Buyer-Related Vertical Restraints (Upfront access payments and category management) - Proposed sections in the EC Guidelines on Vertical Restraints

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New proposed section on upfront access payments

- Defined as where suppliers pay fixed fees "in the framework of a vertical relationship" to distributors to gain access to their distribution network
- Commission concerns
  - Anti-competitive foreclosure of <u>other distributors</u> (supplier focuses on distributors where he has paid to enter)
  - Anti-competitive foreclosure of <u>other suppliers</u> (raising barriers to entry for smaller entrants)
  - Payments may facilitate collusion <u>between distributors</u> in a concentrated distribution market (with payments passed on by suppliers in higher prices)

Upfront access payments (2)

- Recognition that may lead to more efficient allocation of space for new products
- “Block exempt” where supplier’s and buyer’s market shares are less than 30%
- NB. Upfront access payment as compensation to distributors for risk of lesser sales on new product (as compared to an existing one) and/or cost of promoting products which fail
- Background of increasingly organized distribution, demanding more for its (high value) “one-stop-shop” sales opportunity

New proposed section on category management

- Defined as where "within a distribution agreement" the distributor entrusts the supplier (the "category captain") with the marketing of a <u>category</u> of products, including its own and those of its competitors
- Again, "block exempt" where supplier's and buyer's market shares are less than 30%

Commission concerns

- Foreclosure of <u>other suppliers</u>' competing products by "category captain"
- <u>Distributor foreclosure</u> of products which compete with the distributor's own-branded products
- Risk of collusion <u>by distributors</u> through use of a common category manager
- Agreements may facilitate collusion <u>between suppliers</u>, through increased opportunities to exchange sensitive information <u>via</u> retailers
- Communications between distributor and supplier may lead to collusion, e.g. through <u>price-fixing of the distributor's brand</u>

Category Management – Positive aspects

- Efficiencies:
  - Distributors and suppliers may achieve better economies of scale
  - Suppliers can better anticipate demand and therefore tailor their promotions accordingly
  - Higher consumer satisfaction
- NB Clearly recognised in other US and UK Competition Authority studies and EC merger case, Proctor & Gamble / Gillette

General Comments

- Hot topics for many years (mainly at national level)
- Not clear that <u>either needs block exemption at all</u> (above or below 30%) (and it may be misleading to suggest that, if the real concerns are more specific <u>horizontal collusion</u> or <u>abusive practices</u>)
- Reports and cases often appear to <u>worry about what might happen</u>, but do not actually find things which are anti-competitive
- NB Much compliance now on ‘triangular’ supplier-retailer-supplier (or <u>vice-versa)</u> concerns

General Comments (2)

- Inclusion of these sections in the EC Proposed Vertical Guidelines widens their scope
  - Current EC Vertical Guidelines offer discussion and commentary on the different types of vertical distribution agreements used
  - Treatment of upfront access payments has usually been more in market concentration studies and the context of buyer power
- Category management is generally considered distinct from the distribution agreement: i.e. a service is rendered to the distributor

General Comments (3)

- NB Many possible variations of category management:
  - Often involves only recommendations and advice, with the distributor deciding what to do
  - So "category adviser" may be the more apt expression and inferring an "agreement" on what to stock and at what price may go too far
- Important to distinguish between aspects which may be a concern, rather than the practice as such (and to recognise this more in the EC Guidelines – if the proposed section is retained)

Upfront access payments comments (1)

- Far from clear that there is a risk of suppliers withholding new products from other sales channels (unless part of an exclusive product launch strategy, which the Commission is recognising more openly now as pro-competitive)
- Important to recognize that suppliers usually do not want to pay such fees; they do so because of the buyer power of the large retailers (again raising the question of “agreement”)

Upfront access payments comments (2)

- Quite a difference between an upfront access payment and a "pay-to-stay" fee.
  - One is meant to be about defraying the reasonable cost and risk of the launch of a new product
  - The other is more about competing for shelf-space (which is a broader issue)
- NB Different treatment in Draft UK Groceries Supply Code of Practice
- Important not to confuse scale economics and anti-competitive foreclosure (some smaller companies are shut out from large retailers just because they are too small)

Category management comments (1)

- Advice has been given on category management for many years
- Often the <u>leading supplier</u> may be invited to do it, so the compliance concern about abusive practices is high and <u>companies are generally very careful</u>
- NB. The block exemption may often not apply anyway
- Some “abuse” cases (which would likely be infringements even without category management, e.g. <u>Conwood / US Tobacco (2002)</u>)
- Suppliers (dominant or not) are usually aware that they should not be directly exchanging confidential business secrets (pricing, coming promotions, new product launches)

Category management comments (2)

- In some cases suppliers use Chinese walls to prevent information from retailers on competitors' products going to their own sales teams
- Often there are also checks and balances against excess:
  - Retailers check or "validate" recommendations by a supplier
  - Category advisers may also be concerned that even objective recommendations (e.g. based on recent sales data) may be viewed as too favourable to them
- Usually retailers still dominate the process

Category management comments (3)

- The key issue is the sales strategy <u>of the retailer</u> to maximise profit through focus on best selling brands, private label and optimising shelf-space
- <u>Private label issues</u> (because the retailer is competing with the supplier) <u>are not specific to category management</u>
- Discussion about "<u>creating opportunities</u>" for collusion, without conclusions that category management has led to collusion in fact
- Do these "<u>soft</u>" comments about practices which "<u>may</u> lead to" or "<u>facilitate</u>" (tacit) collusion really belong in a Notice designed to give "<u>hard</u>" legal guidance as to what is lawful and what is not?

Selected references

- EC Proposed Vertical Guidelines, paras 199-204 and paras 205-209
- UK Competition Commission: "*The supply of groceries in the UK-market investigation*", 30 April 2008; Chapter 8 and Appendix 8.1 on category management, with focus on fruit supply; a food supplier; and yoghourt study
- Proctor & Gamble / Gillette, Case COMP/M.3732, Commission Decision of 15 July 2005
- Report on FTC Workshop on Slotting Allowances and Other Market Practices in the [US] Grocery Industry (February 2001)