The European Commission's investigatory and fining powers were the same as under the EU competition rules. In particular, the Commission could, by decision, "impose fines on system vendors, parent carriers, participating carriers and/or subscribers for infringements of this Regulation up to a maximum of 10 % of the annual turnover for the relevant activity of the undertaking concerned" (Article 16.2).

³⁶⁸ Commission Staff Working Document, Impact Assessment on the Proposal for a regulation of the European Parliament and of the Council on a Code of Conduct for computerised reservation Systems, p. 4: "Changes in CRS technology and economics are gradually eroding the key features of the competitive landscape for which the Code of Conduct was designed. First, many airlines have divested their CRS ownership. Three of the four CRSs (Galileo, Worldspan and Sabre) no longer have any airline ownership, and three airlines only hold a minority share in Amadeus. Second, thanks to the development of alternative distribution channels, such as the airlines' Internet websites or their call centres, consumers have nowadays access to a multiplicity of information and booking channels for air transport services. About 40% of all airline tickets in the EU are booked via alternative channels and about 60% via travel agents and CRSs".

³⁶⁹ Commission Staff Working Document, Impact Assessment on the Proposal for a regulation of the European Parliament and of the Council on a Code of Conduct for computerised reservation Systems", p. 11: "Today, the majority of airlines have divested from their participation in CRSs. Three out of four CRSs are now completely spun off (Galileo, Sabre and Worldspan). Only Amadeus keeps an airline ownership as it has three airlines as minority shareholders. Most European airlines have also sold off their ownership of the National Marketing Companies (NMC) of the CRSs. These are companies – subsidiaries of the CRS or not – that market or promote the services of a particular CRS in given national markets. However, a few air carriers still have stakes in the NMC and some of them may be considered as parent carriers. It cannot be excluded that airlines may regain control of CRSs in the future, especially if they were no rules specific to parent carriers".

³⁷⁰ Regulation 80/2009, Article 3.1: "A system vendor shall not: (a) attach unfair and/or unjustified conditions to any contract with a participating carrier or require the acceptance of supplementary conditions which, by their nature or according to commercial usage, have no connection with participation in its CRS; (b) make it a condition of participation in its CRS that a participating carrier may

Interestingly, in a contemporaneous merger between two CRSs (Travelport/Worldspan), the Commission discarded the existence of a competition problem because on-line air-ticket bookings are now widely available and airlines can bypass the CRSs bottleneck³⁷⁵.

All in all, CRSs have been subject to stringent regulatory obligations for 25 years even though their vertical integration (now absent for the most part) and the potential discriminatory/unfair practices over airlines (the regulatory obligations were put in place before these practices actually materialised) would have escaped control under conventional competition rules (i.e., abuse of dominance and anticompetitive agreements).

(2) Mobile Communication Networks

The mobile communications markets of the EU have seen significant and, in many areas, increasing regulatory intervention, even though the European Commission and the national regulators (as well as their competition counterparts) have long considered that the retail markets were operating competitively³⁷⁶.

not at the same time be a participant in another system or that a participating carrier may not freely use alternative reservation systems such as its own Internet booking system and call centres”.

³⁷¹ Regulation 80/2009, Article 3.2: “A system vendor shall load and process data provided by participating carriers with equal care and timeliness, subject only to the constraints of the loading method selected by individual participating carriers”.

³⁷² Regulation 80/2009, Article 5.1: “A system vendor shall provide a principal display or displays for each individual transaction through its CRS and shall include therein the data provided by participating carriers in a neutral and comprehensive manner and without discrimination or bias. Criteria to be used for ranking shall not be based on any factor directly or indirectly relating to carrier identity and shall be applied on a non-discriminatory basis to all participating carriers. The principal display(s) shall not mislead the user, shall be easily accessible and shall respect the rules set out in Annex I”.

³⁷³ Regulation 80/2009, Article 7: “1. Any marketing, booking and sales data may be made available by system vendors provided that such data are offered with equal timeliness and on a non-discriminatory basis to all participating carriers, including parent carriers. Data may and, on request, shall cover all participating carriers and/or subscribers. 2. Participating carriers shall not use such data in order to influence the choice of the subscriber”.

³⁷⁴ Regulation 80/2009, Article 3.3: “A system vendor shall publicly disclose, unless this is otherwise made public, the existence and extent of a direct or indirect capital holding of an air carrier or rail-transport operator in a system vendor, or of a system vendor in an air carrier or rail-transport operator”. Article 4: “1. A system vendor shall not reserve any specific loading and/or processing procedure, any other distribution facility, or any changes to these, for one or more participating carriers, including its parent carrier(s). The system vendor shall provide information about changes to its distribution facilities and loading/processing procedures to all participating carriers. 2. A system vendor shall ensure that its distribution facilities are separated, at least by means of software and in a clear and verifiable manner, from any carrier’s private inventory and management and marketing facilities”.

³⁷⁵ Vannini 2008. Interestingly, competition authorities seem to be reluctant to allow vertical integration between airlines and airports out of fear that a vertically integrated airport could discriminate against competing airlines. See, for example, The Independent, “Watchdog could foil Ryanair plan for Stansted stake”, 10.09.2012.

³⁷⁶ Retail mobile communications have not been in the lists of markets susceptible of ex ante regulation, adopted by the Commission (Recommendation on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation - C(2007)5406, and Commission Recommendation on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communication networks and

First, in relation to national two-way interconnection agreements, the European Commission has actively recommended³⁷⁷ and the regulators of the Member States have imposed cost-based termination pricing on all networks or, at least, the leading ones.

Second, regarding national one-way access agreements, several Member States have mandated wholesale access to the networks of the mobile operators under a collective dominance analysis, despite network operators' allegations that the retail market was sufficiently competitive³⁷⁸.

Third, the EU has also imposed price caps on international interconnection agreements between mobile operators (wholesale roaming), as well as on retail international calls and sms (retail roaming), as well as other structural and behavioural remedies (e.g., open-up of networks to roaming services of MVNOs) even though most, if not all, national markets for retail mobile communications are considered to be competitive³⁷⁹. Furthermore, the European Commission has proposed a new legislative package that would, among many other measures, suppress roaming fees³⁸⁰.

services, C(2003)497). See also Commission Staff Working Document *accompanying the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, "Progress report on the single European electronic communications market (15th report)", SEC(2010) 630 final/2, 25.8.2010, p. 15: "Mobile markets in the EU Member States usually count three to four network operators. At a national level, the market share of the leading operator is generally below 40% [footnote: In some cases this is much lower e.g. in the UK around 21%] and the main competitor average market share is around 30%. The leading operator and/or the main competitor are usually owned by one of the four main mobile groups which have pan European strategies in terms of marketing and of bargaining with suppliers. In terms of services, however, markets remain national."*

³⁷⁷ See European Commission Recommendation for the Regulatory Treatment of Fixed and Mobile Call Termination Rates in the EU, OJ L 124, 20.05.2009.

³⁷⁸ The Commission originally considered that the market for wholesale access and call origination on public mobile telephone networks was susceptible of ex ante regulation but it excluded this market from the latest Recommendation on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation - C(2007)5406.

³⁷⁹ Regulation 531/2012 of the European Parliament and of the Council, of 13 June 2012, on roaming on public mobile communications networks within the Union, which repealed and replaced the original Regulation 717/2007 of the European Parliament and of the Council, of 27 June 2007, on roaming on public mobile telephone networks within the Community and amending Directive 2002/21/EC. For more information on the EU's position on roaming, see http://ec.europa.eu/information_society/activities/roaming/index_en.htm. Roaming is explained in lay terms: "When you travel to a foreign country, your mobile phone keeps working: you are roaming. You can make & receive mobile phone calls, write text messages (SMS) or surf the internet and download content. Your calls, SMS and other data services are operated by a foreign network because your home provider does not normally operate in that country. For providing this service, the foreign network operator charges your home operator and your home operator passes this additional cost on to you".

³⁸⁰ See the "Connected Continent legislative package" at <http://ec.europa.eu/digital-agenda/en/connected-continent-legislative-package> and, in particular: "We want roaming to end, and we want to give the market a chance to make this happen.[...]. Operators will lose the right to charge for incoming calls while a user is travelling abroad in EU as of 1st July 2014. They will additionally face a choice between a carrot and stick. The carrot is that they can be largely free of European regulation, if they extend their domestic plans/bundles from 2014 so that by 2018 at the latest, customers throughout the Union are able to use their phones and smartphones while travelling throughout the Union at domestic rates. There will be a glidepath from July 2014, allowing operators to adapt either the number of plans they offer or the number of countries they cover at domestic rates. The stick is being subject the 2012 roaming regulation which forces companies to offer their customers the possibility to roam with new

All in all, despite the finding that retail markets were sufficiently competitive from a regulatory and competition law standpoint, regulators have defined wholesale access/interconnection and network termination markets in order to impose regulatory and even competition law remedies on these narrowly defined markets.

(3) Internet Service Providers

Historically, ISPs have not charged content providers for the content delivered to the ISP's customers, nor discriminated among similar content providers (applications) in terms of the delivery services (traffic management) provided. This state of affairs has been defined as "Internet/Net Neutrality". Public authorities all over the world are supportive of the Net Neutrality principle and some countries have preventively enacted specific laws expressly mandating Internet neutrality or are considering regulating it. At the EU level, the European Commission adopted the Communication "The open internet and net neutrality in Europe"³⁸¹. This Communication considered that the existing regulatory regime could adequately safeguard net neutrality, without discarding ad hoc regulation if significant and persistent problems emerge³⁸². Furthermore, the European Commission reserved the right to apply competition rules³⁸³, although it admitted that these rules may not be an effective remedy in competitive bottleneck-type scenarios³⁸⁴. However, following the European Parliament's Resolution in support of the Internet neutrality principle, in which it condemned discriminatory practices and

competitors (alternative roaming providers) as of July 2014. From this date a customer will have the right to leave their domestic operator when travelling and take cheaper roaming services from a local company or a rival company in the home country. Operators should take advantage of the opportunities to offer Roam Like at Home to their consumers. The Commission will review the implementation of the Roaming regulation in 2016 and may consider further Regulatory options."

³⁸¹ Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions, "The open internet and net neutrality in Europe" ("Communication on net neutrality"), COM(2011) 222 final, 19.4.2011. The Commission's consultation on the "open internet and net neutrality" is available at: http://ec.europa.eu/information_society/policy/ecomm/library/public_consult/net_neutrality/index_en.htm

³⁸² Communication on net neutrality, p. 9: "On the basis of the evidence and the implementation of the telecom framework provisions, the Commission will decide, as a matter of priority, on the issue of **additional guidance** on net neutrality. If significant and persistent problems are substantiated, and the system as a whole - comprising multiple operators - is not ensuring that consumers are easily able to access and distribute content, services and applications of their choice via a single internet subscription, the Commission will assess the need for **more stringent measures** to achieve competition and the choice consumers deserve. Transparency and ease of switching are key elements for consumers when choosing or changing internet service provider but they may not be adequate tools to deal with generalised restrictions of lawful services or applications. Such additional measures may take the form of guidance or general legislative measures to enhance competition and consumer choice, such as by further facilitating consumer switching, or if this should prove to be insufficient, by for example imposing specific obligations regarding unjustified traffic differentiation on the internet applicable to all ISPs irrespective of market power. This could include the prohibition of the blocking of lawful services".

³⁸³ *Id.*, p. 9: "In this regard, the Commission reserves its right to assess under Articles 101 and 102 of the TFEU any behaviour related to traffic management that may restrict or distort competition".

³⁸⁴ *Id.*, p. 4: "At the same time, the adequacy of the competitive environment as a guarantor of the openness of the internet can be affected by the possible existence of market failures, of oligopolistic practices, of bottlenecks to the provision of high quality services to consumers and of information asymmetry."

urged the Commission to assess the need for regulatory measures, the Commission' new legislative proposal "Connected Continent" expressly regulates Net Neutrality³⁸⁵.

In the US, the Open Internet Order, adopted by US Federal Communications Commission (FCC) on 21 December 2010, imposed a far-reaching net neutrality obligation³⁸⁶. The FCC argued that each ISP is a gatekeeper to its own Internet users and has the incentive and ability to discriminate content providers. Interestingly, the FCC held that even if these threats to the current competitive functioning of the Internet would materialise in the absence of ISP market power in the end user market, the presence of market power therein would exacerbate them³⁸⁷.

(4) Internet Search Engines

The European Commission is currently investigating Google for allegedly overcharging and discriminating third-party content providers in favour of its own content in free

³⁸⁵ European Parliament resolution of 17 November 2011 on the open internet and net neutrality in Europe, P7_TA-PROV(2011)0511 and Connected Continent legislative package, available at <http://ec.europa.eu/digital-agenda/en/connected-continent-legislative-package>: "Net Neutrality: This proposal will end discriminatory blocking and throttling and deliver effective net neutrality [https://ec.europa.eu/digital-agenda/node/10545]. It goes wider than the measures in the US (which does not prevent blocking or throttling of services such as VOIP on mobile). It sets out clear rules for traffic management which has to be non-discriminatory, proportionate and transparent.

Companies would however be allowed to differentiate their offers (for example by speed) and compete on enhanced quality of service. There is nothing unusual about this – postal services (express mail) and airlines (economy/business class) have done this for decades.

To meet end-users' demand for better service quality, content providers may agree deals with internet providers to assure a certain quality of service. Such offers will enable telecom operators to generate additional revenue streams from OTT actors, content providers as well as from consumers who are willing to pay for better or faster services. These revenues in turn, will enable operators to finance investments into network upgrades and expansion.

Specialised services must not lead to quality degradation of the "normal"/best efforts Internet. They are coherent with the way the internet was engineered," [emphasis added]

³⁸⁶ Federal Communications Commission Report and Order, "Preserving the Open Internet, Broadband Industry Practices" ("The Open Internet Order"), 10-201, 23.12.2010. The Open Internet Order became effective on 20.11.2011. On appeal, a US Court of Appeals unanimously annulled the Order on jurisdictional grounds (Verizon v FCC, No. 11-1355, 14 January 2014). However, the majority upheld the FCC's analysis of the ISP's gatekeeper role, whereas a dissenting judge rejected it on the basis that the FCC had not produced evidence supporting its arguments. One wonders whether the dissenting judge would have sided with the majority on this point had he been aware of the abuses flowing from supermarkets' gatekeeper role.

³⁸⁷ The Open Internet Order, par. 33: "Although these threats to Internet-enabled innovation, growth, and competition do not depend upon broadband providers having market power with respect to end users, most would be exacerbated by such market power. A broadband provider's incentive to favor affiliated content or the content of unaffiliated firms that pay for it to do so, its incentive to block or degrade traffic or charge edge providers for access to end users, and its incentive to squeeze non-prioritized transmission will all be greater if end users are less able to respond by switching to rival broadband providers. The risk of market power is highest in markets with few competitors, and most residential end users today have only one or two choices for wireline broadband Internet access service", and 34: "In addition, customers may incur significant costs in switching broadband providers because of early termination fees; the inconvenience of ordering, installation, and set-up, and associated deposits or fees; possible difficulty returning the earlier broadband provider's equipment and the cost of replacing incompatible customer-owned equipment; the risk of temporarily losing service; the risk of problems learning how to use the new service; and the possible loss of a provider-specific email address or website.

(non-paid) and sponsored (paid) search queries³⁸⁸. Under a conventional competition analysis, the European Commission's case against Google must rely on a sufficiently narrow product market definition (e.g., general search engines and the associated market for online advertisement in search engines) that confers a very high market share on Google justifying a finding of dominance.

However, it appears that the case against Google rests essentially on its competitive bottleneck role: Google is a competitive bottleneck with locked-in (singlehomed) customers that is able to exploit and discriminate content providers³⁸⁹.

³⁸⁸ See for example, Press Releases of the Commission, "Commission probes allegations of antitrust violations by Google", IP/10/1624, 30.11.2010 and "Commission seeks feedback on commitments offered by Google to address competition concerns", IP/13/371, 25.04.2013: "In March 2013, the Commission formally informed Google of its preliminary conclusion that the following four types of business practices by Google may violate EU antitrust rules prohibiting the abuse of a dominant position (Article 102 of the Treaty on the Functioning of the European Union – TFEU): (i) The favourable treatment, within Google's web search results, of links to Google's own specialised web search services as compared to links to competing specialised web search services (i.e. services allowing users to search for specific categories of information such as restaurants, hotels or products); [...] To address these concerns, Google offers for a period of 5 years to: (i) label promoted links to its own specialised search services so that users can distinguish them from natural web search results, clearly separate these promoted links from other web search results by clear graphical features (such as a frame), and display links to three rival specialised search services close to its own services, in a place that is clearly visible to users, [...]". On 5 February, the Competition Commissioner Almunia announced that a settlement had been reached with Google, Commissioner Almunia, "Statement on the Google investigation", SPEECH/14/93, 05/02/2014. With regards to the treatment of third-party content providers, "to address these concerns, Google has finally accepted to guarantee that whenever it promotes its own specialised search services on its page, the services of rivals will also be displayed in a comparable way. In practice, this means that when Google promotes one of its own specialised search services, there will be three rival services also displayed prominently on the page, in a way that is clearly visible to users. [...]. Of course, for all these situations, it is not possible to show all rivals, in the same way that that could not happen on Google's general web search results. There therefore has to be a selection and Google's proposal provides an objective mechanism for all scenarios. Where Google does not charge for inclusion in its specialised search service, such as in local search, rivals will not be charged to participate in the rival links. Instead, they will be chosen based on their ranking in natural search. Where Google charges merchants for inclusion in its specialised search service, such as in Shopping, the three rivals will be chosen on the basis of a dedicated and transparent auction mechanism."

³⁸⁹ Cave and Williams, "The Perils of Dominance: Exploring the Economics of Search in the Information Society", paper sponsored by ICOMP, 18.03.2011, pp. 29-30: "The narrative that Google has shaped around contestability is expressed simply as "a click away" – the implication that any consumer is able to migrate to another platform instantaneously with almost zero switching costs. This narrative has been carefully crafted by Google, for example, the phrase: "As we put it, the competition is only a click away" has become a strapline for capturing, from the perspective of Google, the inherent intensively competitive nature of the Internet and the market for search. However, what this carefully articulated story fails to discuss are the impediments to contestability, for example the increasing array of defaults on software platforms and applications that mandate Google services. These impediments are multifarious and operate over time and in space. Temporally, the dominance of Google at any one time in terms of both searches and searchers leads to a perception of better results. In other words consumers are only likely to move away if there is a "second Google" out there. Fundamentally, as the literature describes, the major structural impediment, is when a platform has become so embedded in the behaviour of users on both sides of the market, the nature of competition shifts to one for the market rather than competition within the market. Within such a perspective the entry barriers are formidable and the actions of individual consumers close to futile. (...). The impediments to contestability may also be found in the nature of search itself – the scale effects and path dependencies create forms of consumer and advertiser lock-in regardless of the technical efficacy of the search algorithms. So whilst Google continue to remonstrate that their dominance is simply a matter of doing this better and learning by doing the

Interestingly, Google has been a long time proactive supporter of the “Net Neutrality” principle and has supported the FCC’s Open Internet Order.

(5) Internet Domain Name Registration

For many years, the Internet Corporation for Assigned Names and Numbers (ICANN) mandated vertical separation between registries (i.e., those who manage the Internet domain names), and registrars (i.e., those who interact with end-users interested in registering an Internet domain name). However, following the announcement that it intended to lift the prohibition of vertical integration, several stakeholders and Governments voiced strong opposition. In particular, both the US and the EU claimed that competition law enforcement would not be an effective remedy against the potential competitive risks created by vertically integrated registry-registrar activities³⁹⁰. In June 2011, ICANN formally suppressed the prohibition of vertical integration between registrar-registry activities on the basis that the contractual provision against the abusive practices arising out of registry-registrar cross ownership, the self-auditing requirements and the right of contractual termination and punitive damages for breaches of this provision ensured that vertically integrated operators would not incur in discriminatory practices.

(6) Media Platforms

Traditionally, competition authorities have considered that media companies compete in the market for viewers, listeners or readers and in the market for advertising services in the relevant media. In these cases, competition authorities have considered that corporate advertisers were customers of the media platforms on an equal footing from a competition policy standpoint with viewers, listeners and readers. Furthermore, they have been prepared to impose stringent remedies on media mergers or even block them if they threatened to create single or collective dominant positions in the advertising side³⁹¹. Interestingly, as a condition for the clearance of the Carlton/Granada merger, the

consumer experience and behaviour is one that tends towards ‘lock-in’ and ‘path dependencies’. The existence of such behaviours is consistent with the predictions of economic theory”. Even those academics who support Google admit that Google’s conduct might be anticompetitive if it amounted to an “unjustified affirmative interference with the natural workings of the marketplace—for example, deliberately demoting the ranking of a website for purchasing advertisement with a search engine’s competitor”, as per Lao, “Search, Essential Facilities, and the Antitrust Duty to Deal”, unpublished paper, 02.08.2012, p. 6. Lao considers that “giving priority to its own content or services in the presentation of search results is quite different as it does not affirmatively block a competitor’s efforts to compete” (p. 67). Indeed, this is precisely what supermarkets do: interfere with the natural workings of the market by “demoting” independent grocery brands (through pricing and non-pricing practices as well as the misuse of sensitive confidential information and copycating) and very often refusing to “rank” them. In short, they “affirmatively block a competitor’s effort to compete”.

³⁹⁰ See, regarding the EU position, Letter from Gerard de Graaf and Linsey McCallum to Rod Beckstrom and Peter Dengate, INFSO/A3/JS/, 17.06.2011, enclosing the Non-paper regarding the envisaged removal of vertical separation between registries and registrars for new and existing gTLDs by ICANN; and Letter from Gerard de Graaf and Linsey McCallum to Rod Beckstrom and Steve Crocker, 19.01.2012. See, regarding the US position, Letter from Lawrence Strickling (US Department of Commerce) to Peter Dengate-Thrush, enclosing a Letter from James Tierney (US DOJ), 16.06.2011

³⁹¹ See, for examples of mergers where single and collective dominance findings were made, the Press release of the German Bundeskartellamt, “Bundeskartellamt prohibits merger between

UK Secretary of State (on recommendation by the UK Competition Commission) imposed “a set of rules to protect the advertising community from unfair or discriminatory practices in the selling of television airtime”, termed a Contract Right Renewal remedy, enforced by an ad hoc regulator (i.e., the “Adjudicator”)³⁹².

(7) Card Payment Networks

For many years, all sorts of merchants, including supermarkets, have bitterly objected to the Multilateral Interchange Fees (“MIF”) and the restrictions imposed by the card payment networks or their acquiring banks on them. In response to these complaints, regulators (e.g., Central Banks) and competition authorities, including the European Commission and the US DoJ, have intervened in several countries in order to suppress or curtail MIF and the restrictions imposed on retailers³⁹³. However, no single or dominant position has ever been found in the card payment network and the acquiring bank markets. The competition law intervention in this area rests on three main grounds:

(1) Market power is found below single-firm dominance level

The European Commission has considered that the MIF were adopted by agreements (decisions) of the association of banks that integrated the Visa and MasterCard networks in breach of Article 101 TFEU. Likewise, the DoJ has relied on Article 1 of the Shearman Act against some of the restraints imposed by the three main networks (American Express, MasterCard and Visa).

Springer/ProSiebenSat. 1”, 24.01.2006; and the Spanish Competition Authority’s summary of the report-proposal in the second phase case C/230/10 TELECINCO/CUATRO. However, it must be noted that the pricing power of the large media platforms in the advertising market seems to be much more linked to the bargaining power of each media operator vis-à-vis all the advertising buyers (i.e., competitive bottleneck) than to the alleged price transparency and monitoring/reprisal mechanisms in the advertising market.

³⁹² See <http://www.adjudicator-crr.org.uk/index.htm>.

³⁹³ Interestingly, retailers, in particular those operating in grocery field, have fiercely challenged the amount of the access fees they are charged and other competitive restraints they are subject to by their card payment networks. They have filed several complaints before competition authorities, developed intense lobbying before public authorities and executed an aggressive media campaign. See, for example, European Retail Round Table’s website, <http://www.errt.org/key-topics/payment-cards> (“Prices in Europe are artificially inflated because of hidden fees for debit and credit cards transactions, fees which all shoppers end up paying for. The payment cards cartel argues that these fees are essential to run card schemes, whilst there are card schemes in Europe which operate successfully without hidden fees! Europe’s retailers want the best for Europe’s shoppers in terms of price, quality, service and choice. We believe Europe’s shoppers have the right to know. We believe that there should be pan-European competition and real transparency concerning all fees and charges levied on credit and debit cards use.”); EuroCommerce’s website, <http://www.eurocommerce.be/content.aspx?PageId=39895>; and the website set up by EuroCommerce to denounce the fees paid by retailers and the restrictions imposed upon them by card payment networks, www.stopunfaircardfees.eu (“Europe’s retailers want the best for Europe’s shoppers - in terms of price, quality, service and choice. But prices in Europe are artificially inflated because of hidden fees for debit and credit cards – fees which all shoppers end up paying for. We believe Europe’s shoppers have the right to know. That’s why we have set up this website – to inform shoppers of the hidden fees and to encourage decision-makers to crack down on the hidden fees and anti-competitive practices of Visa, MasterCard and the banks behind them”).

(2) Two-sided demand (platforms) does not justify a single product market definition.

Competition authorities have concluded that there are two groups of consumers in the payment cards industry on an equal footing: “cardholders and merchants (as well as subsequent purchasers)”. Therefore, competitive restraints imposed on merchants have been assessed in isolation without any consideration for the alleged cross-market benefits of these restraints (i.e., benefits accrued to cardholders).

(3) Merchants do not constraint platform’s behaviour

Competition authorities have taken into account that a large number of merchants are captive of the large card payment networks and, therefore, cannot exercise any meaningful countervailing power against them.

On the regulatory front and following a public consultation on this issue, the European Commission has proposed a Regulation on interchange fees³⁹⁴. This regulatory proposal impliedly admits that competition law enforcement has not been sufficient in this market and has built a “creative” (to say the least) theory of harm whereby it is alleged that competition to attract card-users drives up MIFs (“inverse competition”) and harms retailers and shoppers paying in cash or with debit cards (“poorer customer”) at the expense of the “richer consumer” paying with credit cards. This regulatory proposal builds on the existence of a category of market power of the card networks over merchants (or economic dependence of the latter) that would not certainly qualify as a dominant position under the conventional competition analysis.

(8) Aftermarkets

In several occasions, competition authorities have found a separate market for the spare-parts and/or repair/maintenance services of specific brands. In the motor vehicle sector, the European Commission has been mandating non-discriminatory access of independent providers repair/maintenance to the goods and services of the car manufacturers without ever concluding that any of them, let alone any of their brands, holds a dominant position in the motor vehicle market or the aftermarkets.

Conclusions on competitive bottlenecks

Competitive bottlenecks are two-sided platforms (i.e., platforms/networks facilitating the interaction between two categories of customers) that exhibit three main features:

³⁹⁴ See Commission Green Paper, “Towards an integrated European market for card, internet and mobile payments”, COM/2011/0941 final, 11.01.2012, Proposal for a Regulation of the European Parliament and of the Council on interchange fees for card-based payment transactions, COM/2013/550-3, 24.07.2013.

(1) They operate in concentrated markets and each of them enjoy some degree of market power even if single-firm dominance does not exist according to a conventional market-share based test³⁹⁵.

(2) They enjoy a high degree of loyalty/lock-in over the customers on one side of the platform (singlehomed customers, who tend to be end-users, not economic operators).

(3) They are able to exploit customers on the other side (multihomed customers, who tend to be economic operators) because they need access to these competitive bottlenecks in order to reach customers on the other side (i.e., end-users) in a viable economic way³⁹⁶.

Up to now, public authorities have only dealt with competitive bottlenecks on a case-by-case basis and only a few economists have tried to conduct a systematic analysis of competitive bottlenecks³⁹⁷. However, this patchwork intervention shows a common pattern: competition authorities are prepared to interpret competition rules flexibly in order to control the practices of the competitive bottlenecks and public authorities are willing to supplement and even supplant competition policy with regulatory remedies:

Competition authorities' proactive intervention takes different shapes: (1) They have defined extremely narrow markets in the mobile communications sector (i.e., call/sms/data termination in an operator's network) and car after-services (i.e., after-service in each manufacturer's network); (2) they have interpreted that the unilateral practices of each Visa and Mastercard are decisions/agreements of the member banks in

³⁹⁵ In par. 105 of the MasterCard Decision, the Commission referred to the need to take into account structural factors in assessing market power, highlighted MasterCard's high shares by different measurements and underlined the network effects: "The primary focus for analysing whether there is an appreciable effect on competition is the position and importance of the parties on the market taken into account the market structure. In assessing MasterCard's market position and, therefore, the impact that its decisions have on competition, it is necessary to understand the different elements that contribute to MasterCard's market position *as a network* and that reinforce each other through *network effects*. Mutually reinforcing elements of a payment card scheme's market position include, in particular, the size of its membership network, the penetration amongst different classes of customers (cardholders, merchants), the strong acceptance rate and high transaction volumes and the relative size compared to rival networks". This led the Commission to conclude that the company enjoyed a strong position in the market, see par. 652: "MasterCard has a strong position on the relevant markets, as set out in section 2.2." Likewise, in the Visa Settlement Decision, the Commission simply refers to Visa's strong position in the market: "(18) In the Statement of Objections, the Commission took the preliminary view that Visa Europe has a strong position on the relevant markets in terms of its membership network and the number of VISA / VISA Electron / V PAY cards issued as well as in terms of the number of merchants accepting them in the EEA."

³⁹⁶ The practices that give rise to competition concerns in competitive bottleneck markets tend to be widespread. Since each two-sided platform is the gatekeeper to its single-homed customers, it can exercise the kind of power that it is traditionally associated with single firm dominance over its multi-homed customers. See, for example, MasterCard Decision, par. 655: "Second, MasterCard's MIF is mirrored by similar interchange agreements adopted under the VISA scheme. Several domestic payment card systems also operate with multilaterally agreed interchange fees. It appears, therefore, that the payment card markets are generally governed by networks that apply similar decisions and agreements. There is therefore a cumulative effect on the relevant markets."

³⁹⁷ Most notably, economists (e.g., Armstrong 2006) have concluded that competitive bottlenecks can harm social welfare even in the presence of intense inter-platform competition and this harm can be exacerbated if inter-platform competition is not strong.

order to facilitate the application of Article 101 TFEU; (3) they have supported regulatory remedies (e.g., the non-discrimination rule) over the enforcement of competition rules to address the registry-registrar vertical integration in the web domain name registration sector; (4) they are challenging Google's practices against competitors and business users of their services on the basis of a narrow market definition and a creative dominance analysis even though businesses and consumers may interact directly in the Internet and by-pass Google; and (5) they have considered that competitors and business customers are as worth of protection as end-users in the Internet search engine, media platform and credit card payment networks (curiously, in the three sectors the platform services to end-users are often offered for free and the consumer welfare analysis is absent or highly speculative).

Moreover, competitive bottlenecks have also been subject to regulatory obligations. In many countries, all CRSs have been subject to obligations regarding fair and non-discriminatory access to and fair competition within each CRS platform despite the absence of a dominant position. Likewise, many countries have imposed "net neutrality" obligations on ISPs and fair dealing/fees obligations on credit card payment networks in their dealings with merchants to address practices that would most likely be authorised under competition rules.

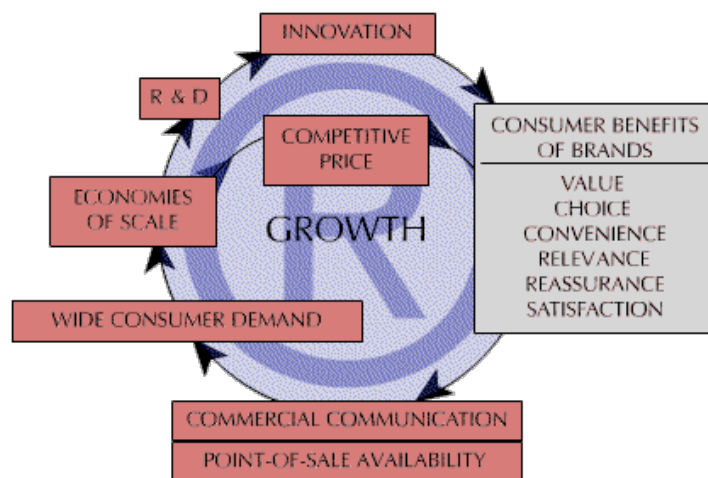
In summary, proactive competition law and regulatory intervention in other competitive bottlenecks contrasts with the free-reign enjoyed by supermarkets in the grocery retailing market.

5.3.2.2 The productivity/innovation growth model of grocery brands

The business model of independent grocery brands is based on four "P"s: product, publicity, points of sale and pricing. Independent brands must constantly develop products that meet human beings' evolving and often latent needs. These products must be brought to the consumers' attention through publicity and they must be available in the widest possible set of distribution points in order to reach as many consumers as possible. Finally, the pricing must be such as to create the appropriate value for consumers. Once the right product, publicity, distribution and pricing are in place, the independent brand will be in a position to achieve the necessary wide-scale demand that generates a virtuous growth circle. Increased demand enables mass production, which allows both a competitive price and investment for research and development³⁹⁸. The expenditure on R&D leads to more innovation that meets or induces changes in

³⁹⁸ Evans, "Payments Innovation and Interchange Fees Regulation: How Inverting the Merchant-Pays Business Model Would Affect the Extent and Direction of Innovation", Economic Paper, 27.06.2011: "Most economic models of investment in research and development find that the optimal investment depends on sales. For example, all else equal a business that is considering investing in process improvements will obtain greater returns if it can average the fixed costs of its research and development efforts across a larger business. An entrepreneur, and its venture backers, would, to take another example, realize a greater return if the sales and profit potential is greater."

consumer needs. As described by Bell, each turn of this virtuous circle leads to economic growth for the business and for the economy as a whole³⁹⁹.



Source: Bell 2009, p. 29.

Successful innovation is the lifeblood of independent grocery brands⁴⁰⁰. It is unquestionable that only new product developments can allow trading up in order to avoid a deflationary trend that would undermine the virtuous cycle and set off a downward spiral of prices, R&D and sales⁴⁰¹.

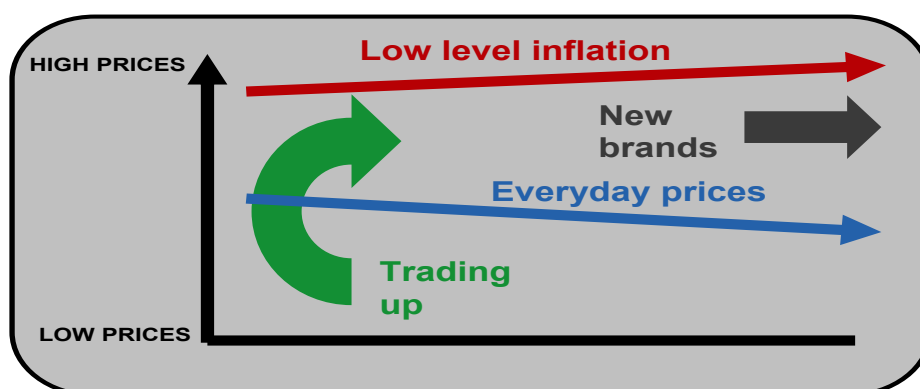


FIGURE ONE: NEW PRODUCTS HELP TO BALANCE TOP LINE PRICING

Source: IRI 2007, p. 4.

³⁹⁹ Bell, “The Business Model for Manufacturers’ Brands”, in *Private Labels, Brands, and Competition Policy: The Changing Landscape of Retail Competition*, ed. by Ariel Ezrachi and Ulf Bernitz, Oxford, 2009, pp. 21-44, p. 29.

⁴⁰⁰ IRI, “New Product Success in Europe”, White Paper, February 2007, p. 4: “It has long been accepted that successful new products are the lifeblood of a dynamic fmeg category”. Certainly, the latest development in the Internet world may be regarded more glamorous and revolutionary than any innovation in the grocery sector but one should not forget that food and water are the primary human needs and innovations in this field may have unmeasurable externalities (e.g., healthy habits and sustainable agriculture) and a profound impact on society.

⁴⁰¹ Trading up stands for increasing the number of features (and their associated benefits) of a product, improving its quality, or backing it with a superior level of service to justify a higher price. Therefore, the business model of independent grocery brands follows closely the competitive rivalry model proposed by Michael Porter.

Accordingly, the number of new product innovations is extraordinarily high⁴⁰², a testimony of the dynamic competition prevailing in this sector. However, new products have to overcome two hurdles to reach success: access to the supermarkets and consumer acceptance.

(1) Access to a broad distribution base is a *sine qua non* condition to remain a viable grocery brand. A sufficiently high weighted distribution is necessary to reach a sufficient number of target customers (those that visit the shops where the brand is available)⁴⁰³. Based on individual interviews with European executives of established independent grocery brands, it can be estimated that the weighted distribution threshold below which new product launches are not profitable and worth the associated R&D and marketing investments is around 70%⁴⁰⁴.

(2) Customer acceptance means transforming target customers into current customers (those that actually buy the brand in the store). However, in the one-stop grocery shop model, customer acceptance not only depends on the intrinsic features of the product. It depends to a large extent on several retail features (i.e., price, presentation and marketing), which are under supermarkets' control and may influence/distort consumers' choice.

These two hurdles take a significant toll on new products. According to IRI only around 20% of them can be considered to be a success and only 10% really outperform the category.

⁴⁰² According to the Mintel Global New Products Database (GNPD), covering 49 of the world's major economies, 20,000 new product launches take place every month in the consumer packaged goods market (food, beverages, beauty & personal care, household items and petfood). See <http://www.mintel.com/gnpd>. See also Weiss 2003, p. 3: "Finally, the food sector is particularly interesting because of the large number of innovations per year. According to Madakom (2001) 32.478 new products have been introduced into the German food market in year 2000, whereas innovative activity is heterogeneously among food industry sectors.

⁴⁰³ See IRI 2007, p. 3 (Executive Summary): "Distribution plays a key part in the success of a new product and levels can vary enormously across countries"; and p. 9: "Having gained distribution, the objective of a new product is to maintain or increase that level over time. It was clear from this study that some brands have difficulty doing this and that this correlates with a poor sales performance either in terms of absolute sales or growth trend."

⁴⁰⁴ Interestingly, the economic expert working for the merging parties in the *FTC v. H.J. Heinz Co.* case reached the same conclusion regarding the weighted distribution of fast moving consumer goods in the US grocery retail market. See full description of the case below in Section 5.7.1. The District Court relied heavily on this expert testimony and considered that a high weighted distribution is needed to be a viable independent grocery brand, whereas the Court of Appeal summarily dismissed this argument. The FTC analysed the market several years later and found that one of the two parties to the failed merger had practically disappeared, most of its market share going to the leader of the market and not even to the other party to the failed merger. The unavoidable conclusion is that both the FTC and the Court of Appeals paid a lip service to the economy, free competition and consumers.

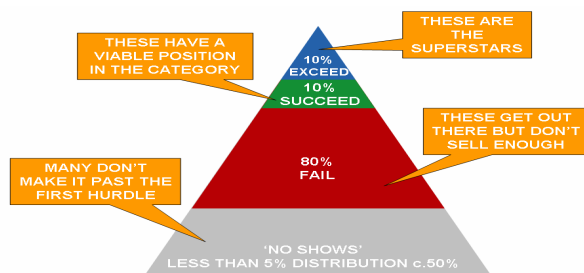


FIGURE EIGHT: NEW PRODUCTS OVERALL

Source: IRI 2007, p. 13.

Those underperforming innovations will start to lose distribution in 9-12 months and the cycle of innovation, access and commercialisation will start all over again⁴⁰⁵.

5.3.2.3 Supermarkets: competitive bottlenecks for independent brands

On the one hand, the nature of grocery demand (e.g., daily consumption and low unitary value to consumers) and offer (e.g., low marginal cost/pricing, high economies of scale in R&D, production and marketing) force grocery brand owners to seek the widest distribution possible in order to be able to reach as many consumers as possible⁴⁰⁶.

On the other hand, the structure and performance of the grocery retail market transform supermarkets into competitive bottlenecks (gatekeepers) vis-à-vis grocery brands⁴⁰⁷:

First, the habit-driven routine/low priority nature of grocery shopping, coupled with supermarkets' loyalty enhancing practices and consumer switching costs bonds consumers to their preferred supermarket (customer lock-in/loyalty). Second, the barriers to supermarket entry and expansion in local markets artificially restrict consumers' choice between competing supermarkets. Third, the transparency of market conditions and, in particular, prices, tend to reduce supermarkets' scope for price differentiation in consumers' eyes. Four, the growing importance of the in-store purchase decision enhances the competitive importance of the in-store setting of each grocery brand, a variable under control of the supermarket (a VGA in the terminology used by Poiesz 2004), which is not constrained by the countervailing power of consumers nor individual grocery brands.

This market reality conforms to the stylised theoretical model developed by Armstrong regarding the status of supermarkets as competitive bottlenecks regarding their

⁴⁰⁵ See IRI 2007, p. 9: "Those products performing less well will typically begin to lose distribution after nine to 12 months from launch, presumably to make space for the next round of new products."

⁴⁰⁶ See above, Section 5.3.2.2.

⁴⁰⁷ See above, Section 5.3.1.4. See also Grimes, "Buyer Power and Retail Gatekeeper Power: Protecting Competition and the Atomistic Seller", *Antitrust Law Journal* 72-2, 2005, p. 563: "The second theme I explore is the unique power large retailers wield over suppliers. Abusive exercises of retailers' gatekeeper power can occur even if a retailer has a market share of 10% or less and even if the sellers are large and oligopolistic."

suppliers⁴⁰⁸. Armstrong's results showed that even under an intensely competitive scenario in the consumer side, supermarkets exploited the grocery supplier to an extent that social welfare was undermined (any welfare benefit on the consumer side was outweighed by a welfare reduction on the producer side). Furthermore, he warned that if the consumer side was not competitive, then the harm to social welfare was exacerbated.

Building on the Armstrong model, competition authorities have argued that market power will only arise if the multi-homing side (e.g., grocery brands) does not enjoy sufficient countervailing power to constrain any abusive behaviour by the competitive bottleneck (e.g., supermarkets)⁴⁰⁹. For example, the European Commission justified its proposal to soften the original Regulation 2299/1989⁴¹⁰ and its clearance of the Travelport/Worldspan merger⁴¹¹ on the fact that airlines had managed to develop over the years countervailing tools against the gatekeeper role of CRSs. In particular, airlines had been able to offer differentiated content to CRSs, thereby promoting competition between them for airlines' products, and develop on-line direct channels to reach travel agents and even end-consumers.

In stark contrast with the developments in the CRS platforms in the last twenty years, the developments in the grocery retail market point to a strengthening of supermarkets' competitive bottleneck vis-à-vis grocery brands. On the consumer side, consumer lock-in, concentration at the national and local level, market transparency and the importance of the in-store competition/purchase decisions are on the increase and undermine consumers' countervailing power.

On the grocery brand side, the following factors minimise or suppress altogether grocery brands' countervailing power vis-à-vis supermarkets: First, grocery brands have not been able to reach directly end-consumers because the one-stop shopping concept assumes the presence of many brands under the same brick and mortar roof⁴¹². Second, online supermarket retailing is one of the least developed Internet commerce activities and it is not likely to emerge as an alternative channel in the foreseeable future⁴¹³.

⁴⁰⁸ See above, Section 5.3.2.1.

⁴⁰⁹ Vannini 2008 and OECD 2009b (Note by the European Commission), discussed above in Section 5.3.2.1.

⁴¹⁰ Commission Consultation paper on a possible revision of Regulation 2299/1989 on a Code of Conduct for computerised reservation systems (CRS), 23.02.2007.

⁴¹¹ Commission Decision of 21.08.2007, Case COMP/M.4523-Travelport/Worldspan and the commentary of this Decision in Vannini 2008.

⁴¹² See, for example, the EU Vertical Guidelines, par. 140: "For final products, foreclosure is in general more likely to occur at the retail level, given the significant entry barriers for most manufacturers to start retail outlets just for their own products."

⁴¹³ See, for example, www.just-food.com, "Global market review: online grocery retailing", 26.05.2010: "The global online grocery retailing market is dominated by the UK and the US, which together accounted for almost 75% of the world total in 2009. At less than 1.5%, however, online and internet channels still account for a very modest share of the global retail grocery market. Furthermore, food and groceries continue to lag well behind non-food items as far as the online retailing market is concerned, with consumers using the internet most frequently for booking travel and holidays, as well as for financial-related tasks such as banking. The global market for online grocery retailing remains at a relatively early stage of development in many parts of the world. To date, sales of food and drinks over

Third, grocery brands have not been able to discriminate among supermarkets in their product offerings in order to increase their bargaining power vis-à-vis them⁴¹⁴. Fourth, a critical factor in the competitiveness of grocery brands (i.e., retail price and presentation) is under control of a competitor, which is able to steer customers away from independent brands towards its own brands without customers noticing it⁴¹⁵.

The supply and demand factors discussed above reveal that independent grocery brands (and shoppers) are not able to exercise any countervailing power when confronted with potential abuses on the part of supermarkets and that retail competition between supermarkets does in no way prevent these abusespower. Furthermore, supermarkets' power is reinforced where bilateral grocery brand-supermarket dealings are at stake:

First, by virtue of the one-stop shopping model, even the largest grocery brand represents a tiny percentage of a supermarket's sales (3%), therefore, all the supermarkets representing more than 3% of the sales of the largest grocery brand enjoy a better bargaining position. Second, loyalty to the supermarket is outweighing loyalty to individual grocery brands⁴¹⁶. Third, the business and financial model of independent grocery brands can collapse if faced with a decline of sales in a supermarket with a relatively modest market share. Growth being the lifeblood of independent grocery

the internet have yet to make the same impact observed in other parts of the consumer goods industry, most notably books, clothing and electronic items such as computer equipment". Likewise, the Paris Grocery Report, par. 89: "Le commerce électronique de produits alimentaires demeure un marché marginal. Selon l'Insee, en 2007, il représentait 1,1% des dépenses alimentaires des Parisiens. La vente de produits alimentaires sur Internet n'a pas connu une progression comparable à celle du commerce en ligne en général, qui a été de l'ordre de 25% par an au cours des dernières années. En 2009, à peine plus de 10% des cyberacheteurs déclaraient avoir commandé des produits alimentaires en ligne au cours de dix derniers mois."

⁴¹⁴ Several factors may work against this countervailing strategy. First, unlike the airline market, where the seat capacity is limited and the limitation of flight information and/or terms to certain travel agents may not undermine full capacity utilization, the grocery brand market does not face capacity limitations and relies on a growth model. Second, market transparency would facilitate retaliatory action by discriminated supermarkets against the independent brand owner and its products. Third, exclusive or preferential agreements with a given supermarket would simply enhance its bargaining power and allow further abusive practices. Fourth, vertical integration creates incentives for supermarkets to foreclose independent grocery brands, rather than to enter into preferential agreements with them.

⁴¹⁵ See above, Section 5.3.1.4.

⁴¹⁶ For what it is worth, a contribution to a Spanish Internet blog relates a conversation with a shop assistant of the supermarket Mercadona in which she justifies the vertical foreclosure strategy of the company on the fact that one-stop shoppers are more loyal to their preferred shop than to individual independent brands. See the blog by Javier Llinares, "De SPB (Siempre Precios Bajos) a SPB (Siempre Productos Baratos)", 31.01.2009 at <http://www.javierllinares.es/?p=910>, and the comment by the participant "Miquel" on 31.01.2009: "Llevaba unos días pensando escribir justo lo mismo que has escrito tú hoy. La semana pasada, en el segundo producto que no encontré la marca que solía consumir, exclamé en voz alta "joder con Hacendado" al lado de una dependienta para ver su reacción. Le conté más o menos lo mismo que has dicho tú, que me daba la impresión de que muchos clientes íbamos a dejar de acudir a Mercadona si no encontrábamos un porcentaje de las marcas que solemos consumir y que conscientemente lo hacemos. Ella también se sabía la "estrategia". Pero también me tuvo que reconocer que un sector importante de los clientes no íbamos a ir de supermercado en supermercado eligiendo qué productos comprábamos en cada uno, sino que elegiríamos el supermercado que más nos satisfacía en promedio respetando nuestros gustos, y en él realizaremos todas las compras. Para nosotros, el factor tiempo y comodidad es más importante que unos precios un 5 o un 10% menores en compras semanales que no llegan a los 50€."

brands, their financial structure is necessarily adapted to this dynamic⁴¹⁷. Typically, they have a level of non-variable costs (i.e., costs that can be varied in the medium term but do not vary directly in line with changes in volume) at approximately 50% of sales value. Since direct variable costs account for 50% of total sales value, only half of any increase in sales value is required to cover direct cost and the remaining 50% flows directly through to profit. Thus profitability rises or declines disproportionately with increases/decreases in sales and makes independent brands extremely vulnerable to any unforeseen loss of sales.

Table 2.3 The effect on profit of a change in sales

Financial structure	Predicted sales	10% fall in sales	Difference %
Sales value	100	90	-10
Variable cost	50	45	-10
Advertising	12	12	0
Fixed costs	38	38	0
Net margins	10	5	-50

Source: Bell 2009, p. 30⁴¹⁸.

As a consequence, supermarkets without a market share traditionally associated with single-dominance thresholds (40-50%), emerge as bottlenecks in respect of independent brands, both for their new products (i.e., they need a wide weighted-distribution in order to be able to generate a cycle of growth) and the existing ones (i.e., any (sudden) loss of access/sales to a given supermarket will not be offset by increased sales in other supermarket and profits will fall dramatically)⁴¹⁹.

As an example, Bell 2009 analysed the exclusionary effect on the independent brands WIPP (laundry) and Whiskas (pet food) of the unilateral decision to delist them by given supermarkets respectively in Spain and Germany⁴²⁰. The Whiskas case is

⁴¹⁷ The discussion on the financial structure of independent brands is drawn from Bell 2009, p. 30.

⁴¹⁸ Table 2.3 seems to reflect very accurately the financial structure of leading Fast Moving Consumer Good companies. For example, Nestlé's average gross margins and net profit margins were respectively 52,86% and 8,59% in the 2006-2010 period (<http://markets.ft.com/research/Markets/Tearsheets/Financials?s=NESN:VTX>); whereas Unilever's net profit margins were 10.62% (<http://markets.ft.com/research/Markets/Tearsheets/Financials?s=ULVR:LSE>) in the same period. Therefore, a 10% net profit margin is likely to be the best possible scenario from a FMCG manufacturer's perspective.

⁴¹⁹ Bell 2009, p. 30: "The sensitivity of brand profitability to a change in sales makes the brand extremely vulnerable to any unforeseen loss of sales"; and p. 33: "The loss of volume has a significant effect on the financial viability of manufacturer brands. In general these have large margins after variable cost but high fixed costs associated with distributing and developing their products. This results in an inability to adjust costs proportionately to changes in volume".

⁴²⁰ WIPP had entered the liquid detergents segment in 1998 supported by a high advertising budget, which generated a negative net margin. However, faced with a decline in market share and value sales in 1999, WIPP reduced advertising significantly in order to stabilise its net margin level (it averaged 2,5% over the 1998-2000 period, compared with the category average of 12%). The following year sales and

particularly relevant because it was the market leader in Germany and it did reduce prices and increase advertising in the hope of offsetting the reduced weighted-distribution with higher sales in other supermarkets. In 1997, 61% of Whiskas sales were concentrated in four German retailers (Tengelmann, Edeka, Rewe, and Markant). By 2001, Whiskas sales had declined by 62% in Tengelmann, by 30% in Rewe⁴²¹. Initially, Whiskas increased trade promotions (average price reduction of 0.5 in all outlets, 2.5 in the retailers that were heavily promoting their own pet food brands) and advertising, but sales and net margins declined. Subsequently, Whiskas reduced advertising, but volume and value sales continued falling and net margins were not restored⁴²². In the event, the loss of distribution led to a negative net margin and the competitive bottleneck role of the leading supermarkets was vindicated⁴²³.

The Rewe/Meinl Decision was about competitive bottlenecks

This market reality was accurately reflected in the European Commission's Rewe/Meinl Decision⁴²⁴. The Decision referred to the relative small size of the largest grocery brand

market share decreased again, advertising had to be increased again and net margin fell significantly over the prior year (6.2%). This leads Bell 2009 to the following conclusion (p. 44): "The example from Spain shows the effect of reducing the number of lines listed by one retailer [Mercadona] for all manufacturers. The action was not specific to the range of one manufacturer. (...). In the Spanish example, the manufacturer compensated by reducing by reducing advertising to protect their profit margin but still suffered a reduced level of profitability. The consequence was that they failed to benefit from the heavy marketing expenditure that had been undertaken to support their entry into new market segments. The unpredictable action (to the supplier) of a retailer changing their product range increased the risk to the supplier's investment into new product development and range expansion".

⁴²¹ In the same period, the volume share of the competing supermarket brand rose from 20% to 54% in Tengelmann and from 40% to 55% in Rewe.

⁴²² Whiskas volume market share fell from 24.6% to 17.6% in the 1997-2001 period, whereas its value market share fell from 30.5% to 24.7% in the same period.

⁴²³ Bell 2009, p. 43: "In summary Whiskas lost sales due to reduced distribution in two major retailers. Increased advertising could not drive up sales in other retailers, where distribution was already close to 100 per cent, to compensate for lost distribution in Tengelmann and Rewe"; and p. 44: "In the German example the effect of selective action by two retailers led to the manufacturer's brand becoming unprofitable. In contrast to Spain, the manufacturer sought to maintain advertising in the face of decreasing sales volumes. Such a response in an atomistic retail structure, where consumers shop in several stores, can be expected to increase distribution of the brand. However, in an oligopolistic retail structure sales of Whiskas did not increase and those retailers that reduced Whiskas' distribution did not suffer any loss of market share".

⁴²⁴ See an analogous analysis in the Spanish Grocery Report, Section II.4.2 ("Factors that determine bargaining power") and Section II.4.3 ("Bargaining power in Spain"). Against this background, it is impossible to reconcile the European Commission's conclusions in the Rewe/Adeg Decision (discussed below, in Section 7.2.2.1) with the evidence available at the time of the Rewe/Meinl Decision and beyond the merger control area. See for example, the Report of the Austrian Competition Authority published in 2007 ("the Austrian Grocery Report"), analysed in e-Competitions, "The Austrian competition authority concludes general inquiry in the highly concentrated food distribution sector while highlighting indications of strong buyer power (*Branchenuntersuchung Lebensmittelhandel*)", June 2007. The Report focused on the buyer power of the leading supermarkets (the two largest retail groups had in 2005 a combined market share of 57% or, if discount stores were excluded, 72.7%). The Authority followed the criteria used by the Commission in the Rewe/Meinl Decision, both in terms of definition of product categories and of the thresholds for relevance of buyer power, and therefore identified nine distinct procurement markets capable of giving competition concerns. The Authority also took into account the emergence of supermarket brands and the risk of arbitrary exclusion of certain products from the retailers' shelves. The Report also found that supermarkets were able to impose retroactive rebates or ex-post negotiations which may affect, without objective justifications, the business plans of the suppliers, and

compared to the leading supermarkets⁴²⁵. It also noted the strong loyalty to the supermarket at the expense of individual grocery brands, including the leading brands⁴²⁶. Finally, it verified that switching of supermarkets by independent grocery brands was financially burdensome at a 5-10% level of sales and became financially unsustainable at a 20-22% level of sales⁴²⁷. Likewise, the Carrefour/Promodès Decision followed the same reasoning advanced in the Rewe/Meinl Decision.

undermine their investment activity. The Report concluded that there were indications of buyer power in the Austrian food distribution sector that could run counter to Art. 4 (3) of the Austrian Competition Act, which prohibits the abuse of economic dependence.

⁴²⁵ The Rewe/Meinl Decision, par. 103: "Rewe/Billa and Meinl, on the other hand, are not dependent on individual suppliers. The leading supplier to the Rewe group (the Nestlé group) covers, according to the notification, only about [...] % of the volume of purchases. In the case of Meinl, the leading supplier covers approximately [...] % of the volume of purchases. The result is a much heavier dependence of the supplier side on Rewe/Billa/Meinl than the other way round. This is the norm, moreover, with large food retailers. Range flexibility in the trade is far greater than the flexibility of producers in production and distribution. Hence it is much easier for the trade not to buy something than it is for the producer not to produce it. This puts the market share study well and truly into context."

⁴²⁶ The Rewe/Meinl Decision, pars. 104-106: "(104) The parties argue, by contrast, that they, for their part, are dependent on certain producers. This is true, they say, of one branded goods producer who makes "must carry" products, as Rewe/Billa and Meinl risk losing customers if those products are not on their shelves. They add, moreover, that, in view of the strong preference of Austrians for Austrian products, there is for the same reason a dependence on Austrian producers. The latter argument is not valid, however. While it may be true that Rewe/Billa and Meinl cannot do without Austrian products, especially in the fresh produce sector (such as dairy products and bread), a dependence on individual suppliers cannot be deduced from this. The Commission's investigations have established that there are in the fresh produce sector a large number of Austrian suppliers potentially at the parties' disposal. If individual suppliers drop out, there are sufficient alternatives for the parties to turn to. (105) The answer to the question as to the extent to which a trader is dependent on branded goods producers depends on what consequences the non-availability of certain brands has for the trader. What matters here is how the trader's customers react to the absence of a product. In the case of foodstuffs purchases, the duration of a shopping trip is an essential consideration to customers. One-stop shopping, meaning buying everything needed from one shop, is preferred. If a branded product which the customer wants is not stocked by such an outlet, the risks have to be weighed up that the customer might: (1) stop shopping or put off making the purchase till later, (2) go to another shop to look for the desired article, but otherwise remain faithful to "his" trader, (3) take his business elsewhere in the longer term, or (4) buy another brand. (106) The answer depends first on the importance of the product to the customer, and secondly on the availability of alternative sources of supply. In the case of foodstuffs which are purchased frequently and for which the convenience of shopping as a rule outweighs other aspects such as price and quality, the importance of the product is somewhat slight. This is all the more true if the customer finds in his shopping environment almost nothing but outlets of one and the same trader. It can accordingly be assumed that, in the event of a delisting of branded goods, the trader suffers less than the producer, especially since he will usually have more alternative possibilities open to him."

⁴²⁷ The Rewe/Meinl Decision, pars. 97 and 101-102: "(97) For these reasons [switching between different sales channels is extremely difficult] and because of the large role played by the food-retailing trade in the sale of products in the above categories in Austria, it follows that a "lost" food-retailing trade customer is as a rule difficult for producers to replace. The producers surveyed stated that they could replace without difficulty only small food-retailing trade customers (accounting on average for less than 5 % of turnover). Even food-retailing customers accounting for 5 to 10 % of turnover are, according to the same source, not easy to replace. Switching to other sales channels is normally out of the question owing to the difficulties referred to above. And the larger producers, both international and Austrian, especially already have as a rule, attained a very high degree of distribution through all sales channels and in particular through all the major food retailers. This shows clearly that in Austria the opportunities for producers to switch to other buyers are much more limited than the opportunities for buyers to switch to other producers. (101) The Commission asked producers above what proportion of turnover, with a given customer could not be switched to other sales channels without difficulty. It transpired that on average 22 % of turnover is the figure above which a customer can be replaced only at the cost of very heavy

However, ever since these decisions, conventional competition analysis has dissociated supermarkets' practices vis-à-vis independent grocery brands from the concept of market power (i.e., monopsony/oligopsony power under conventional terminology) and, instead, has associated them with bargaining power in specific bilateral settings⁴²⁸. The European Commission's finding of a threat threshold in the Rewe/Meinl and Carrefour/Promodès Decisions was certainly linked to a single-firm dominance analysis⁴²⁹, despite the use of the concept "economic dependence" in the Carrefour/Promodès Decision⁴³⁰, but the Commission has since abdicated from this analysis⁴³¹.

Supermarkets enjoy market power (not merely bargaining power)

This distinction between monopsony power and bargaining power seems to be sterile and misguided for the following reasons:

First, as explained above, supermarkets are operating as sellers of services to independent grocery brands⁴³². Therefore, the distinction between seller power and buyer power loses all meaning in this market. As a result, the dilemma between monopsony power and bargaining power, exclusively associated with the analysis of buyer power, is devoid of purpose⁴³³.

Second, the conceptual distinction between monopsony power and bargaining power loses ground where the measurement tool for both is identical. Conventional competition analysis rightly holds that the extent of a buyer's monopsony power is determined by the existence of alternative buyers for sellers⁴³⁴, but it proposes the same

financial losses, if at all. The parties have contended that a producer behaving in an economically realistic manner must be able to withstand turnover reductions of up to about 20 %. The Commission proceeds in this case, having regard to supplier structures in the indicated procurement markets and assuming the existence of a dominant position in the distribution market, on the premise that the position which Rewe/Billa will occupy in the procurement markets after the operation takes place will be of an order of magnitude such that either a dominant position is created or an existing dominant position is strengthened. (102) It must be borne in mind here firstly that, when they lose a major customer, producers do not have much in the way of alternatives. In the food-retailing trade, especially if the firm concerned is already on the list of the leading competitor Spar, only small competitors are left, and they are hardly in a position to take up a large share of turnover. Switching to other sales channels is difficult, costly and, in the short term at least, generally impossible. Switching to exports, mentioned by the parties as an alternative, is likewise not feasible in the short term. To build up export markets, an on-the-spot presence and an intensive, costly canvassing of the market are normally necessary. The Commission has information in its possession which indicates that it can take about five years to attain a satisfactory level of exports, to Germany for example. The upshot is that already on the supplier side there is a strong dependence on Rewe/Billa/Meinl, a dependence which will grow as a result of the merger." Interestingly, even the merging supermarkets accepted that a turnover reduction of 20% would not be sustainable for an independent grocery brand.

⁴²⁸ OECD 2009a, Executive Summary, pp. 9-12.

⁴²⁹ See below, Section .

⁴³⁰ The Carrefour/Promodès Decision, par. 52.

⁴³¹ See, for a recent example, the Rewe/Adeg Decision, discussed below, in Section 7.2.2.1.

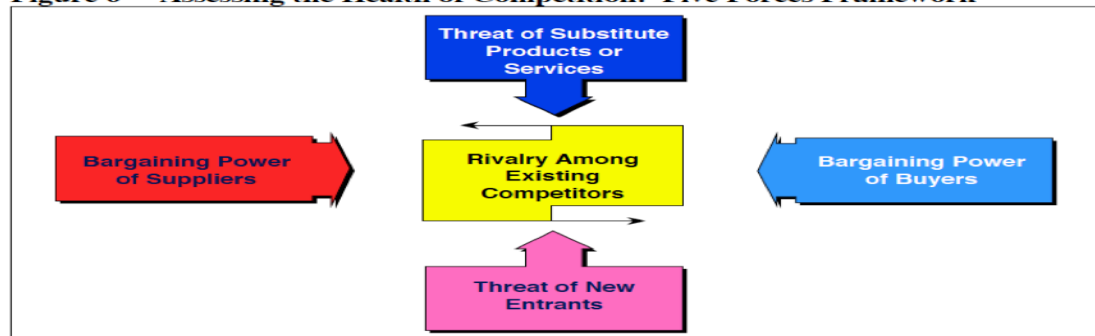
⁴³² See above, Sections 5.1.3.

⁴³³ See above, Sections 5.2.2.

⁴³⁴ OECD 2009a, Executive Summary, p. 10: "If sellers can easily find other buyers, then a buyer will have limited monopsony power. Other buyers may be in different geographic regions, have a different use for the input, or demand a different input that can be made from the same productive assets.

methodology to assess a buyer's bargaining power⁴³⁵. Indeed, the Spanish Competition Authority has held that most markets, including the grocery retail market, see a small number of sellers and buyers negotiating bilateral agreements and, therefore, the concept of bargaining power is the only one that suits real markets⁴³⁶. This is certainly the view of economists such as Porter (see his "five forces framework" below), as well as anyone familiar with real-life markets:

Figure 6 Assessing the Health of Competition: Five Forces Framework



Source: M.E. Porter, *Competitive Strategy: Techniques for Analyzing Industries and Competitors* 187 (1980).

Third, the Rewe/Meinl Decision's analysis of substitutability of buyers (supermarkets), including the 5-10% "significant loss" threshold and the 20% "irreparable loss" threshold, covered the whole market (category by category) and not purely bilateral negotiations between large supermarkets and small suppliers. It means that any supermarket above a 5-10% market share is not substitutable for most, if not all, suppliers (weighted by their market shares in a given product category). In this regard, the very low threat thresholds indicate that many supermarkets are able to impose unfair/exclusionary terms of business to many, if not all, independent grocery brands and that retail competition does not prevent them. This amounts to a higher degree of market power in the hands of supermarkets than the standard of market power applied by competition authorities when they assess the seller (market) power of independent

The relevant market for the purpose of identifying monopsony power is the smallest set of products in the smallest geographic area such that a hypothetical monopsonist of those products in that area would be able to depress prices by a small but significant and non-transitory amount".

⁴³⁵ *Id.*, Executive Summary, p. 10: "The greater the effectiveness of a buyer at bargaining, the larger the buyer's outside option, and the smaller the outside option of the seller, the greater the share of incremental surplus captured by the buyer. The value of the buyer's outside option depends on its ability and willingness to substitute alternative suppliers. Similarly, the value of the seller's outside option depends on its ability and willingness to substitute alternative buyers."

⁴³⁶ The Spanish Grocery Report, p. 107: "La concepción del poder de compra como poder de monopsonio resulta más apropiada para mercados de *commodities*, donde existe un precio uniforme y donde compradores y vendedores interaccionan sobre la base de unas reglas fijas de intercambio. El poder de compra como poder de negociación es más descriptivo de mercados donde existen relativamente pocas empresas aguas arriba y aguas abajo, por ejemplo, grandes distribuidores y grandes fabricantes, y éstas negocian de modo bilateral sobre las condiciones y términos de aprovisionamiento. Al contrario de lo que sucedería en un contexto de monopsonio, en este contexto los compradores negocian descuentos individuales y pueden existir grandes diferencias en los precios que pagan los distintos distribuidores. En principio, el escenario que mejor refleja la mayor parte de las relaciones entre los distribuidores y sus proveedores es el de poder de compra como poder de negociación". This conclusion vindicates the methodology proposed by Michael Porter.

brands. For example, in the framework of Article 102 TFUE or merger control, the European Commission has not hesitated to find single-firm dominance if a seller of an intermediate good held a +40 market share. This means that companies operating in the final good market and/or end-product customers up to 60% of the total demand were not even direct/indirect customers of the dominant seller⁴³⁷. Therefore, the latter was not able to engage into any exploitative/foreclosure practice in respect of these non-customers making up a majority of the purchases/final product. By the same token, the “dominant” seller’s bargaining power was therefore confined to a narrow set of direct/indirect consumers. Likewise, the EU Vertical Guidelines hold that market power may exist below 40% market share levels and intervention may be necessary against networks of parallel agreements by non-dominant sellers. For example, the European Commission offers as an example of anticompetitive single-branding agreements, those of a non-dominant consumer good company with a 40% market-share that has exclusive agreements with retailers regarding 90% of its sales (36% tied market-share). Therefore, if just 10% of the company’s sales are channelled through 64% of the retail market (measured by sales), it seems very plausible that the company does not hold any bargaining power vis-à-vis the largest constituency of the retail market⁴³⁸.

Supermarkets’ market power covers leading suppliers

However, in the modern grocery retail market, the evidence shows that a large proportion of supermarkets impose their standard terms and conditions on all independent grocery brands, large or small⁴³⁹. Even though some independent grocery

⁴³⁷ See, for an example in the grocery field, Commission Decision of 9.11.2007, Case No COMP/M.4824 - KRAFT/ DANONE BISCUITS (combined market shares for brand sweet biscuits and savoury biscuits of 45-55% and 35-45% respectively in the Spanish wholesale market). This argument is even stronger if the dominant seller’s market share is shared by many customers on a non-exclusive basis, which would show that the seller is not an unavoidable partner for any of them.

⁴³⁸ The EU Vertical Guidelines, par. 149: “Example of non-compete obligation: The market leader in a national market for an impulse consumer product, with a market share of 40%, sells most of its products (90%) through tied retailers (tied market share 36%). The agreements oblige the retailers to purchase only from the market leader for at least four years. The market leader is especially strongly represented in the more densely populated areas like the capital. Its competitors, 10 in number, of which some are only locally available, all have much smaller market shares, the biggest having 12%. Those 10 competitors together supply another 10% of the market via tied outlets. There is strong brand and product differentiation in the market. The market leader has the strongest brands. It is the only one with regular national advertising campaigns. It provides its tied retailers with special stocking cabinets for its product. The result on the market is that in total 46% (36% + 10%) of the market is foreclosed to potential entrants and to incumbents not having tied outlets. Potential entrants find entry even more difficult in the densely populated areas where foreclosure is even higher, although it is there that they would prefer to enter the market. In addition, owing to the strong brand and product differentiation and the high search costs relative to the price of the product, the absence of in-store inter-brand competition leads to an extra welfare loss for consumers. The possible efficiencies of the outlet exclusivity, which the market leader claims result from reduced transport costs and a possible hold-up problem concerning the stocking cabinets, are limited and do not outweigh the negative effects on competition. The efficiencies are limited, as the transport costs are linked to quantity and not exclusivity and the stocking cabinets do not contain special know-how and are not brand specific. Accordingly, it is unlikely that the conditions of Article 101(3) are fulfilled.”

⁴³⁹ As explained above, the use of standard terms & conditions is quite common among competitive bottlenecks and Council Regulation 93/13 regulates them in the Business-to-Consumer (B2C) relationships on unfair terms in consumer contracts. See, in particular, article 3: “1. A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of

brands may have more relative bargaining power than other independent brands, supermarkets have not shied away from delisting leading independent brands in order to impose their terms on these brands, which could have been considered to be dominant under the conventional competition analysis⁴⁴⁰. For example, the seven largest supermarket in the US, Costco, delisted Coca Cola until a satisfactory agreement was reached⁴⁴¹; the Belgian supermarket, Delhaize, delisted hundreds of Unilever SKUs until a satisfactory agreement was reached⁴⁴²; the Spanish supermarket Mercadona delisted, from one day to the other, more than 800 references, among which leading brands⁴⁴³; the Swiss supermarket, Co-op delisted several Procter&Gamble references in order to force it to lower its wholesale prices⁴⁴⁴. Industry insiders provide other examples of leading brands temporarily or permanently delisted by supermarkets in other Member States⁴⁴⁵. The Latin aphorism “*a maiori, ad minus*” is applicable to the delisting of leading independent brands. If supermarkets can delist leading brands without bearing any economic harm or, at least, bearing much less economic harm than the delisted brand, there is no doubt that they can delist other non-leading independent brands at will. Furthermore, if supermarkets can delist all independent grocery brands,

good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer. 2. A term shall always be regarded as not individually negotiated where it has been drafted in advance and the consumer has therefore not been able to influence the substance of the term, particularly in the context of a pre-formulated standard contract. The fact that certain aspects of a term or one specific term have been individually negotiated shall not exclude the application of this Article to the rest of a contract if an overall assessment of the contract indicates that it is nevertheless a pre-formulated standard contract. Where any seller or supplier claims that a standard term has been individually negotiated, the burden of proof in this respect shall be incumbent on him. (...)”

⁴⁴⁰ Public delisting only represents the tip of the iceberg. A supermarket will normally get away with its wishes on the basis of a simple threat of delisting. Threats may be escalated with in-store discriminatory practices that undermine brand sales. If these practices are not sufficiently heart-sweetening, they may be reinforced with partial delisting of the leading brand or secondary brands owned by the same company. Finally, if everything else is not sufficient to subjugate the leading brand, the supermarket will announce pompously that it is delisting the independent grocery brand. This practice will send a strong message to the market: independent grocery brands will face delisting if they do not give in to supermarkets' wishes.

⁴⁴¹ Bloomberg, “Costco Stops Restocking Coca-Cola Products in Dispute”, 16.11.2009. On November 16, 2009, Costco announced that it would stop selling Coca-Cola products due to the soft drink maker refusing to lower its wholesale prices. Following intense negotiations, both companies reached a fresh agreement on December 14, 2009.

⁴⁴² Bloomberg, “Unilever Talks With Delhaize After Grocer Scraps 320 Products”, 11.02.2009. On February 10, 2009, Delhaize announced that it had stopped buying 250 Unilever products. Weeks before it had already removed 70 other Unilever products and announced that it could not guarantee that new Unilever products would get shelf space. On March, 6, 2009, both companies reached a fresh agreement.

⁴⁴³ Expansión, “Mercadona fuerza la selección natural en sus estanterías”, 13.01.2009.

⁴⁴⁴ European Supermarket Magazine, “Coop delists P&G brands”, 21.10.2011. Coop delisted 35 references.

⁴⁴⁵ Thomassen 2006, pp. 23-24: “In 2004 one of Scandinavia's biggest retailers, the COOP, decided that Kellogg's was not being a sport as it was failing to comply with the pricing wishes of the big retailer. This resulted in Kellogg's being delisted in all of the COOP's Scandinavian stores. The market could not believe it. We suspect that neither could Kellogg's, which as a result was rumoured to have lost hundreds of million of kroners in annual turnover... In 2005, after nine months' absence Kellogg's was back in the COOP stores and we suspect that the COOP got what it had initially wanted as it relisted the cereal brand on its shelves. Talk about being squeezed (Jessen, 2005)!... More importantly, it is not a unique story. For a while almost all of Gillette's products were removed from the shelves in another large-scale Scandinavian retailer, ICA.”

they may employ other less traumatic anticompetitive practices (i.e., unfair practices and/or gradual or creeping vertical foreclosure) as well. As a consequence, none of the leading brands, let alone other brands, is immune to the leading supermarkets' anticompetitive practices described below in Section 5.5. For example, most supermarkets operate and expand their activities under a negative working capital model that is rather unique in the economy. Supermarkets extract from all their suppliers substantial credit terms (i.e., free-funding) that finance their business⁴⁴⁶. Furthermore, some of the anticompetitive practices are specifically targeted at the leading brands⁴⁴⁷, many of which are considered to be unavoidable trading partners by competition authorities without much more evidence than a high market-share on a given category or the supermarkets' self serving statements⁴⁴⁸. Finally, all grocery brands must buy the access services offered by supermarkets and pay the corresponding fees⁴⁴⁹.

The supermarkets' power to dictate the terms of business to all independent grocery brands, large or small, surfaces even in competition proceedings targeting independent grocery brands, despite it almost being a taboo for competition authorities⁴⁵⁰.

Evidence: Canadian chocolate cartel

In the "Canadian chocolate cartel", a large grocery wholesaler, ITWAL, threatened commercial retaliation against the leading chocolate confectionery brands if they did not reduce trade spending with competitors and control their retail prices⁴⁵¹.

⁴⁴⁶ See Appendix 8.1.1 for a description of the credit terms enjoyed by the leading UK supermarkets. Likewise, according to Fernández Reguero, "Análisis de una propuesta de inversión: Mercadona", 17.10.2010, p. 15, the largest Spanish retailer, Mercadona, enjoyed 46 days of free-trade from its suppliers in 2009, amounting to revenues of 1,833 million euro over its sales in that year. Likewise, Mercadona's Annual Report 2011 indicates that the company's short-term debt with suppliers is 2,091 million euro, whereas the company is just owed 78 million by consumers. Furthermore, the company has a cash availability (liquidity) of 2,576 million euro (positive working capital), which would enable it to pay its suppliers without the need for a credit-term.

⁴⁴⁷ See, for example, Sections 5.5.1.1 ("Misuse of sensitive commercial information") 5.5.2.1.1 ("Artificial price gaps") and 5.5.2.2.4 ("Copycats").

⁴⁴⁸ See, for example, the European Commission Decision of 9.11.2007, Case COMP/M.4824 - Kraft/ Danone Biscuits, par. 28. "The parties explained in their notification that none of their products should be considered as must-have brands in light of the fragmentation of the market. This has not been confirmed by the market investigation. As respondents explained, certain traditional biscuit brands and foreign brands with high recognition must be kept on shelves in order to attract consumers and remain profitable. In particular, respondents indicated that several brands of Kraft (such as Fontaneda, Oreo, Artiach, Marbú) and of Danone Biscuits (e.g. LU, Principe) are must-have brands. When it comes to competitors' brands, Cuétara is considered as having must-have products by half of the respondents (Cuétara is the only brand of the Cuétara company and accounts for the entire market share of Cuétara). In view of the fact that retailers stock on average around 16 brands of sweet biscuits, the transaction as initially notified would combine half of the must-have brands of biscuits in the Spanish market. Therefore the merged entity would become an unavoidable trading partner for these retailers."

⁴⁴⁹ See the French judgments condemning services imposed by supermarkets to all grocery brands, mentioned above, in note 93.

⁴⁵⁰ The market power of supermarkets vis-à-vis leading brands, has always been a taboo under the conventional competition analysis of seller power, because it would turn upside down the decades-old competition practice in the field of vertical restraints (e.g., prohibition of retail price maintenance), single-firm dominance (e.g., leading brands impose agreements on supermarkets that foreclose smaller brands); and merger control (e.g., leading brands are unavoidable trading partners).

Evidence: the Toys “R” Us case

The “Toys “R” Us case” in the US also exemplifies how a toy retailer with a 20% share of the market for toy retailing in the US becomes a “critical” trading partners for toy manufacturers⁴⁵² and can force them to stop doing business with smaller retailers⁴⁵³.

⁴⁵¹ See civil action by Giant Eagle Inc. v. The Hershey Company, Hershey Canada Inc., Mars Canada Inc., Mars, Incorporated, Nestlé Canada Inc., Nestlé S.A., Nestlé USA, Inc., Cadbury Adams Canada, Inc., Cadbury Schweppes plc, and ITWAL Ltd., 26.03.2008. The complaint reveals the information submitted to a Canadian court by the Canadian Competition Authority in support of a request for a search warrant, including the following evidence of the ITWAL’s role in this alleged infringement: “ITWAL, while engaged in the supplying of chocolate confectionery products, during the period commencing as early as February 2002, and continuing until at least February 2004, the exact dates being unknown, did by agreement, threat, promise or like means, attempt to influence upward, or to discourage the reduction of, the price at which Cadbury [Adams Canada Inc.], Hershey [Canada Inc.], Mars [Canada Inc.] and Nestlé [Canada Inc.] supplied or offered to supply or advertised chocolate confectionery products within Canada, and did thereby commit an indictable offense contrary to paragraph 61(1)(a) of the Competition Act, RSC 1985, c C-34.” (p. 22 of the complaint); ITWAL during the period commencing as early as February 2002, and continuing until at least February 2004, the exact dates being unknown, did by threat, promise, or like means, attempt to induce suppliers, namely Cadbury [Adams Canada Inc.], Hershey [Canada Inc.], Mars [Canada Inc.] and Nestlé [Canada Inc.], as a condition of ITWAL doing business with the suppliers, refuse to supply chocolate confectionery products to a particular person or class of persons because of the low pricing policy of that person or class of persons, and did thereby commit an indictable offense contrary to subsection 61(6) of the Competition Act, RSC 1985, c C-34.” (p. 22 of the complaint); The filing cabinet in the office of Elizabeth Cloran, assistant to Ross Robertson, the Vice President and General Manager, and Glenn Stevens, the President and CEO of ITWAL, contained letters dated February 21, 2002 from Stevens addressed to each of Bob Leonidas (Nestlé [Canada Inc.]), Rick Meyers (Hershey [Canada Inc.]), Don Robinson (Mars 24 [Canada Inc.]), and Arthur Soler (Cadbury [Adams Canada Inc.]). The letters are substantively the same and the following statement is taken from the letter to Nestlé [Canada Inc.]: “At the ‘end of the day,’ it is only the suppliers’ control and discipline of trade spending that can restore the functionality of the marketplace. The problem is very serious and completely out of control on the part of the suppliers. I am being forced to reexamine how we operate in the market and I am not sure it would be in the best interests of Nestlé. I urge you to meet and take action before this chocolate bar ‘bubble bursts.’” (p. 23 of the complaint); A folder labeled “TAN [Take Action Now] notices” was found in a filing cabinet in the office of Ms. Cloran and contained a number of letters from ITWAL addressed to various persons including employees of Cadbury [Adams Canada Inc.], Hershey [Canada Inc.], Mars [Canada Inc.] and Nestlé [Canada Inc.]” (p. 23 of the complaint); The TAN notices folder contained a “TAN Information Bulletin” dated March 7, 2002. Accompanying the TAN Information Bulletin was a fax cover sheet to each of Bob Leonidas (Nestlé [Canada Inc.]), Rick Meyers (Hershey [Canada Inc.]), Don Robinson (Mars [Canada Inc.]), and Arthur Soler (Cadbury [Adams Canada Inc.]). The faxes were all in substantively similar terms. The fax to Cadbury [Adams Canada Inc.] contains the following statement: “Further to my letter of February 21, 2002, please find attached information forwarded by Members on product and pricing available from diverters. In view of the seriousness of the problem, I will forward information as received under the acronym, T.A.N., which stands for ‘TAKE ACTION NOW!’ I trust you will accept the information in the spirit with which it is intended. I look forward to meeting with you to learn what steps Cadbury is taking to address this problem.” D. Glenn Stevens” (p. 24 of the complaint). The complaint quotes other TAN notices that evidence the degree of monitoring exercised by ITWAL over the commercial actions of competitors and, indirectly, over the business dealings of independent chocolate brands with them.

⁴⁵² United States Court of Appeals Opinion Affirming the Opinion and Final Order of the FTC (7th Cir. August 1, 2000), Toys “R” Us, Inc., Petitioner-Appellant, v. Federal Trade Commission, Respondent-Appellee, Docket 98-4107, pp. 2-3: “TRU is a giant in the toy retailing industry. The Commission found that it sells approximately 20% of all the toys sold in the United States, and that in some metropolitan areas its share of toy sales ranges between 35% and 49%. The variety of toys it sells is staggering: over the course of a year, it offers about 11,000 individual toy items, far more than any of its competitors. As one might suspect from these figures alone, TRU is a critical outlet for toy manufacturers. It buys about 30% of the large, traditional toy companies’ total output and it is usually their most important customer. According to evidence before the Commission’s administrative law judge, or ALJ, even a company as large as Hasbro felt that it could not find other retailers to replace TRU--and Hasbro, along with Mattel, is

Indeed, a Commissioner of the FTC concurred with the finding that the retailer entered into several vertical anticompetitive agreements and dissented with the finding of a horizontal boycott by the toy manufacturers orchestrated by the retailer, on the grounds that the toy manufacturers were subjugated by the retailer's power⁴⁵⁴. One wonders whether the FTC would reach the same conclusion if Toys "R" Us engaged in the same practices discussed in Section 5.5.

Evidence: the Kerry/Breeo merger

Likewise, leading supermarkets' market power can be discerned even in merger proceedings involving independent grocery brands, despite the unwarranted focus of competition authorities on "must-have" brands. For example, this biased approach unravelled in the Kerry/Breeo merger between two leading grocery brands in the Irish market (they held combined market shares of 47% and 48% in the markets for rashers and non-poultry cooked meats, respectively). Under the conventional competition analysis, the Irish Competition Authority concluded that the merger combined under

one of the two largest toy manufacturers in the country, accounting for approximately 12% of the market for traditional toys and 10% of a market that includes video games. Similar opinions were offered by Mattel and smaller manufacturers."

⁴⁵³ United States Court of Appeals Opinion Affirming the Opinion and Final Order of the FTC (7th Cir. August 1, 2000), *Toys "R" Us, Inc., Petitioner-Appellant, v. Federal Trade Commission, Respondent-Appellee*, Docket 98-4107, p. 8: "Based on this record, the Commission drew three central conclusions of law: (1) the TRU-led manufacturer boycott of the warehouse clubs was illegal per se under the rule enunciated in *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284 (1985); (2) the boycott was illegal under a full rule of reason analysis because its anticompetitive effects "clearly outweigh[ed] any possible business justification"; and (3) the vertical agreements between TRU and the individual toy manufacturers, "entered into seriatim with clear anticompetitive effect, violate section 1 of the Sherman Act." FTC opinion at 46."

⁴⁵⁴ Opinion of Commissioner Orson Swindle, Concurring in Part and Dissenting in Part *In the Matter of TOYS "R" US, INC.*, Docket No. 9278: "The argument for a horizontal combination, on the other hand, lacks a firm foundation. As the majority makes clear, each manufacturer that entered into one of the vertical undertakings bowed to TRU's power in the market for toys. The majority opinion, true to the evidence in this case, casts TRU in the unmistakable role of the nation's preeminent year-round, full-line toy retailer -- the one customer whose patronage many manufacturers considered essential to survival. It is entirely plausible that particular manufacturers would react to pressure from TRU by deciding -- *on their own* -- to disfavor the club stores. No inference of horizontal agreement is necessary to make sense of the manufacturers' actions... Given the tension between the vertical and horizontal theories in this case, it is not surprising that the proof of the horizontal case is weak. Consider the vertical story: TRU was the toy retailing leviathan without whose business many manufacturers could not survive. TRU's very indispensability gave each toy manufacturer every incentive -- every *unilateral* incentive -- to knuckle under to TRU's demands regarding the clubs [footnote: *See id.* at 6, 70 *et seq.* for the majority's discussion of TRU's importance as a purchaser from the major toy manufacturers]. On the other hand, consider the thrust of the horizontal case: that TRU coordinated an agreement among the toy manufacturers to restrict their supply of toys to the clubs. Without convincing evidence of an agreement among the manufacturers, the majority opinion relies on the premise that such an agreement was necessary to execute TRU's scheme. This conclusion disregards the ample reasons that each capitulating manufacturer, *acting on its own*, had to obey TRU. TRU's hammerlock on the manufacturers made a horizontal agreement among the manufacturers simply unnecessary [footnote: My colleagues also assert that TRU's "'club policy' was squarely *contrary* to the independently determined business interests of the toy manufacturers." *Id.* at 57. That is true only if one disregards the great pressure that TRU brought to bear on the manufacturers -- pressure that derived from any rational manufacturer's weighing of the clubs' tiny position in the market against TRU's overwhelming presence. Once the club policy was in place, TRU's formidable power in the toy market clearly made compliance with the policy in each manufacturer's *individual* self-interest].

one corporate roof several “must-have” brands for supermarkets and prohibited the transaction⁴⁵⁵. This prohibition was appealed before the Irish High Court, which handed a landmark judgment highlighting supermarkets’ power vis-à-vis independent grocery brands (“the Kerry/Breeo Judgment”)⁴⁵⁶. The Judgment of the Irish High Court was vindicated by in the UK Competition Commission’s Kerry/Headlands Decision, possibly the first ever merger case where the competition analysis was conducted *ex post*⁴⁵⁷. It provided evidence that an independent brand holding approximately 50% of the frozen ready meals (“FRM”) market and supplying an even higher share of the supermarket brands’ input in that category, did not have any market power vis-à-vis UK supermarkets.

5.3.2.4 Supermarket alliances

The EU Horizontal Guidelines, and conventional competition analysis in general, essentially views supermarkets’ buying groups as combinations of merchants for the purposes of securing lower wholesale prices than those that would be negotiated individually by the individual members⁴⁵⁸. Certainly, potential anticompetitive effects are also discussed, such as the absence of pass-through of the better wholesale prices⁴⁵⁹, exploitation of suppliers leading to sub-optimal supply⁴⁶⁰, and collusion in the retail market as a consequence of the commonality of costs⁴⁶¹ and the exchange of commercially sensitive information⁴⁶². However, the conventional competition analysis suggests that they bring lower wholesale prices and, thus, they are pro-competitive⁴⁶³. Even though emphasis is placed on the need to pass-on these lower wholesale prices⁴⁶⁴,

⁴⁵⁵ Determination of the Irish Competition Authority, M/08/009 - Kerry/ Breeo, 28.08.2008.

⁴⁵⁶ High Court Judgment of 19.03.2009, Rye Investments Ltd -v- Competition Authority, [2009] IEHC 140. The judge hearing the case was Mr Justice Cooke, who had spent several years at the European Court of First Instance, where he heard numerous European competition cases. See full analysis of the judgment in Section 5.7.

⁴⁵⁷ UK Competition Commission, Kerry Foods Limited/Headland Foods Limited merger inquiry, Final Report, 22.12.2011 (“the Kerry/Headlands Decision”). See full analysis in Section 5.7.

⁴⁵⁸ The EU Horizontal Guidelines, par. 189: “Joint purchasing arrangements usually aim at the creation of buying power which can lead to lower prices for consumers.

⁴⁵⁹ *Id.*, par. 196: “In case the parties have a significant degree of market power (which does not necessarily amount to dominance) on the selling market(s), the lower purchase prices achieved by the joint purchasing arrangement are likely not to be passed on to consumers.”

⁴⁶⁰ *Id.*, par. 197: “If the parties have a significant degree of market power on the purchasing market (buying power) there is a risk that they may force suppliers to reduce the range or quality of products they produce, which may bring about restrictive effects on competition such as quality reductions, lessening of innovation efforts, or ultimately sub-optimal supply”.

⁴⁶¹ *Id.*, par. 208: “Purchasing agreements may lead to a collusive outcome if they facilitate the coordination of the parties’ behaviour on the selling market. This can be the case if the parties achieve a high degree of commonality of costs through joint purchasing.”

⁴⁶² *Id.*, par. 210: “The implementation of a purchasing agreement may require the exchange of commercially sensitive information such as purchase prices and volumes. The exchange of such information may facilitate coordination with regard to sales prices and output and thus lead to a collusive outcome on the selling markets.”

⁴⁶³ *Id.*, par. 212: “Purchasing agreements can give rise to significant efficiency gains. In particular, purchasing agreements can lead to cost savings such as lower purchase prices or reduced transaction, transportation and storage costs, thereby facilitating economies of scale.”

⁴⁶⁴ *Id.*, par. 214: “Efficiency gains attained by indispensable restrictions must be passed on to consumers to an extent that outweighs the restrictive effects of competition caused by the purchasing

the competitiveness of the retail market is almost taken for granted⁴⁶⁵. Furthermore, the EU Horizontal Guidelines offer a practical example of a pro-competitive agreement whereby several retailers with a combined 20% market form a buying alliance to compete against the two leading retailers (C1=35% and C2=60%), giving rise to a very concentrated market structure (i.e., C3=80%) that paves the way for a new buying alliance between the remaining retailers (i.e., C4=100%) or the addition of new retailers to the existing alliances (i.e., C3=100%)⁴⁶⁶. As a corollary, no buying alliance has ever been subject to competition proceedings in the EU.

Not surprisingly, supermarket alliances have sprung up at the national and international level and the scope of their activities is much broader than the conventional competition analysis suggests, as noted by the European Commission itself⁴⁶⁷.

Furthermore, these alliances often, if not always, function as a first access point vis-à-vis independent grocery brands and they can rely on any of the anticompetitive practices (e.g., access fees) that may distort brands' access to supermarkets⁴⁶⁸. The outstanding

agreement. Hence, cost savings that only benefit the parties to the purchasing agreement will not suffice. Cost savings need to be passed on to consumers, i.e., the parties' customers, e.g., in the form of lower prices on the selling markets. Lower purchasing prices resulting from the mere exercise of buying power are not likely to be passed on to consumers if the purchasers together have market power on the selling markets, and thus do not meet the criteria of Article 101(3). Moreover, the higher the market power of the parties on the selling market(s) the less likely they will pass on the efficiency gains to consumers to an extent that would outweigh the restrictive effects on competition."

⁴⁶⁵ See above, Section 3.

⁴⁶⁶ The EU Horizontal Guidelines, par. 216: "150 small retailers conclude an agreement to form a joint purchasing organisation. (...) They have a combined market share of 20% on both the purchasing and the selling markets. A and B are their two large competitors. A has a 25% share on both the purchasing and selling markets, B 35%. There are no barriers which would prevent the remaining smaller competitors from also forming a purchasing group. The 150 retailers achieve substantial cost savings by virtue of purchasing jointly through the purchasing organisation." The Commission considers that the alliance has a moderate market position on the purchasing and the selling markets, even though it would reach the threat threshold identified in the Rewe/Meinl Decision. Not a single mention is made of the impact of this alliance and the new market structure on suppliers. Indeed, the Commission "suggests" that the remaining retail competitors may form another alliance (or possibly join this one).

⁴⁶⁷ Commission staff working document, "On Retail Services in the Internal Market", accompanying document to the European Commission Report on Retail Market Monitoring: "Towards more efficient and fairer retail services in the Internal Market for 2020", SEC(2010) 807, 5.7.2010, p. 11: Within the grocery sector, to further leverage bargaining power against multinational suppliers, several EU retailers have created international buying alliances. The affiliates of such alliances can include large multi-EU market or smaller national and regional retailers. The aim is again to achieve economies of scale in purchasing through increased buying power by pooling together both expertise and volume across different Member States. Many of these buying alliances also aim at developing, sourcing and managing private labels on a larger scale. Furthermore, these groups can also work as a platform for exchange of management expertise (especially in the area of suppliers' listing and logistics) or even to undertake joint investments, although this is still the exception. Currently, there are 4 major buying groups at the European level: AMS [footnote: With shareholdings of Ahold (NL), Booker (UK), Dansk supermarket (DK), Hagar (IC), Elornos (GR), ICA (SW), Jeronimo Martins (PT), Kesko (FI), Migros (CH) WM Morrison (UK), Superquinn (IRL), Esselunga (IT), Delhaize (BE), Système U (FR), Uniarne (PT).], EMD [footnote: With a much broader membership of more than 1000 smaller retail chain across 22 European countries.], COOPERNIC [footnote: Set up as a cooperative with membership of Colruyt (B), CONAD(IT), COOP (CH), E Leclerc (F) and Rewe (D).], Agenor/Alidis [footnote: With shareholdings of Eroski (ES), Edeka (D) and ITM (FR)].

⁴⁶⁸ See, for example, the analysis of the access fees charged by buying groups in the market study of the Italian Competition Authority mentioned in Section 4 of this Report and the Système U Judgment

question is whether the access practices of supermarket alliances would survive the competition test that the competition authorities apply to agreements of sellers setting joint prices and other terms of service. For example, the European Commission considered in the MasterCard Decision that the MIF adopted by payment card networks included cost elements such as the free funding period afforded to credit card holders, the collection and write off of bad debts in the card holder side and the setting up and management of current bank accounts that did not sufficiently benefit retailers (par. 742 of the Decision). Furthermore, the existence of the alliance may facilitate anticompetitive practices by its members, because independent grocery brands will fear losing access to the whole alliance if they challenge or upset one of its members.

On the other hand, by combining their input purchases for their own brands, supermarkets are reducing competition between them and commoditising their own brand offering⁴⁶⁹. Furthermore, the joint development of their own brand can also act as a collective incentive to use discriminatory in-store practices against independent grocery brands.

No competition authority has ever imposed remedies on supermarket alliances aimed at avoiding excessive access fees, unfair commercial terms and discrimination of independent brands at the expense of the supermarket alliances's brand.

However, the Italian Competition Authority has recently opened infringement proceedings against a supermarket alliance on the basis that it may lead to a reduction of (1) variety, quality, innovation and investments on the part of its suppliers and (2) competition between the members of the alliance in the retail markets.

Interestingly, the alliance holds a 23% market share in the procurement market and the aggregate market share of its members in some retail markets is around 40%, thresholds that other competition authorities have considered not to raise competition concerns and would appear to be in line with the, arguably flawed, assessment of buying alliances exposed in the EU Horizontal Guidelines⁴⁷⁰.

2006, where the French Court condemned Système U, a network of retailers, for imposing access fees to its suppliers in the form of a service called "Action de construction et de diffusion de Tronc d'Assortiment Commun (TAC)". Interestingly, these access fees did not even secure access to the individual retailers, which were free to source the grocery brands of their choice. Indeed, grocery brands had to pay access fees also to these individual retailers in the form of a service called "Détention Numérique". For example, Danone paid Système U 28,25 million euro in 2003, out of which 18,13 million corresponded to TAC fees. Likewise, Nestle paid Système U 21,25 million euro in 2003, out of which 11,63 million corresponded to TAC fees.

⁴⁶⁹ See, for example, Kumar 2007, p. 33: "To leverage economies in sourcing beyond those that would otherwise be available to a single retailer, Ahold and eight other European retailers have formed an alliance that negotiates very hard with private label manufacturers on hundreds of products, from paper goods to soft drinks, which are then sold under the *consortium brand* Euroshopper". See also, Section 5.5.1.1.

⁴⁷⁰ See press release of the Italian Competition Authority, "GDO: Antitrust avvia istruttoria nei confronti della supercentrale d'acquisto 'Centrale italiana' e delle 5 catene distributive concorrenti per verificare l'esistenza di una possibile intesa, con potenziali effetti sia sui fornitori che sui consumatori", 12.12.2013: "La Centrale Italiana è un'alleanza tra catene concorrenti nel settore della GDO, creata con il principale obiettivo di centralizzare la funzione di contrattazione delle condizioni di acquisto delle

5.4 Theories of Harm

Competition authorities are increasingly trying to articulate the competitive concerns behind any competition case under a coherent theory of harm⁴⁷¹.

The conventional competition analysis of the grocery retail market focuses on the perceived existence of a virtuous circle of low purchase price and low retail prices. The theoretical background of this analysis is the neoclassic output-price model, where supermarkets take the role of consumers and, in stark contradiction with the long tradition of competition law enforcement against vertical restraints, a purist Chicagoan view of vertical power and integration as a pure rent-distribution exercise that promotes economic efficiency. Both economic models have received a well-deserved criticism:

On the one hand, the neoclassic output model, where only a seller and a final buyer interact, overlooks any consideration of the role of retailers in the configuration of the supply and demand. Indeed, the vast majority of economic studies on seller market power do not account for the behavior of retailers in the sellers' pricing strategies. One of the reasons is that information on wholesale prices and marginal costs of production or distribution are generally difficult to obtain and methods relying on demand side data, where only retail prices are observed, require the structural modelling of vertical contracts between manufacturers and retailers in an oligopoly model. Researchers have thus tried to develop methodologies allowing to estimate price-cost margins that are necessary for market power analysis and policy simulations, using only data on the demand side (i.e., sales quantities, market shares and retail prices). Until recently, most economic papers assumed that sellers set prices and that retailers act as neutral pass-through intermediaries or that they charge exogenous constant margins.

On the other hand, the Chicagoan view of the vertical chain as a single-monopoly profit to be shared-up between sellers and buyers (e.g., competition authorities claim that disputes between suppliers and retailers only concern rent-distribution) is blatantly incoherent with the long-history of competition policy intervention to promote intra-brand competition, ignores new economic theories that expose the exclusionary and

imprese aderenti, per ottenere risparmi di costo nella fase di acquisto delle merci. Delle 5 catene interessate dall'istruttoria, solo Sigma non detiene partecipazioni nella Centrale Italiana ma vi aderisce in base a un contratto di collaborazione e di mandato stipulato con Coopitalia. Il potenziale d'acquisto delle parti interessate dall'istruttoria si attesta mediamente intorno al 23% dei mercati di approvvigionamento: si tratta di un dato che indica un elevato potere di mercato nei confronti dei produttori, rafforzato dalla distribuzione territoriale delle quote di vendita delle imprese aderenti, di gran lunga superiori al 40 per cento in numerosi mercati locali. L'istruttoria dovrà verificare se l'alleanza riduca la capacità di competere di produttori efficienti ma contrattualmente più deboli, con effetti negativi, nel medio periodo, sulla varietà e/o la qualità dei prodotti, sugli sforzi di innovazione e sugli investimenti. Ugualmente andrà verificato l'impatto, nei mercati a valle, di un eventuale coordinamento delle politiche di vendite o, quanto meno, di una forte riduzione degli incentivi a competere: ne potrebbe derivare che i prezzi di acquisto più bassi ottenuti dall'accordo di acquisto in comune non siano trasferiti ai consumatori."

⁴⁷¹ See, for example, Zenger and Walker, "Theories of Harm in European Competition Law: A Progress Report" (February 22, 2012), *Ten years of the effects-based approach in EU competition law*, Denis Waelbroeck, ed., forthcoming.

collusive effects of vertical integration and relies on flawed/restrictive theoretic assumptions that have been widely criticised⁴⁷². For example, the Chicago school wrongly claims that an upstream monopolist protected by durable barriers to entry can claim a monopoly profit only once⁴⁷³; the use of non-realistic assumptions such as no price discrimination and fixed amount of the input in the final product⁴⁷⁴; and, most notably, the view that retailing is perfectly competitive and, therefore, the manufacturer-retailer relation amounts to a principal-agent arrangement⁴⁷⁵.

⁴⁷² For an overall critique of the Chicago School's views on antitrust, see Pitofsky (ed.), *How the Chicago School overshot the mark*, Oxford University Press, 2008. A European systematic critique was advanced in Cucinotta, Pardolesi and van der Bergh (eds.), *Post-Chicago Developments in Antitrust Law*, Edward Elgar, 2002. Two members of the FTC have also expressed criticism of the Chicago School and supported the need for a Post-Chicago vision in antitrust. See, for a measured view, Leary, "Antitrust Economics: Three Cheers and Two Challenges", Meeting of the Western Economic Association, July 7, 2001: "A number of economists have been closely identified with a critique of Chicago-School economics from within the economics profession itself. They have, for example, identified situations where vertical restraints may cause consumer harm or where predatory behaviour might pay off. Terms like "raising rivals' costs" and "network effects" have gained common currency and engage the attention of the antitrust community. A new level of complexity has been introduced by so-called "post-Chicago" economic theories. An appropriate analogy for me is the evolution of physics in the 20th century. Einstein did not demonstrate that Newton was wrong; Newton's equations will still yield the right answers in ordinary circumstances. But, there are certain extreme situations where Einstein's corrections have to be taken into account. Similarly, post-Chicago economists (or most of them) do not seem to claim that Chicago learning is wrong, but rather that it is incomplete". For an outright condemnation, see the Republican appointee and former Chicago School follower ("I fell in love with the rival Chicago School of economics after *GTE Sylvania* in 1976"), Rosch, "The Redemption Of A Republican", FTC Watch, June 1, 2009; and "Antitrust Law Enforcement: What To Do About The Current Economics Cacophony?", Bates White Antitrust Conference, Washington, D.C., 1 June 2009, pp. 6-7: "With the recent financial crisis, however, one has to wonder if the Chicago School's fundamental presumptions are still tenable. In a January speech before the New York Bar Association, I suggested that, in light of the economic crisis, the Chicago School was on life support if not dead. As it turns out, other Republicans—including many who have embraced the Chicago School over the years at least as fervently as I—share this view."

⁴⁷³ Riordan, "Competitive Effects of Vertical Integration", Columbia University, Department of Economics, Discussion paper Series 0506-11, 2005, p. 8: "If an upstream monopolist can use contracts to extract fully a monopoly profit from a downstream market, then there is no role for vertical integration to play in leveraging monopoly power to obtain any additional profit". The article describes five economic theories on the competitive effects of vertical integration: "Two theories, dubbed "single monopoly profit" and "eliminating markups", derive from the Chicago School. Two other theories, "restoring monopoly power" and "raising rivals' costs", are from Post-Chicago Economics. The remaining theory, "facilitating collusion" has long roots in competition policy, but only recently began to receive a firmer grounding in the modern economic theory of collusion" (p. 2). The first two theories advance pro-competition justifications for vertical integration. The last three do the opposite. The general discussion of these theories in this section draws from this article.

⁴⁷⁴ Riordan 2005, pp. 19-20: "The double marginalization argument for vertical integration breaks down if sufficiently powerful contracts enable efficient price discrimination. (...). The theory also fails if the downstream technology uses the monopolized upstream input in variable proportions with other inputs and it is not possible to control input usage contractually. In this case, any attempt of the upstream monopolist to raise W prompts the downstream industry to substitute toward other inputs. In this case, an inability of an upstream monopolist to dictate the input usage of downstream customers undermines the logic of the single monopoly profit theory".

⁴⁷⁵ Dobson and Waterson, "Vertical Restraints and Competition Policy", OFT Research Papers 12, 2006, p. 2: "The traditional Chicago view is based on what Steiner (1991) describes as 'single-stage modelling', with the vertical arrangement represented in terms of an uncomplicated principal-agent relationship, where the retailer is merely an agent to distribute the manufacturer's (i.e. the principal's) product. The retailing function is taken to be perfectly competitive by virtue of the standard characteristics of easy entry, numerous competitors, and a high degree of buyer and seller mobility in response to small price differences (due to homogeneity of retailer services and an absence of switching

All in all, conventional competition analysis has failed to take into account that any competition and consumer welfare analysis in the grocery supply chain must factor in that supermarkets' commercial relations with their suppliers and their in-store practices can influence horizontal competition between grocery brands and between themselves.

In contrast with the conventional analysis of supermarkets, the new economic paradigm of modern grocery retailing shows that:

- (1) the retail market is not perfectly competitive and
- (2) supermarkets have transformed themselves into bottleneck platforms offering services not only to shoppers, but also to independent grocery brands⁴⁷⁶.

Therefore, the traditional neo-classic model has to be enriched with the Post-Chicago⁴⁷⁷ economic literature on competitive bottlenecks and the economic theories on vertical foreclosure and collusion, which rely on modern game-theory analysis.

In this Section, supermarkets' practices are assessed under the following economic theories: (1) the (modernised) neo-classic one-sided price/volume model; (2) the two-sided competitive bottleneck model; (3) the anticompetitive access fees models; and (4) the vertical foreclosure/collusion models.

The modernised neo-classic model sticks to the simplistic price/volume analysis in a static setting but takes into account the role of supermarkets as providers of an output (shelf-space, which translates into variety and choice) that can be artificially restricted for anticompetitive purposes.

The two-sided competitive bottleneck is a more developed model. It serves to explain the origin of supermarkets' power vis-à-vis independent grocery brands and predicts

or search costs). Furthermore, even if one or more of these features is absent, it is assumed that manufacturers may use restraints to replicate perfectly competitive downstream conditions, e.g. by using resale price maintenance (RPM) or franchise fee extraction (i.e. two-part tariffs) to relieve retailers of their profits while at the same time correcting any pricing distortions.”

⁴⁷⁶ Dobson 2006, p. 2: “In contrast, the recent literature stresses that retailing is much more than simply being a mechanism for distribution. The ‘service’ provided by retailers contributes to the value which consumers place on the product. In particular, retailers provide both specific and general services to (potential) customers, including demonstration facilities, information, stocks, etc., so that demand is not exogenous to retailing. Moreover, this service provision is likely to result in retailers incurring fixed costs, many of which contain a sunk element, e.g. fixtures and fittings. The presence of these fixed costs and the market power that retailers may have from offering differentiated (or even unique) services imply that perfect competition is an unattainable ideal. Accordingly, it may be more appropriate to consider the effects of both manufacturers and retailers actions through ‘dual-stage modelling’, recognising that imperfect competition can be present at successive market stages. In these circumstances, manufacturer and retailer interests may be expected to diverge where externalities arise from individual rather than joint decision-making. Vertical restraints may then be a response to harmonise these interests either by one side of the market imposing its will on the other, or from mutual agreement when they are jointly preferred. While these restraints may increase the joint profits for the firms involved (by removing externalities), it cannot be presumed that these are socially desirable. Firms will generally desire to restrict competition to raise profits while in contrast society may prefer more intense competition.”

⁴⁷⁷ Hovenkamp is considered to be the first scholar that used the term “post-Chicago” in the antitrust field (“Antitrust Policy After Chicago”, 84 Mich. L. Rev. 213, 225, 1985).

anti-competitive effects on the side of grocery brands, whether the retail market is competitive or not. However, the fact that even efficient suppliers will be excluded from the supermarket platforms means that the grocery brand assortment (variety and quality) will be reduced and consumer choice restricted.

The economic theories on the anticompetitive effects of wholesale access fees in the retail market apply modern game-theory analysis in oligopolistic settings and predict supra-competitive retail prices or the foreclosure of smaller supermarkets.

Finally, the vertical foreclosure views of different branches of the new industrial economics offer a holistic explanation of the supermarkets' practices and their anti-competitive effects on the market.

5.4.1 Neo-classic model: output reduction

Under the neo-classic model, a monopoly will reduce output in order to increase prices (or the other way around). If the supermarkets' role of providers of services (sellers) to independent grocery brands (buyers) is factored in, then restricting shelf-supply or increasing access fees would amount to an output limitation/price increase. Furthermore, supermarkets' practices aimed at transferring unexpected risks or risks under their control onto independent grocery brands will create two types of inefficiencies associated with the monopolist environment. On the one hand, these practices lead to an X-inefficiency in the supermarkets' operations. They will not have any incentive to control and minimise trading risks (why tackle thefts and wastage if suppliers-competitors have to shoulder it?). On the other hand, they will create productive inefficiency (i.e., consumer surplus reduction) in the operations of independent grocery brands, which will not be able to operate efficiently if faced with unexpected costs or costs that they cannot control or minimise.

5.4.2 Competitive bottleneck model

Armstrong and other economists have shown that competitive bottlenecks can lead to socially inefficient outcomes and the European Commission and other competition authorities have endorsed this theory of harm. In particular, in the supermarket model developed by Armstrong, the prices paid to suppliers are always too low, whereas the prices charged to shoppers depend on the retail market power enjoyed by the supermarket and the overall effect is always socially undesirable (the harm to suppliers outweighs any benefit that shoppers could gain). Even though Armstrong contends that the harm is confined to the grocery supplier side, the fact that even efficient brands will be excluded from the supermarket platforms means that the grocery brand assortment will be reduced and consumer choice restricted. Therefore, harm on the grocery brand side irremediably causes harm on the consumer side.

The Armstrong neo-classic model (output/price) focused on supermarkets' power to lower purchase prices below competitive levels. Since lower purchase prices are in

principle pro-competitive, the European Commission has advocated regulatory remedies beyond competition law in order to safeguard social efficiency.

However, even if it is accepted that the goal of competition policy is to protect consumer welfare and not social welfare, this Report shows that supermarkets operate as two-sided platforms where both independent grocery brands and shoppers can be termed customers.

Furthermore, supermarkets offer distribution services to independent grocery brands and they may exploit their market power to the detriment of competition and consumers in many other forms not necessarily linked to lower purchase prices.

5.4.3 Anticompetitive access fees

The EU Vertical Guidelines devote Section VI.2.2.7 to “upfront access payments”⁴⁷⁸. They draw from the economic theory to discuss the pro-competitive and anti-competitive rationale for supermarkets’ access fees⁴⁷⁹.

On the efficiency side, the EU Vertical Guidelines argue that access fees may signal/screen the best new products⁴⁸⁰. On the anti-competitive side, three possible anticompetitive effects are mentioned: First, high access fees charged by large retailers may lead to exclusive supply arrangements with suppliers and the exclusion of smaller retailers⁴⁸¹. Second, high access fees paid by a large supplier may foreclose market

⁴⁷⁸ Upfront access payments are defined in the EU Vertical Guidelines, par. 203: “Upfront access payments are fixed fees that suppliers pay to distributors in the framework of a vertical relationship at the beginning of a relevant period, in order to get access to their distribution network and remunerate services provided to the suppliers by the retailers. This category includes various practices such as slotting allowances, the so called pay-to-stay fees, payments to have access to a distributor’s promotion campaigns, etc.”

⁴⁷⁹ See a full discussion of the different economic theories on access fees in the context of grocery retailing in Appendix 8.3.

⁴⁸⁰ The EU Vertical Guidelines, pars. 207-208: “207. However, the use of upfront access payments may in many cases contribute to an efficient allocation of shelf space for new products. Distributors often have less information than suppliers on the potential for success of new products to be introduced on the market and, as a result, the amount of products to be stocked may be sub-optimal. Upfront access payments may be used to reduce this asymmetry in information between suppliers and distributors by explicitly allowing suppliers to compete for shelf space. The distributor may thus receive a signal of which products are most likely to be successful since a supplier would normally agree to pay an upfront access fee if it estimates a low probability of failure of the product introduction. 208. Furthermore, due to the asymmetry in information mentioned in paragraph (207), suppliers may have incentives to free-ride on distributors’ promotional efforts in order to introduce sub-optimal products. If a product is not successful, the distributors will pay part of the costs of the product failure. The use of upfront access fees may prevent such free riding by shifting the risk of product failure back to the suppliers, thereby contributing to an optimal rate of product introductions.”

⁴⁸¹ The EU Vertical Guidelines, par. 204: “Upfront access payments may sometimes result in anti-competitive foreclosure of other distributors if such payments induce the supplier to channel its products through only one or a limited number of distributors. A high fee may make that a supplier wants to channel a substantial volume of its sales through this distributor in order to cover the costs of the fee. In such a case, upfront access payments may have the same downstream foreclosure effect as an exclusive supply type of obligation. The assessment of that negative effect is made by analogy to the assessment of exclusive supply obligations (in particular paragraphs (194) to (199)). See, for example, an economic modelling of anticompetitive access fees in Marx 2007.

access to small entrants⁴⁸². Third, high access fees in an oligopolistic retail setting may soften wholesale/price competition between retailers⁴⁸³.

The European Commission's approach has to be criticised on three accounts: First, the competitive effects of access fees cannot be dissociated from the trend towards growing vertical integration by supermarkets. As explained below, competitive bottleneck platforms have the incentive and capacity to increase access fees to competing independent grocery brands in order to promote their own brands and thereby reduce intra-platform and inter-platform competition. Second, competition analysis has so far failed to analyse the competitive effects of access fees in day-to-day practice, even though they are growing and are not limited to new product innovations. Third, the signalling/screening theory cannot explain the pervasiveness of access fees (all payments and deductions that are not related to the wholesale price) and has been criticised even by the proponents of the only other theory supporting access fees: the "promotional shelf-space" theory.

- (1) Access fees clearly exceed the introductory/opportunity costs of new products⁴⁸⁴.
- (2) Upfront access fees are not proportional because manufacturers bear the fee even when the new product is successful and raises the profitability of the supermarkets⁴⁸⁵.
- (3) Access fees are also charged to products that have been listed by supermarkets for a long time⁴⁸⁶.

⁴⁸² The EU Vertical Guidelines, par. 205: "Exceptionally, upfront access payments may also result in anticompetitive foreclosure of other suppliers, where the widespread use of upfront access payments increases barriers to entry for small entrants. The assessment of that possible negative effect is made by analogy to the assessment of single branding obligations (in particular paragraphs (132) to (141))".

⁴⁸³ The EU Vertical Guidelines, par. 206: "In addition to possible foreclosure effects, upfront access payments may soften competition and facilitate collusion between distributors. Upfront access payments are likely to increase the price charged by the supplier for the contract products since the supplier must cover the expense of those payments. Higher supply prices may reduce the incentive of the retailers to compete on price on the downstream market, while the profits of distributors are increased as a result of the access payments. Such reduction of competition between distributors through the cumulative use of upfront access payments normally requires the distribution market to be highly concentrated". See, for example, an economic modelling in Shaffer, "Slotting Allowances and Resale Price Maintenance: A Comparison of Facilitating Practices", RAND Journal of Economics, 22-1, 1991.

⁴⁸⁴ Klein and Wright, "The Economics of Slotting Contracts", George Mason University Law and Economics Research Paper Series 06-37, 2006, p. 33: "However, an explanation for slotting that is based on the increased transaction costs of stocking the larger number of products now carried by supermarkets is inconsistent with the fact that slotting fees are much greater than these narrow transaction costs."

⁴⁸⁵ Klein 2006, p. 34, footnote 48: "Screening models also generally do not take account of the possibility that manufacturers could make some alternative contingent arrangement, such as introductory price allowances based on sales and liberal refunds for product returns, to insure retailers against new product failure". See also Foros and Jarle Kind, "Do Slotting Allowances Harm Retail Competition?", CESifo Working Paper No. 1800, September 2006, pp. 19-20: "However, even proponents of the view that slotting allowances solve problems with asymmetric information, emphasize that there may be alternative instruments. In cases where the retailer does not fear that the manufacturer will go bankrupt, buy-back guarantees are an alternative signalling and screening device (NCA, 2005). Manufacturers that accept buy-back guarantees are more likely to have high quality".

⁴⁸⁶ *Id.*, p. 34: "However, this view of slotting also is inconsistent with the fact that slotting fees and other promotional allowances often are paid by manufacturers on established products with predictable

(4) Some supermarkets do not demand access fees at all, but lower wholesale prices⁴⁸⁷.

(5) Signalling/screening fails to answer why supermarkets are able to pass on costs (risks) to suppliers and not to customers⁴⁸⁸.

On the other hand, even though the “promotional shelf-space” theory is successful at exposing the flaws of the signalling/screening theory, it fails to justify the pro-competitive effects of access fees. It implicitly assumes that access to the supermarkets’ shelf-space is an asset that can be exploited vis-à-vis suppliers and argues that supermarkets prefer access fees instead of lower wholesale prices, in order not to compete them away. Therefore, it implies market power on the part of supermarkets and it unwillingly supports public control rather than a hands-off approach to access fees.

Indeed, the oligopolistic structure of the retail market (aggravated with monopolies/duopolies at the local level) and the competitive bottleneck role played by supermarkets vis-à-vis independent grocery brands enables supermarkets to substitute

demand, and that slotting contracts are often renewed after supermarkets have market experience with a particular new product.

⁴⁸⁷ *Id.*, p. 6, footnote 16: “Wal-Mart usually insists upon receiving the single best wholesale price that suppliers can offer in lieu of slotting fees. For example, Wal-Mart Chairman S. Robson Walton describes Wal-Mart’s policy as “encourag[ing] suppliers to quote us net-net prices. We don’t charge slotting fees, and we don’t take special deal money, reimbursements to cover double-coupon expenses, and so on.” S. Robson Walton, “Wal-Mart, Supplier-Partners, and the Buyer Power Issue”, 72 Antitrust L. J. 509, 519 (2005). Similarly, a Costco representative testified that “what we do is say, ‘are you paying other discounts or what is your menu of discounts,’ and if slotting is on there, we want to get the same bottom line. Whether they call it a slotting allowance or advertising allowance or promotional allowance doesn’t make a lot of difference.” (*FTC Report*, Eagan Tr. at 61.)”

⁴⁸⁸ *Id.*, p. 35: “Furthermore, the transaction cost and risk cost theories do not attempt to answer the fundamental economic question underlying the existence of slotting contracts, namely why consumers do not pay for the higher costs of supermarket operations in a higher retail price, rather than having manufacturers cover the increased costs with a per unit time slotting fee”. They extend a similar critique to the Sullivan’s model. It does not take into account that consumer demand for variety may be reflected in higher sales and profits for the supermarkets providing the optimum variety, without there being a need for charging manufacturers to find this optimum level. *Id.*, pp. 36-37: “However, consumers generally should be willing to pay for increased product variety that raises supermarket selling costs. Brand extensions, even if they do not decrease consumer search costs, presumably are valuable to consumers. A supermarket that increases its shelf space and takes on an increased number of new products, increasing its costs by decreasing its sales per square foot, is producing benefits for consumers in terms of increased product variety. Therefore, inter-retailer competition should result in supermarket compensation for this consumer benefit in the form of an increased margin and/or increased sales. Specifically, competition will result in supermarkets choosing the optimal subset of products that are demanded by consumers and consumers will “pay” for the increased costs of increased shelf space per dollar of sales in an increased supermarket margin, even if there is no decrease in search costs. In these circumstances, a separate slotting contract would not be necessary to compensate supermarkets for their higher selling costs. On the other hand, if there is not a consumer demand for increased variety, competition among supermarkets would not have led to an increased number of SKUs and higher retailer costs in terms of lower sales per square foot. Competitive supermarkets could have provided a more limited number of products and, hence, have larger sales per square foot and lower costs”. See also Foros 2006, pp. 19-20: “Slotting allowances may also be used to balance the risk between manufacturer and retailers regarding new products. However, buy-back guaranties will also be an alternative to slotting allowances for this rationale (Sudhir and Rao, 2006)”.

lower wholesale prices with higher access fees that are less likely to be competed away (as pointed out by Klein 2006):

First, shelf-space is a resource that supermarkets can restrict strategically (e.g., devoting more shelf-space to non-grocery products). Accordingly, the scarcity of shelf-space increases its value (price) to independent grocery brands. Second, the increase in access fees will lead to a growth trend in the wholesale prices and recommended retail prices to all supermarkets, since the fixed costs of the independent brand will have increased and its value signal (i.e., access fees) as well. Third, the retail price transparency will facilitate a general increase in supermarket retail prices. At the end of this process, leading supermarkets will have improved their competitive position via higher margins than their smaller competitors.

This anticompetitive dynamic was denounced by Aldi, a new entrant in the Australian retail market that did not charge access fees, in the context of the report prepared by the Australian Competition Authority:

“In dealing with suppliers, we do not charge them slotting, or any other fees, in order for them to obtain product exposure. We consider such arrangements to be inconsistent with our low cost approach and incompatible with supplying our own exclusive brand products. Ultimately the customer will carry the cost of slotting fees in the form of higher prices and they may also miss the opportunity to obtain the best value product. With slotting fees and other supplier funded promotional activity, customers are not offered the best product but the product that is able to pay for placement.”⁴⁸⁹

Likewise, French supermarkets have argued that access fees cannot be dissociated from the purchase price. In other words, independent grocery brands and supermarkets view access fees and wholesale prices as a whole: a higher access fee in favour of the supermarket will tend to be compensated by a higher purchase price in favour of the grocery brand⁴⁹⁰.

⁴⁸⁹ Australian Competition and Consumer Commission, “Inquiry into the competitiveness of retail prices for standard groceries”, July 2008, p. 339.

⁴⁹⁰ See the Carrefour Judgment I, 2009: “Attendu, ainsi qu’il en a été débattu lors de l’audience publique du 24 juin 2009, qu’il résulte de ces dispositions rédigées par les services du groupe Carrefour que l’accord de partenariat et l’accord commercial forment un seul et même contrat entre les parties; Attendu que cette indivisibilité juridique est aussi économique; qu’en effet aucun fournisseur ne prendrait le risque de fixer ses prix de vente sans tenir compte de l’accord de partenariat qui constitue une charge pouvant aller jusqu’à 35% du chiffre d’affaires, avec une moyenne de 19.45% pour ce qui concerne les accords visés par la présente instance; que c’est précisément dans le but de relever le seuil de revente à perte que le système dit de marges arrières a été instauré; qu’il s’ensuit que les prix de vente négociés par les fournisseurs sont substantiellement plus élevés que ceux qui seraient pratiqués en l’absence de marges arrières”; and the Carrefour Judgment II, 2012: “Le dernier paragraphe de l’accord-type de partenariat précise que «les parties sont liées par le présent accord de partenariat et l’accord commercial. Ces deux contrats forment un ensemble indivisible»...La société Carrefour Hypermarchés soutient que cette indivisibilité serait également économique, l’achat de marchandises par carrefour au fournisseur et la réalisation par ses soins de services de coopération commerciale formant, selon elle, une ensemble économique indivisible. Elle en déduit l’impossibilité de prononcer la nullité des clauses fixant la rémunération des services litigieux car cela conduirait à des conséquences disproportionnées”. However, the Carrefour Judgment II, 2012, considered that small suppliers are not capable of recouping through

Contrary to what some competition authorities and economic articles have assumed, this anticompetitive dynamic emerges naturally as a consequence of the high degree of concentration, transparency and entry barriers in the retail grocery market, without it being a necessary condition that contracts between each supplier and retailer are public. Indeed, several features of this market reinforce the transparency of supplier-retailer dealings⁴⁹¹:

First, as retailers reduce the shelf-space available in the market and, thus, their assortment, the number of wholesale tariffs and retail prices to be monitored diminishes.

Second, leading supermarkets constantly monitor competitors' retail prices⁴⁹². This monitoring enables them to match competitors' lower retail prices, reprimand the supplier whose brand is undersold by a competitor, pass-on to the supplier the "cost" incurred by the supermarket (i.e., reduced retail margins) via unilaterally imposed payments and deductions (e.g., retroactive amendments to their procurement agreement) and renegotiate their purchase agreement⁴⁹³. These reprisals force suppliers to worsen

wholesale prices all the access fees they pay supermarkets: "Il convient en effet d'observer que les PME sont confrontées à des difficultés croissantes pour obtenir le référencement de leurs produits par les distributeurs, en particulier pour celles commercialisant leurs produits sous marques propres, et qu'elles subissent un rapport de force de plus en plus déséquilibré faces aux groupes de la grande distribution qui s'est traduit par une tendance à la diminution des prix de cession net qu'elles obtenaient de la part desdits distributeurs. Il est donc illusoire de considérer, comme le voudrait l'appelante, que les PME peuvent à loisir revoir leurs tarifs à la hausse pour compenser les demandes de rémunérations abusives de services auxquelles elles se trouvent confrontées dans leurs négociations avec les fournisseurs."

⁴⁹¹ Some competition authorities have rejected the collusive effect of slotting fees on the ground that wholesale contracts are not observable by competing retailers. See, regarding the Nordic Competition Authorities, Foros 2006, p. 4: "The second critical assumption employed by Shaffer and other papers in the same tradition, is that wholesale tariffs are observed by rival retailers. This assumption is more dubious than that of irreversibility [footnote: The Norwegian Competition Authority (NCA) doubts that slotting allowances can be used by retailers as a facilitating practice à la Shaffer (as claimed in the press), since they find the assumption of contract observability unrealistic (NCA, 2005 [Payment for Shelf Space (Betaling for hylleplass), Report 2/05], and Gabrielsen and Sjørgard, 2005 [Hylleplassavgifter: Bedriftsøkonomiske motiver og samfunnsøkonomiske konsekvenser, The Norwegian Competition Authorities]). However, NCA has initiated an investigation to clarify the extent of information exchange between retailer groups."

⁴⁹² See the Canadian chocolate cartel, the Toys "R" Us case, and the Toys Decision, pars. 237-247. Interestingly, UK supermarkets told the Competition Commission that their buyers dealing with suppliers were expected to know the retail prices of their competitors, even if they were not surveyed! See, the UK Grocery Report 2000: "Many of the parties told us that their buyers were expected to know competitor prices for all the lines they were responsible for, even if these were not formally surveyed on a regular basis. This applied to any relevant competitors, as well as the parties."

⁴⁹³ See, for example, the Toys Decision and, in particular, pars. 248-249: "248. En réaction à ces écarts de prix, Carrefour a, dans certains cas, baissé le prix de produits lorsque l'écart était dû à une erreur de Carrefour sur les arrondis pour le calcul du seuil de revente à perte ou en cas de produits vendus par Carrefour au-dessus du seuil de revente à perte. 249. Dans d'autres cas, il a contacté les fabricants pour résoudre le « problème ». Ces contacts ont pu avoir pour résultat un alignement des concurrents sur le prix de Carrefour. Lorsque Carrefour n'a pas obtenu un alignement des prix des distributeurs, il a tenté d'obtenir des compensations financières des fabricants ou a retiré les produits de la vente. Les produits ont également été retirés de la vente à titre temporaire, en attendant qu'une solution soit trouvée." See also the Spanish Grocery Report, par. 192: "Another supermarket practice often applied to suppliers is the unilateral amendment of the contract with retroactive effects and the threat of delisting in order to obtain advantages not agreed in advance. 56% of the suppliers state that they have been regularly or occasionally

their terms to maverick supermarkets and/or to induce them to respect the supracompetitive retail prices desired by the leading supermarkets⁴⁹⁴.

Third, suppliers adopt wholesale tariff lists that are generally applicable to all supermarkets. The latter may bargain for lower tariffs or higher access fees. In light of the retail price transparency, any retail price undercutting by one of them is likely to be competed away by the others. Therefore, supermarkets favour higher access fees over lower wholesale prices⁴⁹⁵.

Fourth, leading supermarkets have the power to secure Most Favoured Customer treatment in their dealings with independent grocery brands⁴⁹⁶. These clauses can easily cover wholesale prices but are more difficult to enforce in respect of access fees⁴⁹⁷.

Fifth, buyer groups are prevalent in the grocery retailing and their purchase agreements with suppliers are visible to all their members. These buyer groups have an incentive to increase access fees (i.e., an upfront revenue) at the expense of the wholesale prices charged to the buyer group. This dynamic is common to all buyer groups and creates a cross incentive to raise access fees without regard for the level of wholesale prices⁴⁹⁸.

subject to retroactive amendments of the contractual terms previously negotiated with supermarkets”. This payment may be dressed-up as compensation for a service allegedly provided by the supermarket. See for an account of the massive scale of these later payments, par. 190: “The analysis of supplier replies reveals that the most widespread practice in the retail grocery is commercial payments and, in particular, listing and shelf replenishment fees (more than 70% of suppliers state that these payments are made frequently and more than 85% claim that they happen at least occasionally), as well as payments for auxiliary services (almost 60% of the suppliers state that these payments are made frequently and almost 80% claim that they happen occasionally)”. Furthermore, according to graph 19 in p. 81, more than 40% of suppliers are subject to other type of payments categorised as “atypical” (payments for retail sales or margins below expectations, obligation to repurchase unsold items or wedding presents”). See also the Leclerc Judgment 2009, where the Court found that Leclerc’s practice of forcing its suppliers to pay a monetary compensation, once it discovered that Carrefour had enjoyed better access fees, constituted an unjustified request for a retroactive payment.

⁴⁹⁴ See the Toys Decision, pars. 258-262 and, in particular, par. 262: “On constate aussi que des distributeurs (autres que Maxi Toys) se sont alignés sur le prix de vente de Carrefour alors que sur certains produits, leur seuil de revente à perte n’était pas le même que celui de Carrefour du fait de conditions d’achat différentes. C’est notamment le cas de La Grande Récré et Toys'R'Us qui avait acheté des produits Meccano hors de France en 2001 (RAE – Cote Pégase 37381). C’est aussi le cas en 2002 pour PickWick avec un produit Chicco (RAE – Cotes Pégase 37401 à 37402).”

⁴⁹⁵ Klein 2006.

⁴⁹⁶ The Spanish Grocery Report, par. 193: “23% of suppliers state that supermarkets have at some point in time imposed Most Favoured Customer clauses on them, i.e., they have been required to extend to another customer the best commercial terms offered to any customer” and par. 197: “ – leading suppliers are more often subject to threats of delisting and Most Favoured Customer clauses in their dealings with distributors.”

⁴⁹⁷ See, however, the evidence of growing transparency regarding access fees, in note 506.

⁴⁹⁸ Foros 2006, pp. 14-16: “Because wholesale contracts are unobservable between the buyer groups, the procurement headquarters cannot use the wholesale contracts strategically to raise the rival’s prices. However, each buyer group is aware of the fact that the rival has incentives to use slotting allowances to soften competition between its own sub-chains. Assuming that each procurement headquarters has correct expectations about the rival’s wholesale contract (which seems reasonable, since there is no uncertainty in the model), we find a unique symmetric equilibrium (...). Hence, the use of slotting allowances will in general increase the end-user price even though the wholesale contracts are unobservable across the buyer groups. (...). The assumption that the buyer groups have correct

Sixth, information flows between supermarkets arise naturally as a consequence of corporate transactions (e.g., M&A, alliances) and constant membership changes in buyer groups. Indeed, several sources have reported complaints by independent grocery brands regarding retroactive demands by a supermarket of the most advantageous terms offered to another supermarket, following a merger of both supermarkets.

Seventh, recommended retail prices provide a retail price benchmark and an indirect source of information on wholesale prices (i.e., the wholesale price is the recommended retail price plus an average supermarket margin).

Eighth, the leading supermarket in each market may act as a barometric leader at both the wholesale and retail level. Indeed, Wal-Mart (US) and Mercadona (Spain) seem to demand at the wholesale level a Most Favoured Customer treatment and they are more focused on net-net wholesale prices (i.e., most payments and deductions by suppliers are reflected in the invoiced unit price) and a retail strategy of “Everyday Low Prices”. Therefore, both supermarkets will know what the lowest wholesale price in the market is and what the lowest retail price could be and their retail tariff/margin acts as a reference for the remaining supermarkets⁴⁹⁹. On the other hand, the absence of sufficient retail competition should allow them to reap higher retail margins than their competitors, which are forced to make up this margin imbalance through higher access fees⁵⁰⁰.

Curiously, the European Commission did gauge in the Carrefour/Promodès Decision that French supermarkets were shifting their bargaining power from wholesale price

expectations about each other’s wholesale contracts, is of course a simplification which is due to the information structure in the model. However, we believe that it corresponds pretty well with reality. In its investigation of the Norwegian retail market, the Norwegian competition authorities found that even though the contracts between each buyer group and the producers were secret, the essence of the procurement contracts was widely known. This was revealed by the internal documents found in the investigated firms by the Norwegian Competition Authority, and it was confirmed by the respective market participants”.

⁴⁹⁹ Mercadona’s tariffs for the standard basket of independent brands and own brands are the price-benchmark for competitors. See Presentation by Netquest, “Let’s talk about Retail”, available in Rapidshare.

⁵⁰⁰ Even the proponents of the promotional services theory admit that the lowest wholesale prices do not translate into the lowest retail prices for market leaders such as Wal-Mart. See Klein 2006, pp. 31-32: “Inter-retailer competition considerations also explain why Wal-Mart accepts promotional shelf space payments primarily in the form of lower wholesale prices rather than slotting fees. Although Wal-Mart faces significant inter-retailer competition and passes on to consumers a large fraction of the overall wholesale price savings it receives, Wal-Mart is not forced by inter-retailer competition to pass on most of the wholesale price discount it receives from a manufacturer in a lower retail price of the particular manufacturer’s product. Wal-Mart’s policy is not to advertise low prices of individual products, but to advertise the fact that it has low overall everyday prices and this is the reputation it has created among its consumers. In addition to creating loyal customers who know that Wal-Mart charges a low overall package price on their purchases, Wal-Mart is not forced by competitive market pressures to pass a large fraction of any individual wholesale price discount on to consumers on the particular product’s retail price because competing retailers are compensated for promotional shelf space largely with per unit time payments. Consequently, manufacturers can obtain the benefits of making promotional payments for shelf space at Wal-Mart primarily with lower wholesale prices.” See also the information on Mercadona’s retail prices in Section 5.3.1.5.

negotiations to access fees⁵⁰¹, but it concluded that it was a manifestation of inter-supermarket competition rather than a sign of tacit collusion⁵⁰². The Commission's conclusion was difficult to reconcile with its own finding that the increase in access fees (due to the economic dependence of suppliers) run in parallel with higher wholesale prices that operated as minimum retail prices by virtue of the law⁵⁰³. For the future, the Commission warned that, since supplier-supermarket negotiations are a repetitive process⁵⁰⁴, they could bring about more transparency and merited a close monitoring⁵⁰⁵. Indeed, even though the Commission considered that hidden margins (access fees) were not transparent, evidence uncovered subsequently points to the opposite conclusion⁵⁰⁶.

⁵⁰¹ See a similar conclusion regarding the negotiations of suppliers with the Spanish supermarkets in Cruz Roche (Coordinator), *Los Canales de Distribución de Productos de Gran Consumo. Concentración y Competencia*, Ediciones Pirámide, Madrid, 1999, pp. 138-140 and Annex 12.5; and the comprehensive commentary of this practice in the Basque Grocery Report, pp. 162-175.

⁵⁰² The Commission noted that even though the "front margins" were increasingly uniform, the core of the supplier-supermarket negotiations had shifted to "back margins", where no transparency existed. See the Carrefour/Promodès Decision, par. 103: "Il apparaît en définitive qu'en dépit d'une relative uniformisation des marges avants, il n'existe, du moins pour le moment, aucune transparence ou échange d'informations concernant les marges arrières, conditions vers lesquelles le jeu concurrentiel s'est largement déplacé. Bien au contraire, il ne semble y avoir, pour les distributeurs, aucun intérêt à dévoiler à leurs concurrents les marges arrières qu'ils obtiennent auprès des fournisseurs, les marges arrières servant, entre autres, à développer les positions à l'aval."

⁵⁰³ The Carrefour/Promodès Decision, pars. 102: "Ainsi, en imposant de calculer le seuil de revente à perte à partir du prix unitaire sur facture et en interdisant aux distributeurs de déduire les marges dites «arrières» qui rémunèrent les services, la négociation entre les distributeurs et les fournisseurs s'est, dans une large mesure, déplacée des «marges avants» vers les «marges arrières», c'est-à-dire vers la coopération commerciale qui est le budget payé par l'industriel au distributeur pour la rémunération de services tels que la présence de son produit dans un prospectus publicitaire, la mise en avant de ses produits dans les linéaires ou en tête de gondole etc. En principe, distributeurs et fournisseurs devraient rechercher à coordonner leurs stratégies respectives afin d'optimiser le budget de coopération commerciale. Cependant, le développement des marges arrières peut également masquer des situations de dépendance du fournisseur par rapport au distributeur."

⁵⁰⁴ According to the economic game-theory, as applied to oligopolistic settings, the prisoner's dilemma (non-cooperative oligopoly), arising in a one game setting, transforms into a cooperative oligopoly in an infinite or finite, but indefinite, number of games.

⁵⁰⁵ The Carrefour/Promodès Decision, par. 104: "Néanmoins, la réalisation de la présente opération pourrait, dans le futur, donner lieu à d'autres rapprochements (alliances ou concentrations) dans le secteur et ce mouvement pourrait, dans certaines conditions et même compte tenu des particularités du secteur, conduire, à terme, à une situation de dominance collective. Cela résulte, en particulier, des conditions dans lesquelles, d'ores et déjà, sont conduites les négociations périodiques entre fournisseurs, en particulier les plus dépendants, et distributeurs: les premiers ne sont en position de demander des adaptations de conditions d'achat que pour autant qu'ils peuvent, sur base de l'évolution de leurs coûts (les rémunérations versées aux distributeurs au titre des marges arrières constituant une partie de ces coûts), en justifier le bien-fondé. Il en résulte, inévitablement, que chaque distributeur acquiert peu à peu une connaissance des coûts supportés par ses fournisseurs. Dans la mesure où le nombre de distributeurs serait encore réduit significativement, l'on pourrait craindre que, chacun d'eux disposant de la même information sur les mêmes fournisseurs, les conditions d'achat n'en viennent à s'uniformiser. L'évolution de ces éléments fera l'objet d'une attention particulière de la Commission dans l'examen des éventuels rapprochements à venir."

⁵⁰⁶ See, for example, the Toys Decision, par. 86: "De même, pour MegaBrands, les documents présents au dossier montrent que les relations avec Carrefour sont assises sur un montant global. Ainsi, les montants des services de coopération commerciale ne sont pas liés aux prestations elles-mêmes mais au niveau global des prestations et même au niveau des prestations payé à un concurrent. En effet, un message électronique interne à MegaBrands datant de mai 2001 explique la manière dont les conditions commerciales sont négociées avec Carrefour:...La suite du message précise que ces montants correspondent aux conditions que la centrale Auchan, qui les a transmis à Carrefour, a obtenu de MegaBrands en 2000 (-mail interne de MegaBloks sur leurs relations avec Carrefour – Cotes Pégase 1527

All in all, access fees by supermarkets have several anti-competitive effects, namely the exclusion of independent brands and the facilitation of collusion between supermarkets.

5.4.4 Anticompetitive vertical integration

Conventional competition analysis has considered that the competitive relationship between supermarkets and grocery brands is purely vertical and the theories of harm exposed by authorities and scholars have focuses on the principal-agent model (e.g., a single monopoly profit). Even if this vertical focus is accepted as a starting point, a modern competition analysis reveals that supermarkets' practices may lead to anticompetitive effects:

In the (modernised) neo-classic price/volume model, supermarkets may overcharge for access to their shelf/distribution services and thereby reduce the number of independent grocery brands present in supermarket platforms below competitive levels.

In the competitive bottleneck model developed by Mark Armstrong, supermarkets fix infra-competitive wholesale prices and thus exclude socially efficient manufacturers, even though price competition in the retail market may be intense. This model signals the power of supermarkets to exclude manufacturers under a linear-fee model corresponding to the traditional merchant model.

In the different economic models of anti-competitive access fees imposed by supermarkets, the predicted outcomes are the exclusion of smaller supermarkets or overall supra-competitive prices.

However, none of the above theories of harm contemplate the risk of vertical foreclosure of independent grocery brands by supermarkets. Likewise, competition authorities have been utterly reluctant to consider the critical horizontal angle of the relationship between vertically integrated supermarkets and independent grocery brands. When they have superficially addressed this question, they have made the simplistic argument that supermarket brands increase choice and lower prices, disregarding the net reduction in choice (massive disappearance of independent brands, some of which were cheaper than the supermarket brands) and the cross-subsidisation of the lower priced supermarket brands by the overpriced independent brands.

Indeed, vertical integration by supermarkets is not bad as a matter of principle and may

à 1528). Carrefour souhaite obtenir les mêmes. Ces relations sont également exposées dans une note manuscrite retrouvée chez MegaBrands sur lequel est inscrit (document manuscrit décrivant une réunion entre MegaBlocks et Carrefour – Cotes Pégase 1770 à 1775).” and the Leclerc Judgment 2009 (Auchan discovered that Carrefour enjoyed better access fees (“marges arrière”) and claimed that he was entitled to request this information from suppliers and to claim compensation for this differential): “Qu’il prétend avoir été victime de discrimination de la part de ses fournisseurs qui ont négocié avec son concurrent CARREFOUR un budget de coopération commercial supérieur à celui qu’il a obtenu”.

even create efficiencies (e.g., reduction of transaction costs), even though supermarkets rarely integrate fully upwards (e.g., R&D, production and packaging) and, very often, merely own the commercial brand. However, vertical integration may also create new incentives to adopt inefficient conducts that foreclose competitors without benefitting consumers. As pointed out by Lao 2012, only the practices that amount to an “unjustified affirmative interference with the natural workings of the Marketplace” and “affirmatively block a competitor’s efforts to compete” are the object of this report and should concern public authorities:

If a supermarket elects to make a 25% margin on an independent brand and a 5% or no retail margin on the competing supermarket brand, this conduct is neither neutral nor efficient from a competition and consumer-welfare standpoint. It shows that the margin made with the independent brand is likely to subsidise the margin of the supermarket brand (i.e., the business decision to launch and promote a supermarket brand) to the detriment of free undistorted competition between brands and consumers. If vertical integration allows the supermarket to work with a 5% retail margin on its own brand, fairness towards competing independent brands and consumers mandates a 5% margin on the latter. Likewise, if the independent brand is more profitable for the supermarket or, even more importantly, commands higher consumer acceptance, it is neither neutral nor efficient from a competition and consumer-welfare standpoint that the competing supermarket brand enjoys (1) pre-market access to the independent brand’s secret innovative efforts and business plans; (2) copycat packaging; and (3) privileged shelf-positioning.

In light of the above, it is necessary to assess supermarkets’ practices under the three theories of anticompetitive vertical integration⁵⁰⁷: (1) monopoly rent preservation⁵⁰⁸, (2) raising rivals’ costs⁵⁰⁹; and (3) facilitation of collusion⁵¹⁰.

(1) Monopoly rent preservation/expansion

Supermarkets may be faced with a commitment problem if they sequentially grant access to their shelves to competing grocery brands. Vertical integration, by reducing the shelf-space available for independent grocery brands, helps solving the commitment

⁵⁰⁷ These economic theories are fully discussed in Appendix 8.4. They have been encapsulated in the section of the European Commission Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings (“EU Guidelines on non-horizontal mergers”, OJ C-256/6, 18.10.2008) devoted to anti-competitive vertical mergers, summarised in Appendix 8.4.1.

⁵⁰⁸ See the seminal articles by Hart and Tirole, “Vertical Integration and Market Foreclosure”, Brookings Papers on Economic Activity: Microeconomics, 1990 special issue; and Rey and Tirole, “A Primer on Foreclosure”, paper for the Handbook of Industrial Organization III, edited by Mark Armstrong and Robert Porter, Elsevier, 16 July 2003.

⁵⁰⁹ See, for example, Salop and Riordan, “Evaluating Vertical Mergers: A Post-Chicago Approach” Antitrust Law Journal, 63, 1995; and Salop and Scheffman, “Cost-raising Strategies”, Journal of Industrial Economics, 36, 1987.

⁵¹⁰ Nocke and White, “Do Vertical Mergers Facilitate Upstream Collusion?”, Penn Institute for Economic Research Working Paper 05-013, 2005.

problem and achieving a monopoly profit. Furthermore, vertical integration allows them enough flexibility to supply access to the brands that are perceived to command substantial consumer loyalty and yet favour their own grocery brand⁵¹¹. On the other hand, aside from offering retail distribution services to independent grocery brands, supermarkets also buy them for resale. Therefore, they control critical parameters of competition within their stores (e.g., retail pricing, promotions, shelf-placement and staff advice to shoppers), which they can manage for exclusionary/collusive practices. This could explain why supermarkets have not formally foregone their merchant role (downstream competition) even though they are increasingly focusing on distribution services and, in practice, they find ways to transfer many, if not all, trading risks to independent grocery brands⁵¹².

The three motivations for horizontal foreclosure advanced by Rey and Tirole are also relevant⁵¹³:

First, grocery brands are inputs of the grocery retail service (experience) provided by supermarkets, but at some point they could be sold directly to grocery shoppers without the intermediation of supermarkets and they are indeed sold in other retail markets (e.g., hotels and restaurants). In this regard, they are a separate source of monopoly power⁵¹⁴.

Second, even though forward vertical integration by each grocery brand is very difficult in the brick and mortar world, Internet commerce may in the future facilitate entry of new independent grocery retailers or forward vertical integration by grocery brands. By foreclosing the grocery brand market, supermarkets may protect their core grocery retailing operations against the potential threats posed by Internet commerce.

Third, supermarkets' grocery brands enjoy the same advantages enjoyed by generic manufacturers whilst independent grocery brands do not enjoy patent protection or any other appropriation of the R&D efforts reserved to the original manufacturers. This leads to a reduction of the R&D efforts of independent grocery brands that is not

⁵¹¹ Even though spatial location and shopper-single-homing confer supermarkets substantial market power, supermarkets are not pure bottlenecks, and some customers may want to switch stores if they are loyal to a grocery brand to the point of foregoing their supermarket of choice. Indeed, not even a legal monopoly could be termed a pure bottleneck because other inferior products and services in neighbouring markets may compete to some extent with the monopolised good. Likewise, in the grocery retailing market, a supermarket's market power follows a gliding path as its catchment area expands and other supermarkets enter shoppers' radar screen.

⁵¹² According to Rey 2003 (pp. 28-29), the "Coasian pricing problem" (i.e., the monopolist's commitment problem) is more likely to arise when bottlenecks are at more upstream levels, that is, when they have to supply (competing) intermediaries to reach final consumers. However, if the monopolist is at the interface with consumers, it is naturally inclined to "internalize" any negative externality between its competing suppliers, and is thus induced to maintain monopoly prices. Assuming the monopolist can make take-it-or-leave-it offers to its suppliers, it can at the same time extract all profits from them and charge the monopoly price to final consumers. "Hence, from either the consumers' or total welfare perspective, it is preferable to put the more competitive segment downstream".

⁵¹³ Indeed, the horizontal foreclosure motivations advanced by Rey 2003 are treated as motivations for vertical foreclosure in dynamic markets in Riordan 2005.

⁵¹⁴ Currently, supermarkets' grocery brands are only sold in supermarkets but nothing prevents supermarkets from competing with independent grocery brands in other retail markets. If independent grocery brands are foreclosed from the grocery retailing market, they will be less competitive in other retail markets.

compensated by the R&D efforts of the supermarkets' labels.

(2) Raising rivals' costs

The raising rivals' costs theory could also explain supermarkets' strategy towards grocery brands⁵¹⁵. The limitation of shelf-space induced by the growth of a supermarkets' grocery brand may force excluded grocery brands to bid-up the price of other supermarkets' shelf-space and thus there is a widespread increase in access prices. These higher access costs disadvantage independent grocery brands in competition with the supermarkets' grocery brands. Some of them will exit the market and the remaining ones will bear a substantial increase of their access costs. The increased costs will push up their selling prices to all supermarkets and ultimately to the shoppers, as downstream price transparency prevents any price undercutting. As predicted by Chen, the competitive response by the surviving independent grocery brands is to "make a deal with the devil" by paying inflated access fees that dissuade supermarkets from foreclosing the grocery brand market and thus weaken downstream competition between independent grocery brands and retailer brands⁵¹⁶. This collusive effect of vertical contracting arises because the supermarket treats the foregone access profit as an opportunity cost of winning a downstream sale of its own brand. Thus, the independent grocery brand, by contracting with the supermarket, effectively raises the opportunity cost of the vertically integrated supermarket, thereby driving up downstream prices and profits, to the detriment of final consumers.

(3) Facilitation of collusion

Finally the theory on collusion facilitation may also explain the strategic interaction between independent grocery brands and vertically integrated supermarkets⁵¹⁷:

The outlet effect implies that an independent grocery brand can no longer expect that price-undercutting of competing brands will be passed-on to consumers of vertically integrated supermarkets, since it will negatively affect the profitability of supermarkets' own brands⁵¹⁸.

The reaction effect implies that any vertically integrated supermarket will price aggressively its own brand if a competing independent brand was sold at lower wholesale/retail prices in a competing supermarket. A variation of this reaction effect is that the integrated supermarket controls the retail pricing of the competing brand and

⁵¹⁵ Salop 1995 and Salop 1987.

⁵¹⁶ Chen, "On Vertical Mergers and Their Competitive Effects", RAND Journal of Economics, 33, 2002, pp. 667-685; and Chen and Riordan, "Vertical Integration, Exclusive Dealing, and Ex Post Cartelization", Columbia University, Department of Economics discussion paper 0203-13, 2003.

⁵¹⁷ Nocke 2005.

⁵¹⁸ See, for a commentary of the umbrella-pricing strategy followed by supermarket brands, Section 5.1.2 and Rabobank 2011.

can strategically price it to prevent sweetheart deals with a competing supermarket⁵¹⁹.

The lack of commitment effect implies that the right strategy for supermarkets is not to purchase the brands of competing supermarkets, as they can always be price undercut by the brand owner (i.e., the vertically integrated supermarket). Conversely, the punishment effect may induce supermarkets to price aggressively their own brand. However, in this case, the pro-competitive effects of competitive pricing of the retailer brands is marginal in relation to the anti-competitive effects of the foreclosure and collusive effects caused by supermarkets.

The above theories of anticompetitive vertical integration place supermarkets' uncompromising march into the grocery brand sector into a new light. In a dynamic setting, as soon as the leading supermarkets realise their competitive bottleneck power over manufacturers, they will resort to a vertical integration strategy to capitalise on the foreclosure and collusive effects of their practices⁵²⁰. In this scenario, leading supermarkets do not have to exercise any self-restraint in order to avoid too much exploitation (foreclosure) of manufacturers, since it will benefit their own integrated operations⁵²¹. Likewise, they may go along in a collusive equilibrium with some grocery brands until they decide to foreclose them as well. In short, once the strategic role played by supermarket brands is understood, then the puzzle of supermarket domination of the grocery chain is complete⁵²².

To sum up, supermarkets' practices facilitate a virtuous circle of reduced inter-platform

⁵¹⁹ The supermarket may create an artificial price-gap with its own brand in order to switch customers to its own brand or it may set below-cost prices in order to (1) spark a price-war that destroys the value of the independent brand, (2) deter other supermarkets from pricing this brand competitively, and (3) induce competing supermarkets to request the independent brand to bear the costs (reduced profitability) of the price-war.

⁵²⁰ Competition authorities have tended to view supermarket brands as a bargaining tool to obtain lower prices from powerful independent grocery brands. This view assumes that grocery brands enjoy different degrees of market power whereas supermarkets hold no market power at all. However, in real life, supermarkets behave as competitive bottlenecks and can exploit their market power over independent grocery brands without having to rely on the threat of supermarket brands. Indeed, supermarket brands are part of a much more ambitious supermarket strategy. They serve as a catalyst for a virtuous foreclosure process leading to market domination.

⁵²¹ Even in the absence of vertical integration, the free-rider or prisoner dilemma scenario might lead supermarkets to overexploit their manufacturers. However, in the presence of vertical integration, foreclosure of competing manufacturers is the best strategy in economic terms. See, for an example of the failure to factor in vertical integration in the competitive analysis and the ensuing wrongful conclusion, Rao and Mahi, "The Price of Launching a New Product: Empirical Evidence on Factors Affecting the Relative Magnitude of Slotting Allowances", *Marketing Science* 22-2, 2003, p. 266: "Because retailers should prefer to deal with multiple manufacturers rather than a single manufacturer, and because charging of a slotting allowance may result in reduced competition among manufacturers, it is unlikely that retailers will charge slotting allowances to such a degree as to eliminate all but one vendor. So, unless retailers engage in free riding (hoping that other retailers will ensure the availability of an abundance of manufacturers), it is not in the retailer's long-term self-interest to charge slotting allowances and thus reduce competition in the vendor marketplace".

⁵²² Interestingly, not even the economic theories that seek to explain slotting fees as a by-product of supermarkets' power, have taken into account the aggravated exclusionary and collusive effects of their own brands.

and intra-platform competition at the expense of independent brands and consumers.

In terms of the EU Guidelines on non-horizontal mergers, leading supermarkets have the ability to substantially foreclose access to shelf-space/distribution services (input) or consumers⁵²³, as well as the incentive to do so.

Furthermore, their foreclosure strategy produces a significant detrimental effect on competition downstream, in the form of non-coordinated effects (anticompetitive foreclosure and access to commercially sensitive information) and coordinated effects (collusion).

This theory of harm was anticipated in the Basque Grocery Report, which objected to the practices dealt with in this Report on the basis that they could be abuses of a collective dominant position held by the three leading Spanish supermarkets.

⁵²³ The Guidelines on non-horizontal mergers distinguish between input foreclosure (par. 31: “Input foreclosure arises where, post-merger, the new entity would be likely to restrict access to the products or services that it would have otherwise supplied absent the merger, thereby raising its downstream rivals’ costs by making it harder for them to obtain supplies of the input under similar prices and conditions as absent the merger. This may lead the merged entity to profitably increase the price charged to consumers, resulting in a significant impediment to effective competition. As indicated above, for input foreclosure to lead to consumer harm, it is not necessary that the merged firm’s rivals are forced to exit the market. The relevant benchmark is whether the increased input costs would lead to higher prices for consumers. Any efficiencies resulting from the merger may, however, lead the merged entity to reduce price, so that the overall likely impact on consumers is neutral or positive”) and customer foreclosure (par. 58: “Customer foreclosure may occur when a supplier integrates with an important customer in the downstream market. Because of this downstream presence, the merged entity may foreclose access to a sufficient customer base to its actual or potential rivals in the upstream market (the input market) and reduce their ability or incentive to compete. In turn, this may raise downstream rivals’ costs by making it harder for them to obtain supplies of the input under similar prices and conditions as absent the merger. This may allow the merged entity profitably to establish higher prices on the downstream market. Any efficiencies resulting from the merger, however, may lead the merged entity to reduce price, so that there is overall not a negative impact on consumers. For customer foreclosure to lead to consumer harm, it is thus not necessary that the merged firm’s rivals be forced to exit the market. The relevant benchmark is whether the increased input costs would lead to higher prices for consumers”). As far as supermarkets are concerned, this distinction is not critical since they can be considered both sellers of input to independent grocery brands (shelf-space/distribution services) and retailers (offering access to customers).

SNOWBALL EFFECT

Sequence X: Oligopsony of retail distribution
(1) Demand for commercial payments and conditions
(2) Increase in transfer prices as a result of (1)
(3) Increase in retail prices as a result of (2)
(4) Reduction in retail competition as a result of (3)
(5) Increase in retail concentration as a result of (1) and (4)
Sequence X+1: Tacit collusion of the oligopsony
(6) Increase in commercial payments and conditions as a result of (5)
(7) Increase in transfer prices as a result of (6)
(8) Increase in retail prices as a result of (7)
(9) Reduction in retail competition as a result of (8)
(10) Increase in the retail concentration as a result of (5) and (9)
Sequence X+2: Weakening of competition in the manufacturer's market
(11) Increase in commercial payments and conditions as a result of (10)
(12) Exclusion of economically weaker suppliers as a result of (11)
(13) Increase in transfer prices as a result of (11) and (12)
(14) Increase in retail prices as a result of (13)
(15) Reduction in retail competition as a result of (14)
(16) Increase in the retail concentration as a result of (11) and (15)
Sequence X+3: Monopolization of the manufacturer's market by the oligopsony
(17) Increase in commercial payments and conditions as a result of (16)
(18) Exclusion of economically weaker suppliers as a result of (17)
(19) Increase in transfer prices as a result of (17) and (18)
(20) Increase in retail prices as a result of (19)
(21) Private-label Brand (vertical integration) excludes suppliers as a result of (17) and (20)

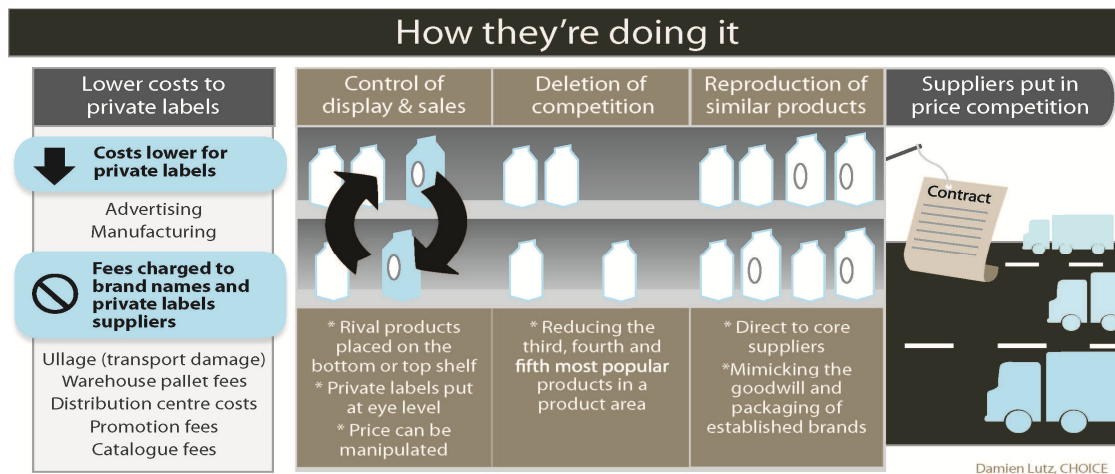
Source: *the Basque Grocery Report*, p. 153.

5.5 Assessment of individual practices

The oligopolistic nature of the retail market and the competitive bottleneck enjoyed by leading supermarkets facilitate practices that distort inter-platform and intra-platform competition to the detriment of consumers. These practices relate to (1) the conditions governing access by independent grocery brands to the supermarket platforms; and (2) the conditions governing in-store competition between grocery brands. This market reality contrasts with the conventional competition analysis, which has simply focused on the exclusionary practices of independent grocery brands without ever challenging the exclusionary practices supermarkets against independent grocery brands⁵²⁴. In stark contrast with the silence of most competition authorities, consumers' organisations have

⁵²⁴ See, for example, Carameli, "The anti-competitive effects and anti-trust implications of category management and category captains of consumer products", *Chicago-Kent Law Review*, N. 74, 2004, pp. 1312-1355. He considers the most prominent factors that a retailer can leverage to improve category performance are: (1) the assortment of products the store carries; (2) the placement of those individual products on the shelf relative to other products in the category, the placement of entire categories within the store relative to other categories, and how much total shelf space to allot a category and each individual product therein; (3) the price of the product relative to both its reasonable substitutes in the same store and comparable products at other retailers in the same geographic market; and (4) the promotion of the product. In line with the views expressed by many other scholars and competition authorities, Carameli only considers potential foreclosure and collusion led by an independent grocery brand and fails to consider supermarkets' vertical integration. He recommends a non-discriminatory management of the category by an independent third party or by the retailer: "In the end, a balance needs to be reached whereby the most efficient actor performs retail-level Category Management decisions in a way that best serves consumers and protects competition. The safest way from an antitrust perspective is to shift the work back to the retailer or to a third party".

denounced the anticompetitive foreclosure of independent brands by vertically integrated supermarkets:



Source: CHOICE Australia, <http://www.choice.com.au>, 2012

Source: *Consumers International* 2012, p. 9.

(1) Access to the supermarkets

Vertically integrated supermarkets have the capacity and incentive to foreclose independent brands' access to the market in the categories in which they compete with supermarket brands.

Access foreclosure may take place through (a) an upfront refusal of access that undermines innovations by competitors; (b) misuse of the sensitive commercial information provided by competitors; (c) access fees and unfair contractual/unilateral terms that deter entry or increase the wholesale prices of competitors; and (d) an abrupt termination of access that causes havoc in a competitor.

(2) In-store competition

Once under control of a vertically integrated supermarket, a competing independent grocery brand may be undermined through exclusionary (a) pricing and (b) non-pricing practices.

- (a) The pricing practices undermine an independent brand's value proposition to consumers through (i) an artificial price gap between the targeted independent brand and the supermarket brand; (ii) a loss-leading price of the independent brand that undermines its quality perception; (iii) a refusal to pass-through promotional wholesale prices of independent brands to their retail prices; and (iv) a prohibition of the on-package promotions carried out by the independent brands.
- (b) The non-pricing practices distort the consumers' in-store choice through (i) degradation of the in-store services provided to the competitor (e.g., poor replenishment); (ii) switch marketing techniques, often executed by the shop

assistants (including the virtual ones employed in e-commerce); (iii) better positioning of the supermarket brands; and (iv) copycat packaging of targeted competitors.

5.5.1 Access to the supermarket platforms

The business model of grocery brands relies on three self-reinforcing factors: (1) innovation responding to consumer (implicit) demand; (2) communication to the consumer in order to generate this demand; and (3) availability of the innovation to as many consumers as possible.

In the past, grocery brands were merely concerned with (1) and (2), as (3) was perceived to follow naturally once (1) and (2) were met⁵²⁵. However, the emergence of supermarket bottlenecks has turned this model upside down. Nowadays, innovation and, much less, communication, do not guarantee the success of a grocery brand. A recent survey by Kantar WorldPanel has unveiled another side effect of the Virtual Guardian Angel (VGA) role described by Poiesz 2007 and played by supermarkets vis-à-vis consumers today: consumers learnt about 67% of new product launches in the stores and not before, i.e., supermarket stores are the primary source of information on innovations for an overwhelming number of consumers.

6- DOS DE CADA TRES LANZAMIENTOS SE DESCUBREN EN LA TIENDA



Source: Kantar-WorldPanel Spain, 11.07.2012

Grocery shopping has become store-centric as opposed to product-centric and this

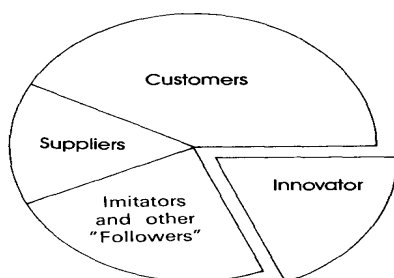
⁵²⁵ See, for example, Kashani, Miller and Clayton, "A virtuous circle: Innovation, Consumer Value and Communication", IMD and PIMS Associates, 2000: "Innovation, consumer value creation and communication are all elements of a virtuous cycle of brand building. At each turn of the cycle, innovative brands create more consumer value. Thereby earning greater consumer franchise, which, in turn, translates into growth in sales and market share, higher savings in communication expenditure, and greater returns on investment. With greater returns come the added resources for further innovation and, thus, the cycle repeats itself".

evolution transforms leading supermarkets into essential facilities vis-à-vis independent grocery brands. Business success in the grocery sector critically depends on access to a sufficient number of supermarkets. David Teece anticipated this scenario when he coined the concept of “distribution bottlenecks”. His proposed solution, vertical integration, is not available to grocery brands. Therefore, they have to seek access from supermarkets in order to build as much weighted distribution possible. However, vertically integrated supermarkets have the power and the incentive to refuse or degrade access to their platform in order to favour their own brands.

5.5.1.1 Misuse of sensitive commercial information

Innovation is the driver of growth in the grocery brand sector and it makes the difference between business success and failure. Furthermore, only a small percentage of innovations are successful and those innovations not living up to supermarket or consumer expectations risk being delisted after 9-12 months⁵²⁶.

However, innovators, defined as the first to introduce a new product or process in the market, often fail to capture the benefits of their innovation, despite a first mover advantage. Indeed, as David Teece pointed out in a seminal article, an innovation may be a success in the market but the innovator himself may commercially succumb to imitators (competitors) and owners of complementary assets (suppliers/distributors)⁵²⁷.



What determines the share of profits captured by the innovator?

Fig. 1. Explaining the distribution of the profits from innovation.

Source: Teece 1986, p. 286.

The two most important determinants of innovation profits are the appropriability regime and access to the complementary assets. The former concept refers to the factors that govern an innovator’s ability to capture the profits generated by an innovation (e.g., the nature of the technology and the efficacy of legal mechanisms of protection)⁵²⁸.

⁵²⁶ See above, Section 5.3.2.2.

⁵²⁷ Teece, “Profiting from technological innovation: Implications for integration, collaboration, licensing, and public policy”, *Research Policy* 15, 1986, pp. 285-305.

⁵²⁸ According to Teece 1986, tight appropriability regimes are exceptional (p. 290): “In those few instances where the innovator has an iron clad patent or copyright protection, or where the nature of the product is such that trade secrets effectively deny imitators access to the relevant knowledge, the innovator is almost assured of translating its innovation into market value for some period of time. Even if the innovator does not possess the desirable endowment of complementary costs, iron clad protection of intellectual property will afford the innovator the time to access these assets. If these assets are generic,

Patent protection, where it exists, is seldom efficient and other factors, such as lead time and secrecy may be as important for an efficient appropriability, if not more⁵²⁹. The latter concept implies a competitive access (contractual or ownership-like) to generic, specialised or co-specialised manufacturing and distribution assets. Contracting rather than integrating is likely to be the optimal strategy when the innovators appropriability regime is tight and the complementary assets are available in competitive supply (i.e. there is adequate capacity and a choice of sources). On the other hand, David Teece warns against the “current euphoria over ‘strategic partnering’”, because owners of bottleneck assets may be in a better position to copy and exploit the innovation that the inventor is not able to protect⁵³⁰. Indeed, with a great foresight, the author advances that bottlenecks are likely to arise in distribution (and specialised manufacturing assets) and suggests vertical integration as a possible way out for innovators⁵³¹. In any event, he concedes that in a weak appropriability regime, the innovator will often lose out to imitators and/or asset holders, even when the innovator is pursuing the appropriate strategy⁵³². In a dynamic context, the article notes, among others, four trends: the existing appropriability regime and access to complementary assets condition future R&D efforts⁵³³; control of cospecialized assets is critical for long-run survival, where

contractual relation may well suffice, and the innovator may simply license its technology. (...). Tight appropriability is the exception rather than the rule. Accordingly, innovators must turn to business strategy if they are to keep imitators/ followers at bay.”

⁵²⁹ Teece 1986, p. 287: “It has long been known that patents do not work in practice as they do in theory(...). Many patents can be “invented around” at modest costs. They are especially ineffective at protecting process innovations. Often patents provide little protection because the legal requirements for upholding their validity or for proving their infringement are high. In some industries, particularly where the innovation is embedded in processes, trade secrets are a viable alternative to patents. Trade secret protection is possible, however, only if a firm can put its product before the public and still keep the underlying technology secret(...). The degree to which knowledge is tacit or codified also affects ease of imitation”. For an overview of the different studies on the effectiveness of patents and other means, see Sattler, “Appropriability of Product Innovations: An Empirical Analysis for Germany”, Research papers on marketing and retailing No. 003, University of Hamburg, May 2002. These studies report that lead-time, superior sales or service efforts and secrecy in general are considered to be more effective than patents.

⁵³⁰ Teece 1986, p. 294: “Briefly, there is the risk that the partner won’t perform according to the innovator’s perception of what the contract requires; there is the added danger that the partner may imitate the innovator’s technology and attempt to compete with the innovator. This latter possibility is particularly acute if the provider of the complementary asset is uniquely situated with respect to the complementary asset in question and has the capacity to imitate the technology, which the innovator is unable to protect. The innovator will then find that it has created a competitor who is better positioned than the innovator to take advantage of the market opportunity at hand”.

⁵³¹ *Id.*, p. 295: “However, if the innovation is not tightly protected and once “out” is easy to imitate, then securing control of complementary capacities is likely to be the key success factor, particularly if those ties are in fixed supply so called “bottlenecks.” Distribution and specialized manufacturing competences often become bottlenecks”; and pp. 296-297: “Three classes of players are of interest: innovators, imitators, and the owners of cospecialized assets (e.g. distributors). All three can potentially benefit or lose from the innovation process. The latter can potentially benefit from the additional business the innovation may direct in the asset owners direction. Should the asset turn out to be a bottleneck with respect to commercializing the innovation, the owner of the bottleneck ties is obviously in a position to extract profits from the innovator and/or imitators.”

⁵³² *Id.*, p. 297.

⁵³³ *Id.*, p. 301: “...if an innovating firm does not target its R&D resources towards new products and processes which it can commercialize advantageously relative to potential imitators and/or followers, then it is unlikely to profit from its investment in R&D”.

legal protection is weak or nonexistent⁵³⁴; as markets mature and a greater proportion of the relevant cospecialized assets are vertically integrated, new entry becomes more difficult⁵³⁵; and past configuration of firm boundaries (e.g., deployment of specialized and/or cospecialized assets) may no longer have compelling efficiencies⁵³⁶.

David Teece's theoretical framework for innovation and economic growth sets the stage for the analysis of the business model of most supermarkets' brands: the Imitation and Price Discounting model identified by Porter 2002. Perhaps the best evidence of the competitive bottleneck role played by supermarkets and their market power over grocery brands is an often forgotten reality: brands must disclose well in advance (e.g., sometimes more than 12 months before their commercialisation) their otherwise secret innovative efforts and associated business secrets to their competitors if they want to have access to their distribution networks⁵³⁷. In a competitive market, (1) brands would normally not trust their most valued business secrets to a competitor and, if they exceptionally did it, they would demand stringent guarantees against competitive misuse of that information; and (2) supermarkets would put in place exceptional measures to avoid any misuse of the commercial secrets provided by brands, out of fear of legal action and/or supply restrictions. However, in the modern grocery retailing market, independent brands need access to the main supermarkets (each of them being a competitive bottleneck) and can only sit down helpless while the latter misuse their commercial secrets with impunity (e.g., me-too products). This reality possibly exceeds the worst-case scenario for innovation ever imagined by David Teece⁵³⁸.

⁵³⁴ *Id.*, pp. 301-302: "In industries where legal methods of protection are effective, or where new products are just hard to copy, the strategic necessity for innovating firms to integrate into cospecialized assets would appear to be less compelling than in industries where legal protection is weak. In cases where legal protection is weak or nonexistent, the control of cospecialized assets will be needed for long-run survival.(...). Generally, if legal protection of the innovator's profits is secure, innovating firms can select their boundaries based simply on their ability to identify user needs and respond to those through research and development. The weaker the legal methods of protection, the greater the incentive to integrate into the relevant cospecialized assets."

⁵³⁵ *Id.*, p. 302.

⁵³⁶ *Id.*, p. 302: "Considerations which once dictated integration may no longer hold, yet there may not be strong forces leading to divestiture. Hence existing firm boundaries may in some industries especially those where the technological trajectory and attendant specialized asset requirements has changed be rather fragile. In short, history matters in terms of understanding the structure of the modern business enterprise. Existing firm boundaries cannot always be assumed to have obvious rationales in terms of today's requirements."

⁵³⁷ Condon, "Brand New: Wal-Mart's Foray into Private Labels", *STERN Business*, Fall/Winter 2002, p. 46: "Since Wal-Mart represents between 15 percent to 50 percent of many major branded manufacturers sales, it is often able to coerce branded manufacturers into handing over detailed data on new production introductions up to a year before these products hit the shelves. This has allowed Wal-Mart to bring quickly to market private label imitations that are of similar quality and lower cost. However, Wal-Mart likely does not have the culture or the research and development facilities to become a true innovator across thousands of categories."

⁵³⁸ This scenario has led Paul Dobson and Ratula Chakraborty to term "me-too" supermarket brands as "blood suckers". See Dobson and Chakraborty, "Private Labels and Branded Goods: Consumers' 'Horrors' and 'Heroes'", in *Private Labels, Brands, and Competition Policy: The Changing Landscape of Retail Competition*, ed. By Ariel Ezrachi and Ulf Bernitz, Oxford, 2009, pp. 99-124, p. 113: "'The blood sucker' – This is where the private label feeds off brands' success in creating markets. The private label product deliberately free rides on the marketing, formulation, and packaging of leading brands in the segment. It waits for brand manufacturer investment to create demand in a new area then enters the

The European Commission has addressed the competition risk of a competitor having access to sensitive commercial information a company in the EU Horizontal Guidelines (commercialisation agreements between competitors) and the EU Guidelines on non-horizontal mergers⁵³⁹. However, until the recent Spanish Grocery Report and the Finnish Grocery Report⁵⁴⁰, no competition authority had ever questioned the misuse by supermarkets of independent grocery brands' commercially sensitive information in favour of their own brands, even though they were acquainted with this market failure⁵⁴¹. Even the industry insiders and analysts have come to accept this market failure as a natural feature of the market⁵⁴². To our knowledge, the first economic paper

segment with a 'me-too' private label offering, exploiting its second mover advantage to save on marketing and research and development costs. In the process, this free-riding behaviour undermines brand producers' incentives to innovate and pioneer new segments and invest in improving their products and thus ultimately choking innovation to the detriment of consumers [footnote: The 'me-too' private label offering has traditionally been the most common entry route into an established category for a retailer, seeking to emulate the quality and general appearance of the leading brands without having had to go through the long development process and marketing costs required to build up successful brands and develop consumer demand. Previously, brands could be assured of having a significant head start on me-too private labels, as they took time to source and bring to market. However, this time lag has been significantly eroded in recent years with the emergence of sophisticated private label producers and with retailers informed of new brand developments while they are in the pipe line (as a condition of gaining new shelf space when they are launched), with the effect of dramatically improving private labels' speed to market but, in the process, cutting down brands' first-mover advantage and allowing them less time to recoup their initial investment costs.]

⁵³⁹ See, for example, Guidelines on non-horizontal mergers, par. 78: "The merged entity may, by vertically integrating, gain access to commercially sensitive information regarding the upstream or downstream activities of rivals. For instance, by becoming the supplier of a downstream competitor, a company may obtain critical information, which allows it to price less aggressively in the downstream market to the detriment of consumers. It may also put competitors at a competitive disadvantage, thereby dissuading them to enter or expand in the market."

⁵⁴⁰ See Section 4, above.

⁵⁴¹ See Hildebrand, *Economic Analyses of Vertical Agreements. A Self-Assessment*, Kluwers law International, 2005, p. 62: "On the other hand, retailers themselves use the know-how of manufacturers for the successful production of their own private label articles. In this respect, the retailer free rides on the specific investments in the brand and advertising made by the manufacturer of branded products. In the aforementioned study prepared by the Swedish competition authority, 75 per cent of the suppliers declare that retailers use the strategic advantage of information from pre-launch product presentations to produce their own competitive private label articles. This effect should not be underestimated from the economic point of view, because the manufacturer of the branded product loses profit margin in the long term, which are required to amortize investments in product innovations. Product innovations come almost exclusively from manufacturers of branded products. These innovations are extremely important for the preservation of a brand, because only through a continuous development of a brand its reputation can be maintained and extended. Incentives to investment, which have generally positive economic effects, are significantly weakened by the shifting of the balance of power between manufacturers of branded products and retailers. In order to obtain innovations, the research potential and capital of the manufacturers of branded products is required. From a business perspective, these innovations only occur when in the product launching phase the first-mover advantage generates adequate profits. Only in that case the manufacturer can be sure that the research costs incurred will eventually yield a return. If retailers abuse their position in order to copy the innovations for their private label products, it is very likely that the innovative initiatives as well as the incentives of the manufacturers will decrease."

⁵⁴² See, for example, Rabobank 2011: "The copycat stage is the starting point for private label. The prime motive for introducing private label is to strengthen the food retailer's position at the negotiation table. By introducing a 1:1 copy of a branded product at a 20 percent to 30 percent cheaper retail price, the retailer is able to demand a larger share of the profit pool. To put pressure on the brand supplier in the negotiation process and convince the consumer that the private-label product is a suitable substitute for

that mentioned this issue only appeared in November 2011⁵⁴³. This paper, written by Allain, Chambolle and Rey, shows that vertical integration may generate foreclosure in markets where firms need to exchange sensitive information with vertically integrated suppliers or customers. As long as there is a risk of imitation, it *de facto* reduces the “quality” of the integrated supplier/customer for the independent competitor; this enhances the non-integrated supplier/customer’s market power and thus raises the cost of supply for the independent competitor, who must share with the non-integrated supplier/customer the benefit of its R&D effort. This “input foreclosure” discourages the independent competitor from investing in R&D and increases the integrated firm’s profit at the expense of independent rivals — even if these can “fight back” and integrate as well⁵⁴⁴. The foreclosure effect increases with the risk of imitation. As long as this risk remains limited, the integrated supplier/customer still exerts a competitive pressure on the market. As a result, the independent competitor retains part of the value of its innovation and thus remains somewhat active on the innovation market (“partial foreclosure”). By contrast, when the imitation concern is maximal, the non-integrated supplier/customer can then extract the full benefit of any innovation by the independent competitor, which thus no longer invests in R&D. The integrated customer/supplier then *de facto* monopolizes the innovation market segment (“complete foreclosure”). The paper concludes that this type of vertical foreclosure harms consumers and reduces total welfare⁵⁴⁵.

Most notably for the purposes of this Report, the paper considers that the grocery retail sector raises the risk of “customer foreclosure”⁵⁴⁶ and quotes an empirical survey showing that independent brand innovations are copied faster by supermarket brands than by other independent brands⁵⁴⁷.

Finally, from a policy perspective, the paper argues that an *ex post* control of anticompetitive or unfair behaviour would not prevent foreclosure. Therefore, protective

the brand, the copycat or mainstream private-label product needs to stay close to the looks and product characteristics of its branded counterpart.”

⁵⁴³ Allain, Chambolle and Rey, “Vertical Integration, Innovation and Foreclosure”, November 25, 2011 (a first draft was released on March 10, 2011), p. 1, footnote 2: “Brand manufacturers have for example stressed such issues in connection with the development of private labels. As the promotional activities associated with the launch of new products generally require advance planning with the main retailers, manufacturers are concerned that it gives these retailers an opportunity to reduce or even eliminate the lead time before the apparition of “me-too” private labels.”

⁵⁴⁴ The authors speculate that in a dynamic setting, the vertically integrated firm may increase its R&D following the foreclosure of its non-integrated competitor, thereby possibly compensating the initial reduction in consumer and total welfare. They consider that it may depend on who is the genuine innovator.

⁵⁴⁵ The analysis is robust to various changes in the modelling assumptions (e.g., information leakages, bilateral bargaining power, imperfect imitation, imperfect competition in the downstream/upstream market, number of competitors and multiple vertical integration).

⁵⁴⁶ Allain 2011, p. 16: “the development of private labels by large retail chains, may there again exacerbate the risk of information leaks and discourage manufacturer’s innovation”.

⁵⁴⁷ *Id.*, p. 16, footnote 26: “In a recent market study, DIW reports that new national brand products are imitated more quickly by private labels (with an average delay of 10,9 month) than by other national brands (12,3 months). Similar observations apply for packaging imitation (Zunehmende Nachfragemacht des Einzelhandels, Eine Studie für den Markenverband (DIW Econ))”.

measures are required ex ante because the integrated firm has no incentives to provide such measures and foreclosure may arise without any ex post fraudulent behaviour⁵⁴⁸.

Back to the grocery retail market, it seems to make good the saying “reality exceeds fiction [theoretic models]”. Vertically integrated supermarkets control a substantial share of the modern grocery retail market. Therefore, innovative independent brands are caught between a rock and hard place. If they turn to the decreasing number of non-integrated supermarkets they will enjoy marginal weighted distribution. However, if they share their commercial secrets with the leading supermarkets, they face the prospect of early me-too competition⁵⁴⁹. In both scenarios, independent brands will see the reward to their innovative and marketing efforts significantly reduced or annulled⁵⁵⁰.

This market failure, aggravated by other practices identified in this Report, undermines innovation and dynamic competition and is much more harmful for economic growth than any anticompetitive agreement leading to output restriction or price increase in static neoclassic terms⁵⁵¹. The anticompetitive effects of the early access and misuse of

⁵⁴⁸ *Id.*, pp. 36-37: “This analysis has direct implications for antitrust or merger policy. For example, even in an industry where (possibly costly) instruments exist for protecting customers’ information (such as firewalls, compensating guarantees, and so forth), a merged entity may lack the incentives to invest in such instruments — and may instead choose to invest in (possibly costly) ways to exploit its customers’ information. Similar insights apply when information transmitted to the downstream division can be exploited by the integrated supplier. Therefore, the adoption of such protective instruments should be a prerequisite for merger clearance. Indeed, in our model no imitation happens in equilibrium, and yet the threat of information disclosure suffices to create foreclosure. Thus, an ex post control of anticompetitive or unfair behavior would not prevent foreclosure: if protective measures are not required at the time of the merger, the integrated firm has no incentives to provide such measures and foreclosure may arise without any ex post fraudulent behavior”.

⁵⁴⁹ The empirical study cited in Allain 2011 shows that the advance information enjoyed by supermarkets enables them to copy innovations faster than other competitors could. This early copying by supermarket brands has another anticompetitive effect. If the innovator is afraid to take legal action against the supermarket brand, then further legal action against copies of other competitors may be less effective or viable and competitors may feel safe to copy the innovation without fear of legal action.

⁵⁵⁰ Seth 1999, p. 281: “The history of OL [own label] is that retailers’ products have been imitations of manufacturers’ brands (with the major exception of chilled prepared foods, where retailers have led from the start). What manufacturers complain about is that they invest in the innovation and development of new products, and expect to have the opportunity to recoup this investment by a period of selling at a reasonable margin. We may compare the situation in pharmaceuticals, which is an extreme case: millions need to be invested in R&D to produce a new drug, but it is protected from imitation by patent for a period, so that the manufacturer can earn a return large enough to repay the outlays and make profits. In grocery products, retailers have strong relationships with captive suppliers, and can imitate a new brand within a very short time. They will sell it at a significantly lower price than the brand, eating into its sales and possibly putting downward pressure on its price.”

⁵⁵¹ Campbell, “Innovation and the Law: The Contributions of David Teece”, *Research Policy Conference 20th Anniversary of the Publication of Profiting from Technological Innovation*, September 21, 2006: “The failure to consider that monopoly does not exercise power simply by restricting supply and increasing price – that the real danger in monopoly, is that it deadens innovation, has been virtually unrecognized in the courts. There is an occasional statement most famously by Learned Hand that the reward for monopoly is an easy life or the lazy monopoly theory which has been utterly refuted by capital markets theory but is also the rare recognition of any aspect of harm from a monopoly from the point of view of innovation. As I have studied more and more industries in my own work in the antitrust economics area I’m convinced that the model lifting price and restricting output is quite the exception, and to the extent that there is market power, it is generally exercised in protecting oneself against the innovations of others rather than by restricting output which would only invite entry”.

sensitive commercial information are diverse:

First, the privileged access to independent brands' innovations and the me-too imitation by supermarket brands is nothing else than the X-inefficiency always associated with monopolists instead of competition on the merits. Supermarket brands try to replicate independent brands but not to outperform them in terms of innovation and quality. This Imitation and Price Discounting model leads to zero-sum competition, commoditisation of grocery brands and the downward quality spiral identified by industry analysts. The extension of this market failure was revealed in the Spanish Grocery Report: 44% of the surveyed leading brands and 24% of the non-leading brands stated that they had received unjustified requests of confidential information on their new product launch plans, information that had been used in favour of the supermarket brands. Furthermore, 80% of the leading brands and 32% of the non-leading brands stated that the presentation of their products had been copied (copycat) by supermarket brands⁵⁵².

Second, the supermarkets' strategy of confining the sales of their own brands in their own stores generally exacerbates their commoditisation⁵⁵³. In order to price-undercut the innovations of independent brands, production of supermarket brands needs substantial scale and this can only be achieved by concentrating the production of different supermarket brands in a single manufacturer⁵⁵⁴. This large supplier becomes a hub and spoke for the sharing of information between supermarkets and it leads to uniform supermarket brands that are only distinguished by their branding⁵⁵⁵.

⁵⁵² See par. 197 of the Spanish Grocery Report.

⁵⁵³ Supermarkets always argue that supermarket brands help supermarkets differentiate themselves from competition and this strategy justifies confining the sales of each supermarket brand to the owner's stores. However, supermarkets may also fear that (i) their brands are subject to the same anticompetitive practices reported in this Report and (ii) their hidden uniformity (i.e., competing supermarkets rely on the same supplier) is revealed to the public.

⁵⁵⁴ The Spanish Competition Authority has referred to them as "hidden giants". See the Spanish Grocery Report, pars. 97-98: "96. In recent years, a new manufacturer category has emerged, known as "hidden giants". They are manufacturers specialising in the production of private label for different retailers, even though they may exceptionally sell their own brands in specific market niches. Some of them have grown fast in a context of increased sector concentration and have become multinational companies and leaders in their product category (e.g., Sovena in the olive oil category and Senoble in yoghurts), even though they are unknown to consumers. 97. Hidden giants participate in the calls for offers launched by international retailers. Their competitive advantage rests on their large size, that enables them to be competitive in price. The growth of hidden giants has been facilitated by the downward pressure on price exerted by the retail label, the growth of value-price product lines, the existence of common product ranges in different countries and inverse auctions."

⁵⁵⁵ United Coffee provides a representative case of a supplier of supermarket brands to the main supermarkets in several Member States (www.unitedcoffee.com). See United Coffee Factsheet: "United Coffee is retail market leader in The Netherlands, Spain, UK and Switzerland with 30- 50% market share. In the out-of-home market, United Coffee is the market leader in The Netherlands, Switzerland and the UK. Its share of the fragmented out-of-home markets is single digits except in The Netherlands (11%) and Switzerland (23%). Private label makes up 30-40% of the in-home markets in the countries United Coffee is present. Capsules represent over 20% of in-home value (but only 3% of volume) in United Coffee's markets and is expected to grow to over 30% by 2012." The company claims that "the majority of the key retail players in Europe belong to United Coffee's customer base including Tesco, Waitrose, Mercadona, Lidl and Carrefour".

According to the Spanish Grocery Report, only one Spanish supermarket follows an exclusive sourcing strategy for its own brand in a sample of eight categories. Other supermarkets source their brands from the same suppliers and presumably the largest supermarkets are the ones that source most products from the same suppliers.

Table 21
Percentage of ROB suppliers of a retailer who are present in other retailers. 2010

Retailers	% of ROB suppliers present in other retailers
Retailer 1	67%
Retailer 2	50%
Retailer 3	50%
Retailer 4	33%
Retailer 5	56%
Retailer 6	20%
Retailer 7	5%
Retailer 8	0%
Retailer 9	40%

Source: Prepared in-house based on official requests for information sent to suppliers.

Note: The % indicate the percentage of ROB suppliers included in the six main articles of each retailer in eight specific product categories who are also suppliers of another retailer there.

Source: *The Spanish Grocery Report*, p.111 (English version).

Third, the presence of the supermarket brand forecloses the market to other “low cost” innovations by independent grocery brands⁵⁵⁶. Supermarkets will not grant them access as they compete directly in the ever-broadening quality/price spectrum of the supermarket brand.

Fourth, the opportunity costs of non-innovation have to be taken into account⁵⁵⁷. Companies may cease investing in innovation and exit this market altogether. The remaining ones may see their innovation incentives distorted by the need to secure access to the supermarkets or the need to by-pass them (up to know a “mission impossible” for FMCG). At the end of the day, as David Teece suggested, they will care more about distribution and less about identifying user needs and responding to those through research and development.

All in all, from a public policy perspective, it seems imperative to correct an

⁵⁵⁶ The closed-shop strategy may relate to the category segments where the supermarket brand is present and even extend to new segments, as long as some degree of demand substitutability with the supermarket brand can arise.

⁵⁵⁷ See Campbell 2006: “Another Teeceian characteristic is recognition of opportunity cost – the harm of not inventing, the harm of not expanding a business, the harm of not hiring new people is not captured in traditional antitrust analysis at all. It is a very, very conservative doctrine in antitrust which measures only the alleged welfare triangle of loss and in some aspects not even that instead of considering opportunity cost”.

extraordinary market failure not seen in any other sector of the economy⁵⁵⁸.

5.5.1.2 Access fees & terms

Despite the sheer scale of access fees in the grocery retail sector, they have escaped the attention of the general public and most competition authorities⁵⁵⁹. Even the definition of access fees is controversial. The European Commission's definition of upfront access payments seems to distinguish between conventional linear tariff dealings (wholesale prices) and all other payments (including deductions) that are not reflected in the invoiced wholesale price⁵⁶⁰. Furthermore, the definition of access fees should follow the

⁵⁵⁸ The Author is not aware of any other market in which all non-integrated market players must share their innovations with their vertically integrated competitors at the pre-commercialisation stage in order to be able to access the market.

⁵⁵⁹ See, for example, Wilkie, Desrochers and Gundiach, "Marketing Research and Public Policy: The Case of Slotting Fees", *Journal of Public Policy & Marketing*, Vol. 21-2, Fall 2002, pp. 275-288: "A recent article about the U.S. marketing system stressed that much of its operation occurs in millions of private "behind the scenes" business episodes and thus remains unperceived by anyone beyond the individual participants (Wilkie and Moore 1999). This can present special difficulties for policymakers and analysts in the public policy realm when the private, episodic nature of marketing activities hides vital information. When this occurs, a sole reliance on certain simplifying economic assumptions can be detrimental to enlightened policy determinations. Public policymakers should be aware that insights from the field of marketing can offer real value in these circumstances. Slotting fees represent a particularly interesting aspect of the U.S. marketing system, but with much of the activity cloaked in the "behind the scenes" nature of marketing. Information about this practice has been difficult to obtain, inhibiting public policy development". Martínez-de-Albéniz and Roels, "Competing for shelf space", Submitted to Production and Operations Management, manuscript no. JS-08-12.R2: "Not only have these fees taken astronomical proportions, they are also controversial and kept secret (to the point that some of the manufacturers testifying before the Senate hid their identities by wearing black hoods, see Kaikati and Kaikati 2006), and may be judged to be anti-competitive by the Federal Trade Commission (FTC Report 2001)".

⁵⁶⁰ In the US, experts and competition authorities have emphasized the difference between fixed and variable payments/deductions from an economic and competition policy perspective. See, *FTC v. H.J. Heinz, Co.*, 116 F.Supp.2d 190, (D.D.C.2000), at 197. On appeal, *FTC v. H.J. Heinz, Co.* 246 F.3d 708 (D.C. Cir. 2001), at 712: "At the wholesale level Heinz and Beech- Nut both make lump-sum payments called "fixed trade spending" (also known as "slotting fees" or "pay-to-stay" arrangements) to grocery stores to obtain shelf placement. Id. at 197. Gerber, with its strong name recognition and brand loyalty, does not make such pay-to-stay payments. The other type of wholesale trade spending is "variable trade spending," which typically consists of manufacturers' discounts and allowances to supermarkets to create retail price differentials that entice the consumer to purchase their product instead of a competitor's". See, also, emphasizing the difference between fixed and variable payments but noting the practical difficulties in distinguishing them, Salop, "Presentation to the FTC Slotting Fee Workshop", May 31, 2000: "Trade spending may involve fixed or variable payments, or both. That is, payments may involve a lump sum, upfront payment that does not depend on the quantity of goods sold. However, payments may also be made on a per unit basis, so that they reduce the retailer's effective wholesale price. Some types of trade spending fall in between these two ends of the continuum. In particular, lump sum payments may be made contingent on some performance by the retailer, such as an advertising program, special product placement, coupons or price reductions, and so on. My understanding is that the breakdown of trade spending across the categories varies by brand, category, retail chain and geographic market". Shotlander seems to confine variable payments to discounts (as we propose), "Slotting fees and merger efficiencies: can fewer competitors yield a lower price?", *George Mason Law Review*, Vol. 13:6, 2006, pp. 1273-1308, p. 1273: "For the purpose of this Comment, I define slotting fees as fixed per-unit time payments from manufacturers to retailers in exchange for some allocation of shelf space. These are lump-sum payments distinguishable from variable payments, which are correlated with the quantity of goods sold (such as discounts)"; whereas Klein 2006 distinguishes slotting allowances (access fees) from trade spending (variable payments) (pp. 5-6): "Payments by suppliers for promotional retail shelf space, including product displays and in-store advertisements, have existed since at least the 1950s. But these

principles developed for the competitive assessment of upfront access fees and include (1) all other payments and deductions, (2) whatever their justification (e.g., services provided by the supermarket), (3) at any stage of the contract, (4) that are not volume-related (variable) and, thus, do not lower the wholesale price. This definition of access fees would even cover contractual terms that afford unreasonable/unfair financial advantages to supermarkets at the expense of independent grocery brands⁵⁶¹. In short, it is the competitive effects of these payments/deductions that matters and not their formal characterisation⁵⁶².

early arrangements are not considered slotting because they did not involve primarily a per unit time payment for retail shelf space. Manufacturer contracts for prominent shelf space, such as end-of-aisle displays, are more generally referred to as trade promotions, with retailer compensation in such contracts taking many forms in addition to upfront cash, including wholesale price discounts and other variable payments [footnote: Trade promotions may include wholesale price quantity discounts, cash rebates, coupons, consignment programs, co-op advertising reimbursement, display allowances, off-invoice allowances, bill-back allowances, promotional allowances, free goods, and performance funds, in addition to upfront slotting fees]. While a trade promotion consisting of a reduced wholesale price in return for preferential retail shelf space is analytically similar to slotting in the fundamental economic sense that the manufacturer is offering special terms contingent on retailer supply of shelf space, a trade promotion is not commonly referred to as slotting unless a major element of retailer compensation includes an upfront or per unit time payment. When commentators describe the growth of slotting arrangements since the early 1980s they are referring to the growth of shelf space contracts in this sense of per unit time compensation.”

⁵⁶¹ Therefore, the concept of access fees would cover (1) supermarket demands for payments and deductions without justification (e.g., year-end deductions if the supermarket performance has not met forecasts) or as compensation for services rendered that are within the realm of merchant activities (i.e., once the product has been delivered to the supermarket); and (2) manifestly disproportionate and/or unbalanced contractual terms imposed by supermarkets that impose a financial cost on suppliers (e.g., penalties and payment terms and service contracts with third parties selected by the supermarket). For example, large supermarkets may impose substantial credit terms to their suppliers. The positive difference between the credit terms and the product turnaround (time gap between product supply and product sale) reflect free-funding of supermarkets (and their retailer brands) by their suppliers/competitor brands.

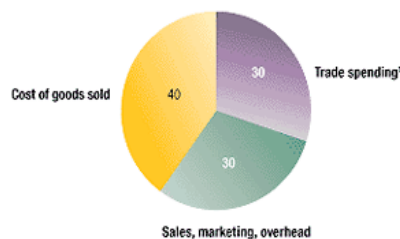
⁵⁶² See, in this regard, Rowe, “An investigation into the unintended consequences of downstream channel allowances”, Doctoral Dissertations, Paper 9, University of Kentucky, 2010, p. 4: “This pay-to-play phenomenon goes by many names across multiple industries. Specific to the marketing literature, this practice is referred to as slotting fees, display fees, failure fees, pay-to-stay fees, presentation fees, and merchandising allowances among many others. However, there is a fundamental problem with using multiple descriptives, often in a generic way, to describe all such pay-to-play practices. First, the most common of these terms, slotting fee, is outdated. Slotting fee was originally used in reference to manufacturers paying for ‘slots’ in the warehouse of a distributor. There were costs associated with adding products in the warehouse so a slotting fee was charged to the manufacturer as a way of transferring those costs. Today, the term slotting fee is used to describe many different arrangements such as paying for shelf space in a retail store or paying for product placement on a website. Second, the term has become outdated from a legal perspective. For example, when the Federal Trade Commission (2003) questioned retail customers regarding the practice of slotting fees, customers frequently stated that their company did not charge nor accept slotting fees. While technically true, many of these companies did extract payments from sellers in other ways such as promotional and advertising allowances, failure fees, or charge-backs. While technically true, many of these companies did extract payments from sellers in other ways such as promotional and advertising allowances, failure fees or charge-backs. While these practices are not technically “slotting fees”, they are effectively the same. That is, financial consideration being paid by the seller to the customer in exchange for either initial or continued access to a distribution channel. Third, these fees and allowances are not solely being charged by customers to sellers. In fact, manufacturing firms frequently offer payment, in these many forms, as a way to gain access within a channel of distribution. For example, a consumer goods manufacturer may offer a merchandising allowance to a retailer in exchange for distribution or additional space in the retailer’s store”. Consequently, Rowe 2010 proposes a broad definition of access fees (p. 5): “Thus, in an effort to

Access fees are one the most salient manifestation of the new economic paradigm⁵⁶³. Indeed, experts have referred to supermarkets' shelf space as "the most expensive real state in the world"⁵⁶⁴. Reports from different countries confirm that access fees have reached a massive scale and, overall, they may range between 20 to 40% of the independent grocery brands' sales to the supermarkets in each country⁵⁶⁵. In the US, access fees were reported to exceed 15% of the grocery manufacturers' turnover as far back as 2002⁵⁶⁶. Back in 2000, McKinsey estimated that trade spending, defined as all of a manufacturer's cash payments to grocery retailers beyond "terms and conditions", such as bonuses, discounts, and advertising allowances, accounted for up to 30 percent of the costs of a typical consumer goods manufacturer and concluded that "such is the power of retailers that an absolute reduction in trade spending is hardly realistic".

EXHIBIT 1

Trade spending: A cost of doing business

Share of total costs for a typical consumer goods manufacturer, percent



¹Includes listing fees, which are paid to a retailer in return for shelf space.
Source: Annual reports; McKinsey analysis

Source: McKinsey Quarterly, May 2000

In Spain, the Spanish Grocery Report mentioned that access fees ranged between 20-

combine all of these various payments into one concept and to allow for concise study, I propose the conceptualization of downstream channel allowances to describe any form of financial consideration flowing from a seller to a customer with the intended outcome of gaining access to a distribution channel controlled by the downstream channel partner (i.e., the customer)."

⁵⁶³ See above, Section 5.1.

⁵⁶⁴ Kaikati and Kaikati, "Slotting and Promotional Allowances: Red Flags in the Supply Chain", *Supply Chain Management: An International Journal*, 11, 2002, pp. 140-147.

⁵⁶⁵ Certainly, access fees may vary for each brand, category and supermarket.

⁵⁶⁶ Kaikati 2002 reported that the US Senate Small Business Committee evaluated the amount spent in slotting allowances to \$9 billion in 2000. Forster, "The Hidden Cost of Shelf Space", *Business Week*, April 15, 2002, quoted Cannondale Associates' data: \$100 billion per year in the US, representing about 15% of the consumer-good manufacturers revenues: "It's no secret that top consumer brands get a huge edge from a special ingredient: cash manufacturers pay stores to stock their wares. But just how much the likes of Kraft Foods and PepsiCo spend on these givebacks has always been a mystery because most have kept it as a closely-guarded trade secret. Now, thanks to a Financial Accounting Standards Board rule that took effect in 2002, the public will see how big the payments are--for one year, anyway. That's because the companies must restate their 2001 accounts by subtracting the incentives from reported sales. Before, they included them in sales numbers. The results are startling: Kraft lopped \$4.6 billion, or nearly 14%, off its top line; Kellogg Co.'s 2001 sales shrank 15%, to \$7.6 billion. On average, food companies spend \$60 billion a year on givebacks. That's the lion's share of the \$100 billion consumer-goods companies spend in the U.S. for such payments, says marketing consultant Cannondale Associates. Net profits weren't affected, because the companies deducted the rebates as costs elsewhere, usually lumping them with general expenses."

30%⁵⁶⁷. In the UK, a survey commissioned for the UK Competition Commission uncovered the large scale of these payments⁵⁶⁸. The Russian Competition Authority has also denounced the growth of access fees in Russia⁵⁶⁹. In France, access fees (i.e., “marges arriere”) were estimated to reach 22% of the invoice price in 1999 and escalated up to 33,5% in 2005⁵⁷⁰. In particular, the Toys Decision estimated that despite the public policy of limiting them up to 3% of the suppliers’ sales, they had escalated to 20-30% of the toy manufacturers’ sales to grocery supermarkets⁵⁷¹. Likewise, the Carrefour Judgment I, 2009, found that the average access fees charged by Carrefour to a sample of independent grocery brands amounted to 19,45% of their sales to the

⁵⁶⁷ The Spanish Grocery Report, p. 205.

⁵⁶⁸ The UK Grocery Report, 2008, Appendix 5.4: “40. The supplier survey conducted on behalf of the CC by GfK indicates that around 70 per cent of suppliers make regular or occasional payments to grocery retailers as marketing contributions or other promotional investments. Other forms of payment are less common. However, 43 per cent of respondents stated that they paid some ‘other rebates’ to retailers. Overall, this suggests that in trading between grocery retailers and suppliers, contracts are not of the form assumed by the ACS in its model. In fact, tariffs tend to have multiple parts, where the unit price is only one portion. 41. The qualitative survey conducted by [-] on supplier–retailer negotiations also provides some useful insights. In their small sample, all suppliers interviewed said that they would resist any reduction in unit costs as much as possible, preferring to differentiate in terms of their trade investment. Consistent with this, they also found that a substantial proportion of the difference in trade terms obtained by different customers would not show up in the ‘headline’ or invoice price.”

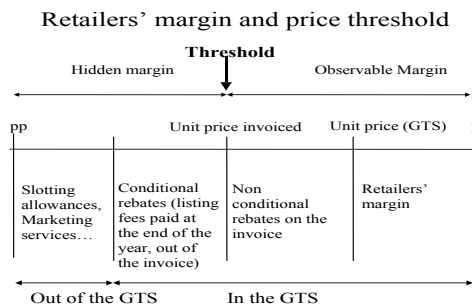
⁵⁶⁹ See, above, note 98.

⁵⁷⁰ OECD 2009a, Note by the Delegation of France, p.163: “Plus précisément, si la législation française prohibait la revente à perte depuis 1963, la législation dite «Galland» votée en 1996 a accru le seuil de revente à perte en le définissant à partir du seul prix de facturation net des remises quantitatives acquises à la date de la transaction. Les remises conditionnelles et la rémunération des services de coopération commerciale (mises en avant des produits dans les linéaires, présence des produits dans les catalogues de l’enseigne, etc.) ne pouvaient donc plus être incluses dans le seuil de revente à perte. Cette législation s’est juxtaposée à celle, bien antérieure, interdisant à un fournisseur de pratiquer des conditions de vente discriminatoires entre ses distributeurs, lorsqu’elles ne sont pas justifiées par des contreparties réelles et proportionnées. Ces deux dispositions avaient notamment pour objectif de protéger des effets de la puissance d’achat des grandes distributeurs les fournisseurs et le petit commerce de détail. Elles ont toutefois eu pour principale conséquence une hausse des prix des produits de grande consommation, notamment des produits alimentaires. Parallèlement, le niveau des « marges arrière », c’est-à-dire les différentes ristournes octroyées aux distributeurs et la coopération commerciale facturée aux fournisseurs, a également cru de manière rapide [note en bas de page: De 22% du prix des produits en 1999, elles passent à 33,5% en 2005 et 37% en 2006 (source : ILEC)], témoignant de l’échec de ces lois à encadrer l’exercice de la puissance d’achat. Ces évolutions sont toutefois conformes à l’analyse économique des relations verticales: combiné à l’interdiction de discriminer, le nouveau seuil de revente à perte introduit par la Loi Galland a permis aux fournisseurs d’imposer des prix uniformes à l’ensemble des distributeurs. Les producteurs en ont profité pour accroître leur prix de vente et ont acheté l’agrément des entreprises clientes par le biais de «marges arrière», qui, en vertu de la définition du seuil de revente à perte introduit par la loi Galland, ne pouvaient être rétrocédées aux consommateurs.”

⁵⁷¹ The Toys Decision, par. 55: “La circulaire de 1993 [fiches de DDCCRF de Nantes sur la concurrence et la transparence tarifaire du 28 juin 1993] répondait à la question « *Quelle incidence financière peuvent avoir ces accords de coopération commerciale?* » que « *Cette incidence financière ne peut être que marginale. Dans leur accord du 12 septembre 1989, industriels et distributeurs ont commenté cette condition en formulant un objectif selon lequel la coopération commerciale ne devrait entraîner que 3 % maximum de réduction de prix* ». En pratique, dans tous les secteurs de la distribution, la loi Galland a conduit à un déplacement des relations commerciales et, par voie de conséquence, de la rémunération des distributeurs. La négociation commerciale entre les fabricants et les distributeurs de jouets s’est ainsi déplacée du prix de vente facturé, tel qu’il résulte des conditions générales ou particulières de ventes, vers les réductions de prix hors facture et la coopération commerciale, c’est-à-dire la “marge arriere” qui atteint en moyenne entre 20 % et 30 % du chiffre d’affaires des fabricants de jouets.”

supermarket, reaching up to 35% in some cases⁵⁷².

Furthermore, the French grocery retail market provides a compelling story about the positive link between supermarkets' power, access fees and retail prices. According to the French industry association ILEC, hidden margins (payments and deductions off-invoice) had increased up to 88% of the supermarkets' total grocery margins in 1999, the remaining 12% accounted for by "observable margins" (rebates on the invoice), in line with the growth of supermarkets' power⁵⁷³:



Product category	Observable / Hidden margin	
	1995	1999
Grocery	26/74	12/88
Fresh and dairy products, frozen items	50/50	34/66
Cosmetics, detergents	-6/106	14/86
Drinks	-1/101	11/89
Other non-food	61/39	56/44

Source: Allain 2004, p. 3.

The French Competition Authority attributed this increase in access fees to the adoption of the Galland Law, which introduced a precise definition of the actual purchase price and hence of the below-cost retail price floor for the purposes of the legal prohibition of sales below cost⁵⁷⁴. Thus, according to the French Competition Authority, suppliers

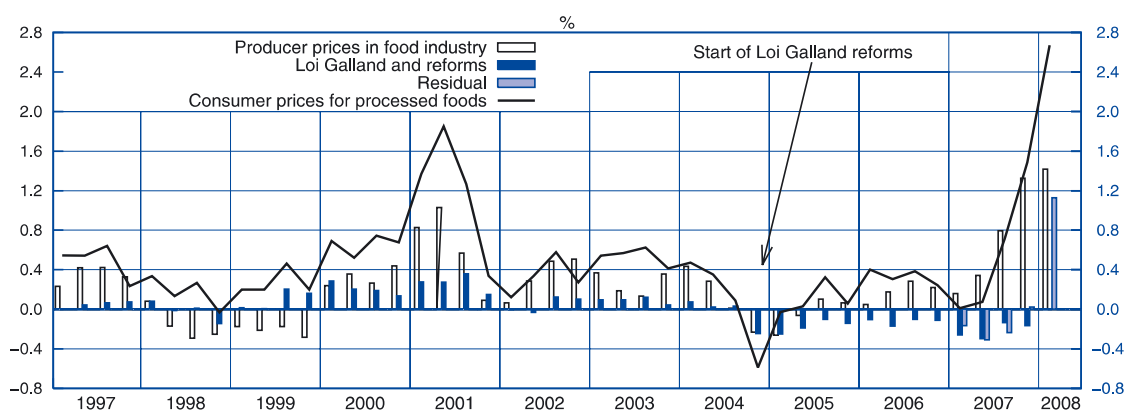
⁵⁷² The Carrefour Judgment I, 2009, p. 11.

⁵⁷³ Allain and Chambolle, "Loss-leaders banning laws as vertical restraints", Ecole Polytechnique, Centre National de la Recherche Scientifique, Cahier n° 2004-023, August 2004, p. 3: "on average, for most products, hidden margins are the largest part of super-markets margins, and in fact they express the bargaining power of large retail chains". A similar trend was spotted in the US by the District Court in *FTC v. H.J. Heinz Co.* 116 F. Supp. 2d 190, 192 (D.D.C. 2000): "Long-term allowances are paid in the bid competitions that have taken place between Heinz and Beech-Nut, but there is no evidence that any retailer has ever refunded money after failing to meet a sales target. Dr. Baker's econometric analysis revealed that trade spending levels had no effect on price, even in markets where all three firms are present. Variable trade spending has fallen, and fixed trade spending has risen, in response to retailer consolidation, which has allowed retailers greater bargaining power in negotiating contracts with manufacturers. Increases in trade spending during bid competition for these contracts consisted almost entirely of increases in fixed spending."

⁵⁷⁴ Boutin and Guerrero, "The 'Loi Galland' and consumer prices", INSEE Conjoncture in France, June 2008: "The Loi Galland gave a simple, precise definition of the actual purchase price and hence of the below-cost retail price floor: "The actual purchase price is the unit price stated on the invoice plus taxes on sales, specific taxes applied to the resale, and transportation costs." Since 1997, the definition of purchase price has thus been restricted to the price stated on the invoice, with no deductions such as year-end discounts. The Act also tightened official verification and raised fines. Only the margins formally applied at the invoice date

could achieve higher wholesale prices and, by virtue of the legal prohibition on sales below cost, also higher retail prices, by offering higher access fees to supermarkets. However, this inference seems to miss completely the source of market power and its impact on competition and consumer welfare. French supermarkets were requesting access fees before the Galland Law came into force and they have continued to request access fees after the Galland Law was partially amended (2006) and subsequently replaced by the Châteil Law (2008)⁵⁷⁵. These access fees were deemed to have an inflationary effect on retail prices⁵⁷⁶. Furthermore, the economists who assessed the effects of the Galland Law on retail prices admitted that except for a short period following the supermarkets' price-contention agreement with the Government in 2004, retail food prices had gone up since 2005 at a faster pace than in the period up to 2004.

2 - Contributions to consumer price growth for food products excluding unprocessed foods



Note: For better legibility, residuals are shown for 2007 and 2008 only.
Source: INSEE

Source: Boutin 2008, p. 24.

All in all, the evidence on the French retail grocery market shows that: (1) supermarkets have increased the access fees charged to suppliers; (2) supermarkets' retail prices have

and shown on the invoice—the “upfront margins” (marges avant)—can be passed on to final consumers through reductions in the final selling price. By contrast, all other discounts are described as “hidden margins” (marges arrière) and therefore excluded from the below-cost retail price floor. Examples include margins linked to an annual sales volume, to the retailer's display of the product on a minimum shelf length, to business cooperation, or simply to the respect of mutual commitments over a certain period. Consequently, hidden margins can in no way be passed on to consumers.” Incidentally, other competition authorities (e.g., Ireland and Spain) have found that the national regulations on below-cost pricing were ineffective against supermarkets' pricing practices, which again points to supermarkets as the primary drivers of access fees.

⁵⁷⁵ Boutin 2008, p. 22, Table “Stages in Loi Galland reform”: “ - June 17, 2004: Under the aegis of French authorities, retailers and producers commit to a long-term reduction in prices of basic consumer products. Following up on this agreement, the Economy Minister commissions a report to review existing legislation and its economic effects, and proposes reforms aimed at lowering prices. - October 18, 2004: Canivet Commission submits report to French government. - August 2, 2005: Dutreuil II Act, inspired by the Canivet Report, allows partial deduction of hidden margins from purchase price paid to supplier, in the following stages: + from January 1, 2006, the share of hidden margins exceeding 20% of the purchase price; + from January 1, 2007, the share of hidden margins exceeding 15% of the purchase price. - January 4, 2008: Châteil Act published in Journal Officiel, the government publication of record. Starting March 1, 2008, retailers are allowed to deduct all hidden margins from the purchase price.”

⁵⁷⁶ See the views of the French Competition Authority, above, note 570.

increased more than producer prices; (3) the combined effect of (1) and (2) point to an increase of supermarket margins at the expense of supplier margins⁵⁷⁷; and (4) retailer brands have benefited from the increased retail prices of independent grocery brands through higher sales and/or margins.

The French example is not exceptional: supermarkets in other Member States, with or without regulations on loss-leading sales, have profited from this strategy at the expense of consumers, independent grocery brands and small supermarkets.

Indeed, the conclusion that access fees are anti-competitive underlies the UK Competition Commission's ban of access fees except in two limited scenarios (new products and retail promotions) and yet under stringent conditions⁵⁷⁸ (the Spanish Law 12/2013 on the efficient operation of the food chain contains a similar provision) and the statutory limitation of access fees to 3% of the grocery brand's sales to the supermarket in the Slovak Republic⁵⁷⁹.

5.5.1.3 Abrupt termination of access

The abrupt termination by supermarkets of their access agreements with independent brands is common ground⁵⁸⁰. Such a sudden loss of volume cannot be channelled into other supermarkets and it is bound to cause a permanent economic harm (downward spiral of volume and net profit margin) on independent brands.

Unfair competition rules and/or the general rules on contracts often provide for a notice

⁵⁷⁷ The Commission acknowledges that some intermediaries impose guaranteed margins and this affects end-consumer prices. This is a widespread practice among supermarkets and an evidence of market power on their part. See Commission staff working document, "Competition in the food supply chain", accompanying document to the European Commission "A better functioning food supply chain in Europe", SEC(2009) 1449, 28.10.2009, p. 14: "In addition to this, the way the margins are determined might also have an influence on the difference between consumer prices and producer prices. For instance, it would seem that in certain cases intermediary margins are kept within a certain pre-established range regardless of the fluctuations of producer prices and other market conditions. If this mark-up phenomenon would multiply at each intermediary level, it is possible to presume that the end price would also be increased as a result thereof."

⁵⁷⁸ The UK Grocery Report 2008 discusses the competitive implications of access fees versus price discounts in Appendix 5.4, pars. 13-15: "13. The ACS model assumes that contracts between suppliers and retailers take the form of simple wholesale prices (linear prices) and do not include lump sum payments. The ACS acknowledges that supply contracts in the retail industry are often highly complex. However, the ACS points out that the qualitative results of the model should extend to other forms of contract, so long as the discounts obtained by retailers affect the unit price. 14. With this assumption of simple linear pricing, when retailers obtain a discount, they will have an incentive to lower final consumer prices (ie to pass on part of the discount they obtain from suppliers). By contrast, if discounts are given exclusively in the form of lump-sum payments, they result in a transfer of profits between suppliers and retailers without affecting the final retail price. With this latter type of payment arrangement, there is no scope for a waterbed effect to arise. 15. The waterbed effect may only occur when large grocery retailers extract discounts that affect the unit price they pay to suppliers. In this case, part or all of the discounts will be passed through to final consumers in the form of lower retail prices."

⁵⁷⁹ See above, note 102, the Slovak Law 172/2008 on Inappropriate Conditions in Commercial relationships and on Supplementation of the Slovak National Council Act No. 30/1992 Coll. on the Slovak Chamber of Agriculture and Food Industry as amended, article 1, Section 3(1).

⁵⁸⁰ The Spanish Grocery Report, par. 257.

period and/or compensation when established commercial relationships are terminated. However, the evidence in the grocery retail market shows that supermarkets hardly ever comply with the notice periods and compensation provided for in the laws and independent brands never enforce them. As a representative example, in October 2009, the Spanish leading supermarket, Mercadona, publicly announced its decision to delist around 800 references with immediate effects. Independent brands constituted the vast majority of the delisted brands and several of them held leading market shares. Not a single supplier filed legal action against Mercadona, even though the Spanish Law on Unfair Competition establishes a 6-month notice period for the complete or partial cessation of established commercial relations⁵⁸¹.

The abrupt cessation by supermarkets of their business relations with independent grocery brands has to be assessed in light of the existing competition between independent brands and supermarket brands. The abrupt termination of commercial relations with independent brands primarily responds to a strategy of substitution of independent brands by the supermarket brands. Therefore, the abrupt termination of a commercial relationship is a perfect tool to raise a rival's costs and unleash a downward sales/profits spiral on a competitor of the supermarket brand.

5.5.1.4 Refusal of access

If a significant part of the grocery retail market is not available due to the “closed platform/network” strategies of the supermarkets, independent grocery brands are foreclosed from the market and this undermines innovation, inter-brand competition and inter-supermarket competition⁵⁸².

Therefore, it is relevant to look at the weighted distribution achieved by the best launches in different Member States:

⁵⁸¹ Law 3/1991 on Unfair Competition, article 16.3.a. In stark contrast with its handling of independent brands, Mercadona has entered into a “Convenio Marco de Buenas Prácticas Comerciales” (“Framework Agreement on Good Commercial Practices”), that envisages a 3-year glide-path for the termination of commercial relationships with the exclusive suppliers of its supermarket brands.

⁵⁸² See above, Section 5.3.2.2, for the importance of achieving a sufficiently high weighted distribution.

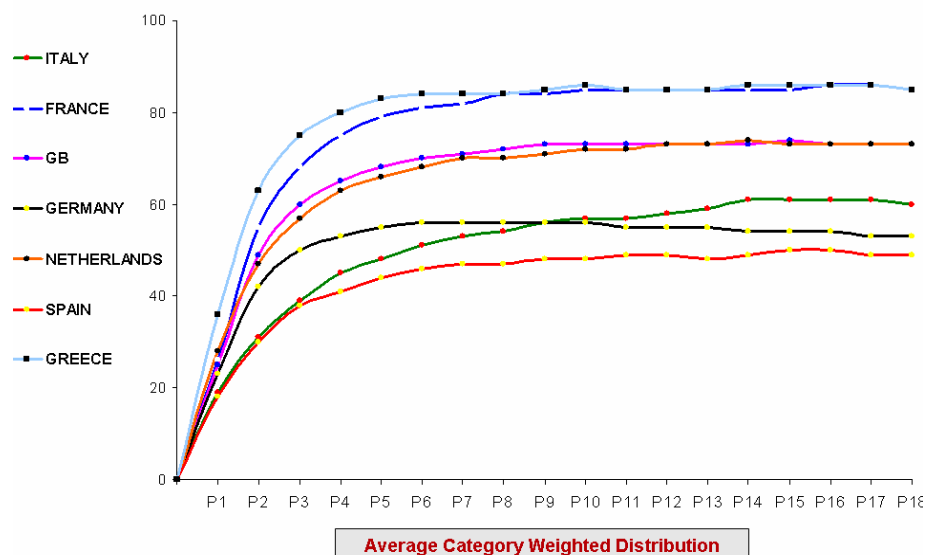


FIGURE FOUR: PRODUCT AVAILABILITY BY COUNTRY
THE BEST GROUP OF NEW PRODUCTS GAIN DISTRIBUTION QUICKLY, BUT OFTEN FALL SHORT OF
THE MAXIMUM POSSIBLE

Source: IRI 2007, p. 13.

This data sends an alarm warning regarding access to the market in Germany, Spain and, to a lesser extent, Italy. In Germany, successful new product launches achieve around a 50% weighted average distribution a year after coming into the market⁵⁸³, whereas in Spain this percentage goes down to around 40%⁵⁸⁴. Distribution in Italy is a slow-building exercise and can reach around 60% weighted distribution well after a year⁵⁸⁵. UK and the Netherlands stood in the 70% region, whereas France and Greece are the countries where the successful brands achieved greatest weighted distribution: around 80%.

The limited distribution achieved by successful product launches in Germany and Spain is alarming because it responds to a deliberate “closed platform/network” strategy by the leading supermarkets.

The market foreclosure in the Spanish market is paradigmatic because it has been precipitated by the switch of the leading supermarket (Mercadona) from an “open

⁵⁸³ IRI 2007, p. 8: “The situation is different in Germany where distribution builds slowly and on average begins to fall even before the end of the first year. Poorly performing new products are weeded out quickly and overall, new products can often achieve relatively low levels of settled distribution”.

⁵⁸⁴ *Id.*, p. 9: “The lowest level of all, however, is seen in Spain. On average, the distribution in Spain, for the best performing new products, is still less than 50% after 18 months. The Spanish retail trade, as is the case in Italy is still fragmented across a large number of retail groups and store fascias. Another consideration in assessing the distribution information is store size. Smaller stores inevitably offer a reduced range and there is more pressure on available shelf space. Although the Spanish trade is well endowed with large grocery outlets it has a significant number of small supermarkets”.

⁵⁸⁵ *Id.*, p. 8: “In contrast, in Italy, the trade is highly fragmented with 11 retailer groups operating some 28 separate store chains to deal with. Distribution is therefore slow to build and on average, even after 12 months, is no higher than the 60% that new products attain in Great Britain after just 12 weeks”.

network” to a “closed network” strategy starting in 1997 up till today⁵⁸⁶. This shock in the market has made visible the harmful effects on innovation that “closed networks” can produce in the grocery sector.

An independent report prepared for the Commission’s DG Enterprise and Industry (“The Private Label Report”) noted the collapse of innovations in Spain: “The number of product introduction goes down in Spain. This is due to two factors: the rapid increase of private-label market share and the reduction of the number of stock keeping units in many supermarket formulas”⁵⁸⁷. The Private Label Report found that in the 2005-2009 period the number of new product introductions “dropped dramatically” in Spain and the independent brands suffered most, whilst new product introduction by retailer brands remained stable⁵⁸⁸.

⁵⁸⁶ Bell 2009 notes that the private label share of total packaged groceries in Mercadona grew from 0.7% in 1997 to 34.2% in 2001 (p. 36). This share was around 48% in 2008 (Source: TNS) and it reached 55% at the end of 2011 (Source: Kantar). Mercadona’s market share of the one-stop shop grocery retailing was 28,4% in 2010 (Source: Nielsen Homescan).

⁵⁸⁷ LEI, Wageningen University & Research Center, “The impact of private labels on the competitiveness of the European food supply chain”, January 2011, p.6. See also “The number of new product introductions has become very low in Spain due to the fall in the number of new product introductions from 2005 till 2009. This is probably due to the growing market share of discounters and other retail formulas with a limited product assortment (see section 6)” (p. 91), and “Innovation is not declining in the food and beverage industry, at least not in the sectors studied, with the exception of Spain... - The number of new product introductions grew between 2005 and 2009 for fruits and vegetables, dairy and cereal products, except in Spain where a reduction in the number of new product introductions by brands producers is due to the fact that they have limited access to a large part of the retail market. This is a result of two legitimate strategies of major retailers: the promotion of private labels and the reduction in the number of SKUs” (pp. 156-157). The Report concludes that innovation is not in danger in other countries based on the steady number of products listed in the Innova database. The Report does not consider any market foreclosure practice (refusal of access, undue use of commercial information and in-store discriminatory practices) that undermines the returns on the innovation. Furthermore, it does not deal with the opportunity costs on innovation ensuing from these practices.

⁵⁸⁸ The Private Label Report, pp. 90-92.

Table 5.13 Number of products introduced in 2009								
	France	Germany	Hungary	Italy	NL	Spain	UK	Total
Baking ingredients	33	124	15	72	74	6	54	378
Bread & bread products	104	94	37	218	151	32	65	701
Breakfast cereals	42	75	22	40	66	7	71	323
Cakes & pastries	90	166	18	202	95	16	230	817
Cereal & energy bars	43	68	18	61	27	7	84	308
Savoury biscuits/crackers	29	85	20	89	60	7	42	332
Sweet biscuits/cookies	187	251	60	232	122	26	159	1037
Total	528	863	190	914	595	101	705	3896
Cheese	218	202	71	350	34	13	43	931
Creamers	11	17	18	18	2	0	12	78
Dairy alternative drinks	11	3	4	20	21	5	13	77
Dairy drinks	24	96	30	69	31	24	43	317
Fats & spreads	10	17	35	28	6	0	11	107
Other dairy products	1	7	2	3	0	0	0	13
Yogurt	89	176	30	77	18	24	84	498
Total	364	518	190	513	112	66	206	1969
Fruits	86	66	10	103	38	6	51	360
Potato products	39	36	2	43	10	5	13	148
Vegetables	199	63	3	215	31	7	49	567
Juice & juice drinks	191	148	34	174	88	14	92	741
Total	515	313	49	535	167	32	205	1816
Source: Own elaboration on the basis of the INNOVA database.								
Grand Total	1.407	1.694	429	1.962	874	199	1.116	8797

Source: Private Label Report, p. 93 (Grand Total by the author of this Report).

Spanish suppliers indicated that ensuring access to the supermarket was the critical business factor⁵⁸⁹, in light of the number of vertically integrated supermarkets with a “closed shop” strategy⁵⁹⁰.

The Spanish Grocery Report has confirmed the findings of the Private Label Report and has led the Spanish Competition Authority to conclude that the current grocery retail structure may become a barrier to innovation in the medium to longer term⁵⁹¹. Based on a survey carried out among the Spanish supermarkets, the Spanish Competition Authority observed that the aggregate listings of new references supplied by independent brands in eight representative categories, has fallen dramatically in the 2006-2010 period, as compared with the 2000-2003 period (from 6.89% to 1.67%)⁵⁹². In

⁵⁸⁹ The Private Label Report, pp. 107-108: “For branded goods, and also many private label products, in Spain framework contracts are concluded for a year, a season or sometimes a couple of years. The most important negotiation item is the number of SKUs to be listed. This is particularly important because of the reduction in the number of SKUs in Spain by some of the largest retail chains. Some of the suppliers of branded products indicated that it is increasingly difficult to get products listed. Retailers have a stronger bargaining position because they control shelf space and the stakes for retailers are smaller than they are for suppliers, even large suppliers. Another supplier said this is very easy: one simply has to pay.”

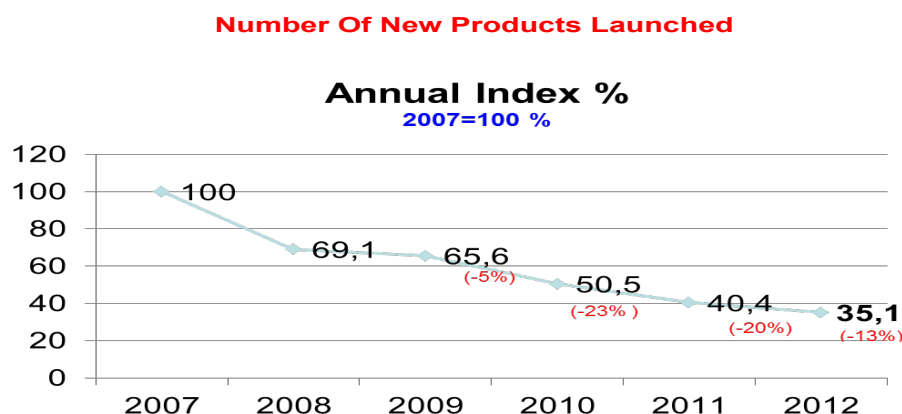
⁵⁹⁰ The Private Label Report, p. 92: “In Spain, retail chains that offer a small number of SKUs - including but not exclusively discounters - gained market share at the cost of hypermarkets.”

⁵⁹¹ The Spanish Grocery Report, par. 174.

⁵⁹² The Private Label Report, p. 74.

the same period, new listings of supermarket brands have declined less markedly (from 5.84% to 4.24%)⁵⁹³. Interestingly, since the independent brands introduce more new products than supermarket brands, the dramatic fall faced by the former has weighted more heavily than the comparatively minor decline faced by the latter. Thus, the total number of new product listings has gone down significantly in the 2006-2010 period, as compared with the 2000-2003 period (from 6.78% to 1.94%)⁵⁹⁴. In several of the surveyed categories (e.g., oils, rice, canned fish, milk and bakery) the market share of the supermarket brands has increased substantially over the 2000-2010 period up to >50% levels (see Appendix 8.6), a pre-eminence which has not been accompanied by a corresponding surge in new product launches in order to offset the (forced) decline of new product launches by independent brands. Not surprisingly, the Spanish Grocery Report reported that 70% of suppliers complained about being discriminated vis-à-vis retailer brands and listed the refusal to list independent brands' innovations as one of the main discriminatory practices⁵⁹⁵. Suppliers' complaints relate to the Spanish supermarkets that have adopted the "closed shop/network" model: Aldi, Dia, Lidl and Mercadona. Their business strategy has reduced/foreclosed access by independent brands to around 45-50% of the Spanish modern retail market, thus making it impossible for most innovations to achieve the minimum weighted distribution thresholds to be worthwhile.

Several other independent sources such as Alimarket and IRI, agree that innovation is dangerously declining in Spain:

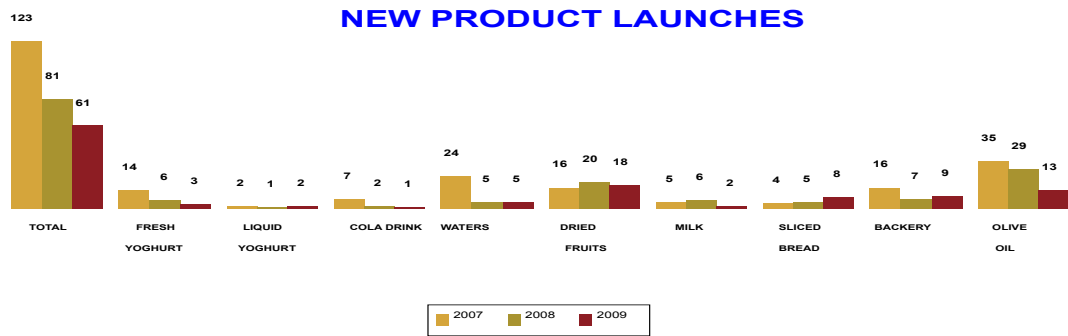


Source: Alimarket and KWP Annual reports on Innovation 2008-2009-2010-2011-2012 * New database in 2009

⁵⁹³ *Id.*, p. 74.

⁵⁹⁴ *Id.*, p. 73.

⁵⁹⁵ The Spanish Grocery Report, pp. 97-98.



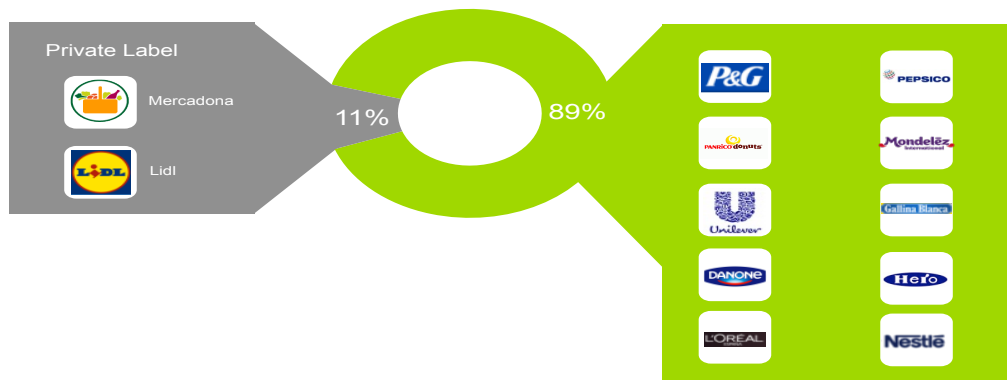
Source: : IRI InfoScanCensus™. Total Spain H+S.

A recent report by Kantar WorldPanel (“Innovation Radar 2013”) has produced shocking conclusions regarding the relationship between the closed access strategy of leading Spanish supermarkets and its effects on innovation and economic growth:

First, breakthrough innovation (i.e., “SKU which contributes a new feature to the category”) is driven by independent grocery brands:

INNOVATION IS DRIVEN BY BIG MANUFACTURERS

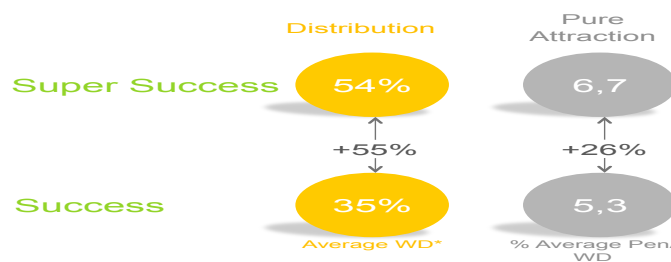
Share by number of innovative SKU's launched



Fast Moving Packaged Food. July 2012 – July 2013
Source: Kantar Worldpanel Innovation Radar

Second, the success of innovations is primarily driven by their access to consumers (i.e., access to distribution):

DISTRIBUTION EXPLAINS THE BIGGEST PART OF A SUPER SUCCESS

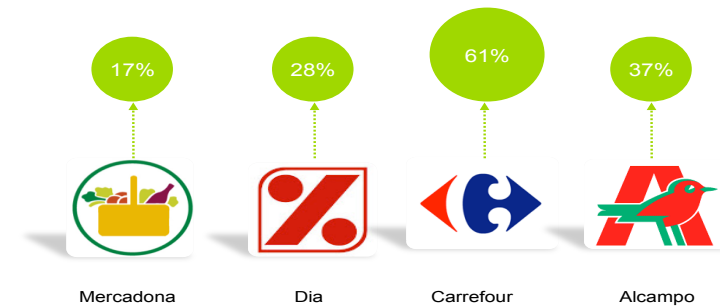


*Calculated over modern distribution and based in consumer panel data
Fast Moving Packaged Food. July 2011 - June 2013
Source: Kantar WorldPanel Innovation Radar

Third, the leading Spanish supermarkets such as Mercadona and Dia have adopted a closed access strategy against independent brands and their innovations:

LEADING RETAILERS LIST LESS MANUFACTURER'S INNOVATIONS

% of Manufacturer Brands innovative SKU's listed



Fast Moving Packaged Food. July 2012 – July 2013
Source: Kantar Worldpanel Innovation Radar



Fourth, less access to distribution (i.e., consumers) means less sales and unleashes a vicious circle of less innovations being launched:

IN 2013: LESS AND LESS SUCCESSFUL LAUNCHES



Fast Moving Packaged Food. TAM2: June – July
Source: Kantar Worldpanel Innovation Radar

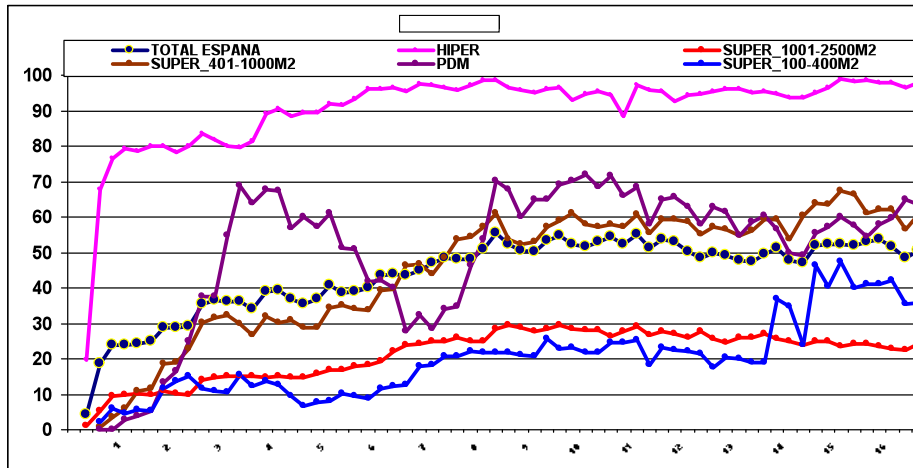
This closed shop strategy reflects a business model and not store-size limitations, as evidenced by the weighted distribution by store format achieved by a sample of two new products⁵⁹⁶:

The first product belongs to the household category and was launched in February 2009. Its maximum weighted distribution level stood at the 50%-55% range, achieving a mere 27% in the large supermarket segment (1,001-2,500 square metres), the most important

⁵⁹⁶

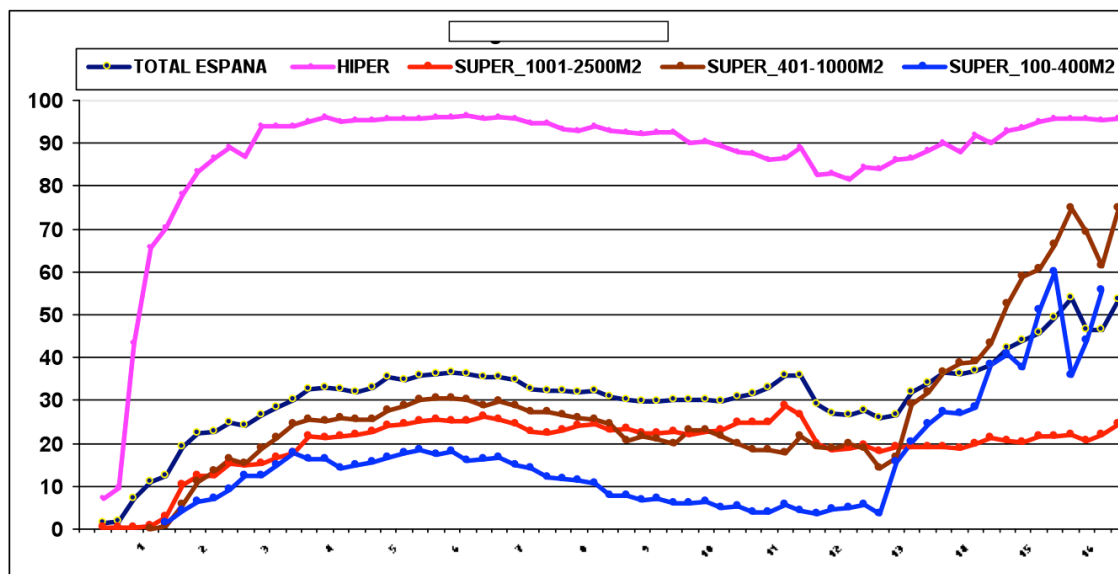
The brand names are not disclosed for confidentiality reasons.

in terms of sales and where Mercadona is the undisputed leader.



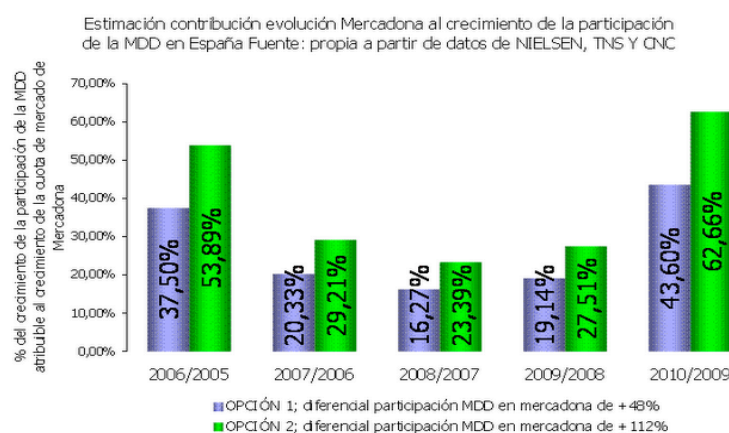
Source: IRI Infoscan - Base multicategoría MPG

The second product belongs to the processed food category and was launched in March 2009. Its maximum weighted distribution level stood at the same 50%-55% range, achieving a mere 25% in the large supermarket segment.



Source: IRI Infoscan - Base multicategoría MPG

Interestingly, both at the beginning and at the end of the period studied in the Spanish Grocery Report (2006 and 2010), the contribution of Mercadona to the growth of the supermarket brands' market share was extraordinarily high.



Source: Imanol Torres, *Blog Distribución alimentaria: el cambio permanente*, 16.11.2011

Overall, the comparison of the IRI data on weighted distribution achieved by new product launches of independent grocery brands with the penetration of supermarket brands' by country⁵⁹⁷ suggests that weighted distribution risks falling below economically viable levels when supermarket brands achieve a significant market share on an aggregate basis (e.g., 40%)⁵⁹⁸.

Furthermore, the data on grocery innovations registered in the Innova database (year 2009) raises some questions regarding the effects of supermarket brands and a single sourcing strategy on innovation. For example, Italy (1,962) stands out as the most innovative country, well ahead of larger countries such as Germany (1,694), France (1,407) and the UK (1,116). On the other hand, Spain illustrates the devastating effects on innovation of a market dominated by medium-large supermarkets with a “closed network” strategy that deliberately excludes independent brands.

Finally, the evidence confirms that supermarkets rely on a “creeping/progressive foreclosure” strategy that sees a combination of different practices. They do not refuse access in categories where their own brand is not well positioned. Rather they resort to other practices such as the misuse of confidential information and in-store practices that cannibalise independent brands in favour of competing supermarket brands. Once supermarket brands enjoy an established or even a prevalent presence in the market, leading supermarkets may engage in a systematic refusal of access to new products that may undermine the established position of their own brands⁵⁹⁹.

⁵⁹⁷ See the Table of supermarket brands' market shares in several Member States (Private Label Manufacturers Association 2013 Yearbook), above in Section 5.1.2.

⁵⁹⁸ In Italy, supermarket brands enjoy relatively small market share but the regional compartmentalisation of the supermarkets makes distribution of new product launches a slow-building exercise. This natural feature of the market does not seem to undermine new product launches, in contrast with the countries (i.e., Germany, Spain and the UK) where the closed shop model of the leading supermarkets “artificially” restricts the distribution of independent grocery brands.

⁵⁹⁹ Kuipers, “Retailer and private labels: asymmetry of information, in-store competition and the control of shelf-space”, in *Private Labels, Brands, and Competition Policy: The Changing Landscape of*

5.5.2 Competition within supermarket platforms

Once independent grocery brands are under control of the supermarkets, the latter can discriminate them in many ways without fear of losing consumers to rival supermarkets⁶⁰⁰. A consumer may, at least theoretically, complain and even switch to another supermarket if his preferred brand is delisted permanently in a given supermarket⁶⁰¹. However, the nature of multiproduct grocery retailing and, possibly, the competition policy-bias in favour of retailers, enables vertically integrated supermarkets to use discriminatory in-store pricing and non-pricing practices in order to favour their own brands⁶⁰². These practices go largely unnoticed to consumers even though they restrict their freedom to buy the grocery brands of their choice and, thus, are not constrained by retail competition⁶⁰³. Furthermore, they seemed to have gone unnoticed

Retail Competition, ed. By Ariel Ezrachi and Ulf Bernitz, Oxford, 2009, p. 203: “More generally where PLs [private labels] have captured a category, it will be an uphill battle for branded NPDs [new product developments], even if the quality is better, to find their own place on the shelves in that market. Put differently: it is much easier for PLs to find their way into a product market populated by branded goods, than it is for branded goods to find their way into a market dominated by PLs. This is another ‘asymmetry’, so to speak, of competition between PLs and brands.”

⁶⁰⁰ Kumar 2007, p. 18: “The manufacturer challenge is exacerbated by the inherent conflict for manufacturers between retailers as customers and retailers as competitors. The areas of conflict are legion. Retailers are inclined to devote the best shelf-space to their own brands, while manufacturers obviously disagree. Retailers may feel (often incorrectly, as shown in Chapter 6) that they benefit from a large price gap between their own private label and leading manufacturer brands, while manufacturers are wary of that strategy. Manufacturers desire a high pass-through for their price promotions, while retailers may feel that they gain more by pocketing these promotions rather than passing them on to consumers, especially since the profitability of many promotions for retailers is small at best.”

⁶⁰¹ Even this scenario is becoming less and less likely, as loyalty to the preferred supermarket prevails over loyalty to independent grocery brands. See, for example, Thomassen 2006, Chapter 3.

⁶⁰² Behavioural economics and marketing experts have long demonstrated that shopping behaviour can be largely irrational up to a point where the notion of fair value does not play any meaningful role. See, for a representative example of a vast academic and empirical research, Poundstone, “*The Myth of Fair Value (and How to Take Advantage of It)*”, Hill and Wang, 2010. If the fair value and even the intrinsic features of consumer goods are difficult to ascertain for grocery shoppers, then it is easy to understand that supermarkets control of in-store competition may be sufficient to distort several parameters of competition that are much more important in shaping consumers’ demand than the old-fashioned purchase price (value)/quality concept employed by competition authorities (e.g., copycats, reference pricing and shelf-positioning). For practical examples, see Dobson 2009, p. 114: “‘*The flesh eater*’ – The purpose here is to develop and then favour private label through the retailers’ control over in-store variables, allowing it to eat into brands’ sales. The retailer tries different ways – some subtle, some not so subtle – to persuade consumers to switch to and then keep buying its private label offering. For instance, the retailer may try to undermine brands with poor shelf positioning, artificial price differentials, deliberate stock-outs, and value destroying promotions (such as occasional deep discounts that raise questions in consumers’ minds about the true value for money offered by brands). As such, the retailer exploits role as a ‘double agent’, being both the brand producer’s customer *and* competitor, using private label as a lever to substitute brand sales with private label sales and in the process extend its buyer power over brand producers (allowing it to obtain more favourable terms, perhaps at the expense of its rival retailers).”

⁶⁰³ The promotional services theory holds that promotional shelf-space does not generate inter-retailer competition (Klein 2006, p. 16): “Although individual retailers operate in a highly competitive environment, they have the ability by allocating promotional shelf space to a particular branded product to induce sales of that product to “marginal consumers”. The simplest case to consider is a retailer deciding which brand of a product category to display more prominently than other brands, for example, which brand should receive the retailer’s eye-level shelf space. All brands demanded by consumers are assumed to be available in this example so there are unlikely to be any inter-retailer effects from the retailer’s decision to supply promotional shelf space to a particular brand. We can reasonably assume for

to competition authorities until recently with the exception of the Spanish Grocery Report, Finnish Grocery Report and Paris Grocery Report⁶⁰⁴. However, according to some scholars, this factor alone can explain the exponential growth of supermarket brands, which can undermine the long-term competitive equilibrium once present in the grocery brands market⁶⁰⁵. Not long ago, supermarkets felt comfortable enough describing their discriminatory in-store practices towards independent grocery brands:



Today supermarkets do not boast about these practices but competition authorities are increasingly aware of them (even though no public intervention is forthcoming):

“Since the retailers know the prices of the goods offered by the parties, they have the advantage to be in a position to fix the prices for their own private labels in reaction to the producers of branded products. In contrast, these producers are not able to readjust their prices to the retailers’ private label prices. Therefore, the retailer has the capacity to counteract efficiently against the leading brands of the parties with its own private labels, whilst the parties have an asymmetry of information vis-à-vis prices for private labels”⁶⁰⁶.

5.5.2.1 Pricing practices

In multi-product grocery retailing, consumers also value variables other than price (e.g., proximity) at the time of selecting a supermarket. Furthermore, consumers are not perfectly informed about prices and price-sensitive consumers will typically compare the price of the shopping basket or, at most, the prices of a small number of KVI

purposes of the analysis that no consumer will switch to an alternative retailer because their desired brand is not prominently displayed.”

⁶⁰⁴ See above, Section 4.

⁶⁰⁵ See, for example, Hoch, Montgomery and Park, “Why Private Labels Show Long-Term Market Share Evolution”, Hoch, Montgomery and Park, “Why Private Labels Show Long-Term Market Share Evolution”, Carnegie Mellon University, Tepper School of Business, Paper 333, 2002. They cite numerous empirical studies evidencing that most consumer packaged goods markets are in long-run competitive equilibrium due to consumer loyalty and, most importantly, the competitive reaction of competitors, which nullify attempts by one independent brand to take unilateral action to increase its share. However, they find that supermarket brands are a notable exception to this principle and demonstrate theoretically and empirically that the anomalous behaviour of the supermarket brand largely occurs because it is the only brand that controls not only its own marketing mix decisions, but also exerts a substantial measure of control over many of the marketing mix decisions made by its competitors: “We consider the viability of alternative explanations including changes in consumer and national brand behaviour and find that none of them can adequately account for the trend in private label share. We offer an analytical explanation and empirical support for why private labels can grow even though national brands shares are relatively stable. We argue that the retailer is in the best position to opportunistically appropriate different sources of category growth because not only does it control its own marketing spending, it also exerts some influence over the ultimate marketplace spending of their national brand competitors” (Abstract).

⁶⁰⁶ Commission Decision of 15.07.2005, COMP/M.3732, Procter&Gamble/Gillette, par. 124.

between supermarkets⁶⁰⁷. Therefore, vertically integrated supermarkets may strategically use retail pricing in order to favour their own brands. Olbrich and Buhr have coined the term “price scenery”, thereby indicating that supermarkets fix retail prices without regard for the interests of individual competing brands⁶⁰⁸.

Stages	Positioning of private labels	Price sceneries (examples)
Stage 1	Private labels in the entry-level price range Delisting C brands	Direct contrast of branded articles and private labels in the shelves (price campaigns, umbrella pricing intrastore)
Stage 2	Private labels as allegedly direct competitors for A and B brands Delisting B brands	Massive diversion of demand through advertising support for the price comparisons (umbrella pricing interstore)
Stage 3	Exclusion of intrastore competition between branded articles and private labels Delisting A brands (pure own brand ranges)	Artificial creation of price comparisons through setting recommended prices

Fig. 1: Price sceneries in the retail sector

Source: Olbrich 2004, p. 15

The main strategic pricing weapons in the hands of supermarkets in order to foreclose rival independent grocery brands are the following: (1) an artificial price gap with the leading independent grocery brand; (2) price-dumping of the independent brand in order to destroy its brand value; (3) pocketing of promotional wholesale prices; and (4) prohibition of on-packaging promotions.

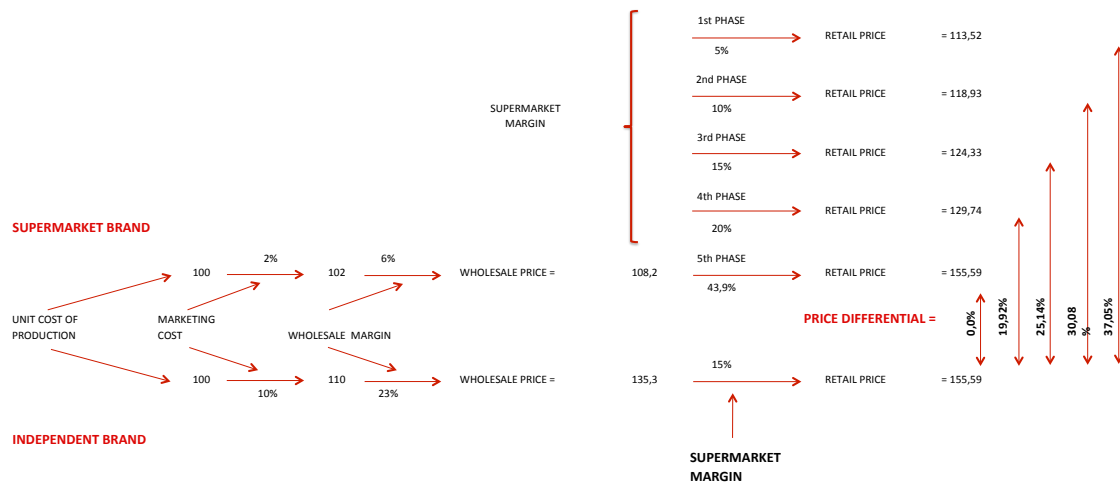
⁶⁰⁷ Caprice and von Schlippenbach, “Consumers’ Shopping Costs as a Cause of Slotting Fees: A Rent-Shifting Mechanism”, unpublished preliminary version, 2010, p. 2: “If consumers bundle their purchases, their buying decision depends rather on the price for the whole shopping basket than on individual product prices; and Hosken and Reiffen, “Pricing behavior of multiproduct retailers”, working paper, June, 2007, p. 25: “Specifically, the typical supermarket sells over 35,000 items, and consumers cannot possibly know all of the prices that will be relevant to their decision-making without visiting each retailer, or having retailers list all their prices in a public forum. As a practical matter, it is costly for consumers to visit retailers and for retailers to advertise their prices, so that consumers will be less than fully informed about prices. Nevertheless, as Lal and Matutes (L&M, 1994) show, even without knowledge of every price, consumers can be well informed about the surplus they will receive at each retailer. L&M show that when retailers advertise a subset of prices, consumers can draw correct inferences about the remaining prices, and therefore calculate the surplus they will receive that [sic] each retailer.”

⁶⁰⁸ Olbrich and Buhr, “The impact of private labels on welfare and competition - how retailers take advantage of the prohibition of retail price maintenance in European competition law”, Department of Business Administration and Economics, FernUniversität Hagen, Research Paper 1, 2004, p. 15: “The term ‘price scenery’ is used for the complete set of prices for a retail assortment. The term emphasises the fact that the prices of private labels and branded goods are deliberately set by the retailer to convey to the consumer a particular price image for the assortment as a whole without regard to the prices the branded goods industry would like to see. Because of this it sometimes seems to be justified to use the attribute ‘artificial’ in connection with price sceneries. The use of price sceneries can be described in stages (figure 1)”. The authors mention among the pricing practices the following ones: “umbrella pricing”, “explicit price comparison” and “artificial creation of price configurations”.

5.5.2.1.1 Artificial price gaps

Academic researchers have long observed that leading supermarkets create an artificial/strategic price gap (i.e., unrelated to the cost of procurement and retailing) between leading independent grocery brands and their own competing brands in order to promote their own brands⁶⁰⁹:

TABLE No 1
MODEL EXAMPLE OF SUPERMARKET BRANDS' PROFITABILITY



Source: Méndez 2000.

Vertically integrated supermarkets have an incentive to do so because consumers' constrained rationality places more weight on reference/relative prices than absolute prices (Poundstone 2010) and the overall price of the shopping basket may remain unaltered as the increased price of the leading independent brand is offset by a lower price in the competing supermarket brand⁶¹⁰. Evidence of the widespread use of this

⁶⁰⁹ See, for example, Méndez, Oubiña and Rozano, "Influencia de las marcas de distribuidor en las relaciones fabricante-distribuidor", *Distribución y Consumo* 53, Agosto-Septiembre 2000. They argue that supermarkets strategically set lower retail prices for the supermarket brands and, as they increase their market share at the expense of independent brands, their prices and margins matches and even exceeds that of independent brands. An analogous practice has been analysed and criticised in the mobile telephony market, where leading mobile operators have cornered new entrants through high interconnection fees and different retail prices for off-net and on-net calls. The supermarket strategy of offsetting the increased price in a given independent branded with a lower price of the competing supermarket brand may extend to price-reductions across other supermarket brands or independent grocery brands that made up the standard shopping basket. See, for the different options available, Kumar 2007, p. 104: "The retailer might also play the classic price game. In this case, it attempts to increase the price gap between its store brand and the manufacturer brand to ensure that the price premium commanded by the manufacturer exceeds the gap in perceived quality an image utility with the store brand. One way to increase the attractiveness of its private label is to increase the price of the manufacturer brands. (...). However, sometimes retailers disfavour manufacturer brands that they imitate by charging higher prices, while lowering the price of manufacturer brands that they do not imitate. The obvious alternative is to offer the private label at a low price so that the price gap between the manufacturer brand and the retailer's own private label becomes sufficiently large – at least for a sizable market segment – to compensate for the lower perceived quality and/or image utility of the sore brands."

⁶¹⁰ See Reece, "Book Review: *Priceless – The Myth of Fair Value (and how to Take Advantage of It)*", Baker Richards, available at <http://www.thinkaboutpricing.com/left-navigation/price-value.html>: "The first lesson in Poundstone's book is that price is not an absolute, because price is really just a

practice is mounting:

- The Paris Grocery Report of the French Competition Authority has found that the leading supermarket in the Paris grocery retail market, Casino, is consistently overpricing independent brands compared to other retailers, whereas its own brands are competitively priced compared to competing supermarket brands⁶¹¹. The French Competition Authority has concluded that this practice restricts consumers' freedom of choice and competition⁶¹².
- The Finnish Grocery Report has reached similar conclusions regarding the Finnish grocery retail market.
- The Kerry/Breeo Judgment assumed that supermarkets controlled price differentials between independent grocery brands and their own brands and could promote switching behaviour or maintain an average price differential that maximized

number, and numbers are only understood in relation to one another. What this means is that people are more sensitive to the differences between numbers and not to the number itself. Given that most buyers don't really know the actual cost that went into manufacturing the product they're considering buying and are therefore unable to make an informed decision about whether the asking price is 'fair', the first question they're likely to ask is how does this price compare with prices for similar products? Well, they could compare product X by company A with product X by company B and go for the cheapest, but the smart company wants the buyer to compare product X1 by company A with product X2 by company A and purchase either X1 or X2. How do they do this? Poundstone explains using the example of two bread makers, priced at \$279 and \$429 respectively, both manufactured by the William-Sonoma company. The \$279 model was released first and sales were ok, but after introducing the \$429 model, sales for the cheaper model nearly doubled. It didn't matter that sales for the more expensive version were terrible, the very presence of the \$429 model made the cheaper version more attractive. This is a classic example of the anchoring technique. Anchoring is now such a widespread tactic that almost anyone selling anything anywhere is making use of it. By creating a reference point, sellers are priming buyers by providing them with a kind of measuring stick so the focus becomes the difference in price and not the price itself."

⁶¹¹ The Paris Grocery Report, pars. 132-133: "a) Des prix élevés pour les produits de marque nationale, des prix compétitifs pour les produits à marque de distributeur: Pour les produits de marque nationale, les relevés de prix présents au dossier font état, pour les magasins *Franprix*, de prix de produits de marque nationale significativement supérieurs à ceux de certaines enseignes concurrentes, notamment vis-à-vis des groupements coopératifs. L'écart de prix tend d'ailleurs à croître avec les surfaces de vente comparées : il est plus important pour les supermarchés (plus de 400 m²) que pour les supérettes (moins de 400 m²). 133. Les magasins *Franprix* indiquent compenser ces prix supérieurs des produits de marque nationale en proposant aux consommateurs des prix compétitifs sur les produits à marque de distributeur. Ceux-ci constituent effectivement une forte proportion des ventes du groupe Casino et notamment de l'enseigne *Franprix* ([50 – 60]% en volume et [40 – 50]% en valeur en 2011), significativement plus élevée que dans d'autres enseignes de proximité, et les prix de ces produits apparaissent effectivement compétitifs par rapport à ceux d'autres enseignes exploitées à Paris."

⁶¹² The Paris Grocery Report, par. 136: "Ensuite, les marques de distributeur peuvent représenter une part importante du chiffre d'affaires des magasins *Franprix*, non du fait de la préférence intrinsèque des consommateurs pour ces produits, mais parce que les prix élevés des produits de marque nationale dans les magasins *Franprix* contraignent les consommateurs à acheter des marques de distributeur. De fait, le positionnement commercial choisi par Casino peut répondre à son propre objectif de maximisation des profits – les marges des distributeurs sont fréquemment plus élevées sur les produits à marque de distributeur que sur les produits de marque nationale – et non aux souhaits des consommateurs : la concurrence étant structurellement limitée sur le marché parisien du fait du poids important des magasins du groupe Casino, celui-ci est en effet en mesure de s'abstraire des préférences des consommateurs et de la concurrence. A l'inverse, une concurrence plus forte pourrait contraindre le groupe Casino à réduire les prix de ses produits de marque nationale."

the aggregate revenue from both brands⁶¹³.

- Evidence collected by the Spanish Ministry for Agriculture on prices along the supply chain shows that supermarkets were artificially subsidising the prices of their own milk and olive oil brands (low margins or even negative margins) with higher prices/margins in the leading independent milk and olive oil brands⁶¹⁴.

- Furthermore, a field study by The Brattle Group of the retailers' margins and prices on independent brands and supermarket brands in Spain, possibly the first ever of its kind, has uncovered how the creeping foreclosure of independents brands takes place behind the scenes⁶¹⁵:

⁶¹³ The Kerry/Breco Judgment, pars 9.25-9.26: "9.25 It is to be noted that the evidence available to the Authority included the fact that retailers do not price their private label products (at least primarily) by reference to the cost to them of the product plus a margin, but by fixing both the retail price of those products and of the branded products so as to create a differential which optimises the overall return from both lines. The Court considers that in assessing prospectively the potential constraining effect of private label sales by themselves and independently of the other mechanisms of influence available to retailers against the merged entity, the Authority was correct to assume that the current business models including the maintenance of the average price differential would be maintained. 9.26 It is undoubtedly true that, having regard to the peculiarities of the market structure and notably the "gate-keeper" role of the multiple chains, the latter could, if they chose to do so, depart from that pricing structure, abolish the differential and thereby make their private label products direct and close competitors of the branded products. It is also true that the evidence of discounted promotions demonstrates that higher levels of substitutability can be achieved between brands and private label products but the sales lost to the brands and gained by the private label are only lost and gained so long as the retailer chooses to continue the promotion. When it ceases, the evidence indicates that the pre-existing pattern resumes. This ability of the retailers to manipulate substitutability is clearly a factor to be considered in assessing the significance of countervailing buyer power but so long as the two product markets under consideration continue to be characterised by the deliberate differentiation between the branded and private label products, the Court considers that it was open to the Authority on the evidence available to it to assess the predictable effects of the merger on competition in these markets on the basis that this model would continue."

⁶¹⁴ See Appendix 8.5. The market share of supermarket brands in the milk and oil categories are in the 50% range and growing, according to Kantar-WorldPanel (Appendix 8.6). Other sources estimate that the current market shares of the supermarket brands reach 70% in the oil category and 60% in the milk category (http://elpais.com/diario/2011/11/20/andalucia/1321744928_850215.html).

⁶¹⁵ José Antonio García y Juan Delgado, "Análisis de la Competencia en el Mercado Minorista de Distribución en España", The Brattle Group, 12.04.2012 ("the Brattle Study 2012"). A press release with a link to the study can be found at <http://www.brattle.com/NewsEvents/NewsDetail.asp?RecordID=1204>: "The study provides empirical evidence that suggests the existence of dominant positions at the retail level of Mercadona in the regions of Comunidad Valenciana and Andalucía, and Eroski in the Basque Country. It concludes that the increased concentration of retailers, the tendency toward vertical integration, and the rise in the market share of private labels are already having a negative effect on price (and quality) competition and on the incentives of manufacturers to invest in new products and innovate. It further highlights that the discriminatory management of manufacturer and retailer brands adopted by dominant retailers may have exclusionary effects for the manufacturer brands that may ultimately reduce the consumer welfare. The authors propose a list of guidelines to promote competition in the Spanish food supply market, including prohibitions to privileged information exchanges between manufactures and retailers related to strategic variables (such as prices, costs structures, promotions and sales) and the imposition of FRAND (Fair, Reasonable and Non-Discriminatory) conditions on the commercial relations between manufacturers and retailers." The "Public presentation of the the Brattle Study 2012" in a powerpoint format can be found at <http://www.brattle.com/news-and-knowledge/publications>.

The Brattle Study 2012 conducts two ground-breaking analyses: (1) a price regression analysis that covers the quarterly evolution of the prices of the supermarket brand and the three largest independent brands for 15 of the most representative products of the shopping basket in the seven largest supermarket chains in seven regions of Spain in the period 2008-2011; (2) a retail margin analysis on 12 products

First, leading supermarkets apply higher retail margins to all of the 12 products (comprising six mass-consumption categories) under analysis, thereby creating an artificial price difference between independent brands and supermarket brands that switch customers to the later.

Table 7: Comparison of Sales Prices and Margins for MBs & ROBs

Product		Year	Brand Type	Transfer Price	RRP excl. VAT	Margin per Unit	
				(Index)	(Index)	(Index)	(%)
				[A]	[B]	[C]	[D]
				See Note	See Notes	[B]-[A]	[C]/[A]
Product A	[1]	2011	MB	100	125	25	25%
			ROB	44	46	2	5%
Product B Type 1	[2]	2011	MB	100	132	32	32%
			ROB	80	88	8	10%
Product B Type 2	[3]	2011	MB	100	155	55	55%
			ROB	82	89	8	10%
Product C	[4]	2011	MB	100	137	37	37%
			ROB	59	64	4	7%
Product D Format X	[5]	2011	MB	100	114	14	14%
			ROB	76	76	0	0%
Product D Format Y	[6]	2011	MB	100	115	15	15%
			ROB	71	76	5	7%
Product D Format Z	[7]	2011	MB	100	115	15	15%
			ROB	68	75	7	10%
Product E Format α	[8]	2011	MB	100	149	49	49%
			ROB	73	99	25	34%
Product E Format β	[9]	2011	MB	100	166	66	66%
			ROB	93	110	17	18%
Extra Virgin Olive Oil	[10]	2007-2008	MB	100	122	22	22%
			ROB	84	85	1	1%
		2008-2009	MB	100	137	37	37%
Olive Oil	[11]		ROB	83	67	-16	-19%
		2007-2008	MB	100	116	16	16%
			ROB	83	85	2	2%
Milk	[12]	2008-2009	MB	100	134	34	34%
			ROB	86	79	-8	-9%
			MB	100	148	48	48%
			ROB	79	103	24	30%

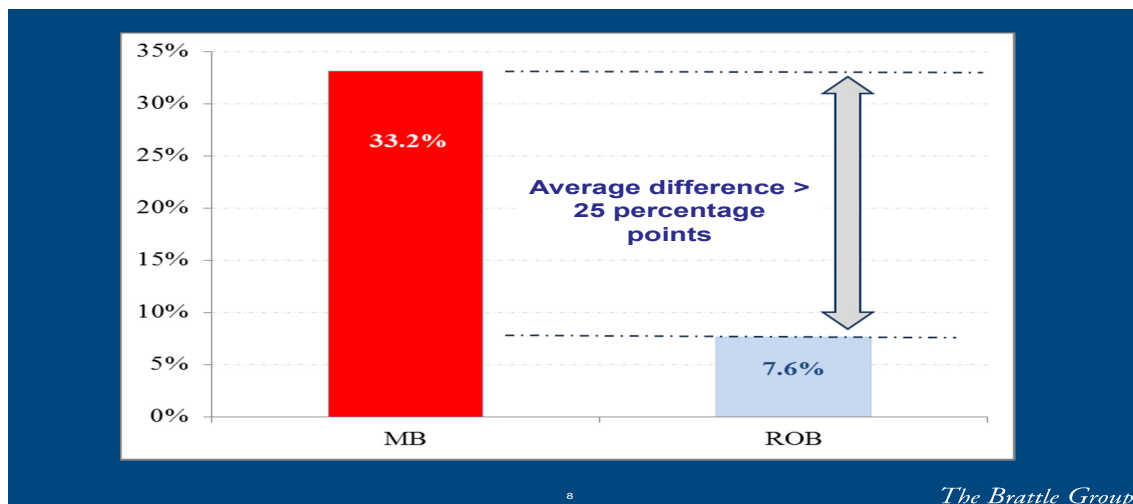
Source:
 [1] to [9]: Information obtained by Brattle by means of direct conversations with companies and associations in the sector
 [10], [11]: Food Price Observatory, MARM, Study of the Value Chain and Price Formation for Olive Oil, January 2010 and June 2011
 [12]: Food Price Observatory, MARM, Study of the Value Chain and Price Formation for Packaged Liquid Milk, April 2009

The Brattle Group

Source: Public presentation of the Brattle Study 2012, slide 9 (“MB” stands for Manufacturer Brands and “ROB” for Retailers’ Own Brands).

As a consequence, the margin differential applied to independent brands in respect of supermarket brands is higher than 25 percentage points on average:

Average Retail Margin in MBs and ROBs (%)

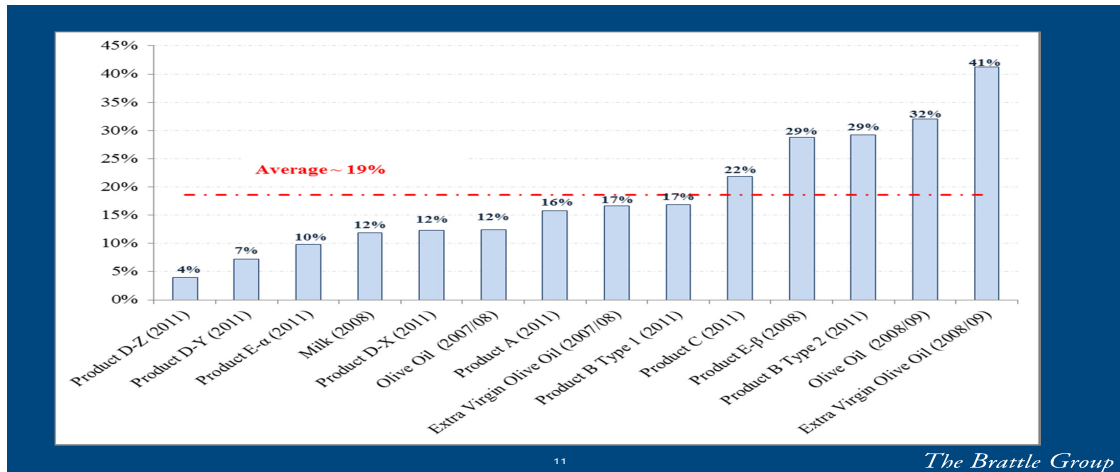


Source: Public presentation of the Brattle Study 2012, slide 8.

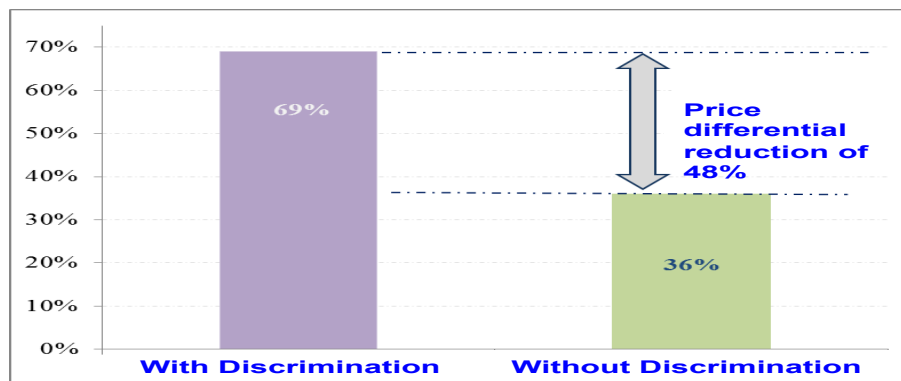
belonging to 6 mass-consumption categories in a given period of time. The data for the olive oil and milk categories is from a public source, whereas the other products and categories are kept confidential for fear of retaliation by retailers.

If these margins (retail price less wholesale selling price) were matched, the prices of independent brands would fall between 4% and 41%, depending on the product, which would mean an average prices decrease of 19%. This would result in the price differential between the independent brand and the supermarket brand declining by nearly 48%.

Elimination of Discriminatory Practices (ii)



Source: Public presentation of the Brattle Study 2012, slide 11.



Source: Own elaboration based on The Brattle Study 2012 and the Public presentation of the Brattle Study 2012, slide 10.

Second, as the market-share of supermarket brands grows, leading supermarkets increase the retail prices of independent brands but they also increase substantially more the prices of their own brands:

Table 6: Impact of Penetration of ROBs on MB and ROB Prices

	MB Price	ROB Price	Relative Price MB vs. ROB
Beer	+	+	-
Biscuits	0	+	-
Canned Fish	+	+	+
Cereals	+	0	0
Chocolate	-	+	-
Cocoa Cream	+	-	+
Coffee	-	+	-
Detergents	-	+	-
Dishwasher Detergent	+	+	-
Milk	+	-	+
Oil	+	+	+
Pasta	+	0	0
Shower Gel	0	+	-
Soft Drinks	+	+	-
Toothpaste	+	+	0

Source: Own elaboration, based on data obtained from independent market research firm. «0» means that market power does not have an effect on the price of the given product; «+» means that the greater the market power, the higher the price; and «-» means that the greater the market power, the lower the price. Level of significance is 95%.

16

The Brattle Group

Source: Public presentation of the Brattle Study 2012, slide 16.

The authors argue that this price gap drives customers from the remaining independent brands to supermarket brands and the later grow at the expense of the independent brands that are delisted and the declining market-share of the leading brands.

All in all, the authors conclude that leading supermarket's power is distorting competition in Spain and undermining consumer welfare in terms of innovation, variety, quality and prices. They suggest competition and regulatory remedies analogous to the ones proposed in this Report.

Competition policy has to a large extent facilitated this practice by condemning retail price maintenance by independent brands. Certainly, competition policy takes a benign view on maximum retail price maintenance (see the Vertical Guidelines, pars. 226 and 229 and the Finnish Grocery Report). However, this remedy comes too late for independent brands, as recognised by the Finnish Competition Authority, because supermarkets have by now achieved such a degree of market power that it enables them to reject upfront any such request or to adopt other discriminatory practices towards any supplier that seeks to enforce a maximum resale price (e.g., delisting of some references, poor shelf-positioning, loss-leading pricing)⁶¹⁶.

5.5.2.1.2 Loss-leading

Frequently, this strategy of artificial price gaps is supplemented with targeted price-dumping of independent brands, which destroys their value in the eyes of consumers and may convince them that their regular and, possibly, artificial price differential with

⁶¹⁶ Press release of the Finnish Competition Authority (FCA), 10.01.2012: "According to the suppliers' responses, retailers often price brand products above private label products. According to the study, this phenomenon and the possible competition distortions created by it could possibly be prevented by the suppliers' maximum resale price maintenance. However, it is difficult to present tenable estimates about the possibilities and incentives of the supplier level to include conditions on maximum resale price maintenance into the agreements."

supermarket brands is not justified by superior performance⁶¹⁷. The regular price variations and loss leading of independent brands by supermarkets can be fatal for these brands and for the competitive process, an outcome that is constantly ignored by competition authorities⁶¹⁸.

5.5.2.1.3 Pocketing of promotional wholesale prices

Competition policy prevents independent brands from setting/negotiating the resale prices of their products. Therefore, if they feel their resale prices are too high all they can do is to offer supermarkets promotional wholesale prices in the hope that they will be transformed into lower/promotional retail prices⁶¹⁹. Therefore, supermarkets' power to distort the retail prices of competing independent brands is reinforced by their power to prevent full pass-through of independent brands' promotional prices.

In recent years, the use of promotional prices has gained economic importance. However, independent brands have regularly complained that these promotional prices are not passed-through to end consumers, because retailers keep for themselves a substantial percentage of promotional fees⁶²⁰. A number of studies have tried to estimate

⁶¹⁷ Poundstone 2010 highlights that human beings are averse to extremes and this translates into a preference for middle-priced products over extremely low-priced products and extremely high-priced products. Paul Dobson calls this strategy "*Dubious Brand Value*" *Tactic*: brand prices are raised and lowered in yo-yo fashion or in Edgeworth Cycles (small steps down then big jump up) to confuse consumers on real value and encourage trial of more consistently priced supermarket Brands ("*Switch Marketing: The Implications for Consumers and Competition*", Conference on Trends in Retail Competition, Institute of European and Comparative Law, University of Oxford, May 2009). See also Kuipers 2009, pp. 212-213: "First and foremost, branded firms develop differentiated assortments of products, each with their own 'positioning', including price-point positioning. In terms of price positioning: budget, standard and premium-positionings are common. Branded firms develop assortments along these and other criteria. Via advertising and other means they communicate their product positionings directly to the consumer. Branded firms have a legitimate interest that carefully developed positionings are not destroyed and that a premium positioning does not, because of the retailer's in-store pricing, change into a *de facto* budget image. (...) Traffic building by loss-leading is in fact another way to free-ride on goodwill and investments of brands. Retailers make use of the name and fame of brands to attract shoppers. The losses on those products are earned back on other products (including PLs). By offering brands at below-value prices, goodwill value is affected both in terms of brand positioning and because of delisting by other retailers".

⁶¹⁸ Klante, "Identifikations- und Erklärungsansätze für Markenerosion", Wiesbaden: Deutscher Universitäts-Verlag, 2003. As a consequence of frequent retailer pricing actions, 83% of the brands suffered a strong or very strong negative change in brand image and confidence and 56% of the brands suffered a decrease of declared repetitive purchase.

⁶¹⁹ In this Report, promotional prices are considered to be the supplementary compensations (including lower wholesale prices) that independent brands offer to supermarkets aimed at securing temporary lower retail prices (or higher quantities at the existing retail prices). Therefore, they can be distinguished from other access fees that do not directly lower the wholesale/retail price of the independent brand. These promotional agreements have possibly grown out of the negative stance of competition authorities towards resale price maintenance agreements. If an independent brand cannot control the resale price of its products, it will have to resort to promotional-type arrangements in order to secure lower retail prices than the prevailing ones without engaging into suspect retail price fixing initiatives.

⁶²⁰ Besanko, Dubé and Gupta, "Own-Brand and Cross-Brand Retail Pass-Through", *Marketing Science* 24-1, Winter 2005, p. 123: "In the packaged goods industry, over 60% of manufacturers' marketing budgets is now channeled through the retailer in the form of trade promotion spending (Cannondale Associates 2001). This amounts to 16% of the revenues of these manufacturers. The annual

the degree of pass through of trade promotions, with particular focus on the US grocery retailing. Overall, these studies conclude that the pass through of promotional spending is irregular and the average pass-through is well below 100%, in line with the complaints expressed by independent brands⁶²¹. This lower rate of pass through may be exacerbated when leading supermarkets are vertically integrated, thereby foreclosing independent grocery brands. The owners of supermarket brands (i.e., the supermarkets) control the retail prices of their products whereas independent brands must struggle to achieve a 50% pass through rate, which places them at a competitive disadvantage and harms their consumers⁶²².

5.5.2.1.4 Prohibition of on-package promotions

The power of leading supermarkets over independent brands is so overwhelming that they feel entitled to authorise what goes on the packaging of the latter. For example, the Spanish Grocery Report revealed that some supermarkets refuse to accept packaging that contains promotions, whether they require the supermarket's in-store cooperation or not (e.g., out-of-store draws and prizes, which are managed by the independent grocery brand).

5.5.2.2 Non pricing practices

Even though competition authorities tend to focus on price competition, consumers' buying decisions and the competition between grocery brands are conditioned by many other non-pricing practices under control of the supermarkets.

Cannondale survey shows that year after year, the single biggest concern of manufacturers is the inefficiency of this trade promotion spending. Manufacturers believe that "nonpass-through" of trade-promotion money to consumers is a major contributor to the inefficiency. They contend that only about half of their trade spending is passed through to the consumer, while retailers claim that percentage is substantially higher. In the 2001 Cannondale survey, for example, food manufacturers claimed that 52% of trade funds were passed through to consumers, 21% covered retailers' promotion costs, and 27% were applied to the bottom line of the retailer. By contrast, food retailers said they passed through 62%, used 24% to cover promotion costs, and 14% went to the bottom line. Based on the estimated trade-promotion expenditure of \$75 billion, the gap between manufacturers' and retailers' reported amounts of pass-through exceeds \$7.5 billion". The EU grocery retail market is more concentrated than the US grocery retail market. Therefore, the percentage of non pass-through is likely to be higher in the EU than in the US.

⁶²¹ See, for example, Armstrong, "Retail Response to Trade Promotion: An Incremental Analysis of Forward Buying and Retail Promotion," unpublished doctoral dissertation, School of Management, University of Texas at Dallas, 1991; Blattberg and Neslin, "Sales Promotions: Concepts, Methods and Strategies", Prentice Hall, 1990; Blattberg, Briesch and Fox, "How promotions work", Marketing Science 14-3, pp. 122-132, 1995; and Besanko 2005. In particular, Besanko and his colleagues analyse the degree of pass through of trade promotions using scanner data for eleven product categories at a Chicago supermarket chain: 8 out of 11 categories show pass through rates of less than 100 percent.

⁶²² See, for example, Hess and Armstrong, "To Deal or Not to Deal: Trade Dealing with Opportunistic Retailers", Marketing Science Conference, University of California, Berkeley, 1997; and Hoch and Lodish, "Store Brands and Category Management," Working Paper, The Wharton School, University of Pennsylvania, 1998.

5.5.2.2.1 Degradation of services

In principle, no independent grocery brand is in a position to monitor and, even less, prevent a supermarket from engaging in a subtle degradation of the in-store management of the product (e.g., stock-outs, poor replenishment and biased advice from store assistants to consumers). Moreover, supermarkets often force grocery brands to shoulder the costs of shelf-replenishment activities carried out by third companies selected by the former. These companies have an incentive to compensate/favour those who select them (i.e., supermarkets and their brands) and to overcharge or discriminate those who are bound to pay their services (i.e., independent brands)⁶²³.

5.5.2.2.2 Switch marketing

Supermarkets may reinforce their exclusionary pricing practices with a subtle but highly effective switch marketing strategy aimed at publicising their own brands' pricing advantages, supported with proactive guidance from store assistants or online assistants⁶²⁴.

5.5.2.2.3 Preferential shelf-space

Preferential shelf-placement may increase the sales of a brand significantly (e.g., 10-15%). Aware of this reality, supermarkets regularly devote the best shelf-space to their own brands. The proponents of the promotional services theory (this theory holds that brands compete for promotional shelf-space) assume that supermarkets are likely to treat all brands alike in terms of promotional shelf-space, either without access fees⁶²⁵ or with them⁶²⁶. They consider an ideal, but hardly realistic, level playing field where the supermarket brand competes with other independent brands on an arms' length basis⁶²⁷.

⁶²³ See the prevalence of this practice in Spain, above in note 109.

⁶²⁴ See, for practical examples, Dobson 2009b: "*Sainsbury's 'Switch and Save'*": Advertising campaign promoting "Switch to Sainsbury's own brand and save at least 20%". JS survey indicates a third of customers switched to own brand (Dec 2008). *Tesco 'Cheaper Alternatives!'*: web tool on tesco.com and backed up by TV advertising campaign. 40% of Tesco online customers regularly using the web feature (March 2009). Olbrich 2004 reports that this practice is widespread in Germany (p. 16).

⁶²⁵ Klein 2006, pp. 20-21: "The manufacturers with the greatest profitability from incremental sales (the products with the greatest promotion-induced increase in sales multiplied by the manufacturer margin [formula]) will be able to pay the most for shelf space and will win this competition. Without shelf space contracts with manufacturers, retailers would allocate shelf space across products so that retailer incremental profit, [formula], would be approximately the same across all products. The retailer would not take account of the substantially higher marginal manufacturer profits that may exist on some products in determining what to stock."

⁶²⁶ Klein 2006 concedes, however, that access fees may increase the cost of distribution (pp. 4-5): "Competition for shelf space that leads to slotting may raise the cost of obtaining retail distribution, but it does so for everyone. An artificial barrier to entry is created only if one assumes that the increased cost necessary to distribute a product imposes a higher cost on new entrants relative to incumbents, for example, because of imperfections in the capital market. However, competition between incumbents and entrants for retail distribution generally occurs on a "level playing field," in the sense that all manufacturers can openly compete for shelf space and it is the manufacturer willing to pay the most for a particular space that obtains it."

⁶²⁷ Klein 2006, page 18, footnote 25: "A retailer deciding to use promotional shelf space to stock its own private label brand, on the other hand, receives essentially all the profit on incremental sales because

However, reality contradicts their predictions in many respects: First, this theory wrongly assumes that supermarkets run the competition for shelf-space on a transparent and objective basis in order to attract as many bidders as possible. In reality, suppliers never know the criteria under which supermarkets allocate shelf-space and very often are unable to monitor compliance with the agreed terms. Second, this theory wrongly assumes that supermarket brands are subject to the same profitability criteria. However, it disregards the strategic use of supermarket brands in order to reduce inter-brand and inter-supermarket competition. For example, supermarkets may devote preferential space to a non-profitable brand (even though it may be subsidised with the higher retail prices of the competing independent grocery brand) in order to reduce its customers' demand elasticity and increase its market power in local areas.

The empirical data collected in Spain supports the conclusion that supermarkets use preferential shelf-space in favour of their own brands for strategic reasons⁶²⁸.



Source: Agriculture Ministry (MARM) Market Research: - Food Consumption and Distribution Observatory – Historical Report – February 2010 Results

competition between alternative (non-brand name) manufacturers of the product for the retailer is likely to drive the wholesale price close to marginal cost. Therefore, even if there are no inter-retailer effects the retailer will make the correct stocking decision with regard to private label products, i.e., use promotional shelf space to stock a private label product as long as its return exceeds the opportunity cost of the shelf space. The retailer is operating as if it were vertically integrated into manufacturing.”

⁶²⁸ Fernández and Gómez, “Estrategias de las marcas de distribuidor”, *Distribución y Consumo* 45, 1999, pp. 30-49; and “Shelf space management: a case study in Spanish Retailing”, *Journal of Retailing and Consumer Services*, 12, 2005. For a more recent survey, see Gómez and Rozano, “Marcas de distribuidor: análisis del espacio en el lineal por categorías y enseñanzas”, *Cuadernos de Gestión* 9-1, 2009: “The purchase decision of 3 out of 4 grocery goods is taken in the store and approximately 50% of these kind of purchases is impulsive (Gómez and Rubio 2005). Therefore, point-of-sale initiatives are critical in order to influence the consumer...This study confirms the increased prevalence afforded to the supermarket brand in the shelf. In some of the stores surveyed these brands monopolise the shelf, whereas in other stores they coexist with independent brands whilst enjoying preferential shelf-presence...The preferential presence of supermarket brands in the shelves necessarily reduces the availability of independent brands, i.e., the number of brands available in the category, and thus may reduce consumers’ choice. Most of the time, the shopper that does not find an independent brand in the shelf of a given supermarket will switch to a supermarket brand.”

This privileged treatment is hardly ever justified by consumer demand considerations (e.g., measured in terms of market share) and very often not even by brand-to-brand profitability comparisons⁶²⁹.

5.5.2.2.4 Copycats

The European Commission has described this practice as follows:

“Parasitic copying can be defined as the practice of marketing products which are designed to resemble or look like pre-existing products of well established brands. The similarities between the products lead consumers to associate or confuse the two competing products. Products put on the market under a parasitic copying strategy are usually referred to as "parasitic copies", "look-alikes", "knock-offs" or "slavish imitations".

Testing the borderlines of intellectual property rights such as trade marks, designs and copyright, look-alikes are designed to exploit the selling power of well established products and divert sales while carefully avoiding situations of blatant infringement of exclusive rights. Indeed, parasitic copying typically consists in reproducing the main presentational features of market leading products (such as the shape of the product or of its packaging, colour combination and graphic arrangement) but usually there is just enough difference to avoid a clear-cut trade mark, design or copyright infringement. Still they often generate deception or confusion among consumers”⁶³⁰.

Supermarkets’ early access to commercially sensitive information about new launches places them in a unique position to launch me-too competing products and they also copycat the packaging of the independent brand in order emphasize the similarities between the two competing products and induce consumers to switch from the targeted brand to the supermarket brand⁶³¹. Not surprisingly, independent brand innovations are

⁶²⁹ See Agustín and Iniesta, *Fidelización de los consumidores. Cómo pueden los fabricantes y los distribuidores fidelizar a través marcas y tiendas*, Ed. Gestión, 2000. They compare supermarket brand’s share of the shelf with its volume and value market share in 28 product categories. Furthermore, they estimate supermarket brand profitability as the price differential with the independent brand divided by its market share and conclude that many of the categories where the supermarket brand enjoys shelf-preponderance are the most profitable for the supermarket, even though the own brand preponderance in others is not justified for profitability reasons and may indeed undermine the overall profitability of the category. See also Gómez, “Factores determinantes de la gestión de espacio en el lineal de los establecimientos minoristas españoles”, Cuadernos de Economía y Dirección de la Empresa. Núm. 23, 2005, pp. 93-116. She observes that the surveyed hypermarkets privileged shelf-presence of their own brand in 17 out of the 40 categories studied. Furthermore, she inverts the profitability formula developed in Agustín 2000 and concludes that in 5 out of the 17 categories where the presence of the supermarket brand exceeds its market share, its profitability does not justify this over-presence. She argues that the supermarket brand enjoys more shelf support in these categories, despite its lower profitability, because they are new categories (or the supermarket brands are new entrants) or they relate to products with high consumer royalty to incumbent independent brands (e.g., higher perceived risk of the product)”.

⁶³⁰ European Commission, Invitation to tender n° MARKT/2010/20/D: Study on trade secrets and parasitic copying (look-alikes), 28.10.2010, p. 18 (http://www.ecta.org/IMG/pdf/invitation-markt-2010-20-d_lookalikes-2.pdf).

⁶³¹ See par. 197 at p. 84 of the Spanish Grocery Report (44% of the surveyed leading brands and 24% of the non-leading brands stated that they had received unjustified requests of confidential information on their new product launch plans, information that had been used in favour of the supermarket brands) and par. 197 at p. 84 of the Spanish Grocery Report (80% of the leading brands and

copied faster by supermarket brands than by other independent brands⁶³². Furthermore, whereas independent grocery brands do not hesitate to sue other independent brands and seek damages whenever copycatting takes place, they hardly ever sue their major customers, who can go on copycatting their competitors unconstrained.

The effects of this practice on competition and consumers are significant. An independent study into consumer reaction to copycats in five Member States made these findings:

“A population-weighted average of 46.4% of grocery shoppers across the 5 countries admitted to having been confused and misled by the packaging of two grocery shopping items which looked similar. An average of 39.2% of grocery shoppers across the 5 countries admitted to having accidentally bought the wrong grocery item by mistake because the packaging was similar to the item they wanted, varying from 23% in Germany up to 60% in Poland. Amongst 37 combinations of brand and parasitic copy across the countries, for 31 of these pairs, shoppers thought it more likely than unlikely that one of the products could be bought by accident believing it to be the other.”⁶³³

In response to the grave concerns raised by this practice, the Commission tendered an independent study on parasitic copying⁶³⁴. However, this study does not address this question from a competition law standpoint and it overlooks the fact that the lack of *ex party* enforcement of the relevant laws against supermarket brands responds to fear of reprisals by supermarkets.

5.6 Anti-competitive effects

Leading supermarkets enjoy market power in the grocery retail market (Section 5.3.1). Likewise, supermarkets enjoy a competitive bottleneck status vis-à-vis independent grocery brands (Section 5.3.2). As anticipated by various theories of harm (Section 5.4), this market power facilitates supermarket practices regarding access to their platforms (stores) and competition within them that have the potential to distort competition between supermarkets and between grocery brands (Section 5.5). It is difficult to estimate the anti-competitive effects of some of these practices, as they may reduce dynamic incentives to compete, innovate and be more efficient, which are not

32% of the non-leading brands stated that the presentation of their products had been copied by supermarket brands). See the British Brands Group webpage (<http://www.britishbrandsgroup.org.uk/pages/parasitic-copying>) for a detailed discussion and several examples of copycatting.

⁶³² Allain 2011, p. 16, footnote 26: “In a recent market study, DIW reports that new national brand products are imitated more quickly by private labels (with an average delay of 10,9 month) than by other national brands (12,3 months). Similar observations apply for packaging imitation (Zunehmende Nachfragemacht des Einzelhandels, Eine Studie für den Markenverband (DIW Econ))”. This early copying by supermarket brands has another anticompetitive effect. If the innovator is afraid to take legal action against the supermarket brand, then further legal action against copies of other competitors may be less effective or viable and competitors may feel safe to copy the innovation without fear of legal action.

⁶³³ Don Edwards & Associates Limited, “A study into the impact of similar packaging on consumer behaviour in France, Germany, Spain and Poland”, 2.02.2012, unpublished study commissioned by a trade association and made available to the author of this Report.

⁶³⁴ Hogan Lovells Final Report on Parasitic Copying for the European Commission, “Study on Trade Secrets and Parasitic Copying (Look-alikes)”, MARKT/2010/20/D.

measurable under static econometric models⁶³⁵. Indeed, regulatory and competition law intervention in other competitive bottleneck markets has been preventive (i.e., before anti-competitive effects could materialise) or has only advanced the theory of harm to competition, without relying on material effects.

However, this Report has provided ample evidence that leading supermarkets have embarked on a strategy to (1) increasingly transfer trading risks to independent grocery brands through access fees, that are often impossible to foresee by independent grocery brands; and (2) discriminate independent grocery brands in respect of access to and competition within their platforms.

Furthermore, the grocery retail markets of different Member States provide more evidence of material harm to competition than any other competitive bottleneck market subject to regulatory or competition law remedies. This competitive harm manifests itself through lower innovation⁶³⁶, lower quality⁶³⁷, lower variety⁶³⁸ and higher retail prices⁶³⁹.

Overall, the practices of the leading supermarkets are restricting competition in the grocery brand market and this, in turn, distorts competition in the supermarket platform market. Olbrich 2004 has described in two tables how supermarkets distort competition between independent grocery brands and their own brands on four competitive

⁶³⁵ Vertical integration by supermarkets (competitive bottlenecks), which do not provide any guarantee against misuse of confidential information supplied by independent grocery brands, is likely to reduce *per se* the incentives to innovate of the latter.

⁶³⁶ See, in particular, Sections 5.5.1.1 (“Misuse of sensitive commercial information”), 5.5.1.2 (“Access fees & conditions”), 5.5.1.4 (“Refusal of access”) and 5.5.2.2.4 (“Copycats”).

⁶³⁷ Quality is normally associated with innovation (product innovation brings better or new products to market) and even variety (different consumers may have different perceptions regarding quality). However, supermarkets’ foreclosure and exploitative practices vis-à-vis suppliers may also have an unintended effect on the intrinsic quality of grocery products. See, OECD 2009a, Note by Finland, p. 155: “Assessing the detrimental effect of buyer power of the retail sector deserves closer attention. With the downstream competitive process in the working, the problem is not in that the result of this power would not transfer into lower consumer prices, but in that the industry is faced with terms that may: - induce it to lower the standards of products (quality degradation); - be tempted to fail on the environmental requirements in their production may be relevant questions in the near future”; and p. 306: “A delegate from Finland noted that there were two specific concerns. First, bargaining power might be used not only to negotiate discounts, but also to impose exclusive supply requirements. Second, there is evidence that suppliers subject to bargaining power were responding by lowering their costs either by reducing quality or violating environmental regulations”. In this regard, one could wonder whether there is a link between the worsening of the overall quality of packaged milk sold in Spain and supermarkets’ pricing practices in the milk category (see Appendix 8.5).

⁶³⁸ See, Section 5.1.2 for an account of the progressive reduction of competing grocery brands in the supermarkets, as a consequence of their ROB+1 strategy.

⁶³⁹ See Sections 5.3.1.5 (i.e., supracompetitive retail prices); 5.5.1.2 (i.e., inflationary effects of access fees & conditions); 5.5.2.1.1 (i.e., artificial price gaps or umbrella-pricing); 5.5.2.1.3 (i.e., pocketing of promotional wholesale prices); and 5.5.2.1.4 (i.e., prohibition of on-package promotions). Furthermore, quality and variety reductions with constant/higher prices are equivalent to price increases from a consumer welfare perspective.

dimensions and its consequences: a market where vertically integrated supermarkets eliminate or distort competition on all four competitive dimensions⁶⁴⁰.

		Competition between products in retailing	
		Intrabrand	Interbrand
Competition between retailers	Intrastore	Branded articles over time are subject to a market appearance controlled by the retailers (in particular through changing marketing strategies of the retailers)	Branded articles compete with each other and with private labels (in particular through competition for shelf space and misuse as a price umbrella for private labels)
	Interstore	Branded articles are subject to pricing competition between retailing systems (in particular through price promotions and loss leaders)	Branded articles compete with each other and with private labels (in particular through profiling strategies of the retailers and as a price umbrella for private labels)

Fig. 3: Competition fields of branded articles in the consumer goods sector

		Competition between products in retailing	
		Intrabrand	Interbrand
Competition between retailers	Intrastore	No competition at the level of private labels	No competition between different private labels
	Interstore	No competition because private labels are only represented in one retailer's outlets	Increasing sealing off through delisting branded articles Increasing sealing off through business concentration (private labels are merged) Increasing sealing off through delisting branded articles

Fig. 2: Competition fields of private labels in the consumer goods sector

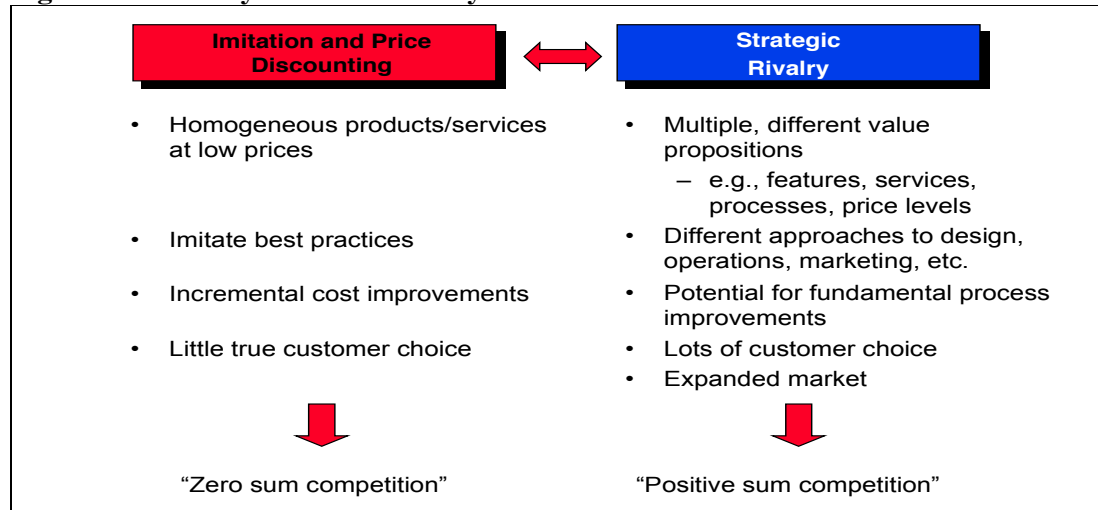
Source: Olbrich 2004, pp. 19-20

⁶⁴⁰ Olbrich 2004, pp. 19-20: "The exclusion of *intrastore-intrabrand* competition is executed directly for private labels, because the retailer directly controls the market entrance of these products. In addition, the market appearance of the branded article in the retailer's outlets is controlled by the retailer itself. *Interstore-intrabrand* competition does not in fact take place because private labels are only represented in the respective retailer's distribution network. The exclusion of *intrastore-interbrand* competition between private labels is given through the direct control of the respective retail system. The sealing off from competition between private labels and branded articles is now driven even further by delisting B and C brands. The exclusion of *interstore-interbrand* competition between different private labels of various retailing systems is coming closer and closer as a consequence of business concentration (private label product ranges are merged). In addition, delisting branded articles takes effect here as well and furthers sealing off. In contrast to this, branded articles are subject to intensive competition in all four competition fields which is even partly distorted in favour of the retailing trade through its pricing behaviour as sketched above (figure 3). *Intrastore-intrabrand* competition is controlled by the retail sector and leads to the problem that branded articles are positioned differently depending on the retailers' strategies. With this stands and falls the possibility for coherent sales policy strategies of the branded articles industry. In the *interstore-intrabrand* competition branded articles are subjected continuously to the retail sector's pricing competition. In the *intrastore-interbrand* competition a branded article is in competition not only with competitive branded articles but also with private labels along with corresponding pricing policy tactics. In addition, in the *interstore-interbrand* competition the branded article can be used either as a profiling instrument or as a price umbrella as well, depending on the retailer's strategy."

The end result is a commoditised grocery retail market where (1) product innovation, quality and diversity are undermined whilst (2) retail prices are supracompetitive, both in absolute and quality-adjusted terms.

The first part of this equation (1) reflects the “Imitation and Price Discounting” model described by Porter 2002, or the downward quality/price spiral warned by others⁶⁴¹, which leads to “zero sum” competition⁶⁴² and little consumer choice⁶⁴³.

Figure 7 Rivalry and Productivity Growth



Source: Porter 2002, p. 16.

In this regard, Inderst has been the first economist to model the effects of supermarkets’ power and vertical integration on innovation and his conclusions are alarming:

“This report first sketches how as retailers have grown in size, functions have

⁶⁴¹ See Rabobank 2011(note 119), IRI 2007 and Bell 2009.

⁶⁴² See Kumar 2007, pp. 33-35: “These store brands are copycats in the sense that they imitate the leading manufacturer brands in the category...Often, copycat store brands are uncomfortably close in terms of packaging as the Cif (Unilever) and Nescafé (Nestlé) examples demonstrate in figure 2-3. Placing these look-alike store brands adjacent to the leading brand encourages both brand comparison and brand confusion on the part of shoppers. Retailers aggressively promote copycat brands using price promotions and comparative messages...To ensure quality, retailers analyse the contents of a leading manufacturer brand and then re-create the product step-by-step, a process called reverse-engineering. In this sense, they are free-riding on the manufacturer’s innovation, research, product development, and image-building efforts for its brand. Since there are few research and development or sales and marketing expenses for the retailer, and the products are aggressively outsourced for low-cost manufacturing, the price on such copycat store-branded products is considerably lower than the referent manufacturer brand while still delivering high margins to the retailer, at least in percentage terms...Copycat store brands by retailers do not face the risks associated with new product introduction, because they only introduce such copycat brands once the manufacturer’s new product has become a hit...In categories where new products are the lifeblood of the industry, this can be a considerable advantage since new products usually have a high miss-to-hit ratio. By adopting only the hits, copycat retailers do not have to absorb the costs of the misses.”

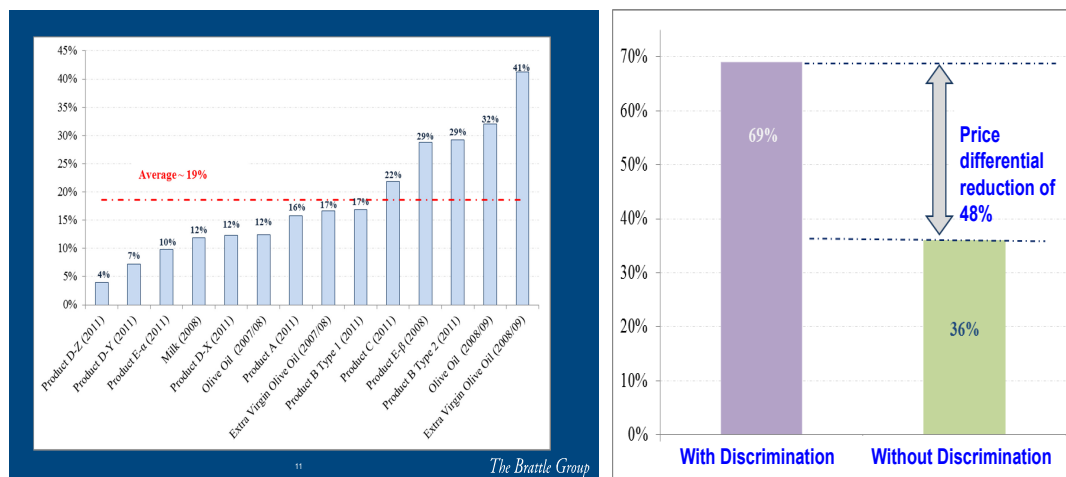
⁶⁴³ EFE Press Agency, “Casi el 90 % de los consumidores es fiel a su establecimiento de compra”, Efecom, 06.07.2011, quotes the results of an independent research by the Instituto Sondea: around 30% of Spanish consumers did not find their preferred brands in their primary store and this percentage almost reached 40% in the Valencia region, where the market-share of the Mercadona chain is around 40%. This would suggest a direct relationship between the closed-shop strategy followed by Mercadona, including the unannounced delisting of around 800 references in 2009, and consumer harm.

increasingly shifted to large retailers, notably in European food retailing. With respect to private labels, this comprises increasingly also the function of innovation. This observation provides the background for the formal economic analysis, which is at the core of this report. The analysis considers a simplified economic model in which a branded goods manufacturer and retailers can develop a new product and bring it to the market. The key result is that as the large retailer grows in size, this can lead to an inefficient shift of innovative activity away from the branded goods manufacturer and to the large retailer, which can further be detrimental to smaller retailers. What is key for this potential inefficiency to arise is an asymmetry between manufacturers and retailers, as the latter control access to consumers, in particular when they can act ‘gatekeepers’....The present report shows how both a ‘hold-up problem’ and a large retailer’s ‘rent appropriation incentives’ can contribute towards an inefficient substitution of manufacturer innovative activity. Importantly, this may even distort horizontal competition in retailing when, by ‘crowding out’ the innovative activity of branded goods manufacturers, a large retailer gains a competitive advantage vis-à-vis smaller retailers (an innovation ‘waterbed effect’). The formal analysis also shows how the threat of imitation of manufacturers’ innovation by large retailers with private labels can aggravate these inefficiencies and the resulting harm to competition.”⁶⁴⁴

Furthermore, not even the static “low price” advantage associated with the Imitation and Price Discounting model is present, because the lower prices of the supermarket brands are to a large extent “subsidised” by the R&D and marketing costs of independent grocery brands, the access fees to the supermarkets and the inflated retail margins on independent grocery brands. Perhaps the best evidence of the inflationary effects of supermarkets’ practices is the inflated margins earned on independent brands in order to subsidise market growth of supermarket brands. According to the Brattle Study 2012, if supermarkets were prevented from earning higher margins on independent brands and lowered them to the margin levels of the competing supermarket brands in each category, the prices of independent brands would go down between 4% and 41% (19% on average) and their price differential with competing supermarket brands would go down by 48%:

⁶⁴⁴ Inderst, “Implications of Buyer Power and Private Labels on ‘Vertical Competition’ and Innovation”, October 2013.

Elimination of Discriminatory Practices (ii)



Source: The Brattle Study 2012 and the Public presentation of the Brattle Study 2012, slides 10 and 11.

Furthermore, as the market share of supermarket brands grows at the expense of the marginalised independent grocery brands, supermarkets are able to set the prices of their own brands at the level of independent brands or even higher⁶⁴⁵.

The second part of the equation (2) implies that leading supermarkets' retail market power (fuelled by high concentration, barriers to entry, price transparency and consumer lock-in), enables them to charge supracompetitive prices overall, irrespective of the lower innovation, quality and variety of the products offered.

The combined anticompetitive effect of the individual practices analysed in Section 5.5 can be dramatic, as evidenced by the study of Olbrich and Grewe of a product group of the ready-meal category in the German grocery retailing⁶⁴⁶. The study discusses the proliferation of supermarket brands in Germany at the expense of independent grocery brands (Chapter I), then reviews the previous economic studies on the price and variety effects of supermarket brands and notes that the most recent literature points towards negative effects (Chapter II)⁶⁴⁷ and finally presents the negative effects of supermarket brands on three competitive factors: variety⁶⁴⁸; prices⁶⁴⁹; and turnover⁶⁵⁰ (Chapter III).

⁶⁴⁵ See findings of the Brattle Study 2012. Several studies have theorised that, as the market shares of the supermarket brands grow at the expense of the independent brands, supermarkets tend to reduce the artificial price gaps favouring supermarket brands by increasing comparatively more their prices (Méndez 2000). According to SymphonyIRI, "La marca de distribuidor en España" (January 2012), the yearly growth of supermarket brands in Spain was the highest of the European countries surveyed by IRI and reached 41% (by value) of the market in 2011. In the October 2010-october 2011 period, their prices went up by 6.3%, tripling the retail price increases of independent brands, thereby reducing the price differential between them by 5 points.

⁶⁴⁶ Olbrich 2009. According to the authors, the study is the first to make a long-term analysis covering such a long period (six years) and several outlet formats (previous studies have predominantly been static or short-term and mostly only covered one outlet format). Furthermore, the selected product group from the ready-meals category is particularly suitable in view of the increasing penetration of supermarket brands in the category.

⁶⁴⁷ *Id.*, *Overview of the results*: "II. At first glance, the literature seemed to paint an inconsistent picture of the effects of private labels on prices and the variety of products available. There is evidence

Even consumers' organisations have denounced that the leading supermarkets' practices identified in this report undermine consumer welfare:

Table 3: Effects of buyer power abuse on consumers

EFFECTS OF ABUSE ON SUPPLIERS	EFFECTS ON CONSUMERS
Overall downward pressure on supply prices	- Threat to suppliers' viability may affect supply and over time push prices up and reduce choice - Suppliers forced to cut production costs (possibly ingredient quality, and may squeeze working conditions in intensive stages of production)
Additional costs to supplier	- In the long run, may result in higher consumer prices - In the short run, may result in higher consumer prices in non-supermarket outlets
Risk of stocking new products forced on to supplier	Fewer new products, with potential knock-on effects on range and quality
De-listing	- Replacement of branded goods with retailers' own brand - Loss of choice and possibly of quality
Cost and risk of shrinkage and/or retailers' forecasting errors passed back to supplier	Price, range and quality are all put at risk through reduced funds available to suppliers for investment and promotion
Adversely affects suppliers' cash flow	
Risk and cost of product changes borne by supplier, increasing costs and uncertainty	Consumers misled about sustainability of low prices
Domino-effect demands for lower prices from other supermarket customers	
Competitors' costs are raised	- Affects the availability of products to other retailers - Reduction of store choice
Loss of IP rights, leading to a lower rate of innovation	Lower rate of innovation and thus of product range

Source: Consumers International 2012.

However, paradoxically, the conventional analysis of the competition authorities concludes that these practices do not undermine consumer welfare. This apparent contradiction raises an interesting question: do competition authorities sitting on their

however, especially regarding more recent studies, that private labels have produced negative effects, particularly in terms of a reduction in the number of national brands listed and rising prices (Chapter 2.).”

⁶⁴⁸ *Id.*, *Overview of the results*: “III. The empirical study, in all the outlet formats taken into consideration, showed that the increase in the proportion of listed private labels was accompanied by an overall decline in the number of different products in the product group. In the process, the added private labels have not compensated the severe decline in listed national brands. Hence, the absolute number of different products in the product group has been reduced due to the fact that national brands are being ‘squeezed-out’ by a disproportionate number of private labels. For the consumers, this ultimately means a reduction in choice and can therefore be regarded as a negative factor in terms of competition policy (Section 3.1.).”

⁶⁴⁹ *Id.*, *Overview of the results*: “IV. A rise in price level of national brands and private labels in all outlet formats studied – both per product as well as per kg – was recorded during the study period. The low prices of private labels, so often perceived by consumers, only exist because the national brands are used as ‘reference products’ by retailers when setting their prices. That means that the prices per kg of private labels are kept below those of the national brands, although at an ever-rising level. Notable in this context is the fact that it has been a statutory regulation, in the form of a per se ban on vertical price fixing and the associated freedom in pricing, that first opened up such possibilities to retailers. Even now, increases are clearly evident regarding prices of national brands and private labels, which must be regarded as a negative factor in terms of pricing policy due to the associated disadvantages for consumers (Section 3.2.).”

⁶⁵⁰ *Id.*, *Overview of the results*: “V. Only among the discount stores studied were slight increases in turnover achieved in the product group. In the supermarkets and in particular in the hypermarkets, however, there was a decrease in total turnover. Such turnover trends can be observed in parallel with steadily rising percentages of private labels listed. Whether the significant declines in overall turnover figures have been over-compensated by higher profit margins is highly questionable. To this extent it is conjecturable that retailers, in their management of private labels, are pursuing a policy of ousting smaller brand manufacturers from the market. The proliferation of private labels is in this way contributing to accelerating the concentration at manufacturer level (Section 3.3.).”

desks know what raises/undermines consumer welfare better than consumer associations themselves?

All in all, the leading vertically integrated supermarkets in each country enjoy a competitive bottleneck status and dominate the grocery retail market. As a consequence, their anticompetitive practices restrict innovation, quality, variety and choice and lead to higher retail prices. The ensuing anticompetitive practices following a virtuous cycle of growth by a single supermarket, envisioned by the European Commission in the Rewe/Meinl Decision⁶⁵¹, are now widely applied by the leading supermarkets. This state of affairs should aggravate competition authorities' concerns rather than appease them. Indeed, as warned by behavioural economists, success may transform consumers' guardian angels⁶⁵² into devilish competitive bottlenecks meriting public oversight⁶⁵³.

Furthermore, leaving aside the negative effects of these practices on consumer welfare, some other negative effects on the economy can also be discerned:

For example, an OECD study has evidenced that regulatory barriers to entry, grocery retail market concentration and retail brands reduce trade flows, suggesting a direct link between each of these factors and market power⁶⁵⁴. First, it concludes that market concentration in the retail sector reduces trade in food products⁶⁵⁵. Second, it shows that

⁶⁵¹ The Rewe/Meinl Decision, par. 74: "Buyer power also gives a trader considerable influence over the choice of products which come to market and hence are obtainable by consumers. Products which are not bought by a dominant buyer have practically no chance of reaching the final consumer as the supplier lacks alternative outlets. Lastly, the dominant buyer determines the success or otherwise of product innovations."

⁶⁵² Poesz 2004, p. 329: "Under conditions of full trust (as the positive expectation regarding future performance based upon repeated positive experiences in the past), the consumer is likely to delegate, to the supplier, the purchases that are either uninteresting (motivation), too complex (capacity) and/or too time-consuming (opportunity – think of double income families). In turn, the supplier will honor the invested trust, and will select those products and services that are most likely to further increase satisfaction. Consumers will be unable to judge a package's price level. This seems to be a critical point in the argument. However, as the relationship is based upon trust and the intention to continue the relationship, neither party will exploit the situation unfairly".

⁶⁵³ *Id.*, pp. 332-333: "The government may play a role in setting rules for such VGAs to perform. It is very unlikely that the available anti-trust rules apply in the expected new market situation. The government is advised to monitor market changes closely and to be ready for new VGA-like structures and processes in markets to develop(...). The government should stimulate a discussion as to the boundaries within which VGAs or similar structures may develop. These boundaries may refer to the types of products or services (health insurance? Charity?), the types of organizations (can the government be part of such a system?), the types of consumers (what is the starting age; what are special requirements for the elderly?), the type of relationships (members; participants, subscribers?), and the type of exchanges taking place (per transaction; monthly payment; automatic deduction from salary?)."

⁶⁵⁴ Kyvik 2008.

⁶⁵⁵ *Id.*, p. 26: "4.2 Does market concentration in the retail sector affect trade in consumer goods? This section explores the relationship between market concentration in the retail sector and trade in consumer goods. There are several possible measures of market concentration. The share of the five largest retailers in total retail sales in each importing country measures ownership concentration. This share is calculated from data from Mintel and is available for the years 2001, 2003 and 2005. We find market concentration to have a relatively large and negative impact on trade in consumer goods. A one percentage point increase in the market share of the five largest retailers is related to a reduction in trade value by 1.2% for food items and 2% for non-food items." The authors also introduce retail density as a market concentration variable (although the first one better reflects the competitive structure of the market) and assessed both criteria together, reaching the same conclusion at p. 27 of the study: "Since the

regulatory barriers reduce food imports⁶⁵⁶. Third, it confirms that as the shares of retail brands grow, food imports also diminish and shift in favour of non-developed countries⁶⁵⁷. Fourth, it establishes a causal link between grocery retail concentration and the consumer pass-through of tariff reductions⁶⁵⁸. Last, it addresses the policy implications and, as far as OECD countries are concerned, it argues that if retailers have either buyer or seller power, they will typically not pass tariff reductions on to consumers, as shown by data on food imports by grocery retailers⁶⁵⁹, therefore calling

two measures of market concentration are not strongly correlated, we also ran regressions where both measures of market concentration were included. The results suggest that ownership concentration has the strongest effect on trade. For food the two measures of market concentration point in the same direction; both ownership and geographic concentration are associated with lower imports. This finding indicates that high market concentration in food retailing could constitute a trade barrier in its own right. For non-food consumer goods the results are less clear. Ownership concentration is associated with lower imports, but geographic concentration is associated with *higher* imports. A possible explanation is that a high ownership concentration may reduce competition, while a geographical concentration (after controlling for ownership concentration) may result in a more efficient scale and larger total sales.”

⁶⁵⁶ *Id.*, p. 27: “We make an attempt to shed more light on this issue by including the Economics Directorate of the OECD’s indicator of regulation in the retail sector in our regressions. The indicator is described in Boylaud and Nicoletti (2001). It is available for 1998 and 2003 and ranks countries on a scale from 0 to 6 where 6 indicates the strictest regulation. We split the sample in two groups, the first scoring below and the second scoring above average on this indicator. When splitting the sample this way, we find that the lightly regulated countries on average have 16% higher food imports than the heavily regulated countries, but for non-food imports the two groups had similar import patterns.”

⁶⁵⁷ *Id.*, p. 28: “Do private labels stimulate trade in consumer goods in general and do they stimulate imports from developing countries in particular? In order to investigate this question we introduce the share of private labels in total sales and GDP per capita in the gravity equation. Data on private labels are from ACNielsen, cover the years 2003 and 2005 and are available for 36 countries in 2003 and 38 in 2005. We introduce this variable for the importing countries – i.e. the OECD countries. The first step is to add this variable to the standard gravity equation. Interestingly, we find that private labels are positively associated with imports of non-food consumer goods and negatively associated with imports of food and beverages. Both are significant at a 1% level. A one percentage point increase in the private label share would increase imports of non-food consumer goods by 0.65%, while the same change in private label share would reduce imports of food and beverages by about 2%. [...]. We find that the propensity to import from poor countries indeed does vary with the private label share in the importing country. For non-food items the marginal impact on imports of an increase in the private label share is -2 if the partner country is non-poor and 0.3 if it is poor. For food and beverages the marginal impact of an increase in the private label share is -2 if the country is non-poor and 1.3 if it is poor. Thus, both for food and non-food items an increase in the private label share appears to shift sourcing to poor countries”.

⁶⁵⁸ *Id.*, p. 30: “In order to assess a possible linkage between market concentration in the retail sector and trade liberalisation, we created a dummy which takes the value one if the market share of the largest five retailers is above average for our sample and zero otherwise. This variable divides the sample into two groups, one with a higher and one with a lower than average retail ownership concentration. This dummy was interacted with the bilateral tariff rate, in order to assess whether the two groups respond differently to trade liberalisation. We find that they do. Countries with a higher retail ownership concentration than average had an import demand elasticity of -0.75 for food and beverage items (BEC category 1), and an import demand elasticity of -7.5 for non-food items. The group of countries with a lower retail ownership concentration, in contrast, had an import demand elasticity of -2.4 for food items and -7.7 for non-food items. These findings suggest that retail ownership concentration makes a lot of difference regarding the effect of trade liberalisation on food items, while the difference is less important for non-food consumer goods.”

⁶⁵⁹ *Id.*, p. 32: “On the other hand if retailers have market power either on the buying or the selling side, they will typically not pass tariff reductions on to the consumer and the trade response to trade liberalisation may be undermined by the retailer. This may be the case for imports of food, and could seriously diminish the expected gains from trade liberalisation in agriculture and food processing industries. Therefore, in order to ensure that trade liberalisation is followed by gains in market access, there may be a role for complementary competition policy measures.”

for complementary competition policy measures. Regarding retailer brands, the results in the food product sector show that the growth of retailer food brands reduces imports and competition⁶⁶⁰.

Moreover, even if it is difficult, if not impossible, to measure the impact of supermarkets' practices on the employment, they are likely to undermine economic activity and thus, employment, up the grocery supply chain (i.e., industry and primary production)⁶⁶¹.

5.7 Independent grocery brands' market power and practices

This Report has showed that each of the main supermarkets is able to dictate the terms of access to and competition within its platform to an appreciable extent independently of other competitors, independent grocery brands and grocery shoppers.

Indeed, there is plenty of evidence that leading supermarkets have delisted or imposed abusive/discriminatory terms regarding access to and competition within their platforms to independent grocery brands that have been found or could be found to be dominant under formalistic market share thresholds.

This new economic paradigm desperately calls for a reassessment of the enforcement of competition rules in respect of independent grocery brands.

⁶⁶⁰ *Id.*, p. 32: "Private standards for instance related to private labels are a difficult policy area and the jury is still out on whether or not private labels could distort competition to the detriment of suppliers, including foreign suppliers, and consumers or whether it increases competition and consumer welfare. Gabrielsen and Sørsgard (2006) for instance show that private labels may under certain circumstances lead to higher prices of the branded goods and reduce total welfare, while for instance Steiner (2004) argues that private labels constrain the market power of branded goods suppliers to the benefit of consumers. Our evidence suggests that private labels may reduce import demand for food products and increase import demand in non-food products. The trade and competition impact thus appears to depend on product and market characteristics and no general policy conclusion can be made." The Study cites Robert Steiner's article, "The nature and benefits of national brand/private label competition", *Review of Industrial Organisation*, 24, 2004, pp. 105-127. However, Robert Steiner's argument is not so much concerned with retailer brands' countervailing power, but the need to guarantee competition on the merits between them and independent brands in the face of signs of collusion between them. See, abstract: "Consumer welfare is maximized when private labels and national brands compete vigorously rather than when either one is too dominant. There is some ominous recent evidence that the vigour of national brand/private label competition is sometimes being diminished by collusion between the two kinds of brands".

⁶⁶¹ See on this point, the words of the President of the American Antitrust Institute, Foer, "Mr. Magoo visits Wal-Mart: finding the right lens for antitrust", The American Antitrust Institute Working Paper No. 06-07, November 30, 2006, p. 16: "The history of suppliers who were apparently healthy when they commenced doing business with Wal-Mart but ended up losing their independence or their corporate life suggests that Wal-Mart has not always been the very considerate and team-oriented partner that it self-portrays [footnote: For example, consider the experiences of Vlasic, Huffy, Lovable, and Levi Strauss as related by Fishman, 79-109.]; and p. 19: "Lynn reports that since 2004, Kraft, which had recently been celebrated as a leading company, announced plans to close 39 plants and eliminate one quarter of its products, a reduction in products that he attributes to the demands of Wal-Mart and other discounters to continue to lower Kraft's prices. Lynn, "Breaking the Chain," *Harper's Magazine* (July 2006), 29, 30. We do not know to what extent the quarter of Kraft's products that were eliminated have been replaced by near substitutes". See also Kumar 2007, p. 18: "In February 2006, Kraft Foods, Inc., the maker of Oreo cookies and Oscar Mayer lunch meat, announced it was closing twenty plants and laying off as many as eight thousand workers as private labels ate away at its sales".

5.7.1 Dominance

The Kerry/Breeo Judgment brought to light for the first time in merger control history, evidence of the way commercial negotiations were handled by leading supermarkets in respect of independent grocery brands found to be “must stock” brands (i.e., dominant) by competition authorities and, often self-servingly, by supermarkets themselves⁶⁶². This evidence showed that the supermarkets’ power vis-à-vis independent grocery brands was not constrained even by the leading grocery brands, which are very often considered to be dominant under a conventional analysis focused on market-shares. Indeed, the market structure present in the Kerry/Breeo merger would have led, in all likelihood, to a finding of dominance against the leading independent brand in any other jurisdiction:

“9.3 Thus, in the market for rashers the Authority concluded [DET. 5.97]:

- The market shares of Galtee and Denny have been stable over the period 2005-2007;
- These two brands are each others closest competitors in the market and post-acquisition would account for 47% of the market;
- There are no credible alternative brands which would enable retailers to constrain the merged entity from raising prices;
- The combined market share of other brands is only 6% with only one brand being in excess of 1% (Cookstown);
- New entrants would be unable to establish a sufficiently strong presence within a two year period so as to act as a constraint on the merged entity;
- Notwithstanding a combined market share of 36% by value, private label products are not considered by retailers to be sufficiently close competitors to Denny and Galtee which must be stocked as “must have” brands;
- Retailers will be unable to discipline the merged entity in the absence of credible alternative branded rashers; of entry of sufficient branded rashers to the market within two years; and because private label rashers would be unable to replace the merged entities’ products as they are not sufficiently close competitors.”⁶⁶³

“9.4 Similarly, in the N-PCM market it found at para. 6.164 that: o The merged entity would have 48% of the market by value post-acquisition with other brands having only 5.8% and none having more than 1%;

- Kerry and Breeo’s combined market share has increased from 2005 – 2007 from 44.7% to

⁶⁶² See a discussion of the relevant court findings, above, Section 5.3.2.3. The Court was highly critical of the weight attached by the Irish Competition Authority to the supermarkets’ self-serving statements regarding “must stock brands”. See, par. 9.65: “The material is, of course, “opinion evidence” as it is described by the appellant. It may be particularly important, therefore, to exercise caution as to the inherent probative value of responses to retailer surveys in this area when regard is had to the fact that the question is posed by a competition authority to operators in a sector which may have become accustomed to the critical scrutiny of regulatory authorities. (The Court notes that in 2008 alone the Competition published three “Global Monitor Reports” on its detailed examinations of the structure and operations, on price trends in and on the application of retail planning systems to the grocery sector.)”; and par. 9.68: “The Authority then gives its conclusion at para. 5.4: “In terms of being able to successfully resist a post-merger price increase although the evidence is somewhat mixed, on balance it shows retailers will have difficulty resisting such a price rise.” The Court cannot agree that this is a justifiable conclusion to draw from the evidence which the Authority has just recited. Having regard to the incentives for self-serving responses to the leading question, it is more significant, surely, that 50% of those who replied had no concern as to their ability post-merger to conduct negotiations with the merged entity as owner of the two leading brands”.

⁶⁶³ The Kerry/Breeo Judgment, par. 9.3.

48%;

- The Kerry and Breeo brands are each other's closest competitors in the market;
- Private label share has declined from 50.9% in 2005 to 46.2% in 2007. Retailers do not consider private label products to be sufficiently close to the Kerry and Breeo brands;
- There are no credible alternative brands in the market which could credibly act as a constraint;
- New entrants would be unable to establish a sufficiently strong presence within two years to act as a constraint;
- Retailers do not have sufficient countervailing buyer power to act as a constraint post-acquisition because of the absence of alternative branded suppliers;
- The unlikelihood of the entry of branded alternative suppliers within two years; and the fact that private label products are not considered sufficiently close competitors to act as a constraint.”⁶⁶⁴

Leaving aside speculations as to market dynamics post-merger, fuelled by the self-serving statements of the supermarkets, the conclusion of the Irish Competition Authority rested on the fact that the combined market share of the merging parties exceeded the 40% threat threshold, without serious consideration for the supermarkets' power and their incentives to favour their own brands. However, for the first time, a leading independent brand was prepared to submit evidence of the supermarkets' practices and to fight its case in court. Furthermore, the High Court, possibly helped by the significant competition law expertise and, perhaps more importantly, the common sense of judge Cooke, was prepared to depart from formalistic assumptions and conduct a comprehensive analysis of the real-world bargaining power of supermarkets that offered policy conclusions well beyond the scope of the specific case.

The High Court introductorily described the new economic paradigm (i.e., supermarkets are gatekeepers controlling access to their stores and competing with independent grocery brands)⁶⁶⁵. Then it noted the availability of alternative suppliers of supermarket brands and independent brands, which supermarkets could sponsor with ease⁶⁶⁶. The High Court then dealt with the Competition Authority's contention that, even if buyer

⁶⁶⁴ *Id.*, par. 9.4.

⁶⁶⁵ *Id.*, par. 9.39: “As has already been remarked, it is one of the prominent characteristics of the grocery market and accepted by the Authority [DET. 2.34] that a small number of multiple chain retailers account for 65% of all grocery products sold in the State. Furthermore, in the case of the food products of the notifying parties, these chains may account for something in the region of 78% of their sales of the relevant products while those sales represent only 2% of the total purchases of their customers. It is a further characteristic and unusual feature of the market, of course, that the retailers perform the “gatekeeper” role in which they fix the retail prices of the appellant's products and control their access to shelf space while at the same time being competing producers of similar products whose prices they also fix at retail level. It is also not disputed by the Authority that in these markets the main multiple chains can exercise considerable buyer power in different forms which include not only de-listing entire brands from a particular supplier but also “de-ranging” or limiting the package sizes or formats of particular products within a range or refusing to support promotions, reducing purchases or moving products to less favourable display positions [DET. 2.35]. It is, on the face of it, not surprising therefore that this asymmetric relationship of dependence of the suppliers on the main retail chains can be readily exploited to the advantage of the latter in their dealings with suppliers.”

⁶⁶⁶ *Id.*, pars. 9.41-9.47. See, in particular, par. 9.47: “The significance of these factors in the present context is that in assessing the reality of buyer power it is clear that retailers have available to them, on the evidence, potential sources of ready supply of both own label product and brand products such that supply as such is not obstacle to the exercise of disciplinary buyer-power.”

power existed pre-merger, it would not persist post-merger⁶⁶⁷. In this regard, the High Court noted the evidence produced by the appellant of delisting threats and practices employed by supermarkets, and discarded as inconclusive by the Irish Competition Authority⁶⁶⁸. Notably, it considered that a threat of delisting employed by Tesco to obtain better margins (not even lower wholesale prices) was sufficient evidence of buyer power⁶⁶⁹ and concluded that it would persist post-merger⁶⁷⁰. It further analysed other written communications from supermarkets to the merging parties that showed the former were not prepared to list products or accept price increases from the latter if their margins (including those made on their own brands) were affected⁶⁷¹ and reiterated its conclusion that supermarkets' buyer power would not be affected post-merger⁶⁷². The

⁶⁶⁷ *Id.*, par. 9.52 "As already mentioned, the Determination recognises the existence of buyer power on the part of retailers in the Irish grocery markets [DET. 2.34] and that it can take a number of different forms [DET. 2.35]. However, it points out, citing the Guidelines of the European Commission that "it is not sufficient that buyer power exists prior to the merger, it must also exist and remain effective following the merger. This is because a merger of two suppliers may reduce buyer power if it thereby removes a credible alternative" [DET. 2.31]. In that regard, as has already been remarked, it is undoubtedly the case that this acquisition will effectively remove the ability of a retailer to play Kerry off against Breeo as separate suppliers."

⁶⁶⁸ *Id.*, par. 9.53: "In examining the basis upon which the Authority concluded that the exercise of such buyer power would be insufficient to operate as a constraint, it is first necessary to look at the direct evidence of the actual exercise of buyer power submitted by the notifying parties and summarised by the Authority at paras. 2.50 – 2.70 of the Determination. This comprised a set of email correspondence over the period 2003 – 2008 which the notifying parties claim proved some 30 instances of retailers exercising buyer power tactics. The Authority rejects the evidence in these terms: "In general, the documents are inconclusive, either in that they do not tell us whether the threat to de-list was in fact carried out, or else no evidence is provided to show that de-listing was carried out for any motive other than the normal course of business." [DET 2.51]"

⁶⁶⁹ *Id.*, par. 9.57: "Insofar as this appraisal is put forward as a reason for rejecting the implications of the Tesco threat of 15th August, 2008, the Court considers that it is unwarranted. While it is true that Breeo pleaded the existence of the merger process as a basis for persuading Tesco to defer its threat, there does not appear to be any basis for supposing that Tesco's threat to de-list 23 product units in the breakfast meats category was in any way influenced by that process or had any objective other than the one stated namely, to procure a 4.54% improvement in margin."

⁶⁷⁰ *Id.*, par. 9.58: "The significance of the example is that it is direct evidence of pre-acquisition exercise of buyer power and if such a tactic can be employed pre-acquisition in order to obtain an improvement in margin by a retailer there is no reason for supposing that it might not be equally exercised post-merger in order to deter a price increase. It is true that, post-acquisition, Tesco would be dealing with a single undertaking as owner of both leading brands, but the "must have" character attaches to the brand and not to ownership of the business."

⁶⁷¹ *Id.*, paras. 9.59-9.61. See the High Court's comments on the role played by retail margin considerations, in par. 9.59 ("Given that it is Tesco that sets the retail price for a product, doing so by reference to the differential it seeks to maintain with its own products, it is notable that in an email of 3rd January, 2006, this retailer refuses to list a number of Kerry cooked meat lines because the margins are unacceptable") and in par. 9.60 (A letter of 30th July, 2007, from Musgraves to Kerry in relation to a request for price increases is not untypical of these. The Musgrave Dairy Trading Manager "insists" on the following... margin needs to be maintained at all times in the price amendment proposal form and we also require receipts from the competition before we are in a position to proceed with the implementation. (The Court notes in passing that the propriety of the demand for "receipts from the competition" must be questionable.)"

⁶⁷² *Id.*, par. 9.62: "It may be remarked that these exchanges are perhaps typical of tough negotiations between supplier and customer with the latter seeking to strike the best possible bargain. Nevertheless, taken as a whole and having regard to the facility and short notice with which the retailers are prepared to de-list and de-range particular lines as a weapon in that negotiation, the material is direct evidence which contradicts the proposition that the retailers cannot credibly de-list brands such as Denny or Galtee

High Court also relied on evidence of supermarkets' delisting practices towards independent grocery brands (10 out of 11 competitors had been subject to delisting or deranging practices and 7 confirmed that it was a recurrent practice)⁶⁷³. Furthermore, the High Court noted that full delisting was only one of the several practices that supermarkets could employ vis-à-vis "must have brands"⁶⁷⁴ and it cited supermarkets' own statements to that effect⁶⁷⁵. All in all, the High Court concluded that the four leading Irish supermarkets enjoyed buyer power and severely criticised the flawed analysis of the Irish Competition Authority⁶⁷⁶.

Subsequently, the UK Competition Commission's Kerry/Headlands Decision lent further support to the competitive analysis of the High Court in the Kerry/Breo

because of their "must have" character. If retailers consider these to be "must have" brands post-acquisition they must be "must have" brands before it as well."

⁶⁷³ *Id.*, par. 9.72: "Furthermore, the probative force of the Annex 6 evidence must also be seen in the light of other related evidence which was available to the Authority and which is not referred to in the Determination itself but was invoked by the notifying parties at paras. 7.59 – 7.68 of the written response to the Assessment dated 15th August, 2008. Amongst other items of evidence, they drew attention to the fact that of eleven competitors (that is, other suppliers of products to the retailers,) interviewed by the Authority and asked if they had been subjected to de-listing or de-ranging by the multiples, ten confirmed that they had. Seven said it was a frequent practice. Another customer/retailer stated "On a continual basis when listing products, reviewing terms or agreeing promotional offers, it is standard practice to threaten to switch business to rival suppliers unless competitive terms are received."

⁶⁷⁴ *Id.*, par. 9.74: "Furthermore, given the variety of tactics available to retailers, it is clear that they do not necessarily have to make the choice of abandoning "must have" brands as such if they are to defeat the hypothetical price increase. It is also clear that a retailer would not necessarily have to maintain any of the tactics over a protracted period of time in order to make it unprofitable for the merged entity to impose the hypothetical price increase. As was pointed out by the appellant, if one assumes a margin of 25% on the products supplied, a 3% price increase will be defeated by an 11% loss of sales. Furthermore, it is clear from the evidence that buyer-power tactics are not necessarily confined to targeting products to the relevant product market. Where a supplier such as Kerry is providing products across a variety of food categories, a price increase in rashers or cooked ham might be rendered unprofitable by the de-listing of one or more other lines in other sectors where the "must have" factor was of less importance to the retailer."

⁶⁷⁵ *Id.*, par. 9.72 ("Another said: "Suppliers have to justify why they believe a price rise is merited. One option post-acquisition would be to run fewer promotions on the merged entity's products. Another option would be to re-examine shelf space allocation with a view to changing the merged entity's products, e.g. by placing the products in less attractive positions on the shelf such as above or below eye level, etc.")

⁶⁷⁶ *Id.*, par. 9.75: "For these reasons the Court finds that the Authority has made a material and significant error in its appraisal of the existence of sufficient countervailing buyer power post-merger to deter a price increase by the merged entity. It has, in the Courts view, misjudged the significance and weight of all of the evidence available to it as to the reality of the buyer power exercisable by the four main multiple chains both in the form of the evidence submitted in Annex 6 to the written submission and the other evidence gathered by its case team in the form of responses received from retailers and competitors. Furthermore, in relying upon the responses of those retailers who expressed concerns as to the impact of the acquisition, the Authority has attributed undue weight as compared with the responses of retailers who expressed no such concerns". The merged company seems to have faced a stagnant market post-merger, which further vindicates the High Court's ruling (The Independent, "Did Kerry pay over the odds for Breo?", 04.11.2012: "The Competition Authority objected to the deal and Kerry only secured its objective after a lengthy legal battle the following year. As a result of the delay Kerry was able to negotiate a €25m reduction in the Breo purchase price. Even that reduced price is now looking very expensive. Kerry must now surely regret not having used the Competition Authority's objections as an excuse to walk away from the deal altogether.")

Judgment⁶⁷⁷. The previous consummation of the merger offered *ex post* evidence that an independent brand holding approximately 50% of the frozen ready meals (“FRM”) market and supplying an even higher share of the supermarket brands’ input in that category⁶⁷⁸, did not have any market power vis-à-vis UK supermarkets. The UK Competition Commission noted that initially the merged company managed to increase its prices but supermarkets’ bargaining power and switching behaviour finally returned prices to its pre-merger levels⁶⁷⁹, at a significant cost for the company in terms of lost sales⁶⁸⁰ and, presumably, increased costs (flowing from the acquisition of the Headlands’ assets). However, one could wonder whether the pre-merger prices (fixed through tenders) were infracompetitive, in light of the fact that Headland, the second most important supplier in the market, was making losses⁶⁸¹ and, probably, pushing overall market prices below competitive levels⁶⁸².

Furthermore, these and other merger cases in the fast moving consumer goods sector have never dealt with the “dark side” of the dealings between independent brands and

⁶⁷⁷ UK Competition Commission, Kerry Foods Limited/Headland Foods Limited merger inquiry, Final Report, 22.12.2011 (“the Kerry/Headlands Decision”).

⁶⁷⁸ The Kerry/Headlands Decision, par. 7.3: “Before the merger, Kerry and Headland were the largest suppliers of FRM to UK customers, accounting for [40–50] per cent of FRM by both number and value of FRM sold. The next largest supplier was Heinz, which only manufactured its own-brand FRM. Kerry and Headland together supplied a slightly higher proportion ([50–60] per cent) of own-label FRM sold in the UK. No other manufacturer accounted for more than 10 per cent of the own-label FRM supply.”

⁶⁷⁹ The Kerry/Headlands Decision, par. 7.44: We looked at what customers did, or were actively planning to do in response. We set out our evidence in Appendix G. The evidence showed clearly that many customers were able to find alternative FRM suppliers for ranges of products within the UK and overseas, albeit at significant cost in one case, and that these suppliers were nearly all able to supply at prices cheaper than Kerry’s post-merger prices. In most cases, the prices customers are paying after switching are at or around the prices in the market pre-merger, or if they are higher, are generally higher to an extent that could be explained by increases in raw materials costs.

⁶⁸⁰ The Kerry/Headlands Decision, par. 7.43: “We set out in Table 1 the price rises sought by Kerry and the price rises eventually imposed. Kerry told us that since the merger it had lost nearly £[40–45] million of business across [%] customers, either through products being switched to alternative suppliers or being delisted.”

⁶⁸¹ The Competition Commission discarded the “failing firm” defence as a counterfactual on the basis that the target company was planning to close a plant and put in place a restructuring plan that was expected to produce a break-even scenario and, “possibly” lead to profitability in the future. See the Kerry/Headlands Decision, Section 6. However, the reasoning expresses doubts as to the long-term viability of the target even after the restructuring. See, par. 6.6: “We found that Headland would have continued to supply FRM to retail/brand customers at all price points (value, mid-tier and premium) for at least the foreseeable future. Owing to anticipated cost inflation and continued pressure on prices from its core retail/brand customers, it is possible that Headland’s profitability would have reduced over a two-to three-year period following the restructuring”.

⁶⁸² Supermarkets awarded the supply contracts following competitive tenders that saw the merging companies closely compete against each other (the Kerry/Headlands Decision, pars. 7.6-7.10). The acquiring company implicitly made this point in the Kerry/Headlands Decision, par. 6.3: “Kerry submitted that Headland was not operating a sustainable business: it was persistently and seriously loss-making, and was pricing at an unsustainable level in order to win or hold on to mostly loss-making business. It submitted that successive plans by its private equity owner, Chamonix, had failed, and it was dependent on cash injections from it; the closure of the Flint factory and relocation to Grimsby was, at the time of the merger, highly unlikely to have succeeded without further substantial investment. It submitted that there was no reason to believe that Headland’s venture capital owners, had they been told that Kerry was not interested in purchasing Headland, would have continued to operate that entity as a substantial FRM manufacturer for any significant further period.”

supermarkets: access fees. As far as the author of this Report is aware, only in the *FTC v. H.J. Heinz Co. and Milnot Holding Corporation* case did this issue arise prominently⁶⁸³. The FTC challenged a merger between the number two (Heinz) and number three (Beech-Nut) baby food manufacturers in the U.S at the time, on the grounds that it would create a duopoly in the market⁶⁸⁴. The FTC argued that wholesale competition between the two merging parties for the second and last spot on supermarket shelves ensured lower retail prices for their products⁶⁸⁵. Furthermore, the FTC contended that the two remaining companies would have more incentives to collude and innovation would be reduced⁶⁸⁶. The FTC/Heinz District Court Judgment sided with the merging parties and recognised the pro-competitive impact of the merger on “consumer competition”, “distribution competition” and “innovation and product differentiation”⁶⁸⁷. The District Court described how distribution competition works and the importance of variable and fixed “trade spending” in order to gain supermarkets’ favour⁶⁸⁸. Then, it rejected the FTC’s claim that the upward level of fixed trade spending had any downward effect on retail prices, as acknowledged by the retailers’ testimonies, and held that the FTC had not proven its case regarding variable trade

⁶⁸³ See *FTC v. H.J. Heinz Co.* 116 F. Supp. 2d 190, 192 (D.D.C. 2000), *rev’d*, 246 F.3d 708 (U.S. App. D.C. 2001). The District Court (“the FTC/Heinz District Court Judgment”) sided with the merging parties but the Court of Appeals (“the FTC/Heinz Court of Appeals Judgment”) reversed the lower court’s judgment and the parties ultimately abandoned their merger plans.

⁶⁸⁴ Chen, “The Evolution of the Baby Food Industry 2000-2008”, FTC Bureau of Economics, Working Paper No. 297, April 2009, p. 2: “According to the original court documents, the U.S. baby food market was an \$865 million to \$1 billion industry, dominated by three firms: Gerber with 65% market share, Heinz with 17.4%, and Beech-Nut with 15.4%.”

⁶⁸⁵ Chen 2009, p. 3: “The FTC argued that with the elimination of a competitor, there would be decreased competition at the wholesale level, and as a result, both wholesale and retail prices would increase. Grocery stores typically stocked either one or two brands. Because they almost always stocked Gerber, Heinz and Beech-Nut competed for the secondary spot; hence, they were each other’s most direct competitors, even if they almost never appeared together on the same shelf. The two competed for shelf space by offering grocery stores fixed trade spending (i.e., slotting fees) and variable trade spending (i.e., promotional spending). The FTC argued that such competition at the wholesale level was healthy and the absence of such competition would lead to higher retail prices.”

⁶⁸⁶ *Id.*, p. 4: “In addition to its concerns about unilateral price increases, the FTC also considered the potential of the two remaining competitors to tacitly coordinate. Other things equal, theory suggests that coordination between two firms is easier than three, and such behavior would result in higher prices for consumers. The FTC was also concerned that the merger would decrease incentives to innovate and to maintain high quality.”

⁶⁸⁷ The merging parties also raised production and distributional efficiencies.

⁶⁸⁸ *FTC v. H.J. Heinz Co.* 116 F. Supp. 2d 190, 192 (D.D.C. 2000): “By far the bulk of the evidence submitted by both parties concerned the nature and extent of distribution competition—the competition between Heinz and Beech-Nut to be the second brand on the shelf. Trade spending is the clearest indicator of distribution competition. Trade spending is characterized as either “fixed” or “variable” and involves the payment of negotiated sums of money to retailers or retail chains. Fixed payments consist of “slotting fees,” “pay-to-stay” arrangements, new store allowances, etc., but are all essentially given in exchange for shelf space and desired product display. Variable payments, unlike fixed payments, are ostensibly tied to sales volume, and consist of “long term allowances” and merchandising funds. Long term allowances are payments to retailers, typically made upfront, that are intended to assure a specific sales volume and lower shelf price. In theory, these allowances are refundable on a pro rata basis in the event that the retailer does not meet the desired volume. Merchandising funds are offered to support temporary price reductions and sales, and include price discounts, retailer “loyalty card” discounts, or coupons.”

spending either⁶⁸⁹. Furthermore, it noted that retail concentration increased retailers' market power and it led to higher fixed trade spending at the expense of variable trade spending, which, in any event, was paid to retailers' irrespective of their market performance⁶⁹⁰. Regarding innovation (dynamic efficiency), the District Court noted the importance of achieving sufficient weighted distribution to recoup innovations and found that the merger of the two companies would enable them to meet this goal⁶⁹¹.

However, on appeal, the FTC/Heinz Court of Appeals Judgment sided with the FTC. Regarding the distribution competition, the Court of Appeals plainly considered that competition at the wholesale level was good for consumers⁶⁹². Regarding innovation, the Court of Appeals considered that it was very difficult to prove this kind of efficiency⁶⁹³ and was unconvinced by the companies' claim, supported by expert

⁶⁸⁹ FTC v. H.J. Heinz Co. 116 F. Supp. 2d 190, 192 (D.D.C. 2000): "The Commission attempted to show that trade spending competition between Heinz and Beech-Nut benefits consumers and that the merger will eliminate that benefit. With respect to fixed trade spending, the attempt failed completely. Fixed trade spending, according to testimony by Heinz's expert, which was corroborated by retailers' testimony, has no effect on the shelf price. Variable trade spending does benefit consumers in theory, but the record provides no basis for quantifying that benefit. Moreover, the record leaves substantial doubt that the proposed merger would actually affect variable spending levels. All three companies use discounts, coupons and loyalty card programs to create price differentials. The merger will not change the need for such spending."

⁶⁹⁰ FTC v. H.J. Heinz Co. 116 F. Supp. 2d 190, 192 (D.D.C. 2000): "Long-term allowances are paid in the bid competitions that have taken place between Heinz and Beech-Nut, but there is no evidence that any retailer has ever refunded money after failing to meet a sales target. Dr. Baker's econometric analysis revealed that trade spending levels had no effect on price, even in markets where all three firms are present. Variable trade spending has fallen, and fixed trade spending has risen, in response to retailer consolidation, which has allowed retailers greater bargaining power in negotiating contracts with manufacturers. Increases in trade spending during bid competition for these contracts consisted almost entirely of increases in fixed spending."

⁶⁹¹ FTC v. H.J. Heinz Co. 116 F. Supp. 2d 190, 192 (D.D.C. 2000): "The conditions for increased competition in the form of product innovation and product differentiation will be enhanced by the merger, because the distribution of the combined entities will add Heinz's ACV to Beech-Nut's ACV. Current Heinz policy disfavors attempts to launch new products in the absence of substantial nationwide distribution. The testimony of defendants' expert Professor Baker explains and justifies that policy. He testified that new product launches are only practical when a firm's ACV is high enough—his threshold is 70 percent—to ensure higher levels of distribution, so that marketing is cost effective. The merged entity will have an ACV of about 90 percent (some 10 percent of food stores carry only Gerber). That ACV will be high enough to support introduction of the Heinz Environmental "Oasis" program that is already in place in Europe, as well as a planned aseptic baby food product. As Heinz describes its Oasis program, it is an effort to convince mothers that Heinz baby food is "more nutritious and safe than anything that they can do themselves.""

⁶⁹² FTC v. H.J. Heinz Co., 246 F.3d 708 (U.S. App. D.C. 2001): "In rejecting the FTC's argument regarding the loss of wholesale competition, the court committed two legal errors. First, as the appellees conceded at oral argument, no court has ever held that a reduction in competition for wholesale purchasers is not relevant unless the plaintiff can prove impact at the consumer level...Second, it is, in any event, not the FTC's burden to prove such an impact with "certainty." To the contrary, the antitrust laws assume that a retailer faced with an increase in the cost of one of its inventory items "will try so far as competition allows to pass that cost on to its customers in the form of a higher price for its product.""

⁶⁹³ FTC v. H.J. Heinz Co., 246 F.3d 708 (U.S. App. D.C. 2001): "This kind of defense is often a speculative proposition. See 4A Areeda, et al., *supra*, ¶ 975g (noting "truly formidable" proof problems in determining innovation economies)."

testimony, that a 70% weighted distribution was necessary to make the launch of new products profitable⁶⁹⁴ or to achieve promotional economies⁶⁹⁵.

Several years after the aborted merger, the market had not evolved as the FTC and the Court of Appeals have predicted. The leading baby food brand (Gerber) had increased its leadership at the expense of the former Heinz baby food brand (“Nature Goodness”) and Beech-Nut. Nature Goodness had steadily declined after the failed merger⁶⁹⁶ and ended up as a marginal player (2% share), whereas the market share of Beech-Nut had slightly decreased⁶⁹⁷. Furthermore, Heinz, a baby food producer present in many countries, had exited the baby food category in the US⁶⁹⁸. Despite the market evolution

⁶⁹⁴ FTC v. H.J. Heinz Co., 246 F.3d 708 (U.S. App. D.C. 2001): “The court below accepted the appellees’ argument principally on the basis of their expert’s testimony that new product launches are cost-effective only when a firm’s ACV is 70% or greater (Heinz’s is presently 40%; Beech-Nut’s is 45%). That testimony, in turn, was based on a graph that plotted revenue against ACV. According to the expert, the graph showed that only four out of 27 new products launched in 1995 had been successful—all for companies with an ACV of 70% or greater. The chart, however, does not establish this proposition and the court’s consequent finding that the merger is necessary for innovation is thus unsupported and clearly erroneous...In the absence of reliable and significant evidence that the merger will permit innovation that otherwise could not be accomplished, the district court had no basis to conclude that the FTC’s showing was rebutted by an innovation defense.”

⁶⁹⁵ FTC v. H.J. Heinz Co., 246 F.3d 708 (U.S. App. D.C. 2001): “Moreover, Heinz’s insistence on a 70–plus ACV before it brings a new product to market may be largely to persuade the court to recognize promotional economies as a defense. Heinz argues that to profitably launch a new product, it must have nationwide market penetration to recoup the money spent on advertising and promotion...As one authority notes, however, “[t]he case for recognizing a defense based on promotional economies is relatively weak.” 4A Areeda, et al., supra, ¶ 975f, at 77.”

⁶⁹⁶ Chen 2009, p. 6: “As soon as the merger collapsed, the Heinz baby food business started a steady decline and changed hands various times without any success. See After the unsuccessful merger, in December of 2002, H.J. Heinz sold Nature’s Goodness (along with Starkist tuna, Kibbles ‘n Bits dog food, 9-Lives cat food, and Cottage Inn soup) to Del Monte, an American company best known for its canned fruit and vegetable products...By the time Del Monte purchased Nature’s Goodness, the brand was already on the decline [footnote: Del Monte’s chairman and chief executive officer, Richard G. Wolford reportedly believed that “... the trouble started two years earlier when the Federal Trade Commission managed to block Heinz’s \$185 million plan to buy the maker of Beech-Nut foods...After the failed deal, Heinz’s strategic direction seem to fall apart, senior management had moved on to other projects, and no one devoted much energy to baby food, said Wolford.” Lindeman, Teresa. “Del Monte Relaunches Baby Food Line with New Packaging.” *Pittsburgh Post-Gazette (via Knight-Ridder/Tribune Business News)*. December 19, 2003...In the spring of 2006, Del Monte sold Nature’s Goodness to Bay Valley Foods (a division of the publicly traded company, Treehouse Foods)...Analysts of the merger claimed that the private label soup business fit well with Bay Valley’s line of private label products, but Nature’s Goodness did not. “After meeting with TreeHouse management, Credit Suisse First Boston analysts Robert Moskow and David C. Nelson last month said Del Monte’s soup business would, at the right price, be a good fit for the Chicago company. But they also noted in their report that any deal would come ‘with the ‘hair’ of a not so attractive baby food business.”

⁶⁹⁷ *Id.*, p. 4: “However the relevant market is defined, that is, whether baby yogurt should be included or not, a few commonalities emerge. Beech-Nut’s market share remains relatively stable, hovering between 10 and 13% throughout all the years. The share of Nature’s Goodness has steadily declined to 2%. Earth’s Best has steadily increased, surpassing Nature’s Goodness; yet, it still remains a minor player. Lastly, Gerber’s share has grown. The only question is a matter of magnitude. If baby yogurt is included in the relevant market, then Gerber’s market share has only increased slightly from 71% to 73%. If baby yogurt is excluded, then Gerber has gained quite a bit of market share from 72% to 80%. Regardless of how the baby food market is defined, only Gerber and Beech-Nut hold double-digit market shares today.”

⁶⁹⁸ *Id.*, p. 7: “After H.J. Heinz sold Nature’s Goodness, it ceased production in the U.S. Despite having considerable sales in Canada, Europe, and other parts of the world, it completely exited the U.S. baby food industry.”

into a duopoly, retail prices in 2008 were comparable to prices in 2000, adjusted for inflation and quality⁶⁹⁹. Indeed, both Gerber and Beech-Nut had continuously innovated over that period and this innovation sustained the category⁷⁰⁰, even though Beech-Nut only managed to increase its production efficiency at the expense of a significant delay (8 years) and financial investment as compared with the expected production efficiencies of the failed merger⁷⁰¹.

Overall, the market dynamics following the aborted merger vindicated the merging parties' allegations and the FTC/Heinz District Court's Judgment. The FTC conventional competition analysis overlooked entirely supermarkets' power and their control of the three main variables influencing competition between grocery brands: consumer competition (e.g., retail prices); distribution competition (e.g., access fees); and innovation competition (e.g., listing of new products). As a consequence, the FTC's intervention paid a lip service to competition and consumer welfare.

In light of the numerous examples of supermarkets' bargaining power over independent brands, there is little legal and economic basis to argue that independent grocery brands hold market power and even less a dominant position in the modern grocery retail channel.

However, the European Commission's approach to mergers of independent brands is anchored on the formalistic "narrow market definition – high resulting market shares – automatic dominance" analysis and the Unilever/Sara Lee merger is a good example⁷⁰²:

⁶⁹⁹ *Id.*, p. 12: "The average prices for baby food have fluctuated somewhat over the years as shown in Table 4, but the average price in 2008 is the same as that in 2000, after adjusting for inflation and changes in the composition of consumption...The price change in percentage terms from 2000 to 2008 was calculated by using the quantities sold from 2000 in order to account for shifts in consumer spending over time. Such accounting is necessary as illustrated by the following example. Suppose consumers shifted toward buying more organic baby food, which is more expensive, over time. Then the usage of a simple average price change would overstate the real price change, because it would capture the higher price due to the shifts in consumer demands for organic baby food."

⁷⁰⁰ *Id.*, pp. 14-15: "Aside from preventing monopolistic prices, another reason to promote competition is to preserve incentives to innovate. In this industry, despite the high market concentration, both Gerber and Beech-Nut innovated during the past eight years, the former in terms of packaging and the latter in terms of nutrition. Starting in 2001, Gerber introduced plastic packaging after decades of using glass jars. Gerber was the first baby food manufacturer to offer this new packaging alternative...The plastic packaging innovation was sufficiently successful to warrant Gerber's further investment of it. The production of this new packaging began at Gerber's Fremont, Michigan, plant. At the end of 2003, Gerber began a \$65 million investment to incorporate new equipment for the plastic packaging at their Fort Smith plant in Arkansas. Beech-Nut has also innovated over the years. In 2002, Beech-Nut improved the nutrition in its food by including DHA, an omega-3 fatty acid found naturally in breast milk. Beech-Nut continued expanding this line in 2007 by introducing a new line of DHA-plus+. The "plus" indicates that the food also includes prebiotics that helps digestion and the absorption of calcium."

⁷⁰¹ *Id.*, p. 16: "In sum, although Beech-Nut may be able to achieve the same production efficiencies without the merger, this achievement required a delay of eight years and a substantial, additional investment."

⁷⁰² European Commission Decision of 17.11.2010, Case No COMP/M.5658 – UNILEVER/SARA LEE.

Market definition

The Commission found that male and non-male deodorants belonged to different product markets and as a result, the merger resulted in high market shares in the male deodorant market. The Commission's arguments included a "Small but Significant Non-transitory Increase in Price (SSNIP) Test" that relied on a 5% price increase in the male deodorant segment. It is striking that, despite all its limitations, the SSNIP is still being used in the FMCG market where product and price differentiation between specific brands clearly exceeds the 5% range as a rule. If competition authorities applied the SSNIP test regularly, the top-priced brands would always be found to constitute monopolies in their own market: a non-starter.

Dominance

The Commission based its dominance assessment on the leading position of Unilever post-merger, the fact that Sara Lee had contributed to important innovations in the market, a merger simulation with one-level and two-level nested logit models, the lack of countervailing buyer power and the barriers to new entry or competition from supermarkets' brands.

Leaving aside the only undisputed fact (Unilever's leading position post-merger), the other arguments showed a worrying lack of knowledge/understanding of the new economic paradigm represented by supermarkets:

(a) Innovation

The blood of independent grocery brands is innovation and the merger could bring together the innovative efforts and capabilities of Unilever and Sara Lee in the deodorant market. Furthermore, the innovation/production synergies would be reinforced with improved access of the innovations to distribution.

(b) Merger simulations

The use of merger simulations to assess sellers' incentives to increase prices post-merger is not only a crystal-ball glazing exercise, it is unfair because it takes no account of the supermarkets' market power and vertical integration. In the Commission's own words, the merger simulation "had several limitations due to the necessary restrictions in its assumed structure. As explained further in the Technical Annex, such restrictions are standard in the economic literature of merger simulations. However, they constrain the results' possible scope of interpretation. The assessment of the results must be put in context with the other qualitative and quantitative analysis carried out during the investigation". Notably, as the parties noted, it overlooked the supplier-retailer dynamics (including horizontal competition between them).

(c) Supermarkets' power and vertical integration

The competition authorities of some of the Member States affected by the merger had found that supermarkets enjoy strong bargaining power over their suppliers but the Commission disregarded it and, no surprisingly, it relied heavily on the self-serving statements of the supermarkets (and other independent brands). Interestingly, one of the affected Member States was Ireland and one wonders what would have happened had the Irish High Court that delivered the Kerry/Breeo Judgment reviewed the Commission's decision on appeal. Likewise, the Commission also rejected Unilever's argument that even smaller supermarkets enjoyed bargaining power because it was difficult for the supplier to replace a 5% volume loss (i.e., the Commission's own conclusion in the Rewe/Meinl Decision) and the existence of buying alliances was also downplayed. Interestingly, Unilever had provided examples of delisting of its relevant brands by smaller supermarkets in order to evidence the loss of volume (which the Commission did not consider to have been substantiated) but possibly more important than the loss of volume was the fact that smaller supermarkets could afford to delist Unilever and go on without its brands whilst Unilever had much more to lose than to win if it stopped supplying them.

When it came to assessing the competitive impact of supermarkets' brands, the Commission's reasoning was again far from today's market reality and common sense. For example, despite the fact that the combined market share in terms of volume of all supermarket brands in the Belgian market exceeded that of any independent brand, the Commission argued the following: "The elements put forward by Unilever do not alter the conclusions on weak competition from private label products. First, it is not clear why total sales of private label products in volume terms would be a good indicator of the competitive constraints exerted by private label products on branded products]. In differentiated branded product markets such as deodorants, sales in value and their associated market share will usually be considered to better reflect the relative strength of each brand. In value, private label products have a share of [5-10]*% which is significantly below those of the main non-male deodorant brands in Belgium. Moreover, the total share of private label products brings together products of several "suppliers", which adds to the complexity of the competitive interaction" [par. 411]. The Commission overlooked the fact that supermarket brands follow a selective distribution strategy (they are only sold in their own stores) and all the independent brands, including Unilever, are discriminated against in terms of access to the supermarkets' stores and competition against the incumbent supermarket brand in the stores of each supermarket. Likewise, the Commission also overlooked that volume is indeed highly relevant in the FMCG market because it shows that a high number of consumers is purchasing supermarket brands and this volume (loyalty) can later be translated into value at the expense of independent brands (whose retail display, including price is under control of their competitors), which will end-up losing first volume and then value.

On the other hand, in order to sustain its case against the merger, the Commission was prepared to concede that the retail market is not sufficiently competitive: supermarkets are more concerned about their margins than the procurement price, they are more inclined to accept general price increases (provided their margins are the same or higher) and can ensure that outcome by observing retail prices (“During such negotiations, the main focus of the retailers in price discussions is to achieve an advantage vis-à-vis the other retailers (or to avoid suffering a disadvantage) and to secure their margins, rather than the actual price itself” [par. 215]; “While several retailers confirmed that they could never be sure that their competitors would receive the same supply conditions, it was also indicated that retailers try to resolve the uncertainty by observing the pricing behaviour of the market before deciding on a pass-on” [par. 222]; “Second, a general price increase would leave the retailers target margin and its relative competitive position unchanged” [par. 223]). Furthermore, Unilever had showed that supermarkets retained a higher share of the surplus but the Commission claimed that it only showed buyer power pre-merger and that would change post-merger (“Even if the share of surplus figures were an indication of bargaining power, it is not sufficient that buyer power exists prior to the merger, it must also exist and remain effective following the merger. However, the main effect of the merger...removes a substitute to Unilever's brands and therefore shifts bargaining power from the retailer to the supplier that is Unilever” [par. 303]. “In conclusion, the surplus split analysis is not sufficient to support the claim that buyer power would exist post-merger” [par. 304]). It seemed that the Commission considered that the goal of the merger control process was to preserve supermarkets’ market power rather than preserve competition between suppliers-supermarkets and protect consumers.

5.7.2 Vertical restraints

Competition authorities view with great suspicion two types of vertical restraints imposed by independent grocery brands: single branding and resale price maintenance.

Single branding

The EU Vertical Guidelines hold that single branding practices by non-dominant grocery brands can foreclose market access of competing grocery brands. The European Commission considers that given the entry barriers prevailing in the retail level and the importance of inter-brand competition in-store, significant anti-competitive effects may start to arise if a non-dominant supplier ties 30% or more of the relevant market⁷⁰³. Furthermore, cumulative anticompetitive foreclosure effects may also arise when the total tied market share exceeds 40%, provided all suppliers have market shares below 30%, and even when the total tied market share exceeds 30%, where the market share of at least one company exceeds the 30% threshold, without being dominant⁷⁰⁴. By way of

⁷⁰³ The EU Vertical Guidelines, par. 129: “Under the heading of ‘single branding’ fall those agreements which have as their main element the fact that the buyer is obliged or induced to concentrate its orders for a particular type of product with one supplier” and par. 140.

⁷⁰⁴ The EU Vertical Guidelines, par. 141, *sensu contrario*.

example, the EU Vertical Guidelines condemn a non-dominant leader with a 40% market-share of an impulse consumer good category, which ties with non-compete obligations retailers making up 90% of its sales (i.e., 90% of 40% equals a 36% tied market-share). Thus, the Commission considers that Article 101 TFEU can be used to facilitate access of competitors to the tied 36% of the retail market (by sales), even though the market leader does not tie 64% of the retail market, eleven other competitors have only tied another 10% of the retail market and, therefore, 54% of the retail market is not tied by any non-compete agreement⁷⁰⁵.

The willingness of the European Commission to tackle single branding agreements in order to open the grocery retail market to as many suppliers as possible overlooks the existence of supermarket brands and their competitive impact on the market⁷⁰⁶. Independent grocery brands compete for the second spot on the supermarket shelves and often, for the “privilege” of being listed at all.

From a competition standpoint, the supermarkets’ ROB+1 strategy is much more dangerous for independent brands (since it is widespread and it leads to structural changes in the market) than the distribution competition between them, which is always run by the supermarkets. Therefore, competition authorities should ensure that their intervention is at least coherent, if not effective: either supermarkets’ practices aimed at restricting market access of independent grocery brands are considered to distort competition or the ensuing distribution competition between independent grocery brands should be tolerated, even though these partial single branding agreements will lead to the exclusion of some independent grocery brands at the expense of others⁷⁰⁷.

However, as the Heinz/Beech-Nut merger showed, independent grocery brands always end-up on the wrong side of the conventional competition analysis, whereas supermarkets’ practices always escape any control.

Resale price maintenance

Resale price maintenance has been for decades the cardinal sin in the field of vertical restraints all over the world⁷⁰⁸. For example, Article 4 of the EU Vertical Regulation

⁷⁰⁵ The EU Vertical Guidelines, par. 149.

⁷⁰⁶ In the merger control area, the European Commission has assessed wholesale markets for branded products, disregarding the impact of supermarket brands on the wholesale market (access to the supermarket platform) and the in-store competition. See, for example, Commission Decision of 9.11.2007, Case COMP/M.4824 - Kraft/Danone Biscuits, par. 25: “The market position of the parties and their competitors in Spain in the market for branded biscuits at wholesale level are the following...”.

⁷⁰⁷ These agreements are hybrid or partial since they never foreclose competition by the supermarket brand. On the contrary, even the independent brand that secures the second (exclusive) spot in a supermarket’s shelves will be subject to the discriminatory practices analysed above in Section 5.5.

⁷⁰⁸ For an analysis of the different pro- and anti-competitive theories on resale price maintenance, see the comprehensive article by Orbach, “Antitrust vertical myopia: the allure of high prices”, *Arizona Law Review* 50, pp. 261-287, 2008.

treats minimum and fixed resale prices as hard-core restrictions and excludes them from the scope of the block exemption⁷⁰⁹.

The Vertical Guidelines offer a few examples where resale price maintenance may be pro-competitive⁷¹⁰, but the standard practice of competition authorities is to condemn resale price maintenance as an objective restriction of competition and independent brands are understandably reluctant to enter into resale price maintenance agreements with retailers⁷¹¹.

In the US, however, the Supreme Court's "Leegin Judgment" has considered that resale price maintenance is not per se illegal and should be assessed under the rule of reason⁷¹².

The Supreme Court's analysis of resale price maintenance and vertical competition is highly relevant in the retail grocery field: First, the pro-competitive justifications of resale price maintenance are similar to those for other vertical restraints: the promotion of inter-brand competition⁷¹³. Second, resale price maintenance can also benefit new product introductions⁷¹⁴. Third, consumer welfare is not necessarily reflected in lower prices but in a healthy inter-brand rivalry that takes care of quality and innovation⁷¹⁵.

⁷⁰⁹ See also the EU Vertical Guidelines, par. 123: "As explained in section III.3, resale price maintenance (RPM), that is, agreements or concerted practices having as their direct or indirect object the establishment of a fixed or minimum resale price or a fixed or minimum price level to be observed by the buyer, are treated as a hardcore restriction. Where an agreement includes RPM, that agreement is presumed to restrict competition and thus to fall within Article 101(1). It also gives rise to the presumption that the agreement is unlikely to fulfil the conditions of Article 101(3), for which reason the block exemption does not apply."

⁷¹⁰ The EU Vertical Guidelines, par. 225, mention as pro-competitive scenarios the following: the launch period of a new product, a coordinated short term low price campaign (2 to 6 weeks in most cases) in a franchise network and, experience or complex products justifying a pre-sales service that would not otherwise be provided.

⁷¹¹ The European Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty establishing the European Community, OJ C 368, 22.12.2001, considers that vertical agreements involving parties with market shares below 15% do not appreciably restrict competition in the market. However, it excludes resale price maintenance from this *de minimis* analysis (par. 11. (a). (1)).

⁷¹² US Supreme Court, *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, Op. No. 06-480, Decided June 28, 2007 ("the Leegin Judgment").

⁷¹³ The Leegin Judgment, p. 10: "Minimum resale price maintenance can stimulate interbrand competition—the competition among manufacturers selling different brands of the same type of product—by reducing intrabrand competition—the competition among retailers selling the same brand. See *id.*, at 51–52. The promotion of interbrand competition is important because "the primary purpose of the antitrust laws is to protect [this type of] competition."

⁷¹⁴ *Id.*, pp. 11-12: "Resale price maintenance, in addition, can increase interbrand competition by facilitating market entry for new firms and brands. "[N]ew manufacturers and manufacturers entering new markets can use the restrictions in order to induce competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer."...New products and new brands are essential to a dynamic economy, and if markets can be penetrated by using resale price maintenance there is a procompetitive effect."

⁷¹⁵ *Id.*, pp. 15-16: "Respondent is mistaken in relying on pricing effects absent a further showing of anticompetitive conduct. Cf. *id.*, at 106 (explaining that price surveys "do not necessarily tell us anything conclusive about the welfare effects of [resale price maintenance] because the results are generally consistent with both procompetitive and anticompetitive theories"). For, as has been indicated already, the antitrust laws are designed primarily to protect interbrand competition, from which lower prices can later result. See *Khan*, 522 U. S., at 15. The Court, moreover, has evaluated other vertical restraints under the

Fourth, in general, the interests of manufacturers and consumers are aligned with respect to retailer profit margins⁷¹⁶.

All in all, the Leegin Judgment displayed a modern economic thinking at odds with the conventional competition analysis that confounds static prices with consumer welfare and identifies retailers' welfare with that of consumers. The new economic paradigm represented by modern grocery retailing poses a new challenge to competition authorities: is it beneficial for dynamic and even static competition that a vertically integrated supermarket fixes the retail price of a rival independent brand? The Leegin Judgment would suggest a negative answer:

First, bearing in mind that "antitrust laws are designed primarily to protect interbrand competition"⁷¹⁷, independent brands should be allowed to control their retail prices in order to prevent supermarkets from employing pricing practices that distort competition between their own brands and independent brands⁷¹⁸. Second, innovation is the

rule of reason even though prices can be increased in the course of promoting procompetitive effects. See, e.g., *Business Electronics*, 485 U. S., at 728. And resale price maintenance may reduce prices if manufacturers have resorted to costlier alternatives of controlling resale prices that are not per se unlawful. See *infra*, at 22–25; see also *Marvel* 371.”; and p. 17: “Many decisions a manufacturer makes and carries out through concerted action can lead to higher prices. A manufacturer might, for example, contract with different suppliers to obtain better inputs that improve product quality. Or it might hire an advertising agency to promote awareness of its goods. Yet no one would think these actions violate the Sherman Act because they lead to higher prices. The antitrust laws do not require manufacturers to produce generic goods that consumers do not know about or want. The manufacturer strives to improve its product quality or to promote its brand because it believes this conduct will lead to increased demand despite higher prices. The same can hold true for resale price maintenance.” [emphasis added]

⁷¹⁶ *Id.*, pp. 16-17: “Respondent’s argument, furthermore, overlooks that, in general, the interests of manufacturers and consumers are aligned with respect to retailer profit margins. The difference between the price a manufacturer charges retailers and the price retailers charge consumers represents part of the manufacturer’s cost of distribution, which, like any other cost, the manufacturer usually desires to minimize. See *GTE Sylvania*, 433 U. S., at 56, n. 24; see also *id.*, at 56 (“Economists . . . have argued that manufacturers have an economic interest in maintaining as much intrabrand competition as is consistent with the efficient distribution of their products”). A manufacturer has no incentive to overcompensate retailers with unjustified margins. The retailers, not the manufacturer, gain from higher retail prices. The manufacturer often loses: interbrand competition reduces its competitiveness and market share because consumers will “substitute a different brand of the same product.” *Id.*, at 52, n. 19; see *Business Electronics*, *supra*, at 725. As a general matter, therefore, a single manufacturer will desire to set minimum resale prices only if the “increase in demand resulting from enhanced service . . . will more than offset a negative impact on demand of a higher retail price.” [emphasis added]

⁷¹⁷ See, the Leegin Judgment and the EU Vertical Guidelines, par. 98: “Vertical restraints are generally less harmful than horizontal restraints. The main reason for the greater focus on horizontal restraints is that such restraints may concern an agreement between competitors producing identical or substitutable goods or services. In such horizontal relationships, the exercise of market power by one company (higher price of its product) may benefit its competitors. This may provide an incentive to competitors to induce each other to behave anti-competitively. In vertical relationships, the product of the one is the input for the other-, in other words, the activities of the parties to the agreement are complementary to each other. The exercise of market power by either the upstream or downstream company would therefore normally hurt the demand for the product of the other. The companies involved in the agreement therefore usually have an incentive to prevent the exercise of market power by the other.”

⁷¹⁸ See above, Section 5.5.2.1 and Olbrich 2004. See also, several entries on Jesus Alfaro’s blog (<http://derechomercantilesmana.blogspot.com.es>), criticising on economic grounds the restrictive approach of competition authorities towards resale price maintenance: “Otra prueba más de la irracionalidad de prohibir el PVP”, 09.07.2012; “B. Klein: el restatement definitivo sobre fijación del precio de reventa (RPM)”, 18.01.2010; “Algo se mueve en Europa con la fijación del precio de reventa”, 31.07.2009.

lifeblood of the grocery categories and supermarkets offer a narrow window of time to recoup the investment⁷¹⁹. The retail marketing and pricing of these new products may be critical in order to attract consumer demand. Therefore, control of retail prices may allow an independent grocery brand to introduce new products successfully. Third, prices alone do not tell anything about consumer welfare. As the US Supreme Court held, “the antitrust laws do not require manufacturers to produce generic goods that consumers do not know about or want”. Innovation and quality improvement is the source of competitive rivalry and economic growth and “the manufacturer strives to improve its product quality or to promote its brand because it believes this conduct will lead to increased demand despite higher prices”⁷²⁰. In the grocery sector, as in all other sectors of the economy, the Strategic Rivalry model associated with competition between independent brands brings more economic and consumer welfare than the Imitation and Price Discounting model associated with supermarkets’ practices. Fourth, the interests of independent grocery brands and shoppers are regularly aligned. Grocery brands are most interested in minimising their cost of distribution (i.e., supermarkets’ margins). A manufacturer will desire to set the retail price at the point where the value proposition of the brand is highest for consumers. A higher price will be more than offset by a reduction in demand and a lower price may undermine the value perception of the product. However, supermarkets have a different agenda. On the one hand, they may fix higher prices than the manufacturer would like in order to subsidise their retail activities or promote their own competing brands⁷²¹. On the other hand, they may dump the price of a product in order to attract consumers to the store and recoup the losses on that product with the margins made on others, at the expense of the value perception of the dumped product. This mismatch between the economic interests of the supermarket and those of individual grocery brands and their consumers leads to substantial inefficiencies and non-optimum prices as far as the independent brands are concerned.

Alfaro refers to the opinion of Klein, “Competitive resale maintenance in the absence of free-riding”, FTC Hearings on Resale Price Maintenance, 17.02.2009. Klein rightly points out that a manufacturer has to prevent retailer price discounting in order to assure that other retailers continue to distribute and adequately promote its products. Indeed, it is critical for independent grocery brands to achieve a high level of weighted distribution. However, the concern identified by Klein is aggravated by a new concern: competition from supermarket brands, which are in a position to dictate the retail prices of independent grocery brands.

⁷¹⁹ See above, Section 5.3.2.2.

⁷²⁰ See Orbach 2008, p. 277: “The underlying premise of antitrust laws is that, for any given product, consumer welfare is inverse to the product’s cost to the consumer, which includes its nominal price, search costs, and other costs. This assumption is also one of the most fundamental working tools of standard economic analyses... While the premise that “paying less is better” seems rather straightforward, contradicting market phenomena are widespread and their causes are equally straightforward: many people are willing to pay a premium for a brand, irrespective of quality and other tangible benefits.”; p. 278: “Prices sometimes even influence perceptions of quality: scientific evidence shows that increases in wine prices tend to affect positively the perceived flavor pleasantness of wines. These findings are consistent with other studies that show that information about beer brands affects the pleasure of drinking beer. Some studies indicate that, in certain circumstances, consumers who pay discounted prices may derive less actual benefit from consuming the product than consumers who purchase the same product for a full price”; and p. 279: “The resentment for loss-leader pricing among many manufacturers of branded goods is yet another reflection of manufacturers’ preferences for high prices. They believe that, although in the short term low prices may boost sales and revenues, in the long term low prices would damage their product image and result in decline in demand.”

⁷²¹ See above, Sections 5.5.2.1.1 and 5.5.2.1.4.

Conversely, resale price fixing by grocery brands may even lead to lower overall prices. For example, as the Leegin Judgment recognised, resale price maintenance may reduce prices if manufacturers have resorted to costlier alternatives of controlling resale prices that are not *per se* unlawful. In the retail grocery sector, supermarkets themselves are demanding guaranteed margins from independent grocery brands, thereby adopting the role of service providers (or even agents)⁷²². However, they do not want to relinquish their power to set retail prices of independent grocery brands. In short, if retail prices fall below their expectations, independent grocery brands have to assume the financial burden. If retail prices exceed their expectations, they pocket the financial gain. And in any case, they are able to use in-store prices to promote their own brands at the expense of independent grocery brands. Faced with this scenario, independent grocery brands can only rely on wholesale price promotions in order to reduce their retail prices and experience has shown that they are largely pocketed by supermarkets and not transferred to the retail prices of the relevant individual grocery brand⁷²³.

All these reasons have led Olbrich and Buhr to recommend the lifting of the prohibition of resale price maintenance in the grocery retail market. They argue that resale price maintenance could put a brake to the supermarkets' foreclosure practices in favour of their own brands and, in particular, to their extreme price sceneries described above in Section 5.5.2.1⁷²⁴. They show that the current *de facto* prohibition of resale price maintenance enforced by competition authorities, disregards the market power of supermarkets⁷²⁵ and reduces (1) grocery brand innovation and competition; and (2) horizontal competition between supermarkets⁷²⁶. They argue that supermarkets' vertical

⁷²² See above, Section 5.1.1.

⁷²³ See above, Section 5.5.2.1.3.

⁷²⁴ Olbrich 2004, pp. 25-26: "Pure private label product ranges would in the end make competition vanish almost completely (figure 4)...Only a competing branded article distribution system with fixed prices could put a brake on these developments (figure 5). In this case extreme price sceneries, which distort the pricing competition one-sidedly in favour of the retail stage, are shut out to a great extent on the retail stage. Interbrand competition between branded articles would once again be able to refer more to the performance components 'quality' and 'extra utility', whereby a pricing competition between branded articles, triggered by the industry, would also be promoted, because the industry could then advertise a defined price which is contractually agreed with the retailers. At the same time, at the retail level elements of performance profiling (such as, e.g., a broad, differentiating product range and local proximity to the consumer, and services, e.g. more customer service) could once again gain importance."

⁷²⁵ *Id.*, p. 28: "In view of the global change experienced by the power relationship between retailers and manufacturers in the last 30 years, and because of the accompanying negative effects on competition, which this study has only examined in part, it is no longer clear today, in particular when looking at this sector of the economy, what the reasons for not changing the prohibition of resale price maintenance might be."

⁷²⁶ *Id.*, p. 28: "This paper showed in detail the negative consequences of the prohibition of resale price maintenance under the aspect of product variety, the horizontal competition between retail companies and of the competitive position of branded article manufacturers. A decision in favour of an exception to the prohibition of resale price maintenance suggests itself for branded goods at least, because the possibility for manufacturers of these products to fix consumer prices themselves has to a certain extent the function of encouraging them to innovate. Because in many cases developing new products is only worthwhile in combination with this possibility: a uniform market appearance of a product is an important factor for its success on the market and the price is a significant component of this market appearance."

integration strategy is foreclosing the grocery brand market⁷²⁷ and resale price maintenance by independent brands will only partially offset the current distortion of competition, since supermarkets and their brands will keep control over many other variables of inter-store and inter-brand competition⁷²⁸. Furthermore, resale price maintenance may lead to lower retail prices of independent grocery brands and, indirectly, lower retail prices of supermarket brands (by virtue of the umbrella pricing effect)⁷²⁹.

⁷²⁷ *Id.*, pp. 28-29: “All the same, European competition policy places great importance on the prohibition of resale price maintenance. Its concern here is that price fixing could lead to intrabrand competition being sealed off. As was shown above with reference to the retail sector, in the recent past it is not the manufacturers of branded articles who have sealed off competition in several fields, but the retail sector itself through the introduction of private labels. The trend towards this kind of exclusion of a large portion of competition through the retail sector is based in part on the deliberate use of branded articles at the cost of the branded articles manufacturers, because the latter are no longer able to achieve a uniform appearance of their marketing instruments for the final consumers.”

⁷²⁸ *Id.*, p. 27: “It is true that even with a relaxation of the prohibition of resale price maintenance or even a reintroduction of the price-fixing option for the retail sector it would still be possible for retailers to make use of umbrella pricing and to avoid various competition fields. However, the extreme excesses, such as the artificial 'rise in price' and the 'price knockdown' of branded articles, would not be found any longer. This makes it clear that even a reintroduction of the price-fixing option for the branded goods industry would only be a certain compensation for disadvantages it has now. Against the background of the mature and still very marked eliminatory competition in the retail sector this compensation for disadvantages promises to strengthen those competitive forces which affect the readiness to innovate and invest on the part of the industry and the performance profiling on the part of the retail sector”, and p. 29: “After all, along with setting the price, retail companies have numerous other opportunities for influencing the image of branded articles for the consumer: among other things they decide on the type and location of the placing in the sales area, on special sales promotion measures or on the stock-keeping policy, which, depending on the arrangement, leads to out-of-stock-situations with a lesser or greater probability. Even with the possibility of resale price maintenance branded articles would still be exposed to competition from private labels, such as the price-independent dimensions of the interstore-intrabrand competition (figure 3). These price-independent dimensions especially include the different placings, stockings and advertisings of a particular branded article by different retailers.”

⁷²⁹ *Id.*, p. 27: “Finally, because of the retail sector's pricing policy tactics shown here, a general increase in prices would not have to be reckoned with as a consequence of fixed prices in parts of the retail assortments, because extreme price umbrellas would be avoided and, from the point of view of the branded goods industry, the price difference to the private labels would have to be carefully observed”. Moreover, if the access fees paid by independent brands were suppressed, supermarkets would bargain harder over the purchase price and independent brands would have more leeway to be competitive on prices.

6 The Common Agricultural Policy

Producers of agricultural products can be impacted by supermarkets' practices in different ways:

First, if producers supply directly to supermarkets, they can be subject to abuses regarding access fees and terms. Their bargaining power is null because even though they may have their own commercial brands, consumers are rarely familiar with them and supermarkets are in a position to switch suppliers without any cost, whereas the producers will incur substantial costs in channelling production to a new supermarket that was not a customer beforehand or to an existing supermarket customer whose requirements from a given producer are already covered.

Second, if producers integrate vertically forward into industrial processing and develop commercial brands, they may be prey to any of the practices described in this Report.

Third, producers will also suffer indirectly as input suppliers of the agrifood industry, as Appendix 8.5 reveals. The Imitation and Price Discounting model adopted by supermarket brands, however profitable may be for supermarkets, leads to zero sum competition. The producer and industrial links in the agricultural chain do not make enough profits to foster innovation and productivity growth (value), leading to the supply of homogeneous products at infracompetitive wholesale/procurement prices. On the other hand, upward retail prices and access fees ensure healthy profits for supermarkets at the expense of consumers, who end up with less innovation, variety and quality, as well as supracompetitive prices. All in all, there is a sustained destruction of economic value in the agricultural chain.

The Common Agricultural Policy (CAP) is a basic pillar of the EU policies and it has been afforded a special status from a competition law perspective⁷³⁰. For many years, producers have unsuccessfully demanded a general exemption of their agreements from the scope of competition rules. However, Regulation 261/2012 has opened the door to collective bargaining in the milk sector, a policy breakthrough that is likely to extend to other sectors in the next CAP reform⁷³¹. Now, any producer organisation constituted by dairy farmers or an association of producer organisations may negotiate prices and other contract terms, provided that the total volume of raw milk covered by such joint

⁷³⁰ Article 42 TFEU provides that EU rules on competition shall apply to production of and trade in agricultural products only to the extent determined by the European Parliament and the Council within the framework of Article 43(2) TFEU, which itself provides for the adoption of a common market organisation for agricultural products.

⁷³¹ Regulation 261/2012 of the European Parliament and of the Council amending Council Regulation 1234/2007 as regards contractual relations in the milk and milk products sector, OJ L 94/38, 30.03.2012, *Preamble*, par. 14: "In order to ensure the rational development of production and so to ensure a fair standard of living for dairy farmers, their bargaining power vis-à-vis processors should be strengthened which should result in a fairer distribution of value-added along the supply chain."

commercialisation does not exceed: (i) 3.5% of the EU production, and (ii) 33% of the national production of any particular Member State where the milk is produced or delivered (the threshold is set at 45% of the national production if the production in that Member State is below 500,000 tonnes)⁷³². However, if leading grocery brands with high market shares cannot constrain supermarkets' access and in-store practices, nothing suggests that joint commercialisation by producers will undermine supermarkets' power other than marginally. Therefore, any public initiative confined to increasing concentration at the production or industrial level will do nothing to offset supermarkets' market power vis-à-vis suppliers, their incentives and capacity to employ abusive and/or exclusionary practices and, ultimately, the suppression of the Competitive Rivalry model in favour of the Imitation and Price Discounting model (Porter 2002).

⁷³²

Regulation 261/2012, new article 126 quater of Regulation 1234/2007.

7 Legal Remedies

The modern competition analysis has evidenced that supermarkets enjoy market power and their practices produce anticompetitive effects on grocery brands and consumers. Therefore, it is necessary to design and enforce legal remedies that address these anticompetitive practices. These remedies may be provided by economic regulations (i.e., ex ante remedies) and/or competition rules (i.e., ex post remedies). Indeed, both instruments often work together to facilitate the efficient operation of several economic markets. As the European Commission reckons, economic regulation may be necessary in order to (1) prevent market failures that can have a devastating effect on consumers, but also a systemic effect, with repercussions beyond the interests of those immediately affected; and (2) open up markets to competition, as an instrument of liberalisation (e.g., network industries)⁷³³. Not least because competition rules rely on ex post enforcement, “ex ante regulation is preferable to resolve structural problems and open up markets to competition by laying down the conditions for market entry, giving potential new entrants legal certainty and thus encouraging them to invest”⁷³⁴. Furthermore, regulation may also take into account other public policies worth of protection⁷³⁵. As a matter of principle, economic regulation and competition rules “are complementary instruments” and regulation “works best when it takes into account competition objectives”, whereas concurrent “competition enforcement takes account of the regulatory context and regulatory objectives”⁷³⁶. Against this background, several arguments point towards the need to supplement competition policy enforcement with the economic regulation of supermarket platforms⁷³⁷:

First, the retail market structure, characterised by significant concentration, barriers to entry, price transparency and consumer loyalty to the store, is not likely to become more competitive in the foreseeable future. To the contrary, the retail market concentration is growing and the room left for new entry or growth of small players is vanishing.

Second, individual supermarkets have become competitive bottlenecks for independent grocery brands, which have no countervailing power against supermarkets’ abuses⁷³⁸. The European Commission itself has acknowledged that competition bottlenecks are

⁷³³ Almunia, “Competition v Regulation: where do the roles of sector specific and competition regulators begin and end?”, Center on Regulation in Europe (CERRE), 23.03.2010.

⁷³⁴ *Id.*

⁷³⁵ *Id.*

⁷³⁶ *Id.*

⁷³⁷ The term economic regulation does not necessarily refer to an *ad hoc* piece of legislation. It may be embedded in sector-specific laws or in generic provisions of national competition laws that apply stricter rules on unilateral practices.

⁷³⁸ Independent grocery brands cannot reach grocery shoppers directly or ply supermarkets against each other in order to obtain favourable terms.

better dealt with under an ex ante regulatory regime than under competition rules⁷³⁹. Likewise, competition authorities have also considered that buyer power, the concept under which the conventional competition analysis has assessed supermarkets' dealings with independent grocery brands, is better addressed through regulation⁷⁴⁰.

Third, supermarkets' anticompetitive practices are long-standing, widespread, simultaneous and multifaceted, which seems to be the best evidence of a structural market failure⁷⁴¹.

Fourth, supermarkets' vertical integration and foreclosure practices place the old vertical relationship between grocery brands and supermarkets in a new horizontal dimension: a non-reciprocal commercialisation agreement with a competitor, whose own brand competes head-on with independent brands in the store. Furthermore, once in the store, consumers care about the price of the entire shopping basket and supermarkets can distort the price-differential between independent brands (e.g., overpriced) and their own brands (e.g., underpriced) as well as many other non-price factors, unnoticed by consumers, that may be almost as influential (e.g., shelf placement and switch-marketing) as prices in determining their choice between competing brands.

Fifth, for many years, competition policy enforcement has been biased against manufacturers (sellers) and in favour of retailers. The concept of intra-brand competition is an artificial creation that constraints sellers' commercial freedom and tilts vertical relationships in favour of retailers, even though inter-brand competition may be intense. Conversely, conventional competition policy has not developed tools to deal with the new economic paradigm. Therefore, supermarkets have benefited from an asymmetric competition regime (e.g., the prohibition of resale price maintenance) for many years and it is only fair that their anticompetitive practices are banned upfront and expeditiously through economic regulation. Obviously, this conclusion does not relieve competition authorities of the need to modernise competition analysis to tackle supermarkets' anticompetitive practices, but it will certainly take much more time to

⁷³⁹ See OECD 2009b, Note by the European Commission, Section 3.3. ("The limits of competition policy"), p. 169: "Armstrong points out that even if the platforms do not make excessive profits overall, the multi-homing side faces too high a charge from the point of view of social welfare. Bolt and Tieman (2006) in a comparatively simple two-sided platform model, obtain a similar result. They show that in the social optimum, platform-pricing leads to an inherent cost recovery problem. This result is driven by the inter- group network effect of participation that users on either side of the market exert on the opposite side. The contribution of this positive externality to social welfare leads the social planner to choose a corner solution, in terms of full participation of the more elastic buyers' side of the market and recovering costs from the price-inelastic sellers' side. In fact a social planner will price below marginal costs, leading to an under-recovery of costs and hence an operational loss for the platform. The positive network externalities operate like economies of scale on demand, analogous to the case of a natural monopoly. It follows that even adequate competition policy enforcement alone may not always lead to best outcomes. This suggests, at least in some instances that regulation may be pertinent". [emphasis added]

⁷⁴⁰ OECD 2009b, Executive Summary, p. 10: "The welfare effects of the exercise of buyer power should inform policy towards conduct that creates, enhances, or maintains buyer power. However, it may be difficult for competition policy and enforcement institutions - both agencies and courts - to restrain the exercise of buyer power effectively. The control of the exercise of buyer power, if required, may therefore be better assigned to a regulatory agency."

⁷⁴¹ See, for example, conclusions of the UK Grocery Report 2000 and the Spanish Grocery Report.

develop a coherent framework through *ex post* enforcement than any public intervention through *ex ante* economic regulation⁷⁴².

Sixth, public intervention in other competitive bottlenecks suggests that economic regulation is more efficient than the exclusive enforcement of competition rules⁷⁴³. Preventive regulatory intervention against the threat of anticompetitive practices, despite the absence of single-firm dominance, has been the remedy chosen in the field of CRSs⁷⁴⁴, interconnection between mobile telecommunications networks⁷⁴⁵, provision of Internet access⁷⁴⁶, and Internet domain name registration⁷⁴⁷.

The EU's passive stance regarding the abuses taking place in the grocery retail market contrasts with its proactivity in other competitive bottlenecks. It has regulated CRSs for a long time, it has warned that it may resort to economic regulation if anti-competitive practices emerge in the provision of Internet services and it has vocally opposed, alongside the US authorities, the legal initiative aimed at lifting the prohibition of vertical integration in the field of Internet domain names. Furthermore, it has launched a public consultation regarding, among other things, the potential regulation of the access fees and commercial terms imposed by card payment networks on merchants, because it is felt that competition law enforcement was insufficient⁷⁴⁸. Indeed, the Competition Commissioner has claimed that despite the "the self-regulatory efforts of the industry, and the hard work done by the national competition authorities", *ex ante* regulation may be the best solution to the competition problems identified in that market⁷⁴⁹.

On the other hand, some of the European Commission's initiatives to tackle competition bottlenecks under competition rules highlight the limitations of this avenue under a

⁷⁴² See Section 0.

⁷⁴³ For a general discussion of competitive bottlenecks, see Section 5.3.2.1.

⁷⁴⁴ See Appendix 8.2.1. The regulation of CRSs provides a good benchmark for measuring the need for regulation, and its scope, in the modern grocery retailing. At the time Regulation 2299/1989 was adopted, the CRS market was concentrated but no single-dominance was deemed to exist, there were vertical links with airline carriers that posed a risk of vertical foreclosure of competing airline carriers, and these risks were more notorious in markets where the parent airline carriers enjoyed a dominant position. Currently, many modern retail grocery markets are even more concentrated than the CRS market, the vertical integration is growing apace facilitated by discriminatory/exclusionary practices of the leading supermarkets, their individual stronghold in some regional retail markets comes close to or amounts to a dominant position (e.g., Casino in the Paris area) and the prospect of direct access by independent grocery brands to consumers is remote.

⁷⁴⁵ See Appendix 8.2.2.

⁷⁴⁶ See Appendix 8.2.3.

⁷⁴⁷ See Appendix 8.2.5.

⁷⁴⁸ See Appendix 8.2.7.

⁷⁴⁹ Almunia, "Integrating payments in the EU: A new approach", Conference on Card, Internet and Mobile Payments Brussels, 4 May 2012. Almunia relays the conventional argument against the access fees (i.e., MIFs) charged to retailers: "The model is also opaque; on the one hand, cardholders cannot see how much merchants are charged; on the other, the rewards built into many schemes encourage them to use the cards with higher fees. As a result, we end up using the more expensive cards, but the retailers fear of losing business if they refuse them. And – like all costs – these too are eventually passed on to all consumers – including those who do not use cards." If one substituted the words *cardholders* by *grocery shoppers*, *retailers* by *grocery brands*, and *card schemes* by *supermarkets*, the Commission's reasoning would lead to the inescapable conclusion that *ex ante* regulation is also needed in the grocery procurement/retailing market.

conventional analysis and the innovative interpretation of the competition rules required to deal with them. For example, the investigation against Google's practices will have to rely on a narrow market definition (e.g., general search engines) and a high customer lock-in (despite the one click-away presence of competitors), in order to be able to conclude that Google enjoys a dominant position on the basis of a very high market share (a conventional competition analysis)⁷⁵⁰. Furthermore, any enforcement action against Google will not address the, apparently more intense, discriminatory practices of Google's competitors against non-integrated content providers and Google itself. These widespread practices would evidence that neither content providers nor Internet users can constrain the market behaviour of the main market players, let alone Google.

Likewise, the practices of media platforms vis-à-vis advertisers are only addressed when these platforms merge. However, leaving aside outright prohibition of mergers, the scope for competition remedies is severely limited (remedies are limited to the prohibition of joint commercialisation of advertising or bundling of advertising in different channels) unless regulatory-type remedies such as those adopted following the Carlton/Granada merger are put in place (e.g., regulation of access pricing and terms and an "adjudicator" to monitor the remedies and arbitrate disputes)⁷⁵¹.

Seventh, supermarkets' power has enabled them to bundle two business models in order to profit from their respective advantages: they *de facto* behave as service providers vis-à-vis independent grocery brands (i.e., they provide distribution services) whilst controlling retail competition through their formal role of merchants⁷⁵². Conversely, independent grocery brands are forced to shoulder the disadvantages of both models: they are forced to accept supermarkets' access fees and commercial terms whilst not being able to control the retail commercialisation of their products. This market failure may call for a regulatory clarification of the boundaries of the supermarkets' business model. As Rey and Tirole explained, the "Coasian pricing problem" (i.e., the monopolist's commitment problem) is more likely to arise when bottlenecks are at more upstream levels, that is, when they are not at the interface with consumers. In this latter case, a monopolist can make take-it-or-leave-it offers to its suppliers in order to extract all profits from them and charge the monopoly price to final consumers. Therefore, "from either the consumers' or total welfare perspective, it is preferable to put the more competitive segment downstream"⁷⁵³.

Last, but not least, economic regulation may also take into account other public policies worth of protection, such as the agricultural or industrial policy. Supermarkets' anticompetitive practices and their Imitation and Price Discounting business model (Porter 2002) may have a profound impact on producers of agricultural products and the

⁷⁵⁰ See Appendix 8.2.4.

⁷⁵¹ See Appendix 8.2.6.

⁷⁵² For a practical example of the distortions caused by this bundled model, see the discussion in Section 5.7.2 on the guaranteed margins demanded by supermarkets (a wholesale feature) whilst controlling retail prices of the independent grocery brands (a retail feature).

⁷⁵³ See above, footnote 512 and Rey 2003, pp. 28-29.

agrifood industry⁷⁵⁴. The Common Agricultural Policy is the most important EU policy in terms of economic resources. In 2010 the budget for direct farm payments (subsidies) and rural development - the twin pillars of the Common Agricultural Policy – amounted to 58 bn. euro, out of a total EU budget of 123bn euro, that is, 47% of the total⁷⁵⁵.

In light of the tremendous economic resources poured on the agricultural sector by the EU and the critical role of the agrifood industry in the EU economy, it comes as a big surprise that no regulatory measure has been adopted at the EU level against the supermarkets' practices that undermine the efficiency and competitiveness of the agrifood value chain.

For all the foregoing reasons, the economic regulations adopted in a growing number of Member States to prevent supermarkets' abusive practices, including the GSCOP mandated by the UK Competition Commission under regulatory-type powers, are not only legitimate, but the most efficient way of addressing these practices as well.

In any event, both regulatory and competition remedies should be inspired by the same hierarchy of goals proposed by economists such as Michael Porter (see Section 5.2.1) and complement each other.

7.1 Regulation

Basically, the economic regulation of modern grocery retailing would ensure fair and non-discriminatory access to and competition within the supermarket platforms for all grocery brands, whilst preserving and fostering supermarket platforms' incentives to be efficient and compete against each other. The economic regulation of supermarkets could extend to all supermarkets, cover the leading ones only or provide different scales of intervention according to the market power/size of the supermarkets.

In this regard, two recent developments in the EU could blaze a new regulatory trail:

On the one hand, in January 2013, the European Commission published for consultation a Green Paper on Unfair Trading Practices in the Business-to-Business Food and non-Food Supply Chain in Europe ("the EU Green Paper")⁷⁵⁶. This consultation takes stock of retailers' market power and the existence of unfair trading practices ("UTPs") and seeks the views of public and private stakeholders on the appropriate remedies:

"Over the last two decades, the B2B food and non-food supply chain has changed considerably for economic, social and demographic reasons. Increased concentration and vertical

⁷⁵⁴ See Section 6 (The Common Agricultural Policy) and 5.3.2.2 (The productivity/innovation growth model of grocery brands).

⁷⁵⁵ BBC News, "Q&A: Reform of EU farm policy", 12.10.2011. The direct payments alone totalled 43 billion euro.

⁷⁵⁶ COM (2013) 37 final, 31.01.2013. All the information regarding the Green Paper is available at http://ec.europa.eu/internal_market/consultations/2013/unfair-trading-practices/index_en.htm. Even though the Green Paper is not confined to grocery retailing, the European Commission has acknowledged that it responds primarily to the concerns expressed by many public authorities and private operators regarding the business practices grocery wholesalers and retailers.

integration across the EU have led to structural changes in the B2B food and non-food supply chain. Various international retailer buying alliances have emerged seeking economies of scale in sourcing through greater buying power. The expansion of retailers' own brands has turned some merchants into direct competitors of their suppliers. A small number of relatively strong players in the supply chain appear to have considerable negotiating power. These factors may, in some cases, lead to unfair trading practices (UTPs) along the B-to-B food and non-food supply chain. UTPs are practices that grossly deviate from good commercial conduct and are contrary to good faith and fair dealing. [p. 3]. In parallel, the Commission will begin working on an impact assessment of the different options to address the issue of UTPs. The impact assessment will examine also to what extent this problem can be dealt with locally or whether an EU-level solution would be needed. This approach will preserve the achievements of the High Level Forum in the food sector while considering all possible solutions ranking from self-regulation to legislation. [p. 4]. UTPs may have detrimental effects on the EU economy and for the B2B food and non-food supply chain in particular. Such practices may affect companies', including SMEs', capacity to invest and innovate. [p. 5]. UTPs are typically imposed in a situation of imbalance by a stronger party or a weaker one - which is often not in a position to to abandon the unfair relationship and switch to another business partner due to the costs implied by such change or to the lack of alternatives to the contractant. [p. 6]. In a market which functions ptimally, the lack of trust between the parties would result in switching to another business partner. High switching costs or the very lack of such a possibility concretely translates into a favourable bargaining position which may encourage the stronger party to behave unfairly. The inability to switch to another business partner and to terminate the existing relationship is a key factor in the development of UTPs. In addition, the weaker party often fears that the commercial relationship could be terminated in the event of a complaint on its part. This 'fear factor' makes these complaints significantly less likely to occur and is therefore one the most important issues to be examined when assessing the appropriateness of an enforcement mechanism. [p. 7]."

The Green Paper goes on to identify seven UTPs, six of which concern supermarkets, whereas the seventh relates to "territorial supply constraints" imposed by suppliers, a practice that has been extensively dealt with by competition authorities and has resulted in a significant curtailment of suppliers' freedom to manage their distribution networks and a corresponding increase in the bargaining power of distributors. Out of the six practices associated with supermarkets, five of them relate to the procurement contract, i.e., the access fees and commercial terms that supermarkets impose on suppliers in order to allow them access to their platforms: ambiguous contract terms, lack of written contracts, retroactive contract changes, unfair transfer of commercial risk (including access fees) and unfair termination of a commercial relationship. The sixth, interestingly, deals with one aspect of the competition between independent brands and supermarket brands: unfair use of information ("While it is legitimate for a party to request some information on the products proposed, the details received should not be used, for example, to develop its own competing product, which would deprive the weaker party of the results of its innovation (...) Elements of a fair practice could be that information provided to a contracting party within a commercial relationship must be used fairly (notably in situations where the business partners are also partially competitors)"[p. 19]).

Moreover, in September 2013, the representative associations of the grocery industry and retailers launched “The Supply Chain Initiative”, a voluntary scheme that comprises The Principles of Good Practices in vertical relationships in the Food Supply Chain and The Framework for the implementation and enforcement of such Principles (“the EU Code of Conduct”):

“Following a request made on 10 March by the European Commission in the B2B Platform of the High Level Forum for a Better Functioning Food Supply Chain, a multi-stakeholder dialogue was created to discuss fair/unfair practices along the food supply chain. This dialogue has the objective to contribute to the High Level Forum process, on the basis of the platform’s mandate. The core of the discussion has been to find a solution to the asymmetry and possible misuses of bargaining power by actors operating in the food chain.

The outcomes of the multi-stakeholder dialogue are attached in the form of a set of principles of good practice and a list of examples of unfair and fair practices in vertical trading relationships. These outcomes demonstrate i) a recognition that unfair commercial practices may occur throughout the whole food supply chain and ii) stakeholder willingness to address those practices in a consensual and effective way.

The members of the multi-stakeholder dialogue believe that these principles of good practice provide a framework for doing business that respects contractual freedom and ensures competitiveness, trust and continuity, all required for business development, innovation and the three pillars of sustainability (economic, social and environmental). Ultimately these will benefit consumers and society at large.”⁷⁵⁷

The EU Code of Conduct contains three general principles (Consumers, Freedom of contract and Fair dealing), seven specific principles (Written agreements, Predictability, Compliance, Information, Confidentiality, Responsibility for risk and Justifiable request) and examples of fair/unfair practices regarding the following issues: Agreements written/unwritten, General terms and conditions, Termination, Contractual sanctions, Unilateral actions, Information, Entrepreneurial risk allocation, Listing fees (upfront access payments), Threatening business disruption, Tying and Delivery and reception of goods. The UTPs included in the EU Code of Conduct are similar to the UTPs covered in the European Commission’s Green Paper. They focus on the procurement stage of an alleged vertical relationship. However, fair competition between independent brands and supermarket brands is also covered as regards the misuse of the sensitive commercial information of independent brands by supermarkets in order to favour their own competing brands (“A contracting party uses or shares with a third party, sensitive information provided confidentially by the other contracting party, without the latter’s authorization, in a way that enables it to obtain a competitive advantage”) and the prohibition of promotions by independent brands (“Preventing a contracting party from making legitimate marketing and promotional claims on their products”).

Both the EU Green Paper and the EU Code of Conduct mark a breakthrough. It is the first time that the European Commission acknowledges that the bargaining power of the supermarkets is leading to UTPs that undermine suppliers’ capacity to invest and

⁷⁵⁷ All information regarding The Supply Chain Initiative can be found at <http://www.supplychaininitiative.eu/>.

innovate and identifies several UTPs that could be subject to public regulation and enforcement. Likewise, it is the first time that the representative associations of the supermarkets impliedly acknowledge that their members are employing several UTPs and commit to suppress them.

However, both texts fail to offer a holistic solution to all the UTPs and anticompetitive practices that are taking place in grocery retailing. First, they recognise the platform role played by supermarkets, which enables them to transfer risks and charge fees to their suppliers, but they do not offer rules or guidelines to demarcate the merchant role from the service provider role. Second, they overlook the horizontal competition between independent brands and supermarket brands regarding access to and competition within each supermarket platform save for two instances: the misuse of sensitive commercial information and the prohibition of independent brands' promotions. Third, the EU Code of Conduct can hardly be considered a suitable tool to address supermarkets' unfair and anticompetitive practices as long as it is voluntary (certainly, if all the supermarkets joined in, this issue would be resolved) and no public enforcement (e.g., ex officio investigations and sanctions) is available.

All in all, even though these two texts represent a significant headway, they are inspired by a conventional vision of the food supply chain and view retailers as buyers in a vertical relationship with suppliers and not as two-sided platforms which exhibit competitive bottleneck features. Therefore, public authorities should also draw inspiration from the regulatory experience with other competitive bottlenecks such as CRSs (see Appendix 8.2.1). In the EU, Regulation 2299/1989 put in place regulatory remedies regarding (1) access to CRSs; (2) competition within each CRS; (3) legal and functional separation between CRSs and their parent airline carriers; and (4) effective guidance and enforcement by the Commission with the aid of independent auditors. Even though airlines have divested their stakes in CRSs and the latter's competitive bottleneck status has been undermined by airlines' direct access to consumers and travel agents, Regulation 80/2009 has continued to impose regulatory remedies regarding access to and competition within each CRS.

7.1.1 Demarcation of service provider and merchant activities

Bearing in mind the evolution of modern grocery retailing from a merchant model to a *sui generis* model where the distribution service provided to independent brands (i.e., suppliers) is mixed with the retail function, the economic regulation should clarify the boundaries of each model. Currently, leading supermarkets can and often impose on suppliers the cost of: (1) delivery in pallets and crates of third parties (selected by the supermarkets) to the individual stores or the provision by the supermarket of centralised delivery & warehousing services; (2) the in-store replenishment; (3) in-store promotions and marketing activities; (4) product shrinkage; (5) consumer complaints; and/or (6) unsold items. They also demand guaranteed margins or retroactively impose payments/deductions to meet their margin forecasts, essentially foregoing their role of retailers.

The EU Green Paper identifies the role of supermarket platforms/networks and the distribution services they provide to independent brands (“This model is part of many modern retailers’ business models and consists in bundling the purchase of goods with some additional services which retailers offer to suppliers for a charge”) but its efforts to distinguish legitimate and proportional services and fees from the excessive/unfair ones fail because the very access to the supermarket platform is by itself a service that can be priced according to the laws of supply/demand⁷⁵⁸. The EU Code of Conduct’s provision on “Entrepreneurial risk allocation” does not offer much help either. The examples of unfair practices (“Transfer of unjustified or disproportionate risk to a contracting party, for example imposing a guarantee of margin via payment for no performance” and “Imposing a requirement to fund a contracting party’s proprietary business activities”) are offset by the examples of fair ones (“Transfer of risk which is negotiated and agreed by the parties to obtain a win-win situation” and “Contracting parties agree the terms and conditions corresponding to their contribution to either parties’ proprietary activities and/or promotional activities”).

In light of the difficulty, if not impossibility, of demarcating the fair/unfair and proportionate/excessive transfer of supermarkets’ risks to independent brands, public authorities should consider confining supermarkets to the role of providers of distribution services (by analogy with market-places and shopping malls): grocery brands would pay upfront fees and/or variable fees on sales to gain access to the supermarket platforms and would interact with shoppers directly or through agency agreements with supermarkets⁷⁵⁹. Under this role, supermarkets would auction their shelf-space and associated in-store services to grocery brands. Therefore, all grocery brands, including supermarkets’ own brands, would compete on an arms’ length basis for access to the supermarkets, whilst being able to control such in-store variables as their retail price. This market structure is the one favoured by Internet supermarkets such as Alice and Amazon, which are not associated with incumbent brick and mortar supermarkets. Their business model would show that when supermarkets cannot leverage their market power against suppliers, they are more inclined to adopt a market-

⁷⁵⁸ EU Green Paper, p. 19: “Another type of UTP is the abusive use of so-called ‘rever margin’ practices. This model is part of many modern retailers’ business models and consists in bundling the purchase of goods with some additional services which retailers offer to suppliers for a charge (e.g., promotion and transport fees, services linked to use of shelf-space, etc.). Such practices are legitimate under most circumstances. However, in some cases, they can also be excessive and unfair: in some EU jurisdictions (e.g., France), courts state that listing fees should be considered legitimate only if they are linked to real services, are proportionate and are being charged for in a transparent manner. Elements of a fair practice could be that contracting parties should agree that each operator takes responsibility for its own risk and does not unduly attempt to transfer its risks to other parties. Contracting parties should agree on the terms and conditions for their contribution to either party’s proprietary and/or promotional activities. Fees for legitimate services should correspond to their value. It could also include that, when listing fees are agreed between both parties, they should be proportionate to the risk incurred. Contracting parties should never ask demand payments manifestly not corresponding to the value/cost of the service rendered.”

⁷⁵⁹ See, in the introductory part of Section 7, the ground number seven for adopting an *ex ante* regulation complementing the enforcement of *ex post* competition rules.

place role whilst letting grocery brands direct access to retail consumers⁷⁶⁰. Furthermore, this market-place model evidences that more grocery brands may find distribution at lower retail prices than the current mixed model followed by the leading supermarkets.

If the public authorities do not consider appropriate to impose the service provider (market-place) model on supermarkets, at least they should regulate the respective boundaries of the distribution service provider model and the merchant/retailer model, and supermarkets should be forced to choose any of the two models.

7.1.2 Access Terms

Public authorities should mandate access to the supermarkets on FRAND terms (“Fair, Reasonable and Non-Discriminatory”) and, possibly, on an open basis as well. This obligation could cover all supermarkets or just the supermarkets that exceed a market-share or turnover threshold.

7.1.2.1 Fair access

The principle of fairness requires that the agreements (1) are written; (2) cover at least the most important elements of the contractual relationship; and (3) the rights and obligations on both sides are balanced. Furthermore, the sensitive commercial information provided by independent grocery brands to supermarkets should not benefit competing supermarket brands.

The EU Green Paper and the EU Code of Conduct address all these issues. Furthermore, the UK GSCOP extensively deals with fair access and can offer a regulatory benchmark as well (even though it does not deal expressly with the use of sensitive commercial information)⁷⁶¹. It contains a general provision regarding fair dealing and several provisions regulating access terms such as the form of contracts and retrospective adjustments; changes to supply procedures in the course of a supply contract;

⁷⁶⁰ See, for example, Alice’s frequently asked questions, at www.alice.com: “*How does Alice work?* Alice is a service that provides you a cost effective way to manage all of your household essentials online. You tell Alice what you buy -- choosing from great deals on 1000's of products -- and we go to work. We organize all of your products, find coupons and deals for you, remind you when you might be running low, and help you order just the items you need so you can avoid the chore of household shopping. And all this convenience comes direct to your door with free shipping on orders over \$40 included. *What kind of products can I buy on Alice?* Alice carries all of the goods that keep your house running -- items like garbage bags, laundry detergent, dish soap, shaving cream, diapers, and cough syrup, to name a few. You'll find thousands of household essential products on Alice, from the big name manufacturers you trust, to the up and coming brands that can't afford space on the traditional store shelf. *Is Alice different than other online retailers?* Alice.com isn't an ordinary retailer. You order from Alice just like you would a retailer, but behind the scenes we work like a marketplace, allowing manufacturers to sell directly to you without the added costs of a retailer. Eliminating this extra layer between the people that make the goods and the people that buy them (that's you!) creates a lot of extra savings that can be passed along to you in the form of lower prices.”

⁷⁶¹ See a description of the UK GSCOP above in Section 4.

forecasting errors; contracting with third parties; wholesale promotional prices; payment⁷⁶² and the termination of the supply relationship.

Furthermore, the terms of delivery, including a fair dispute resolution mechanism⁷⁶³ and proportionate penalties, should be regulated in order to avoid disputes as to the scope of the fair dealing principle in this area⁷⁶⁴.

Finally, the UK GSCOP provides that supermarkets must not transfer to independent brands the risks of activities falling within the merchant business model configured by the regulation. For example, supermarkets should bear the cost of shrinkage, wastage and customer complaints (unless the supermarket is legally entitled to a compensatory action before the supplier).

7.1.2.2 Access Fees

Currently, supermarkets perform indistinctly distribution service provider and merchant functions. The access fees associated with their distribution service provider role undermine the competitiveness and efficiency of grocery brands, discriminate independent grocery brands in favour of supermarket brands and have an inflationary effect on retail prices⁷⁶⁵.

If supermarkets adopted the distribution service provider role exclusively, transparent access fees would be the ordinary course of business and the activities and risks associated with selling to consumers would fall in the hands of grocery brands (including those store-related activities that supermarkets would perform under the distribution service contract for them). Each supermarket could legitimately seek to

⁷⁶² The UK GSCOP provides that supermarkets must pay “within a reasonable time after the date of the Supplier’s invoice”. However, public authorities should evaluate whether supermarkets should enjoy a credit term at all. Independent grocery brands are forced to finance supermarkets, that is, their competitors. These funds could generate more value added to the economy if they went back to the owners (independent brands) instead of financing supermarket activities that may be in direct competition with those of independent brands.

⁷⁶³ See the Auchan Judgment 2011, p. 14: “Que le Code de Commerce (L442-6 8°) prohibe la deduction d’office de pénalités à l’encontre du fournisseur, lorsque ce dernier n’a pas été en mesure de vérifier la réalité du grief causé au distributeur; que dans les engagements pris le 05.10.2010 par les professionnels du secteur de la distribution en matière de relations commerciales dont Auchan était signataire les grandes enseignes s’étaient engagées notamment à établir de bonnes pratiques dans le domaine des conditions de mise en œuvre de pénalités et plus particulièrement à la mise en place avant la fin d’année d’une procédure permettant au fournisseur de vérifier que le grief est bien établi ; qu’à la date des plaidoiries cette procédure n’avait pas été portée à la connaissance du Tribunal.”

⁷⁶⁴ See, for example, the Auchan Judgment 2011, where the Court found that a delivery rate (“taux de service”) of 98.5% imposed by Auchan in its general terms, with associated penalties of 10% of the faulty sales value, reaching 20% for promotional sales, did not respect the fair balance of commercial relationships. The Court considered that (1) this provision had not been the object of negotiation with suppliers, (2) it was too generic and lacked precision, (3) it was contrary to the recommendations of the Efficient Consumer Response (ECR) group; (4) it was very high and calculated on a monthly basis, thereby excluding periodic, seasonal and exceptional events; (5) it disregarded the complexity of the delivery chain and the interplay of several players other than the supplier, including Auchan itself; (6) 60% out of 5,829 suppliers had faced this penalty on a single month, it had caused several disputes and administrative burdens, and Auchan had abstained from claiming 75% of the penalties due; and (7) the penalty was not proportionate to the contractual breach and the damage suffered by Auchan.

⁷⁶⁵ See the theory of harm (Section 5.4.3) and the market analysis (Section 5.5.1.2).

maximize access fees whilst competition between supermarket platforms, including regulatory measures aimed at reducing concentration in local markets, would ensure that these access fees remained within reasonable levels.

However, if supermarkets favoured a merchant business model, public authorities should evaluate whether access fees should be regulated: they could be subject to a test of proportionality and due consideration, as the EU Green Paper and the EU Code of Conduct suggest, or they could be prohibited or capped altogether. Indeed, this debate also arouse in the context of the regulatory remedies imposed on CRSs: the European Commission proposed an amendment of the Regulation 2299/1989 to make sure that the fees charged to a subscriber for equipment and services were non-discriminatory, reasonably structured and reasonably related to the cost of the service provided and used; and were, in particular, the same for the same level of service; whereas a submission of the Antitrust Division of the DOJ to the Department of Transport (DOT), argued in favour of 0-pricing in respect of access fees charged by CRSs to airline carriers (see Appendix 8.2.1).

Several arguments militate in favour of an upfront prohibition or limitation of access fees in the merchant business model⁷⁶⁶:

First, in a competitive retail model, supermarkets should be encouraged to minimize the purchase price of grocery brands and the prohibition of access fees would incentivise that effort. Second, the litigation flood in France evidences that supermarkets charge disproportionate access fees or fees without due consideration and this field would be a permanent source of conflict. Third, from an economic, industrial and agricultural policy standpoint, it may be more desirable to lift access barriers that may hinder access of grocery brands, in particular the smaller ones, to supermarkets. Fourth, access fees by a vertically integrated supermarket are discriminatory and may facilitate a foreclosure strategy.

7.1.2.3 Non-discriminatory access

The principle of non-discrimination requires that the terms of access are transparent, objective and neutral in respect of all grocery brands, be they independent brands or supermarket brands⁷⁶⁷.

The principle of non-discriminatory access might come to play once the supermarket has decided its assortment strategy (“light non-discrimination”) or it may be extended to

⁷⁶⁶ See, for example, the substantial restrictions imposed in the UK GSCOP (note 578), the Slovak Republic (note 579) and the Spanish Law 12/2013 on the food chain. Regarding the prohibition of access fees (with limited exceptions) in the UK, see a practical example in The Grocer, “Tesco eye-level fees breached GSCOP says Adjudicator”, 21.12.2013 (<http://m.thegrocer.co.uk/Article/352997>).

⁷⁶⁷ Up to know, the *ex ante* regulations adopted in this field have assumed that suppliers and supermarkets are linked by a vertical relationship and have focused on supermarkets’ abusive (exploitative) dealings with independent grocery brands. However, public authorities should bear in mind that the prohibition of these abusive practices (e.g., access fees), in the presence of supermarket power, will simply incentivise the refusal of access/delisting of independent grocery brands by supermarkets.

the listing criteria used to select the listed grocery brand(s) (“pure non-discrimination). The light non-discrimination provision would leave room for a ROB+1 strategy, provided the listed independent brand is not discriminated in the terms of access (e.g., access fees which are only paid by the independent brand).

The pure non-discrimination obligation would leave each supermarket freedom to determine the number of brands per category/segment but the listing criteria would have to be applied to both independent and supermarket brands on a non-discriminatory basis. As a consequence, a supermarket might favour a limited assortment strategy (e.g., one brand per segment/category) but its supermarket brand would have to compete on an arms’ length basis with independent brands for the limited space. The regulation could offer public authorities flexibility to impose either the light non-discrimination obligation or the pure non-discrimination obligation (e.g., pure non-discrimination obligation would apply to supermarkets exceeding a certain market-share/turnover threshold).

7.1.2.4 Open access

In certain sectors, economic regulations have mandated open access to a facility, subject to capacity/technical constraints⁷⁶⁸. It has been argued that open access in the grocery retail sector is impossible due to the limited shelf-space available and the ever-changing features of the grocery categories and segments⁷⁶⁹. However, even technology platforms are faced with capacity constraints and this has not prevented open access obligations

⁷⁶⁸ Open access obligations have not been confined to essential facilities under competition rules. See, for example, the CRSs and wholesale access to mobile telephony networks. In the first case, Regulation 2289/99 mandated open access across all CRSs. In the second case, national regulators (e.g., Spain) have relied on the concept of collective dominance on the wholesale access market to mandate access, even though the retail market was considered to be fairly competitive.

⁷⁶⁹ Supermarkets have constantly argued that shelf-space limitations explain the assortment restrictions and access fees. However, shelf-space limitations are mostly driven by supermarkets’ in-store strategies: First, vertical integration into groceries is the main driver of their decision to restrict the assortment of competing grocery brands. Second, supermarkets diversify into non-grocery areas at the expense of a broader assortment of grocery categories and competing brands. These non-grocery categories are already being served by other formats, whilst the reduction in the assortment of grocery brands cannot be offset by other formats. See, for example, the UK Grocery Report 2008, p. 86: “6.66. A second form of diversification that has been adopted to varying degrees by UK multiples is to extend into non-grocery retailing. As the ability to offer non-grocery lines is ultimately constrained by store space, it has tended to be those operators with a portfolio of larger stores that have been able to pursue this route more successfully...6.69. The impetus for diversification into non-grocery, we were told, arose from several factors: (a) traditional grocery lines, as mentioned earlier, offered few opportunities for commercial growth; (b) the presence of attractive non-grocery lines could generate higher numbers of customers at stores; (c) the larger multiples had the logistical ability to offer these products with minimal disruption to the supply chain; (d) in some instances there were opportunities for cross-promotion between the two sides of the business, for example offering additional loyalty card points to purchasers of financial services, or advertising financial services within stores; and (e) the retailing of grocery and non-grocery lines offered scope for cross-subsidy between the two sides of the business.” Third, supermarkets may devote more store space to other ancillary services related to grocery sales at the expense of a broader assortment of categories and competing brands. The example of the leading Spanish supermarket, Mercadona, is particularly illustrative. It has embarked on a strategy of full substitution of independent grocery brands by its own brands and it is now devoting significant floor-space to market-test its own products with consumers and seek their feedback. See, Mercadona Annual Report 2011, p. 26.

(e.g., CRSs). In the grocery retail sector, this difficulty may be overcome by fixing a minimum number of competing brands in each category or sub-category (e.g., 3-4), subject to objective capacity constraints. This obligation would facilitate dynamic competition between grocery brands and may be particularly required in Member States where supermarkets adhering to a “closed network” strategy prevail and it is impossible for independent grocery brands to build significant weighted distribution (e.g., above 70%). Furthermore, the evidence produced in this Report shows that a limited assortment strategy based on supermarket brands and, by the same token, independent grocery brands, does not necessarily translate into lower retail prices⁷⁷⁰. In Member States where access problems have not been detected so far, public authorities might favour the inclusion of a generic open access obligation (without even mentioning the specific minimum thresholds) in the economic regulation, and retain leeway to enforce it or not, depending on the progress achieved under the obligation of non-discriminatory access⁷⁷¹.

7.1.3 In-store competition

In line with the FRAND terms governing access to the supermarket platforms, supermarkets should ensure that in-store competition between grocery brands takes place on fair and non-discriminatory terms. This obligation should apply to all supermarkets and, in particular, those that are vertically integrated into grocery brands.

In the field of non-pricing competition, the enforcement of these principles should be straightforward in respect of practices such as degradation of in-store services⁷⁷², switch marketing⁷⁷³ and allocation of preferential shelf-space⁷⁷⁴. Regarding copycat, the study commissioned by the European Commission has evidenced that legislative action at the EU level may be necessary⁷⁷⁵. In the interim, it may be necessary to introduce a specific provision against copycats in this sector, in light of the dual role played by supermarkets⁷⁷⁶.

⁷⁷⁰ See the evidence regarding the Spanish grocery retail market in Sections 5.3.1.5 (“Direct evidence: pricing power and spatial competition”) and 5.5.1.4 (“Refusal of access”). Small as well as large supermarkets with a broad assortment of grocery brands price as competitively, if not more, than the market leader (Mercadona), which follows an aggressive limited assortment strategy. Furthermore, the prices of the supermarket brands of the chains adhering to a limited assortment strategy are higher than the prices of the supermarket brands of the chains adhering to a broader assortment strategy.

⁷⁷¹ The prohibition of discrimination against independent brands may be the most efficient driver towards an open access strategy by supermarkets. See, in that regard, the evolution of the CRS market, where access obligations imposed on CRSs are credited for having led airlines to abandon their vertical integration strategy.

⁷⁷² See Section 5.5.2.2.1.

⁷⁷³ See Section 5.5.2.2.2.

⁷⁷⁴ See Section 5.5.2.2.3. The UK GSCOP forbids payments by independent grocery brands for preferential shelf-space. The next logical step should have been the prohibition of preferential allocation of shelf-space to supermarket brands to the detriment of independent grocery brands.

⁷⁷⁵ See Section 5.5.2.2.4.

⁷⁷⁶ In other economic sectors, companies do not hesitate to take legal action against copycatting by competitors. However, as a rule, independent grocery brands do not take legal action against copycatting by supermarket brands due to fear of retaliation by their largest customers.

In the field of pricing competition, a fair dealing and non-discrimination obligation may be more difficult to enforce in some areas. Certainly, the prohibition by supermarkets of on-package promotions by independent grocery brands should not be tolerated and is now prohibited by the EU Code of Conduct sponsored, among others, by the European supermarket associations⁷⁷⁷. Regarding the pocketing of promotional wholesale prices⁷⁷⁸, the UK GSCOP has provided that supermarkets must calculate on a transparent basis the quantities ordered at promotional prices and cannot over-order with the purpose of selling at higher retail prices⁷⁷⁹. This provision, however, does not address retail promotions that are financed by independent grocery brands, which cannot effectively control whether these promotions have been effectively carried out by the supermarkets⁷⁸⁰.

Regarding artificial retail price gaps⁷⁸¹, competition authorities have only recently woken up to their anticompetitive implications (e.g., the Spanish Grocery Report, the Paris Grocery Report and the Finnish Grocery Report). However, no remedy has been advanced yet. The economic regulation of this practice could provide that supermarkets may not earn higher retail margins on independent grocery brands than they do on their own competing brands, in order to avoid cross-subsidisation of the latter at the expense of the former. This remedy, though, would not address the supermarket's incentive to employ an umbrella-pricing strategy (i.e., parallel increase of the price of the leading brand and the competing supermarket-brand).

Regarding brand-destruction through loss-leading retail prices⁷⁸², admittedly, it has never been a concern for competition authorities, which were more focused on static intra-brand price competition than on dynamic inter-brand competition. Moreover, some EU Member States have passed rules prohibiting sales below cost, but they have been largely ineffective, in part due to the suppliers' fear of (1) retaliatory measures by supermarkets and (2) penalties for retail price fixing by competition authorities. However, a rule prohibiting vertically integrated supermarkets from selling independent brands at a loss may have pro-competitive effects deserving a specific regulation to that effect.

Finally, there is the outstanding issue of retail promotions. A basic tenet of competition authorities is that suppliers should not interfere with the retailers' pricing freedom and, accordingly, they have enforced for many years a *de facto* prohibition of resale price maintenance. However, supermarkets keep requesting independent brands to fund retail promotions and, on some occasions, independent brands take the lead in offering to

⁷⁷⁷ See Section 5.5.2.1.4. If supermarkets incur any extra cost that they would not incur absent this on-packaging promotion, they are free to negotiate better purchase prices.

⁷⁷⁸ See Section 5.5.2.1.3.

⁷⁷⁹ The UK GSCOP, Schedule 1, Part 4.14 (*Due care to be taken when ordering for Promotions*).

⁷⁸⁰ The UK GSCOP, Schedule 1, Part 4.13, only provides that the "Retailer must only hold that Promotion after Reasonable Notice has been given to that Supplier in writing", but does not lay down any *ex post* monitoring mechanism (e.g., documentary evidence that the promotion has been carried out in the terms agreed with the independent brand).

⁷⁸¹ See Section 5.5.2.1.1.

⁷⁸² See Section 5.5.2.1.2.

fund retail promotions⁷⁸³, in order to ensure a competitive retail pricing of their products. Fairness in dealings between suppliers and supermarkets would suggest that if the former cannot dictate retail prices, then supermarkets should not request (*impose* more often than not) that suppliers fund promotional retail prices. The UK GSCOP has tried to strike a balance by prohibiting supermarkets from requiring suppliers “predominantly to fund the costs of a Promotion” and forcing them to “hold that Promotion after Reasonable Notice has been given to that Supplier in writing”⁷⁸⁴.

All in all, the issues raised by the supermarkets’ pricing practices in respect of independent grocery brands, especially when they are vertically integrated and have an incentive to expel independent competitors from the market, should force public authorities to consider the authorisation, if not the mandatory obligation, of resale price maintenance in the modern grocery wholesaling/retailing. This remedy would certainly conflict with the current competition policy on resale price maintenance. However, if the main purpose of competition policy is to protect and promote inter-brand competition, the prohibition of resale price maintenance should be reconsidered at least as far as the grocery retail sector is concerned. The current shortsighted focus on intra-brand competition undermines efficient practices of independent brands⁷⁸⁵ and has not changed the oligopolistic features of the market⁷⁸⁶. On the other hand, supermarkets’ access terms and fees, as well as their control of price and non-price competition between brands within their stores allows them to (1) reduce inter-brand competition by expelling independent brands from the market and (2) reduce competition between supermarkets by increasing their differentiation (which raises consumers’ information and switching costs and works to their disadvantage) and the overall level of prices⁷⁸⁷. One can only speculate as to the evolution of the market had the prohibition of resale price maintenance not existed, but it could well be the case that supermarkets’ market power had not grown out of control and they had evolved into market-places such as the ones emerging in the highly competitive on-line market (e.g., Alice.com and Amazon)⁷⁸⁸.

⁷⁸³ In this instance, the boundaries between a promotional wholesale price (UK GSCOP, Schedule 1, Part 4.14) and funding by the supplier of the retail promotions undertaken by the supermarket (UK GSCOP, Schedule 1, Part 4.13) would be blurred.

⁷⁸⁴ The UK GSCOP, Schedule 1, Part 4.13: “(1) A Retailer must not, directly or indirectly, Require a Supplier predominantly to fund the costs of a Promotion. (2) Where a Retailer directly or indirectly Requires any Payment from a Supplier in support of a Promotion of one of that Supplier’s Grocery products, a Retailer must only hold that Promotion after Reasonable Notice has been given to that Supplier in writing. For the avoidance of doubt, a Retailer must not require or request a Supplier to participate in a Promotion where this would entail a retrospective variation to the Supply Agreement.”

⁷⁸⁵ See Sections 3 (“Conventional competition analysis”), 5.2 (“The goals of competition policy”) and 5.7 (“Independent grocery brands’ market power and practices”).

⁷⁸⁶ See Section 5.3.1 (“Market power in the modern grocery retailing”).

⁷⁸⁷ See Sections 5.4 (“Theories of harm”), 5.5 (“Assessment of individual practices”) and 5.6 (“Anti-competitive effects”).

⁷⁸⁸ See, for example, Mercer, “The abolition of resale price maintenance in Britain in 1964: a turning point for British manufacturers?” Economic History working papers, 39/98, London School of Economics and Political Science, 1998, p. 1: “The paper analyses the effects of the Resale Prices Act 1964, which banned resale price maintenance in the UK and makes the following finding: “the effect of the Act was to give legal acknowledgement to the growing powers of multiple retailers, not only over

7.1.4 Separation of vertical activities (supermarket brands)

Regulation 2289/99 mandated legal separation of the CRS and the airline carrier activities in order to ensure the effective enforcement of the fair and non-discriminatory dealing obligation imposed on CRSs vis-à-vis airline carriers. The non-mandated divestitures of stakes in CRSs carried out by airline carriers process sends an interesting message that could be relevant in the modern grocery retailing. If discrimination of competitors is forbidden by regulation, then economic efficiency reasons alone may no longer justify vertical integration.

Therefore, a legal and functional separation of the supermarket brand activities from the supermarket (retail) activities may be necessary in order to guarantee that independent grocery brands enjoy a fair and non-discriminatory treatment by supermarkets, irrespective of the business model they adopt (e.g., distribution service provider or merchant):

- Under the distribution service model, supermarkets should fix their business strategy and access terms and conditions without any bias in favour of their own brands. Furthermore, the fairness and objectivity of the auctions and negotiations with brands would be compromised if supermarkets kept their grocery brand operations in-house.
- Under the merchant (retail) model, just the goal of protecting the innovative efforts by independent grocery brands should be sufficient to justify a legal separation of the supermarket's distribution and grocery brand activities. Neither the obligation of fair and non-discriminatory dealing nor internal preventive measures (e.g., a Chinese wall) seem sufficient to guarantee that a supermarket will not misuse the confidential information received from an independent grocery brand (e.g., the same supermarket department procures independent brands and supermarket brands). The legal separation would also ensure better control and enforcement of the fair and non-discriminatory competition between all grocery brands regarding access to the supermarkets and in-store competition within them.

7.1.5 Enforcement

It is a fact that independent grocery brands hardly ever take legal action against supermarkets and no complaints have been filed under EU competition rules against the

smaller retailers, but more importantly over manufacturers. In turn the Act opened up a period in which, by the 1980's the shift in the balance of power between retailers and manufacturers was known, marked and the subject of academic and government enquiry as to its effects on consumer welfare". The paper develops three arguments (p. 2): "First, that the backbone of rpm [resale price maintenance] derived from manufacturers, although supported by independent retailers, and that this tendency was actually increasing up to 1964. Secondly, the paper outlines the ways in which retailer dominance was asserted as a result of 1964, especially through the growth of retailer brands. Finally, the paper argues that the government's decision to abolish rpm was therefore a deliberate siding with large retailers in the competitive struggle, and involved a vital shift in the distribution of property rights between manufacturers and retailers."

latter⁷⁸⁹. Therefore, any economic regulation in this field either puts in place an independent enforcement mechanism or is doomed to fail. This mechanism could rely on a newly created public authority charged with the enforcement of the regulation⁷⁹⁰ or an existing authority such as the Competition Authority⁷⁹¹.

If the enforcement power was vested on a newly created authority, it should be able to (1) issue interpretative guidelines; (2) settle/arbitrate bilateral disputes⁷⁹²; (3) open infringement proceedings, *ex officio* or following complaints by affected parties or their representative associations, and impose remedies and economic fines; (4) publish reports and recommendations.

It comes as no surprise that the Groceries Adjudicator Bill foresees that the new regulator (the Adjudicator) shall (1) give advice on any matter relating to the Groceries Code to suppliers or large retailers, issue recommendations to large retailers and publish guidance about: (a) the application of any provision of the Groceries Code; (b) steps that large retailers need to take in order to comply with the Groceries Code; and (c) any other matter relating to the Groceries Code; (2) arbitrate disputes between suppliers and large retailers; (3) investigate whether a large retailer has broken the Groceries Code or has not followed a Recommendation of the Adjudicator and impose fines on large retailers and; (4) publish a report after the end of each reporting period, describing what the Adjudicator has done during the period, including information on (a) disputes referred to arbitration under the Groceries Supply Order; (b) investigations carried out by the Adjudicator; (c) enforcement measures adopted; and (d) any recommendations that the Adjudicator has made to the Office of Fair Trading for changes to the Groceries Code.

If the enforcement power was vested on the Competition Authority, it could retain the powers (1) to (4) mentioned above or share some of them with the Administration (e.g., the Ministry for Economic affairs and/or Agriculture). For example, the Competition Authority would retain control over the infringement proceedings and sanctions, whereas the Administration could issue interpretative guidelines, settle/arbitrate disputes and file formal complaints before the Competition Authority⁷⁹³.

⁷⁸⁹ The absence of formal complaints evidences the degree of market power enjoyed by supermarkets vis-à-vis independent grocery brands. This is the fear factor described in the EU Green Paper.

⁷⁹⁰ See, in the UK, the Groceries Adjudicator Bill, above, note 40.

⁷⁹¹ In this case, the economic regulation may be a stand-alone legislative measure that confers enforcement powers to the Competition Authority or a set of provisions embedded in the Competition Law. For an example of a stand-alone measure, see Article 62 of the Italian “Liberalisation” Decree 1/2012. For an example of the provisions embedded in the Competition Law, see Article 13.2 of the Latvian Competition Act, which regulates an *ad hoc* dominance in the retail trade and lays down a specific prohibition of abuses by dominant retailers, to be enforced by the Competition Authority.

⁷⁹² This function is not normally found in competition proceedings but is widely used in regulated sectors.

⁷⁹³ Article 11.2(a) of Regulation 2299/1989 provided that Member States could file formal complaints before the Commission regarding infringements of the Regulation.

Furthermore, since the vertical integration of supermarket and grocery brand activities and the supermarkets' control over in-store competition (under the retail business model) raises significant compliance problems, public authorities should consider the introduction of an audit mechanism such as the one put in place by Regulation 2299/1989⁷⁹⁴.

7.1.6 Control of retail concentration

The evidence gathered in different studies conducted by competition authorities points to the existence of long-term concentrated markets in several regions⁷⁹⁵.

As acknowledged by the UK Competition Commission and the French Competition Authority, merger control rules or structural remedies under single-dominance provisions are not able to address the spatial pre-emption of local markets by a given supermarket through organic growth.

Therefore, the UK Competition Commission proposed a Competition Test that would prevent new store openings by the leading supermarket in a highly concentrated local area⁷⁹⁶. For its part, the French Competition Authority has sought specific powers to order structural remedies (i.e., store divestitures) in highly concentrated markets⁷⁹⁷.

The inclusion of a Competition Test in the economic regulation, complemented with the specific power to adopt *ex post* structural remedies, seems absolutely justified in this sector. Commercial land for grocery retailing is a scarce resource and legal barriers often exacerbate the scarcity of this land. Therefore, store opening at the local level resembles very much the auction of a limited number of business licences in other sectors (e.g., mobile telephony). Understandably, public authorities configure these auctions in a way that guarantees a minimum number of licensees in the market in order to preserve its competitive nature and they should proceed accordingly in the grocery retail sector.

7.2 Competition Law

All over the world conventional competition rules seek to avoid anti-competitive agreements (e.g., in the EU, Article 101 TFEU) and abuses of a single or collective dominant position (e.g., in the EU, Article 102 TFEU). Competition rules are a living and adaptable instrument that should be able to deal with new economic paradigms such as the supermarkets' competitive bottleneck status.

⁷⁹⁴ See below, note 920.

⁷⁹⁵ See, for example, the UK Grocery Report 2008 (Appendix 7.1), the Spanish Grocery Report and the Paris Grocery Report.

⁷⁹⁶ See the UK Grocery Report 2008, par. 11.14(g): “(g) a particular retailer would fail the test if: (i) the grocery retailer was not a new entrant in the local area; (ii) the total number of fascias in the local area were three or fewer; and (iii) the retailer would have 60 per cent or more of groceries sales area (including the new store) in the local area (this decision taken on the basis of a majority of four to two).”

⁷⁹⁷ See above, Section 4.

7.2.1 Article 101 TFEU

The current EU Vertical and Horizontal Guidelines fail to offer a holistic solution to the competition problems raised by supermarkets. Therefore, this Report proposes a new legal framework under Article 101 TFEU to deal with the supermarkets' abusive and exclusionary practices.

7.2.1.1 The conventional analysis: EU Vertical and Horizontal Guidelines

The complexity of the modern grocery retail sector is illustrated by the European Commission's failed attempt to deal with this sector in the EU Vertical Guidelines⁷⁹⁸.

The Commission claimed at the time of the consultation leading to the current EU rules on vertical restraints that buyer power of big retailers and on-line sales were the most important market developments that needed to be addressed⁷⁹⁹. However, the outcome of this process has offered new arguments to those who argue that conventional competition analysis is ill-placed to address supermarkets' power and anti-competitive practices. The following examples illustrate this mismatch:

First, the buyer power of large retailers led the European Commission to introduce a second market-share threshold (30%) for the buyer, alongside the original market share threshold (30%) in place for the seller. Originally, the Commission proposed that the buyer threshold should cover any downstream market where the buyer resold the product⁸⁰⁰. However, following a public consultation where retailers strongly opposed the Commission's proposal, the latter finally confined the buyer market-share threshold to the procurement market. Therefore, the vast majority of European supermarkets currently benefit from the buyer market share threshold (30%), which contrasts with the lower threat thresholds (i.e., market power/dominance) identified by the Commission in the Rewe/Meinl and Carrefour/Promodès Decisions (i.e., 5-10% and 20%).

⁷⁹⁸ See above, Section 3.

⁷⁹⁹ European Commission press release IP/09/1197, "Antitrust: Commission launches public consultation on review of competition rules for distribution sector", 28.07.2009: "The main suggestions for amendments intend to take account of recent market developments, in particular the increased buyer power of big retailers and the evolution of on-line sales on the Internet... Competition Commissioner Neelie Kroes stated: "Competitive and efficient distribution are essential for consumer welfare and for our economy. The review launched today aims to ensure that the assessment of supply and distribution agreements under the competition rules takes account of recent market developments, namely further increased market power at the level of buyers and new forms of distribution including the opportunities brought by the Internet"."

⁸⁰⁰ See Draft Commission Notice - Guidelines on Vertical Restraints, SEC(2009) 946/3, par. 23: "The Block Exemption Regulation creates a presumption of legality for vertical agreements depending on the market share of the supplier and the buyer. Pursuant to Article 3 of the Block Exemption Regulation, it is the supplier's market share on the market where it sells the contract goods or services and the buyer's market share on the market(s) where it resells the contract goods or services or where it sells its product produced with the help of the contract goods or services which determine the applicability of the block exemption. The supplier's as well as the buyer's market share may not exceed the threshold of 30 % in order for the block exemption to apply."

Second, since supermarkets' brands compete with independent grocery brands, the supply agreements between the latter and supermarkets would have to be assessed first under the EU Horizontal Guidelines, by virtue of Article 2(4) of the EU Vertical Regulation⁸⁰¹. However, the EU Vertical Guidelines came to the rescue of supermarkets by considering that those retailers that do not manufacture the products sold under their own brands are not to be considered manufacturers, *ergo* competitors of these manufacturers⁸⁰². This reasoning overlooks the fact that mere manufacturing is not relevant from a competition law perspective. Indeed, many independent companies manufacture for both independent grocery brands and supermarkets and competition policy has special rules for sub-contracting agreements⁸⁰³. The relevant competition in the market takes place between grocery brands and those who exercise business control over them, regardless of who manufactures them.

Third, the EU Vertical Guidelines specifically address two aspects of the supermarkets-grocery brands relationship (i.e., category management and access fees), but they utterly fail to address supermarket power and the new economic paradigm.

Basically, the EU Vertical Guidelines assume that category management and access fees are practices driven by leading independent grocery brands in order to exclude smaller brands⁸⁰⁴. Having accepted as a matter of principle that supermarkets who sell their own brands but do not manufacture them are not competitors of independent brands, the EU Vertical Guidelines only refer in passing to the dual role of supermarkets: they mention that vertically integrated supermarkets may refuse access to their platforms to independent grocery brands in the section devoted to category management practices⁸⁰⁵. Furthermore, the EU Vertical Guidelines hold that the assessment of category management practices is to be done by analogy with the assessment of single branding

⁸⁰¹ The EU Vertical Guidelines, par. 27: "Article 2(4) of the Block Exemption Regulation explicitly excludes 'vertical agreements entered into between competing undertakings' from its application. Vertical agreements between competitors are dealt with, as regards possible collusion effects, in the Commission Guidelines on the applicability of Article 81 of the EC Treaty to horizontal cooperation agreements. However, the vertical aspects of such agreements need to be assessed under these Guidelines."

⁸⁰² See last sentence of the par. 27 of the EU Vertical Guidelines: "A distributor that provides specifications to a manufacturer to produce particular goods under the distributor's brand name is not to be considered a manufacturer of such own-brand goods."

⁸⁰³ The EU Vertical Guidelines, par. 22.

⁸⁰⁴ The EU Vertical Guidelines, par. 210: "While in most cases category management agreements will not be problematic, they may sometimes distort competition between suppliers, and finally result in anti-competitive foreclosure of other suppliers, where the category captain is able, due to its influence over the marketing decisions of the distributor, to limit or disadvantage the distribution of products of competing suppliers"; and par. 205: "Exceptionally, upfront access payments may also result in anticompetitive foreclosure of other suppliers, where the widespread use of upfront access payments increases barriers to entry for small entrants". The EU Vertical Guidelines also consider other ancillary theories of harm such as foreclosure of small supermarkets by access fees (par. 204) and collusion between supermarkets through category management (par. 211).

⁸⁰⁵ The EU Vertical Guidelines, par. 210: "...While in most cases the distributor may not have an interest in limiting its choice of products, when the distributor also sells competing products under its own brand (private labels), the distributor may also have incentives to exclude certain suppliers, in particular intermediate range products..."

obligations⁸⁰⁶. However, the framework of the competition analysis (i.e., single branding restraints) and the available remedies (i.e., termination of the exclusivities or the category management agreements) are only suited for supplier-to-supplier foreclosure practices. In sum, the EU Vertical Guidelines do address specific practices arising in the supermarket-independent grocery brand dealings but they focus on supplier-to-supplier foreclosure. They ignore the fact that supermarkets enjoy market power vis-à-vis independent grocery brands and they can rely on access fees and category management to foreclose independent grocery brands in favour of their own brands⁸⁰⁷ and restrict competition between them⁸⁰⁸.

Fourth, even if the supermarkets' practices vis-à-vis independent brands were deemed to enjoy legal protection under the EU Vertical Regulation, the European Commission has never relied on two instruments provided for in the EU Vertical Regulation against parallel networks of similar vertical agreements that individually fall within its safe harbour: the "withdrawal procedure"⁸⁰⁹ and the "disapplication of the Block Exemption Regulation procedure"⁸¹⁰.

The widespread and simultaneous execution by the leading supermarkets of the anti-competitive practices identified in this Report should have prompted the European Commission to assess their cumulative effects on the market and consider the eventual application of "the withdrawal procedure" and "the disapplication of the Block Exemption Regulation procedure". The Commission's silence on the cumulative effects of supermarkets' practices contrasts with its hard stance on the cumulative effects of single branding restraints imposed by suppliers (Section VI.2.2 of the EU Vertical Guidelines)⁸¹¹: paragraph 140 and 141 of the EU Vertical Guidelines deal respectively with the single and cumulative effects of single branding agreements at the retail level. In light of the significant entry barriers in the retail market faced by most manufacturers

⁸⁰⁶ The EU Vertical Guidelines, par. 210: "...The assessment of such upstream foreclosure effect is made by analogy to the assessment of single branding obligations (in particular paragraphs (132) to (141)) by addressing issues like the market coverage of these agreements, the market position of competing suppliers and the possible cumulative use of such agreements".

⁸⁰⁷ See Sections 5.4.4 and 5.5.

⁸⁰⁸ See, for example, the inflationary effects of access fees, discussed in Section 5.4.3 and the empirical evidence provided in Section 5.5.1.2.

⁸⁰⁹ The EU Vertical Regulation, Articles 6-7 and the EU Vertical Guidelines, pars. 74-78. Articles 6 and 7 of the EU Vertical Regulation respectively afford the European Commission and the NCAs (in respect of agreements whose effects are felt only in their Member State), the power to find that individual agreements infringe Article 101 TFEU with *ex nunc* effects.

⁸¹⁰ The EU Vertical Regulation, Article 8 and the EU Vertical Guidelines, pars. 79-85. Article 8 of the EU Vertical Regulation enables the European Commission to exclude from its scope, by means of regulation, parallel networks of similar vertical restraints where these cover more than 50% of a relevant market. Such a measure is not addressed to individual undertakings but concerns all undertakings whose agreements are defined in the regulation disapplying the EU Vertical Regulation. Where appropriate, the Commission may also specify the market share level which, in the specific market context, may be regarded as insufficient to bring about a significant contribution by an individual undertaking to the cumulative effect. The EU Vertical Guidelines (par. 82) suggest that the disapplication procedure may be preferred over the individual withdrawal procedure when the undertakings concerned or the geographic markets affected are numerous.

⁸¹¹ The EU Vertical Guidelines refer by analogy to single branding restraints when assessing potential foreclosure of independent grocery brands by retailer brands.

and the risk of reduced inter-brand competition in the stores, the Commission takes a hard line on foreclosure risks. When assessing cumulative foreclosure risks, the Commission considers two scenarios: (1) where all suppliers have market shares below 30%, a cumulative anticompetitive foreclosure effect is unlikely if the total tied market share is less than 40% and withdrawal of the block exemption is therefore unlikely; and (2) where not all companies have market shares below the threshold of the EU Vertical Regulation but none is dominant, a cumulative anticompetitive foreclosure effect is unlikely if the total tied market share is below 30%.

Interestingly, the presumption of cumulative anticompetitive effects developed by the Commission seems to apply to several product categories of different national markets, where the combined market share of the supermarket brands exceed the 40% threshold and the shares of individual supermarket brands may be close to or above the 30% threshold.

Leaving aside the EU Vertical Guidelines, the EU Horizontal Guidelines also deal with another feature of the modern grocery retailing: buyer alliances⁸¹². However, the analysis once again misses the new economic paradigm. Basically, the EU Horizontal Guidelines view supermarkets' buying alliances as combinations of merchants for the purposes of securing lower wholesale prices than those that would be negotiated individually by the individual members⁸¹³. The pro-retailer bias can be discerned in a practical example of a pro-competitive agreement presented in the EU Horizontal Guidelines: the European Commission blesses a joint buying agreement covering 20% of the purchasing and retail markets even though the market-share threshold below which no anticompetitive effects are likely to arise is fixed at 15%⁸¹⁴. Furthermore, this agreement would give rise to a triopsony, where the three companies exceed the threat threshold identified in the Rewe/Meinl and Carrefour/Promodès Decisions⁸¹⁵. The new buying group, as well as the two remaining competitors, will have market power vis-à-

⁸¹² See above, Section 5.3.2.4.

⁸¹³ See, for example, the EU Horizontal Guidelines, par. 189: "Joint purchasing arrangements usually aim at the creation of buying power which can lead to lower prices for consumers."

⁸¹⁴ The EU Horizontal Guidelines, par. 208: "There is no absolute threshold above which it can be presumed that the parties to a joint purchasing arrangement have market power so that the joint purchasing arrangement is likely to give rise to restrictive effects on competition within the meaning of Article 101(1). However, in most cases it is unlikely that market power exists if the parties to the joint purchasing arrangement have a combined market share not exceeding 15 % on the purchasing market or markets as well as a combined market share not exceeding 15 % on the selling market or markets. In any event, if the parties' combined market shares do not exceed 15 % on both the purchasing and the selling market or markets, it is likely that the conditions of Article 101(3) are fulfilled."

⁸¹⁵ The EU Horizontal Guidelines, par. 216: "150 small retailers conclude an agreement to form a joint purchasing organisation. (...). They have a combined market share of 20% on both the purchasing and the selling markets. A and B are their two large competitors. A has a 25% share on both the purchasing and selling markets, B 35%. There are no barriers which would prevent the remaining smaller competitors from also forming a purchasing group. The 150 retailers achieve substantial cost savings by virtue of purchasing jointly through the purchasing organisation." The European Commission considers that the alliance has a moderate market position on the purchasing and the selling markets, even though it would reach the threat threshold identified in the Rewe/Meinl Decision. Not a single mention is made of the impact of this alliance and the new market structure on suppliers. Indeed, the Commission "suggests" that the remaining retail competitors may form another alliance (or possibly join this one).

vis their suppliers and this will facilitate the abusive practices described in this Report. Furthermore, the joint procurement of the supermarket brands will facilitate the exclusion of independent grocery brands.

All in all, the European Commission's Guidelines evidence that it has tried but failed to address retailers' increasing buyer power under Article 101 TFEU: it has focused on the merchant role of retailers and their vertical relationship with independent grocery brands, disregarding their competitive bottleneck role and the horizontal aspects of their relationship with independent brands.

7.2.1.2 Proposed legal framework

In light of the economic and social importance of the agrifood sector and the emergence of supermarkets as competitive bottlenecks playing a triple role vis-à-vis independent grocery brands (i.e., providers of distribution services, retailers and competitors), it is suggested that the European Commission should abandon the conventional analysis discussed in Section 3 and design a holistic legal framework under Article 101 TFEU that would also offer enforcement guidance under Article 102 TFEU.

7.2.1.2.1 The inter-platform/intra-platform competition test

The proposed legal framework would adapt the relevant inter-brand/intra-brand competition test developed by the EU Guidelines on Article 101(3) to the supermarket platforms. A supermarket platform offers one-stop services to shoppers in competition with other supermarket platforms (inter-platform competition) and offers distribution services to competing grocery brands (intra-platform competition)⁸¹⁶.

As far as inter-platform competition is concerned the competition test would question whether the supermarket's practice or agreement with independent brands, restricts actual or potential competition between supermarkets that would have existed without the agreement (e.g., does a single branding obligation foreclose other supermarkets?).

As far as intra-platform competition is concerned, the competition test would question whether the supermarket's practice or the agreement with an independent brand, restricts actual or potential competition between grocery brands that would have existed in the absence of the contractual restraints (e.g., does the access fee or the commercial information shared with the supermarket restrict competition between grocery products in the chain?).

In order to assess the competitive effects of the agreements between supermarket platforms and independent grocery brands, the content of the agreement would have to be appraised at two levels: (1) the overall agreement ("main operation") and the

⁸¹⁶ See the MasterCard Decision, par. 532: "For those reasons and based on the Commission's consistent case practice, the following questions will be examined to see whether MasterCard's MIF falls outside the scope of Article 81(1): First, could banks co-operate in an open-card system without the MIF? Second, if a MIF were indeed necessary for such co-operation, are less restrictive means available than the MasterCard MIF that would enable the banks to co-operate, as well?"

restraints that are directly related and necessary for its operation (“ancillary restraints”); and (2) all other restrictions⁸¹⁷. Restraints that are desirable with a view to the commercial success of the main operation but not necessary for its viability have to be assessed under Article 101 (3) TFEU⁸¹⁸.

In that regard, it should not matter whether the anticompetitive restraint is formally laid down in the agreement (e.g., provisions covering upfront access fees, disproportionate obligations and penalties or a long length of payment) or unilaterally imposed by the supermarket on the independent grocery brand with the express or tacit acquiescence of the latter⁸¹⁹. Independent brands keep contracting with supermarkets for years and expressly or implicitly consenting to their terms and practices regarding access (including access fees and the use of sensitive commercial information) and in-store competition (e.g., switch marketing, pricing, self-placement and copycatting). Conversely, competition authorities have pursued under Article 101 TFEU the retail price maintenance initiatives of suppliers for many years even in the absence of a contractual provision to that effect and even if the retailer did not expressly accept it or even abide by it. Once assumed that vertically integrated supermarkets are obligatory trading partners for independent grocery brands, competition policy should put in place a legal framework that prevents supermarkets from exploiting their competitive bottleneck to restrict competition, including in-store competition between independent brands and their own brands.

7.2.1.2.2 New Regulation/Guidelines

This inter-platform/intra-platform competition test should be enshrined in a sector-specific block exemption regulation⁸²⁰, a specific section in the EU Horizontal Guidelines or specific provisions supplementing section 6 of the current EU Horizontal Guidelines, devoted to (non-reciprocal) commercialisation agreements between competitors⁸²¹.

⁸¹⁷ See, for a general policy description and a practical example, the MasterCard Decision, pars. 524-527.

⁸¹⁸ See the MasterCard Decision, par. 527.

⁸¹⁹ See, regarding the factors that prove tacit or explicit acquiescence in the context of vertical agreements, EU Vertical Guidelines, par. 25.

⁸²⁰ In principle, the Commission does not favour sector-specific block exemption regulations, but in duly justified cases it has relied and still relies on sector-specific regulations (e.g., motor vehicle distribution). A comparison of market structures (horizontal competition) and competitive dynamics in the motor vehicle sector and the grocery sector reveals that the need for a sector-specific block exemption in the modern grocery retail sector is much more pressing than the need for a specific regulation in the motor vehicle distribution sector.

⁸²¹ The Horizontal Guidelines, Section 6 (“Agreements on commercialisation”), pars. 225-256. Par. 226 expressly mentions distribution agreements as an important category of commercialisation agreements between competitors and clarifies that “(t)he Block Exemption Regulation on Vertical Restraints and Guidelines on Vertical Restraints generally cover distribution agreements unless the parties to the agreement are actual or potential competitors”.

7.2.1.2.2.1 General principles

In line with the basic goal of competition policy (i.e., preservation of horizontal competition), the focus of this legal framework should be on the horizontal aspect of the relationship between supermarkets and independent grocery brands⁸²². Indeed, the new economic paradigm shows that all supermarkets are current or potential competitors of independent grocery brands⁸²³.

The new focus would highlight that, as in the case of commercialisation agreements between competitors, vertically integrated supermarkets can handle independent brands in a such a way as to reduce competition in several ways: price fixing, output limitation, market/customer sharing, exchange of strategic information relating to aspects within or outside the cooperation or commonality of costs which may result in collusive outcomes⁸²⁴. For example, supermarkets are able to align the retail prices of their own brands and competing independent brands; they may refuse to pass-on lower wholesale prices or request higher access fees, thereby limiting the output of independent brands; they may reduce in-store (intra-platform) competition between their own brands and independent brands and, indirectly, inter-platform competition between supermarkets, which leads to market/customer sharing; and supermarket brands may align their competitive strategies to those of independent brands by virtue of the sensitive commercial information shared by independent brands with the supermarkets.

The new focus would also allow competition authorities to take into account the effects of the independent brand-supermarket relationship in all the relevant markets, without

⁸²² See the policy statement contained in the EU Vertical Guidelines, par. 98. See also the EU Horizontal Guidelines, par. 227: “If competitors agree to distribute their substitute products on a reciprocal basis (in particular if they do so on different geographic markets) there is a possibility in certain cases that the agreements have as their object or effect the partitioning of markets between the parties or that they lead to a collusive outcome. The same can be true for non-reciprocal agreements between competitors. Reciprocal agreements and non-reciprocal agreements between competitors thus have first to be assessed according to the principles set out in this Chapter. If that assessment leads to the conclusion that co-operation between competitors in the area of distribution would in principle be acceptable, a further assessment will be necessary to examine the vertical restraints included in such agreements. That second step of the assessment should be based on the principles set out in the Guidelines on Vertical Restraints.”

⁸²³ See above, Section 5.1.2. The EU Vertical Guidelines define actual and potential competition in par. 27: “Two companies are treated as actual competitors if they are active on the same relevant market. A company is treated as a potential competitor of another company if, absent the agreement, in case of a small but permanent increase in relative prices it is likely that this first company, within a short period of time normally not longer than one year, would undertake the necessary additional investments or other necessary switching costs to enter the relevant market on which the other company is active. That assessment must be based on realistic grounds; the mere theoretical possibility of entering a market is not sufficient.” Nowadays, any supermarket may launch its own grocery brand in any category within a year. It may turn to one of the multinational “hidden giants” supplying supermarket brands or enter into an agreement with an independent grocery brand in order to have its products supplied under the supermarket brand.

⁸²⁴ The EU Horizontal Guidelines, pars. 230-233.

drawing an artificial distinction between procurement and retail markets or inter-platform and intra-platform competition⁸²⁵.

In order to increase legal certainty, the European Commission could lay down market share thresholds, below which no anti-competitive effects arise (if a specific block exemption is adopted) or are likely to arise (if the new provisions are included in Guidelines)⁸²⁶. These thresholds would not depart significantly from current competition practice but would reconcile the different competitive roles played by supermarkets and their competitive bottleneck status. For example, for non-vertically integrated supermarkets (i.e., potential competitors), a 10-15% market-share threshold in the procurement market could deal with the vertical aspects of the relationship (if public authorities wanted to lower these market-share threshold to cover more supermarkets, regulatory remedies under fair dealing principles could be put in place)⁸²⁷. For vertically integrated supermarkets, the 10-15% market-share threshold in the procurement market should be supplemented with two other market-share thresholds in order to deal with the horizontal aspects of the relationship: a combined market-share threshold of 15% in each grocery product market⁸²⁸ and a market-share threshold of 25-30% in any given retail market⁸²⁹. When the competition analysis concerned the collective practices of a buying alliance or the individual practices of any member of a buying alliance, the aggregate market-share of the members would be taken into account for the calculation of each threshold.

⁸²⁵ See, for example, the EU Horizontal Guidelines, par. 229: “To assess the competitive relationship between the parties, the relevant product and geographic market or markets directly concerned by the co-operation (that is to say, the market or markets to which the products subject to the agreement belong) have to be defined. As a commercialisation agreement in one market may also affect the competitive behaviour of the parties in a neighbouring market which is closely related to the market directly concerned by the co-operation, any such neighbouring market also needs to be defined. The neighbouring market may be horizontally or vertically related to the market where the co-operation takes place.”

⁸²⁶ The EU Horizontal Guidelines, pars. 240-241: “240. Commercialisation agreements between competitors can only have restrictive effects on competition if the parties have some degree of market power. In most cases, it is unlikely that market power exists if the parties to the agreement have a combined market share not exceeding 15 %. In any event, if the parties’ combined market share does not exceed 15% it is likely that the conditions of Article 101(3) are fulfilled. 241. If the parties’ combined market share is greater than 15 %, their agreement will fall outside the safe harbour of paragraph 240 and thus the likely impact of the joint commercialisation agreement on the market must be assessed.”

⁸²⁷ The Rewe/Meinl Decision’s analysis of substitutability of buyers (supermarkets) revealed a 5-10% “significant loss” threshold and a 20% “irreparable loss” threshold, the latter being associated with a dominant position. Therefore, the 5-10% significant loss threshold would indicate the presence of market power under Article 101 TFEU. See above, Section 5.3.2, for a full discussion of the supermarkets’ power vis-à-vis independent grocery brands, even in the presence of low market shares on the part of the former. Furthermore, the current EU Horizontal Guidelines lay down a 15% market-share threshold for buying alliances (par. 208).

⁸²⁸ See, by analogy, the market-share threshold for commercialisation agreements between competitors (EU Horizontal Guidelines, par. 240).

⁸²⁹ See, by analogy, the Non-Horizontal Merger Guidelines, par. 25: “The Commission is unlikely to find concern in non-horizontal mergers, be it of a coordinated or of a non-coordinated nature, where the market share post-merger of the new entity in each of the markets concerned is below 30 % and the post-merger HHI is below 2,000.”

In addition to market share thresholds, the European Commission should consider adopting a list of hard-core practices⁸³⁰. This list should be comprehensive and it should not be relevant whether they are freely negotiated or not by independent grocery brands⁸³¹. However, the burden of proof that the practices fulfil the four criteria laid down in Article 101(3) TFEU would rest with the party imposing them, i.e., the supermarkets⁸³². They would have to show that (1) the practices produce substantial efficiencies; (2) the restraints are indispensable and do not go beyond what is necessary to achieve these efficiency gains⁸³³; (3) the efficiencies guarantee a fair share to *all* customers, including independent grocery brands⁸³⁴; and (4) they do not eliminate competition between supermarkets and between grocery brands. Furthermore, they would have to prove their case with “a detailed, robust and compelling analysis that relies in its assumptions and deductions on empirical data and facts”⁸³⁵. In any event, the wording of the European Commission’s Guidelines could offer little room for a benign analysis of these practices, as it is the case today with some of the suppliers’ practices such as retail price maintenance⁸³⁶. For example, the Guidelines could suggest the possible existence of dominant positions in the procurement and local retail markets below the conventional “unofficial” market-share threshold (40%) and the possible existence of an intra-platform (in-store) market⁸³⁷.

⁸³⁰ All other practices would be subject to the market-share thresholds and a case-by-case analysis would be warranted.

⁸³¹ Supermarkets hold sufficient market power to dress their unilateral practices as mutually negotiated with independent brands.

⁸³² See, by analogy, the EU Horizontal Guidelines, par. 248. For a practical example, see the MasterCard Decision, par. 695. The European Commission refers to Case C-552/03 P, Unilever Bestfoods v Commission, par. 102 and Case 42/84, Remia v Commission, par. 45.

⁸³³ See, by analogy, the EU Horizontal Guidelines, par. 249.

⁸³⁴ See, by analogy, the MasterCard Decision, par. 740: “There is no reason to assume from the outset that an interchange fee paid by acquirers to issuers increases the utility of the payment card system to *both* groups of customers alike. The Commission does not dispute that merchants may benefit through enhanced network effects from the issuing side, but this does not necessarily offset their losses which result from paying inflated merchant fees. In setting a MIF the member banks of the system must guarantee a fair share of the benefits to *all* customers, not only those that are on the side of the scheme which receives the MIF. In a scheme where the MIF is paid by the acquirer to the issuer, the efficiencies must in particular counterbalance the restrictive effects to the detriment of merchants (and subsequent purchasers). MasterCard has not submitted evidence in this respect”; and par. 741: “...MasterCard’s issuing banks are not obliged under the network rules to use interchange proceeds from MasterCard’s MIF in a particular manner and it remained unclear to which extent MasterCard’s issuers indeed pass the fee proceeds on to their customers. However, it can be left open in this case whether cardholders sufficiently benefit from MasterCard’s MIF. The Commission’s concerns under the second condition of Article 81(3) of the Treaty in this decision relate to the customer group which bears the cost of the MIF, that is the merchants.”

⁸³⁵ The MasterCard Decision, par. 732. In par. 695, the Commission calls for some sort of empirical evidence of the efficiencies alleged by the parties: “...To the extent that objective efficiencies cannot be established empirically, they cannot be balanced with the restrictive effects. Some form of convincing empirical evidence on the actual of a MIF on the market is therefore required.”

⁸³⁶ Likewise, the EU Horizontal Guidelines express a negative/critical stance on some practices as soon as the market share of the parties exceeds the safe harbour thresholds.

⁸³⁷ See the suggested policy regarding Article 102 TFEU in Section 7.2.2. Regarding the existence of an intra-platform market, see, by analogy, the interventionist approach taken in Regulation 461/2010 in order to promote competition in the supply of spare parts and repair and maintenance services for each manufacturer’s vehicles, justified on the possible existence of separate after-markets for each manufacturer’s vehicles. The preamble of Regulation 461/2010 openly states: “(13) In so far as a separate

Furthermore, the European Commission should not refrain from dealing with seemingly exploitative issues (e.g., the form and content of the agreements, including contractual breaches) for the following reasons:

First, unfair contractual clauses can also constitute an abuse of a dominant position under Article 102 TFEU. Second, these clauses can create market inefficiencies and transfer an excessive or unjustified risk to grocery brands, thereby reducing competition in that market⁸³⁸. Last, but not least, these clauses are exclusionary (e.g., raise rivals' costs) when applied by vertically integrated supermarkets.

In this regard, it is worth recalling the European Commission's practice in the car vehicle sector. Regulation 1400/2002 offered car dealers protection against exploitative practices that were traditionally considered to fall outside the competition law remit: the right to oppose sales targets and stock requirements; the right of the dealer or authorised repairer to sell his business and all the associated rights and obligations to another member of the brand network; the obligation to state the reasons for terminating an agreement; the right to arbitration in the event of a dispute relating to the agreement; the obligation to conclude agreements of limited duration for a minimum period and to require a period of notice in the event of non-renewal or termination of the agreement⁸³⁹. Some of these contractual guarantees have disappeared following the entry into force of Regulation 330/2010 on 31 May 2013, but the European Commission has made it clear that in the assessment of individual cases under competition rules, it will take into account suppliers' adherence to fair dealing guarantees enshrined in Codes of Conduct⁸⁴⁰. Be it as it may, the Commission has imposed fair dealing guarantees in

aftermarket can be defined, effective competition on the markets for the purchase and sale of spare parts, as well as for the provision of repair and maintenance services for motor vehicles, depends on the degree of competitive interaction between authorised repairers, that is to say those operating within repair networks established directly or indirectly by vehicle manufacturers, as well as between authorised and independent operators, including independent spare parts suppliers and repairers. The latter's ability to compete depends on unrestricted access to essential inputs such as spare parts and technical information."

⁸³⁸ See the discussion of the rationale and the substance of the UK GSCOP, *supra* in Section 4.

⁸³⁹ See the discussion of the block exemption regulations adopted by the Commission in the field of motor vehicle distribution, above in Section 5.2.2 and, in particular, note 181.

⁸⁴⁰ Commission notice — Supplementary guidelines on vertical restraints in agreements for the sale and repair of motor vehicles and for the distribution of spare parts for motor vehicles, OJ C 138, 28.5.2010, preamble (7): "The history of competition enforcement in this sector shows that certain restraints can be arrived at either as a result of explicit direct contractual obligations or through indirect obligations or indirect means which nonetheless achieve the same anti-competitive result. Suppliers wishing to influence a distributor's competitive behaviour may, for instance, resort to threats or intimidation, warnings or penalties. They may also delay or suspend deliveries or threaten to terminate the contracts of distributors that sell to foreign consumers or fail to observe a given price level. Transparent relationships between contracting parties would normally reduce the risk of manufacturers being held responsible for using such indirect forms of pressure aimed at achieving anticompetitive outcomes. Adhering to a Code of Conduct is one means of achieving greater transparency in commercial relationships between parties. Such codes may inter alia provide for notice periods for contract termination, which may be determined in function of the contract duration, for compensation to be given for outstanding relationship-specific investments made by the dealer in case of early termination without just cause, as well as for arbitration as an alternative mechanism for dispute resolution. If a supplier incorporates such a Code of Conduct into its agreements with distributors and repairers, makes it publicly available, and complies with its provisions, this will be regarded as a relevant factor for assessing the supplier's conduct in individual cases."

favour of dealers for more than 10 years in the field of car vehicle distribution, even though (1) no manufacturer enjoyed a dominant position in the car market; and (2) the distribution of its vehicles was a vertical aspect of its competitive strategy. In contrast, the European Commission has never considered the possibility of intervening against the supermarkets' unfair/anti-competitive practices even though (1) supermarkets have become competitive bottlenecks for independent grocery brands and instances of supermarket dominance in specific local markets are commonplace; and (2) supermarkets are employing discriminatory practices that restrict competition between brands in order to favour their own vertically integrated grocery brands.

The suggested approach should enable the European Commission and the National Competition Authorities to deal with all the anti-competitive access and in-store practices identified in this Report. The new Regulation and/or Guidelines should be able to accommodate most, if not all, the regulatory remedies proposed in Section 7.1.

7.2.1.2.2.2 Distribution services and merchant activities

The boundaries between the provision of distribution services to independent brands and merchant activities should be clarified either by regulatory instruments (see Section 7.1.1) or the new competition law rules.

If supermarkets adopted the distribution service provider model, they would auction their shelf-space and associated in-store services and grocery brands would pay upfront fees and/or variable fees on sales to gain access to the distribution services offered by supermarkets and then interact with shoppers directly⁸⁴¹. However, if supermarkets adopted the merchant business model, competition authorities would have to deal with the exploitative/exclusionary effects of the retail risk-transferring practices.

7.2.1.2.2.3 Access to supermarket platforms

The new Regulation and/or Guidelines could deal with the following issues, in line with the regulatory remedies proposed in Section 7.1.2:

(1) Misuse of sensitive commercial information

The European Commission should consider whether the mere prohibition may be sufficient (e.g., often the same supermarket department is responsible for procurement of independent brands and supermarket brands) or a “Chinese Wall” and even a legal/functional separation of supermarket brand operations may be necessary.

(2) Fair access terms

Remedies regarding fair access are explored in Section 7.1.2.1. Even though exploitative practices are considered to fall outside the Article 101 TFEU remit, the European

⁸⁴¹ The adoption of this business model would facilitate the control of exploitative/discriminatory practices.

Commission's practice in other sectors such as the car distribution arena shows that fair dealing provisions may be inserted in block exemption regulations and/or Guidelines. Furthermore, the new rules could refer to existing EU laws (if the Green Paper evolves into EU legislation) or Codes of Conduct.

(3) Access fees

Under the current distribution service provider/merchant/competitor business model adopted by supermarkets, access fees undermine the competitiveness and efficiency of independent grocery brands, discriminate independent grocery brands in favour of supermarket brands and have an inflationary effect on retail prices⁸⁴². Outside the pure distribution service provider model, access fees may have serious anti-competitive effects. Therefore, absent a regulatory intervention, the new competition rules should either impose a rigorous test of proportionality and due consideration on access fees or consider them as hard-core restrictions of competition⁸⁴³.

(4) Abrupt termination of access

Even assuming that a supermarket had no obligation to provide/refuse access on an objective and non-discriminatory basis, the sudden/abrupt termination of access may significantly distort the competitiveness of a competing independent brand at the expense of a supermarket brand. This would be neither efficient from an economic perspective nor fair from a competition standpoint. Therefore, the termination of contracts should follow a fair procedure for both parties, in line with the measures adopted in the past in the field of car distribution.

(5) Non-discriminatory access

The new competition rules should mandate non-discriminatory access to their networks in order to exempt supermarkets' commercialisation agreements with independent brands along the lines suggested in Section 7.1.2.3.

Even in the absence of new rules, competition authorities could explore the legal avenue suggested by the current EU Vertical Guidelines (i.e., refusal of access by vertically integrated supermarkets is to be appraised as a single branding restraint) and condemn the exclusive sourcing policies of supermarkets regarding the suppliers of their own brands. Likewise, competition authorities may consider the enforcement of the non-discrimination obligation if the exclusive sourcing policies of leading supermarkets hinder access of independent brands to the market. The current EU Vertical Guidelines take a hard look at the market foreclosure effect caused by the vertical restraints imposed by suppliers, alone or in a cumulative way. For example, they argue that an exemption is not likely in market scenarios where (1) the leading brand (40% market-share) enforces non-compete clauses covering 36% of the retail market and 10 other

⁸⁴² See the theory of harm (Section 5.4.3) and the market analysis (Section 5.5.1.2).

⁸⁴³ See Section 7.1.2.2. The prohibition of access fees seems more efficient than a proportionality/due consideration test that faces many practical difficulties.

competitors foreclose another 10% of the retail market (par. 159); (2) the leading brand (40% market-share) enforces quantity forcing restraints (up to 75% of the retailer's procurement) covering 24% of the retail market and 12 other competitors foreclose another 25% of the retail market (par. 160); (3) the five leading brands (25%, 20%, 15%, 15% and 10% market-share each) in a 7-player market operate quantitative selective distribution networks and the network access requirements hinder access by discount retailers (par. 198). This last example is self-explanatory. If the European Commission considers that discounters should be protected in a 7-brand market, it should also seek to protect an independent brand supplier from the abuses of a (vertically integrated) supermarket in a 7-player retail market.

Finally, competition authorities could also condition the exemption of the formation of supermarket alliances or, at least, the joint procurement of their own brands, to the non-discriminatory access by independent brands to their networks.

(6) Open access

Competition authorities could even consider whether some sort of open access to supermarket's networks may be necessary, subject to objective capacity constraints. In the grocery retail sector, the capacity limitation problem (i.e., limited shelf-space) may be overcome by fixing a minimum number of competing brands in each category or sub-category (e.g., 3-4) served by the supermarket (see Section 7.1.2.4.)⁸⁴⁴.

Indeed, the European Commission has facilitated access of third parties to the services of platforms under both Articles 101 and 102 TFEU:

Under Article 101 TFEU, the Commission has facilitated access by dealers to the selective distribution networks and the products of manufacturers⁸⁴⁵. Likewise, it has mandated open access to the car components of car manufacturers in favour of repairers⁸⁴⁶ and protected multi-brand dealers (i.e., third-party car manufacturers' access to the otherwise closed distribution networks of other car manufacturers)⁸⁴⁷ and access by third-party breweries to the distribution network of leading breweries⁸⁴⁸.

Under Article 102 TFEU, the Commission has been proactive in the field of computer-related platforms, where screen-constraints largely resemble shelf-constraints, in order to provide open/non-discriminatory access by vertically integrated operators to third parties. For example, the European Commission has forced Microsoft's Windows PC operating system to display a minimum number of competing Internet browsers. In its press release, the Commission emphasized that this settlement was important for

⁸⁴⁴ Supermarkets have constantly argued that shelf-space limitations explain the assortment restrictions and access fees. However, shelf-space limitations are mostly driven by supermarkets' in-store strategies. See the evidence discussed in Section 5.5.1.4.

⁸⁴⁵ See discussion of the European Commission's enforcement of competition policy in the car distribution sector in Section 5.2.2.

⁸⁴⁶ See also the general discussion of aftermarkets in Appendix 8.2.8.

⁸⁴⁷ See above, note 180.

⁸⁴⁸ See, for example, European Commission's Press Release IP/03/545, "European Commission opens up Interbrew's Belgian horeca outlets to competing beer brands", 15.04. 2004.

millions of customers as it would ensure competition on the merits between web browsers, facilitate consumer choice and protect innovation incentives:

“Competition Commissioner Neelie Kroes said: “Millions of European consumers will benefit from this decision by having a free choice about which web browser they use. Such choice will not only serve to improve people's experience of the internet now but also act as an incentive for web browser companies to innovate and offer people better browsers in the future.”

Under the commitments approved by the Commission, Microsoft will make available for five years in the European Economic Area (through the Windows Update mechanism) a “Choice Screen” enabling users of Windows XP, Windows Vista and Windows 7 to choose which web browser(s) they want to install in addition to, or instead of, Microsoft's browser Internet Explorer.

(...)

The Commission's preliminary view was that competition was distorted by Microsoft tying Internet Explorer to Windows. This was because it offered Microsoft an artificial distribution advantage not related to the merits of its product on more than 90 per cent of personal computers. Furthermore, the Commission's preliminary view was that this tying hindered innovation in the market and created artificial incentives for software developers and content providers to design their products or web sites primarily for Internet Explorer.

The approved commitments address these concerns. PC users, by means of the Choice Screen, will have an effective and unbiased choice between Internet Explorer and competing web browsers. This should ensure competition on the merits and allow consumers to benefit from technical developments and innovation both on the web browser market and on related markets, such as web-based applications.”⁸⁴⁹

Likewise, one of the four concerns expressed by the European Commission against Google in the ongoing investigation (i.e., the favourable treatment, within Google's web search results, of links to Google's own specialised web search services as compared to links to competing specialised web search services) revolves around the concept of open access of third-party content providers to Google's search engine. In order to settle the case, the company has offered to (1) display links to three rival specialised search services close to its own services, in a place that is clearly visible to users, (2) label promoted links to its own specialised search services so that users can distinguish them from natural web search results, and (3) clearly separate these promoted links from other web search results by clear graphical features (such as a frame)⁸⁵⁰. This remedy is

⁸⁴⁹ European Commission, “Commission accepts Microsoft commitments to give users browser choice”, IP/09/1941, 16/12/2009.

⁸⁵⁰ European Commission, “Commission seeks feedback on commitments offered by Google to address competition concerns”, IP/13/371, 25/04/2013. On 5 February, the Competition Commissioner Almunia announced that a settlement had been reached with Google, Commissioner Almunia, “Statement on the Google investigation”, SPEECH/14/93, 05/02/2014. With regards to the treatment of third-party content providers, “to address these concerns, Google has finally accepted to guarantee that whenever it promotes its own specialised search services on its page, the services of rivals will also be displayed in a comparable way. In practice, this means that when Google promotes one of its own specialised search services, there will be three rival services also displayed prominently on the page, in a way that is clearly visible to users. [...] Of course, for all these situations, it is not possible to show all rivals, in the same way that that could not happen on Google's general web search results. There therefore has to be a selection and Google's proposal provides an objective mechanism for all scenarios. Where Google does not charge for inclusion in its specialised search service, such as in local search, rivals will not be charged

analogous to the light non-discrimination obligation discussed in this Report and interested third-parties have rejected this remedy claiming that it would perpetuate the favourable treatment afforded by Google to its own content, which would have been displayed prominently at all times without being subject to the same relevance criteria applied by the search engine to display the content of third-parties. Essentially, third parties are asking for an open access remedy.

All in all, both Article 101 and 102 TFEU may offer legal ground for an open access obligation on supermarket platforms and the problem posed by the limited shelf-space could be overcome the same way it has been done in other sectors (e.g., CRSs). Certainly, traditionally, open access obligations have been considered to belong to the Article 102 TFEU remit but one should not forget that the combined market share (measured at the national or regional/local level) of the supermarkets which are currently engaging in any of the discriminatory practices identified in this Report exceeds by far the minimum market-share thresholds currently used by competition authorities in single-dominance cases (i.e., 40%).

7.2.1.2.2.4 In-store competition

Article 101 TFEU should also cover supermarkets' in-store practices that distort the competition between independent brands and their own brands along the lines suggested in Section 7.1.3. Formally, at that time supermarkets own the independent brand goods but these practices implicitly reflect the terms of business supermarkets apply to their contracts with independent brands. In that regard, they are not different from a suppliers' unilateral practice aimed at forcing retail price maintenance on a retailer, which competition authorities consider an anticompetitive agreement under Article 101 TFEU.

In the field of non-pricing competition, the new competition rules could deal with degradation of in-store services⁸⁵¹, switch marketing⁸⁵² and allocation of preferential shelf-space⁸⁵³ and copycat, in light of the dual role played by supermarkets (retailer/competitor)⁸⁵⁴.

In the field of pricing competition, the dual role of supermarkets vis-à-vis independent brands poses many challenges to competition authorities and it remains to be seen whether Article 101 TFEU can effectively deal with the prohibition of on-package

to participate in the rival links. Instead, they will be chosen based on their ranking in natural search. Where Google charges merchants for inclusion in its specialised search service, such as in Shopping, the three rivals will be chosen on the basis of a dedicated and transparent auction mechanism.” See a general discussion of the Google case in Section 5.3.2.1 and Appendix 8.2.4.

⁸⁵¹ See Section 5.5.2.2.1.

⁸⁵² See Section 5.5.2.2.2.

⁸⁵³ See Section 5.5.2.2.3.

⁸⁵⁴ See Section 5.5.2.2.4. However, competition authorities may feel disinclined to set the boundaries between actionable copycatting and the unobjectionable similarities in the packaging and presentation of competing goods.

promotions by independent grocery brands⁸⁵⁵, the pocketing of promotional wholesale prices⁸⁵⁶, artificial retail price gaps (higher retail margins on independent brands than on supermarket brands)⁸⁵⁷ and brand-destruction through loss-leading retail prices⁸⁵⁸, or it should be better dealt with via regulatory remedies. Furthermore, as discussed in the section devoted to regulatory remedies regarding in-store competition, the challenges raised by the supermarkets' pricing practices in respect of independent grocery brands should force public authorities and especially those responsible for competition policy to reconsider their negative stance towards retail price maintenance in this market⁸⁵⁹. Today, retail price maintenance by independent brands seems much more pro-competitive than the current state of affairs, where supermarkets distort the prices of independent brands that compete against their own brands, thereby reducing competition between grocery brands and between supermarkets⁸⁶⁰. However, competition authorities should take into account that, nowadays, the lifting of the *de facto* prohibition of resale price maintenance is to no avail in light of the supermarkets' power vis-à-vis their suppliers⁸⁶¹. Therefore, the lifting of the prohibition should be reinforced with proactive remedies (e.g., mandatory retail price fixing by independent brands, the prohibition of duress on the part of supermarkets to prevent retail price maintenance by independent brands or, in the absence of retail price maintenance, the limitation of the retail margin of the independent brand to the retail margin earned on the competing supermarket brand).

7.2.2 Article 102 TFEU

Even though Article 101 TFEU is the best framework to address the competitive bottleneck status of supermarkets vis-à-vis their suppliers and all the access and in-store practices that may distort competition in the market, Article 102 TFEU may complement any new Regulation and/or Guidelines adopted under Article 101 TFEU. In order to do so, this Section proposes a new approach to market definition and dominance to deal with supermarkets' abusive/exclusionary practices.

7.2.2.1 Market definition and dominance

Many, if not all, the practices identified in this Report could be considered "abusive" if they were applied by a dominant supermarket either unilaterally or in contracts with independent brands. Therefore, the critical question seems to be whether supermarkets can be deemed to enjoy a single or collective dominant position in a given market and

⁸⁵⁵ See Section 5.5.2.1.4.

⁸⁵⁶ See Section 5.5.2.1.3.

⁸⁵⁷ See Section 5.5.2.1.1.

⁸⁵⁸ See Section 5.5.2.1.2.

⁸⁵⁹ See Section 5.7.2.

⁸⁶⁰ See Section 5.5.2.1.1.

⁸⁶¹ The Finnish Competition Authority has acknowledged that allowing independent brands to impose maximum resale prices would not be effective in light of the supermarkets' bargaining power (see Section 4).

up to now competition authorities have never applied Article 102 TFEU to one or several supermarkets.

However, the same competition authorities have been prepared to interpret competition rules flexibly when faced with other competitive bottlenecks. This pragmatism has led competition authorities to be creative and treat customers on both sides as deserving equal protection (e.g., advertisers and the audience in media platforms; merchants and card holders in card payment networks), define narrower market definitions (e.g., call termination on each operator's network in mobile communication networks or aftermarkets in the motor-vehicle sector) or find market power and, in particular, single or collective dominance.

This Report suggests that competition authorities should consider (1) lowering the dominance thresholds in procurement markets; (2) defining an intra-platform market (each supermarket) where brands compete; and/or (3) narrowing the geographic scope of local retail markets.

(1) The procurement/distribution service

The European Commission displayed a special sensitivity to the competitive bottleneck issues raised by supermarkets in the Rewe/Meinl and Carrefour/Promodès Decisions⁸⁶²:

In the Rewe/Meinl Decision, the Commission concluded that the merging parties' combined market share of 32-43%⁸⁶³ and a few other competitive advantages would place them in a dominant position in the Austrian grocery retail market⁸⁶⁴, even though the immediate competitor's (Spar) market share was also significantly high (23-28%).

The European Commission's unconventional competition analysis (i.e., departure from the market-share-centric analysis) went even further in the assessment of the procurement market. It verified that switching of supermarkets by independent grocery brands was financially burdensome at a 5-10% level of sales and became financially

⁸⁶² Prior to the Rewe/Meinl and Carrefour/Promodès Decisions, the European Commission prohibited the Kesko/Tuko merger but the overwhelming combined market share of the merging party did not pose any challenge from a legal standpoint. Commission Decision M.97/277 Kesko/Tuko, OJ L110, 26.4.97, par. 106: "The combined market share of Kesko and Tuko of at least 55%, whether assessed at local, regional or national level creates a presumption of dominance. This presumption is further strengthened by Kesko's and Tuko's position as regards large retail outlets, their control of a significant part of all business premises suited for retail outlets in Finland, their customer loyalty schemes and private label products, their distribution systems and, not least, by the position of their central organs as buyers of daily consumer goods."

⁸⁶³ See par. 25 of the Rewe/Meinl Decision regarding the sources used by the Commission: "The market shares worked out by the Commission are based on turnover figures which the Commission has itself ascertained and do not differ much from the data set out in the statistical yearbook of AC Nielsen (for the food-retailing market minus discount stores), a GfK study, a market survey by M+M Eurodata and a study by Regioplan."

⁸⁶⁴ The Commission argued that the merged party would have (1) an exceptionally strong position in the key region of Eastern Austria and, in particular, in Vienna (pars. 32-36); (2) a well developed network of highly productive large stores (pars. 37-41); a strong position in conurbations and have especially favourable locations (pars. 42-48); the comparative advantage of being a centrally managed chain-store company (pars. 49-52); and financial advantages (par. 53).

unsustainable at a 20-22% level of sales⁸⁶⁵. This led the Commission to conclude that the merging party would enjoy a dominant position in nine procurement markets⁸⁶⁶, where their market shares exceeded the 20-22% threshold.

Product category	Ø share Rewe/Billa	Ø share Meinl	Ø share Rewe + Meinl
Dairy products	[15-25]%	[<10]%	[25-35]%
Bread and pastries	[20-30]%	[<10]%	[30-40]%
Soft drinks	[20-30]%	[<10]%	[25-35]%
Hot beverages	[25-35]%	[<10]%	[25-35]%
Basic foodstuffs	[20-30]%	[<10]%	[25-35]%
Baby foods	[25-35]%	[<5]%	[30-40]%
Pet foods	[25-35]%	[<5]%	[25-35]%
Detergents, polishes and cleaning products	[20-30]%	[<5]%	[25-35]%
Body-care products and cosmetics	[25-35]%	[<5]%	[30-40]%

Source: the Rewe/Meinl Decision

Likewise, the Carrefour/Promodès Decision concluded, although in a nuanced way, that the merger could give rise to a dominant position in some procurement markets⁸⁶⁷, where the market shares of the merging parties exceeded the 20-22% threat threshold⁸⁶⁸.

⁸⁶⁵ The Rewe/Meinl Decision, pars. 97 and 101-102, discussed in Section 5.3.2.3.

⁸⁶⁶ The Rewe/Meinl Decision, par. 88: “It is to be assumed that the operation will lead to the creation or strengthening of dominant positions on the part of Rewe/Billa/Meinl in nine Austrian procurement markets.”

⁸⁶⁷ The Carrefour/Promodès Decision, pars. 87-88: “(87) Les parts et volumes d’achat importants de Carrefour, combinés à certains atouts dont disposera le nouveau groupe sur l’aval, pourraient entraîner la création d’une situation qui conférerait à la nouvelle entité des avantages permanents en terme de conditions commerciales par rapport à ses rivaux. Une telle situation pourrait permettre à Carrefour de creuser encore l’écart avec ses concurrents sur les marchés de l’amont ce qui aurait pour effet mécanique de renforcer ainsi sa position à l’aval. Le renforcement des positions à l’aval aura lui-même un effet d’entraînement sur les positions à l’amont et ainsi de suite (voir supra, paragraphes 45 et 46). (88) Notons que le développement d’un tel scénario dépend d’une série de facteurs dont plusieurs ne sont pas encore connus (comme, par exemple, l’issue des contentieux en cours entre Carrefour et les autres actionnaires de Cora, la création ou le renforcement potentiels de nouvelles centrales d’achat ou l’entrée sur le marché français de concurrents étrangers de poids par voie d’acquisition, etc.). Cependant, à ce stade, on ne peut complètement exclure que le nouveau groupe Carrefour puisse obtenir une position dominante unique sur certains marchés de l’approvisionnement.”

⁸⁶⁸ The Carrefour/Promodès Decision, Table at par. 49 and explanation in par. 50. See also pars. 52-53: “(52) Lors de son enquête, la Commission a demandé aux fournisseurs d’indiquer à partir de quel pourcentage de leur chiffre d’affaires ils considéraient que la perte d’un client représenterait une menace pour l’existence même de leur entreprise. La moyenne des réponses obtenues fait apparaître un seuil de 22%. Ce seuil de 22% avait été également retenu dans l’affaire Rewe/Meinl. Il convient de noter que les réponses recueillies auprès des fournisseurs font apparaître des différences selon les groupes de produits considérés. Par exemple, en moyenne, les fournisseurs du groupe « liquides » ont ainsi indiqué que la perte d’un client représentant plus de 24% de leur chiffre d’affaires risquait de mettre en péril la survie de leur entreprise. Pour les fournisseurs d’épicerie sèche, ce taux de menace se situe aux alentours de 22%. D’une manière générale, les taux mentionnés par les fournisseurs se situent aux alentours de 20-22%. Les données obtenues de l’enquête doivent bien évidemment être nuancées (pour certains groupes de produits, le nombre de réponses obtenues est en effet trop faible pour constituer un échantillon représentatif). A priori, on pourrait en déduire que lorsqu’un distributeur dépasse un tel seuil dans le chiffre d’affaire d’un de ses fournisseurs, ce dernier se retrouve de facto en situation de « dépendance économique ». (53) Au

Furthermore, even though the Carrefour/Promodès Decision considered that the transparency of the procurement market was not sufficient to facilitate the emergence of a collective dominant position, two arguments point to the opposite conclusion⁸⁶⁹. First, the transparency of the market may be sufficient to focalise supermarkets' strategy on increased access fees, vertical integration and parallel retail prices of, at least, the independent grocery brands. Second, litigation before the French courts has uncovered evidence that supermarkets learn about the access fees (commercial payments by suppliers to supermarkets) earned by their competitors.

In light of the above, competition authorities could revive the 20% market-share threshold as a benchmark for single dominance in the grocery procurement (distribution services) market⁸⁷⁰. Furthermore, if two or three supermarkets exceeded this threshold, competition authorities should consider the possible existence of a collective dominant position, at least under merger control rules⁸⁷¹. In the ambit of merger control, competition authorities should not care only about the structure of retail markets and focus on the procurement markets as well. The remedies proposed in this Report could well be applicable to mergers involving leading supermarkets (see the discussion of the European Commission's Rewe/Adeg Decision below) and supermarket alliances.

(2) Intra-platform competition

Supermarkets enjoy substantial autonomy vis-à-vis independent grocery brands and consumers regarding their access policies since proximity drives store selection, habit drives loyalty to the store and 70% of the purchase decisions are taken in-store⁸⁷². Moreover, supermarkets' power over independent brands and consumers becomes a monopoly as far as it concerns in-store competition between different brands. For example, supermarkets may employ anti-competitive non-pricing practices (degradation of services, switch marketing, preferential shelf-space and copycats) and pricing practices (artificial price gaps, loss leading, pocketing of promotional wholesale prices and prohibition of on-package promotion) to distort consumers' free choice in favour of

regard des parts de marché établies sur la base de l'ensemble des canaux de distribution, la nouvelle entité dépasserait sensiblement ces taux de « menace » sur quatre groupes de produits, à savoir « Droguerie », « Parfumerie/Hygiène », « Produits périssables en libre service » et « Epicerie sèche ». Les concurrents suivants de la nouvelle entité Lucie et Opéra auraient des parts de marché inférieures aux taux de menace mentionnés ci-dessus pour chacun de ces groupes de produits.”

⁸⁶⁹ See discussion of the eight factors facilitating the transparency of the procurement and retail markets and the evidence uncovered before the French courts above, in Section 5.4.3.

⁸⁷⁰ Interestingly, Latvia has amended article 13(2) of its Competition Law in order to lower the dominance threshold in the retail sector and Finland has added a new section 7(a) to the Competition Act 948/2011, according to which a grocery trade operator is considered to have a dominant market position in the grocery trade market if its market share in Finland exceeded 30 per cent. The analysis of the procurement market could be supplemented with an analysis of the strength of the relevant supermarket in local retail markets, where it will likely enjoy higher market shares.

⁸⁷¹ It seems that competition authorities have given up on enforcing Article 102 TFEU to collective dominant positions and they only deal with them occasionally under merger control. See Petit and Henry, “Why the EU Merger Regulation Should Not Enjoy a Monopoly Over Tacit Collusion - A Close Look at Five Common Misconceptions”, January 31, 2010 and The Basque Grocery Report, which concluded that the three leading Spanish retailers enjoyed a collective dominant position in the Spanish grocery procurement market.

⁸⁷² See above, Section 5.3.1.4.

their own brands. In some instances, these practices will not be visible to consumers (e.g., pocketing of promotional wholesale prices and prohibition of on-package promotions). In other instances, these practices will be visible to consumers but they will not notice (apprehend) that the supermarket is trying to distort their free choice in order to favour its own brand (e.g., preferential shelf-space, switch marketing, copycats and artificial price gaps). Indeed, a practice such as the creation of artificial price gaps may create the impression on consumers that independent grocery brands are overcharging them (in consumers' mind, the retail price of these products is fixed by the brand owners) whereas the "subsidised" pricing of supermarket brands earns supermarkets the role of consumer champions. In any event, the price of the shopping basket will not change for a given consumer, as long as he/she substitutes the more expensive independent brand by the cheaper supermarket brand. Finally, even if a loss leading may in principle attract more consumers to an independent grocery brand, it may also lose its quality appeal to other consumers and, in any event, as soon as the supermarket increases its retail price, the price-sensitive consumers will come to the conclusion that the new price is a rip off for which the brand itself has to be blamed.

These in-store practices suggest that there may exist a distinct intra-platform market where each supermarket is able to control competition between grocery brands. In the past, similar intra-platform markets have been found in the mobile telecommunications markets (i.e., wholesale access to the each mobile network)⁸⁷³ and aftermarkets such as spare parts and repair and maintenance services for the cars of each car manufacturer⁸⁷⁴. In these markets, commercial agreements were also necessary between the dominant company and third parties in order to ensure transport of the call from the third party network to the customer of the dominant network or access by third parties to original spare parts and technical information from each car manufacturer in order to operate in the markets for spare parts and the repair and maintenance services of each car⁸⁷⁵.

(3) Local retail markets

Competition authorities tend to identify local geographical markets for modern grocery retailing⁸⁷⁶. Indeed, the growing importance of the proximity factor in consumers' demand patterns points to a narrow definition of the geographic market for modern grocery retailing (e.g., 5-10 minute-drive isochrones even for the largest supermarkets).

A finding of single firm dominance in any local market would justify intervention against the anticompetitive in-store practices of the dominant supermarket in the local market concerned. Moreover, two arguments would also justify intervention against the anticompetitive access practices against independent grocery brand:

⁸⁷³ See Appendix 8.2.2.

⁸⁷⁴ See Appendix 8.2.8.

⁸⁷⁵ Therefore, the fact that supermarkets acquire property rights over independent brands does not undermine the basic concept that brands compete against each other in supermarkets. Indeed, supermarkets and independent brands frequently reach commercial agreements whereby independent brands are able to influence in-store competition (e.g., shelf-positioning and price promotions).

⁸⁷⁶ See above, Section 5.1.3 and, in particular, note 128.

First, the anti-competitive access practices identified in this Report may cause consumer harm in the local markets where the supermarket is dominant⁸⁷⁷. For example, consumers may see the choice of brands restricted and distorted by the undue preference given to the supermarket's own brand. Likewise, the wholesale/retail prices of the listed independent brands may go up as a consequence of the access fees commanded by the dominant supermarket.

Second, the Commission has emphasized the links between the procurement and retail markets and noted that a "snowball effect" can unleash when a dominant position arises in one of them⁸⁷⁸.

All in all, the suggested policy simply takes stock of the close interaction between the procurement (distribution service) and the retail side of the market, a feature often emphasized by competition authorities. It simply broadens the conventional competition analysis to take into account all the competition variables that can be distorted by supermarkets. For example, the European Commission's Rewe/Adeg Decision assessed the competitive situation at the level of the 121 Austrian political districts in order to establish whether Rewe might be able to avoid substantial market share losses following a price increase due to local strength of the combined entity⁸⁷⁹. On this basis, the Commission found 24 critical districts where the combined turnover share exceeded

⁸⁷⁷ It is irrelevant whether these practices produce effects across all the stores of the supermarket in a given country. The fact is that the welfare of consumers in local markets where this supermarket enjoys a dominant position will be particularly affected.

⁸⁷⁸ The Rewe/Meinl Decision, pars. 72-74: "(72) In the retail trade there is a close interdependence between the distribution market and the procurement market. Retailers' shares of the distribution market determine their procurement volume: the bigger the retailer's share of the distribution market, the larger the procurement volume. And the larger the procurement volume, the more favourable as a rule are the buying conditions which the trader obtains from his suppliers. Favourable buying conditions can in turn be used in various ways to improve one's position in the distribution market (sometimes through internal or external growth, but also through low-price strategies targeted at competitors). The improved position in the distribution market is itself reflected in a further improvement in buying conditions, and so on. (73) The spiral described above leads to ever-higher concentration both in distribution markets and in procurement markets. In the short term, final consumers may benefit from the process, as there may be a period of intense (predatory) competition in the distribution market during which the powerful buyer/trader is forced to pass on his savings to consumers. But this will last only until such time as a structure (as in this case, an individual dominant position) is arrived at in the distribution market which leads to a clear reduction in competitive intensity. At this stage, any consideration for the final consumer goes by the board, as he is left with few alternatives. (74) Buyer power also gives a trader considerable influence over the choice of products which come to market and hence are obtainable by consumers. Products which are not bought by a dominant buyer have practically no chance of reaching the final consumer as the supplier lacks alternative outlets. Lastly, the dominant buyer determines the success or otherwise of product innovations."

⁸⁷⁹ Commission Decision of 23.06.2008, COMP/M.5047 - Rewe/Adeg ("the Rewe/Adeg Decision"). The analysis of the Decision is based on the information given in König 2008. The Commission concluded that the geographic scope of the grocery retail market was national in light of the national pricing policies of the main supermarkets. By failing to define local/regional geographic markets, the Commission overlooked (1) the established competition practice of looking at demand rather than offer patterns in order to define markets; (2) the fact that supermarkets compete on many locally adjustable variables other than price, as evidenced in the UK Grocery Report 2008; and (3) the risk that a locally dominant supermarket's discriminatory listing and category management practices may undermine the right of local customers to buy the products of their choice, as opposed to the products prescribed by the dominant supermarket.

45% with an increase in turnover due to the merger or where the combined turnover share was between 35% and 45% with an overlap of at least 5% due to the merger. The 24 districts represented a very substantial part of Rewe's retail turnover in Austria and corresponded to a population share of approximately 20%. Therefore, despite emphasizing that these 'thresholds' did not represent market shares and were not supposed to give guidance on whether the Commission considers market shares likely or unlikely to raise competition concerns, it concluded that it could not be excluded that Rewe's strength at the district level might influence its national price setting and thereby cause a significant impediment of effective competition on the Austrian retail market⁸⁸⁰.

However, had the Commission asked the question whether Rewe's strength at the district level might influence its capacity and incentives to distort access by independent grocery brands to its platform and in-store competition between them and Rewe's own brand, the answer would have been affirmative⁸⁸¹. Unfortunately, the Commission did not even refer to the Austrian Grocery Report, published by the Austrian Competition Authority some months before, which had identified Rewe's buyer power and its "unfair" practices vis-à-vis independent brands⁸⁸². Regretably, the European Commission and the Austrian Competition Authority missed a great opportunity to advance remedies against the anticompetitive/unfair practices of supermarkets against independent brands.

7.2.2.2 Abuses

This Report has proposed that all the practices identified in Section 5.5 be dealt with in a legal instrument adopted under Article 101 TFEU. Certainly, the very same practices that were considered to fall afoul of Article 101 TFEU would certainly be abusive under Article 102. On the other hand, should some of these practices fall outside the scope of Article 101 TFEU (e.g., a unilateral practice), then the market definition and market power criteria proposed in the previous sections should secure an Article 102 TFEU enforcement against practices that would otherwise go unscrutinised under competition rules.

In principle, all the anti-competitive practices analysed in Section 5.5 of this Report could fall under one or several of the examples of abuses provided by Article 102 TFEU and, in particular, Article 102(a) TFEU:

"Such abuse may, in particular, consist in:

⁸⁸⁰ The merger was cleared in Phase I following the submission by Rewe of commitments aimed at reducing the combined turnover shares below the critical level in the affected districts.

⁸⁸¹ Indeed, the Commission's contention that the local strength of a supermarket may influence its national pricing decisions is purely speculative, whereas the empirical evidence that supermarkets' local strength (reinforced by their competitive bottleneck status) facilitates anti-competitive access and in-store practices is compelling.

⁸⁸² See above, note 424. The penetration of supermarket brands reached 38% of the Austrian market in 2011.

- (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
- (b) limiting production, markets or technical development to the prejudice of consumers;
- (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
- (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.”

Furthermore, this Report has provided evidence that these practices restrict competition between supermarkets and between grocery brands. It is irrelevant whether these practices could also be considered as unfair under national rules aimed at preventing unfair competition practices or plainly illegal under other national rules governing commercial relations between economic operators. Indeed, Article 102(a) TFEU considers that unfair (exploitative) trading conditions imposed by a dominant company amount to an abuse of a dominant position⁸⁸³. But more importantly, since these practices are aimed at existing or potential competitors, they have exclusionary (horizontal) effects besides any exploitative (vertical) effect (see the discussion of the Raising Rivals’ Cost theory in Section 5.4.4).

Therefore, dominant supermarkets should not put in place terms of access to their networks (e.g., access fees, abusive contractual terms, disruptive and unjustified termination of contract) and terms that influence in-store competition (e.g., placement, marketing, copycatting and pricing) that favour their own brands without objective justification⁸⁸⁴.

Furthermore, the enforcement of Article 102 TFEU to the practices described might justify a legal and functional separation of the supermarket brand operations from the supermarket (procurement and retail) operations⁸⁸⁵. In particular, neither the ex post enforcement of the non-discrimination obligation nor internal preventive measures (e.g., a Chinese wall) seem sufficient to guarantee that a supermarket will not misuse the confidential information received from an independent grocery brand in favour of its

⁸⁸³ The Commission has applied Article 102 (a) in cases such as *Tetra Pak II*, OJ L 72, 1992; *Amministrazione Autonoma dei Monopoli di Stato*, OJ L 252, 1998 and *DSD*, OJ L 166, 2001. According to O’Donoghue and Padilla, *The Law and Economics of Article 82 EC*, Hart Publishing, 2006, “In *DSD*, the Commission articulated a more comprehensive definition of unfair terms outside the egregious facts of *Tetra Pak II*” (p. 652). “In basic terms, it requires a balancing between the object of the contract, the terms of the contract, and the contractor’s justification for those terms. Thus, the clause should: (1) have a legitimate objective other than consumer exploitation; (2) be “effective,” that is to say, capable of achieving the legitimate goal; (3) be “necessary” in the sense that there is no alternative that is equally effective in achieving the legitimate goal but less with a restrictive or less exploitative effect; and (4) be “proportionate,” in the sense that the legitimate objective pursued by the dominant firm should not be outweighed by its exploitative effect on the trading party in question.” (pp. 654-655).

⁸⁸⁴ Up to know, the *ex ante* regulations adopted in this field have focused on supermarkets’ abusive dealings with independent grocery brands. However, public authorities should bear in mind that the prohibition of these abusive practices, in the presence of supermarket power, may simply incentivise the refusal of access/delisting of independent grocery brands by supermarkets.

⁸⁸⁵ The EU has enforced this remedy in another competitive bottleneck before: Regulation 2289/1999 mandated legal separation of the CRS and the airline carrier activities in order to ensure the effective enforcement of the fair and non-discriminatory dealing obligation imposed on CRSs vis-à-vis airline carriers.

own brand. The legal separation would also facilitate fair competition between all grocery brands regarding access to the supermarkets and in-store competition within them.

7.2.3 National provisions on unilateral conduct

Some Member States have competition rules on unilateral conduct that are more stringent than Article 102 TFEU. Some of these rules have been specifically introduced to address retailers' abuses (e.g., Italia, Finland and Latvia), whereas others generally subject non-dominant companies to the same obligations governing the conduct of dominant companies or subject dominant companies to other supplementary obligations⁸⁸⁶. These rules seem particularly apt to fill the perceived holes in the conventional competition analysis of "buyer power" and, in particular, to address supermarkets' practices regarding access to and competition in their platforms⁸⁸⁷. National rules on unilateral conduct are allowed by Article 3(2) of Regulation 1/2003, which lays down that "Member States shall not under this Regulation be precluded from adopting and applying on their territory stricter national laws which prohibit or sanction unilateral conduct engaged in by undertakings"⁸⁸⁸. This contrasts with the convergence rule imposed on Article 101 TFEU by the same Article 3(2) of Regulation 1/2003.

However, the European Commission's Directorate General for competition (DG COMP) seems to have concluded that the convergence rule should extend to Article 102 TFEU as well. In 2009, the European Commission adopted a Report on the functioning

⁸⁸⁶ Latvia has amended article 13(2) of its Competition Law in order to lower the dominance threshold in the retail sector and Finland has added a new section 7(a) to the Competition Act 948/2011, according to which a grocery trade operator is considered to have a dominant market position in the grocery trade market if its market share in Finland exceeded 30 per cent. On a more general level, for example, Article 3 of the Spanish Competition Law (unfair practices that restrict competition in the market) and section 6(1)(c) and (2) of the Fair Trading Act 1973, replaced by the provisions on market investigations in the Enterprise Act 2022. Interestingly, Section 5 of the FTC Act plays a similar role in the US antitrust legal framework. Lately, it is being vigorously enforced by the FTC to deal with practices such as unfair and exploitative terms by powerful players that may not necessarily fall within the scope of Section 2 of the Shearman Act, which deals with monopolisation and attempted monopolisation (Section 2 of the Shearman Act is the US equivalent to Article 102 TFEU). See FTC Workshop, "Section 5 of the FTC Act as a Competition Statute". Agenda, transcript, and recorded webcast available at <http://www.ftc.gov/bc/workshops/section5/index.shtml> and Lande, "Revitalizing Section 5 of the FTC Act Using "Consumer Choice" Analysis", the antitrustsource, February 2009 ("In conclusion, Section 5 of the FTC Act should be interpreted to be significantly broader than the other antitrust laws. But this expansive mandate only should be used within the consumer choice framework").

⁸⁸⁷ For example, the UK GSCOP would in all likelihood not have materialised had the UK Competition Commission's powers been confined to the enforcement of Articles 101 and 102 TFEU and the equivalent provisions under national competition law.

⁸⁸⁸ Council Regulation 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, OJ L 1, 4.1.2003. On the other hand, Article 3(3) of Regulation 1/2003 specifies that paragraphs 1 and 2 do not preclude the application of national provisions that predominantly pursue a legitimate objective different from that pursued by Articles 101 TFEU and 102 TFEU (i.e., protecting or promoting competition). This may be the case with unfair competition rules. Recital 9 of Regulation 1/2003 states that national rules on acts of unfair trading practices pursue a legitimate objective, "irrespective of the actual or presumed effects of such acts on competition on the market". It goes on to give an example: legislation which prohibits undertakings from imposing on their trading partners, obtaining or attempting to obtain from them terms and conditions that are unjustified, disproportionate or without consideration.

of Regulation 1/2003, which was accompanied by a Staff Working Document⁸⁸⁹. Section 4 of the Report (“Application of EC Competition Law in accordance with Article 3 of Regulation 1/2003”) praised the convergence rule provided for in Article 3 of Regulation 1/2003 regarding the compatibility of national competition rules with Article 101 TFEU⁸⁹⁰. On the other hand, the Report noted criticism by industry and legal community regarding the lack of a convergence rule for Article 102 TFEU. In particular, the Report identified four categories of stricter national competition laws, namely national provisions: a) regulating abuse of economic dependence, 'superior bargaining power' or 'significant influence'; b) prohibiting resale at loss or below cost; c) foreseeing different standards for assessing dominance; and d) making the conduct of dominant undertakings subject to stricter rules. The Report concluded that this issue should be further examined, both in terms of evaluating the extent of the problems caused and assessing the need for action at European level.

The apparent economic distortions caused by the lack of a convergence rule for Article 102 TFEU prompted the Commission to launch the tender COMP/2009/A4/021 for the provision of a study on the impact of national rules on unilateral conduct that diverge from Article 102 TFEU. The objective of the study is “to obtain a high quality study which provides a full overview of stricter national competition laws on unilateral conduct throughout the EU, of the overall impact of such stricter national competition provisions and of the impact of a possible extension of the convergence obligation to unilateral conduct”. The study will provide: (1) an exhaustive overview and detailed explanation for each Member State of the European Union of stricter national competition law provisions on unilateral conduct and of their application in practice; (2) a review and assessment of the impact of stricter national competition law provisions on undertakings and their compliance and business strategy; and (3) a qualitative and/or quantitative assessment of the macro-economic impact of both (a) the divergence of such types of stricter national provisions, and (b) a possible extension of the convergence obligation to national competition laws concerning unilateral conduct. Not surprisingly, the Executive Summary of the Final Report offers a damning condemnation of all these national rules and provides an uncompromising support for the extension of the convergence rule to Article 102 TFEU: (1) “There is a remarkable fragmentation of legal rules on unilateral conduct, which affects as many as 18 Member States”; (2) “Such fragmentation can hamper the internal market, in particular by raising compliance costs for affected undertakings”; (3) “The enterprises most affected by the

⁸⁸⁹ Communication from the Commission to the European Parliament and the Council, Report on the functioning of Regulation 1/2003 (COM(2009) 206 final, 29.4.2009) and Commission Staff Working Paper accompanying the Report on the functioning of Regulation 1/2003 (SEC(2009) 574 final, 29.4.2009). Article 44 of Regulation 1/2003 provided that the Commission shall by 1 May 2009 (i.e. after five years of application), report to the European Parliament and the Council on its functioning.

⁸⁹⁰ Article 3(1) of Regulation 1/2003 obliges national competition authorities and courts to apply Articles 101 TFEU and 102 TFEU to agreements or conduct capable of affecting trade between Member States. Article 3(2) provides that national rules cannot prohibit agreements, concerted practices and decisions by associations of undertakings which are compatible with Article 101 TFEU, whereas Member States are not precluded from enacting and applying stricter laws than Article 102 TFEU to prohibit or sanction unilateral conduct that is compatible with Article 102 TFEU.

current legal fragmentation are of three types: enterprises active in certain Member States in grocery retailing, and their suppliers; suppliers of intermediate products; and enterprises active in network infrastructure such as electricity, pipeline gas, and telecommunications”; (4) “Some of the national rules that are stricter than Article 102 TFEU harm consumers”; (5) “National rules on abuse of economic dependence/superior bargaining power create little benefits, and substantial shortcomings”; (6) “Rules on sales below cost reduce competition in retailing and keep prices artificially high”; and (7) “Extending the convergence rule of Article 3(2) Reg. 1/2003 to Article 102 TFEU would not have significant negative consequences for consumers, businesses, and public authorities”⁸⁹¹.

The Report has relied heavily on the submissions of European retailers and, in particular, supermarkets. Furthermore, since it was not part of its remit, it has avoided any analysis into the causes of these regulations and the current market power of supermarkets and their anti-competitive practices vis-à-vis independent grocery brands. Therefore, it is highly questionable that the extension of the convergence rule to Article 102 TFEU will benefit businesses, consumers and the public good. As the conclusions of the UK GSCOP, the Spanish Grocery Report, the Finnish Grocery Report and the Paris Grocery Report show, the national rules on unilateral conduct, alongside sector-specific regulations, are currently the only efficient remedy against supermarkets’ anticompetitive practices. Therefore, the European Commission should not consider proposing a convergence rule for Article 102 TFEU without having first advanced an efficient remedy against supermarkets’ anticompetitive practices under competition rules and/or other EU legal instruments. In that regard, any initiative by DG COMP in favour of the Article 102 TFEU convergence across the EU should come on the back of a satisfactory regulatory remedy against supermarkets’ anticompetitive/unfair practices at the EU level.

⁸⁹¹ College of Europe and CEPS, “Study on national rules on unilateral conduct that are stricter than article 102 TFEU”, Executive Summary-Final Report, p. 2. The final version of the Study has not been published by the Commission yet.

8 APPENDICES

8.1 The shortcomings of general accounting ratios and price indexes

The conventional competition analysis holds that supermarkets compete fiercely, based on the sector's comparatively low (1) net operating margins⁸⁹² and/or (2) consumer price index. Furthermore, the alleged intensity of retail price competition leads to the automatic conclusion that the grocery retail market is competitive overall.

The main critique to this analysis is that it focuses on a comparison of industry-wide data without evaluating competitive advantages enjoyed by leading supermarkets over the remaining supermarkets in the relevant markets. Furthermore, a detailed analysis of the approach to accounting ratios and price indexes reveals that they are irrelevant to measure the leading supermarkets' market power or rather support its existence.

8.1.1 Accounting/economic ratios

The use of an accounting ratio (e.g., net operating profit⁸⁹³), to measure market power is an exceptional event in competition law analysis. Indeed, there are several reasons against the use of accounting ratios to assess market power and the competition authorities have always been reluctant, if not openly opposed, to use them⁸⁹⁴:

⁸⁹² European Commission staff working document, "Competition in the food supply chain", accompanying document to the European Commission "A better functioning food supply chain in Europe", SEC(2009) 1449, 28.10.2009, p. 9: "One of the key findings of the current exercise is that competition at retail level is fierce, both between retailers themselves and increasingly between different retail formats. This has also translated into lower net operating margins for retailers (e.g. according to data presented by the retail sector, retail margins are on average around 4%, even lower on fresh produce where they near 2%) and has contributed to cheaper prices for consumers on the long term. Such findings seem to contradict wide-spread perception that retailers currently have the highest margins in the food supply chain". The Commission compares these margins with those of leading brand suppliers: "The profit margins of such "unavoidable" suppliers are generally higher than those of retailers. As an illustration, on average in 2006, the average net profit margins of European retailers were around 4%, whereas these same margins in the case of The Coca-Cola Company and the Group Danone were around 20% and 11%, respectively. These differences in profitability can be explained by the fact that retailers compete mostly on price-related criteria whereas branded good producers compete on other factors in addition to price including brand image, product characteristics, consumer preferences for special flavours, etc. Furthermore, in the processed food and drinks industry, concentration has occurred earlier and some of the leading brands are supplied by a very small number of producers."

⁸⁹³ The net operating profit of a company is an accounting ratio used to measure what proportion of a company's revenue is left over after paying for variable costs of production (e.g., wages and raw materials). It is calculated by dividing a company's operating income by its net sales and it is considered to reflect a company's pricing strategy and operating efficiency.

⁸⁹⁴ See, for a general criticism of the use of profit ratios (and prices) to assess substantial market power, OECD 2008 and, in particular, the Executive Summary by the Secretariat of the views expressed by all the Competition Authorities, at pp. 9-10: "(6) *Direct evidence of substantial market power, such as a firm's profitability, is not frequently used in single firm conduct cases. Methods for directly measuring market power are very data-intensive; and even if the necessary data are available, they are typically subject to different interpretations and therefore will not conclusively establish that a firm has the*

First, accounting data is prone to errors and manipulations, thereby undermining its usefulness⁸⁹⁵. Furthermore, it may not reflect an accurate picture of all the dealings between suppliers and retailers in the grocery sector. For example, the association of French retailers sent the European Commission evidence of low net operating profits (2%) in the sale of a product (salad)⁸⁹⁶. According to the example, 53% of the retail end-

requisite degree of market power. However, direct evidence may be useful to support a finding of substantial market power in the appropriate circumstances, provided it is used in conjunction with other evidence.[...]. One can also try to examine whether a firm's profitability is consistent with the finding that the firm has substantial market power. There are a number of significant concerns associated with this methodology, including the difficulty in obtaining accurate economic profitability data from accounting data, the difficulty in ascertaining the competitive norm for a comparison, the possibility that supra-competitive profits may be explained by factors other than substantial, durable market power, and the difficulty in obtaining data about long-term profitability. Profitability data therefore also play a limited role in the analysis of substantial market power. Nevertheless, if high profits have been persistent and are consistent with other evidence, they could in certain circumstances be used as an indicator of substantial market power. For example, some competition authorities have found that unusually high profits could be relevant in a mature, capital-intensive commodity industry in which brand name, innovation and advertising are not important and investments appear to have been earned back. By the same token, low profitability should not automatically be regarded as evidence of the absence of substantial market power, as it could be the result of a firm's inefficiency". See also the Background Note for the roundtable, also drafted by the Secretariat, at pp. 40-42: "3.2.2 Performance-profitability: "Another approach which might be useful in certain circumstances is to determine whether a firm's performance (profitability) is consistent with the finding that the firm has substantial market power. The inquiry is focused on whether a firm's persistent profits can be considered excessive, compared to some measurement of the competitive norm. Looking at economic profits to determine market power would make intuitive sense: in a model of perfect competition, firms would earn zero economic profits, whereas in a model of monopoly, the firm would earn very large profits. [...]. The economic and legal literature, however, while generally supportive of the logic behind the use of profitability estimates, has in general been rather sceptical about the use of profitability data as evidence of substantial market power. Judge Posner, for example, declared: "It is always treacherous to try to infer monopoly power from a high rate of return... Not only do measured rates of return reflect accounting conventions more than they do real profits (or losses), but there is not even a good economic theory that associates monopoly power with a high rate of return." Judge Posner's statement identifies two frequently expressed concerns about using profitability data as evidence of market power: the difficulty of obtaining valid economic profitability data; and the possibility that supra-competitive profits may be explained by factors other than market power. Given that a firm's profits and rates of return typically are based on accounting data, rather than on profits in an economic sense, even commentators who support the idea of using profitability data to infer market power acknowledge the practical difficulties in methods of economic profit estimation. Others have pointed out that excess economic profits would have to be measured in the long run which is a perspective accounting data do not provide. Another problem frequently acknowledged in the literature is that allocating costs and assessing profitability can be especially difficult for multi-product firms. In addition, excess profits could be rewards for taking risks and rewards to a competitive advantage such as superior efficiency, and therefore have perfectly legitimate reasons. It has thus been proposed that excess profits should be considered as evidence of market power only if they are not attributable to superior performance; put positively, persistent excess profits could be relevant evidence if they are the result of a firm's ability to reduce output. It is also not clear whether the lack of excessive profitability should be treated as relevant evidence for the absence of market power. Some have argued that profits persistently below competitive levels should indicate that a firm does not have significant market power. But others have pointed out that the lack of excessive profitability is not necessarily an indication that a firm does not have substantial market power as it may spend profits to insulate itself from competition, or undertake unprofitable expenditures".

⁸⁹⁵ For a recent example, note the accounting error in a nationalised German bank, which has reduced the country's ratio of public debt to GDP by 2.6% and "enriched" the country out of the blue by 55 billion euro. See, BBC News, "Germany finds 55 bn. Euros after accounting error, 28.10.2011, <http://www.bbc.co.uk/news/business-15503097> (visited on 28.10.2011).

⁸⁹⁶ European Commission staff working document, "Competition in the food supply chain", accompanying document to the European Commission "A better functioning food supply chain in

consumer price of a salad reflected a mark-up over the purchase price, out of which 25% amounted to various logistical costs and around 29% represented the commercial margin of the retailer. However, this ratio may not account for the side payments made by the suppliers to retailers and, in particular, the transfer of logistic costs, merchandise destruction costs and other variable costs (e.g., shelf replenishment and customer complaints) to them via upfront payments and/or retroactive payments/discounts, which may take effect in different accounting years. Furthermore, a low net operating profit would leave little room for financing fixed costs, let alone investments in new logistic platforms and stores (the undisputed source of growth for retailers). Against this accounting reality, market reality attests that the leading retailers have embarked upon a growth race (significant capital expenditure) first within their national borders, then in neighbouring countries and now increasingly worldwide.

On the other hand, if profits provided a relevant indication of market power, then economic profits would have to be taken into account and not accounting profits⁸⁹⁷. Yet, estimation of market power based on economic profits shares many of the practical problems one faces when relying on accounting profits and it has been rarely applied by competition authorities⁸⁹⁸. Indeed, the UK Grocery Report 2000 provides a practical example of the difficulties involved in trying to assess market power on the basis of economic profits. In this Report, the UK Competition Commission assessed the sector-wide profitability in order to assess whether the supermarkets were making “excessive profits”⁸⁹⁹:

First, it looked at the overall financial performance of 11 of the UK’s main supermarkets (excluding discount stores and cooperatives) and compared their sector-wide profitability with the (1) other UK food and drug retailers; (2) 19 food producers and processors; and (3) the aggregated results of over 650 industrial and commercial

Europe”, SEC(2009) 1449, 28.10.2009, pp. 13-14: “For example, in 2008, in France, the price of a salad was structured as follows [footnote: Data of the Fédération des Entreprises du Commerce et de la Distribution (FCD) available at: http://www.fcd.asso.fr/maj/upload/docs_fcd/communiqués/91.pdf]: the end-consumer retail price per unit was € 0.83. Out of this, 47% of end price (€ 0.39) went to the producer/seller [footnote: Salad conditioned to be sold includes price paid to producer, conditioning fee and first seller margin] around 25% amounted to various logistical costs and around 29% represented the commercial margin of the retailer. Out of this gross retailer margin of 29%, the net operating margin amounted only to 2%. The rest was absorbed by the cost of destruction of merchandise (8%), labour costs (8%) and other variable costs (11%).”

⁸⁹⁷ See OECD 2008 in note 894. See also The Private Label Report, p. 74: “Two qualifications can be made. First, note that profitability measured by gross operating surplus as a percentage of turnover is higher in food processing than in food retail (compare figures 4.6 and 4.8). However, one should take into account that food processing and food distribution are different activities. One cannot directly compare their ‘profitability numbers’. In the end, the relevant criteria is return on investment and return on equity. Profitability in terms of turnover is higher in food processing than in food retail, because investment is higher. The main conclusion of this section is that there was no overall deterioration in profitability in either food processing or food retail.”

⁸⁹⁸ The only notable exception seems to be the UK Competition Commission, which has relied on economic profits calculations, coupled with many other direct and indirect factors, in market investigations and a few competition cases.

⁸⁹⁹ The UK Grocery Report 2000, Chapter 8, pp.145-180. See also OFT, Assessing profitability in competition policy analysis, Economic Discussion Paper 6, 2003 (report prepared by Oxera), Section 11 (Competition Commission inquiry into supermarkets), pp. 155-156.

companies in the UK. In order to conduct this analysis the UK Competition Commission focused on two measures of profitability: ROS (Return On Sales) and RONO (Return On Net Operating Assets)⁹⁰⁰.

Second, it also undertook a profitability analysis using overseas multiple stores as an alternative benchmark. For this analysis, the following three measures of profitability were computed: gross margins, ROS and ROCE (Return On Capital Employed).

Third, it also examined the IRRs (Internal Rate of Return) achieved by the grocery businesses of the five major supermarkets for the periods 1993–99 and 1996–99, and compared these with their WACC (Weighted Average Cost of Capital).

In light of the available evidence, the UK Competition Commission concluded that, whether compared with other UK industries, other grocery retailers overseas or the cost of capital, there was no indication of excess profitability in the industry for the period 1996 to 1999.

However, a rigorous assessment of the UK Competition Commission's profitability analysis reveals that it was either entirely irrelevant for the purpose of verifying the existence of market power by the leading supermarkets or led to the opposite conclusions:

First, the UK Competition Commission did not explain why it was relevant from a market power standpoint to compare supermarkets' financial performance with other markets (food producers and processors and industrial and commercial companies from other sectors)⁹⁰¹.

Second, the UK Competition Commission relied on a profitability comparison with leading overseas grocery retailers, without assessing whether the competitive structure of the markets in which they operated were comparable, a mistake analogous to the well-known "cellophane fallacy" trap⁹⁰².

Third, the UK Competition Commission accepted, with some caveats, that the IRR/WACC is a relevant data for the assessment of market power, as opposed to accounting

⁹⁰⁰ RONO is operating profits over net operating assets, where net assets are defined as operating working capital plus total long-term assets, minus interest-bearing long-term liabilities.

⁹⁰¹ See also The Private Label Report, p. 74: "Two qualifications can be made. First, note that profitability measured by gross operating surplus as a percentage of turnover is higher in food processing than in food retail (compare figures 4.6 and 4.8). However, one should take into account that food processing and food distribution are different activities. One cannot directly compare their 'profitability numbers'. In the end, the relevant criteria is return on investment and return on equity. Profitability in terms of turnover is higher in food processing than in food retail, because investment is higher. The main conclusion of this section is that there was no overall deterioration in profitability in either food processing or food retail."

⁹⁰² It mistakes a monopolist's inability to exercise market power by raising price above the *current* price for an inability to have already exercised market power by raising price significantly above the *competitive* price.

ratios⁹⁰³. Furthermore, the Authority reckoned that the five largest supermarkets achieved higher IRR and ROCE than their smaller competitors.

Fourth, the UK Competition Commission estimated that the weighted average IRR for the five largest supermarkets for 1993 to 1999 was 17.0 per cent as against an average cost of capital of 13 per cent, pointing to the existence of some degree of market power. Intriguingly, the UK Competition Commission went on to downplay this figure by shortening the time-period analysed, highlighting the stability of their gross and operating margins and comparing these ratios and ROCE with those of leading international retailers⁹⁰⁴.

Fifth, although the UK Competition Commission did not expressly refer to it, it seems that the IRR/WACC or ROCE/WACC of the leading supermarkets were higher than the respective ratios of the smaller competitors.

⁹⁰³ The UK Grocery Report 2000, Chapter 8, pp. 164: “8.83. It has been conventional in setting allowable revenues for regulated utilities to seek to allow efficient companies to earn an IRR equivalent to their cost of capital. This reflects the view that persistent returns greater than the cost of capital are excessive. 8.84. This inference does not automatically apply here. First, in a regulatory regime the IRR is calculated for anticipated revenues and costs. There is no presumption that any company or even the industry concerned must or will make a return equal to its cost of capital. Some companies will exhibit superior efficiency and do better, others the reverse. 8.85. Second, in the non-competitive environment of a regulatory regime it is reasonable to assume that all the companies concerned will survive. Even if some do not this does not undermine the appropriateness of setting revenues to bring the IRR and WACC into line for the purpose of setting prices. In a more competitive environment there is the potential for a so-called ‘survivor bias’. If some companies earn more than their cost of capital and some less, and if some of the latter group, as a result, cease to trade, then the measured average IRR of the surviving companies will exceed their cost of capital, even if all of them are in a fully competitive market. As a result a degree of caution is needed when making comparisons of IRR and cost of capital in the case of multiples”. This illustrates the contradiction between using an industry benchmark for measuring competitiveness and the prevalence of a survivor effect (e.g., virtuous growth) linked to the market power enjoyed by some market players. In any event, the UK Grocery Report 2008 discarded the prevalence of a survivor effect in the retail grocery market eight years later (pp. 10-11): “Another possible source of endogeneity relates to the Demsetz (1973) critique. In this case, efficient firms drive less-efficient rivals out of the market, or are the only ones capable of opening new stores in local markets. In other words, high profit margins are the result of lower costs, which are associated with a more concentrated local market. We do not think this source of simultaneous bias is likely to be serious and our various specification tests indicate that it is not. By and large, the grocery sector is relatively mature with no major player exiting or restructuring, while most of the competitors included in this dataset have opened new stores across the country.”

⁹⁰⁴ The UK Grocery Report 2000, Chapter 8, pp. 164: “8.87. [...] For the period 1996 to 1999, which is a better guide to the current situation, the weighted average IRR was 13.7 per cent against an average cost of capital of 12.6 per cent and for three out of the four largest multiples the difference between IRR and WACC was less than 0.7 per cent. 8.88. Our analysis highlights the fact that growth in turnover has dropped over the period 1997 to 2000 compared with the period 1993 to 1996, yet gross and operating margins have remained moderately stable for the period 1993 to 2000. Operating margins decreased in 1997 by 0.4 percentage points from 1996 and have since been steady at around 5.5 per cent to 1999. Both the gross and operating margins have been slightly in excess of those of our international comparators. Gross margins were approximately two percentage points in excess, while operating margins as reported were approximately one percentage point higher. 8.89. In addition, our analysis of IRR and ROCE shows that the returns over the period 1996 to 2000 have been lower than those for the earlier period 1993 to 1996 which supports our margin analysis that returns over the latter years have been declining. Further, the ROCEs have been on average three percentage points lower than those of the international comparators.”

Sixth, it would appear that the UK Competition Commission did not factor into the IRR and ROCE estimations the trade credit enjoyed by the “complex monopoly”⁹⁰⁵:

TABLE 8.29 Trade creditors in terms of days' sales

	1993	1999
Tesco	24.3	23.4
Sainsbury	25.7	27.3
Asda	28.8	30.7
Safeway	36.6	33.1
Morrison	29.7	36.9
Weighted average	28.0	27.9

Source: Company data and CC analysis.

Seventh, as recommended by the study commissioned by the OFT on the analysis of profitability in competition cases, profit analysis is a difficult exercise and caution is required when using it for competition law purposes⁹⁰⁶: it cannot capture x-inefficiencies and it should always be assessed in conjunction with other competition indicators, such as structural (entry barriers) and behavioural market conditions.

All in all, if one were to reassess the profitability data used in the UK Grocery Report 2000 in light of the OFT study on profitability analysis, he could conclude that the members of the “complex monopoly” made supracompetitive profits over a sustained period of time, based on direct and indirect evidence. It seems that the shortcomings of the profitability analysis carried out in the UK Grocery Report 2000 prompted the UK Competition Commission to abandon an industry-wide, a “complex monopoly” or even a company profitability analysis the UK Grocery Report 2008⁹⁰⁷. Instead it conducted a profitability analysis in highly concentrated local markets and found that the leading supermarkets were making supracompetitive profits⁹⁰⁸.

⁹⁰⁵ Trade credit is an important source of free finance enjoyed by retailers across the world at the expense of suppliers. For example, the largest Spanish retailer, Mercadona, enjoyed 46 days of free-trade from its suppliers in 2009, amounting to revenues of 1,833 million euro over its sales in that year (Fernández 2010, p. 15).

⁹⁰⁶ OFT, “Assessing profitability in competition policy analysis”, Economic Discussion Paper 6, 2003 (report prepared by Oxera), p. 3: “Caution should be exercised when undertaking profitability assessments and drawing conclusions from them. However, this holds equally for most of the other indicators and techniques commonly used in competition policy. Conceptual, measurement and interpretation issues also arise, for example, when defining relevant markets based on price-elasticity evidence, or when determining market power based on market shares. Therefore, profitability analysis should be seen as one among a number of complementary economic indicators and techniques that can be used together in a competition policy analysis.

⁹⁰⁷ Supermarkets' profitability in terms of net operating margins was discussed in Chapter 3 (“Grocery retailing in the UK”) but in a very nuanced way and without drawing conclusions. Curiously, the Competition Commission discarded that the allocation of margins along the supply chain could offer evidence of market power (the UK Grocery Report 2008, p. 160): “9.19 We placed limited weight on this data in our assessment of buyer power. We do not believe that the shares of the retail price for a particular product captured by the various segments of its supply chain are a useful indicator of the market power, since the shares are affected by many other factors.”)

⁹⁰⁸ The UK Grocery Report 2008, Appendix 4.4.

8.1.2 Price indexes

Reliance on pricing to assess the competitive nature of a market is faced with the same measurement and benchmarking problems that undermine the profitability analysis⁹⁰⁹. However, competition authorities have also claimed that the grocery retail market is generally competitive based on a comparison of the evolution of the food retail price index with other indexes such as the general consumer price index, the indexes of other goods or the food index in other countries. Competition authorities have hardly ever used this benchmark when assessing competition in a given market. On the contrary, whenever companies under investigation for competition infringements have claimed that market or company prices are competitive, the off-the-shelf response has been that absent the alleged conduct, prices would have been lower⁹¹⁰. Interestingly, for the first time in this field, the Paris Grocery Report has concluded that the leading supermarket in the Paris market, Casino, would lower its prices if it faced more retail competition, even if its net profits were within industry standards⁹¹¹.

⁹⁰⁹ OECD 2008, p. 43: “*Performance – Pricing*: Using excessive prices as indicator of market power suffers from some of the same problems as profitability measurements. It will typically be difficult to determine a benchmark competitive price level against which the allegedly competitive prices could be measured. One commentator has noted, however, that in some cases it might be possible to find a reasonable benchmark by way of cross-sectional comparison, i.e., when the same product is sold in separate markets and one of the markets appears to be structurally competitive while the other is not. In this situation it might be possible to compare a competitive price with the price charged by a firm in a market where market characteristics suggest that a firm has substantial market power. Such cross-sectional comparison might produce useful evidence of market power where relevant markets tend to be local, such as, for example, retail markets. Simply comparing prices that two firms charge, or that the same firm charges in separate markets, however, will not produce reliable evidence of substantial market power. It will not always be obvious whether higher prices in one market can be attributed to the exercise of market power by a firm, or whether they might be caused by other factors as well such as higher costs.”

⁹¹⁰ Contradictorily, in the UK Grocery Report 2008, the UK Competition Commission relied on this standard wording when assessing the negative effect on retail prices and other competitive factors caused by high concentration in local markets, while at the same time it had accepted that the retail market was competitive overall based on evidence of declining food prices in the UK (p. 120): “6.72 Nevertheless, had competition in more local markets been more intense, the decline in UK grocery prices that has been observed until recently (see paragraphs 3.40 to 3.41) may well have been greater. The scale of the impact on national price levels arising from weak local competition, while difficult to measure, is potentially very substantial. For example, for each 0.1 per cent increase in national price levels, consumer expenditure on groceries at the four largest grocery retailers increases by £80 million a year.”

⁹¹¹ The Paris Grocery Report, par. 139: “Dans le cas du groupe Casino, la marge amont, réalisée au travers de Distribution Franprix et Sédifrais, s’élève à [3 – 7]%. Au final, le niveau de marge réalisé par les centrales d’achat du groupe Casino et les magasins *Franprix* autoriseraient donc ces opérateurs à diminuer leurs prix s’ils étaient soumis à une concurrence plus forte”.

8.2 Markets with competitive bottlenecks

This Section discusses several sectors where competitive bottlenecks have been subject to regulatory/competition law remedies and share commonalities with the grocery retailing.

8.2.1 Computer Reservation Systems

At a time when Internet commerce was not widely available for direct plane-ticket bookings, consumers relied on travel agents for booking their tickets and the latter relied on Computer Reservation Systems (CRSs) to access the ticket offerings of airline carriers. Therefore, CRSs were the *de facto* obligatory trading partners for airlines and travel agents. Practically, travel agents only subscribed to one CRS and, therefore, CRSs were expected to compete against each other to attract single-homing travel agents. On the other hand, airline carriers were forced to seek access to all CRSs in order to be able to reach all travel agents and potential travellers. Therefore, all CRSs were considered to enjoy market power vis-à-vis each airline carrier⁹¹². Furthermore, since CRSs were developed and owned by airline carriers, they were also in a position to discriminate non-integrated airlines and distort competition in the airline and CRS

⁹¹² See Commission Consultation paper on a possible revision of Regulation 2299/1989 on a Code of Conduct for computerised reservation systems (CRS), 23.02.2007, pars. 18-20: “18. The vast majority of the travel agencies rely on only one CRS. The major reason is efficiency: for an agency to use multiple reservation systems, it would have to incur additional training costs and implement a costly accounting and recordkeeping system to consolidate transactions across systems. Travel agencies pay a subscription fee to rent equipment from the CRS to which they subscribe. 19. As travel agencies avoid the subscription to several CRSs, the CRS providers compete to attract the travel agencies to their system. Therefore, CRS incentive payments to travel agencies had risen over the years. For smaller agencies, the incentive payments could offset at least partially the subscription fee. But for larger travel agencies, which can generate substantial booking fee revenue, the CRSs effectively paid the travel agency to subscribe. However, travel agents claim that, under the pressure of changing market forces, incentive payments have stopped their upward trend and even have started to decrease in the last three to four years. 20. In order to capture all travel agencies, airlines need to participate in all CRSs. This may give the CRS providers significant negotiating power vis-à-vis the airlines. When a travel agency books a ticket using a CRS, the airline pays the CRS a booking fee. The booking fee is a flat charge per passenger per flight segment (the number of segments increases with the number of intermediate stops). Many airlines complain that high payments to the agencies were being compensated by high booking fees charged to the airlines. See also Reply Comments of the DOJ on the “Notice of proposed rulemaking - computer reservation system regulations” issued by the DOT, Docket Nos. OST-97-2881, OST-97-3014, OST-98-4775, OST-99-5888, June 9, 2003, pp. 5-6: “Moreover, because the vast majority of agents used only one CRS, each CRS controlled access to a discrete group of agents, representing a large share of airline passenger revenue. Given these industry conditions, airlines did not consider different CRSs to be substitutes for one another. As a consequence, we concluded in our 1989 comments that each CRS constitutes a separate market for air carriers, and each is a monopolist with market power over carriers that want to sell airline tickets in areas where the CRS has a significant number of travel agents. The CRSs also sold information services to travel agents. A travel agent only needed to subscribe to one CRS to obtain information on most airlines and, thus, in contrast to the airline side, the CRSs were effective substitutes for one another for their travel agent customers. As a consequence, that side of the industry enjoyed effective competition on both price and service. Indeed, there was considerable evidence that CRSs were sharing some of their high booking fees with subscribers by offering low and even negative prices to agents so that a CRS could increase its travel agent base and thus its market power over airlines”.

markets⁹¹³. As a consequence, the EU, the US and Canada, amongst others, put in place regulatory measures, alongside competition rules, in order to safeguard competition between airline carriers and between CRSs, for the benefit of consumers⁹¹⁴.

In the EU, Council Regulation 2299/1989, of 24 July 1989, on a code of conduct for computerized reservation systems, was the first regulatory remedy adopted in this sector⁹¹⁵. Regulation 2299/1989 recognised that the “bulk of airline reservations are made through CRSs” and that “abuses in the form of denial of access to the systems or

⁹¹³ Both the European Commission and the DOJ mention some discriminatory practices that are easily transposable to the grocery retailing market. See Commission Consultation paper on a possible revision of Regulation 2299/1989 on a Code of Conduct for computerised reservation systems (CRS), 23.02.2007, pars. 22-23: “22. In the context of air transport liberalisation in the 1980s, the vertical integration of airlines and CRSs gave airline-owned CRSs the incentive and ability to restrict competition in both the airline and the CRS markets. The most pervasive anti-competitive practice was display bias: each CRS could give priority on the display screen to flights operated by its parent carrier, and could give the flights of rival carriers less prominence. CRSs could also provide more reliable and up-to-date information on their respective owner-airlines, because the parent carrier’s internal reservation system and the CRS were housed in the same computer (“architectural” bias). In addition, CRSs could impose highly discriminatory booking fees and other access terms on rival carriers, which would raise their direct costs. 23. Parent carriers may have used their own market power to restrict competition in the CRS market. For example, in markets in which a CRS owner-airline had a significant presence, the carrier could limit its participation in, or withhold information from, competing CRSs so as to make the systems unattractive to local travel agents. See Reply Comments of the DOJ on the “Notice of proposed rulemaking - computer reservation system regulations” issued by the DOT, Docket Nos. OST-97-2881, OST-97-3014, OST-98-4775, OST-99-5888, June 9, 2003, Section D (Exclusionary Practices Engaged In By Vertically Integrated CRSs), pp. 7-9: “In airline markets, the CRSs were able to bias information displays to give greater prominence to their affiliated airline flights and to suppress information on competitors’ flights. The CRSs found that even small changes in display prominence could have significant effects in diverting passengers to their flights from competitors. In addition to enhancing the airline owner’s profitability, this traffic diversion discouraged service from its competitors, thereby raising prices to consumers on concentrated routes. The CRSs also biased the quality and timeliness of the information their systems displayed. For example, CRSs often contained more accurate information on the host carriers’ schedules, fares, and fare rules because the vendor controlled the timing in which changes in that information were loaded into its computer [footnote: 1989 Comments at 18. For example, the vendor-carrier would often load its own fare decreases first and its own fare increases last. In extreme cases, CRSs would simply delete some of the sale fares offered by the vendor’s competitors. 1985 Report to Congress at 12 n.15].(...). Booking fees provided the CRS owner-carriers with another way to exercise their CRS market power against competing airlines. CRSs used booking fees as a strategic weapon to raise rival airlines’ costs, charging higher access fees to airlines that were direct airline competitors than they charged to non-competitors (“discriminatory booking fees”). 1985 Report to Congress at 12. (...). Further, to maintain the superiority of their CRSs in regions where the owner-carriers had strong airline presence, the owner-carriers would refuse to participate fully in competing CRSs. In such cases, the revenues from maintaining CRS and airline dominance in their core markets more than compensated for any loss of airline sales through the competing CRSs. 57 FR 43800.”

⁹¹⁴ See a justification of the need for a specific regulatory regime in addition to the generally applicable competition rules in the Commission Consultation paper on a possible revision of Regulation 2299/1989 on a Code of Conduct for computerised reservation systems (CRS), 23.02.2007, par. 2: “Given that the vast majority of airline bookings were made through CRSs and that most CRSs were owned and controlled by airlines, it was felt that, in order to deal with the competition concerns arising in the supply chain of air transport products, it would be more efficient in terms of transport policy and market efficiency to develop an ad hoc regulatory framework than merely rely on the generally applicable provisions of competition law”.

⁹¹⁵ OJ L 220 of 29.07.1989. Regulation 2299/1989 was subsequently amended by Regulations 3089/93 and 323/99. It is noteworthy that the regulatory remedies were euphemistically named “Code of Conduct” an interesting parallel with recent developments in the grocery sector (e.g., the UK GSCOP and the EU Code of Conduct, agreed under supervision of the European Commission).

discrimination in the provision, loading or display of data or unreasonable conditions imposed on participants or subscribers can seriously disadvantage air carriers, travel agents and ultimately consumers”. Therefore, it laid down a comprehensive regulatory regime, including several obligations aimed at safeguarding fair competition between airline carriers and between CRSs⁹¹⁶. This regulatory regime provided for (1) open, fair and non-discriminatory terms of access by airline carriers and travel agents to the services of CRSs, subject to available capacity and technical constraints beyond control of CRSs⁹¹⁷; (2) fair and non-discriminatory competition within each CRS⁹¹⁸; (3) legal and functional separation between CRS and their parent airline carrier(s)⁹¹⁹; (4)

⁹¹⁶ See for an overview of the aims and substance of the Regulation 2299/1989, Commission Consultation paper on the possible revision of Regulation 2299/1989 on a Code of Conduct for computerised reservation Systems, 23.02.2007, par. 3: “The Code of Conduct recognised that Computerised Reservation Systems required a certain degree of regulation in order to ensure that all airlines enjoy the same level of access to travel agents and consumers. It was established with the aim of improving transparency and preventing discriminatory behaviour both by the system vendors themselves and also by airlines, especially those which have a stake in the ownership and control of a CRS. On the one hand, system vendors were required to deal in an even-handed manner with all carriers and travel agents, while, on the other, carriers with a financial stake in a CRS were required not to favour that system over the others. The code also imposed obligations in terms of neutral display in order to avoid discriminatory treatment of airlines on the system’s principal display.

⁹¹⁷ See, for example, Article 3.2 of Regulation 2299/1989: “A system vendor shall allow any air carrier the opportunity to participate, on an equal and non-discriminatory basis, in its distribution facilities within the available capacity of the system concerned and subject to any technical constraints outsider the control of the system vendor”.

⁹¹⁸ The CRS services would correspond to the in-store management of independent brands by supermarkets. Regulation 2299/1989 imposed several obligations aimed at safeguarding competition between airline carriers within each CRS system: CRS shall not manipulate the material supplied by carriers in a manner that would lead to inaccurate, misleading or discriminatory information being provided to consumers (article 4.2); CRS shall load and process data provided by participating carriers with equal care and timeliness, subject to the constraints of the loading method selected by individual participating carriers and to the standard formats used by the CRS (article 4.3); CRS shall provide a principal display or displays for each individual transaction and shall include therein data provided by participating carriers on schedules, fares and seats available for individual purchase in a clear and comprehensive manner and without discrimination or bias, in particular as regards the order in which information is presented (article 5.2.a); the criteria to be used for ranking information shall not be based on any factor directly or indirectly relating to carrier identity and shall be applied on a non-discriminatory basis to all participating carriers (article 5.2.c); where a system vendor provides information on fares, the display shall be neutral and non-discriminatory and shall contain at least the fares provided for all flights of participating carriers shown in the principal display. The source of such information shall be acceptable to the participating carrier(s) and system vendor concerned (article 5.3); CRS shall provide information, statistical or otherwise, other than that offered as an integral part of the distribution facilities, only as follows: (a) information concerning individual bookings shall be made available on an equal basis to the air carrier or air carriers participating in the service covered by the booking (article 6.1.a); (b) any marketing, booking and sales data made available shall be on the basis that (i) such data are offered with equal timeliness and on a non-discriminatory basis to all participating carriers, including parent carriers...”.

⁹¹⁹ See, for example, Regulation 2299/1989, articles 3.1: “A system vendor shall have the capacity, in its own name as a separate entity from the parent carrier, to have rights and obligations of all kinds, to make contracts, inter alia with parent carriers, participating carriers and subscribers, or to accomplish other legal acts and to sue and be sued”; and 4.a.3: “A system vendor shall ensure that its distribution facilities are separated, in a clear and verifiable manner, from any carrier’s private inventory and management and marketing facilities. Separation may be established either logically by means of software or physically in such a way that any connection between the distribution facilities and the private facilities may be achieved by means of an application-to-application interface only. Irrespective of the method of separation adopted, any such interface shall be made available to all parent and participating carriers on a non-discriminatory basis and shall provide equality of treatment in respect of procedures, protocols, inputs and outputs. Where relevant and generally accepted air transport industry standards are

independent compliance audit⁹²⁰; and (5) the European Commission's powers of guidance⁹²¹ and enforcement⁹²².

available, system vendors shall offer interfaces compatible with them.” This amendment was introduced by Regulation 3089/93. See European Commission Report on the application of Council Regulation 2299/1989 on a code of conduct for computerised reservation systems (CRSs), COM(97) 246 final, 09.07.1997, p. 4: “The principal amendments included, firstly, the need to ensure that CRSs make equal functionality available to all participating carriers, and, in particular, by those CRSs which share common systems with their parent carriers. In this respect, the code requires that a system vendor's distribution facilities are clearly separated from the internal reservation system of its parent carriers. The effectiveness of the arrangements put in place to achieve the separation of the two functions is subject to verification by independent external audit. Associated with the technical requirements for the separation of the distribution facilities of a system vendor from the internal systems of its parent carriers, was a requirement for a system vendor to be established as a separate entity from its parent carrier for legal purposes”.

⁹²⁰ Regulation 2299/1989, Article 21.a.: “1. The system vendor shall ensure that the technical compliance of its CRS with Articles 4a and 6 is monitored by an independent auditor on a calendar year basis. For that purpose, the auditor shall be granted access at all times to any programmes, procedures, operations and safeguards used on the computers or computer systems through which the system vendor provides its distribution facilities. Each system vendor shall submit its auditor's report on his inspection and findings to the Commission within four months of the end of the calendar year under review. The Commission shall examine those reports with a view to taking any action necessary in accordance with Article 11(1). 2. The system vendor shall inform participating carriers and the Commission of the identity of the auditor at least three months before confirmation of an appointment and at least three months before each annual reappointment. If, within one month of notification, any of the participating carriers objects to the capability of the auditor to carry out the tasks as required under this Article, the Commission shall, within a further two months and after consultation with the auditor, the system vendor and any other party claiming a legitimate interest, decide whether or not the auditor is to be replaced”. See Commission Report on the application of Council Regulation 2299/1989 on a code of conduct for computerised reservation systems (CRSs), p. 7: “Article 21.a.1 of the code requires a system vendor to ensure that “the technical compliance of its CRS with Articles 4a and 6 is monitored by an independent auditor”. It also requires a system vendor to submit a copy of the auditor's report on his inspection and findings to the Commission once a year. This provision of the code introduced in the review of 1993 represents the first time that the technical compliance of a CRS with any code of conduct in force throughout the world has been subject to statutory audit. In order to provide guidance to the system vendors’ auditors on the nature and extent of the audit checks to be carried out, the Commission appointed a specialist consultant in the field of computer auditing and established a working group, to jointly develop a set of CRS audit guidelines. The audit guidelines defined the nature and scope of the audit checks to be carried out based on a series of defined control objectives. The guidelines were published in October 1994 and copies were also sent to all Member States directly. The guidelines were also used by the Commission’s services as a standard against which the adequacy of the audit reports were to be judged. Although the use of the guidelines is not mandatory, the CRSs’ auditors have generally used them as the basis for the audits they have carried out.”

⁹²¹ European Commission Report on the application of Council Regulation 2299/1989 on a code of conduct for computerised reservation systems (CRSs), pp. 8-9: “Over the period since the adoption of the amended code, the Commission's services have given guidance on the application of a particular provision of the code on three points - advertising in the principal display, display of code share flights and the treatment of passive bookings. The background to the request for clarification and the Commission's services response is set out below. The Commission's services gave their guidance on interpretation without prejudice to any other future positions of the Commission; it is for the Court of Justice to give binding interpretations of Community law pursuant to Article 177 of the Treaty”.

⁹²² See Articles 11 to 16 of Regulation 2299/1989. The Commission’s investigatory and fining powers were the same as under the EU competition rules. In particular, the Commission could, by decision, “impose fines on system vendors, parent carriers, participating carriers and/or subscribers for infringements of this Regulation up to a maximum of 10 % of the annual turnover for the relevant activity of the undertaking concerned” (Article 16.2).

The fairness and non-discrimination principles also extended to the fees charged by a CRS⁹²³. However, airline carriers started complaining early on that they were shouldering, via excessive access fees, the subsidies awarded by CRSs to large subscribers (i.e., travel agencies). The European Commission studied this issue and was satisfied that the increased subsidies were a consequence of the intense competition between CRSs for large travel agencies. Therefore, these subsidies were considered legitimate distribution costs that could be passed-through to airline carriers in the form of access fees⁹²⁴. In any event, the Commission proposed an amendment of the Regulation 2299/1989 to make sure that the fees charged to a subscriber for equipment and services were non-discriminatory, reasonably structured and reasonably related to the cost of the service provided and used; and were, in particular, the same for the same level of service⁹²⁵. Interestingly, a submission of the Antitrust Division of the DOJ to the Department of Transport (DOT), argued in favour of 0-pricing in respect of access fees charged by CRSs to airline carriers⁹²⁶.

⁹²³ See Regulation 2299/1989, Article 10.1.a: “Any fee charged to a participating carrier by a system vendor shall be non-discriminatory, reasonably structured and reasonably related to the cost of the service provided and used and shall, in particular, be the same for the same level of service. The billing for the services of a CRS shall be sufficiently detailed to allow the participating carriers to see exactly which services have been used and the fees therefor; as a minimum, booking fee bills shall include the following information for each segment: [...]. The billing information shall be offered on magnetic media. The fee to be charged for the billing information provided in the form chosen by the carrier shall not exceed the cost of the medium itself together with its transportation costs. A participating air carrier shall be offered the facility of being informed when any booking or transaction is made for which a booking fee will be charged. Where a carrier elects to be so informed, it shall be offered the option of disallowing any such booking or transaction, unless the latter has already been accepted. In the event of such a disallowance, the air carrier shall not be charged for that booking or transaction.”

⁹²⁴ See Commission Report on the application of Council Regulation 2299/1989 on a code of conduct for computerised reservation systems (CRSs), pars. 16-21.

⁹²⁵ See Regulation 2299/1989, article 10.1.b: “Any fee for equipment rental or other service charged to a subscriber by a system vendor shall be non-discriminatory, reasonably structured and reasonably related to the cost of the service provided and used and shall, in particular, be the same for the same level of service. Productivity benefits awarded to subscribers by system vendors in the form of discount on rental charges or commission payments shall be deemed to be distribution costs of the system vendors and shall be based on ticketed segments. When, subject to paragraph 5 of Annex II the system vendor does not know whether a ticket has been issued or not, then that system vendor shall be entitled to rely upon notification of the ticket number from the subscriber. The billing for the services of a CRS shall be sufficiently detailed to allow subscribers to see exactly which services have been used and what fees have been charged therefor”. This obligation seems to be inspired by the goal of preventing a waterbed effect on small subscribers. By preventing price discrimination in the fees charged by CRS on subscribers, it protected small subscribers and served as a disincentive on CRS to increase the subsidies afforded to large subscribers.

⁹²⁶ Reply Comments of the DOJ on the “Notice of proposed rulemaking - computer reservation system regulations”, Summary of Recommendations, p. 3: “DOT has not proposed a rule to remedy non-strategic supracompetitive pricing by CRSs. In the past, DOJ advocated the zero price rule to constrain both the strategic and nonstrategic exercise of CRS market power over price [footnote 1: Such a rule would prohibit CRS vendors from charging or receiving payments from airlines for CRS-related services. Instead, CRSs would have to recover the full cost of airline bookings from travel agents]. We pointed out the advantages of a structural rule, which relies on properly-aligned incentives. We also noted that because the zero price rule would prevent any airline from paying the CRS to disadvantage its competitors, it could eliminate the need for other rules designed to constrain the strategic exercise of CRS market power. It is clear from the NPRM, however, that DOT is unlikely to adopt the zero price rule or any other measure aimed generally at supracompetitive booking fees. 67 FR 69399. Given the disadvantages of the non-discrimination rule and given the potential for the Internet to diminish CRS market power, DOT should forgo any pricing rule at this time. Instead, DOT should assess, after some

Regulation 2299/1989 was only recently repealed and replaced by Regulation 80/2009 of the European Parliament and of the Council of 14 January 2009 on a Code of Conduct for computerised reservation systems. The European Commission openly referred to the two-sided nature of the CRS market and the competitive bottleneck status of CRSs vis-à-vis airline carriers⁹²⁷. However, the Commission noted that this competitive bottleneck is gradually being eroded by the growth of commercial channels that bypass CRSs⁹²⁸. Furthermore, carriers had gradually divested or reduced their shareholdings in CRSs⁹²⁹. On the other hand, the competitive bottleneck features of the market were yet present and full de-regulation (i.e., the general competition law regime) was not considered a valid option⁹³⁰. Therefore, Regulation 80/2009 put in place a partial de-regulation aimed at suppressing some of the obligations that were considered no longer necessary or counterproductive (e.g., non-discriminatory fees on the part of CRSs and obligation to access all CRSs on the part of the airlines reinforced the competitive bottleneck)⁹³¹. The new regulation still imposes several obligations on

reasonable transition period, whether developments in the market continue to erode CRS market power or inhibit its exercise. If they have not, DOT should then reconsider the zero price or another pricing rule”.

⁹²⁷ Commission Staff Working Document, Impact Assessment on the Proposal for a regulation of the European Parliament and of the Council on a Code of Conduct for computerised reservation Systems, SEC(2007) 1496, 15.11. 2007, p. 9: “Because of this particular “two-sided” market structure, the CRS providers have more market power vis-à-vis the airlines than vis-à-vis the travel agencies”; and p. 10: “The particular economics of this two-sided market, and the lack of competition in the upper part of the market (airlines – CRS), incite CRSs and travel agents to increase the incentive payments. At the end of the distribution chain, the consumer pays the air fare – which includes the increasing booking fees – and sometimes a service fee to the travel agent (which was introduced among other reasons to compensate for the reduction of commission payments from the airlines to the travel agents)”.

⁹²⁸ *Id.*, p. 4: “Changes in CRS technology and economics are gradually eroding the key features of the competitive landscape for which the Code of Conduct was designed. First, many airlines have divested their CRS ownership. Three of the four CRSs (Galileo, Worldspan and Sabre) no longer have any airline ownership, and three airlines only hold a minority share in Amadeus. Second, thanks to the development of alternative distribution channels, such as the airlines' Internet websites or their call centres, consumers have nowadays access to a multiplicity of information and booking channels for air transport services. About 40% of all airline tickets in the EU are booked via alternative channels and about 60% via travel agents and CRSs”.

⁹²⁹ *Id.*, p. 11: “Today, the majority of airlines have divested from their participation in CRSs. Three out of four CRSs are now completely spun off (Galileo, Sabre and Worldspan). Only Amadeus keeps an airline ownership as it has three airlines as minority shareholders. Most European airlines have also sold off their ownership of the National Marketing Companies (NMC) of the CRSs. These are companies – subsidiaries of the CRS or not – that market or promote the services of a particular CRS in given national markets. However, a few air carriers still have stakes in the NMC and some of them may be considered as parent carriers. It cannot be excluded that airlines may regain control of CRSs in the future, especially if they were no rules specific to parent carriers”.

⁹³⁰ *Id.*, pp. 28-29: “Although the development of alternative distribution channels provides increasing market discipline on CRS providers, especially with regard to the booking fees, in the present state of the market, the risks of competitive abuse are higher than in other economic sectors and the sole reliance on the general competition rules would not be sufficient, especially in case of close links between airlines and CRSs. In addition, certain market behaviours of the CRSs (e.g. display bias) would be harmful to consumers even if they were not the result of a competitive abuse”.

⁹³¹ *Id.*, p. 4: “Most importantly, the Code’s non-discrimination requirement for booking fees stifles price competition, and the prohibition for airlines to differentiate content between CRSs significantly restricts their negotiating freedom. The ensuing lack of competition leads to higher CRS booking fees and creates a system of economic rents in favour of CRSs and travel agents, at the expense of airlines and their passengers”.

CRSs regarding access⁹³², services⁹³³, displays⁹³⁴, commercial information⁹³⁵ and relations with parent carriers⁹³⁶.

Interestingly, in a contemporaneous merger between two CRSs (Travelport/Worldspan), the European Commission discarded the existence of a competition problem because on-line air-ticket bookings are now widely available and airlines can bypass the CRSs bottleneck⁹³⁷.

If the CRS market and the grocery retail market are compared, the inescapable conclusion is that supermarkets are executing the anticompetitive and discriminatory practices that the original Regulation 2299/1989 tried to prevent. Conversely, the grocery retail market has not become more competitive unlike the CRS market: on-line grocery shopping is one of the least developed Internet commerce activities and grocery brands cannot bypass supermarkets in order to reach one-stop grocery shoppers. The same reasons that led public authorities across the world to regulate CRSs are present, in a much more dramatic fashion, in the grocery retail market.

8.2.2 Mobile communications networks

Network interconnection is a critical issue in several markets (e.g., energy and telecommunications). Interconnection requires a contractual, often bilateral, arrangement among competing network operators. Armstrong categorises

⁹³² Regulation 80/2009, Article 3.1: “A system vendor shall not: (a) attach unfair and/or unjustified conditions to any contract with a participating carrier or require the acceptance of supplementary conditions which, by their nature or according to commercial usage, have no connection with participation in its CRS; (b) make it a condition of participation in its CRS that a participating carrier may not at the same time be a participant in another system or that a participating carrier may not freely use alternative reservation systems such as its own Internet booking system and call centres”.

⁹³³ Regulation 80/2009, Article 3.2: “A system vendor shall load and process data provided by participating carriers with equal care and timeliness, subject only to the constraints of the loading method selected by individual participating carriers”.

⁹³⁴ Regulation 80/2009, Article 5.1: “A system vendor shall provide a principal display or displays for each individual transaction through its CRS and shall include therein the data provided by participating carriers in a neutral and comprehensive manner and without discrimination or bias. Criteria to be used for ranking shall not be based on any factor directly or indirectly relating to carrier identity and shall be applied on a non-discriminatory basis to all participating carriers. The principal display(s) shall not mislead the user, shall be easily accessible and shall respect the rules set out in Annex I”.

⁹³⁵ Regulation 80/2009, Article 7: “1. Any marketing, booking and sales data may be made available by system vendors provided that such data are offered with equal timeliness and on a non-discriminatory basis to all participating carriers, including parent carriers. Data may and, on request, shall cover all participating carriers and/or subscribers. 2. Participating carriers shall not use such data in order to influence the choice of the subscriber”.

⁹³⁶ Regulation 80/2009, Article 3.3: “A system vendor shall publicly disclose, unless this is otherwise made public, the existence and extent of a direct or indirect capital holding of an air carrier or rail-transport operator in a system vendor, or of a system vendor in an air carrier or rail-transport operator”. Article 4: “1. A system vendor shall not reserve any specific loading and/or processing procedure, any other distribution facility, or any changes to these, for one or more participating carriers, including its parent carrier(s). The system vendor shall provide information about changes to its distribution facilities and loading/processing procedures to all participating carriers. 2. A system vendor shall ensure that its distribution facilities are separated, at least by means of software and in a clear and verifiable manner, from any carrier’s private inventory and management and marketing facilities”.

⁹³⁷ See Vannini 2008.

interconnection as vertical (one-way) or horizontal (two-ways)⁹³⁸. In a one-way interconnection, one network relies on (wholesale) access to the services of another network in order to be able to offer its own (retail) services to consumers. On the other hand, a two-way interconnection leads to horizontal compatibility among competing services. Without the two-way interconnection, each operator can provide services but none of them do fully exploit the network externalities.

Bottleneck Inputs in Various Industries

	<i>Markets</i>	<i>Bottlenecks</i>
'One-way' access:	gas supply electricity supply rail services long-distance telecoms value-added telecoms services	gas pipeline transmission network tracks, stations local telecoms networks telecoms network
'Two-way' access without competition:	international post international telecoms	delivery in other country delivery in other country
'Two-way' access with competition:	network competition in telecoms	delivery by rival networks

Source: Armstrong 1998, p. 547.

In the two-way interconnection area, economists have raised the danger of exclusionary or collusive practices in bilateral negotiations between networks. This has led economists to assess the potential collusive and/or foreclosure effects of mobile call termination fees on mobile retail markets. For example, Laffont, Rey and Tirole show that high access charges undermine retail competition when networks compete in linear prices and do not price discriminate on the basis of where the call terminates⁹³⁹; whereas access charges lose their collusive power when networks compete in other dimensions, as is the case of two-part tariffs⁹⁴⁰. López, however, shows that, in a dynamic setting, networks can use (future) reciprocal access charges to soften current competition even with two-part tariffs⁹⁴¹. Finally, López and Rey analyse competition between asymmetric networks, an incumbent and a new entrant. If the incumbent benefits from customer inertia (a virtual switching cost, as opposed to a legal/economic switching cost), then it has an incentive to insist in the highest possible access mark-up even if access charges are reciprocal and even in the absence of actual switching costs⁹⁴².

⁹³⁸ Armstrong, "Network Interconnection in Telecommunications", *The Economic Journal* 108-448, 1998.

⁹³⁹ Laffont, Rey and Tirole, "Network Competition: I. Overview and Non-discriminatory Pricing", *The RAND Journal of Economics* 29, 1998, pp. 1-37.

⁹⁴⁰ Laffont, Rey and Tirole, "Network Competition: II. Price Discrimination", *The RAND Journal of Economics* 29, 1998, pp. 38-56. An increase in the access charge inflates usage prices, but this makes it more attractive to build market share, which results in fiercer competition for subscribers and lower fixed fees: networks can actually find it worthwhile to spend the full revenue from interconnection fees to build market share, so that termination charges no longer affect equilibrium profits. This profit neutrality has since been further studied and shown to depend on three assumptions: full-participation, no termination-based price discrimination and network symmetry.

⁹⁴¹ López, "Using Future Access Charges to Soften Network Competition", January 2008, p. 6: "Moreover, we find that cost-based access charges maximize the social welfare, one may thus conclude that there is scope for regulation in order to prevent potential anti-competitive behaviours."

⁹⁴² López and Rey, "Foreclosing Competition through Access Charges and Price Discrimination", June 2009. The price discrimination between on-net/off-net calls by the incumbent is a critical variable in

The risk of anticompetitive practices in the interconnection negotiations and agreements has led regulators and competition authorities to stress the network effects and lock-in of end-consumers in order to define a relevant market for termination of calls within each network. Therefore, each operator is considered a *de facto* a monopoly in this market and can be subject to regulatory/competition remedies including non-discriminatory and cost-based pricing, as well as separate accounting⁹⁴³.

The mobile communications markets of the EU offer a highly illustrative example of the intense regulatory intervention (i.e., regulation of national and international two-way interconnection agreements and national one-way access agreements), even though the European Commission and national regulators have long considered that the retail markets were operating competitively⁹⁴⁴.

First, in relation to national two-way interconnection agreements, the European Commission has actively recommended⁹⁴⁵ and the regulators of the Member States have imposed cost-based termination pricing on all networks or, at least, the leading ones. Originally, the goal of regulating call termination prices was to prevent foreclosure of

their model (pp. 2-3): “The second argument, which is the focus of this paper, is the presence of demand-side network effects resulting from termination-based price discrimination. If for example the termination charge is above cost, then prices will be lower for on-net calls; as a result, customers favour larger networks, in which a higher proportion of calls remain on-net. Some European NRAs have also relied on this demand-side argument to call for asymmetric termination charges. For example, in its Decision of October 2007, the French regulator stressed the presence of network effects due to off-net/on-net tariff differentials that impede smaller networks’ ability to compete effectively. Similarly, in its Decision of September 2006, the Spanish regulator argued that network effects can place smaller networks at a disadvantage, and that higher access charges can increase the size of such network effects. An in the Common Position adopted on February 2008, the European regulators expressed the concern that, because of network effects, ‘an on-net/off-net retail price differential, together with significantly above-cost mobile termination rates, can, in certain circumstances, tone down competition to the benefit of larger networks’”.

⁹⁴³ Incumbent telecommunication operators opposed the narrowly defined market definition and claimed that as long as the retail market was competitive (no single-firm dominance), it would penalise anticompetitive practices in the interconnection market.

⁹⁴⁴ Retail mobile communications have not been in the lists of markets susceptible of *ex ante* regulation, adopted by the Commission (Recommendation on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation - C(2007)5406, and Commission Recommendation on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communication networks and services, C(2003)497). See also the Commission Staff Working Document *accompanying the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, “Progress report on the single European electronic communications market (15th report)”*, SEC(2010) 630 final/2, 25.8.2010, p. 15: “Mobile markets in the EU Member States usually count three to four network operators. At a national level, the market share of the leading operator is generally below 40% [footnote: In some cases this is much lower e.g. in the UK around 21%] and the main competitor average market share is around 30%. The leading operator and/or the main competitor are usually owned by one of the four main mobile groups which have pan European strategies in terms of marketing and of bargaining with suppliers. In terms of services, however, markets remain national”.

⁹⁴⁵ See European Commission Recommendation for the Regulatory Treatment of Fixed and Mobile Call Termination Rates in the EU, OJ L 124, 20.05.2009.

competitors in the recently liberalised retail market⁹⁴⁶. However, even though retail mobile markets, are nowadays considered to be competitive, call termination in mobile networks has remained regulated under a model based (mostly) on uniform fees (e.g., same fees for all networks), thereby preventing networks from leveraging their bargaining power⁹⁴⁷.

Second, regarding national one-way access agreements, several Member States have mandated wholesale access to the networks of the mobile operators under a collective dominance analysis, despite network operators' allegations that the retail market was sufficiently competitive⁹⁴⁸. For example, in Spain the regulator ordered the three leading mobile operators to open up their networks to independent competitors (so called Mobile Virtual Network Operators, "MVNOs") and its ruling was upheld by the Spanish courts, which defined the competitive structure of the retail market as a "tight oligopoly"⁹⁴⁹.

Third, and finally, the EU has also imposed price caps on international interconnection agreements between mobile operators (wholesale roaming), as well as on retail international calls and sms (retail roaming), as well as other structural and behavioural remedies (e.g., open-up of networks to roaming services of MVNOs) even though most, if not all, national markets for retail mobile communications are considered to be competitive⁹⁵⁰. Furthermore, the European Commission has proposed a new legislative package that would, among many other measures, suppress roaming fees⁹⁵¹.

⁹⁴⁶ See, for an example regarding calls from fixed networks to mobile networks, Armstrong 2007, p. 2: "Broadly speaking, FTM [Fixed To Mobile] call termination viewed in isolation is likely to involve unilateral monopoly pricing if left unchecked. The vast majority of mobile subscribers join just one mobile network, and so callers on the fixed telephone network must route calls through a subscriber's chosen network. No matter how competitive the market for mobile subscribers may be, a mobile network holds a monopoly over—and can set high charges for—delivering calls to its subscribers. That is to say, as was shown by Armstrong (2002, section 3.1) and Wright (2002), FTM call termination gives rise to a competitive bottleneck and regulators need to worry about excessive termination charges". Sometimes, regulators have mandated asymmetric access pricing in favour of (1) smaller networks within a market, in order to promote vigorous competition in the retail market; and/or (2) all networks within a market, in order to promote its growth (e.g., call termination in mobile networks as opposed to fixed networks).

⁹⁴⁷ Armstrong 2007, p. 7: "Since 2003, Ofcom has determined that the mobile retail market is effectively competitive. In contrast, UK regulators have consistently ruled that each mobile network has a monopoly of call termination on its own network, for the reason that there is no practical way for people to call someone on the go without calling the person's mobile phone and having the call terminated by the mobile network to which that person has subscribed."

⁹⁴⁸ The European Commission originally considered that the market for wholesale access and call origination on public mobile telephone networks was susceptible of *ex ante* regulation but it excluded this market from the latest "Recommendation on relevant product and service markets within the electronic communications sector susceptible to *ex ante* regulation", C(2007)5406.

⁹⁴⁹ See Judgments of the Audiencia Nacional of 12.01.2009 (appeal 305/2006 by Vodafone) and 16.03.2009 (appeal 307/2006 by Telefónica).

⁹⁵⁰ Regulation 531/2012 of the European Parliament and of the Council, of 13 June 2012, on roaming on public mobile communications networks within the Union, which repealed and replaced the original Regulation 717/2007 of the European Parliament and of the Council, of 27 June 2007, on roaming on public mobile telephone networks within the Community and amending Directive 2002/21/EC. For more information on the EU's position on roaming, see http://ec.europa.eu/information_society/activities/roaming/index_en.htm. Roaming is explained in lay terms: "When you travel to a foreign country, your mobile phone keeps working: you are roaming. You

The remedies adopted in the mobile communications markets seem highly relevant in the grocery retail sector since grocery brands must enter into commercialisation (access) agreements with their main competitors if they want to reach their customers, who nowadays seem to be more locked-in than the mobile subscribers.

8.2.3 Internet Service Providers

Internet Service Providers (ISPs) provide Internet connectivity enabling content providers and Internet users to interact together⁹⁵². Internet users tend to contract with a single ISP (“single-home”) and, therefore, each ISP becomes a competitive bottleneck for content providers willing to reach the end-users that have bought Internet access from that ISP⁹⁵³. Historically, ISPs have not charged content providers for the content delivered to the ISP’s customers (end-users), nor discriminated among similar content providers in terms of the delivery services (traffic management) provided. This state of affairs has been defined as “Internet/Net Neutrality”. However, leading ISPs have recently claimed that it is fair that the content providers wishing to reach their customers should also pay them and that they should be able to discriminate content in their networks for legitimate traffic management and economic grounds. In essence, ISPs claim that (1) they are two-sided platforms and that they should be able to manage their price-structure (i.e., the fees charged to end-users and content providers) as they wish; and (2) there is no need to have in place an upfront non-discrimination rule because *ex post* regulatory and competition remedies are sufficient to deal with anti-

can make & receive mobile phone calls, write text messages (SMS) or surf the internet and download content. Your calls, SMS and other data services are operated by a foreign network because your home provider does not normally operate in that country. For providing this service, the foreign network operator charges your home operator and your home operator passes this additional cost on to you”.

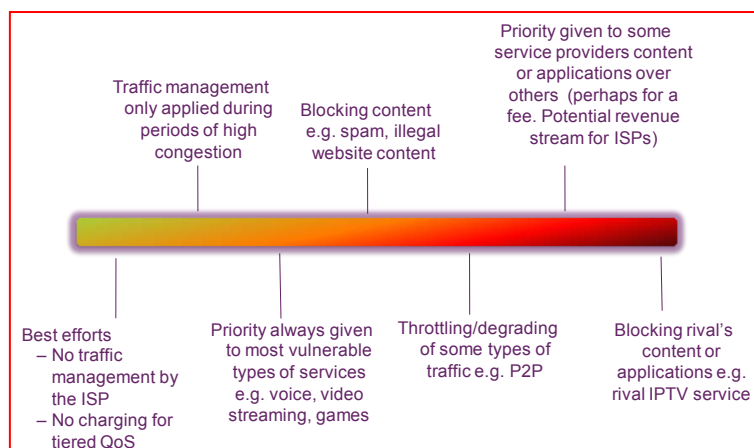
⁹⁵¹ See the “Connected Continent legislative package” at <http://ec.europa.eu/digital-agenda/en/connected-continent-legislative-package> and, in particular: “We want roaming to end, and we want to give the market a chance to make this happen[...]. Operators will lose the right to charge for incoming calls while a user is travelling abroad in EU as of 1st July 2014. They will additionally face a choice between a carrot and stick. The carrot is that they can be largely free of European regulation, if they extend their domestic plans/bundles from 2014 so that by 2018 at the latest, customers throughout the Union are able to use their phones and smartphones while travelling throughout the Union at domestic rates. There will be a glidepath from July 2014, allowing operators to adapt either the number of plans they offer or the number of countries they cover at domestic rates. The stick is being subject the 2012 roaming regulation which forces companies to offer their customers the possibility to roam with new competitors (alternative roaming providers) as of July 2014. From this date a customer will have the right to leave their domestic operator when travelling and take cheaper roaming services from a local company or a rival company in the home country. Operators should take advantage of the opportunities to offer Roam Like at Home to their consumers. The Commission will review the implementation of the Roaming regulation in 2016 and may consider further Regulatory options.”

⁹⁵² In practice, end-users may also act as content providers and the other way around, depending on the circumstances.

⁹⁵³ Armstrong 2001, “The theory of access pricing and interconnection”, May 2001, p. 50: “This brief discussion of some issues concerning access pricing between internet networks is similar in some ways to the earlier analysis of the mobile telephony market. In particular, even though there is effective competition for both consumers and web-site providers, this does not justify a laissez-faire policy towards interconnection arrangements between net- works. Perhaps the main difference between the mobile model and the internet model is that in the latter there are two bottlenecks: (i) once a consumer has signed up with a network, that network has a monopoly over providing communication to that consumer (similar to the case of mobile subscribers above), and (ii) once a web-site has signed up with a network, that network has a monopoly for originating communication from that web-site.”

competitive practices. Conversely, proponents of the Internet neutrality principle claim that, in the absence of this *ex ante* regulation, ISPs would overcharge content providers and discriminate in favour of their own content services.

Figure 1: The Traffic Management Continuum



Source: OFCOM 2010, p. 6.

In order to understand the ISPs' arguments, it is highly instructive to read the discussion paper on Traffic Management and Net Neutrality published by the UK Communications Authority (Ofcom)⁹⁵⁴. Ofcom considered that consumer detriment from exclusionary conduct only arises when vertically integrated ISPs have a substantial degree of market power akin to single firm dominance⁹⁵⁵. Ofcom also considered the risk that the competitive bottleneck status of ISPs gives rise to overcharging of content providers. However, it mentioned some factors that may undermine the competitive bottleneck status of ISPs: (1) countervailing power of content providers: providers of highly valued content are unavoidable trading partners or may commit to exclusive agreements with ISPs; (2) strong competition between ISPs facilitated by ease of consumer switching; and (3) some degree of multi-homing by Internet users⁹⁵⁶. Ofcom's preliminary views showed considerable, if not excessive, faith on the constraining power of well-informed and rational Internet users over ISPs⁹⁵⁷ and a

⁹⁵⁴ Ofcom, "Traffic Management and 'net neutrality'", A Discussion Document, 24.06.2010.

⁹⁵⁵ Ofcom 2010, section 4.14. See, in particular, footnote 25: "Market power needs to be substantial in order for exclusionary behaviour to lead to consumer harm. We have not used any of the legal thresholds— i.e. dominance under the 98 *Competition Act* and Significant Market Power (SMP) under the 03 *Communications Act* — because the discussion is at a broad conceptual level in this document".

⁹⁵⁶ *Id.*, section 4.30-4.38.

⁹⁵⁷ *Id.*, section 4.21: "We are well aware that in order for competition between ISPs to be sufficient to remove or reduce incentives for any ISP to behave anti-competitively, consumers must be able to make well informed decisions and need to be able to change provider without incurring unnecessary switching costs. In Section 5 we look at concerns that consumers may have insufficient information or may not be able to correctly process the existing information. Separately, we will be consulting on how to make the processes for consumer switching easier. We believe that these efforts to ensure that competition between ISPs is vibrant are the most effective way to minimise the risk of anti-competitive behaviour". Interestingly, the views expressed in Section 5 are much more sceptical on the ability of consumers to constrain ISPs and reference is even made to the teachings of behavioural economics. See, for example, section 5.8: "In the previous section, we noted that effective retail competition appears to reduce the

somewhat idyllic vision of their role as neutral intermediaries⁹⁵⁸, a standpoint that may respond to the speculative nature of the problem (no evidence of charging and/or flagrant discrimination of content providers by ISPs had been produced at the time)⁹⁵⁹.

Conversely, the arguments in favour of *ex ante* regulation are nowhere better exposed than in the Open Internet Order, adopted by US Federal Communications Commission (FCC) on 21 December 2010⁹⁶⁰. It imposed a far-reaching Net Neutrality obligation, embodied in three principles: “(1) **Transparency**. A person engaged in the provision of broadband Internet access service shall publicly disclose accurate information regarding the network management practices, performance, and commercial terms of its broadband Internet access services sufficient for consumers to make informed choices regarding use of such services and for content, application, service, and device providers to develop, market, and maintain Internet offerings; (2) **No blocking**. A person engaged in the provision of fixed broadband Internet access service, insofar as such person is so engaged, shall not block lawful content, applications, services, or non-

scope for traffic management to be used anti-competitively. But for that competition to be effective in constraining firms’ behaviour in relation to traffic management consumers need to be able to judge whether their current ISP or network operator is providing a form of traffic management that reflects their particular needs, and if necessary act on this information to switch provider. But clarity of information about traffic management is also an important consumer right in itself. Consumers are often willing to sign 12-24 month contracts for fixed and/or mobile broadband in order to benefit from lower prices and/or free hardware e.g. a modem/router/latest “smart phone”. This is especially the case for mobile broadband. The increasing prevalence of longer term contracts and early termination charges, mean it is important that consumers make the right choice of provider and package when they first sign up, which in turn suggests that clarity about traffic management policies at point of sale is vitally important. In addition, consumers could face additional charges for exceeding their usage caps. We explore some of these difficulties later in this chapter”. Behavioural economics are dealt with in sections 5.41 to 5.46.

⁹⁵⁸ *Id.*, section 4.25: “The main regulatory implication is that when a platform sets the prices on each side it should in theory take into account these linkages to get the right (most profitable) balance between participation on both sides. For example, charging too much to consumers, will lead to reduced take-up of broadband internet. The internet then becomes less attractive to content and application providers. Conversely, if network operators and ISPs overcharged content and applications providers for access to consumers, that would lead to reduced investment in content and applications, which would in turn make the internet less attractive to consumers. In theory, the ISP is well-placed to act as an ‘honest broker’ bringing two sets of preferences together”.

⁹⁵⁹ *Id.*, section 4.40: “Equally though, we would be concerned if the kind of pricing structures implied by the theoretical model of the simple [footnote: For example, in a hypothetical world where consumers single-home and content and application providers did not have bargaining power vis-à-vis the ISPs] “competitive bottleneck” situation started to emerge. In practice, in order to conclude whether such prices are likely to be “too high” one would need further evidence. Currently with the information available Ofcom does not consider that there is a need for controlling future prices by network operators/ISPs and in particular setting them at zero seems difficult to justify, even if Ofcom had the power to impose such a pricing regime. At this stage, there is little concrete evidence to hand as to what kind of pricing models will be proposed either by network operators/ISPs for access, or by content and applications providers for their products. We would be interested to hear stakeholder views and any further evidence they might wish to present. If concerns emerged we may consider it appropriate to review our conclusions in the future”.

⁹⁶⁰ Federal Communications Commission Report and Order, “Preserving the Open Internet, Broadband Industry Practices”, 10-201, 23.12.2010 (“Open Internet Order”). It became effective on 20.11.2011. On appeal, a US Court of Appeals unanimously annulled the Order on jurisdictional grounds (*Verizon v FCC*, No. 11-1355, 14 January 2014). However, the majority upheld the FCC’s analysis of the ISP’s gatekeeper role, whereas a dissenting judge rejected it on the basis that the FCC had not produced evidence supporting its arguments. One wonders whether the dissenting judge would have sided with the majority on this point had he been aware of the abuses flowing from supermarkets’ gatekeeper role.

harmful devices, subject to reasonable network management; and (3) **No unreasonable discrimination.** A person engaged in the provision of fixed broadband Internet access service, insofar as such person is so engaged, shall not unreasonably discriminate in transmitting lawful network traffic over a consumer's broadband Internet access service. Reasonable network management shall not constitute unreasonable discrimination." Furthermore, the Order clarified the scope of the Reasonable Network Management principle that it had exposed in 2005: "A network management practice is reasonable if it is appropriate and tailored to achieving a legitimate network management purpose, taking into account the particular network architecture and technology of the broadband Internet access service"⁹⁶¹.

The FCC argued that each ISP is a gatekeeper to its own Internet users and has the incentive and ability to discriminate content providers. The Open Internet Order mentions at least three types of incentives ISPs face: "*First*, broadband providers may have economic incentives to block or otherwise disadvantage specific edge providers or classes of edge providers, for example by controlling the transmission of network traffic over a broadband connection, including the price and quality of access to end users. A broadband provider might use this power to benefit its own or affiliated offerings at the expense of unaffiliated offerings"⁹⁶². "*Second*, broadband providers may have incentives to increase revenues by charging edge providers, who already pay for their own connections to the Internet, for access or prioritized access to end users. Although broadband providers have not historically imposed such fees, they have argued they should be permitted to do so. A broadband provider could force edge providers to pay inefficiently high fees because that broadband provider is typically an edge provider's only option for reaching a particular end user. Thus broadband providers have the ability to act as gatekeepers"⁹⁶³. The FCC emphasizes that overcharging and foreclosure of content providers will generate negative externalities in terms of reduced investments

⁹⁶¹ Legitimate network management purposes include: ensuring network security and integrity, including by addressing traffic that is harmful to the network; addressing traffic that is unwanted by end users (including by premise operators), such as by providing services or capabilities consistent with an end user's choices regarding parental controls or security capabilities; and reducing or mitigating the effects of congestion on the network.

⁹⁶² Open Internet Order, par. 21. The FCC also criticises "paid for priority" payments, at par. 23: "In addition, a broadband provider may act to benefit edge providers that have paid it to exclude rivals (for example, if one online video site were to contract with a broadband provider to deny a rival video site access to the broadband provider's subscribers). End users would be harmed by the inability to access desired content, and this conduct could lead to reduced innovation and fewer new services. Consistent with these concerns, delivery networks that are vertically integrated with content providers, including some MVPDs, have incentives to favor their own affiliated content. If broadband providers had historically favored their own affiliated businesses or those incumbent firms that paid for advantageous access to end users, some innovative edge providers that have today become major Internet businesses might not have been able to survive".

⁹⁶³ *Id.*, par. 24. The FCC considers that ISPs' gatekeeper or "termination monopolist" role is not undermined by the fact that some end users can be reached through more than one broadband connection ("even so, the end user, not the edge provider, chooses which broadband provider the edge provider must rely on to reach the end user") and even if some edge [content] providers would have bargaining power in negotiations with broadband providers over access or prioritization fees.

and innovation that are not internalised by individual ISPs⁹⁶⁴. “Third, if broadband providers can profitably charge edge providers for prioritized access to end users, they will have an incentive to degrade or decline to increase the quality of the service they provide to non-prioritized traffic. This would increase the gap in quality (such as latency in transmission) between prioritized access and non-prioritized access, induce more edge providers to pay for prioritized access, and allow broadband providers to charge higher prices for prioritized access. Even more damaging, broadband providers might withhold or decline to expand capacity in order to “squeeze” non-prioritized traffic, a strategy that would increase the likelihood of network congestion⁸⁴ and confront edge providers with a choice between accepting low-quality transmission or paying fees for prioritized access to end users”⁹⁶⁵.

Interestingly, the FCC held that even if these threats to the current competitive functioning of the Internet would materialise in the absence of ISP market power in the end-user market, the presence of market power therein would exacerbate them⁹⁶⁶.

⁹⁶⁴ *Id.*, pars. 25-26: “25. Broadband providers would be expected to set inefficiently high fees to edge providers because they receive the benefits of those fees but are unlikely to fully account for the detrimental impact on edge providers’ ability and incentive to innovate and invest, including the possibility that some Edge providers might exit or decline to enter the market. The unaccounted-for harms to innovation are negative externalities [footnote: A broadband provider may hesitate to impose costs on its own subscribers, but it will typically not take into account the effect that reduced edge provider investment and innovation has on the attractiveness of the Internet to end users that rely on other broadband providers—and will therefore ignore a significant fraction of the cost of foregone innovation. See, e.g., OIC Comments at 20–24. If the total number of broadband subscribers shrinks, moreover, the social costs unaccounted for by the broadband provider could also include the lost ability of the remaining end users to connect with the subscribers that departed (foregone direct network effects) and a smaller potential audience for edge providers(...)], and are likely to be particularly large because of the rapid pace of Internet innovation, and wide-ranging because of the role of the Internet as a general purpose technology. Moreover, fees for access or prioritized access could trigger an “arms race” within a given edge market segment. If one edge provider pays for access or prioritized access to end users, subscribers may tend to favor that provider’s services, and competing edge providers may feel that they must respond by paying, too. 26. Fees for access or prioritization to end users could reduce the potential profit that an edge provider would expect to earn from developing new offerings, and thereby reduce edge providers’ incentives to invest and innovate. In the rapidly innovating edge sector, moreover, many new entrants are new or small “garage entrepreneurs,” not large and established firms. These emerging providers are particularly sensitive to barriers to innovation and entry, and may have difficulty obtaining financing if their offerings are subject to being blocked or disadvantaged by one or more of the major broadband providers. In addition, if edge providers need to negotiate access or prioritized access fees with broadband providers, the resulting transaction costs could further raise the costs of introducing new products and might chill entry and expansion.

⁹⁶⁵ *Id.*, par. 29.

⁹⁶⁶ *Id.*, par. 33: “Although these threats to Internet-enabled innovation, growth, and competition do not depend upon broadband providers having market power with respect to end users, most would be exacerbated by such market power. A broadband provider’s incentive to favor affiliated content or the content of unaffiliated firms that pay for it to do so, its incentive to block or degrade traffic or charge edge providers for access to end users, and its incentive to squeeze non-prioritized transmission will all be greater if end users are less able to respond by switching to rival broadband providers. The risk of market power is highest in markets with few competitors, and most residential end users today have only one or two choices for wireline broadband Internet access service”, and par. 34: “In addition, customers may incur significant costs in switching broadband providers because of early termination fees; the inconvenience of ordering, installation, and set-up, and associated deposits or fees; possible difficulty returning the earlier broadband provider’s equipment and the cost of replacing incompatible customer-

It seems that public authorities all over the world share the FCC arguments. For example, some countries have preventively enacted specific laws turning this principle into a statutory obligation (e.g., Chile, Japan, the Netherlands and Norway⁹⁶⁷) or are considering regulating it (e.g., Belgium, France and Italy). The European Commission also conducted a wide-ranging consultation on this principle that led to the adoption of the Communication “The open internet and net neutrality in Europe”⁹⁶⁸. The Communication considered that the existing regulatory regime could adequately safeguard Internet neutrality, without discarding *ad hoc* regulation if significant and persistent problems emerge⁹⁶⁹. Furthermore, the European Commission reserved the right to apply competition rules⁹⁷⁰, although it admitted that they may not be an effective remedy in competitive bottleneck-type scenarios⁹⁷¹. However, following the European Parliament’s Resolution in support of the Internet neutrality principle, in which it condemned discriminatory practices and urged the Commission to assess the need for regulatory measures, the Commission’s new legislative proposal “Connected Continent” expressly regulates Net Neutrality⁹⁷².

owned equipment; the risk of temporarily losing service; the risk of problems learning how to use the new service; and the possible loss of a provider-specific email address or website.

⁹⁶⁷ In Norway, a Code of Conduct was agreed among the stakeholders under the auspices of the Telecommunications Authority.

⁹⁶⁸ Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions, “The open internet and net neutrality in Europe”, COM(2011) 222 final, 19.4.2011. The Commission’s consultation on the “open internet and net neutrality” is available at:

http://ec.europa.eu/information_society/policy/ecomm/library/public_consult/net_neutrality/index_en.htm

⁹⁶⁹ *Id.*, p. 9: “On the basis of the evidence and the implementation of the telecom framework provisions, the Commission will decide, as a matter of priority, on the issue of **additional guidance** on net neutrality. If significant and persistent problems are substantiated, and the system as a whole - comprising multiple operators - is not ensuring that consumers are easily able to access and distribute content, services and applications of their choice via a single internet subscription, the Commission will assess the need for **more stringent measures** to achieve competition and the choice consumers deserve. Transparency and ease of switching are key elements for consumers when choosing or changing internet service provider but they may not be adequate tools to deal with generalised restrictions of lawful services or applications. Such additional measures may take the form of guidance or general legislative measures to enhance competition and consumer choice, such as by further facilitating consumer switching, or if this should prove to be insufficient, by for example imposing specific obligations regarding unjustified traffic differentiation on the internet applicable to all ISPs irrespective of market power. This could include the prohibition of the blocking of lawful services”.

⁹⁷⁰ *Id.*, p. 9: “In this regard, the Commission reserves its right to assess under Articles 101 and 102 of the TFEU any behaviour related to traffic management that may restrict or distort competition”.

⁹⁷¹ *Id.*, p. 4: “At the same time, the adequacy of the competitive environment as a guarantor of the openness of the internet can be affected by the possible existence of market failures, of oligopolistic practices, of bottlenecks to the provision of high quality services to consumers and of information asymmetry.”

⁹⁷² European Parliament resolution of 17 November 2011 on the open internet and net neutrality in Europe, P7_TA-PROV(2011)0511 and Connected Continent legislative package, available at <http://ec.europa.eu/digital-agenda/en/connected-continent-legislative-package>: “Net Neutrality: This proposal will end discriminatory blocking and throttling and deliver effective net neutrality [<https://ec.europa.eu/digital-agenda/node/10545>]. It goes wider than the measures in the US (which does not prevent blocking or throttling of services such as VOIP on mobile).

It sets out clear rules for traffic management which has to be non-discriminatory, proportionate and transparent.

The world-wide consensus against the potential use of access fees and discriminatory practices by ISPs, contrasts with the absence of any debate, until very recently, on the widespread use by supermarkets' of identical practices in the grocery brand market, whose anticompetitive effects have been evidenced in several reports. Indeed, the modern grocery retailing sector seems to vindicate the claim that conventional competition analysis is ill-equipped to deal with competitive bottlenecks such as ISPs and that the regulation of the Internet neutrality principle is necessary.

8.2.4 Internet Search Engines

The European Commission is currently investigating Google for allegedly overcharging and discriminating third-party content providers in favour of its own content in free (non-paid) and sponsored (paid) search queries⁹⁷³. Under the conventional competition analysis, the European Commission's case against Google revolves around a sufficiently narrow product market definition (e.g., general search engines and the associated market for online advertisement in search engines) that confers a very high

Companies would however be allowed to differentiate their offers (for example by speed) and compete on enhanced quality of service. There is nothing unusual about this – postal services (express mail) and airlines (economy/business class) have done this for decades.

To meet end-users' demand for better service quality, content providers may agree deals with internet providers to assure a certain quality of service. Such offers will enable telecom operators to generate additional revenue streams from OTT actors, content providers as well as from consumers who are willing to pay for better or faster services. These revenues in turn, will enable operators to finance investments into network upgrades and expansion.

Specialised services must not lead to quality degradation of the "normal"/best efforts Internet. They are coherent with the way the internet was engineered." [emphasis added]

⁹⁷³ Press Release of the Commission, "Commission probes allegations of antitrust violations by Google", IP/10/1624, 30.11.2010 and "Commission seeks feedback on commitments offered by Google to address competition concerns", IP/13/371, 25.04.2013: "In March 2013, the Commission formally informed Google of its preliminary conclusion that the following four types of business practices by Google may violate EU antitrust rules prohibiting the abuse of a dominant position (Article 102 of the Treaty on the Functioning of the European Union – TFEU): (i) The favourable treatment, within Google's web search results, of links to Google's own specialised web search services as compared to links to competing specialised web search services (i.e. services allowing users to search for specific categories of information such as restaurants, hotels or products); [...] To address these concerns, Google offers for a period of 5 years to: (i) label promoted links to its own specialised search services so that users can distinguish them from natural web search results, clearly separate these promoted links from other web search results by clear graphical features (such as a frame), and display links to three rival specialised search services close to its own services, in a place that is clearly visible to users, [...]". On 5 February, the Competition Commissioner Almunia announced that a settlement had been reached with Google, Commissioner Almunia, "Statement on the Google investigation", SPEECH/14/93, 05/02/2014. With regards to the treatment of third-party content providers, "to address these concerns, Google has finally accepted to guarantee that whenever it promotes its own specialised search services on its page, the services of rivals will also be displayed in a comparable way. In practice, this means that when Google promotes one of its own specialised search services, there will be three rival services also displayed prominently on the page, in a way that is clearly visible to users. [...]. Of course, for all these situations, it is not possible to show all rivals, in the same way that that could not happen on Google's general web search results. There therefore has to be a selection and Google's proposal provides an objective mechanism for all scenarios. Where Google does not charge for inclusion in its specialised search service, such as in local search, rivals will not be charged to participate in the rival links. Instead, they will be chosen based on their ranking in natural search. Where Google charges merchants for inclusion in its specialised search service, such as in Shopping, the three rivals will be chosen on the basis of a dedicated and transparent auction mechanism."

market share on Google justifying a finding of dominance. However, it appears that the case against Google rests essentially on its competitive bottleneck role.

On the one hand, opponents of competition law enforcement against Google have argued that any discriminatory practice by Google can be self-disciplined by the market: Internet users have other general search engines, vertical search engines and the target content (provided they know its web address) at a “click” distance⁹⁷⁴. Furthermore, they argue that the incentives of vertically integrated companies to discriminate in favour of their own products are “ubiquitous” and other general search engines also favour their own content over third-party content⁹⁷⁵.

On the other hand, proponents of competition law enforcement against Google are numerous and they have grouped under two organisations: FairSearch.org and the Initiative for a Competitive Online Marketplace (ICOMP)⁹⁷⁶. They emphasize Google’s extremely high market share, traditionally associated with single firm dominance⁹⁷⁷. But the essence of their claim is that Google has become a competitive bottleneck with locked-in (single-homed) users, which exploits and discriminates content providers⁹⁷⁸.

⁹⁷⁴ See, for example, Manne and Wright, “If Search Neutrality is the Answer, What’s the Question?”, ICLE Antitrust & Consumer Protection Program, White Paper Series, 7.04.2011; and “Defining and Measuring Search Bias: Some Preliminary Evidence”, ICLE Antitrust & Consumer Protection Program, 3.11.2011. ICLE [International Center for Law and Economics] receives financial support from Google.

⁹⁷⁵ Manne 2011, p. 15: “The result that search engine bias is ubiquitous is not surprising. The fact that search engines such as Yahoo – that certainly do not have market power – exhibit similar bias suggests that the practice is not anticompetitive. Moreover, the incentive for a vertically integrated firm to discriminate in favor of its own products is also ubiquitous. Indeed, the more appropriate policy question is whether such bias ultimately benefits or harms consumers.” See also, Edelman and Lockwood, “Measuring Bias in “Organic” Web Search”, 19.01.2011, available at <http://www.benedelman.org/searchbias/>

⁹⁷⁶ They bring together competitors/customers of the vertically integrated activities of Google. See www.fairsearch.org and www.i-comp.org.

⁹⁷⁷ However, market shares tell nothing about the competitive constraints exercised by Internet searchers and content providers on Google. The critical factor is whether searchers/content providers do have outside options and would choose them if Google advanced its own corporate interests rather than those of consumers.

⁹⁷⁸ Cave 2011, pp. 29-30: “The narrative that Google has shaped around contestability is expressed simply as “a click away” – the implication that any consumer is able to migrate to another platform instantaneously with almost zero switching costs. This narrative has been carefully crafted by Google, for example, the phrase: “As we put it, the competition is only a click away” has become a strapline for capturing, from the perspective of Google, the inherent intensively competitive nature of the Internet and the market for search. However, what this carefully articulated story fails to discuss are the impediments to contestability, for example the increasing array of defaults on software platforms and applications that mandate Google services. These impediments are multifarious and operate over time and in space. Temporally, the dominance of Google at any one time in terms of both searches and searchers leads to a perception of better results. In other words consumers are only likely to move away if there is a “second Google” out there. Fundamentally, as the literature describes, the major structural impediment, is when a platform has become so embedded in the behaviour of users on both sides of the market, the nature of competition shifts to one for the market rather than competition within the market. Within such a perspective the entry barriers are formidable and the actions of individual consumers close to futile. (...). The impediments to contestability may also be found in the nature of search itself – the scale effects and path dependencies create forms of consumer and advertiser lock-in regardless of the technical efficacy of the search algorithms. So whilst Google continue to remonstrate that their dominance is simply a matter of doing this better and learning by doing the consumer experience and behaviour is one that tends

They show that, over the years, Google has built trust and expectation on consumers that search engine results are relevant, objective and organic⁹⁷⁹. However, they provide evidence that Google has increasingly reserved screen showing for its own commercial services and that paid-for showing prevails over unpaid showings⁹⁸⁰. These incremental changes in its screen showings represent a dramatic change if a longer time-horizon is considered, attesting a widening gap between consumer perception of the Internet search experience and reality. Furthermore, consumers are offered fewer competitive options and less innovation at a more expensive price⁹⁸¹. In line with the remedies adopted in other networked sectors (i.e., competitive bottlenecks), they propose both regulatory and competition remedies⁹⁸².

Perhaps the most compelling argument for regulatory/competition remedies in the Internet search engine market comes from Google itself. The company has been a long-time proponent of the Internet Neutrality principle in respect of ISPs⁹⁸³, has proposed

towards 'lock-in' and 'path dependencies'. The existence of such behaviours is consistent with the predictions of economic theory."

⁹⁷⁹ ICOMP Powerpoint Presentation, "Anatomy of Search Results The widening reality gap", 22. 07. 2011, p. 2.

⁹⁸⁰ *Id.*, pp. 3-6. It presents Google search results for "Casinos" in 2001 and 2011. In 2001, the screen estate division clearly favoured organic search (68%) over the sponsored one (32%). The sponsored results were clearly labelled as "sponsored links" and there was a clear margin separation from organic search results. In 2011, the screen estate division overwhelmingly favoured sponsored search (53%), Google services (16%) and Google page functionalities, including services (13%) over organic search (11%). Furthermore, there is similar formatting of organic and non-organic results, less-clear labelling of sponsored content (small label "Ads" used) and generic labelling of own services (e.g. "News"), raising potential confusion in consumers.

⁹⁸¹ *Id.*, p. 8 [numbering added by the Author]: "1. Consumers ultimately pay higher costs for online services and are offered fewer competitive options, less innovation: 1.1. With little screen estate left for unpaid listings, SMEs are forced to pay their way onto the 1st search results page to gain any visibility - these costs are ultimately passed through to consumers. 1.2 Google-owned services displace competing services, siphoning away revenues 1.3. Less capital available to competing services, hindering innovation. 1.3.1. Lower revenues. 1.3.2. Restricted access to investment capital (less attractive business model, higher risk, less opportunity). 2. The glide path leads inevitably more domination by Google of web services while reducing innovation and competition".

⁹⁸² Cave 2011, p. 30: "However, one of the key competition policy questions in network industries is assessing the damage to consumer welfare rather than harm to competitors. This perspective raises the question as to whether or not policy makers have a set of expectations or even normative frameworks which should inform the regulation, if any, of a network industry. Hence the debate shifts from a purely economic debate to an analysis of the impact of the network industry, in this case search, upon broader economic and social policy objectives. Further to the focus of any discussion of remedies in network industries, because of the potential risk of monopoly, may default towards regulation (both ex-ante and ex-post) rather than traditional anti-trust and competition law interventions (such as fines and divestitures). The focus on regulation rather than 'remedies' has parallels with other network industries, such as airlines, banking and telecommunications. In all cases the regulatory framework seeks to address issues in terms of both ex-ante and ex-post instruments."

⁹⁸³ See "Guide to Net Neutrality for Google Users", available at Wikipedia's term "Internet Neutrality": "Network neutrality is the principle that Internet users should be in control of what content they view and what applications they use on the Internet. The Internet has operated according to this neutrality principle since its earliest days... Fundamentally, net neutrality is about equal access to the Internet. In our view, the broadband carriers should not be permitted to use their market power to discriminate against competing applications or content. Just as telephone companies are not permitted to tell consumers who they can call or what they can say, broadband carriers should not be allowed to use their market power to control activity online". Google's views on Net Neutrality are available at <http://googlepublicpolicy.blogspot.com/search/label/Net%20Neutrality>.

legislative action to guarantee it⁹⁸⁴ and has actively intervened in the proceedings that led to the adoption of the Open Internet Order⁹⁸⁵.

8.2.5 Internet Domain Name Registration

On 5 November 2010, the Board of the Internet Corporation for Assigned Names and Numbers (ICANN)⁹⁸⁶, proposed to lift the upfront prohibition on vertical integration between the registry-registrar activities regarding Internet domain names⁹⁸⁷. ICANN Board argued that the Code of Conduct applying to registries and registrars (e.g., non-discrimination obligations) and the competition rules were sufficient to address abusive and exclusionary practices. However, several stakeholders and Governments, including, most notably, the US Department of Commerce and the European Commission, opposed the derogation of this rule and supported *ex ante* regulation over the *ex post* application of competition rules⁹⁸⁸. In particular, in its initial non-paper on this issue, the European Commission emphasized the following:

-“Vertical separation between registries and registrars has been widely considered a key feature of ICANN's mission to promote competition in the domain name system. The implementation of this principle has been particularly crucial to ensuring a level playing field for competition at the registrar level for the initial three new generic Top-Level Domains (gTLDs) “.com”, “.net” and “.org””⁹⁸⁹.

-“We are, however, concerned about the envisaged full removal of vertical separation between registries and registrars in the framework of the forthcoming introduction of new gTLDs in view of the possible negative implications for competition that such a decision may entail. The implementation of the principle of vertical separation has, to date, had a key role in ensuring a level playing field for competition at registrar level. A move away from that fundamental principle appears premature given the absence of both expert advice based on well-founded

⁹⁸⁴ See Verizon-Google Legislative Framework Proposal, available at <http://googlepublicpolicy.blogspot.com/2010/08/joint-policy-proposal-for-open-internet.html>

⁹⁸⁵ See, for example, Open Internet Order, footnote 45: “See, e.g., Letter from Alan Davidson, Google, & Thomas J. Tauke, Verizon, to Chairman Genachowski et al., GN Docket No. 09-191 at 2 (filed Jan. 14, 2010) (“It is essential that the Internet remains an unrestricted and open platform, where people can access the lawful content, services, and applications of their choice.”); and footnote 46: “See, e.g., DISH Comments at 2 (“Vertically-integrated broadband providers have the incentive and ability to discriminate against competitors.”); Google Comments at 35 (“Broadband providers will have a natural incentive to use prioritization to favor their own services.”).”

⁹⁸⁶ For a general description of the ICANN activities in respect of Internet domain names and IP addresses, see <http://www.icann.org/en/about/>.

⁹⁸⁷ Registries manage the domain names whereas registrars interact with those interested in registering a domain name.

⁹⁸⁸ See, regarding the EU position, Letter from Gerard de Graaf and Linsey McCallum to Rod Beckstrom and Peter Dengate, INFSO/A3/JS/, 17.06.2011, enclosing the “Non-paper regarding the envisaged removal of vertical separation between registries and registrars for new and existing gTLDs by ICANN”; and Letter from Gerard de Graaf and Linsey McCallum to Rod Beckstrom and Steve Crocker, 19.01.2012.

⁹⁸⁹ Commission’s Non-paper regarding the envisaged removal of vertical separation between registries and registrars for new and existing gTLDs by ICANN, par. 1.

empirical analysis of the relevant market and consensus among stakeholders. In such circumstances, the risks of a negative market outcome for consumers appear real”⁹⁹⁰.

- “It should be noted that all expert reports commissioned by ICANN to evaluate the benefits of vertical integration between registries and registrars recognised not only the potential to yield pro-competitive benefits, but also the risk of anti-competitive effects. (...). In the same vein, the Salop & Wright report of 28 January 2010 highlighted that vertical integration could harm competition in terms of higher prices, lower quality levels, too little product variety or less innovation, most likely in cases in which the integrated registry or registrar enjoyed market power”⁹⁹¹.

- “In the light of the above, we urge ICANN to reconsider its intention to fully remove vertical separation between registries and registrars in the context of the forthcoming introduction of new gTLDs. In view of the concerns outlined above, we consider it preferable to dissociate such a fundamental decision from the new gTLD launch process and maintain for the time being and, subject to the gathering of further data, the existing rules on vertical separation between registries and registrars for both new and existing gTLDs subject to limited exceptions for clearly pro-competitive cases”⁹⁹².

In response to the ICANN letter to the European Commission’s non-paper, the Commission insisted that it did not oppose in principle the lifting of the vertical separation obligation but it was not convinced that it was convenient, taking into account the current state of affairs in the registry-registrar market⁹⁹³. More explicitly, the Antitrust Division of the DOJ acknowledged that regulation might be more appropriate than competition rules in order to prevent discriminatory practices by vertically integrated players⁹⁹⁴. In June 2011, ICANN formally suppressed the prohibition of vertical integration between registrar-registry activities on the basis that the contractual provision against the abusive practices arising out of registry-registrar cross ownership, the self-auditing requirements and the right of contractual termination and punitive damages for breaches of this provision ensured that vertically integrated operators would not incur in discriminatory practices.

⁹⁹⁰ *Id.*, par. 10.

⁹⁹¹ *Id.*, par. 11.

⁹⁹² *Id.*, par. 21.

⁹⁹³ Letter from Gerard de Graaf and Linsey McCallum to Rod Beckstrom and Steve Crocker, 19.01.2012: “Contrary to what your letter appears to suggest, we do not oppose the removal of vertical separation as a matter of principle. On the contrary, we fully understand that there may be a need to revise and to possibly relax the previous set of rules with a view to fostering competition at registry level. However, based on the publicly available information on this issue (including the expert reports mentioned in your letter), we are currently not convinced that the full removal of vertical separation for generic Top-Level Domains (gTLDs), particularly for existing ones such as .com, is the most appropriate solution from a competition point of view”.

⁹⁹⁴ Letter from Lawrence Strickling to Peter Dengate-Thrush, enclosing a Letter from James Tierney, 16.06.2011, p. 3: “In our view, the current structural rule that prohibits vertical integration provides a more effective and easier way to prevent competitive abuse. Moreover, ICANN’s apparent belief that competition agencies can effectively address any competitive harm created by ICANN’s decision to allow vertical integration is misguided. The Antitrust Division questions the effectiveness of this approach as it is not clear that a registry or registrar that operates within the scope of its delegated authority, even if it is able to exercise market power, would pose an enforcement issue under applicable competition laws, at least in the United States”.

8.2.6 Media platforms

Traditionally, competition authorities have considered that media companies compete, on the one hand, in the market for viewers, listeners or readers and, on the other hand, in the market for advertising services in the relevant media⁹⁹⁵. Furthermore, when assessing media mergers or joint advertising agreements, competition authorities have considered that the media companies might hold a single or collective dominant position that restricted competition in the market, despite allegations by the media companies that any improvement in the advertising terms obtained from advertisers would be passed-on in the form of better content to viewers, listeners and readers⁹⁹⁶. Interestingly, the UK Secretary of State (on recommendation by the UK Competition Commission) imposed “a set of rules to protect the advertising community from unfair

⁹⁹⁵ See, regarding the TV advertising market, Commission Decision of 20.09.1995, Case IV/M.553 - RTL/Veronica /Endemol. See also, regarding written media, Commission Decision of 20.4.1999, Case IV/M.1455 – Gruner + Jahr/Financial Times, pt. 15: “From a product point of view, newspaper editors operate in two broad markets: the market for written press, in which consumers are the buyers of the newspapers as a source of information and the markets for advertising space, in which the consumers are the advertisers who buy space in order to promote sales”.

⁹⁹⁶ See, for examples of mergers where single and collective dominance findings were made, the Press release of the German Bundeskartellamt, “Bundeskartellamt prohibits merger between Springer/ProSiebenSat. 1”, 24.01.2006: “According to the Bundeskartellamt’s findings ProSiebenSat.1 and the RTL TV group, which belongs to the Bertelsmann group, together hold a dominant position in the TV advertising market with a constant market share of approx. 40 % over the last years (a so-called “uncompetitive duopoly” without any substantial competition from outsiders). The merger would lead to a further assimilation of the corporate structures of the two conglomerates in the neighbouring markets for newspapers and magazines and would result in a number of interlocks between Springer/ProSiebenSat.1 and Bertelsmann. This would further secure and strengthen the duopoly”; and the Spanish Competition Authority’s summary of the report-proposal in the second phase case C/230/10 TELECINCO/CUATRO: “(19) In the TV advertising market, given the total audience of the channels whose advertising would be managed by TELECINCO after the TELECINCO / CUATRO concentration, if the advertising of those channels was to be marketed jointly it could become an indispensable outlet for advertisers. (20) Furthermore, the current arrangement of the TV advertising market could allow and encourage tacit coordination between the resulting entity and its main competitor, ANTENA 3”. Interestingly, in the recent merger between the number two and three players in the Spanish open TV market, the Spanish Competition Authority has found that each of the two leading operators (Telecinco and Antena 3) are already indispensable partners for advertisers and the merger between Antena 3 and La Sexta will reinforce this indispensability (unilateral effect) and raise the risk of tacit collusion between the two leaders (coordinated effect). See, in particular, pp. 3-4 of the Executive Summary (English version) prepared by the Authority in C/0432/12 ANTENA 3 / LA SEXTA: “Thus, in 2011 the market shares based on income from television advertising were: MEDIASET 43.6%; ANTENA 3 30.5%; LA SEXTA 11.4%; regional government television channels 8.9%. This is due to the fact that from the standpoint of major advertisers, it is not feasible in practice to dispense with sustained advertising on the television channels with the highest audience figures, because it would stand in the way of reaching the minimum objectives of coverage and immediacy in advertising campaigns, especially since RTVE’s departure from the market, with the result that its viewers may not be reached through television advertising campaigns. The indispensable nature of the main channels (especially Telecinco and Antena 3) to advertisers has been reinforced by packaging strategies implemented by MEDIASET and ANTENA 3 for advertising on various channels”. The Authority imposed far-reaching conditions on the merging parties that threatened the viability of the merger but the Government removed the most stringent conditions under its merger control powers and the merger was completed in October 2012.

or discriminatory practices in the selling of television airtime”, termed a Contract Right Renewal remedy, as a condition for the clearance of the Carlton/Granada merger,⁹⁹⁷.

In these cases, the end-consumer was on the other side of the two-sided platform but the competition authorities have considered that corporate advertisers were customers of the media platforms on an equal footing with media consumers. Consequently, competition authorities either conducted an isolated assessment of the advertising market (e.g., joint advertising agreement that increases prices or otherwise worsens the terms offered to advertisers) or considered that the creation or strengthening of market power in the advertising market would spill over the programming market, a waterbed effect that competition authorities have consistently rejected as a matter of principle in the grocery sector.

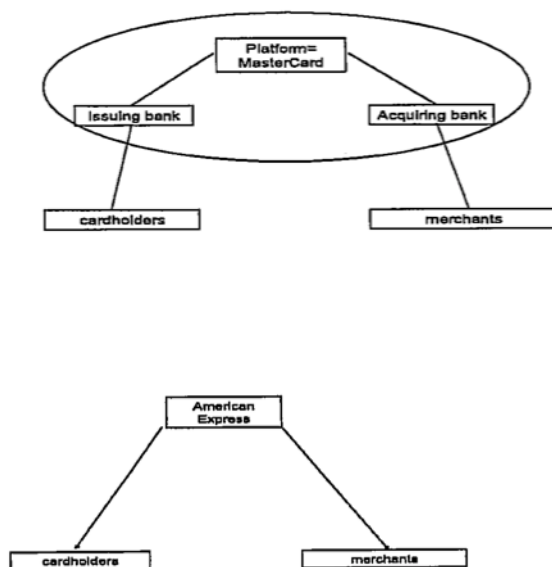
8.2.7 Card Payment Networks

Card payment networks can be vertically integrated (three-party networks such as American Express)⁹⁹⁸ or open to competing issuing/acquiring banks (four-party networks such as Visa and MasterCard)⁹⁹⁹.

⁹⁹⁷ See <http://www.adjudicator-crr.org.uk/index.htm>. The Contract Rights Renewal remedy imposes three main conditions: (1) A no worse off remedy: The remedy caps the maximum commitment from advertisers to ITV. It gives advertisers and media buyers the right to renew their current contracts with Carlton and Granada in future with no increase in the share of their spend that they commit to ITV and no reduction in the discounts they receive. (2) An automatic "ratchet" - a linkage which will reduce the amount advertisers will have to commit if ITV's audience shrinks. (3) An Adjudicator to make sure that fair competition prevails. The role of the Adjudicator is to ensure that Carlton-Granada respond fairly when the demands of advertisers or buyers change from time to time. The Adjudicator will act as an expert to determine the outcome of disputes between Carlton-Granada and its advertising customers. The Adjudicator will be a single individual, based at Ofcom's Riverside House headquarters but will be independent of Ofcom. Ofcom will pay for the costs of the Adjudicator in the first instance and will be reimbursed by Carlton-Granada. In examining a dispute the Adjudicator will have access to all of the merged Carlton-Granada's contracts and trading information. His/her decisions will also be final and binding on Carlton-Granada. Advertisers and media buyers will have a right of appeal to Ofcom under defined circumstances and thereafter to the courts if required.

⁹⁹⁸ In a closed (three-party) payment card system such as American Express or Dinners, the system owner directly signs up cardholders and merchants.

⁹⁹⁹ The Commission has dealt with card payment networks under competition rules in the following decisions: Commission Decision of 9 August 2001, Case No COMP/29.373 — Visa International, OJ L 293, 10.11.2001 (“the Visa Decision 2001”, negative clearance); Commission Decision of 24 July 2002, Case No COMP/29.373 — Visa International — Multilateral Interchange Fee, OJ L 318, 22.11.2002 (“the Visa Decision, 2002”, exemption); Commission Decision of 19.12.2007, Case COMP/34.579 MasterCard (“the MasterCard Decision”) and Commission Decision of 8.12.2010, Case COMP/39.398 - Visa MIF (“the Visa Decision 2010”, commitments). For a general description of the relevant markets, see Visa Decision 2001: “(34) Two types of competition relevant to payment cards can be distinguished. The first is between different payment systems/networks (different payment card schemes/networks and possibly means of payment other than cards), while the second is between financial institutions (usually banks) for card-related activities (essentially issuing of cards to individuals and "acquiring" of card payments from merchants). The former of these two types of competition is conventionally termed "system/network market" or "upstream market", while the latter is conventionally termed "intra-system or downstream market". On the intra-system markets, within each payment system (Visa, for example), financial institutions compete with each other to issue cards bearing that brand or to acquire merchants accepting that card”.



Source: *The MasterCard Decision 2010*.

Three-party networks charge directly card-holders and retailers for joining the card payment network, whereas four-party networks allow the so-called issuing and acquiring banks within their system to charge respectively card-holders and retailers. Furthermore, in four-party networks, issuing banks and acquiring banks have to enter bilateral agreements between them. They can agree on a fee for the services provided among them or they may rely on a default multilateral interchange fee (MIF) set by the network. The MIF is traditionally biased in favour of the issuing banks in order to promote in-take of credit card holders. This may lift upwards the fees charged by acquiring banks to retailers and has caused controversy.

On the one hand, card payment systems argue that the MIF and the restrictions imposed on retailers (such as the no surcharge rule and no-discrimination rule) are necessary in order to promote growth of credit card intake and usage by customers and offer them improved services¹⁰⁰⁰. On the other hand, retailers and most notably supermarkets have bitterly complained against the MIF and the restrictions imposed by the networks for many years¹⁰⁰¹. However, no single or dominant position has ever been found in the

¹⁰⁰⁰ Card payment networks have not even argued that the MIF is related to the services provided by issuers to acquiring banks. Instead, they have defined “interchange fees ‘as a mechanism for balancing cardholder and merchant demand for a payment scheme’s services that operates by allocating between the scheme’s issuers and acquirers the cost of delivering the service’” (par. 153 of the MasterCard Decision).

¹⁰⁰¹ Interestingly, retailers, in particular those operating in grocery field, have fiercely challenged the amount of the access fees and other competitive restraints imposed on them by their card payment networks (e.g., the acquiring banks). They have filed several complaints before competition authorities, developed intense lobbying before public authorities and executed an aggressive media campaign. See, for example, European Retail Round Table’s website, <http://www.ertt.org/key-topics/payment-cards> (“Prices in Europe are artificially inflated because of hidden fees for debit and credit cards transactions, fees which all shoppers end up paying for. The payment cards cartel argues that these fees are essential to run card schemes, whilst there are card schemes in Europe which operate successfully without hidden

card payment network market. The absence of dominant operators and the intense competition between networks has not dissuaded regulators (e.g., Central Banks) and competition authorities across the world from taking measures in order to suppress or curtail MIFs and the restrictions imposed on retailers.

In the field of payment cards, the European Commission has relied on Article 101 TFUE to address some of the unilateral practices of the two largest payment card networks, Visa and MasterCard, which were considered to harm retailers¹⁰⁰². In particular, the Commission has considered that the MIFs established by Visa and MasterCard serve as a lower ceiling when acquiring banks negotiate merchant fees with retailers. This restricts competition in the acquiring market to the detriment of retailers and, as long as these fees are passed through higher retail prices, retail shoppers as well.

The competition law intervention in this area rests on three main grounds:

(1) Market power is found below single-firm dominance level

Aware that an Article 102 TFEU was not an option under a conventional competition analysis in a market dominated by three main players (Visa, MasterCard and AmEx), the European Commission “creatively” considered that the fallback interchange fees were decisions of the association of banks that integrated the Visa and MasterCard networks falling under Article 101 TFEU. MasterCard strongly argued that it was a single autonomous entity following a public IPO in 1996 and a related amendment to its governance rules. Accordingly, MasterCard argued that the Commission should have assessed the MasterCard’s network as “a set of bilateral relationships akin to any licensor-licensee / franchisor-franchisee relationship”¹⁰⁰³. However, the Commission relied on a “lifting the corporate veil” type of reasoning to reject MasterCard claims¹⁰⁰⁴.

fees! Europe's retailers want the best for Europe's shoppers in terms of price, quality, service and choice. We believe Europe's shoppers have the right to know. We believe that there should be pan-European competition and real transparency concerning all fees and charges levied on credit and debit cards use.”); EuroCommerce’s website, <http://www.eurocommerce.be/content.aspx?PageId=39895>; and the website set up by EuroCommerce to denounce the fees paid by retailers and the restrictions imposed upon them by card payment networks, www.stopunfaircardfees.eu (“Europe’s retailers want the best for Europe’s shoppers - in terms of price, quality, service and choice. But prices in Europe are artificially inflated because of hidden fees for debit and credit cards – fees which all shoppers end up paying for. We believe Europe’s shoppers have the right to know. That’s why we have set up this website – to inform shoppers of the hidden fees and to encourage decision-makers to crack down on the hidden fees and anti-competitive practices of Visa, MasterCard and the banks behind them”).

¹⁰⁰² Some authors have argued that Visa and MasterCard’s related practices in the market could have been addressed under Article 102 TFUE as an abuse of a collective dominant position (see, for example, Bijkerk, “The price of plastic: Interchange fees and EC Competition Law”, Thesis, Master International and European Law, University of Groningen, August 2008). However, the European Commission has never addressed oligopolies under Article 102 TFUE.

¹⁰⁰³ The MasterCard Decision, par. 333.

¹⁰⁰⁴ *Id.*, par. 99: “The banks were a driving force behind the IPO of MasterCard Incorporated. They agreed to it as they knew that the new management on the Global Board would continue to act in their common interest. While the European banks were aware that they would lose control over the body setting Intra-EEA fallback interchange fees, they consented to the change in the organisation’s governance with the expectation that the independence of the Global Board would reduce each individual bank’s exposure to regulatory scrutiny and antitrust litigations, thereby safeguarding their proceeds from interchange and maintaining the MasterCard MIF as part of the business model. Considering the IPO in

MasterCard's argument that the MIF was a unilateral conduct and not an agreement between the member banks was critical to avoid antitrust scrutiny: the application of Article 101 TFEU only covers agreements between undertakings or decisions by associations of undertakings and, in the absence of a dominant position, Article 102 TFEU cannot address otherwise abusive practices¹⁰⁰⁵. However, the Commission rejected this defence and counterclaimed that even if no association of undertakings existed, the MIF could still be considered a vertical restraint subject to Article 101 TFEU¹⁰⁰⁶.

In the US, the Antitrust Division of the DOJ and some States have also relied on Article 1 of the Shearman Act, a provision equivalent to Article 101 TFEU, against some of the restraints imposed on retailers directly or indirectly by Visa, MasterCard and even American Express¹⁰⁰⁷. The DOJ inferred market power from direct evidence of merchant's willingness to accept payment cards in order to respond to shoppers' preferences for card payments¹⁰⁰⁸ and not to lose business to competitors accepting these cards¹⁰⁰⁹. Furthermore, the DOJ noted that the three networks had been able to raise merchant fees without losing business¹⁰¹⁰ and had been able to discriminate in the prices fees charged to different type of customers¹⁰¹¹. After listing this evidence, the complaint referred to the networks' market shares in dollar volume: Visa, 43%; MasterCard, 27%; and American Express, 24%¹⁰¹². In the separate market for Travel &

its overall context, the banks voting in favour of the corporate changes to MasterCard Incorporated "outsourced" the co-ordination of their competitive behaviour to an independent body while maintaining control of decision making on other key matters that are not sensitive from an antitrust perspective." See also Sections 7.1.1 ("Association of undertakings") and 7.1.2. ("Decisions by an association of undertakings").

¹⁰⁰⁵ *Id.*, par. 397: "The Commission disagrees with MasterCard's argument that since the IPO interchange fee are "unilaterally" imposed on member banks in a supplier-customer like relationship. Rather, as any other decision of the organization's management bodies, the MIF remains the faithful expression of the association's resolve to coordinate the commercial conduct of its members.

¹⁰⁰⁶ *Id.*, par. 399: "At any rate, even if after the IPO MasterCard Incorporated's relation to banks qualified as that of a franchisor to franchisees rather than being an horizontal form of cooperation within an association of undertakings this is no reason why the MIF should fall outside the scope of Article 81(1) of the Treaty. As is apparent from Commission Regulation (EC) No 2790/1999 anti-competitive aspects of franchise agreements may restrict Article 81(1) of the Treaty, too. MasterCard has provided no reason let alone evidence why the MIF would escape the prohibition of Article 81(1) of the Treaty if it were a vertical restraint."

¹⁰⁰⁷ See *US and some States v. American Express Company, American Express Travel Related Services Company, MasterCard International Incorporated and Visa*, Civil Action No. CV-10-4496, 04.10.2010, US District Court, Eastern District, New York ("US American Express, MasterCard and Visa Litigation 2010"), par. 2: "Plaintiffs bring this action to prevent Defendants from imposing on merchants certain rules, policies and practices ("Merchant Restraints") that insulate Defendants from competition. The Merchant Restraints impede merchants from promoting or encouraging the use of a competing credit or charge card with lower acceptance fees. Each Defendant's Vertical Restraints are directly aimed at restraining horizontal interbrand competition." By judgment of 20 July 2011, the District Court accepted a settlement between the plaintiffs and Visa and MasterCard. The case against American Express is pending.

¹⁰⁰⁸ *US American Express, MasterCard and Visa Litigation 2010*, par. 57.

¹⁰⁰⁹ *Id.*, par. 58.

¹⁰¹⁰ *Id.*, pars. 59-60.

¹⁰¹¹ *Id.*, par. 62.

¹⁰¹² *Id.*, par. 63: "Each of these market shares is consistent with market power in a market with high concentration and other particular characteristics of the General Purpose Cards network services market.

Entertainment (T&E) the market shares were even lower: American Express, 37%; Visa, 36%; and MasterCard, 24%¹⁰¹³. Finally, the complaint mentioned the barriers to entry and expansion, including defendants' Merchant Restraints¹⁰¹⁴.

(2) *Two-sided demand (platforms) does not justify a single product market definition*

The European Commission has concluded that there are two groups of consumers of the payment card networks on an equal footing: "cardholders and merchants (as well as subsequent purchasers)"¹⁰¹⁵. Interestingly, under a conventional consumer surplus analysis, one could conclude that competition policy should favour end-users (cardholders) over retailers. However, by placing retailers on an equal footing with cardholders, the Commission was able to conclude that the MIF adopted by MasterCard restricted competition in the acquiring banks market to the detriment of retailers¹⁰¹⁶, regardless of their cross-benefits for card-holders¹⁰¹⁷. Certainly, the Commission also referred theoretically to potential harm inflicted to the retailers' customers, especially those not using cards¹⁰¹⁸, but the argument was highly speculative¹⁰¹⁹.

For example, the Second Circuit held that MasterCard had market power with a share of 26%. *US v. Visa U.S.A. Inc.*, 344 F. 3d at 239-40. In subsequent litigation, American Express itself alleged that MasterCard "exercised market power in the network services market" when MasterCard's "share was approximately 26%", quite similar to American Express' share in the market for General Purpose Card network services to merchants today". Par. 57 also deals with American Express' alleged market power: "Merchants choose payment networks to accommodate the preferred payment brands of their customers. Some customers strongly prefer a particular brand and in some cases carry only one General Purpose Card brand. For example, in August 2009, 16% of American Express' cardholders used only American Express and no other major General Purpose Cards. Such high cardholder insistence on using American Express gives American Express market power over merchants."

¹⁰¹³ The MasterCard Decision, par. 68.

¹⁰¹⁴ *Id.*, par. 66-67.

¹⁰¹⁵ *Id.*, par. 258; and the Visa Decision 2010, par. 82. For a general policy declaration, see the MasterCard Decision, par. 266: "MasterCards's concept of market definition is also inconsistent with the Commission's long standing case practice in defining product markets in industries with two-sided demand (...)". See also US American Express, MasterCard and Visa Litigation 2010: "40. In addition to selling General Purpose Card network services to merchants, Defendants provide separate network services to a different group of customers: issuers, which provide General Purpose Cards to cardholders. Questions of market power and harm are distinct for the two separate customer groups. Sellers of General Purpose Card network services to merchants could exercise market power over merchants even in circumstances in which they could not exercise market power over issuers. Any benefits received by issuers are not necessarily shared with merchants, and would not offset anticompetitive harm imposed by networks on merchants."

¹⁰¹⁶ The MasterCard Decision, par. 407.

¹⁰¹⁷ *Id.*, par. 453 and, in particular, par. 454: "That argument cannot be accepted. Under Article 81(1) of the Treaty there is legally no reason why the negative effects of the MIF on prices in the acquiring markets to the detriment of merchants (and subsequent purchasers) should not constitute a restriction of competition because of potential benefits which a MIF may create for cardholders".

¹⁰¹⁸ *Id.*, par. 411.

¹⁰¹⁹ Curiously, the retailers and the European Commission have argued that the high card fees increase the prices of the goods sold by retailers. This argument seems to contradict the conclusions of the European Commission regarding the price-competitiveness of the grocery retail market, where access fees are on the rise. The European Commission should explain why retailers' customers are potentially harmed by the high card fees faced by retailers and not when the high listing fees are imposed on independent brands and, indirectly, on their selling prices.

(3) *Retailers do not constraint platform's behaviour*

The European Commission and other competition authorities have claimed that card payment networks and the acquiring banks are not constrained by retailers¹⁰²⁰. Customers tend to value highly the opportunity to pay with the credit card of their choice and retailers tend to accept restrictive clauses and higher card fees instead of canceling card acceptance and risk losing a substantial volume of sales¹⁰²¹. In essence, the Commission took into account that a large number of retailers are captive of the large card payment networks and, therefore, cannot exercise any meaningful countervailing power against them¹⁰²². The Commission's case focused on Visa and MasterCard's MIFs only, but the litigation in the US extended to American Express as well, showing that even a comparatively smaller card payment network such as American Express can impose restrictive clauses and high merchant fees (up to the point of exceeding those of the leading networks), thereby replicating the three-party networks' asymmetric pricing structure model. As MasterCard argued before the European Commission, "while only open payment systems have an *explicit* MIF, closed

¹⁰²⁰ The MasterCard Decision, pars. 258-259 (suggesting that retailers are reluctant to cancel payment cards once accepted and as the number of card holders grow card payment becomes a "must"); Section 7.2.5.2 ("no sufficient constraints from merchants"); and Section 4 (it quotes retailers' claims that they are dependent on card acceptance for their business).

¹⁰²¹ See, in particular, pars. 505-506 of the MasterCard Decision and the US American Express, MasterCard and Visa Litigation 2010: "55. Visa, MasterCard, and American Express each possess market power in the General Purpose Card network services market. The Second Circuit previously held that MasterCard and Visa each has market power in a General Purpose Card network services market. *U.S. v. Visa U.S.A., Inc.*, 344 F.3d 229, 238-39 (2d Cir. 2003). American Express also possesses market power in the General Purpose Card network services market. 56. Merchant acceptance of Defendants' General Purpose Cards is widespread. Merchants accounting for a substantial amount of General Purpose Card purchase volume in the United States accept all three Defendants' General Purpose Cards. 57. Merchants choose payment networks to accommodate the preferred payment brands of their customers. Some customers strongly prefer a particular brand and in some cases carry only one General Purpose Card brand. For example, in August 2009, 16% of American Express cardholders used only American Express and no other major General Purpose Cards. Such high cardholder insistence on using American Express gives American Express market power over merchants. 58. Merchants also consider whether their competitors accept a network's General Purpose Card and, if so, feel additional pressure to accept that network's card. Indeed, many merchants must accept all Defendants' General Purpose Cards to remain competitive with other merchants."

¹⁰²² See, in particular, Annex 2 ("Analysis of MasterCard's methodological criticism regarding the Commission's merchant market survey") of the MasterCard Decision. The Commission highlighted the following factors contributing to retailers' captivity: "91% of the respondents [merchants] observed that they never cancelled a payment card once they started accepting it" (par. 22); "the most important reasons to accept cards are not related to transactional benefits but rather linked to the fact that most customers carry a particular card (90%) and the need to maintain an image as customer friendly company (67%)" (par. 22); "if 41% of the merchant community are assumed to have to accept cards as opposed to 35% [who "considered themselves *not* unable to refuse a card once the number of cardholders had increased above a certain threshold"], then the *majority* of merchants consider payment card acceptance as "a must" or – in MasterCard's words- "merchants are transaction hungry" (par. 23). Furthermore, the Commission emphasized that the low level of card acceptance in the EU did not undermine merchant captivity: "MasterCard's finding of a "relatively low acceptance of payment cards across Europe is no evidence for the absence of merchant captivity. It is not because some customers do not buy a certain product/service that do who do are in a position to exercise sufficient constraints to avoid a price increase above supracompetitive levels". In particular, it does not disprove the Commission's finding that the majority of merchants accept cards, in particular because they risk losing business if they did not ("business stealing effects")" (par. 24).

systems would operate with an *implicit* MIF in the sense that cardholder fees would not necessarily reflect costs on the issuing side and MSCs would not necessarily reflect costs on the acquiring side”¹⁰²³.

On the regulatory front and following a public consultation on this issue, the European Commission has proposed a Regulation on interchange fees¹⁰²⁴. This regulatory proposal impliedly admits that competition law enforcement has not been sufficient in this market and has built a “creative” (to say the least) theory of harm whereby it is alleged that competition to attract card-users drives up MIFs (“inverse competition”) and harms retailers and shoppers paying in cash or with debit cards (“poorer customer”) at the expense of the “richer consumer” paying with credit cards. This regulatory proposal builds on the existence of a category of market power of the card networks over merchants (or economic dependence of the latter) that would not certainly qualify as a dominant position under the conventional competition analysis.

In essence, the European Commission’s stance on MIFs implicitly relies on Armstrong’s model of a competitive bottleneck platform where the harm inflicted on one side (merchants) is considered to outweigh the consumer welfare eventually generated on the other side (card-holders)¹⁰²⁵. The outstanding question is why the same analysis conducted in the market for card payment networks is absent in the grocery retail market.

8.2.8 Aftermarkets

In several occasions, competition authorities have found a separate market for the spare-parts and/or repair/maintenance services of specific brands. In the motor vehicle sector, the European Commission has mandated non-discriminatory access of independent providers of repair/maintenance to the spare-parts and services of the car manufacturers’

¹⁰²³ The MasterCard Decision, par. 620. The Commission has never explained why it has not so far pursued American Express’ merchant fees (substantially higher than those prevailing in Visa’s and MasterCard’s networks). The answer may lie in the very low market share (>5%) held by American Express in the EU. However, it would be interesting to know if the Commission believes, by analogy with the reasoning it exposed in the MasterCard Decision, that the American Express-merchant relationship falls under Article 101 TFEU and the contractual clauses could eventually be considered vertical restraints in breach of the said article.

¹⁰²⁴ See Commission Green Paper, “Towards an integrated European market for card, internet and mobile payments”, COM/2011/0941 final, 11.01.2012, Proposal for a Regulation of the European Parliament and of the Council on interchange fees for card-based payment transactions, COM/2013/550-3, 24.07.2013.

¹⁰²⁵ Almunia, “A fair and open system for payments in the Single Market”, European Payments Council Plenary meeting, Brussels, 14.12.2011: “On the one hand, card schemes compete for issuing banks by offering higher interchange fees; acquiring banks then charge these fees to retailers who cannot refuse for fear of losing customers. On the other hand, banks and payment-card schemes create incentives for consumers to use the high-fee cards, and consumers are happy to use them because they cannot see the true costs of payments. This system leads to a form of inverse competition – a competition for higher fees – which is clearly not in the interest of merchants, consumers, and the market as a whole. Inverse competition is a fact; the most expensive schemes are actually taking over the market in parts of the Union. In the UK – for instance – the market is moving towards Premium cards, which for the moment are not under the scrutiny of competition-enforcement authorities”.

networks without ever concluding that any of them, let alone their specific car brands, holds a dominant position in the motor vehicle market or the aftermarkets¹⁰²⁶.

8.3 Economics of access fees

Economists have noted the growing importance of access fees in the grocery retail market and have tried to analyse their competitive effects.

8.3.1 Pro-competitive effects

Two main economic theories defend the pro-competitive effects of access fees in the grocery retail sector.

8.3.1.1 Compensation for new product costs

Different authors have focused on the charges for new product slots (e.g., “introduction fees”). They argue that listing new products implies a transaction and opportunity cost for supermarkets and slotting fees serve as a signalling or screening mechanism to

¹⁰²⁶ Almunia, “New competition rules for the car sector Press Conference Brussels”, SPEECH/10/270, 27.05.2010: “Since the 2002 Regulation was adopted, experience has taught us that competition on the repair, maintenance and spare parts markets is not very strong. These are markets where one player – the brand network – often has a market share of over 50%. In these circumstances, if the rules aren’t strong enough, consumers may be harmed by anti-competitive practices that push up repair costs. Independent garages constitute an important source of competition for brand networks. Unfortunately, they are also vulnerable to behaviour by car manufacturers that shuts them out of the market, such as failure to grant access to technical information or refusal to honour warranties if consumers use their services. Behaviour of this type really harms consumers by pushing up the cost of repair. As you know, it costs a lot to keep a car on the road - repair bills account for 40% of the total cost of ownership. And unlike car prices, the cost of the average repair and maintenance job has actually risen over the past years”; and “Introductory remarks to European Parliament on review of Motor Vehicle Block Exemption Regulation”, European Parliament Plenary Session, SPEECH/10/214, 5.05.2010: “First, we learned something positive: that consumers in Europe enjoy vigorous competition in the car sales markets. In our annual car price reports we have been reporting on 80 car models of around 25 manufacturers. And prices aren’t the only factor that tells us that competition is healthy. There is also more choice than there was ten years ago, with more brands available for each type of car. In these circumstances it would be difficult to suggest that any carmaker would be able to exercise a dominant position, be it individually or collectively. The current regime contains sector-specific rules that made sense at that time when a wave of consolidation was expected in the vehicle sector. This did not materialise, and instead what we have today is a very competitive market. (...). Concerning the reason why we are proposing to do away with clauses granting contractual protection to the dealers, it is simply because competition law is not the appropriate instrument to address eventual imbalances between contractual parties. These issues belong to the sphere of commercial law. In a competitive market such as the car market, competition law should not interfere with the balance of powers between the different contracting parties. To do so would be intrusive. And we have to be proportionate when we interfere in how markets work. But we also learned something less positive throughout this consultation process: unlike car prices, the cost of the average repair job has actually risen over the past years. Repair and maintenance is very important for consumers, not only for reasons of safety and reliability, but also because repair bills account for 40% of the total cost of owning a car. Unfortunately, the ability of independent garages to compete with authorised repairers is still impaired by a number of restrictions, including limited access to spare parts and to technical information. Therefore, this reform intends to allow independent garages better access to spare parts and technical information, and to prevent them from being shut out of the market by other, newer practices. This will result in better quality repair services and lower prices.”

verify the success potential of new products¹⁰²⁷. Another branch of the new product introduction theory argues that slotting fees serve to price costly and limited shelf-space in a competitive market, thereby efficiently equating the demand and supply for product diversity¹⁰²⁸. Indeed, supermarkets have publicly argued that access fees are aimed at screening and facilitating efficient innovations¹⁰²⁹.

8.3.1.2 Promotional shelf-space

Klein and Wright have provided a lucid critique of the mainstream theories supporting the pro-competitive effects of access fees, while advancing a different pro-competitive theory based on “promotional shelf-space”¹⁰³⁰. Their theory assumes the new economic paradigm: supermarkets are no longer passive conduits of consumer demand; they do actually influence and even prescribe it¹⁰³¹. In particular, they can influence consumer demand through their offering of prominent shelf-space to their existing suppliers¹⁰³².

In this new scenario, the conventional merchant model under which the manufacturers merely set wholesale prices for their products and let retailers independently choose which products to stock and prominently display, is complemented with a slotting fee for the supply of promotional shelf space. These promotional services facilitate a targeted effective price discount to particular consumers who otherwise would not buy the product (marginal consumers)¹⁰³³.

However, some of the assumptions of the promotional shelf-space theory seem to be flawed, whereas some of their justifications for promotional payments point towards consumer harm. The main critiques to this theory can be summarised as follows:

- (1) It admits that payment for these promotional services may increase prices for the infra-marginal consumers who would buy the product without promotional

¹⁰²⁷ See, for example, Chu, “Demand Signalling and Screening in Channels of Distribution”, *Marketing Science*, 11, 1992; Lariviere and Padmanabham, “Slotting Allowances and New Product Introductions”, *Marketing Science* 16, 1997; and Desiraju, “New Product Introductions, Slotting Allowances and Retailer Discretion”, *Journal of Retailing* 77, 2001.

¹⁰²⁸ Sullivan, “Slotting Allowances and the Market for New Products”, *Journal of Law and Economics* 40, 1997, pp. 461-93.

¹⁰²⁹ Shotlander 2006, p. 1276: “In the 2003 FTC Study on slotting practices, six of the seven retailers that provided information claimed that slotting fees charged for new products compensate for the time and financial burden these new products require.”

¹⁰³⁰ Klein 2006.

¹⁰³¹ *Id.*, p. 8: “In contrast to abstract economic models, where consumers are assumed to know the products they want before they enter a store and the sole function of retailing is to reduce shopping costs by providing consumers with their desired products, retailers in the real world have the ability to influence consumer purchases with their stocking and display decisions.”

¹⁰³² *Id.*, p. 16: “Although individual retailers operate in a highly competitive environment, they have the ability by allocating promotional shelf space to a particular branded product to induce sales of that product to “marginal consumers”.

¹⁰³³ To operate, however, such promotional services must be provided free of charge. As with other forms of promotion, consumers are not willing to pay the cost of providing the promotional shelf space, and charging for it would defeat its economic purpose of providing an effective price discount to a subgroup of consumers.

services¹⁰³⁴, hypothesis that they confirm in their discussion of the trade-off between slotting fees and wholesale price reductions.

- (2) It assumes that incentivizing retailers to engage in price competition generally is not a problem¹⁰³⁵. However, if the retail market is highly transparent and supermarkets may quickly adapt their prices, supermarkets are not particularly interested in price competition. Indeed, their discussion of the trade-off between slotting fees and wholesale price reductions shows that supermarkets prefer and thus impose slotting fees rather than wholesale price reductions.
- (3) It concedes that supermarkets also enjoy some market power in pricing and product selection but argue that supermarkets face more elastic demand than manufacturers¹⁰³⁶. Consequently, although retailers do not take account of the manufacturer's much larger profit margin on incremental sales when lowering price, this does not cause a problem in terms of producing too little retailer price competition. The manufacturer can be assured that retail price competition will be approximately optimal¹⁰³⁷. However, evidence shows that consumers select a large majority of the grocery brands in the store and are ready to switch to competing brands where they do not find their preferred one in the store. Therefore, a reduction of the price of a brand in a supermarket is likely to produce significant inter-brand (intra-store) effects. When supermarkets are vertically integrated, neither manufacturers nor competition authorities can be assured that retail price competition is optimal.
- (4) It holds that, in contrast to price competition, there are no inter-retailer competitive effects to offset the fact that retailers do not take account of the manufacturer's margin when deciding to prominently display the manufacturer's product. Therefore, without a separate contract, retailers will not supply promotional shelf space for the manufacturer's product that maximizes joint profit of the retailer and manufacturer. However, the alleged absence of inter-retailer effects does not imply that supermarkets have no incentive to maximize

¹⁰³⁴ Klein 2006, p. 6, footnote 18: "An obvious question is whether supplying an effective price discount to marginal consumers in this way increases the actual market price. Since infra-marginal consumers, who would purchase the product without promotional shelf space, are unlikely to receive any value from the shelf space, the provision of promotional shelf space can be thought of as shifting demand out only for marginal consumers, and by increasing the marginal elasticity of demand result in a decrease in the manufacturer's profit-maximizing price. More generally, promotion can produce some value for infra-marginal consumers, leading to an increase or decrease in the market price. When the market price increases, the net price, i.e., the market price minus the value of the promotional services, will decrease for marginal consumers but possibly increase for some infra-marginal consumers."

¹⁰³⁵ *Id.*, p. 11.

¹⁰³⁶ *Id.*, p. 13: "Individual retailers generally face less than perfectly elastic demands with respect to price and product selection because they possess unique specific factors, such as a particular locational advantage or a reputation for supplying preferred service or for carrying the variety of products desired by a particular group of consumers. But retailers are assumed to face much more highly elastic demands than manufacturers. An individual retailer's reduction in the price of a particular manufacturer's product, while it may lead some of its customers to switch from rival brands to the now lower-priced brand, will also lead consumers that are purchasing that particular product from other retailers to shift their purchases to the retailer that has lowered price".

¹⁰³⁷ *Id.*, p. 15.

the profitability of their assets, including promotional displays, vis-à-vis their customers¹⁰³⁸.

- (5) It claims that competitive bidding for shelf space can be expected to result in a different distribution of products than otherwise would be chosen by retailers. The manufacturers with the greatest profitability from incremental sales (the products with the greatest promotion-induced increase in sales multiplied by the manufacturer margin) will be able to pay the most for shelf space and will win this competition¹⁰³⁹. However, the promotional fees simply ensure that the supermarkets obtain the greatest profitability from incremental sales (i.e., products with the greatest promotion-induced increase in sales multiplied by the supermarket margin), an outcome that can be achieved through the retail competition (consumer demand) process.
- (6) It contends that supermarkets that receive shelf space payments on a per unit time basis do not earn greater than normal profits because supermarkets face significant inter-retailer competition with regard to overall pricing, product selection and service quality¹⁰⁴⁰. By considering low sector-wide net profits after taxes as a measure of grocery retail competition, they overlook the network effect exploited by the leading vertically integrated supermarkets: better purchase terms (high access fees and low purchase prices) serve to (1) expand their capacity (sales) in the homeland or abroad and (2) favour their own brand. This competitive dynamic stabilises/reduces inter- and intra-store competition and allows them to achieve greater returns than their smaller counterparts.
- (7) It admits that from a manufacturer's perspective there will be an advantage in compensating retailers for shelf space with a lower wholesale price because this creates an incentive for retailers to lower prices and increase manufacturer sales¹⁰⁴¹. Furthermore, a wholesale price reduction also is a superior way to measure the market value of the shelf space provided by a retailer since differences in shelf space quality across retail stores and across locations within a store will be related to product sales¹⁰⁴². However, they claim that the costs of inter-retailer competition outweigh these advantages, which leads to slotting fees being more profitable for retailers than lower wholesale prices¹⁰⁴³. Therefore, it

¹⁰³⁸ Since promotional display increases sales to marginal consumers, supermarkets do have an incentive to supply the optimal promotional display (i.e., the one that generates more profits for the supermarkets).

¹⁰³⁹ Klein 2006 contends that without shelf space contracts with manufacturers, retailers would allocate shelf space across products so that retailer incremental profit would be approximately the same across all products.

¹⁰⁴⁰ *Id.*, p. 24: "Any individual supermarket that does not use the rents collected from slotting fees to reduce its quality-adjusted prices can be expected to lose significant sales and thereby collect lower slotting fees. Consequently, the existence of per unit time slotting fees does not result in consumers paying higher grocery prices or supermarkets earning higher profits."

¹⁰⁴¹ *Id.*, p. 25.

¹⁰⁴² *Id.*, p. 25.

¹⁰⁴³ *Id.*, pp. 25-26: "Inter-retailer competition, therefore, will lead retailers to decrease price more than they will increase sales and the manufacturer's shelf space payments to retailers will be eroded. Consequently, the manufacturer must reduce the wholesale price more [...] in order for the retailer to earn the equilibrium per unit time shelf space rental return. Manufacturers must make this "extra" reduction in

is implicitly accepted that supermarkets (1) fix the value of the promotional shelf-space; and (2) prefer slotting fees instead of lower wholesale prices, in order to avoid competing away this rent¹⁰⁴⁴. Furthermore, the empirical observation that slotting fees prevail in products subject to high inter-retailer competition, tends to undermine, rather than support, the assumption that these payments do not have an effect on retail prices¹⁰⁴⁵.

8.3.2 Anticompetitive effects

Taking stock of the link between access fees and the increased market power of supermarkets, a growing number of authors have assessed the anticompetitive effects of access fees.

Back in 1991, Schaffer claimed that slotting fees help supermarkets reduce price competition at the retail level while increasing their upfront revenues¹⁰⁴⁶. In his model, retailers who receive slotting allowances benefit in two ways. The lump-sum payments go directly to their bottom line and the higher wholesale prices reduce price competition. By not seeking a lower wholesale price, a retailer essentially announces its intention to be less aggressive in its pricing. Other firms are induced to raise their retail prices, and the original firm gains through the feedback effects. Furthermore, in response to the economists led by Mary Sullivan, who defended the role of access fees in guaranteeing the socially optimal product variety, Schaffer showed that access fees can be strategically used with anticompetitive purposes in intermediate-good markets¹⁰⁴⁷: access fees may be used to exclude competing brands¹⁰⁴⁸ and consumer

the wholesale price because retailers must be compensated at the market rate for supplying shelf space or they would prefer to supply their promotional shelf space to another manufacturer, including manufacturers that provide compensation at least partially with a per unit time payment.”

¹⁰⁴⁴ *Id.*, p. 29: “Therefore, retailers will lower retail price in response to a manufacturer’s wholesale price decrease by substantially more than if they were only selling to marginal consumers and faced no inter-retailer competition, increasing the manufacturer’s wholesale price decrease required to compensate retailers for shelf space. As the share of total sales made to infra-marginal consumers increases, it becomes more likely that a per unit time payment based on expected sales to marginal consumers will be the efficient way for manufacturers to compensate retailers for promotional shelf space.”

¹⁰⁴⁵ *Id.*, pp. 26-27 and p. 30: “The possibility of inter-retailer competitive dissipation of shelf space rents when retailer compensation is in the form of a lower wholesale price also explains why slotting fees are more likely to be used for products where shelf space arrangements are longer-term, where consumers are more likely to obtain comparable price information across retailers.”

¹⁰⁴⁶ Schaffer 1991, pp. 120-135.

¹⁰⁴⁷ Schaffer 2005, p. 2: “This line of reasoning presumes that allocating scarce shelf space according to willingness-to-pay ensures socially optimal product variety. While this presumption may seem intuitive, it ignores two fundamental aspects of intermediate-goods markets. First, unlike in standard consumer theory where buyers’ valuations are independent, a manufacturer’s willingness-to-pay for shelf space will depend, among other things, on the degree of substitution among the competing products. The more substitutable are the products, the more a manufacturer will be willing to pay to acquire shelf space in order to avoid competing with its rivals. Second, unlike in standard consumer theory where individual buyers are too insignificant to affect prices, the price of shelf space to any one manufacturer is endogenously determined by what the retailer could earn instead by selling its most profitable alternative. This allows manufacturers to be strategic in that each firm can raise its rivals’ cost of obtaining shelf space simply by increasing its own offer of slotting allowances”.

¹⁰⁴⁸ *Id.*, pp. 22-23: “The claim made by some commentators is that, by offering their shelf space to the highest bidders, retailers act as agents for consumers and ensure that only the most socially desirable

welfare is increased if they are prohibited¹⁰⁴⁹. More recently, Marx and Shaffer have argued that slotting fees may also foreclose retail competition under some assumptions¹⁰⁵⁰. Building on the Marx and Shaffer model, Rey, Miklós-Thal and Vergé argue that upfront payments combined with conditional fixed fees (i.e., three part tariffs that allow retailers to “opt out” in case prices become too low), ensure that no efficient retailer is excluded. However, this is achieved at the cost of monopolistic retail prices¹⁰⁵¹. They also deal with the welfare implications of banning slotting fees.

products obtain distribution. I show that this claim does not hold in a model in which a dominant firm and competitive fringe compete for retailer patronage. By using slotting allowances to bid up the price of shelf space, the dominant firm can sometimes exclude the competitive fringe even when welfare would be higher if the fringe obtained distribution. Moreover, slotting allowances are the *sine qua non* of this exclusion. If the dominant firm had to pay for exclusion by offering retailers lower wholesale prices, exclusion would not be profitable. Since the socially optimal product variety in the model is for both products A and B to be sold, it follows that slotting allowances are always (weakly) undesirable.”

¹⁰⁴⁹ *Id.*, p. 12: “When slotting allowances would otherwise be used by a dominant firm to exclude the competitive fringe, the gains from prohibiting slotting allowances can be decomposed as follows. Some consumers who would not pay the monopoly price for product A when product B was unavailable may buy when both products are available at Stackelberg leader-follower prices, respectively. These consumers are clearly better off. Consumers who would pay the monopoly price for product A, but who would switch to product B when it becomes available are also better off. Consumers who would continue to buy product A in the absence of slotting allowances are better off because they pay lower prices. Consumers who would not buy either product regardless of the legality of slotting allowances are no worse off. Hence, a prohibition on slotting allowances is a Pareto improvement for all consumers”.

¹⁰⁵⁰ Marx 2007, p. 838: “We find that exclusion can arise without such restrictions because the retailers can impose de facto exclusivity by demanding upfront payments that are sunk when the contract is signed. The contract terms are structured so that the dominant retailer will buy only if it has an exclusive relationship with the manufacturer, and thus our result relies on the manufacturer rejecting one of the retailers’ offers even though it would have preferred ex ante to sell to both retailers”. See also Wang, “Slotting allowances and retailer market power”, *Journal of Economic Studies* 33- 1, 2006, pp. 68-77. He models an upstream market with a symmetric duopoly selling to a downstream market where a large retailer competes with many small retailers. The model suggests that the large retailer uses slotting fees to capitalize its market power. By requiring the fees from manufacturers, the large retailer raises the wholesale prices faced by competing small retailers, and therefore, lowers their profit margins and market shares. Therefore, slotting allowances may respond to an exclusionary strategy of large retailers and they may raise antitrust concern.

¹⁰⁵¹ Rey, Miklós-Thal and Vergé, “Slotting Allowances and Conditional Payments”, July 2006 (they discuss a preliminary draft of Marx and Shaffer, “Upfront payments and exclusion in downstream markets”), pp. 4-5: “Thus, when combined with conditional fixed fees, upfront payments do not lead to inefficient exclusion but may actually avoid it. Yet, upfront payments are still potentially detrimental for welfare, since they eliminate any effective retail competition. Incidentally, our analysis supports the view that slotting allowances are associated with retail bargaining power. If bargaining power were upstream, the industry monopoly outcome could be achieved without slotting allowances; standard two-part tariffs would suffice. Once retailers have the bargaining power, however, upfront payments are necessary to maintain monopoly prices”. They acknowledge that three-part tariffs are not the only way to achieve the monopoly outcome. More general non-linear tariffs or even two-part tariffs combined with resale price maintenance could also generate a similar outcome. However, these alternative means still involve down payments (“slotting allowances”) by the manufacturer to the retailers (p. 34). This paper was updated as “Buyer power and intrabrand coordination”, 19 April 2010, where the authors highlight that the monopoly outcome without retailer foreclosure may be assured through three-part tariffs: “In contrast to MS [Marx and Shaffer], we show that foreclosure is no longer inevitable once retailers can offer options that are contingent on the relationship being exclusive or not. In a framework similar to that of MS, except that retailers offer contingent contracts to the manufacturer, we find that firms can achieve the industry monopoly outcome in equilibrium. Moreover, there exist common agency equilibria that strictly Pareto-dominate, from the firms’ point of view, the exclusive dealing equilibrium. Three-part tariffs of the type used by MS are sufficiently flexible to achieve industry monopolisation. First, wholesale prices can be set so as to maintain final prices at the monopoly level. Imperfect retail competition however generates positive margins, which creates a risk of opportunistic behaviour: each retailer is tempted to

Logically, they conclude that exclusion is more likely when retailers are close substitutes and/or relatively asymmetric. In this scenario, the exclusion of the less efficient retailer is socially less costly and the positive effects on consumer surplus of banning slotting fees are larger than its negative effects.

All these papers, as well as those of the proponents of the pro-competitive effects of access fees, assume that shelf-space scarcity is exogenous. However, this critical variable is under supermarkets' control and they can increase or reduce it for strategic reasons. Marx and Schaffer develop a model in which shelf-space is restricted by the retailer as part of a rent-shifting strategy and they show that it leads to a reduction in the number and variety of products, even under the assumption that they do not distort the efficient selection of the products and retail prices. They conclude that slotting allowances, by inducing the retailer to limit shelf-space, reduce consumer surplus and total welfare, even though they increase retailers' profits¹⁰⁵². The rent-extraction

offer a lower wholesale price in order to "eat into" its rival's downstream profit. We show that conditioning fixed fees on actual trade provides an effective protection against such opportunism. It allows a retailer to "opt out" and waive the fee if a rival tries to undercut it, which makes the manufacturer less receptive to opportunistic offers. Upfront payments by the manufacturer can then be used to give ex ante each retailer (up to) its entire contribution to the industry profits" (p. 3). Piccolo and Miklós-Thal, "Colluding through suppliers", working paper, June 2012, present a dynamic model of supplier-retail interactions where retail collusion is facilitated by wholesale price-transparency and access fees: "...we show that retailers with buyer power can sustain collusion on retail prices more easily if they also collude on the terms of their input supply contracts. By agreeing to pay above-cost wholesale prices to their suppliers, retailers limit their own short-term profit gain from undercutting the retail price. Slotting fees enable retailers to obtain the entire industry profits in spite of above-cost wholesale prices, which implies that the long-term loss from deviating remains high. Inefficient wholesale prices and slotting fees thus emerge as part of a mechanism to facilitate collusion on downstream prices. Our analysis yields several antitrust policy implications. First, in industries with powerful retailers, a ban on slotting fees decreases the risk of collusion. Second, in industries with powerful retailers, a ban on information exchange between retailers about their input supply terms decreases the risk of collusion. Third, a shift in bargaining power from suppliers to retailers increases the risk of collusion."

¹⁰⁵² Marx and Shaffer, "Slotting Allowances and Endogenous Shelf Space", forthcoming *Journal of Economics and Management and Strategy*, June 2009, p. 22: "In our model, slotting allowances allow the retailer to capture more efficiently the value of its shelf space when shelf space is scarce. By itself, this effect is welfare neutral. Slotting allowances in this case serve only to transfer rents from the weaker manufacturer to the stronger manufacturer and, for some parameters, from the weaker manufacturer to the retailer. However, the problem is that this same mechanism may also induce the retailer to limit its shelf space when shelf space would otherwise be plentiful. This effect tends to reduce welfare and can harm both manufacturers. Welfare decreases when shelf space is scarce because consumers suffer from reduced product choice but do not benefit from lower prices. The manufacturers are worse off when shelf space would otherwise be plentiful because overall joint profit is lower, but the retailer's profit is higher. Our results point to a new source of welfare loss. Policy makers have previously been concerned with whether slotting allowances would lead to higher or lower retail prices, and whether dominant manufacturers might abuse slotting allowances by buying up scarce shelf space in order to foreclose smaller rivals with better products. These concerns have caused policy makers in specific cases to consider whether the excluded firms have equal access to capital markets, whether slotting allowances are coupled with exclusivity provisions (e.g., whether the dominant firm requires that the downstream firm not sell its competitor's product), and whether there are scale economies in production that may prevent an excluded firm from effectively competing elsewhere in the market. However, in our model, there is no effect on retail pricing, and the better product is always chosen conditional on the availability of shelf space. Instead, we find that welfare may be lower because slotting allowances may induce the retailer to limit its shelf space. This suggests that slotting allowances may be harmful even if they are not accompanied by exclusivity provisions, that market does not exhibit scale economies in production, and access to capital markets is not a concern".

rationale also helps explaining the limited use of access fees by some powerful supermarkets (they call it the “Wal-Mart phenomenon”)¹⁰⁵³. Building on the rent-shifting theory, Caprice and von Schlippenbach argue that if the complementary effects of two manufacturers outweigh their substitution effects¹⁰⁵⁴, a retailer may extract rents from the two manufacturers, though the slotting allowances and upward-distorted wholesale prices initially obtained from the manufacturer with less bargaining power¹⁰⁵⁵. They conclude that even though rent-extraction occurs between vertically related agents, the upward-distorted wholesale price induced by slotting allowances harms consumer surplus and total welfare. Therefore, they propose the prohibition of slotting allowances¹⁰⁵⁶.

In addition to the studies specifically devoted to access fees in the grocery sector, it is worth taking into account the economic studies and the regulatory policy on access (wholesale) pricing in the telecommunications field¹⁰⁵⁷.

¹⁰⁵³ *Id.*, p. 23: “In contrast, we suggest that these findings may also (or instead) be due to differences in a retailer’s bargaining power with respect to each manufacturer and with respect to each other. In particular, we have shown that the incidence of slotting allowances may be inversely related to each retailer’s bargaining power. If a retailer with market power has all the bargaining power with respect to each manufacturer, then the retailer extracts all the available surplus in the market and slotting allowances do not arise. But slotting allowances will arise if the manufacturers have all the bargaining power because the retailer will want to limit shelf space all else being equal in order to earn some product. For intermediate levels of bargaining power, the retailer is more likely to limit its shelf space (and therefore slotting allowances are more likely to arise) the less bargaining power it has. This accords well with the observation that slotting allowances tend to arise for items such as ice cream and salad dressing, where strong brand names exist, but not for items where strong brand names do not exist, such as bread and hot dogs. This also accords well with the observation that Wal-Mart, a retailer that is thought to have a lot of bargaining power, allegedly does not accept slotting allowances”.

¹⁰⁵⁴ Caprice 2010. Both goods are supposed to belong to consumers’ shopping basket. Taking consumers’ shopping costs explicitly into account, positive demand externalities arise between both goods offered at the retailer. For a model in which the substitution effects between the two manufacturers prevail over their complementarity effects, see Marx and Shaffer, “Predatory accommodation: below-cost pricing without exclusion in intermediate goods markets”, *RAND Journal of Economics* 30-1, 1999, pp. 22-43. They conclude that below-cost pricing by one supplier can facilitate the transfer of surplus from a second supplier to a retailer and the first supplier by strengthening the retailer’s bargaining position vis-à-vis the second supplier. This below cost pricing stops short of driving the second supplier from the market – hence the label “predatory accommodation”.

¹⁰⁵⁵ The model developed in Caprice 2010 also reveals (see p. 17) that (1) slotting allowances are more likely to be paid by suppliers with relatively little bargaining power vis-à-vis the retailer; (2) slotting allowances are more likely to occur in intermediate good markets, the more suppliers differ in their bargaining strength vis-à-vis the retailer; and (3) powerful retailers never charge slotting fees as they already capture a large share of the industry profit.

¹⁰⁵⁶ Caprice 2010, p. 17: “In our framework, slotting fees are not necessarily used to exploit those suppliers that pay them. It is rather the case that they are induced by a rent-shifting mechanism at the expenses of those suppliers that do not pay slotting fees, i.e. the more powerful suppliers in the intermediate good market. Even though slotting fees only transfer rents between vertically related agents, their occurrence comes along with a welfare loss. This is due to the fact that slotting fees are induced by an upward distorted wholesale price in the first negotiation. As wholesale prices are less distorted if slotting fees are forbidden, we can state that a ban of slotting fees improves social welfare”.

¹⁰⁵⁷ See Appendix 8.2.2.

8.4 Economics of vertical integration

The economic theories dealing with the anticompetitive effects of vertical integration can be classified in three main groups: the theory on restoring monopoly profits, the theory on raising rivals' costs and the theory on the facilitation of collusion. These three theories underlie the approach to vertical integration in the EU Guidelines on non-horizontal mergers.

8.4.1 The EU Guidelines on non-horizontal mergers

The Guidelines on non-horizontal mergers recognise the efficiencies that a vertical merger may generate in terms of “internalisation of double mark-ups” and reduction of transaction costs¹⁰⁵⁸. However, these Guidelines also recognise that there are two main ways in which vertical mergers may significantly impede effective competition: non-coordinated effects (anticompetitive foreclosure and access to commercially sensitive information) and coordinated effects (collusion)¹⁰⁵⁹.

Anticompetitive foreclosure

Regarding the anticompetitive foreclosure, the European Commission distinguishes between input foreclosure¹⁰⁶⁰ and customer foreclosure¹⁰⁶¹.

¹⁰⁵⁸ EU Guidelines on non-horizontal mergers, pars. 13-14 and 52-57.

¹⁰⁵⁹ *Id.*, pars. 17-19. Anticompetitive foreclosure is defined in par. 29: “A merger is said to result in foreclosure where actual or potential rivals' access to supplies or markets is hampered or eliminated as a result of the merger, thereby reducing these companies' ability and/or incentive to compete. Such foreclosure may discourage entry or expansion of rivals or encourage their exit. Foreclosure thus can be found even if the foreclosed rivals are not forced to exit the market: It is sufficient that the rivals are disadvantaged and consequently led to compete less effectively. Such foreclosure is regarded as anti-competitive where the merging companies — and, possibly, some of its competitors as well — are as a result able to profitably increase the price charged to consumers”.

¹⁰⁶⁰ *Id.*, par. 31: “Input foreclosure arises where, post-merger, the new entity would be likely to restrict access to the products or services that it would have otherwise supplied absent the merger, thereby raising its downstream rivals' costs by making it harder for them to obtain supplies of the input under similar prices and conditions as absent the merger. This may lead the merged entity to profitably increase the price charged to consumers, resulting in a significant impediment to effective competition. As indicated above, for input foreclosure to lead to consumer harm, it is not necessary that the merged firm's rivals are forced to exit the market. The relevant benchmark is whether the increased input costs would lead to higher prices for consumers. Any efficiencies resulting from the merger may, however, lead the merged entity to reduce price, so that the overall likely impact on consumers is neutral or positive.”

¹⁰⁶¹ *Id.*, par. 58: “Customer foreclosure may occur when a supplier integrates with an important customer in the downstream market. Because of this downstream presence, the merged entity may foreclose access to a sufficient customer base to its actual or potential rivals in the upstream market (the input market) and reduce their ability or incentive to compete. In turn, this may raise downstream rivals' costs by making it harder for them to obtain supplies of the input under similar prices and conditions as absent the merger. This may allow the merged entity profitably to establish higher prices on the downstream market. Any efficiencies resulting from the merger, however, may lead the merged entity to reduce price, so that there is overall not a negative impact on consumers. For customer foreclosure to lead to consumer harm, it is thus not necessary that the merged firm's rivals are forced to exit the market. The relevant benchmark is whether the increased input costs would lead to higher prices for consumers.”

(1) *Input foreclosure*

In assessing the likelihood of an anticompetitive input foreclosure scenario, the Commission examines, first, whether the merged entity would have the ability to substantially foreclose access to inputs¹⁰⁶², second, whether it would have the incentive to do so¹⁰⁶³, and third, whether a foreclosure strategy would have a significant detrimental effect on competition downstream¹⁰⁶⁴.

Ability to foreclose

First, it can take many forms (e.g., refusal to deal, supply restriction/price increase, worse terms and degradation of the quality of the input supplied)¹⁰⁶⁵.

Second, it may raise competition problems only if it concerns an important input for the downstream product¹⁰⁶⁶.

Third, for input foreclosure to be a concern, the vertically integrated firm resulting from the merger must have a significant degree of market power in the upstream market¹⁰⁶⁷. This may be the case where the remaining upstream suppliers are less efficient, offer less preferred alternatives, or lack the ability to expand output in response to the supply restriction, or the cost of switching to other providers of inputs is relatively high¹⁰⁶⁸. When competition in the input market is oligopolistic, a decision of the merged entity to restrict access to its inputs reduces the competitive pressure exercised on remaining input suppliers, which may allow them to raise the input price they charge to non-integrated downstream competitors¹⁰⁶⁹.

Incentive to foreclose

The incentive to foreclose may depend on (1) the trade-off between the profit lost in the upstream market due to a reduction of input sales to (actual or potential) rivals and the profit gain, in the short or longer term, from expanding sales downstream or, as the case may be, being able to raise prices to consumers¹⁰⁷⁰; (2) the extent to which downstream demand is likely to be diverted away from foreclosed rivals and the share of that diverted demand that the downstream division of the integrated firm can capture¹⁰⁷¹; (3) the extent to which the downstream division of the integrated firm can be expected to benefit from higher price levels downstream as a result of a strategy to raise rivals' costs¹⁰⁷²; (4) the existence of a commitment problem, which may give the merged entity

¹⁰⁶² *Id.*, pars. 33-39.

¹⁰⁶³ *Id.*, pars. 40-46.

¹⁰⁶⁴ *Id.*, pars. 47-57.

¹⁰⁶⁵ *Id.*, par. 33.

¹⁰⁶⁶ *Id.*, par. 34.

¹⁰⁶⁷ *Id.*, par. 35.

¹⁰⁶⁸ *Id.*, par. 36.

¹⁰⁶⁹ *Id.*, par. 38.

¹⁰⁷⁰ *Id.*, pars. 40-41.

¹⁰⁷¹ *Id.*, par. 42.

¹⁰⁷² *Id.*, par. 43.

the incentive to raise the costs of downstream rivals, thereby reducing the competitive constraint they exert on the merged entity in the downstream market¹⁰⁷³.

Effects on competition

First, anticompetitive foreclosure may occur when a vertical merger allows the merging parties to increase the costs of significant (in terms of quantity or individual contribution to the competitive process) downstream rivals in the market thereby leading to an upward pressure on their sales prices¹⁰⁷⁴.

Second, raising the barriers to entry to potential downstream competitors may significantly impede effective competition (e.g., refusal to deal or supply under less favourable terms)¹⁰⁷⁵.

(2) Customer foreclosure

In assessing the likelihood of an anticompetitive customer foreclosure scenario, the Commission examines, first, whether the merged entity would have the ability to foreclose access to downstream markets by reducing its purchases from its upstream rivals¹⁰⁷⁶, second, whether it would have the incentive to reduce its purchases upstream¹⁰⁷⁷, and third, whether a foreclosure strategy would have a significant detrimental effect on consumers in the downstream market¹⁰⁷⁸.

Ability to foreclose

First, customer foreclosure may take various forms (e.g., refusal to buy, reduced purchases or purchases on less favourable terms)¹⁰⁷⁹.

Second, when considering whether the merged entity would have the ability to foreclose access to downstream markets, the Commission examines whether there are sufficient economic alternatives in the downstream market for the upstream rivals (actual or potential) to sell their output¹⁰⁸⁰.

Third, customer foreclosure can lead to higher input prices in particular if there are significant economies of scale or scope in the input market or when demand is characterised by network effects. It may also significantly reduce the ability and incentive to invest in cost reduction, R&D and product quality, thus undermining long-run competition¹⁰⁸¹.

¹⁰⁷³ *Id.*, par. 44.

¹⁰⁷⁴ *Id.*, par. 48.

¹⁰⁷⁵ *Id.*, par. 49.

¹⁰⁷⁶ *Id.*, pars. 60-67.

¹⁰⁷⁷ *Id.*, pars. 68-71.

¹⁰⁷⁸ *Id.*, pars. 72-77.

¹⁰⁷⁹ *Id.*, par. 60.

¹⁰⁸⁰ *Id.*, par. 61.

¹⁰⁸¹ *Id.*, pars. 62-65.

Incentive to foreclose

The incentive to foreclose may depend on the trade-off between the possible costs associated with not procuring products from upstream rivals (e.g., the integrated upstream unit is less efficient, capacity constrained or not entirely substitutable)¹⁰⁸² and the possible gains from doing so, for instance, because it allows the merged entity to raise price in the upstream or downstream markets¹⁰⁸³.

Effects on competition

Foreclosing a large fraction of rivals in the upstream market may progressively place significant downstream rivals at a competitive disadvantage (e.g., increased input costs) and enable the vertically integrated firm to raise prices or reduce the overall output in the downstream market¹⁰⁸⁴. Raising barriers to entry to potential competitors may also significantly impede effective competition on the upstream market¹⁰⁸⁵.

Access to commercially sensitive information

The merged entity may, by vertically integrating, gain access to commercially sensitive information regarding the upstream or downstream activities of rivals¹⁰⁸⁶.

Coordinated effects

Market coordination may arise where competitors are able, without entering into an agreement or resorting to a concerted practice, to identify and adopt a common course of action, endorsed by a coherent system of implicit threats¹⁰⁸⁷.

Vertical integration may (1) facilitate the reaching of a common understanding on the terms of coordination¹⁰⁸⁸; (2) facilitate the monitoring of deviations from this understanding¹⁰⁸⁹; (3) facilitate the creation or enforcement of deterrent mechanisms¹⁰⁹⁰; and (4) reduce the scope for outsiders to destabilise the coordination¹⁰⁹¹.

¹⁰⁸² *Id.*, par. 69.

¹⁰⁸³ *Id.*, par. 70.

¹⁰⁸⁴ *Id.*, pars. 72-74. Par. 73 clarifies that the downstream impact from upstream foreclosure may take some time to materialise: “The negative impact on consumers may take some time to materialise when the primary impact of customer foreclosure is on the revenue streams of upstream rivals, reducing their incentives to make investments in cost reduction, product quality or in other competitive dimensions so as to remain competitive.”

¹⁰⁸⁵ *Id.*, par. 75: “Effective competition on the upstream market may also be significantly impeded by raising barriers to entry to potential competitors. This may be so in particular if customer foreclosure would entail for such potential competitors the need to enter at both the downstream and the upstream level in order to compete effectively on either market. In such a context, customer foreclosure and input foreclosure may thus be part of the same strategy. The concern of raising entry barriers is particularly relevant in those industries that are opening up to competition or are expected to do so in the foreseeable future.”

¹⁰⁸⁶ *Id.*, par. 78.

¹⁰⁸⁷ *Id.*, par. 80.

¹⁰⁸⁸ *Id.*, pars. 82-85. Vertical integration may expel competitors from the market, increase the degree of symmetry between firms active in the market and increase the level of market transparency.

¹⁰⁸⁹ *Id.*, pars. 86-87. Vertical information may facilitate access to sensitive information on rivals or make it easier to monitor pricing.

8.4.2 Restoring monopoly profits

The main proponents of this theory, Rey and Tirole, posit that vertical integration helps overcome the commitment problem (i.e., inability to make enforceable multilateral commitments) faced by an upstream monopolist and “restore” monopoly profit, rather than “extend” it¹⁰⁹². The more competitive the downstream segment is in terms of number of competitors and substitutability among them, the higher the loss of upstream monopoly power associated with the commitment problem. Furthermore, bottlenecks are rarely pure bottlenecks, since they often compete with inferior goods or services. An upstream bottleneck owner must face both the commitment problem and the threat of second sourcing by the downstream firms. Therefore, the bottleneck owner may want to supply a limited but positive amount of the essential input to the downstream affiliate’s competitors, who would otherwise purchase the inferior good¹⁰⁹³. This means that vertical integration may be preferable than exclusive supply contracts because it provides enough flexibility to supply non-affiliates and yet favour the affiliate. Finally, the location of the bottleneck owner upstream or downstream has different welfare implications. If it is at the interface with consumers, it is naturally inclined to “internalize” any negative externality between its suppliers and is thus induced to maintain monopoly prices. Assuming it can still make take-it-or-leave-it offers to its suppliers, it can now at the same time extract all profits from them and charge the monopoly price to final consumers. “Hence, from either the consumers’ or total welfare perspective, it is preferable to put the more competitive segment downstream”¹⁰⁹⁴.

¹⁰⁹⁰ *Id.*, par. 88. A vertically integrated company may be in a position to more effectively punish rival companies when they choose to deviate from the terms of coordination.

¹⁰⁹¹ *Id.*, pars. 89-90. Vertical integration may reduce the scope for outsiders to destabilise the coordination by increasing barriers to enter the market or otherwise limiting the ability to compete on the part of outsiders to the coordination.

¹⁰⁹² See the seminal articles Hart 1990 and Rey 2003, pp. 11-12: “The reconciliation of the foreclosure doctrine and the Chicago School critique is based on the observation that an upstream monopolist in general cannot fully exert its monopoly power without engaging in exclusionary practices. (...) A bottleneck owner faces a commitment problem similar to that of a durable-good monopolist: Once he has contracted with a downstream firm for access to its essential facility, he has an incentive to provide access to other firms as well, even though those firms will compete with the first one and reduce its profits. This opportunistic behaviour ex ante reduces the bottleneck owner’s profit (in the example just given, the first firm is willing to pay and buy less). There is thus a strong analogy with Coase’s durable good analysis. As is well-known, a durable-good monopolist in general does not make the monopoly profit because it “creates its own competition”. Once vertically integrated, the cannibalized profits of the downstream division become an opportunity cost of selling more through an independent retail channel. These opportunity costs provide the needed discipline to discourage sweetheart deals that erode downstream prices and prevent the full extraction of monopoly profits.”

¹⁰⁹³ Rey 2003, p. 35: “Vertical integration thus benefits the integrated firms and hurts the nonintegrated one. Although it maintains production efficiency, it lowers consumer surplus and total welfare. Furthermore, the higher the cost of bypassing the bottleneck producer, the larger the negative impacts on consumers and welfare. Last, it is interesting to note that vertical integration is more attractive, the less competitive the bypass opportunity”.

¹⁰⁹⁴ *Id.*, p. 29: “For example, in the above mentioned telecommunications example, it is preferable to let consumers deal directly with the competing long distance operators who then buy access from the fixed link operator. This idea may provide a rationale for the U.S. gas reform (FERC order 436, 1985)[footnote: Before the reform, pipelines (the bottleneck) sold gas to customers (distribution companies, large industrial customers) and purchased their gas internally or from independent producers who had no direct access to customers. Since the reform, producers can purchase access from pipelines

Rey and Tirole also deal with horizontal foreclosure¹⁰⁹⁵ and advance three theories that undermine the Chicago School's theory of single monopoly profit:

(1) Separate sources of monopoly power: when the products are relatively independent, a second source of monopoly power does not devalue the original monopolized product¹⁰⁹⁶.

(2) Entry deterrence in the tied market to protect the monopolised market: even when the two goods are complements, entry in the adjacent market B may facilitate entry in the monopolized market A. Then, the incumbent monopolist may be tempted to deter entry in the adjacent market in order to help prevent entry in its core market¹⁰⁹⁷.

(3) Innovation in the tied market may reduce long-term competition in that market: the mere fact that the integrated firm M is present in two complementary markets A and B affects that firm's incentives to invest in B, since any increase in competition in B enhances consumers' willingness to pay for the monopolized product in A. This, in turn, alters rivals' incentives to invest and innovate in the adjacent market¹⁰⁹⁸. Choi analyzes the impact of tying, rather than integration as such, on R&D incentives in the tied market and concludes that the welfare implications are ambiguous, since in the short-run tying reduces prices but restricts customer choice, and in the longer run it increases one firm's R&D incentives to the detriment of the other(s)¹⁰⁹⁹.

and interact directly with customers] and the "common carrier" concept, although some caution must be exerted in view of the regulatory constraints in those industries.

¹⁰⁹⁵ *Id.*, p. 45: "We now turn to horizontal foreclosure, referring to situations in which: (i) a firm M is present in two final markets, A and B; and (ii) this firm M has substantial market power in market A, called for simplicity the "monopoly segment" and faces actual or potential competition in market B, labelled the "competitive segment". In such a situation, the traditional "leverage" concern is that M could foreclosure competitors in market B by tying the bottleneck good A to its own offering in B."

¹⁰⁹⁶ *Id.*, p. 47: "If in addition the monopolist has a realistic chance of driving competitors out of — or of discouraging entry in — the adjacent market, then committing to sell the two goods as a bundle, and only as a bundle, can serve as a strategic commitment to be a tough competitor in market B — since then, any lost sale in B implies a lost sale as well in the core market A — and can thus deter potential competitors in market B."

¹⁰⁹⁷ *Id.*, p. 53: "While a monopolistic supplier would suffer from the exit of efficient producers of complementary goods, this exit may make it easier to protect the position of the bottleneck supplier in its core market. This is for example the case when entry in one segment facilitates or encourages entry in the other segment. Two variants of this idea have been explored. Choi and Stefanadis (2001) emphasize that, when entry is risky (e.g., when it involves R&D projects that may or may not succeed), tying the two goods A and B reduces the expected return of entry in each market, since entry in one market is then profitable only when entry is successful in the other market as well; tying may in that case deter entry in both markets. Carlton and Waldman (2002) focus instead on the presence of economies of scope between entry decisions in the two markets."

¹⁰⁹⁸ *Id.*, p. 59: "The ambiguity of the welfare analysis suggests that such antitrust involvement is overall unlikely to foster innovation unless one demonstrates that a) the reduction in the independent B-producers' R&D effort due to M being vertically integrated more than offsets the increase in that of M, and b) M's B-division can be effectively duplicated by entry in the B-market (e.g., through an effective divestiture and in the absence of economies of scope). It is therefore not surprising that antitrust authorities have traditionally shunned direct intervention in the competitive market."

¹⁰⁹⁹ Choi, "Tying and Innovation: A Dynamic Analysis of Tying Arrangements", Mimeo, Michigan State University, 2002.

8.4.3 Raising rivals' costs

A vertically integrated firm might engineer an increase in rivals' costs by driving up the price of a scarce input¹¹⁰⁰. Ordover, Saloner and Salop consider the case of an upstream oligopoly selling a homogeneous input to a downstream oligopoly at a uniform wholesale price¹¹⁰¹. Withdrawal of the vertically integrated firm from the input market (except for self-supply) or raising its input price might increase the market power of the remaining upstream oligopolists, causing these firms to raise prices to the downstream market¹¹⁰². This may in turn benefit the downstream division of the integrated firm. The resulting higher procurement costs disadvantage rival downstream firms in competition with the downstream division of the integrated firm¹¹⁰³. If the independent downstream firms pass on these cost increases to final consumers even partially, then market share is likely to shift in favour of the integrated firm. Consumers will suffer higher prices and less choice if independent downstream firms exit the market¹¹⁰⁴.

An “interesting, and at first blush surprising”¹¹⁰⁵ competitive response for independent downstream firms is to “make a deal with the devil” and contract with the vertically integrated supplier at a supra-competitive price¹¹⁰⁶. Basically, the non-integrated firm is trying to turn the foreclosure incentives of the integrated firm into a collusive trade-off¹¹⁰⁷. In this case, the trade-off reinforces the anticompetitive effect of vertical integration.

¹¹⁰⁰ See, for example, Salop 1995 and Salop 1987. The theory shows that the integrated monopolist can artificially increase its own demand for the scarce input and elevate its market price, thus raising the costs of its non-integrated rivals. On the other hand, self-supplied input requirements are insulated from the price increase. The greater returns of downstream foreclosure outweigh the higher opportunity cost of these assets. This cost-raising strategy benefits the downstream operation of the integrated firm by causing rivals to exit the market or otherwise reduce their supply of the final good.”

¹¹⁰¹ Riordan 2005, p. 23: “If the upstream products are differentiated, so that upstream firms have a limited ability to steal business from a rival with a small price cut, then credibility is less of an issue and a vertical integrated firm has a greater incentive actually to execute a refusal-to-deal strategy.”

¹¹⁰² Ordover, Salop and Saloner, “Equilibrium Vertical Foreclosure”, *American Economic Review*, 80, 1990, pp. 127-142; and “Equilibrium Vertical Foreclosure: Reply”, *American Economic Review*, 82, 1992, pp. 698-703.

¹¹⁰³ Riordan 2005 notes that if two-part tariffs are available, then the raising rivals' cost effect of vertical integration may reduce participation in the downstream market with no offsetting double marginalization effect. Michael Riordan (p. 25): “Suppose an equally efficient rival upstream firm offers a two-part tariff that sets the wholesale price equal to its marginal cost, while exercising market power by setting a positive fixed fee. Then vertical integration has no effect on the variable costs of the downstream industry, and does not result in higher downstream prices unless independent downstream firms exit the market in response to the changed vertical structure. If the vertically integrated firm refuses to deal with independent downstream firms, then the resulting increased market power of upstream rivals could translate into higher fixed fees charged to downstream customers, and the resulting higher fixed costs of market participation could cause some downstream firms to exit the industry. A more concentrated downstream market profits the integrated firm, while presenting consumers with less choice and higher prices.”

¹¹⁰⁴ Downstream competitors may respond by replicating the vertical integration and/or relying on an alternative source of supply.

¹¹⁰⁵ Riordan 2005, p. 24.

¹¹⁰⁶ Chen 2002 and Chen 2003.

¹¹⁰⁷ A rival downstream firm, by promising to pay the integrated supplier a profit on upstream sales, weakens the integrated firm's incentive to compete aggressively in the downstream market. This collusive

If dynamic competition is taken into account, the raising rivals' costs strategy finds strong support. It can preserve the market power of a vertically integrated firm by deterring entry into upstream and downstream markets. The vertically integrated firm may deter a two-level entry strategy by depriving the entrant of present revenue or raising the entrant's present cost by refusing to deal¹¹⁰⁸.

8.4.4 Facilitating collusion

Successful express or tacit collusion requires reaching an agreement, monitoring compliance, and punishing defections. Vertical integration may facilitate collusion at the upstream and/or downstream level by aiding any of these activities.

Nocke and White show that collusion through vertical integration may be facilitated by an "outlets effect", a "reaction effect", and a "lack of commitment effect"¹¹⁰⁹. Weighing against these adverse effects of vertical integration is a "punishment effect" of vertical

effect of vertical contracting arises because the integrated firm treats the foregone upstream profit as an opportunity cost of winning a downstream sale. Thus, the independent downstream firm, by contracting with the upstream firm, effectively raises the opportunity cost of its integrated rival, thereby driving up downstream prices and profits, to the detriment of final consumers.

¹¹⁰⁸ See, for example, Carlton and Waldman, "The Strategic Use of Tying to Preserve and Create Market Power in Evolving Industries", *RAND Journal of Economics*, 33, 2002, pp. 194-220. They conclude that by effectively "tying" the sale of its intermediate good to the sale of its final good, the vertically integrated firm forecloses competition in the downstream market, deters entry into the upstream market, and preserves its market power. Likewise, Gilbert and Riordan, "Product Improvement and Technological Tying in a Winner-Take-All Market", *The Journal of Industrial Economics*, Vol. 55, Issue 1, March 2007, show that a technological tie that forecloses downstream rivals protects a vertically integrated upstream monopolist from downstream innovation competition. By reducing compatibility with a monopolized intermediate good, the vertically integrated firm discourages innovation by possibly more efficient downstream competitors, and thereby protects the return from its own innovations. Such technological tying by a vertically integrated firm harms consumers and reduces economic efficiency if it forecloses more innovative downstream competitors.

¹¹⁰⁹ Nocke 2005, Abstract: "We investigate the impact of vertical mergers on upstream firms' ability to sustain tacit collusion in a repeated game. We identify several effects and show that the net effect of vertical integration is to facilitate collusion. Most importantly, vertical mergers facilitate collusion through the operation of an outlets effect: cheating unintegrated firms can no longer profitably sell to the downstream affiliates of their integrated rivals. However, vertical integration also gives rise to an opposing punishment effect: it is typically more difficult to punish an integrated structure, so that integrated firms are able to make more profits in the punishment phase than unintegrated upstream firms. When downstream firms can condition their prices or quantities on upstream firms' contract offers, two additional effects arise, both of which further facilitate upstream collusion. First, an unintegrated upstream firm's deviation profits are reduced by the reaction effect which arises since the downstream unit of the integrated firm will now react aggressively to upstream deviations. Second, an integrated firm's deviation profit is reduced by the lack-of-commitment effect as it cannot commit to its own downstream price when deviating upstream." See also Riordan 2005, pp. 30-31: "The outlet effect means, that by foreclosing part of the downstream market, a vertically integrated firm reduces the incentive of upstream rivals to defect from an agreement. The reaction effect means that a vertically integrated firm is better able to punish defections of upstream competitors by quickly increasing competition in the downstream market. In contrast, a non-integrated market structure must wait to renegotiate supply contracts before punishing a defection effectively. Finally, the lack-of-commitment effect means that a vertically integrated firm finds a departure from upstream collusion less profitable because of rivalry in the downstream market. Independent downstream firms are less willing to deal with a vertically integrated firm because of a rational expectation that the vertically integrated firm will expand in the downstream market if the collusion breaks down."

integration¹¹¹⁰. They conclude that the outlet effect of a single vertical integration outweighs the punishment effect with non-differentiated inputs¹¹¹¹, as well as with differentiated downstream firms¹¹¹². Normann complements the analysis of Nocke and White with a linear tariff model and concludes that vertical integration facilitates anti-competitive upstream collusion under a repeated game scenario¹¹¹³.

8.5 Retail pricing: foreclosure of independent brands and value destruction along the food supply chain

The evidence regarding the price formation along the agrifood value chain (primary production, processing and modern retailing), reveals that the leading supermarkets' pricing practices are foreclosing independent brands, destroying economic value and threatening the economic sustainability of the Spanish milk and olive oil sectors.

Milk

ESTRUCTURE OF THE COST OF 1 LITER OF PACKAGED LIQUID MILK (€)					
	Min	Max	Max Price/Min Price	% Min Price	% Max. Price
Production	0,330	0,375	1,140	43,47	34,34
Agricultural land cost (seeds, fertilizers)	0,030	0,040	1,330	3,95	3,66
Milk production costs (feeding/purchase of cattle)	0,170	0,185	1,090	22,39	16,94
Fixed costs (machinery, petrol, taxes...)	0,040	0,050	1,250	5,27	4,68
Other exploitation costs (salaries, financing, redemption)	0,050	0,060	1,200	6,59	5,49
Opportunity costs (family rewards, invested money)	0,075	0,080	1,070	9,88	7,33
Net Benefit	0,000	0,005			0,46
Incomes other than milk	-0,035	-0,045	1,290		
Conversion and comercialization . Industry	0,230	0,335	1,460	30,30	30,68
Logistics costs collection	0,020	0,030	1,500	2,63	2,75
Manufacturing costs (workforce, petrol, redemption)	0,070	0,090	1,290	9,22	8,24
Packaging	0,090	0,120	1,330	11,85	10,99
Commercialization costs., marketing and management	0,020	0,080	4,000	2,63	7,33
Logistics distribution costs. Factory	0,025	0,080	3,200	3,29	7,33
Net Benefit	0,005	-0,065		0,66	
Final end comercialization	0,170	0,340	2,000	22,39	31,14
Platform cost/intermediate warehouse	0,040	0,060	1,500	5,27	5,49
Costs of transport (to the shops)	0,030	0,050	1,670	3,95	4,68
Store cost (building, workforce, insurances, advertising)	0,095	0,210	2,210	12,51	19,23
Net Benefit	0,005	0,020	4,000	0,66	1,83
Price without VAT	0,730	1,050	1,440	96,15	96,15
VAT (4%)	0,029	0,042			
Price with VAT	0,759	1,092		100,00	100,00

Source: own based on the "Study of value chain and prices of packaged liquid milk". MARM (Agricultural Ministry). April 2009

Source: Spanish Competition Authority, S/0165/09, Gran Distribución Galicia

This chart, prepared by the Spanish Competition Authority on the basis of data compiled by the Ministry for Agriculture, reveals that the cost differentials in favour of the independent grocery brand were 0.045 euro/litre at the production level, 0.105 euro/litre at the processing level and 0.17 euros/litre at the distribution level, for a total retail price difference of 0.32 euro/litre (VAT excluded). The net benefit obtained by the supermarket on its own brand was 0.005 euro, whereas it went up to 0.020 euro on the

¹¹¹⁰ Riordan 2005, p. 31: "The punishment effect refers to the possibility that acquisition of a downstream firm might increase the integrated firm's incentive to defect from an upstream collusion by securing profits in the downstream market should the collusion collapse".

¹¹¹¹ Nocke 2005.

¹¹¹² Nocke and White, "Vertical merger, collusion and disruptive buyers", International Journal of Industrial Organization 28, 2010, pp. 350–354, Proposition 3: "In the model with differentiated final goods, a vertical merger facilitates upstream collusion, no matter what the size of the integrated downstream firm. A vertical merger with a larger downstream firm facilitates upstream collusion more than a vertical merger with a smaller downstream firm".

¹¹¹³ Normann, "Vertical Integration, Raising Rivals' Costs and Upstream Collusion", Preprints of the Max Planck Institute, 2008/30, 2008, p. 30: "A central result of the paper is that, in a separated industry, a single vertical merger facilitates upstream collusion, that is, it causes a reduction of the minimum discount factor required for collusion. Thus, firms have an incentive for anticompetitive vertical merger."

leading independent brand. The supermarkets would have earned substantially higher margins on independent brands had the distribution (supermarket) costs been evenly apportioned between both brands.

Producers of the milk destined for the supermarket brand just break even (no profit), whereas producers of the independent grocery brand do make a little profit (0.005 euro), which does not seem to be sustainable in light of the losses made by the independent grocery brand to whom they supply the milk (-0.065 euro). On the other hand, the profit of the producer of the supermarket brand is too low (0.005 euro) to expect any transfer of rent up to the input supplier. The only profit centre seems to lie at the retail level, where the supermarket makes substantial profits on the independent brand (0.020 euro) and comparatively less profits on the supermarket brand (0.005 euro), assuming that most retail costs are imputed to the independent brand (+0.17 euro). If the costs were evenly shared between independent and supermarket brands, then the profits made with the independent brand would be subsidising the possible losses on the supermarket brand.

Oil

ESTRUCTURE OF THE COST OF ONE KILOGRAM (KG) OF OLIVE OIL (AO) IN EUROS (€)					
	Min	Max	Max Price/Min Price	% Min Price	% Max. Price
Production	1,783	2,365	1,33	65,34	63,15
Agro-quemical	0,152	0,527	3,47	5,57	14,07
Watering	0,000	0,160	-	0,00	4,27
Workforce	0,696	0,974	1,40	25,50	26,01
Machinery	0,091	0,412	4,53	3,33	11,00
General Expenses	0,158	0,630	3,99	5,79	16,82
Opportunity Costs	0,352	0,677	1,92	12,90	18,08
Oil Producer Benefit	0,334	-1,015		12,24	
Industrialization	0,722	0,675	0,93	26,46	18,02
Reception and manufacturing	0,015	0,257	17,13	0,55	6,86
Commercialization cost	0,000	0,017	-	0,00	0,00
General Expenses	0,071	0,412	5,80	2,60	11,00
Olive Oil Mill Producer net benefit	0,246	-0,501		9,01	
Collection logistics	0,002	0,020	10,00	0,07	0,53
Raw material differential cost	0,131	-0,103		4,80	
Manufacturing	0,034	0,150	4,41	1,25	4,01
Package and packaging	0,087	0,136	1,56	3,19	3,63
Commercial and Financial cost	0,063	0,192	3,05	2,31	5,13
Distribution logistics	0,011	0,033	3,00	0,40	0,88
Packer's net benefit	0,062	0,062	1,00	2,27	1,66
Distribution	0,046	0,489	10,63	1,69	13,06
Warehouse logistics	0,000	0,039	-	0,00	1,04
Warehousing costs	0,000	0,066	-	0,00	1,76
Shop delivery logistics	0,000	0,055	-	0,00	1,47
Shop costs	0,002	0,186	93,00	0,07	4,97
Shop net benefit	0,044	0,143	3,25	1,61	3,82
Price without VAT	2,550	3,500	1,37	93,44	93,46
VAT 7%	0,179	0,245			
Price with VAT	2,729	3,745	1,37	100,00	100,00

Source: own based on the "Study of value chain and prices of olive oil". MARM (Agricultural Ministry). January 2010

This table was prepared by the author of this Report on the basis of the data compiled by the Ministry for Agriculture ("Estudio de la Cadena de Valor y Formación de Precios del Aceite de Oliva, Campaña 2009-2010"). The cost differentials in favour of the independent grocery brand were 0.582 cents at the production level, -0.047 cents at the processing level and 0.443 cents at the distribution level, for a total retail price difference of 0.95 cents (VAT excluded). The net benefit obtained by the supermarket on its own brand was 0.044 cents, whereas it went up to 0.143 cents on the leading independent brand. This difference in the margins made by supermarkets on both brands

would have been substantially higher had the distribution (supermarket) costs been evenly apportioned between both brands.

All in all, the formation of retail prices and their effects on the production-processing chain leaves little room for dynamic competition based on strategic rivalry and threatens the sustainability of the value chain. The destruction of value, facilitated by the supermarkets' pricing strategies and the growth of supermarket brands¹¹¹⁴, could also explain the worsening of the intrinsic quality of the target categories. For example, according to the Spanish consumer association OCU, even though all the packaged whole milk brands marketed in Spain fulfill the stringent sanitary standards provided by food laws, the intrinsic quality of the milk had decreased over a 10-year period and the retail prices were in the same bands¹¹¹⁵.

8.6 Spain: supermarket brands' market-share in eight categories

SUPERMARKET BRANDS' MARKET SHARE IN EIGHT FOOD CATEGORIES IN 2009/2010

	MODERN RETAIL			
	% Volume		% Value	
	2009	2010	2009	2010
OIL	59,1	56,4	50,6	49,0
WATER	20,7	23,2	13,7	15,7
RICE	60,0	63,3	45,0	49,3
CEREAL	51,7	54,8	37,4	40,6
CANNED FISH	64,0	67,8	54,3	58,7
MILK	52,6	51,6	43,1	41,7
BAKERY	56,9	62,9	38,5	45,3
YOGHOURT	54,0	56,8	34,1	37,2

Source: Kantar-WorldPanel

¹¹¹⁴ See Appendix 8.6.

¹¹¹⁵ OCU press release, "Leche entera UHT: diferencias abismales de collidad", 21.06.2011. The worsened features of the milk related to the nutritional aspects and its composition, among which, aged milk (degradation of proteins); added stabilisers (phosphates); very aggressive thermal processes, added whey and use of milk solids or powder milk.

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