

Trends in Retail Competition: Private labels, brands and competition policy

Guidance note on the prohibition of vertical price fixing in the food retail sector

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Overview

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- A. Background: the vertical price fixing case in the food retail sector
- B. The Guidance Note:
 - I. aim and content
 - II. legal and economic background
 - III. case studies
 - IV. prioritisation
- C. Outlook

A. Background: The vertical price fixing case in the food retail sector

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- Investigations into horizontally restricting practices between sweets manufacturers and between coffee manufacturers generated clear hints at Resale Price Maintenance (RPM).
- One leniency candidate in the horizontal proceedings then also came up with an application concerning RPM.
- Initial suspicion of RPM at least with respect to confectionary products, coffee, and pet food.
- On the spot investigations at manufacturers' and retailers' sites in January 2010.

A. Background: The vertical price fixing case in the food retail sector

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- Further “leniency applications” by different manufacturers, but also by an important retailer (new product categories)
 - Question of benefits for applicants (leniency notice not applicable)
 - Applicants sought advice concerning safe/unsafe practices => note containing behavioural advice for cooperating undertakings on how to ensure they had effectively terminated the violation
- IT files showed that RPM concerned a wide range of products and manufacturers. Further proceedings were initiated: beer, baby food, and body care products.
- Lots of defendants, loads of documents.

A. Background: The vertical price fixing case in the food retail sector

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- Priority setting: intensified prosecution (hearing of witnesses, issuing of SO) of those cases in the most important product categories (confectionary, coffee, and beer) that
 - were covering the principal types of behaviour and key players – including the most important retailers,
 - had substantial market impact,
 - were clear-cut and documented especially well,
 - and seemed to be prosecutable with reasonable effort.

A. Background: The vertical price fixing case in the food retail sector

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=> outcome: 38 individual fines imposed on 27 companies

	Manufacturers	Retailers	Fines
altogether			260 Mio. €
<u>thereof:</u>			
Coffee (Melitta)	0	5	50 Mio. €
Confectionary (Haribo)	1	6	60 Mio. €
Confectionary (Ritter)	1	2	34 Mio. €
Beer (AB InBev)	0	11	112 Mio. €

A. Background: The vertical price fixing case in the food retail sector

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- market characteristics: high level of concentration on German food retail market
- different players with different cost structure, range of goods etc. (full-range supermarkets ↔ discounters)
- even strong manufacturers normally cannot risk to be delisted by one of the main retailers
- most retailers do not want to lose turnover with the well-known branded goods
- horizontal agreements / information exchange on the side of suppliers (coffee, beer and others)

A. Background: The vertical price fixing case in the food retail sector

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Typical patterns

- (1.) Rounds of price increases
 - retailers agree to ex-factory price increase only on the *condition* that higher retail prices will be established and preserved by the manufacturer
 - pressure and/or incentives in order to bring about agreement
 - „price moderation“ by manufacturer: coordinated rise of retail prices
- (2.) preservation of increased price level: monitoring, incentives, pressure

B. The Guidance Note – aim and content



Guidance note on the prohibition of vertical price fixing
in the brick-and-mortar food retail sector

Version for public consultation
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aim:

- explain background, purpose and scope of prohibition of RPM
- substantiate and illustrate with practical examples from the sector
- focus on small + medium-sized undertakings
- replace note to cooperating undertakings
- make a few general statements on priority setting
- but no substitute for thorough self-assessment
- no conclusive categorisation and assessment

B. The Guidance Note – aim and content

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B. The Guidance Note – summary of legal background

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- prohibition of anti-competitive agreements (Art. 101 TFEU, Sec. 1 GWB)
 - vertical price fixing as “by object” restriction, presumed to appreciably distort competition
- possible admissibility in individual cases
 - not covered by VBER
 - but exempted if conditions of Art. 101 (3) TFEU are met => scenarios of the Guidelines (para. 225)
- prohibition of attempted vertical price fixing under German law (Sec. 21(2) GWB)
 - if undertakings use incentives or pressure in order to induce other businesses to agree to prohibited price fixing

B. The Guidance Note – summary of the economic theory of vertical price fixing

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- possible anti-competitive effects
 - facilitating implicit + explicit collusion
 - at manufacturer level (facilitating price monitoring)
 - at retail level (hub + spoke situations)
 - securing excessive business margins (of supplier with market power) by reducing pressure on selling prices
 - preventing market developments (foreclosure)
 - new products, alternative distribution systems etc.
- potential efficiencies (solving coordination prob.)
 - addressing “free-rider” problems, esp. if product requires pre-sale advice
 - uncertainty of demand when launching new product
 - solving the problem of “double mark-ups”
 - protecting signalling effect of brand image

B. The Guidance Note – economic theory applied to the German food retail sector

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=> importance of market structure ...

- high level of concentration: four retailers account for 85 % of sales – “gatekeepers”
- “web” of purchase and supply links between major market participants
- vertical price fixing as a common phenomenon

... and products concerned

- mostly well-established “standard products”
- limited scope for genuinely new, innovative products
- availability of less restrictive means to achieve potential efficiencies

B. The Guidance Note - case studies

1. recommended retail prices (RRP)

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- suppliers may express + explain their opinion on retail price they consider appropriate
- and retailer may autonomously decide to follow that recommendation
- but: no agreement on the retail price => prob:
 - adherence to RRP after pressure/incentives
 - retailer informs supplier of intent to adhere to RRP

cc) Variation on the initial case (cf. aa above), para. 62): *In their talks supplier B does not issue any threats to retailer X, but hints that X's major competitors Y and Z have already agreed to raise their retail prices in the forthcoming quarter in compliance with the new RRP's. X states that it is going to "adapt to the developments in the market".*

B. The Guidance Note - case studies

2. quantity management

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- interest in efficient production planning => regarding promotional activities by retailer supplier needs information on additional quantities well in advance
- but: information about the designated promotional retail price?
 - retailer usually able to estimate by itself the effect on quantities needed
 - possibility to ask for assessment on several alternative promotional prices

B. The Guidance Note - case studies

3. guaranteed margins and re-negotiations

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- expected retail prices and margins normal part of discussion on purchase prices
- but: (1) guaranteed margins

Example 1: *Supplier A wishes to impose a purchase price of € 0.60 on retailer X. The previous purchase price of retailer X was € 0.55. The new RRP for the product is € 0.99, including 7 % VAT. This corresponds to an increase of € 0.10 compared to the previous RRP. X has doubts that consumers will accept this price increase. In response to X's concerns A guarantees X a margin of € 0.3252 per piece in case the retail price of € 0.99 (net € 0.9252) "cannot be realised". It also promises to compensate for any differences by granting a discount on the respective purchase price.*

B. The Guidance Note - case studies

3. guaranteed margins and re-negotiations

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- relieves retailers from the risk that market prices will develop differently than expected
- deviation from the usual risk allocation
- may imply assurance that other retailers follow RRP and request to do the same

- (2.) subsequent demand for compensation
 - not necessarily a sign of an illegal agreement on retail prices (concerns purchase price)
 - probl. if connected to information on competitor that currently deviates from RRP and followed by “price management” measures by the supplier

B. The Guidance Note - case studies

4. termination / refusal of business relations

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- no general obligation to supply; irrespective of the reasons for the refusal to do so (e.g. pricing policy of the retailer)
- but:
 - willingness to supply under the condition that RRP is respected may result in agreement on retail price
 - terminating business relationship explicitly referring to pricing policy may be seen as attempt to exert pressure to adjust retail prices

B. The Guidance Note - case studies

4. termination / refusal of business relations

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Example 2: *Supplier A has criticised several times the low retail prices of retailer X. When X again sets a retail price below A's recommended price, A informs X that it will not continue to supply X. Upon inquiries by X, A's sales manager hints that A regrets having to end the supply relationship; however, according to the sales manager, A can only continue to work with retailers that are willing to support A's entrepreneurial philosophy which aims at creating added value in a mutual effort. In response X asserts that it is very much interested in continuing its cooperation with A, regrets the irritations caused and will take all necessary measures to support A's sales policy to the best of its capabilities. As a consequence, A resumes its supplies to X.*

B. The Guidance Note - case studies

5. data exchange

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- provision of data on (past) retail sales prices and quantities generally allowed
- but: data may not be used to coordinate and monitor pricing strategies
 - current data may be problematic if deviations from RRP are followed by interventions of the supplier etc.

B. The Guidance Note - prioritisation

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- in general: extent of the restriction + indications for a possible justification
 - market structure (market position, degree of concentration etc.)
 - product properties (complexity, amount of pre-sale services required, innovativeness etc.)
 - others (extent of harm, obstruction of new distribution concepts etc.)
- finances proceedings
 - only clear-cut infringements, where efficiencies unlikely
 - not necessarily against every undertaking involved (taking into account market position and role in the infringement)
 - reduced or no fine if undertakings cooperate

C. Outlook

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- results of the consultation
 - calls for more precise language
 - and more clarity on the distinction between unilateral conduct and agreement
 - proposals for more case studies
 - extension to other sectors, e-commerce
- publication of final note soon
- more cases?

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Thank you very much for your
attention!



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