SUBMISSION OF PROMARCA (SPAIN) IN RESPONSE TO THE REPORT "THE ECONOMIC IMPACT OF MODERN RETAIL ON CHOICE AND INNOVATION IN THE EU FOOD SECTOR" COMMISSIONED BY THE EUROPEAN COMMISSION

INDEX

1 Executive Summary

We congratulate the Food Task Force and the authors of this Report for the time and resources devoted to this ground-breaking exercise, which is long overdue and a real challenge to undertake.

PROMARCA has been producing data in the same direction as some of the main findings in this study, particularly in the area of the decline in innovation in this sector and "tipping points", and it is reassuring to see that the conclusions coincide on these key points.

There is no doubt now that innovation in the processed food market is declining. The task now is to agree on which are the exclusionary and widespread practices causing this market failure and to adopt the remedies.

We remain available to provide any clarification regarding this submission, and would be delighted to continue providing our data and experiences in the next stage of this critical endeavour.

In PROMARCA's view, the Report has produced two main findings:

1. Innovation, as broadly defined as it has been, has declined over the time period analysed. We believe that if only the most economically significant types of innovations had been considered, this decline would have been substantially higher.
2. The growth of incumbent brands reduces significantly innovation and, to a lesser extent, choice.

The evidence from several independent sources on the Spanish processed food retail market, including the Spanish Competition Authority, fully supports these findings:

1. New product launches have declined since 2006 at least.
2. Choice has declined since 2007 at least.
3. Spain lags behind other Member States in terms of weighted distribution of innovations. Furthermore, several reports, including a market investigation by the Spanish Competition Authority, have identified several discriminatory practices against independent brands in the stores.
4. Econometric analysis has robustly confirmed a tipping point in Spain that starts at 35% market share of supermarket brands on average.

In sum, failure/lack of innovations is primarily retailer-driven, not economy/consumer-driven. Some leading retailers resist listing innovative products systematically as part of their strategy, even with respect to independent brands that are already listed (in basic versions) in their stores. The trend is towards less innovation and choice available to the consumer. The Spanish evidence not only supports the main findings of the Report. It fills some methodological gaps in the Report:

1. The Report adopts a too broad definition of innovations: new product innovations are the most important type of innovation from an economic and competition policy perspective as opposed to other types of innovations considered in the Report such as packaging, particularly when it is related to size or look. Often, additional of different sizes are imposed on manufacturers even to make more difficult price comparison by consumers. The growth of supermarket brands and retailers' discriminatory practices against independent brands are undermining the most important types of innovations.
2. The Report does not single out first-into-the market innovations from copies. Spanish evidence reveals that independent brands are almost the only ones that bring truly new products into the market. Supermaket brands benefit from the inside and confidential/sensitive from independent brands and use it in favour of their own brands, an unfair practice that would amount to a competition law infringement if incurred by independent brands in the market. Also, copycat packaging is widespread.
3. The Report wrongly estimates supplier concentration, retailer concentration ratios and bargaining power ratios to the effect of overestimating supplier power and underestimating retailer power: a double bias in favour of retailers. However, it is precisely retailers' bargaining power vis-à-vis independent brands (and consumers) the lever that enables them to adopt unfair and exclusionary practices against independent brands and their innovations to the benefit of their own brands.
4. The Report should have considered the weighted distribution of the innovative products. It is not the same if the EAN code identified as new has been found in one store or in 70% of stores. The impact in consumer access, and welfare, is very different. In countries like Spain, innovations achieve only a 25% weighted distribution. That is, presence in stores representing 25% of the consumption of the food sector: only one out of every four consumers can ever have the opportunity to purchase them in their chosen stores.

All in all, the main findings of the Report and further evidence from the Spanish market expose the negative effects of retailers' exclusionary and widespread unfair practices against independent brands and their innovations. Independent brands are systematically discriminated against in terms of listing. Some leading retailers resist listing innovative products systematically as part of their strategy, even with respect to independent brands that are already listed (in basic versions) in their stores. In Spain, 50% of the retail market is foreclosed upfront by the closed shop strategy of leading retailers

(Mercadona, Dia and Ldll). The trend is towards less choice available to the consumer, at the expense of secondary and third brands. Brands are also being priced out of the market through systematic margin discriminations. Supermarket brands are being cross-subsidized by the higher margins earned on independent brands. However, once consumers switch to cheaper supermarket brands and independent brands can be delisted, supermarket brands increase significantly their prices.

These practices reveal that, to a large extent, the growth of supermarket brands is not based on merits and, unfortunately, leads to a decline of innovation and consumer welfare in the market.

In light of these findings, PROMARCA suggests that the European Commission, led by the Food Task Force, should build a coherent analytical framework to address retailers' exclusionary practices and provide adequate remedies. It is acknowledged that retailers' dual role as buyers and competitors raises complex issues not present in the analysis of seller power and the implementation of seller-related remedies. However, these difficulties could be overcome with a mixture of regulatory and competition remedies. In the latter field, the urgency of this problem calls for an inmediate revision of some of the retailer-related issues dealt with in the Vertical Guidelines (e.g., dual role of vertically integrated retailers, category management, access fees and cumulative effects). Public intervention in other competitive bottlenecks may offer guidance to the Food Task Force (DG COMP) and DG Internal Market.

Again, we recognize the mammoth task this undertaking represents and congratulate the Food Task Force and the authors of this Report for the time and resources devoted to this ground-breaking exercise and remain available to provide any clarification regarding this submission.

2 Introduction

The Directorate General for Competition of the European Commission is seeking comments from interested parties to the report. PROMARCA is the Spanish association of manufacturers of daily consumer goods and member of AIM. It counts as members close to 50 leading companies and its main goal is to advance fair and undistorted competition between independent brands and supermarket brands in the grocery retail market. Member companies of PROMARCA are the leading innovators in the Spanish processed food market according to independent reports and the association has researched extensively and commissioned several independent studies on the competitive landscape for innovations in the Spanish market.

3 Scope of the submission

PROMARCA adheres to the submission of AIM but would like to present further evidence and arguments on the Report's main finding from a competition law standpoint: the foreclosure effect of supermarkets' own brands ("incumbent brands", "vertically integrated brands" or "private labels") vis-à-vis third party brands ("independent brands", "non-integrated brands" or "manufacturers' brands") and their innovations. PROMARCA considers that there exists plenty of evidence in Spain supporting the existence of a vicious circle that consists of retailer bargaining power, unfair/exclusionary practices vis-à-vis independent brands and their innovations, growth of supermarket brands, decline of net innovation and stagnation of category growth (consumer demand). This vicious circle undermines dynamic competition, economic growth and consumer welfare and calls for competition law and regulatory remedies. In this regard, PROMARCA will refer extensively to its previous submission to the European Commission's Green Paper on unfair trading practices in the business-to-business food and non-food supply chain in Europe[1] and the academic work of Javier Berasategi[2].

4 The Report's main finding: decline in innovation and negative effects of incumbent brands on innovation

In PROMARCA's view, the Report has produced two main findings:

1. Innovation, as broadly defined as it has been, has declined over the time period analysed and, if only the most economically significant types of innovations (product innovations) had been considered, this decline would have been substantially higher.
2. The growth of Private Labels reduces significantly innovation and, to a lesser extent, choice.

Even though the Report advances that the decline of innovation may be due to the economic downturn, PROMARCA is confident, based on the findings of the Report, the evidence regarding the Spanish market and, ultimately, pure common sense, that the decline of innovation and, most notable, of new product launches[3] observed in the market is linked to the foreclosure effects of retailers' practices vis-à-vis independent brands and the ensuing growth of their own brands.

4.1 Decline in innovation

The Report has shown that, although product assortment and store choice have increased in the overall period analysed, innovation has declined at an annual rate of 6.5% since 2008 and the quality of innovation has also fallen, since while in 2004 innovation mainly consisted of new product launches and range extensions, in 2012

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[1] Available at: http://ec.europa.eu/internal_market/consultations/2013/unfair-trading-practices/docs/contributions/individuals-and-others/promarca-spanish-association-of-manufacturers-of-daily-consumer-goods_en.pdf

[2] See the author's website www.supermarketpower.eu and the study "*Supermarkets: serving consumers or harming competition?*" (2014).

[3] The Report has adopted a wide definition of innovation that does not take into account the enormous differences in economic and consumer-welfare terms between different types of innovation: the first new product in the market is a breakthrough innovation that contributes significantly more to economic growth and consumer welfare than a new packaging size.

innovation was principally related to product packaging, which has grown from 4% in 2004 to a third of all innovations in 2012[4].

The study has defined innovation as the introduction of a new EAN bar code and, within this wide concept of innovation, has distinguished between different categories of innovation, granting them all the same value[5]. However, from an economic and consumer welfare perspective, a new product is much more important than a new packaging size and being "first in the market" is much more important than being a copycat.

Despite the broad definition of innovation adopted in the Report, it identifies a 6.8% annual reduction in innovation in the period 2008-2012, which it attributes principally to the economic crisis[6]. In fact, the Report insists on differentiating between the pre-crisis period and the crisis period (2008—2012).

However, it has to be noted that only a pair of years (2006-2008) is considered in the pre-crisis period (there is no comparison with other pair of years in the pre-crisis period) and that the percentage of innovations relative to total EANs declined overall in 2006-2008, 2008-2010 and 2010-2012)[7].

Furthermore, Annex B (Section 11.2.2) of the Report shows a reduction in the percentage of new products in 22 of the 23 categories analysed in the period 2004-2006.

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[4] See European Commission press release, "Competition: Commission publishes results of retail food study", 2 October 2014, http://europa.eu/rapid/press-release_IP-14-1080_en.htm: "At local level, consumer choice has been continuously increasing over the last decade in terms of number of shops, products, brand manufacturers and product package sizes displayed in shops. However, the number of innovations reaching the consumer each year has decreased since 2008 by 6.5%. In 2004 innovation essentially consisted of new-to-the-world products and range extensions (e.g. new flavour), whereas in 2012, roughly a third of all innovations merely concerned the packaging of a product." Relative to the lead position of packaging in 2012, see page 119 del study: "Although new packaging used to represent a small proportion of the overall number of innovation (less than 5% in 2004), it represents the majority of innovations in our sample in 2012."

[5] See page 42-43 of the study: "It is important to outline a number of general limitations, which need to be taken into consideration…Innovation: the definition of innovation from an operational perspective for this study is the introduction of a new EAN code. The Consortium team has not sought to qualify what should and should not be considered a genuine innovation. Therefore, the number of innovations in this study is synonymous with the number of new EANs that appear in the assortments across the sample (with the exception of EANs identified as promotions, which have been excluded), whilst the different categories of innovation have been identified through applying data from © Mintel GNPD. Two different sources have been used for innovation, and therefore the absolute numbers according to each source cannot be reconciled."

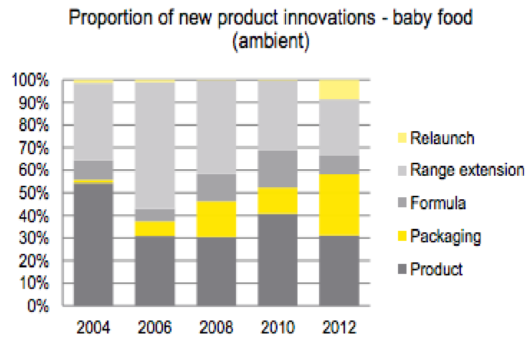
[6] See European Commission press release: "Competition: Commission publishes results of retail food study", 2 October 2014: "*Finally, while choice for European citizens has continuously increased in shops since 2004, the number of innovations reaching the consumer each year has decreased since 2008 largely due to the economic crisis*."

[7] See page 28 of the Report: "The number of innovations increased pre-crisis between 2006 and 2008 (+3.8% annually) but this trend was reversed during the crisis period with falls registered between 2008 and 2010 (-1.2%), as well as 2010 and 2012 (-5.3%). The share of innovations in the total number of products decreased steadily from 43% in 2006 to 30% on average in 2012."

This reduction is, in most of these 22 categories, the largest, in two-year terms, of the entire period 2004-2012.

11.2.2. Evolution of innovation per product category

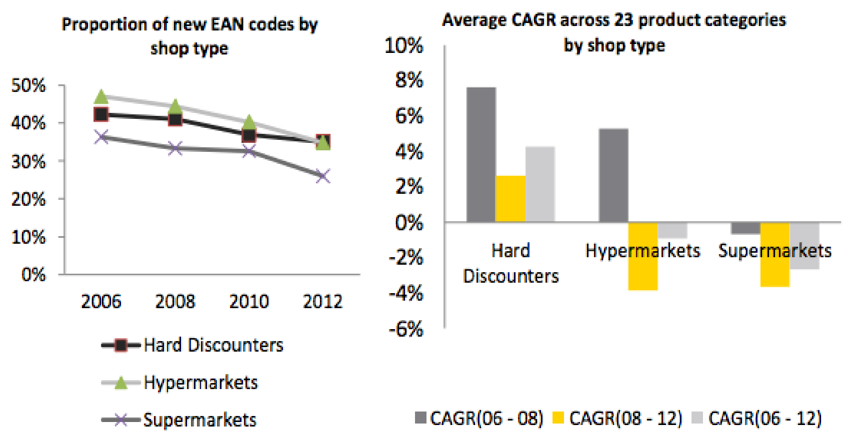
Proportion of new product innovations *Baby food (ambient)*	2004	2006	2008	2010	2012
Product	54%	31%	31%	41%	31%
Packaging	1%	6%	16%	11%	27%
Formula	9%	6%	12%	16%	8%
Range extension	34%	56%	41%	31%	25%
Relaunch	1%	1%	0%	0%	9%
TOTAL	100%	100%	100%	100%	100%



Source: The Report, page 281.

Finally, it is also highly relevant that the econometric analysis has concluded that the larger the store, the more choice and innovation are present, but the data collected indicates that **supermarkets have reduced assortment and innovation since 2006 (well before the start of the economic downturn)** while discounters are increasing them (albeit in much lower absolute terms):

Figure 48: 2008-2012 data set: Evolution of innovations (new EAN codes) by shop type (local level) –6 MS sample (source: EY analysis based on © Nielsen Opus)



Precisely, the evidence in Spain shows that supermarket chains with a closed shop strategy (unrelated to shelf-space constraints or macroeconomic factors) are deliberately refusing to list innovations.

All in all, PROMARCA considers that the decline in innovation and, most notably, new product launches began before 2008 and it is largely attributable to the growth of incumbent labels, fuelled by retailers' unfair and exclusionary trading practices. Several reports on the Spanish market reinforce this conclusion.

4.2 Negative effect of incumbent labels on innovation

The Report published in October 2014 concluded that a high market share of private labels restricted innovation and, to a lesser extent, variety in the market ("tipping point")[8]. This tipping point varied according to the product category between 25% and 50%. In the case of the first product analysed, packaged baby food, the authors of the Report indicated in their public presentation that the tipping point occurs approximately at the 25% mark. On average, the authors stated it to be around 35-40% market share. Understandably, the officials of the European Commission made this "tipping point" or, as per the terminology used in the Rewe/Meinl merger decision of the European Commission, the "threat threshold" the focus of the round table held during the public presentation of the Report. Also, in his presentation to the Agricultural Commission of the European Parliament on 7 October 2014, the Director of the DG Competition responsible for the Food Task Force reiterated the negative impact of private labels on choice and innovation when they exceed 40% market share in general terms.

The crucial importance of this finding, led the European Commission to ask the authors of the Report to conduct further work to refine their analysis on the impact of private label penetration on choice and innovation. The European Commission forwarded to the participants in the public presentation of the Report the new findings on this issue:

"In the conference on the report in October, it was highlighted that the relationship between private label penetration and the measures of choice and innovation appeared to be non-linear. Specifically, graphical analysis of the relationship (see section 9.6 the report) suggested that after a certain "tipping point", private label penetration is associated with a decrease in innovation. This relationship would have been inadequately captured in the initial analysis however, which tested for a linear relationship.

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8 See the Report (version published in October 2014): "We did not find evidence generally that a larger share of private labels (at national or local level) curbed choice. If anything, at least up to a moderate level, it is associated with slightly more choice, except in the case of the range of product prices where a larger share of private labels in a given product category and shop was associated with slightly less choice. However, beyond a certain level (which varies depending on the product category) it appears that a higher share of private labels is associated with less product variety") (p. 34) and "We did not find evidence generally that a larger share of private labels (at national or local level) curbed innovation: the impacts were generally found to be negligible in size even when statistically significant. However, beyond a certain level (which varies depending on the product category) it appears that a higher share of private labels is associated with fewer innovative products being offered" (p. 37).

In order to refine the analysis, the Consortium has now tested for a non-linear relationship between private label penetration and our measures of choice and innovation. Under the refined analysis, the results suggest that there is a ***statistically and economically significant negative relationship between private label penetration and innovation****. Moreover as the relationship is non-linear, the higher the level of private label penetration, the steeper the decline in innovation. The refined analysis suggests however that the impact of private label penetration on choice was not economically significant."*[9]

Accordingly, the final version of the Report now reads as follows in page 35:

*"****High shares of private labels were associated with less innovation***
We found evidence that a larger share of **private labels** *at local level was associated with less innovation, an effect which is larger for cases with higher shares."*

Annex 9.6 of the Report has also been amended accordingly and now the authors acknowledge a significant negative impact of incumbent labels on innovation[10] and, to a lesser extent, on choice[11].

5 The Spanish findings confirm that incumbent brands are foreclosing independent brands and innovation

The two main findings of the Report are coherent with several reports regarding the Spanish market. These reports show that innovation (and variety) started to decline well before the economic downturn, that this decline is retailer-driven to a significant extent (e.g., refusal to list innovations and other unfair/exclusionary practices) and that the growth of integrated brands reduces innovation because independent brands account for the vast majority of innovation in this market.

5.1 New product launches have declined in Spain since 2006 at least

Different reports confirm that new product launches started to decline well before the economic downturn and have continued apace.

[9] Email of 16.12.2014 from Philip Chauve, Head of the Food Task Force, DG Competition.

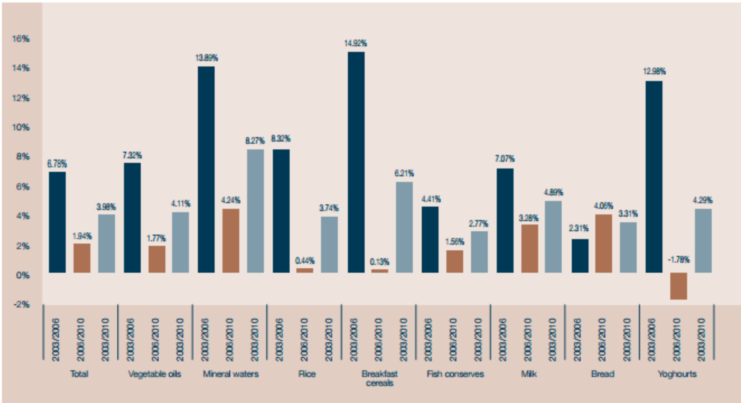
[10] Report, p. 225: "*The suggestion of a non-linear relationship was confirmed in further econometric analysis. When a squared term for the share of private labels was added, a negative relationship between the share of private labels and most innovation measures was found, with the impact increasing as the share of private labels increases (a 1 percentage point increase in share has a larger negative effect on choice at higher levels of private label share). The effect of introducing the squared term is larger than it was for choice (product variety), with a larger negative impact being found. This comes about partly because the (negative) impact of the hard discounter shop type is reduced when the squared term for private labels is introduced: what was previously treated as an effect of being a discounter (where private label shares are higher) is now treated as an effect of high private label share.*"

[11] Report, p. 223: "*The suggestion in Figure 153 of a non-linear relationship was confirmed in further econometric analysis. When a squared term for the share of private labels was added, a negative relationship between the share of private labels and all the measures of choice was found, with the impact increasing as the share of private labels increases (a 1 percentage point increase in share has a larger negative effect on choice at higher levels of private label share). However, the size of this effect was not large.*"

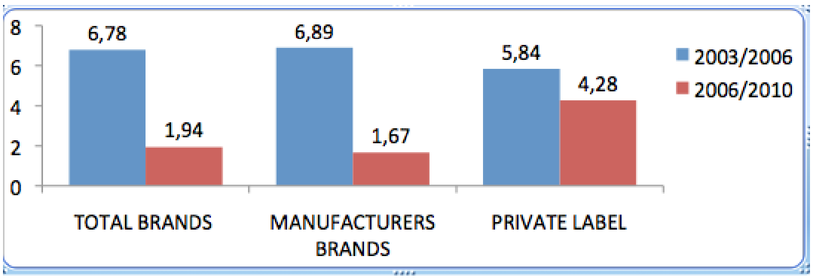
The report "The impact of private labels on the competitiveness of the European food supply chain" commissioned by the European Commission (DG Enterprise) in 2011 found that new product introduction in Spain was declining in the 2005-2009 period analysed due to the difficulties experienced by independent brands in securing access to retailers' stores and the growth of retailers' own brands[12].

The 2011 market investigation of the Spanish Competition Authority found a 71% decline over 2006-2010 as compared with the previous 3 years in the eight product categories analysed:

Figure 16
Average annual rate of introduction of new products (total brands), 2003-2010



Source: Prepared in house using data obtained from retailers.



Source: PROMARCA based on the SCA's tables.

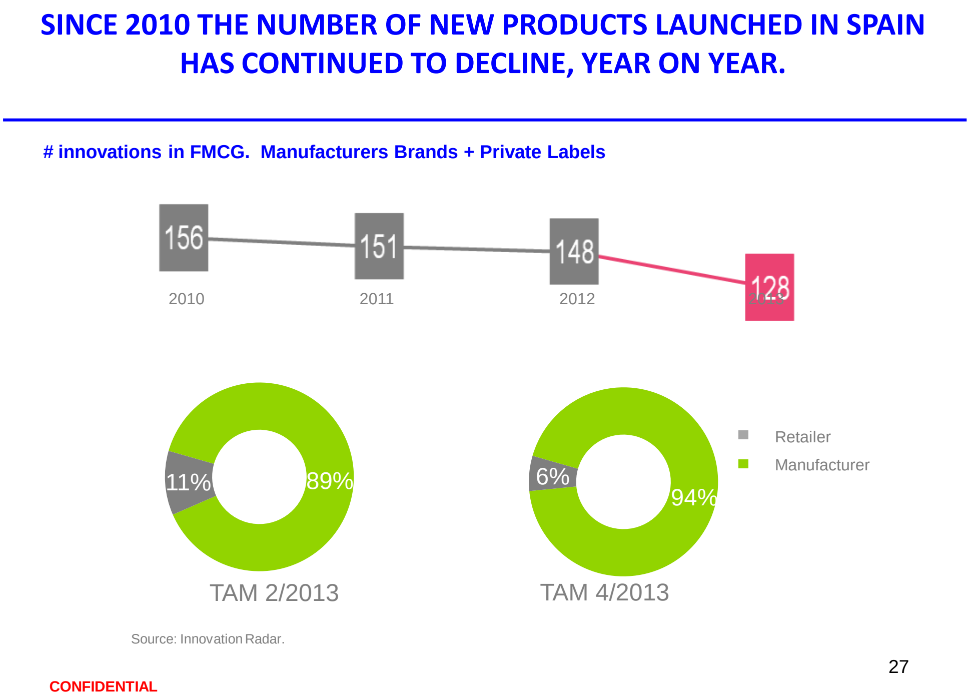
This led the Authority to conclude that "*in summary, although for the time being the indicators are not conclusive, there are reasons to surmise the existence of medium to*

12 The impact of private labels on the competitiveness of the European food supply chain, study commissioned by the European Commission, 2011, p. 91: "*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)*", and p. 169: "*It is increasingly more difficult for brand producers to get new products listed in countries like Spain. Because retail formulas that have a limited product assortment are growing in these countries, it is hard for brand producers to obtain high levels of distribution. This has a negative impact on product development by brand producers (but not by private label suppliers). Moreover, in some cases, such business practices as copycatting also have a negative impact on product development.*"

long-term risks that the current Spanish retailing model may reduce innovation in the grocery industry"[13].

Alimarket (a leading trade magazine) registered a 65% decline over 2007-2012 in their annual reports on innovation[14].

Kantar Worldpanel's "Innovation Radar" research confirmed that in the period 2010-2013 new product launches have declined by 19%[15]



and that in the 2009-2013 period, Spain was lagging behind other EU Member States as far as innovation activity was concerned:

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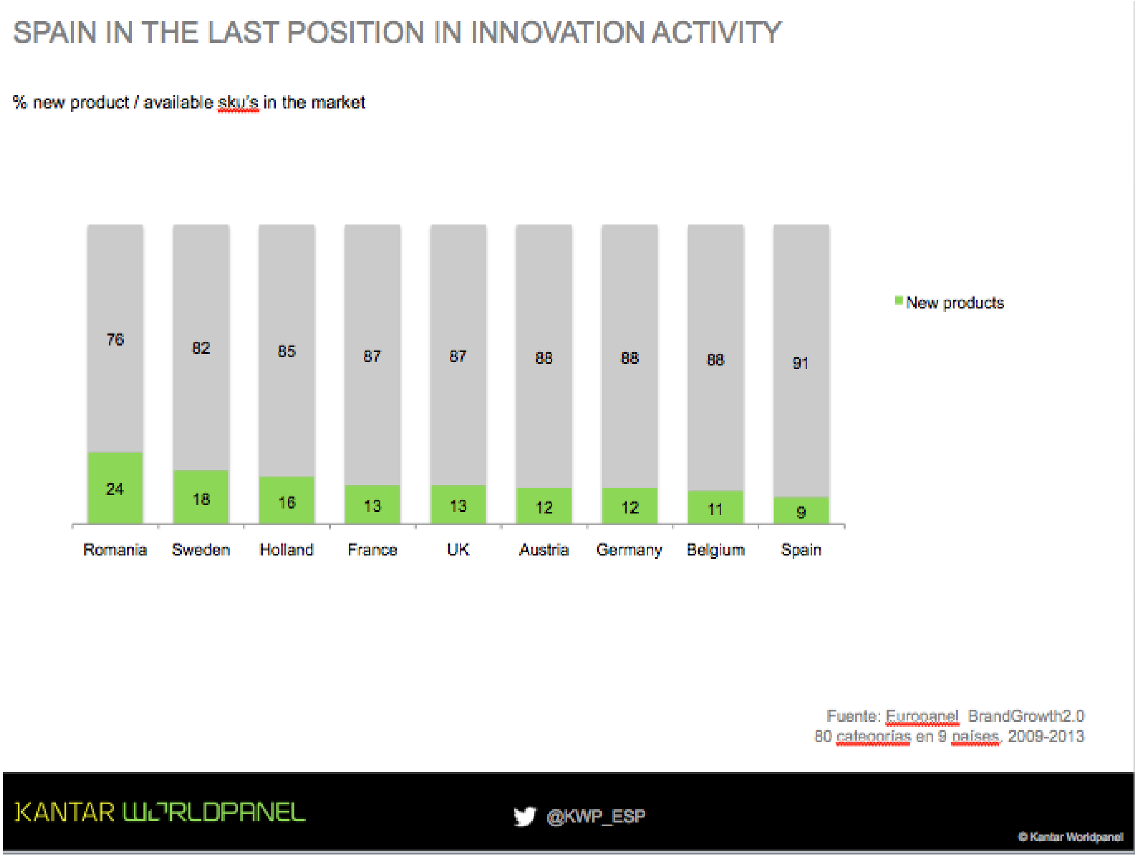
13 Spanish Competition Authority, "Report on relations between manufacturers and retailers", 2011, p. 6.
14 Reports available with PROMARCA.
15 KantarWorldPanel, "Radar de la Innovación", 2014, available at: http://mkt.kantarworldpanel.com/Spain/radarinnovacion2014.pdf



IRI reported a 50% decline over 2007-2009 in nine product categories[16].

5.2 Choice has declined since 2007 at least

A report published by the Business School ESADE in December 2014 has showed that in the period analysed (2007-2013, earlier data not being available), the number of SKUs went down by 3% in the 15 leading retailers of Spain despite the increase in the number of stores (6%) and commercial floor (15%)[17]. The SKUs of independent brands declined by 9% whereas those of private labels increased by 15%.

Supermarket stores accounted for the largest reduction in SKU´s (-9%), whereas hypermarkets only reduced variety by 3% and discounters increased it by 18% from a very low level. The leading Spanish retailer, Mercadona, accounted for a large proportion of the decline in the SKUs of independent brands. It expelled 30% of the SKUs of independent brands and increased by 19% its own SKUs. Not surprisingly, bearing in mind that Mercadona is only present in the supermarket segment, the decline

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[16] Report available with PROMARCA. Source: IRI InfoScanCensus™, Spanish hypermarkets and supermarkets.

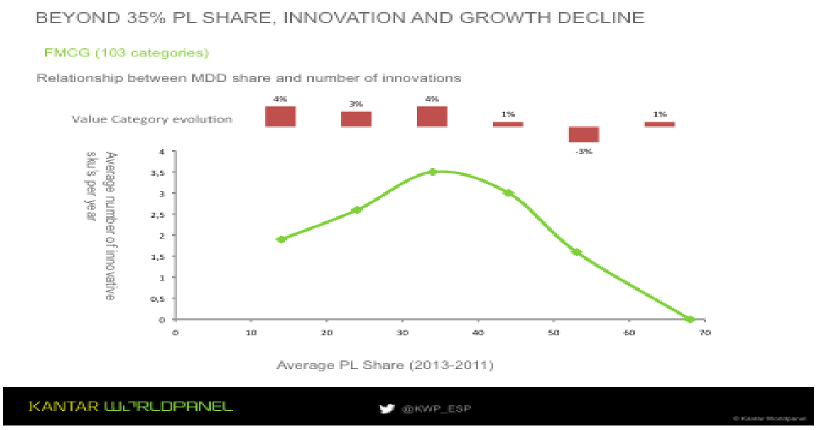
[17] Annex 4 of this submission. Available at: http://itemsweb.esade.edu/wi/Prensa/Resumen%20Ejecutivo%20ESTUDIO%20Surtido%20ESADE_prensa_v151214_sin%20ECI.PDF

of the independent brands' SKUs is more marked in supermarket (-17%) than in hypermarkets (-7%).

Furthermore, neither the Report nor the ESADE report reflect the fact that many retailers source their brands from a single supplier to the point that variety rests with the brand name but not with the product. This single sourcing strategy not only undermines variety but also harmonises costs across retailers' own brands and reduces competition among them. This single sourcing strategy may be carried out in the framework of buying alliances or through specific cooperation agreements between competing retailers. Only recently, the retailer Alcampo (Spanish subsidiary of the French group Auchan) announced enter a cooperation agreement regarding own brand procurement with a Spanish buying alliance (Euromadi)[18]. Failure/lack of innovations is primarily retailer-driven, not economy/consumer-driven

5.3 Econometric analysis has robustly confirmed a tipping point in Spain

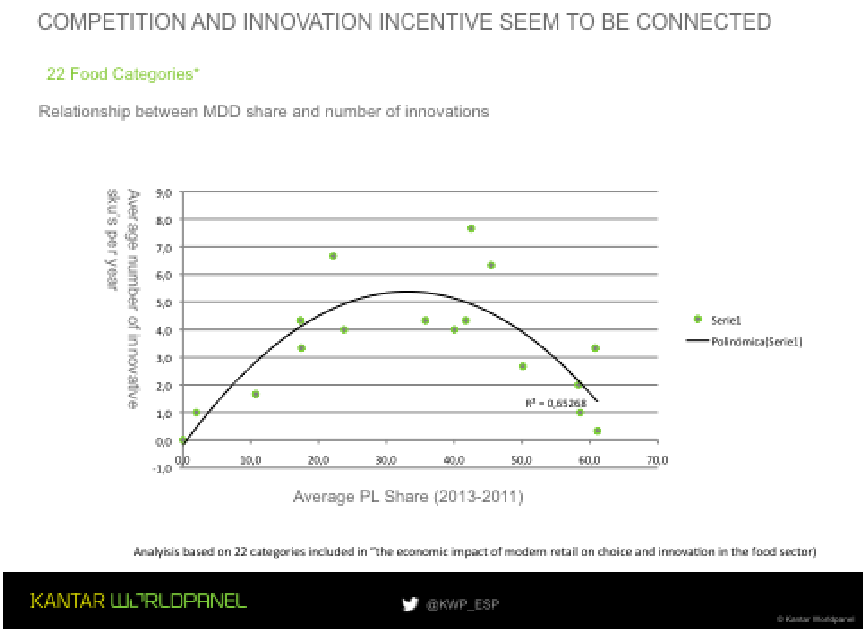
The existence of a threat threshold or tipping point above which the growth of supermarket brands in a product category restrict choice and, notably, innovation has been verified by the Kantar Worldpanel study "Innovating in the post-crisis era"[19] in Spain. The benchmark analysis of 103 categories in the period 2011-2013 lead Kantar to conclude that private label market share above 35% (in value terms) penalises innovation and growth in the market.



Kantar-WorldPanel has performed the same econometric analysis on the 22 food categories included in the econometric analysis of the Report and the results are almost the same:

18 http://www.europapress.es/economia/noticia-economia-empresas-alcampo-simply-suman-fuerzas-euromadi-impulsar-marcas-propias-20150112140637.html

19 Annex 3 of this submission.



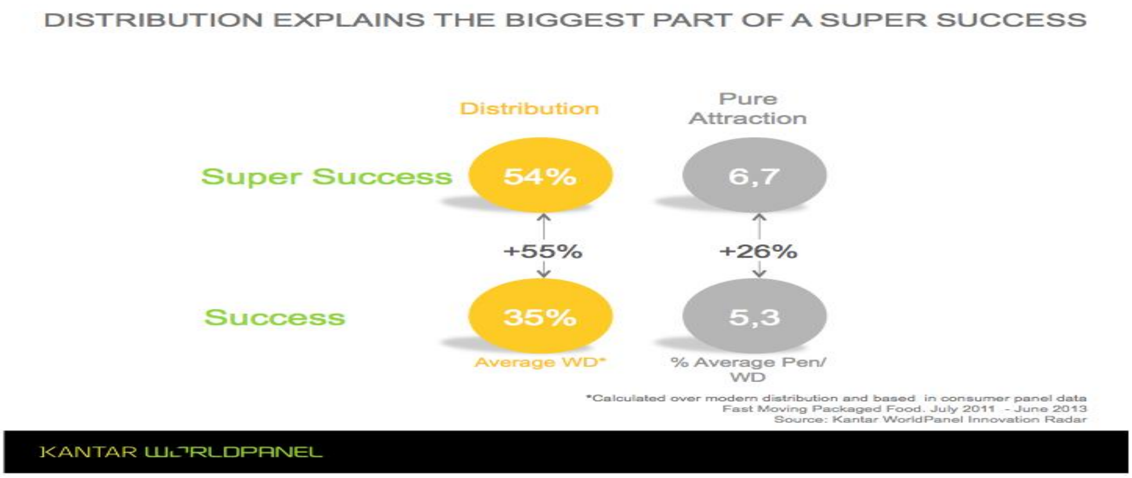
Industry analysts see supermarket brands as a "push" market as opposed to a "pull" market[20]: the growth of supermarket brands is a retailer-driven process. Before they realised that their bargaining power enabled them to vertically integrate upwards, they were already in a position to condition competition between independent brands. Furthermore, the spectrum of independent brands ensured all levels of quality and prices. However, vertical integration not only afforded retailers more bargaining power vis-à-vis independent brands, it offered them a chance to monopolise a distinct market, ring-fence their own market (independent brands are foreclosed before they can actually find a different route to consumers) and reduce competition between retailers (supermarket brands are less comparable than independent brands). Therefore, retailers have entered into subcontracting agreements with manufacturers to supply products to be resold in their stores under their own brands. Once the supermarket brands are established in the market, retailers have little incentive to offer access to the innovations of competing independent brands and, if they do provide access, they have every incentive to distort in-store competition in favour of their own brand.

This dynamic is exacerbated in countries where hypermarket stores do not provide sufficient competition to supermarket and discounter stores. This is the case in Spain where legal barriers have cornered hypermarkets and supermarkets and discounters now dominate the market with limited assortment (closed shop) policies which have nothing to do with space limitation: in stores the same size or smaller, there are chains that offer much more choice and access to market innovations.

[20] See for a thorough analysis, Rabobank, "Private Labels v. Brands", Rabobank International Food & Agribusiness Research and Advisory, 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."

This foreclosure strategy against independent brands and their innovations is reflected in the refusal to list innovations and the alarmingly low level of weighted distribution achieved by innovations[21].

Industry experts emphasize the critical importance of securing a sufficiently high weighted distribution in order for an innovation to be successful (i.e., recoup R&D, manufacturing and marketing costs and make a profit). For example, the IRI White Paper "New Product Success in Europe" (February 2007) claimed that "*distribution plays a key part in the success of a new product and levels can vary enormously across countries*" (p. 3) and "*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.*" (p. 9)[22]. Likewise, Kantar-WorldPanel's "Radar de la innovación" (September 2013) reveals that sufficient weighted distribution is a critical factor in the success of a new product launch, much more important than consumer attraction in the success of an innovation[23].



Unfortunately, many independent sources have singled out Spain as the market where innovations achieve less weighted distribution due to the "closed shop" strategy of retailers in favour of their own brands and have established that the sub-optimal weighted distribution explains the decline in innovation and R&D expenditure.

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21 Weighted distribution is the informal standard in the FMCG sector that measures the percentage of consumers reached by a product. It is calculated by summing up the market shares of the retailers where the product is listed and it is considered an accurate picture of the consumers that could buy the product. Obviously, the higher the weighted distribution of a product, the better chances of achieving higher sales that allow the recoupment of the R&D and marketing costs.

22 IRI White Paper, "New product success in Europe 2007", available at: http://www.iriworldwide.fr/portals/0/articlePdfs/NewProdSuccess_whitepaper.pdf

23 IRI, "Radar de la Innovación 2013", available at http://www.kantarworldpanel.com/es/Noticias/El-Radar-de-la-Innovacin-: *"**¿Cómo es la innovación exitosa?** (…) **Ha de estar disponible**. Dos de cada tres consumidores descubren las innovaciones en el punto de venta, así que estar presente en la distribución es clave para llegar al consumidor."*

The IRI White Paper 2007 offered a comparative analysis of the weighted distribution achieved by successful product launches in several EU Member States and Spain was substantially behind all of them:

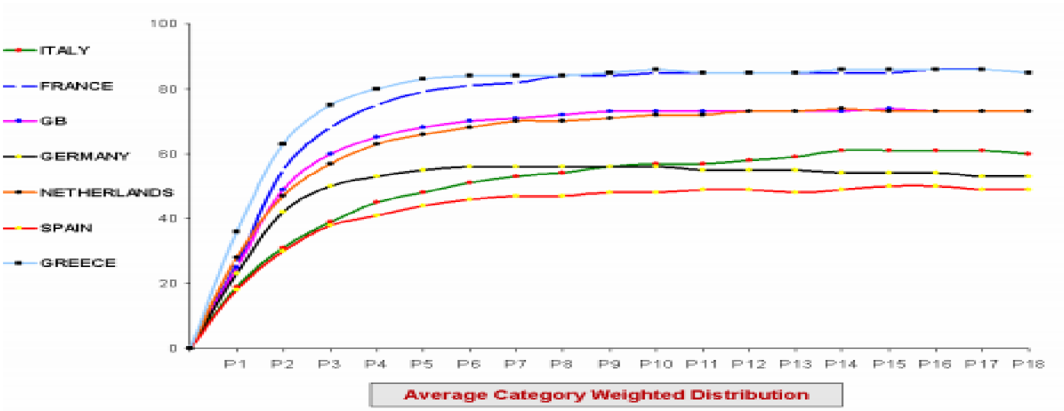
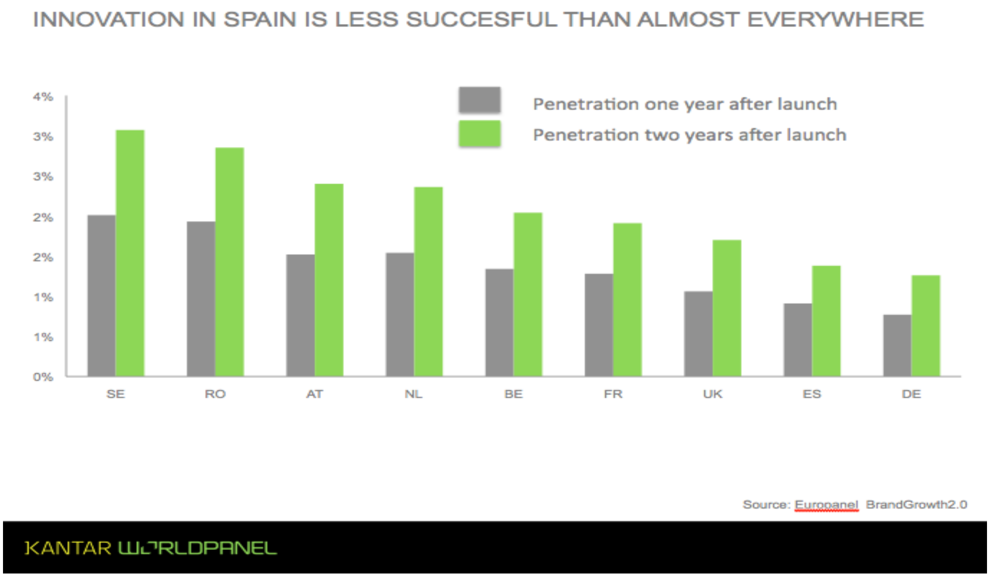


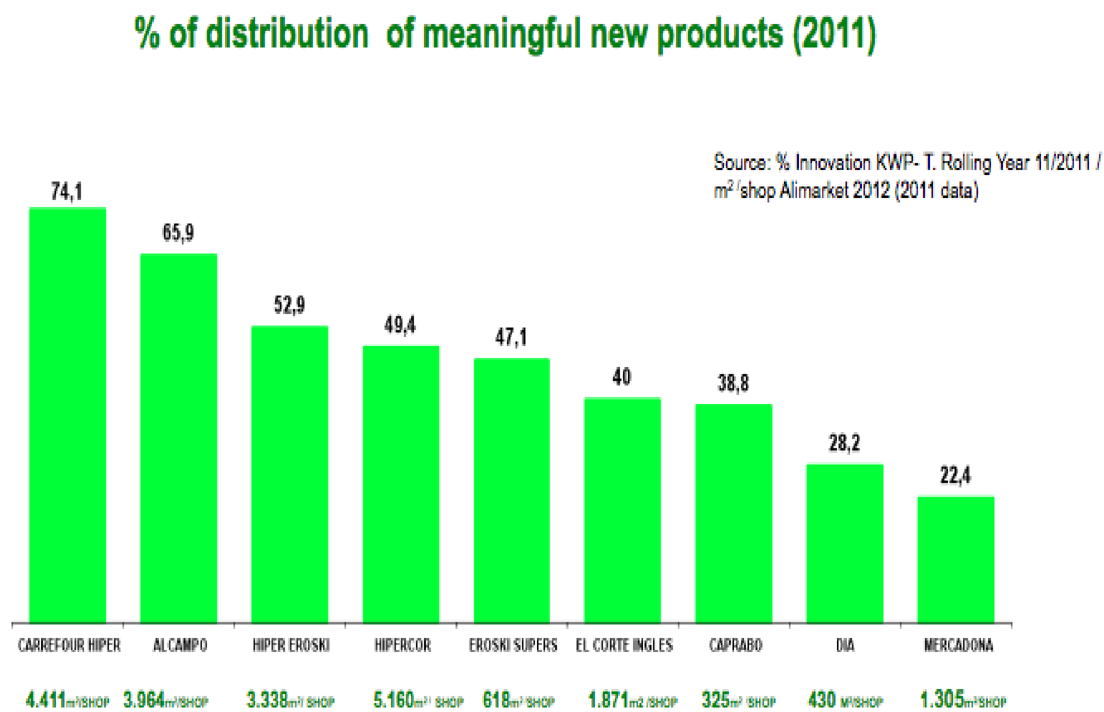
FIGURE FOUR: PRODUCT AVAILABILITY BY COUNTRY
THE BEST GROUP OF NEW PRODUCTS GAIN DISTRIBUTION QUICKLY, BUT OFTEN FALL SHORT OF THE MAXIMUM POSSIBLE

KantarWordPanel's "Innovation Radar 2014" offered similar results:



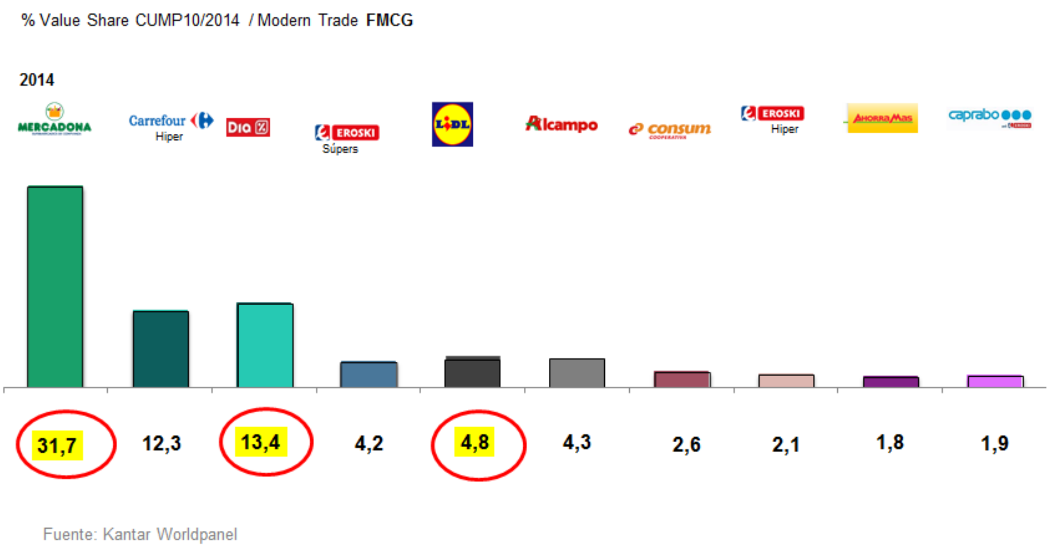
The analysis of the weighted distribution data in Spain reveals that leading supermarkets and, in particular, those that have an aggressive policy of vertical integration and substitution of independent brands by their own brands (Mercadona, Dia and Lidle, which together make up around 50% of the market) list an extremely low number of innovations, up to a point where other stores of equivalent or significantly smaller size list many more innovations than them. Kantar-WorldPanel's "Innovation Radar" reports year after year reveal that the leading Spanish retailer (Mercadona) as well as other retailers refuse to list a large majority of new product launches. See, for example, data presented in "Innovation Radar 2013":

Kantar-WorldPanel data in 2011, offered more detailed results:



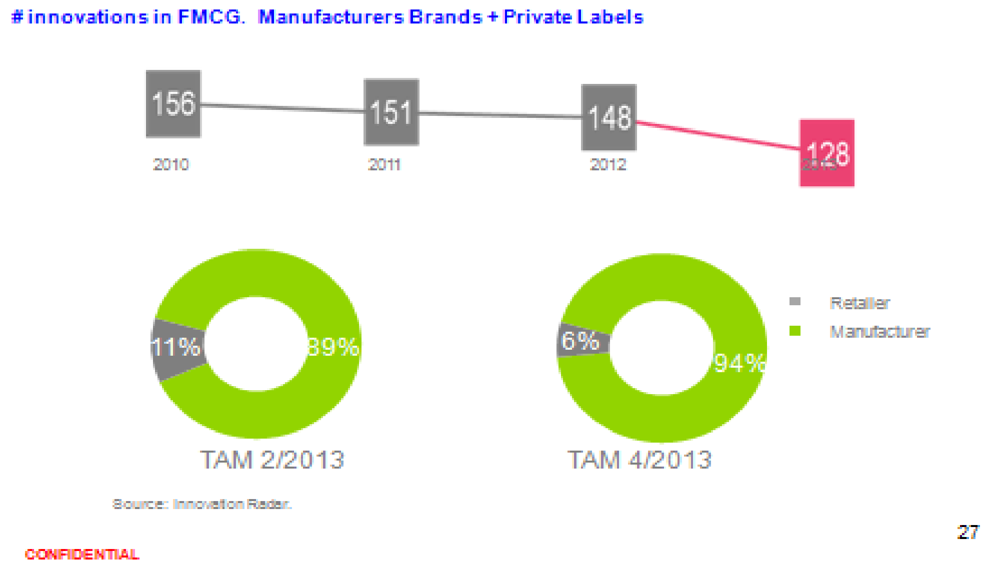
The closed shop strategy of Mercadona, Dia and Lidl forecloses upfront 50% of the Spanish retail market:

SPANISH RETAILER MARKET SHARE (%)

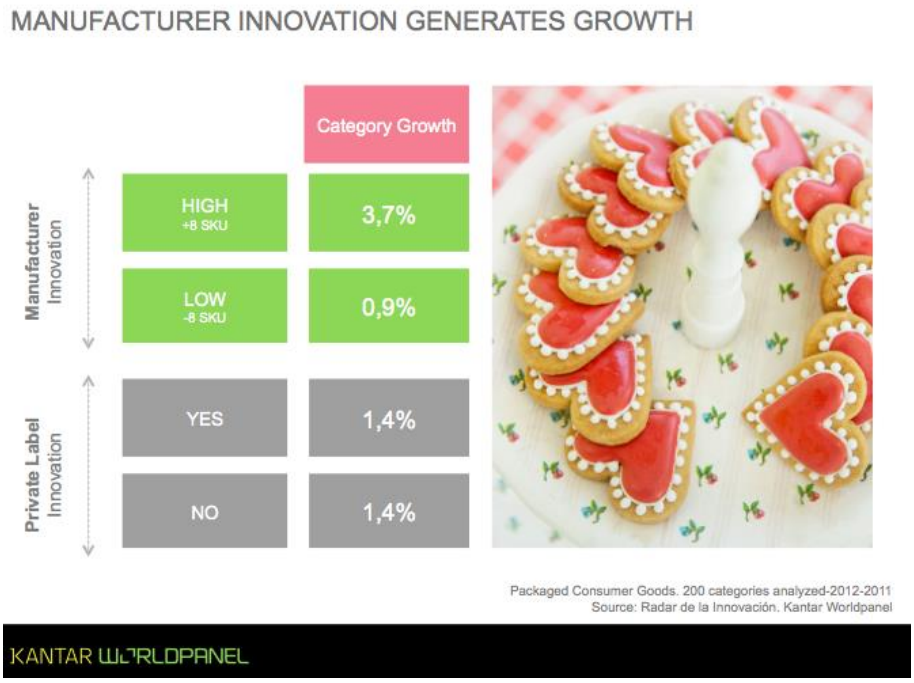


As a corollary of the "closed shop" policy of the leading Spanish retailers (i.e., deliberate refusal to list innovations of independent brands), supermarket own brands enjoy a privileged status in the stores and can grow unchallenged at the expense of innovation, which is launched almost exclusively by independent brands:

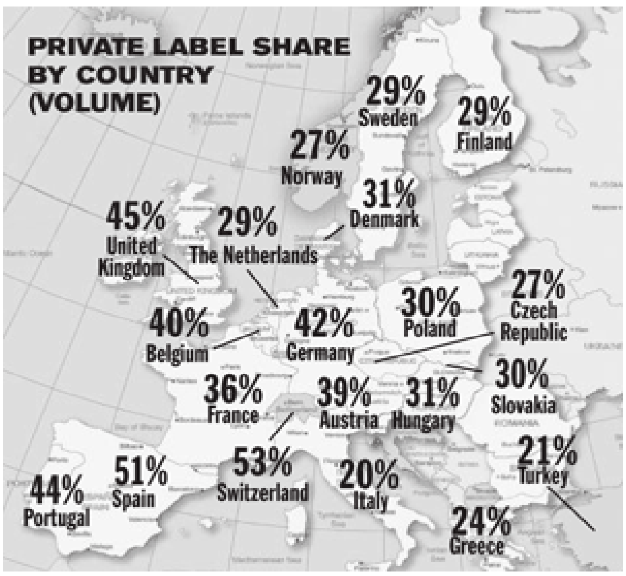
SINCE 2010 THE NUMBER OF NEW PRODUCTS LAUNCHED IN SPAIN HAS CONTINUED TO DECLINE, YEAR ON YEAR.



As innovation decreases, category growth gets also affected (i.e., supermarket brands increase their share of a non-growing and even decreasing pie):



The deliberate refusal to list innovations of some of the leading Spanish retailers and the unfair/exclusionary practices of all of them has placed Spain as the EU market where supermarket brands enjoy a higher market share, at the expense of innovation, dynamic competition, consumer welfare and economic growth:



Source: http://www.plmainternational.com/industry-news/private-label-today, based on Nielsen data regarding 2013.

This vicious circle, now categorised as a “tipping effect” or, better said, a “threat threshold” is present in most, if not all, Member States and it may be more or less acute according to national specificities.

6 Retailers’ bargaining power and unfair/exclusionary practices foreclose competing independent brands

The main criticism that can be exposed against the Report is that it has failed to define correctly supplier concentration, retailer concentration and bargaining power. It has estimated bargaining power by comparing supplier and retailer concentration at the national level. The estimation of supplier concentration is flawed and biased against suppliers because it has excluded the market shares of supermarket brands from the calculation, thereby creating an “artificial” market limited to manufacturer brands[24]. The estimation of retailer concentration is also flawed and biased in favour of retailers because it has excluded purchasing groups[25] from the national concentration analysis despite having reflected their growing importance[26]. Logically, the estimation of bargaining power is flawed and twice biased in favour of retailers. Furthermore, the comparison of supplier and retail concentration to estimate bargaining power is conceptually flawed. Competition authorities have repeatedly affirmed that bargaining power between suppliers and retailers depends on the replacement options that one side has relative to the other (equivalent to economic dependency), and that retailers can more easily dispense with suppliers than the other way around. The German

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24 See page 87 of the Report: “For the purposes of presenting the descriptive statistics in the following chapter, at procurement (national) level, supplier concentration is measured by HHI for brand only market, since negotiations at procurement level occur differently for brand versus private label suppliers. Comparisons with other supplier concentration indicators are made if the differences in results provide relevant information.”

25 See page 83 of the Report: “It is important to clarify how retail concentration is measured at the procurement (national) level. Measuring retail concentration at the buying group level would enable the impact of buying alliances on choice and innovation to be determined. However, in reality, procurement organisations and buying alliances are a complex phenomenon. Procurement organisations exist at pan-European, national and regional level and their scope of purchasing depend on the given shop, product category and whether it concerns a branded product or private label. The key source on procurement organisations is © Planet Retail. A thorough analysis of this database has revealed the complexity of procurement organisations in Europe, as we have found references to several procurement organisations for a given banner and retail group. Furthermore, information is not available on the split and scope and volume of products and brands purchased by each (proportion purchased centrally vs locally, for example), as these arrangements tend to be confidential and informal.

Considering information is incomplete and complex, the Consortium proposed to express retail concentration at procurement level in terms of the retailer group and banner market shares at national level only. Thus retail concentration will not be measured at procurement organisation level.”

26 See page 52-53 of the Report (Section “Organisation in buying groups and alliances”): “Increasing concentration can also be seen at the procurement level, through the development of buying groups. Buying groups are essentially a type of retail purchasing alliance, at a regional, national or international level. In essence, a buying group is an organization created by several shops or retailers with the aim of improving their purchasing conditions as well as enhancing their market competitiveness compared to other types of retail players.

Buying groups, or procurement organisations, have existed since the 1930s but they have developed particularly since the 1980s-1990s, a period which has witnessed the rise of cross-border alliances. The aim of cross-border groups is particularly to strengthen the retailers’ bargaining power through higher volumes to reduce purchasing costs, for the procurement of large international brands or for private labels. (…)”

Competition Authority has recently found that the leading retailers enjoy a stronger bargaining position than supplier after a detailed consideration of the outside options available to both. The Authority has estimated that only 6% of the independent brands are "must stock brands" and is *"convinced that even high-volume suppliers can have relatively weak bargaining power"*[27]. Previously, the Spanish Competition Authority found that "the trend seen in the grocery retailing sector in Spain in the last few decades has led to an increase in the bargaining power of retail distributors", cited as many as nine factors contributing to this bargaining power and estimated that 83% of suppliers were economically dependent on their retailers in 2010 (p. 60)[28]:

Table 15
Evolution and impact of relative dependence of manufacturers from 2003 to 2010

	Year	% Dependent revenue	% Dependent manufacturers
Total	2003	25.8%	65.6%
	2010	38.2%	83.0%

Source: Prepared in-house using data from survey of manufacturers.

The European Commission's Green Paper on UTPs correctly identifies the emergence of grocery retailers as competitive bottlenecks for independent brands:

"*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 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…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*."

Indeed, grocery retailers have emerged as powerful platforms in an oligopolistic environment that dictate to a large extent how consumers and independent brands interact.

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27 See the section on the German competition authority's website dedicated to this question: http://www.bundeskartellamt.de/EN/Economicsectors/Food/food_node.html

28 Spanish Competition Authority, "Relations between manufacturers and retailers", 2011, Section 2.4.3. (*Bargaining power: situation in Spain*).

Leading supermarkets enjoy a significant degree of market power in the grocery retail markets, facilitated by market concentration, barriers to entry, consumers' loyalty to their preferred supermarkets, market transparency and information asymmetries that benefit supermarkets at the expense of consumers.

Furthermore, as the consumers' loyalty to supermarkets grows at the expense of grocery brands (Spanish consumers make their monthly purchase basket at two modern retailers on average[29]) and the purchase decisions of specific brands/innovations are predominantly adopted in the store (2 out of 3 purchase decisions of brands are taken in-store[30] and 2 out of 3 new product launches are brought to consumers' attention in-store[31]), access to and competition within the store becomes a critical competitive variable under control of the supermarkets. In the neoclassic economic model based on bilateral supplier-buyer interaction, distributors are portrayed as neutral operators conveying consumer demand to manufacturers. Modern industrial economics has shown that suppliers with market power (and sometimes without it, as far as hardcore vertical restrictions are concerned) may engage into vertical restraints with distributors that foreclose competitors or harm consumers and this thinking prevails in the Vertical Guidelines of the European Commission. However, the emergence of powerful grocery retailers and their vertical integration upwards is a new development as far as competition policy is concerned in need of a proper economic theory of harm. In this regard, the modern economic theories on two-sided platforms and vertical foreclosure/collusion seem more able to explain the economic effects of leading retailers' bargaining power and practices vis-à-vis independent brands. Each leading supermarket not only reckons that its individual conduct influences the market conduct of its competitors (oligopolistic behaviour). It has also realised that it holds the power to influence and even prescribe what its consumers demand and how suppliers reach consumers. This power has transformed supermarkets into competitive bottlenecks for independent brands that depend on access to each of these if they are to remain viable economic players. Mark Armstrong, the economist who developed 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[32]. Thus, exploitation of suppliers reduced social welfare and, unless supermarket competition was intense, consumer welfare as well. On the other hand, 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 Commission attested in the Rewe/Meinl merger decision and other sources show, a 5-10% drop in turnover may force a supplier

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29 KantarWorldPanel, "Radar de la Innovación 2013".

30 IRI, "El Impacto de la marca de distribuidor en España", 2008, p. 2: "El 82% de los compradores realizan una lista de la compra con el objeto de reducir el importe total del carro y sin embargo el 67% de las decisiones de qué marca comprar se toman en el lineal".
http://www.symphonyiri.es/portals/0/articlePdfs/TT%20EL%20IMPACTO%20DE%20LA%20MDD%20EN%20ESPA%C3%91A_OCT09.pdf

31 KantarWorldPanel, "Decálogo de la innovación exitosa", fecha?

32 Armstrong, "Competition in two-sided markets", The RAND Journal of Economics, 37(3), 2006

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 rely on the "dominant" company).

The existence of bargaining/market power leads naturally to its exploitation by supermarkets vis-à-vis their suppliers. This exploitation has resulted in two types of UTPs:

(1) Vertical UTPs (indirect foreclosure)

Supermarkets have managed to transfer more and more of the risks of their retailing operations to suppliers by means of remunerated service agreements, manifestly unbalanced product supply 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 or request distinct sizes/packages that prevent customers' price comparisons across retailers. On top of that, independent grocery brands may be contractually forced to bear the cost of: (1) delivery 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) return of 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 have transformed themselves into service providers to independent grocery brands and they seek to maximise profits from access to and competition within their platforms.

These costs are not marginal. They represent an average of around 20-40% of the price of the product, according to estimates from various independent bodies[33]. And they are discriminatory, since they are not charged to private labels.

(2) Horizontal UTPs (direct foreclosure)

At some point in time, supermarkets have realised that it is more profitable to exclude independent grocery brands from the market than to exploit them. Therefore, they have integrated vertically by launching supermarket grocery brands (manufactured or not by them).

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[33] Javier Berasategi, "Supermarket Power: Serving Consumers or Harming Competition", 2014 at www.supermarketpower.eu.

Market foreclosure takes place through a set of restrictive practices that are aimed at preventing access to the store of competing independent grocery brands: (a) access fees that prevent distribution of independent brands; (b) an abrupt termination of access that undermines the economic viability of the operations of independent brands; and (c) an upfront access refusal of the independent brands' products and innovations that compete with supermarket brands.

Market foreclosure may also take place through distortion of in-store competition thorugh (a) pricing and (b) non-pricing practices. Even though supermarkets are able to transfer most, if not all, retail risks to suppliers and often operate *de facto* as providers of remunerated services to them as much as online marketplaces do, they have not formally foregone their "retailer" or "merchant" role (i.e., supermarkets 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 (a.1) an artificial price gap between the targeted independent brand and the supermarket brand; (a.2) a loss-leading price of the independent brand that undermines its quality perception; (a.3) a refusal to pass-through promotional wholesale prices of independent brands to their retail prices; and (a.4) a prohibition of the on-package promotions carried out by the independent brands. On the other hand, non-pricing practices may also be used to distort the consumer's in-store choice through (b.1) degradation of the in-store services provided to independent brands; (b.2) switch marketing techniques in favour of supermarket brands; (b.3) better shelf-positioning of the supermarket brands or disproportionate space allocation; (b.4) copycat packaging by supermarket brands of targeted competitors and (b.5) misuse of sensitive commercial information provided by independent brands in favour of incumbent 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 brands.

PROMARCA can provide the Commission with documentary evidence or trust-worthy accounts of all these practices. In a previous section, we have evidenced that some of the leading Spanish supermarket chains and, most notably, the leading one (Mercadona) only lists one out of every five new product innovations. Access refusal kills innovation before it has actually had a chance to compete in the store with the supermarket brand and third brands and effectively hides it from consumers. However, if an independent brands and its innovation is able to secure access to the store, it is only the beginning of a competitive ordeal. The retailer controls category management and can employ several pricing and non-pricing techniques to induce consumers to favour its own brand vis-à-vis the independent brand. One of the most damaging pricing strategies is to apply higher commercial margins to independent brands so as to induce consumers to switch to incumbent brands up to the point where they can be replaced by the competing supermarket brand. Competition authorities have uncovered this practice in the market investigations carried out in Spain, France (Paris) and Finland. However, no remedy has been advanced yet and it is distorting competition and retail prices. Spain is a test case, being one of the Member States where higher price differentials between independent brands and supermarket brands have been detected. If a supermarket chooses 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.

This is not a theoretical exercise. 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 scenes[34]:

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[34] 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"). Annex 1 of this submission. 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. Annex 2 of this submission.
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 belonging to 6 mass-consumption categories in a given period of time. The data for the olive oil and milk

<u>First</u>, leading supermarkets apply higher retail margins to all of the 12 products (comprising 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

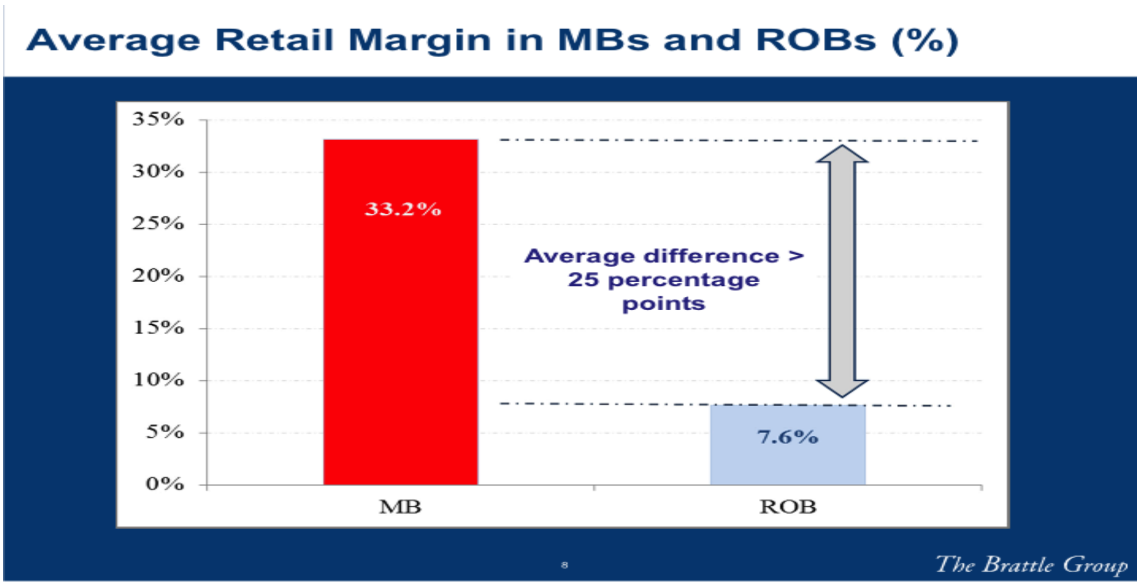
Product		Year	Brand Type	Transfer Price (Index) [A] See Note	RRP excl. VAT (Index) [B] See Notes	Margin per Unit (Index) [C] [B]-[A]	Margin per Unit (%) [D] [C]/[A]
Product A	[1]	2011	MB	100	125	25	25%
			ROB	44	46	2	5%
Product B Type 1	[2]	2011	MB	100	132	32	32%
			ROB	80	88	8	10%
Product B Type 2	[3]	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%
			ROB	83	67	-16	-19%
Olive Oil	[11]	2007-2008	MB	100	116	16	16%
			ROB	83	85	2	2%
		2008-2009	MB	100	134	34	34%
			ROB	86	79	-8	-9%
Milk	[12]	2008	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:



Source: Public presentation of the Brattle Study 2012, slide 8.

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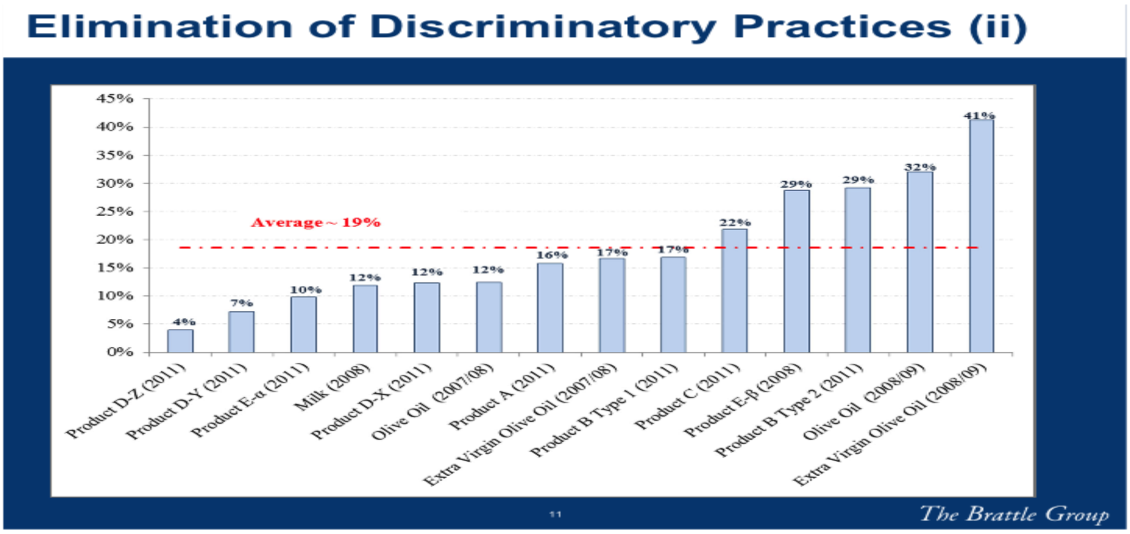
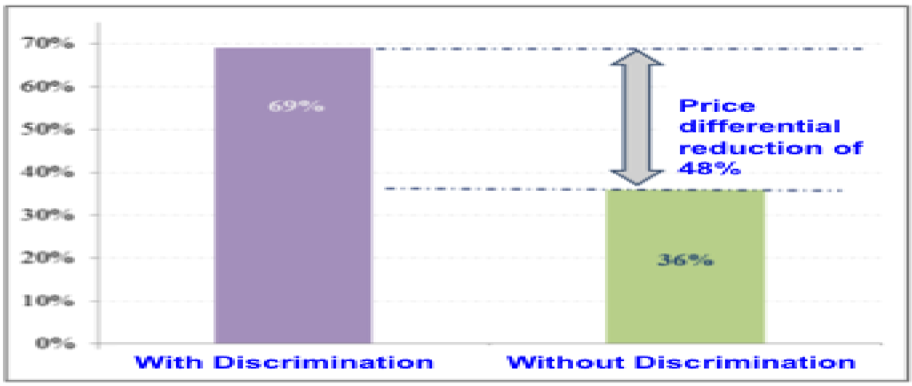
categories is from a public source, whereas the other products and categories are kept confidential for fear of retaliaton by retailers.

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%.



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 Dinks	+	+	-
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. They conclude that leading supermarket's power is distorting competition in Spain and undermining consumer welfare in terms of innovation, variety, quality and prices.

Lastly, and not unimportantly, Brattle finds that the higher the share of a Private Label product, the higher its price to the consumer: a 10% increase in penetration of the Private Label dishwashing detergents, soft drinks, chocolate or shower gels, for example, results in a 5% higher price to the consumer. A similar correlation exists between retailer penetration and the price of its Private Label.

All in all, two features make UTPs in the food-supply chain unique as compared with other economic sectors:

First, they are systemic since large supermarkets enjoy bargaining (market) power over all their suppliers, large and small[35], and this market power reinforces itself, facilitating widespread UTPs.

Second, they are exclusionary since supermarket now compete head on with independent brands (as recognised by the Green Paper: "*The expansion of retailers' own brands has turned some merchants into direct competitors of their suppliers*") and their UTPs are excluding the latter from the market and reducing competition between brands and between supermarkets.

35 According to the Bundeskartellamt report, only 6% of independent brands are considered to be inmune to retailers' baragining power. However, PROMARCA can provide evidence that leading brands with high market shares (even well above the thresholds giving rise to a presumption of dominance) are subject to several of the unfair/exclusionary practices described in this submission.

The Spanish food retail market is a test case of exclusionary practices and market failure:

- More than 50% of the market is closed or access is severely restricted to independent brands, most notably secondary and SME brands.
- Independent brands represent 90% of real innovations.
- Retailers systematically discriminate against the innovations of manufacturers: innovations of Manufacturer´s brands only achieve a 25% weighted distribution, thus resulting in lower consumer welfare through low access to innovations. This also reduces their incentive to continue innovating.
- Retailers systematically discriminate in pricing against their competitors, the independent manufacturers' brands, thus essentially cross-subsidizing supermarket brands via independent brands.
- Retailers that don't allow independent brands to promote in their stores and/or give them low space on the shelfs.

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 and Buhr have described in two tables 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[36].

[36] 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 [Olbrich and Buhr 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."

		Competition between products in retailing	
		Intrabrand	Interbrand
Competition between retailers	Intrastore	Branded articles over time are subjet 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 and Buhr, 2004.

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 Michael Porter, which leads to "zero sum" competition[37] and little consumer choice.

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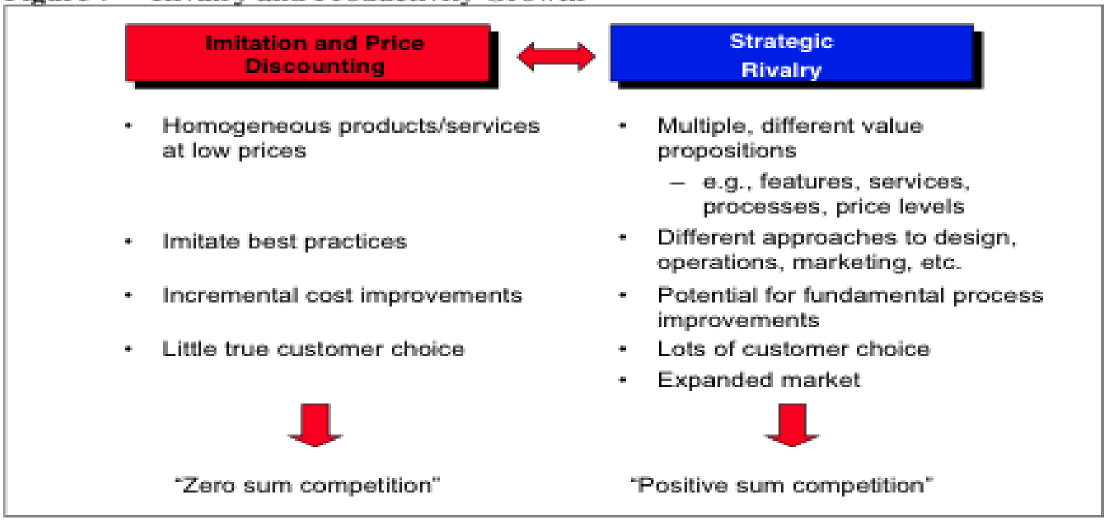
[37] See Kumar and Steenkampt, *Private label strategy – How to meet the store brand challenge,* Harvard Business School Press, 2007, pp. 33-35: "These store brands are copycats in the sense that they imitate the leading manufacturer brands in the category…Often, copycat store brands are uncomfortably 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

Figure 7 Rivalry and Productivity Growth



Source: Michael Porter, "Competition and Antitrust: A Productivity-Based Approach", essay, revised 30.05.2002, p. 16.

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.

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 UTPs 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 retailing[38]. 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

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."

38 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. 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.

notes that the most recent literature points towards negative effects (Chapter II)[39] and finally presents the negative effects of supermarket brands on three competitive factors: variety[40]; prices[41]; and turnover[42] (Chapter III).

Turning back to the Report, PROMARCA congratulates the Food Task Force for having devoted so much time and resources to a challenging exercise. It was worth it. This Report is a landmark: it has found for the for the first time at the EU level that incumbent brands foreclose innovation. Furthermore, some of the unfair/exclusionary practices advanced in this submission may reduce dynamic incentives to compete, innovate and be more efficient, which are difficult to measure under static econometric models[43]. 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: (1) Computer Reservation Systems (CRSs), now known as Global Distribution Systems (GDSs); (2) Mobile Communications Networks; (3) Internet Service Providers (ISPs); (4) Internet Search Engines; (5) Internet Domain Name Registration; (6) Media Platforms; (7) Card Payment Networks; and (8) car aftermarkets (regulation of car manufacturers' networks through a block exemption regulations adopted by the European Commission).

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[39] *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 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.)."

[40] *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.)."

[41] *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.).

[42] *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.)."

[43] For example, the misuse of confidential information supplied by independent grocery brands, is likely to reduce *per se* the incentives to innovate of the latter.

PROMARCA considers that this Report has uncovered at long last a market failure that is undermining innovation and competition in the European food retail sector. Competition authorities must react quickly to address the unfair/exclusionary practices of retailers.

7 Remedies needed to preserve innovation and competition in the market

Innovation is one of the factors (alongside variety, quality and price) that contribute to consumer welfare. 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 development[44]. 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)[45]. For

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[44] See, for example, Porter, "Competition and Antitrust: A Productivity-Based Approach", essay, revised 30.05.2002 [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."

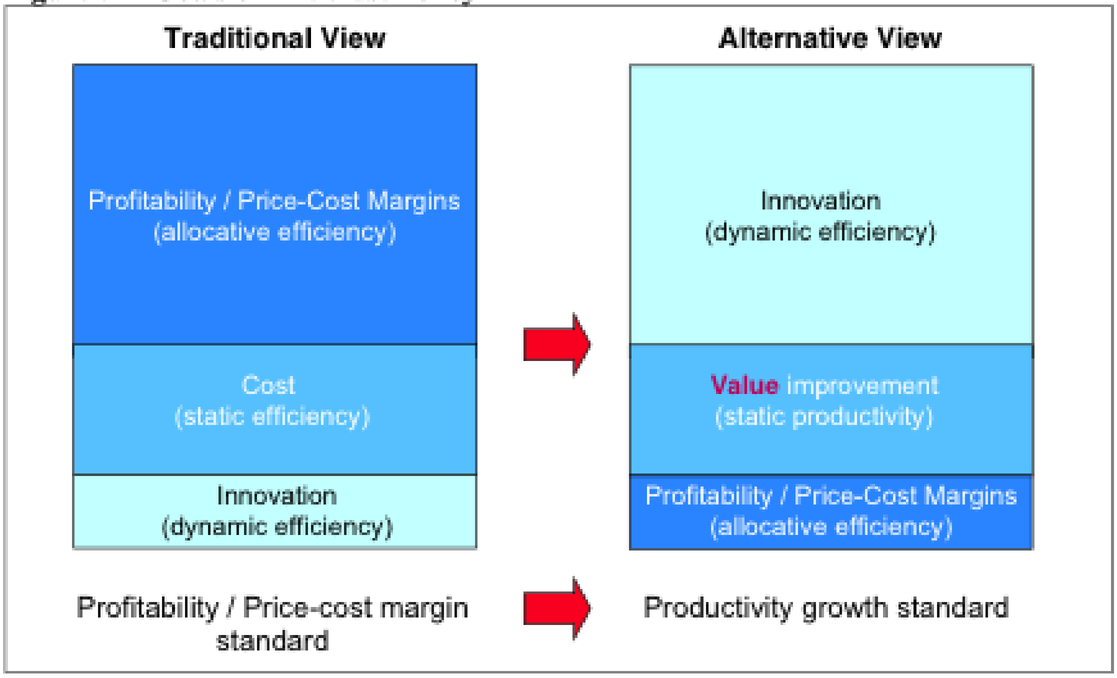
[45] See, prior note and, for a general survey of academic literature, OECD, "Application of Competition Policy to High Tech Markets", OCDE/GD(97)44, 1997, Background Note prepared by the Office of Policy Planning of the FTC, pp. 7-8: "Contemporary economists and antitrust scholars have acknowledged 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 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

example, Porter and Brodley have proposed turning the traditional hierarchy of competition policy goals upside down[46]. The table proposed by Porter is self-explanatory:

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: Ordover & Willig, "Antitrust for High-Technology Industries: Assessing Research Joint Ventures and Mergers," 28 J. Law & Econ. 311, 311-12 (1985) ("Ordover & 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.”

[46] 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 managing[47]. 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. <u>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</u>.

This Report has shown for the first time that the growth of supermarket brands is undermining innovation in Europe. Furthermore, several authorities, including the European Commission's Internal Market Directorate General have verified that retailers are employing unfair trading practices vis-à-vis their suppliers that, in a horizontal context, have exclusionary effects. Indeed, the growth of supermarket brands and the decline of independent brands and innovation are fuelled to a large extent by the unfair/exclusionary practices of retailers regarding access to and competition in their stores and do not respond to the market logic of merit-based undistorted competition between brands.

For many years, competition authorities have argued that unfair practices in a vertical supplier-retailer context fall outside the scope of competition policy. However, when these unfair practices are applied by the leading retailers on a widespread basis, across all suppliers, and have a horizontal impact (foreclosure of independent brands), they lead to a market failure that needs to be addressed by competition policy.

[47] Porter 2002, pp. 11-13.

However, the EU and national competition rules, as currently interpreted, do not seem to be adapted to the competitive bottleneck role enjoyed by retailers and their vertical integration upwards.

In Spain, neither the existing competition/unfair competition rules nor the regulatory/self-regulatory regimes have provided adequate remedies against the retailers' exclusionary practices.

The Law on Unfair Competition (Law 3/1991) contains provisions (e.g., abuse of economic dependence) that might address some of these practices. However, not a single supplier has ever taken a supermarket to court and it remains to be seen whether Spanish courts would consider that supermarkets' practices fall under any of the provisions of the Law 3/1991. The time needed to build the case-law might span several years and at the end of this long process the outcome might evidence that unfair competition rules, as interpreted by the courts, did not address adequately some, if not all, the unfair/exclusionary practices of retailers.

The Competition Law (Law 15/2007) has not helped either. The one and only complaint ever filed against supermarkets was rejected on the basis that (1) none of them held a dominant position; and (2) a collective dominant position was not present. However, the Spanish Competition Authority left open the possibility of applying article 3 of the Law 15/2007 (i.e., unfair practices that distort competition in the market and undermine the public order shall be prohibited). Following this case, the Spanish Competition Authority conducted a market investigation that exposed supermarkets' strong bargaining power vis-à-vis their suppliers and the existence of some practices that could distort innovation, competition and consumer welfare in the medium/longer term[48]. Ever since the publication of the market report (October 2011), the Spanish Competition Authority has not opened any ex-officio proceeding nor suppliers have filed any complaint.

As in other Member States, the common understanding in the sector is that competition rules provide no remedy at all against retailers' unfair/exclusionary because a prior finding of dominance never materialises. As a consequence, unfair/exclusionary practices that could be prohibited if executed by a single supermarket holding a dominant position (for the sake of the argument, a 40% market share) are left unchallenged when applied by several of them whose combined market share may well exceed 80%. To complicate the analysis, competition authorities still approach the independent brand-supermarket relationship as a vertical relationship and look favourably to the exercise of "buyer power" by the supermarket.

The findings of this Report call for a revision of the competition policy in this sector. The Vertical Guidelines addressed for the first time access fees and category

[48] See the English version, "Report on the relations between manufacturers and retailers in the food sector" (2011) at http://www.cncompetencia.es/Default.aspx?TabId=228.

management and raised the possibility that supermarkets could employ them to exclude competing independent brands. However, they did not provide any meaningful remedy when they materialise and undermine innovation, competition and consumer welfare. Supermarkets' brands compete with independent brands and, therefore, the supply agreements between independent brand and supermarkets would have to be assessed first under the EU Horizontal Guidelines, by virtue of Article 2(4) of the EU Vertical Regulation[49]. The horizontal guidelines establish a **15% market-share** safe harbour for non-reciprocal distribution agreements between competitors and joint selling agreements that could address category management practices of leading retailers and brands.

However, the EU Vertical state that those retailers that do not manufacture the products sold under their own brands are not to be considered manufacturers, *ergo* competitors of these manufacturers[50]. The Vertical Guidelines establish a **30% market-share** safe harbour for distribution agreements between con-competitors. 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 practices[51]. 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 obligations[52]. 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.

The European Commission, led by the Food Task Force, should build a coherent analytical framework to address retailers' exclusionary practices and provide adequate remedies. It is acknowledged that retailers' role as buyers and competitors raises complex issues not present in the analysis of seller power and the implementation of seller-related remedies. However, these difficulties could be overcome with a mixture of regulatory and competition remedies. Public intervention in other competitive

[49] 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."

[50] 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."

[51] 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…"

[52] 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".

bottlenecks suggests that economic regulation is a necessary complement to competition rules. 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.

We consider that the European Commission's Green Paper on UTPs was a step in the right direction. However, we missed a reference to the inherent conflict of interest faced by vertically integrated supermarkets when dealing with independent brands that leads to horizontal/exclusionary UTPs. The Green Paper rightly raised one of them (the unfair use of independent brands' commercial secrets in favour of supermarket brands) but there are other horizontal UTPs and the refusal to list meaningful innovations is a fundamental one.

Be it under competition rules or under specific regulatory remedies or under a combination of both, PROMARCA believes that it has to be guaranteed **fair and non-discriminatory access to supermarket platforms and competition within them for all grocery brands (whether they are vertically integrated or not), whilst preserving and fostering supermarket platforms' incentives to be efficient and compete against each other.**

The EU regulatory experience with other competitive bottlenecks such as CRSs should serve as an inspirational source. Regulation 2299/89 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[53]; and (4) effective guidance and enforcement by the Commission with the aid of independent auditors[54].

In the competition policy field, PROMARCA believes that the Commission should consider whether a sector-specific approach is required or not. The current Vertical Guidelines deal with access and in-store competition issues but this Report has shown that a more detailed legal framework with clear guidance is needed. The next revision of the block exemption regulations regarding vertical and horizontal agreements is far away and the Commission should consider immediate action[55].

The Commission could issue a Communication providing supplementary guidance on the relevant paragraphs of the Vertical Guidelines or even consider the withdrawal of

[53] 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, there may no longer exist economic efficiency reasons justifying vertical integration.

[54] Even though airlines have divested their stakes in CRSs and their 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.

[55] Certainly, this issue should also feature prominently in the next revision of the relevant block exemption regulations.

the block exemption to retailers that do not follow FRAND principles regarding access (fees) and category management. The Vertical Guidelines contemplate this scenario where the negative cumulative effects of networks of agreements make it necessary. The widespread and simultaneous unfair/exclusionary practices of the leading retailers falls squarely under the “cumulative effect” scenario: 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 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. A tied market-share of less than **5%** is not considered in general to contribute significantly to a cumulative foreclosure effect (par. 134 of the Vertical Guidelines) and retailers and/or retailer brands with less than 5% market share could benefit from a safe harbour.

If some practices such as the decision to list/delist an independent brand (access refusal/termination) are not considered to fall under Article 101 TFUE, the Commission could consider whether article 102 TFUE may be applicable in some instances (e.g., a retailer’s stores may constitute a separate market if the retailer is so large that access to its stores is a pre-condition for achieving sufficient weighted distribution/viability in the market) or propose regulatory remedies (access obligations) that are proportionate.

In the regulatory field, Member States are embarking on a regulatory race to address retailers’ UTPs but they have failed to address the exclusionary dimension of these practices (the misuse of independent brands’ commercial secrets being the exception). Self-regulatory initiatives have not addressed horizontal competition either and the control & enforcement problem remains a major stumbling block. In that regard, the Food Task Force (DG Competition) and DG Internal Market can offer a coordinated regulatory & competition response to the national initiatives. The EU could set binding rules that provide the minimum threshold of protection across the EU. Member States would be free to lay down more stringent obligations adapted to the national market structures and conditions. For example, access obligations might be needed in Member States such as Spain where the closed shop strategy of the leading retailers is severely undermining innovation.

8 List of Annexes

1. The Brattle Group, “Competitive Assessment of the Spanish Food Supply Chain”, 2012 (English redacted version)
2. The Brattle Group, “Competitive Assessment of the Spanish Food Supply Chain”, 2012 (powerpoint presentation)
3. Kantar Worldpanel, “Innovating in the post-crisis era”, 2014
4. ESADE, “Estudio sobre surtido”, 2014