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POSITIVE COMPETITION

Vertical restraints and the digital world

Time for a more economic approach

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E-commerce: impact on suppliers' brand and product positioning

- There always was the risk that shops with bad service would disrupt high quality, complex and luxury goods
  - But brick and mortar sales were always limited so they were not so damaging for product placement and brand image
- Now the issue is much more serious: if you can systematically buy on a cheaper website, then no one will make the investments and provide services
  - Hence, the magnitude of the pro-competitive rationale of practices like RPM is larger
- What is also true that internet increases competition and potentially drives prices down
- The tradeoffs are the same as before, but the magnitude of the effects is much larger
  - The potential magnitude of the cost to society of the type 1 and type 2 errors are much larger
  - As a consequence, <u>the cost of inadequate and formal rules is much larger</u>
  - We need rules that target harmful behavior and do not hamper firm's development and the building of the internal market

Verticals ***Good*** *or Bad*?

- Firms in vertical relationships face coordination issues and exert externalities on each other
  - They are well documented in the economic literature and economic textbooks put a large emphasis on these

- The *business rationale* for vertical restraints is often to address these issues
  - Vertical agreements primarily aim at improving vertical coordination and aligning incentives between complementary actors.
  - They often restore investment incentives by solving issues like *hold up* or *free riding.*
  - They lower prices and increase consumer welfare by reducing *double marginalization*.
  - They *facilitate entry* by helping firms to establish a brand image, signal product quality or ensure adequate use and costumer satisfaction.

Verticals *Good or **Bad***?

- ## Softening competition
  - Softening *intra-brand competition*: e.g. RPM, MFN, selective distribution system where fewer retailers compete.
  - Softening *inter-brand competition*: a manufacturer can commit to higher prices and rivals react by also keeping prices high (can be an indirect effect of softening intra-brand competition)
- ## Foreclosure
  - Locking-in a significant portion of retailers, or a few strategic ones.
  - Could reduce the profitability of entry.
  - Like for naked-exclusion or rebates: why would retailers enter into these agreements?
- ## Collusion (upstream and downstream)
  - Exclusivity facilitates market sharing
  - Price restrictions such as RPM and PRAs enable manufacturers to monitor each others' behaviour (and therefore to punish deviations).
  - Price restrictions may facilitate collusion among retailers by eliminating intra-brand price competition, providing a focal point for collusion, facilitating punishment of deviations.

The object

- The object of vertical agreements is generally motivated by procompetitive rationale (and so the logic of Cartes Bancaires and similar case law applies)
- AG Bobek in Case C-228/18, Budapest Bank highlights the relevant question:

"Does the legal and economic context of the [...] Agreement call into question its presumed anticompetitive nature? »

- Such an assessment is to be made on the basis of « experience » and AG Bobek clarifies that the progress in economic thinking and tools is a central part of this experience, and its evolution (para. 67, 72);

"The concept of restriction of competition is, after all, mainly an economic concept"

"The standard for the assessment of an alternative procompetitive rationale of the object of a practice is one of "first sight" or "plausibility" (Para. 74 to 82)

"[A]ny time an agreement appears to have ambivalent effects on the market, an effects analysis is required" (Para. 81)

- The exact same logic applies to Art. 101 and Art. 102 (Para. 46)

Focus on theories of harm

- Vertical restraints' object is not to restrict competition, but they could have this effect
- However, *RPM* or *Selective distribution* are not theories of harm
  - Theories of harm are based on a certain number of assumptions
  - One of them is that there should be some market power
  - Intra-brand competition should also be an important driver of consumer welfare
- In many vertical agreements, it is very unclear that there is any theory of harm at all
- Any theory of harm of vertical restraints requires market power

The main theory of harm in RPM

- RPM might solve the classical *monopolist's opportunism* problem and increase prices.
  - A monopolist normally has a *temptation to reduce the wholesale price set to a retailer* (in exchange for compensation) to allow it to expand its market share to the detriment of rival retailers.
  - Since all retailers anticipate that the monopolist could behave in such an *opportunistic* way, they will not be willing to accept to pay a high wholesale price in the first place.
  - Vertical agreements (e.g. RPM or territorial restrictions) may solve this *commitment problem* of the monopolist and allow it to restore its monopolist profits.
  - This can also be the case of MFNs. For example, in the EC's 2012 *Ebook*s case, where MFN clause (with Apple) worked as a joint commitment device for publishers not to lower price to Amazon.
  - Internets a village: opportunism with one retailer has wider consequences than in brick and mortar context

- RPM can also reduce *inter-brand* competition.

- By the way, RPM is not the only way to solve the monopolist's *opportunism problem*, for instance price ceilings also do the trick but they are not *hardcore.*

The same limits apply to enforcement against MFNs

- The Hotel Booking cases are at first about restoring *intra-brand* competition
- If it is easier for me to compare prices and qualities of thousands of hotels in NYC, is it really important that I cannot book one particular hotel at different prices in several platforms?
  - When we have many brands, there is a lot of *inter-brand* competition, what is the additional role of *intra-brand* competition?
  - Should we really focus enforcement there?
  - With many firms, there if often little transparency on prices and quality so practices that increase transparency may drastically increase *inter-brand* competition.
- OTAs increase transparency and foster Interbrand competition.
  - The platform needs to derive revenues from the service it provides.
  - If they do so per-reservation, they need to make sure it is not cheaper to book directly.
  - Is the role of antitrust agency to tell them they should have a different business model or how they should be remunerated?
- This is particularly the case when harm is doubtful in the first place
  - Consumers can be harmed when these practices also reduce *inter-brand* competition, but that can happen only if firms have market power.

Selective Distribution and pro-competitive rationale

- Coty confirms previous case law on Selective Distribution
- Third-party platform bans can be used in Selective Distribution systems in order to maintain the supplier's brand or product image
- The discussion in Coty focused on luxury goods, considering the subject matter and the questions asked by the German Court
- It however remains clear that any selective distribution system strictly applying the *Metro criteria* is compliant with Article 101(1) TFEU
  - Therefore, there is no real difference here to be made between luxury/high quality/prestige
- Coty re-affirms the <u>*pro-competitive rationale*</u> of Selective Distribution systems for any high-quality product that necessities a specific selling environment with expert advice and with underlying investments to maintain a specific product image.
- This is an illustration of what I discussed earlier<u>: if there is a plausible *pro-competitive rationale for the* practice, this is not a restriction by object</u>

The French Bang & Olufsen case

- In 2002, the FCA started a case against the prohibition of online sales for the selective distribution of hi-fi
  - Against Bang & Olufsen France, Bose, Focal JM Lab et Triangle Industries
  - All but B&O settled in 2006 and the FCA waited for Pierre Fabre to impose a fine in 2012
  - The FCA concluded this was a *restriction by object* and imposed a fine of €900,000
- According to B&O, the restriction aims at preventing *freeriding* in order to maintain local shops providing high level of services and advice
  - There is selective distribution in the first place, so there has to be something about it
  - However, the Court of Appeal quashed the argument as it did not seem indispensable to provide advice to sell headphones and accessories
  - As a consequence, it considered the prohibition to be too broad.
  - The Court did not even address the relevant question of whether a network of shops can actually survive based on the sales of the most expensive/complex items only?
  - The fact that we are talking about online sales is crucial here as well: one local shop selling online can attract a large chunk of the French demand (at least for some goods)

The French Bang & Olufsen case

- Given that the arguments of B&O are plausible, you only want to intervene if the restriction is *capable* of generating harm

- Here, B&O has low market share, *inter-brand* competition is what matters and there can be no harm from the restraint

- This is explicitly acknowledged by the FCA and the Court of Appeal
  - French law imposes that fines are proportionate to the damage to the economy
  - The FCA assessed that the harm was “very limited” but imposed a fine of €900,000 based on gravity (even though Pierre Fabre came in 2011)
  - The Court of Appeal reduced the fine to €10,000

- It took 12 years to achieve this result
  - All B&O has to do is to set *objective criteria for selective distribution online* and nothing will change
  - Don’t tell me the rules are clear and working…

The recent EC cases on RPM

- In July 2018, the EC also imposed fines in four different RPM cases
  - This time against Asus, Denon and Marantz, Philipps and Pioneer

- The novelty is the online monitoring of RPM and the role of algorithms
  - By intervening against a limited number of retailers, you can have a market wide effect
  - However, this does not change the nature of it

- The cases are all a bit different
  - Asus sells computers and tablets, like Dell who does not have physical stores, so efficiencies might me minimal
  - Philipps sells a wide variety of goods under selective distribution and the business rationale of RPM for Senseo coffee machines is not entirely obvious
  - Denon and Marantz has selective distribution for HiFi products and is similar to B&O in this respect, with the strongest case for business rationale
  - Pioneer sells more affordable HiFi under both selective and open distribution, and is probably between Denon & Marantz and Philipps

The recent EC cases on RPM

- Despite clear qualitative differences, the paragraph on efficiencies in all cases is literally the same:

"The conduct of xxx also did not meet the conditions for exemption provided for in Article 101(3) of the Treaty. In particular, there are no indications that it was indispensable to induce retailer investment in certain promotional measures or pre-sale services or to alleviate the repercussions of free-riding between online and offline sales channels."

- There is no delineation of any theory of harm
  - This is because the object would be to "restricts competition"
  - Even though, as we discussed, the object could be entirely different in some of these cases

- All four companies "cooperated" and got significant fine reduction
  - Does this mean they genuinely agreed or just that they went for the safest option?
  - Is this really good for the public that there is no jurisdictional review on cases like this?

- On top of this, Pioneer restricted cross-border trade

AB InBev cross-border case

- **AB InBev limited re-imports of Jupiler from the Netherlands to Belgium**
  - AB InBev changed the packaging to make it harder to sell in Belgium
  - AB InBev limited volumes in the Netherlands
  - AB InBev only sold other important products to Belgian retailers who committed not to import Jupiler
  - AB InBev made promotions in the Netherlands conditional on not exporting to Belgium

- **There is no analysis of the effects of this other than:**
  - AB InBev “deprived European consumers of one of the core benefits of the European Single Market, namely the possibility to have more choice and get a better deal when shopping”

- **Again here, there will be no jurisdictional control as AB InBev “cooperated"**

AB InBev cross-border case

- Jupiler is probably more expensive in Belgium because it is more popular

- If AB InBev faces massive re-import (which is uncertain)
  - Prices in Belgium might decrease (by how much?)
  - Prices in the Netherlands might increase (by how much?)

- Some will win and others will lose
  - How do we know that we do more good than harm?
  - How is this even consistent with the Commission’s view on out of market efficiencies?

- If the Commission believes that it is making a positive difference in this type of enforcement, it should conduct an ex-post evaluation
  - Maybe even tender an independent study based on scanner data

The myth of the *internal market objective*

- Allegedly, the prohibition of some practices (the hard core) would be related to the non-economic *objective of the integration of the internal market*
  – This objective is *sui-generis* and there is no economic grounds to discuss these rules
  – How convenient?
- The internal market objective is in fact from the very beginning an economic one
  – It is to have a big internal market
  – The size of the internal US market give a home base to US companies to conquer the world
- This is about allowing European *firms to sell everywhere* in Europe
  – Restrictions are sometimes necessary for firms to enter neighbouring markets/countries: then, who segments the internal market?
- Passive sales actually *do little to help consumers* in practice
  – If passive sales were massive, they would be active: no shop wakes up by chance with a queue

The reform: *de minims* for vertical restraints?

- Vertical agreements are likely to harm consumers only if firms using them possess substantial market power (individually or collectively).
- Since firms with small market shares are unlikely to enjoy substantial market power, competition agencies should not use their limited resources to monitor vertical agreements between them.
  - Unless of course such agreements cover overall a very large share of the market.
- Firms with little market power really need legal certainty that they can enter into vertical agreements as they see more convenient.
  - They are most likely to benefit from these agreements and without a real safe harbour they may not enter into them because of the potential legal costs.
- Rightly so, according to the VBER, Article 101.1 does not apply to vertical agreements in which the supplier does not hold more than 30% market share.
- However, the so called *hard core* restrictions are excluded from the safe harbour, while with no market power they can do no harm.

The reform: a more economic approach

- The Vertical Guidelines have many complicated artificial *form based* legal categories that justify different treatments: agency, selective distribution, exclusive distribution, etc.
  - Firms try to fit in more and more things into these categories.
  - For instance, what conditions are necessary to have a preferential treatment of an agent under the vertical's safe harbour?
  - Does this really make a difference?
- Isn't it time to have more general principles for effects based analysis instead of form based categories for verticals?
  - This would be consistent with other areas of antitrust enforcement (and other Guidelines)
  - This would also be consistent with merger control as firms can always decide to vertically integrate and clearly there is no *form based approach* here.