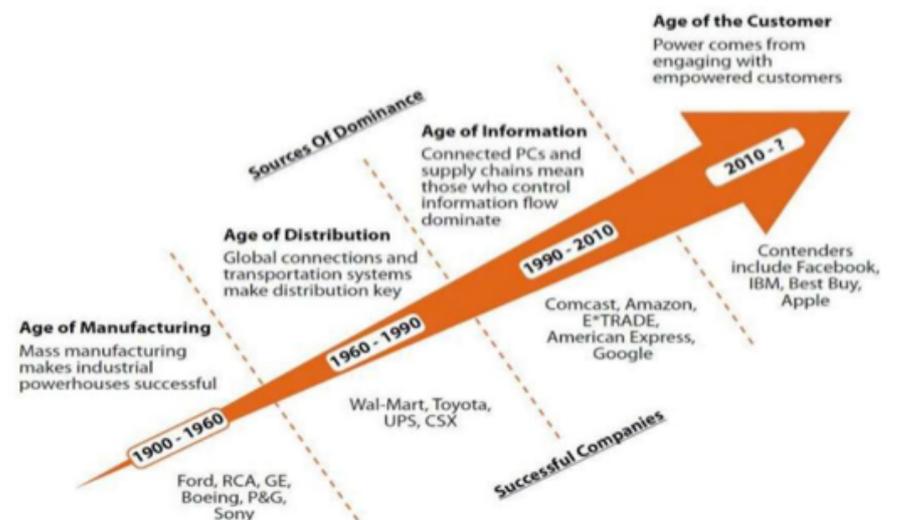


Evaluation Roadmap of the Vertical Block Exemption Regulation

Submission of Javier Berasategi¹

The author considers that the Commission should conduct a revise and modernise the current VBER² in light of the radical developments in the economy. These developments have basically shifted market power from manufacturers to distributors to platforms³. A chart found on Internet illustrates this power shift in the economy⁴:



Source: unknown

¹ The author regularly advises suppliers and their associations on competition law issues involving online platforms and brick and mortar distributors. Opinions expressed in this submission belong solely to the author and do not represent those of his clients.

² The reference to the existing VBER also covers the existing Vertical Guidelines.

³ The author refers the Commission to his study “Supermarket Power: Serving Consumers or Harming Competition”, available at <http://www.supermarketpower.eu/en/documents>, for a comprehensive analysis of the new economic paradigm of two sided vertically integrated online and offline platforms, including food retailers, their unfair trading practices and the potential regulatory and competition law remedies, the latter calling for a modernisation of competition policy.

⁴ Amazon’s purchase of a brick and mortar distributor (Whole Foods) reveals that food distribution is one of the few sectors where power has not shifted from distributors to platforms.

The Commission claimed, at the time of the consultation leading to the current VBER, that buyer power of big retailers and on-line sales were the most important market developments that needed to be addressed⁵.

The Commission considered that these two issues were unrelated and to some extent worked in opposite directions and the VBER and the Vertical Guidelines reflected this contrast. Whereas on-line sales were considered to promote consumer welfare and distributors' freedom to rely on on-line sales had to be safeguarded against manufacturers' restrictive policies, buyer power was no longer considered to be consumer-friendly in all instances and certain practices of distributors targeted at their suppliers merited a comprehensive analysis of their competitive effects.

Ever since, the Commission has focused its efforts on promoting e-commerce and lifting the perceived barriers to its development. The Commission launched the sector inquiry into e-commerce on 6 May 2015, as part of the Digital Single Market strategy, on the basis of EU competition rules, pursuant to Article 17 of Regulation 1/2003. On 10 May 2017, the Commission adopted the Final Report on the e-commerce sector inquiry and published the accompanying Staff Working Document, which set out the main findings of the e-commerce sector inquiry. Whilst acknowledging the growth of e-commerce, the Commission pointed to several competition concerns regarding (1) the growth of selective distribution networks and the contractual restrictions imposed on selective distributors⁶; (2) restrictions on selling and advertising online, namely, pricing

⁵ 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".*"

⁶ Final report on E-commerce Enquiry, p. 8: "(24) ...*Selective distribution may, however, facilitate the implementation and monitoring of certain vertical restraints that may raise competition concerns and require scrutiny. (...) (27) (27) Most of these brick and mortar requirements seek to promote competition on distribution quality. At the same time, certain brick and mortar requirements essentially aim at excluding pure online players from the selective distribution network, without enhancing competition on other parameters than price, such as the quality of distribution and/or brand image. As a result, while*

restrictions/recommendations, restrictions on selling on online marketplaces, geographic restrictions to sell and advertise online; and (3) the use of data in e-commerce.

On the other hand, it appears that the Commission has neglected the issue of buyer power and the current VBER have failed to address buyers' practices that raised potential competition concerns. This failure is aggravated by the seemingly pro-distributor bias of the current VBER⁷. For example, a manufacturer's resale price maintenance strategy is considered a hard-core restriction of competition irrespective of its size. Conversely, the VBER and the Vertical Guidelines are silent on the pricing strategies of upward vertically integrated distributors who control the retail pricing of products that compete with their own⁸. Furthermore, Commission officials have acknowledged in meetings with stakeholders that the reference in the VBER to the exclusionary practices against third-party brands of these upward vertically integrated distributors (par. 210) is a dead letter.

The author believes that the revision of the current VBER should adapt to the modern economy, mostly dominated by the so-called intermediaries or platforms, be they online or offline players. The latter control access to the consumer, centralise a growing number of products/services for them and turn into gatekeepers for most manufacturers of goods or providers of specific services⁹. Public authorities have associated this phenomenon with the online platforms. However, it is not the online/offline or the intermediary/distributor distinction that matters but the capacity to centralise products/services for consumers and the latter's contractual or de facto reliance on

acknowledging that brick and mortar requirements are generally covered by the VBER,¹⁴ certain requirements to operate at least one brick and mortar shop without any apparent link to distribution quality and/or other potential efficiencies may require further scrutiny in individual cases."

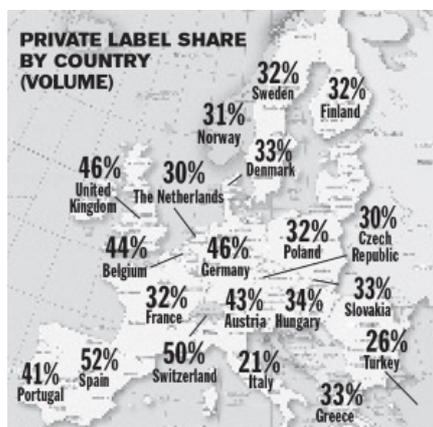
⁷ For a more comprehensive critique of the VBER's failure to address buyer power, see "Supermarket Power: Serving Consumers or Harming Competition", section 7.2.1.1 (The conventional analysis: EU Vertical and Horizontal Guidelines), p. 262 onwards.

⁸ For a more comprehensive critique to the current approach of competition authorities to RPM in food retail distribution, see the author's submission to the Bundeskartellamt in response to the consultation on the "Guidance note on the prohibition of vertical price fixing in the brick-and-mortar food retail sector", available at https://www.bundeskartellamt.de/SharedDocs/Publikation/DE/Stellungnahmen/Stellungnahme%20-%20Konsultation_Hinweispapier_LEH_BERASATEGI_2017.pdf?__blob=publicationFile&v=2.

⁹ Certain products/services may be so unique and directly, easily and individually accessible to consumers that may avoid gatekeepers but the trend goes in the opposite direction.

specific intermediaries. It has been publicly reported that DG COMP is investigating whether Amazon’s dual role as an online platform and as a competing online seller may be foreclosing third party sellers that rely on Amazon’s online platform¹⁰. This dual role is the standard in many offline consumer good sectors such as food retailing and manufacturers have for many years complained informally (the fear factor has prevented formal complaints) that retailers rely on several unfair practices (e.g., access and service fees, misuse of trade secrets, copycat, shelf-space, in-store switch marketing and strategic pricing) to favour their own vertically integrated brands.

Indeed, Amazon’s foray into consumer goods, including the acquisition of retail chains and the opening of shops, is in the early stages as compared with that of the leading food retailers:



Source: Private Label Manufacturers Association (PLMA), 2018 yearbook, <https://www.plmainternational.com/industry-news/private-label-today>

In light of the above, the author believes that it is the right time to revise the VBER and adapt it to the modern economy. The current VBER has failed to address the competition issues raised by buyer power and the Commission’s efforts to promote e-commerce may produce the unintended effect of reinforcing and consolidating the power of online distributors and platforms to the detriment of manufacturers. The author urges the Commission to conduct a holistic revision of the existing VBER that, among other issues, addresses three fundamental ones:

¹⁰ CNBC, “EU regulators want to make sure Amazon isn’t undercutting sellers, commissioner says”, 28.09.2018, available at: <https://www.cnbc.com/2018/09/28/eu-competition-commissionermargrethe-vestager-on-amazon-investigation.html>

1. **Goals of competition policy.** There is a lively debate in the US regarding the goals of competition policy and the adequacy of the consumer welfare standard. The FTC is conducting Hearings on Competition and Consumer protection in the 21st Century in order to assess “*whether broad-based changes in the economy, evolving business practices, new technologies, or international developments might require adjustments to competition and consumer protection enforcement law, enforcement priorities, and policy*”¹¹. Many authors, including prominent US scholars, argue that competition authorities, despite the bombastic speeches of their leaders, basically care about short-term low prices and neglect other more important competition parameters such as innovation and the competitive process¹². As a consequence, current competition policy is unduly restrictive on manufacturers’ distribution strategies whilst being too lenient on buyers/intermediaries’ procurement strategies.
2. **Buyer/intermediary power.** The balance of power has shifted from manufacturers to buyers/intermediaries in many sectors of the economy. Upward vertical integration raises novel and perhaps more dangerous competition issues than downward vertical integration because the former touches on dynamic competition (i.e., innovation, quality and variety). This buyer power is not confined to platforms/intermediaries. The unfair trading practices and potentially exclusionary practices blamed on Amazon have been a recurring topic in some economic sectors such as food retailing¹³. Indeed, if one wanted to learn about

¹¹ FTC press release, “FTC Announces Hearings On Competition and Consumer Protection in the 21st Century”, 20.06.2018, available at: <https://www.ftc.gov/news-events/press-releases/2018/06/ftc-announces-hearings-competition-consumer-protection-21st>

¹² See, for example, Kevin Caves and Hal Singer, “When the Econometrician Shrugged: Identifying and Plugging Gaps in the Consumer Welfare Standard”, June 29, 2018. George Mason Law Review, 2018, available at SSRN: <https://ssrn.com/abstract=3205518>; Marshall Steinbaum and Maurice Stucke, “The Effective Competition standard: A New Standard for Antitrust”, Roosevelt Institute, September 2018, available at: <http://rooseveltinstitute.org/wp-content/uploads/2018/09/The-Effective-Competition-Standard-FINAL.pdf>; Tim Wu, “After Consumer Welfare, Now What? The ‘Protection of Competition’ Standard in Practice”, The Journal of the Competition Policy International, 2018; Columbia Public Law Research Paper No. 14-608, available at SSRN: <https://ssrn.com/abstract=3249173>.

¹³ For a comparative analysis of different two-sided platforms, see the author’s presentations to the OECD’s Food Chain Network (2013), Portuguese Competition Authority (2014), UNCTAD’s Intergovernmental Group of Experts on Competition Law and Policy (2016) and the European

the expected competitive behaviour of online platforms, he would rather look at the evolution of food retailing in the EU. Indeed, it now appears that Amazon is keen to turn (force) third party sellers of its platform into wholesalers of its retailing arm¹⁴. On the other hand, food retailers have for a long time progressively turned their procurement negotiations into negotiations on risk-free service fees and guaranteed commercial margin, thereby enjoying the best of both intermediary/retailer worlds that Amazon seeks to replicate (e.g., upfront access and other services-related fees, reinforced with guaranteed commercial margin coupled with control of retail pricing/product display). Therefore, the conservative online strategy of some manufacturers may respond to legitimate goals such as the avoidance of the distributor/platform trap (short term success leads to distributor/platform dependence and ultimately distributor/platform foreclosure through affiliated goods/services) or the protection of intangible brand values linked to in-person sales irrespective of the premium nature of the goods/services.

3. ***Competition law and regulation.*** Competition law enforcement against the upstream or category management practices of vertically integrated retailers is non-existent. The oligopolistic structure of the market and the apparent absence of single dominance prevent any enforcement under Article 102 TFEU or the equivalent national provisions. In the online platform sector, so far only the Google Decision stands out, a case that lasted 7 years since formal proceedings were initiated, is currently on appeal and has not alleviated DG COMP's concerns with Google's dual role¹⁵. The ongoing informal investigation into Amazon's dual role will first have to overcome the dominance test and then evidence the existence of an abuse. If the Commission ever concluded that

Commission's High Level Forum on Food Supply Chain, Expert Sub-Group on private labels (2017), all available at <http://www.supermarketpower.eu/en/documents>.

¹⁴ Recode, "An Amazon revolt could be brewing as the tech giant exerts more control over brands", 29.11.2018, available at https://www.recode.net/platform/amp/2018/11/29/18023132/amazon-brand-policy-changes-marketplace-control-one-vendor?__twitter_impression=true.

¹⁵ See Reuters' latest news on DG COMP's investigations into Google's dual role practices, "Does Google harm local search rivals? EU antitrust regulators ask", 30.11.2018, available at: <https://www.reuters.com/article/us-eu-google-antitrust/does-google-harm-local-search-rivals-eu-antitrust-regulators-ask-idUSKCN1NZ2ER>

Amazon was abusing its dual role, it would not likely do so before 5 to 10 years from now and the finding would not extend to other non-dominant platforms that engage in the same practices. Not surprisingly, some authors across both sides of the Atlantic have concluded that competition laws, be it because their policy goals are misaligned with the modern economy or because the laws themselves are unfit for the task, should be second best to regulatory responses¹⁶. Indeed, the EU has regulated potential bottlenecks/gatekeeper issues in distinct sectors such as CRS/GDS, Internet access (neutrality), communication access/interconnection/termination, credit card networks and fintech. Currently, the EU is discussing two legislative proposals to address unfair trading practices of buyers in the food supply chain and online providers of intermediation services. At least as far as the food supply initiative is concerned, DG COMP's contribution to the impact assessment has voiced its fierce opposition to any such legislation, citing inflationary risks. However, according to the Commission Joint Research Centre's own econometric studies, cited in the same impact assessment, national laws on unfair trading practices in the food supply chain have had deflationary effects. With all due respect, DG COMP's stance, reflected in the Chief Economist's contribution to the impact assessment¹⁷, resembles that of the proverbial dog in the manger and shows a remarkable lack of understanding of (i) the power relationships in the food supply chain which have led 22 Member States to adopt regulatory measures (sometimes instigated and enforced by the NCAs), (ii) the distinction between unfair trading practices and hard bargaining on prices, and (iii) the innovation

¹⁶ See, for example, Hal Singer's regulatory proposal to address discrimination complaints against vertically integrated platforms outlined in the panel "Understanding Exclusionary Conduct in Cases Involving Multi-Sided Platforms: Issues Related to Vertically Integrated Platforms" of the FTC Hearing: Competition and Consumer Protection in the 21st Century, video available at: <https://competition-consumer-protection-hearings.videoshowcase.net/oct-17-2018-hearing-part-2>.

¹⁷ Commission staff working document impact assessment -Initiative to improve the food supply chain (unfair trading practices), Accompanying the document Proposal for a Directive of the European parliament and of the Council on unfair trading practices in business-to-business relationships in the food supply chain, SWD/2018/092 final - 2018/082 (COD), Annex H - "Economic Impact of unfair trading practices regulation in the food supply chain", prepared by the Chief Economist of DG Comp, pp. 260-268

and foreclosure harm on suppliers¹⁸. A holistic approach to this certainly complex issue is required, one that without abandoning DG COMP's perennial short-term low price concerns (in an economic era where central bankers are more concerned with low inflation than with high inflation) weighs in the more important dynamic competition concerns. For example, the study on "The economic impact of choice and innovation in the EU food sector" (2014), commissioned by DG COMP's Food Task Force, found that innovation and to some extent choice is declining across the sampled Member States after 2008 and that the growth of retailers' brands once a certain threshold is reached has a progressive negative effect on innovation¹⁹. The Chief Economist's note that supposedly assessed the impact of unfair trading practices regulation in the food supply chain overlooked this market reality and did not consider how the regulation of unfair trading practices may help fostering innovation and prevent abuses of the dual role in the market. This illustrates the need for a holistic approach when revising the VBER, one that takes into account static and dynamic parameters of competition and the emergence of powerful distributors/intermediaries that tend to integrate upwards and play a dual role.

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¹⁸ See the author's comprehensive critique of the Chief Economist's note available at <http://www.supermarketpower.eu/en/documents>.

¹⁹ The study reached these conclusions despite some methodological flaws that worked in the opposite direction. Basically, highly concentrated Member States were not included in the sample, the concept of innovation was not confined to first in the market and included copycats, buyers' wholesale concentration ratio did not account for retail alliances and supplier concentration ratio excluded retailer brands.