UPDATE FROM SJ BERWIN

Consumer Sector Group Update

Legal update on issues affecting the retail and consumer sector
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The European Commission's new Vertical Agreements rules - key issues for retailers and suppliers

Key points to note

- New rules on vertical agreements came into force on 1 June 2010
- The rules include the competition analysis of modern retail practices such as category management and upfront access payments
- Category management agreements are in principle exempt if neither the supplier nor the retailer exceed the 30% market share threshold
- Concerns can arise when the category manager either unduly influences retailers' commercial policy or when category management gives rise to information exchange issues
- Upfront access payments are in principle exempt if neither the supplier nor the retailer exceed the 30% market share threshold
- Concerns can arise where upfront access payments prevent small suppliers from being able to access the market or where they result in higher retail prices
- Care must be taken to ensure that the retail practices listed above do not fall foul of national rules (such as in France or Spain) that can be much stricter than those at European level

New rules for Vertical Agreements

Distribution and supply agreements between companies at different levels of the production and distribution chains are, from 1 June 2010, subject to new European Commission ("Commission") rules. These rules take the form of a new Vertical Agreements Block Exemption Regulation ("BER") and associated guidelines. The new rules replace and update the existing block exemption (or "safe harbour") from the Article 101(1) prohibition on anti competitive vertical agreements and guidelines which have been in force for 10 years.

There is a transitional period of one year, for existing agreements. Agreements concluded after 1 June will need to ensure that they are compliant from the start. The new BER will be valid for 12 years, expiring on 31 May 2022.

The BER and guidelines are necessary because commercial practices (in particular selling over the internet) have moved on significantly since the current rules came into force 10 years ago.

Although the BER and guidelines deal with a wide range of issues (for further details, please see Community Week issue 469), this update focuses on the new guidance on two specific aspects of common modern retail practices, namely category management and upfront access payments.

Category management

This practice was described by the Commission in one of the first major cases on the issue (Procter & Gamble/Gillette) as consisting of 'a management method used in modern retail business in order to optimise the retailers' product portfolio and to enable them to better meet the shoppers' demand […]. The category manager or 'category captain' advises a retailer on certain issues relating, for example, to shelf space and placement of products'.

The primary duty of a category captain will be to advise on how retailers can most efficiently stock, place, price and promote products. The category captain will have in-depth market knowledge and experience of how other retailers have successfully sold the product in question, and it is this knowledge that will flow into the category management advice that it gives to retailers.

Up until the Procter & Gamble/Gillette case in 2005, there had been little decisional practice by competition authorities on category management, and many practitioners were positively surprised by the benign way in which the Commission considered the issue.

Category management can in principle give rise to a number of competition concerns: first, the category captain may seek to influence the retailer to either advantage its own products or to disadvantage competitors' products, in both cases potentially giving rise to foreclosure concerns. Secondly, the category captain's influence on the retailer's pricing decisions can give rise to concern as the category captain will generally influence pricing not just relating to its own products but relating also to its competitors' products. Thirdly, the category captain can in certain circumstances risk becoming an information exchange 'conduit', for example between competing retailers. More recently, the UK Competition Commission ("CC") took a less benign view of category management in the Groceries Inquiry final report in April 2008 than the Commission did in Procter & Gamble / Gillette. The CC identified that "the degree of interaction among suppliers arising from category management is a cause for concern", and that there was "an opportunity for competitive harm". Nevertheless, ultimately the CC did not find evidence of collusion in three specific market segments it analysed, and it also noted more generally that category management can give rise to efficiencies.

BER/guidelines treatment of category management

The guidelines accompanying the BER were keenly anticipated as they represent the Commission's current view on a number of modern retail practices. Moreover the guidelines also give a reasonable insight into the likely approach of national competition authorities such as the OFT.

In particular, this is the first time the Commission has outlined its view (in a non-merger context) of how category management agreements should be assessed.

The headline point is that category management agreements are block exempted, and therefore require no further analysis of its possible effects, when both the category manager's and the retailer's market share in the relevant category does not exceed 30%.

Even if these market share thresholds are exceeded, the good news for retailers and suppliers who act as category captains is that (subject to the exceptions below) the Commission does not generally regard category management agreements as problematic, Indeed, the Commission specifically acknowledges that such agreements can lead to efficiencies, particularly where inter-brand competition within the category is high and consumers can easily switch between brands.

However, the Commission flags a number of factual scenarios in the guidelines when category management agreements can lead to competition issues. When analysing whether non-exempted category management agreements are likely to give rise to such concerns, key factors to consider include how much of the category and how many retailers are covered by the agreement, how strong the supplier of competing products in that category are and how widespread category management agreements are in the relevant market.

Discriminatory treatment of competing suppliers' products

1 The first scenario is a situation in which the category manager is able to limit or disadvantage the distribution of products by competing suppliers. The Commission notes that this concern is heightened when the retailer is also active in the category with its own private label goods, as that may give rise to an incentive to stock only the category manager's products and private label products, thus depriving consumers of a wider choice of products and softening inter-brand competition in the relevant category.

Category manager as conduit for collusion between retailers

2 The second scenario is a situation where a supplier is category captain for most or all retailers active in that category. This can give rise to concerns about collusion between retailers (acting on the category advice given) to align their commercial behaviour in the relevant category. This could be the case, e.g., where all retailers follow the category advice on stocking particular products but not others by a supplier competing with the category manager. In that situation, care must be taken that such arrangements do not give rise to a collective boycott.

Category manager as conduit for collusion between suppliers

3 The third scenario the Commission identifies in the guidelines in which category management agreements can give rise to concerns is that such agreements increase risks of collusion between suppliers via retailers because sensitive market information may be exchanged indirectly. This may occur for example because a category manager becomes aware of a retailer's commercial strategy (e.g. what kind of cost price rise the retailer will accept). If that information is subsequently passed on by the category manager to other suppliers, this information exchange is likely to be of concern.

Finally, it is important to note that in addition to avoiding the situations referred to above, category management issues should remain a key focus of both retailers' and suppliers' competition compliance programmes to make sure that the category manager only makes recommendations, that particular care is taken to avoid information exchange issues such as those referred to above and to avoid that pricing recommendations (if they are made at all) do not stray into the territory of illegal price fixing.

Upfront access payments

Upfront access payments ("UAPs") are defined in the guidelines as "fixed fees that suppliers pay to distributors in the framework of a vertical relationship at the beginning of a relevant period, in order to get access to their distribution network and remunerate services provided to the suppliers by the distributors". Examples include slotting allowances (i.e. fixed fees that manufacturers pay retailers in order to get access to their shelf space), "pay-to-stay" fees (lump-sum payments made to ensure the continued presence of an existing product on the shelf for some further period) and payments for promotional activities of the distributor.

UAPs can in principle give rise to a number of competition concerns: first, UAPs can result in anticompetitive foreclosure of other distributors. Secondly, UAPs can act as a barrier to entry or expansion for small suppliers who are less able to afford such fees. Thirdly, UAPs have the potential to push up retail prices because the suppliers may need to pass the cost on to retailers in the form of higher prices, and this may effect retail prices accordingly.

The possible effect of UAPs on small suppliers was analysed by the CC in the Groceries Inquiry but the CC was unable to find any evidence to suggest that lump-sum payments to grocery retailers act as a significant barrier to entry or expansion for small suppliers. In addition the CC did not find any evidence that obtaining lump-sum payments from suppliers distorts competition between grocery retailers or between suppliers. Rather, the CC considered that by compensating a retailer for the risks and costs of listing new products, UAPs such as slotting allowances may facilitate the introduction of products which retailers may otherwise be deterred from stocking.

BER/guidelines treatment of upfront access payments

As with category management, UAPs were not specifically dealt with in the previous iteration of the guidelines, and therefore this is the first time that the Commission has outlined its view of how UAPs should be assessed.

UAPs are block exempted, and therefore require no further analysis of their possible effects, when both the supplier's and the retailer's market share is less than 30%.

Even if these thresholds are exceeded the Commission has stated that in many, if not most, cases UAPs are not likely to be problematic since they give rise to beneficial effects such as efficient allocation of shelf space for new products.

However the Commission highlighted three situations where UAPs might give rise to concern.

1. First, the use of UAPs can become so widespread that it results in anticompetitive foreclosure of other distributors. This may occur where the UAP is so high that it encourages suppliers to channel a substantial volume of sales through one distributor in order to cover the cost of the fee.
2. Secondly if suppliers increase the price charged to retailers to cover the UAP it may reduce the incentive for retailers to compete on price on the downstream market. However, the Commission notes that this is only likely to be possible in retail markets which are highly concentrated.
3. Thirdly UAPs may increase barriers to entry to such an extent that there is an anticompetitive foreclosure of access to shelf space for small suppliers. In such circumstances the Commission will assess the UAP as if it were part of a "single branding obligation". The Commission's guidance on such obligations indicates that concerns are unlikely to arise if the market share of the supplier is below 30% and the combined market share of the five largest suppliers is below 50%.

UAPs may also be subject to additional regulation in some EU Member States. For example, since February 2010 major grocery retailers in the UK are subject to a new Groceries Supply Code of Practice (the "Code") that the CC imposed as a remedy as part of the Groceries Inquiry. The Code states that a retailer must not directly or indirectly require a supplier to make any payment as a condition of stocking or listing that Supplier's Grocery products unless such payment is made:

(a) in relation to a promotion; or

(b) in respect of grocery products which have not been stocked, displayed or listed by that retailer during the preceding 365 days in 25 per cent or more of its stores, and reflects a reasonable estimate by that retailer of the risk run by that retailer in stocking, displaying or listing such new grocery products.

In Spain, the regional Basque Competition Authority has recently expressed its misgivings about UAPs in the Spanish retail market and in France there are several unfair trade rules that can, in certain circumstances, restrict the use of UAPs.

Conclusion

The BER and guidelines published by the Commission last month are a welcome and helpful source of guidance on how the European Commission believes that two common modern retail practices should be assessed in competition law terms. This will give retailers, suppliers and their respective professional advisers a better basis on which to understand the key obligations to which they are subject and, perhaps more importantly, to give them a basis on which to conclude that many of the category management agreements and UAPs are unlikely to be problematic from a competition law point of view.

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