

Vertical restraints in UK

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- The verticals debate
- OFT' s approach
 - Substantive issues
 - Practical issues
- Books and e-books
- Newspaper and magazine distribution
- Hotel on-line booking
- New cars

● The verticals debate

● OFT' s approach

— Substantive issues

— Practical issues

● Books and e-books

● Newspaper and magazine distribution

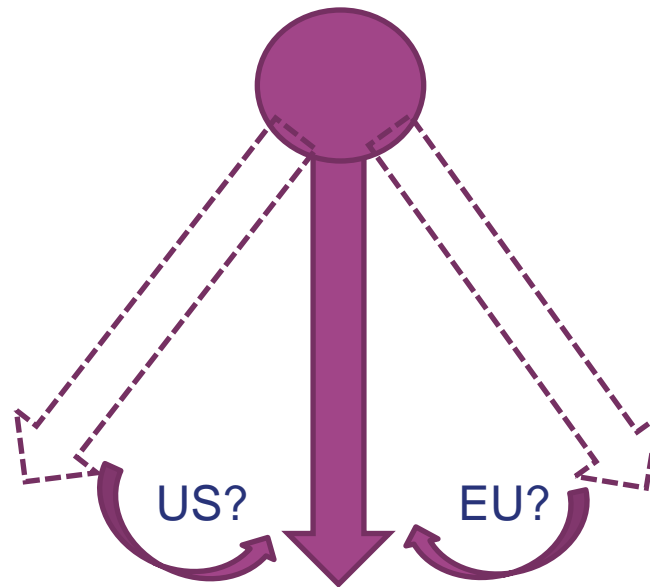
● Hotel on-line booking

● New cars

The verticals pendulum

Pro-competitive Presumption

- Rule of reason
- Chicago 1970s
- One monopoly rent
- Efficient supply chain management



Balancing approach

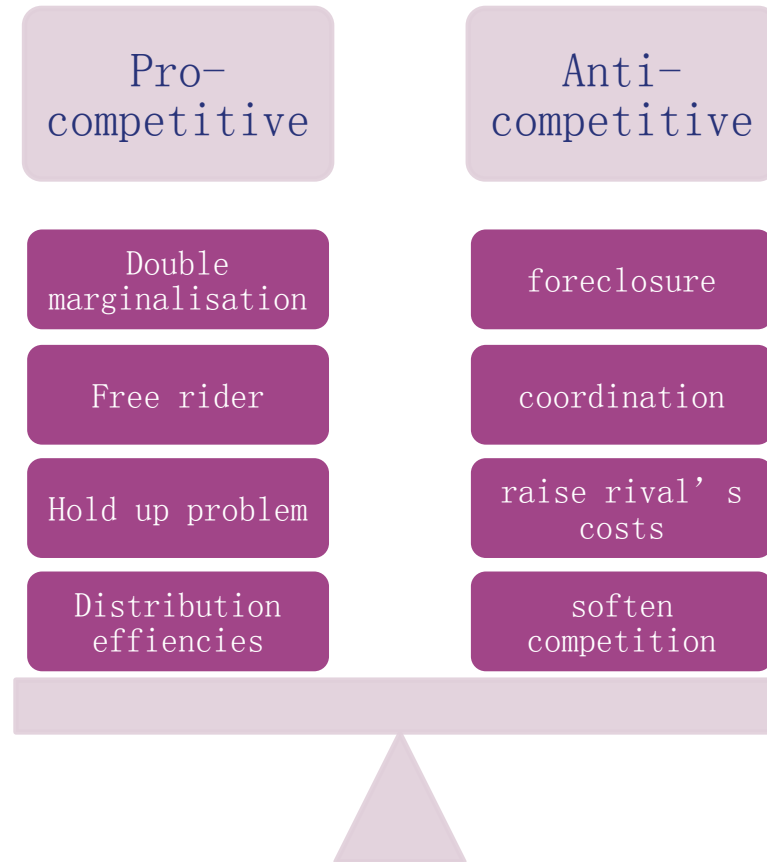
- Block exemptions
- Individual exemptions
- Structured rule of reason

Anti-competitive Presumption

- Strong prohibition approach
- Market segmentation
- Foreclosure/collusion
- Soften competition

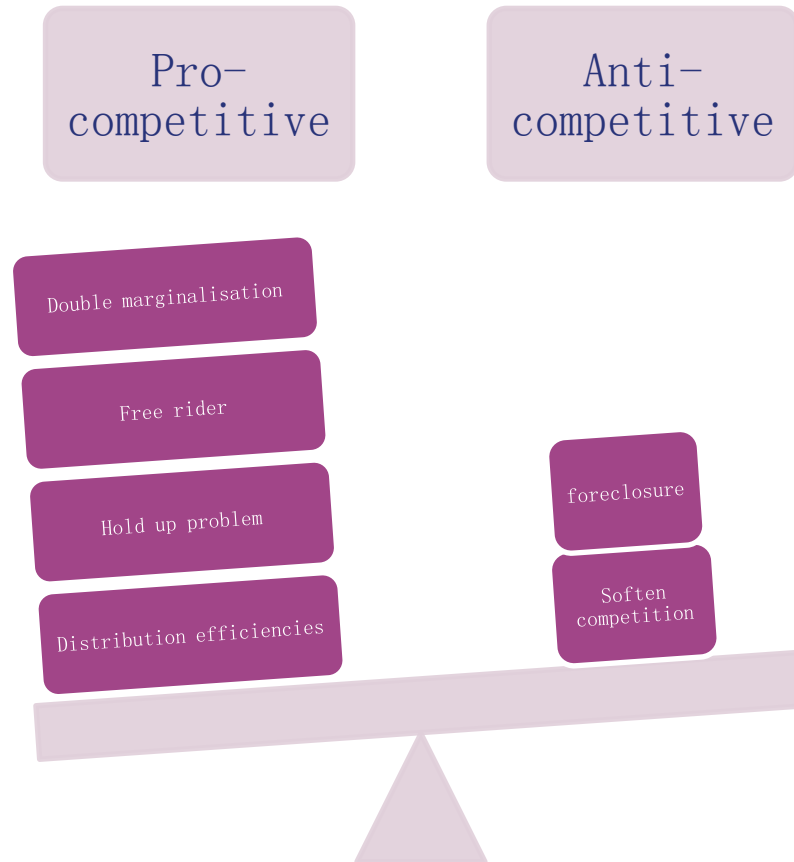
Where should countries be at different stages of development?

The balancing approach



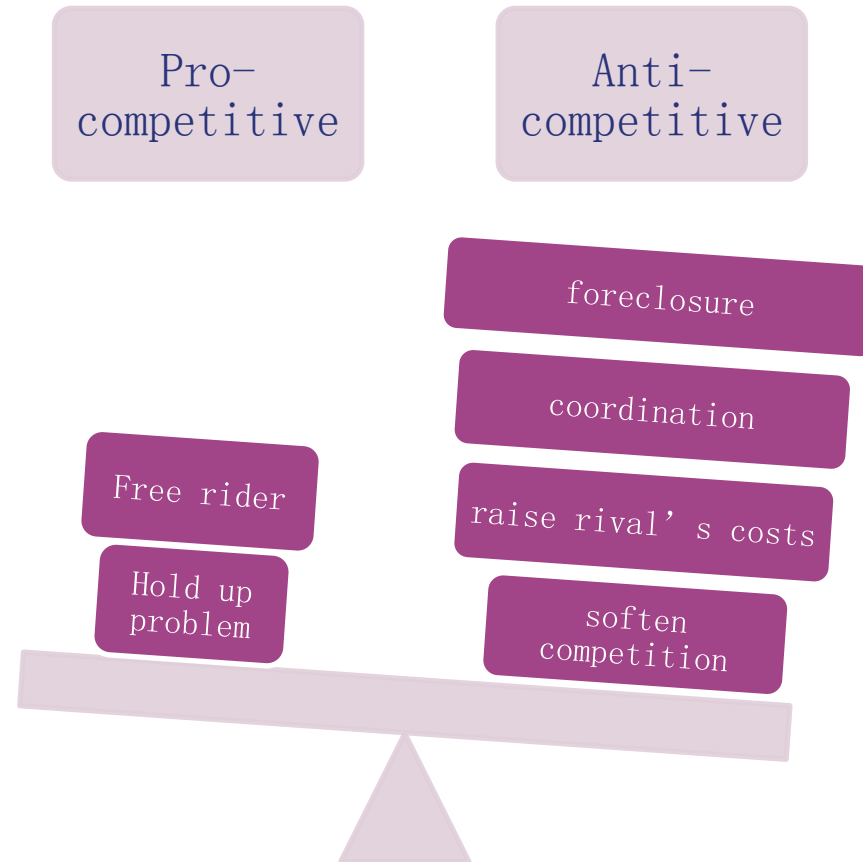
More effects based, but still some strong presumptions

The balancing approach



*Low concentration upstream and downstream any anti-competitive effects presumed minor compared to potential efficiencies. Block exemption (<30%)⁶
But some hardcore exceptions in EU – RPM, passive selling.*

The balancing approach



For higher concentrations, anti-competitive effects of vertical may outweigh efficiencies. EU 'object' presumption but may have individual exemption

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The UK framework

- EU – prohibition on vertical restraints qualified by strong block exemption and individual exemption
 - chapter I/Art 101 (vertical agreements)
 - Interpreted according to EU case law, EU VABER and Guidelines
 - No notification of agreements – self assessment. Opinions
 - OFT, CAT, private actions
- Abuse of dominance prohibition
 - E.g. Refusal to supply
- Market Investigation References (MIR) to the Competition Commission (CC)
 - Supply of beer, New cars – network of agreements/ cumulative effects

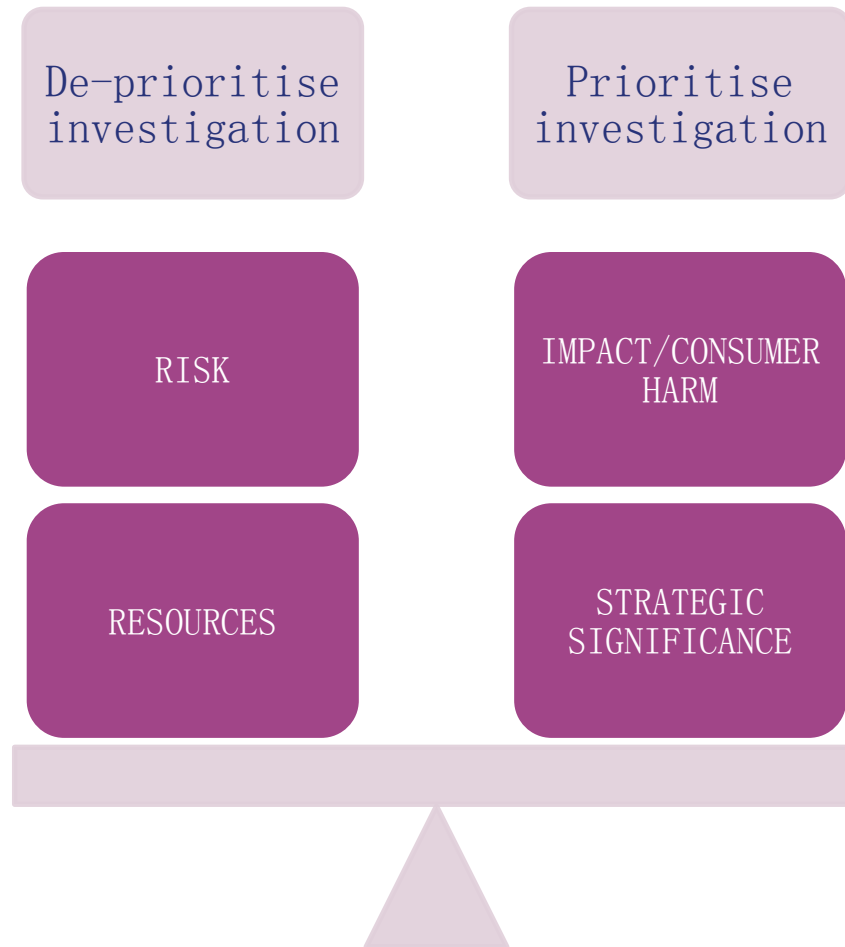
Types of vertical agreement cases (101) in OFT

	No of cases since 2000
RPM	6
Selective/exclusive distribution	3
Exclusive dealing	–
Tie in sales/bundling/full line forcing	1
Quantity forcing	1

Why so few?

- Self-assessment by parties (since 2002)
- Exclusionary verticals often assessed as abuse of dominance
 - E. g. Napp (exclusive dealing), Genzyme
- CC references for network agreements
 - Beer, ice cream, new cars
- OFT Prioritisation criteria - Pre-investigation assessment

OFT prioritisation criteria



Theory of consumer harm	
Foreclosure	Is foreclosure feasible? Are there other routes to market
	Who's initiating the foreclosure - upstream or downstream firms? Is that rational?
	Is there evidence of foreclosed firms
Facilitate Coordination	Initiated upstream or downstream? Is sustained coordination feasible or likely at this level?
Soften competition	How much competition is likely without the vertical restriction?
	Does softening of intra-brand competition matter if there is strong inter-brand competition Is softening of inter-brand competition feasible if there is strong intra-brand competition. Dimensions of competition
Magnitude of harm	How big is the market? Distributional issues?
	Are there obvious efficiencies that consumers benefit from?
Strategic significance	Is a case likely to have strong deterrence value in other markets?

Risk/resources - practical issues

Risks

Do we need to prove anti-competitive effects? How difficult will this be?

How easy is it to prove an agreement? Is it written? Or is it an understanding?

Would we need to use data - e.g. pricing

Is it likely that parties will be able to show that the agreement yields strong efficiencies?

What is the remedy? Will this correct the harm or make it worse?

Resources

How many parties to the agreement? Multi-party cases are costly.

Can the investigation be scoped down to smaller no of parties?

Will the case team need to process large volumes of evidence, data etc

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RPM on books – potential ToH

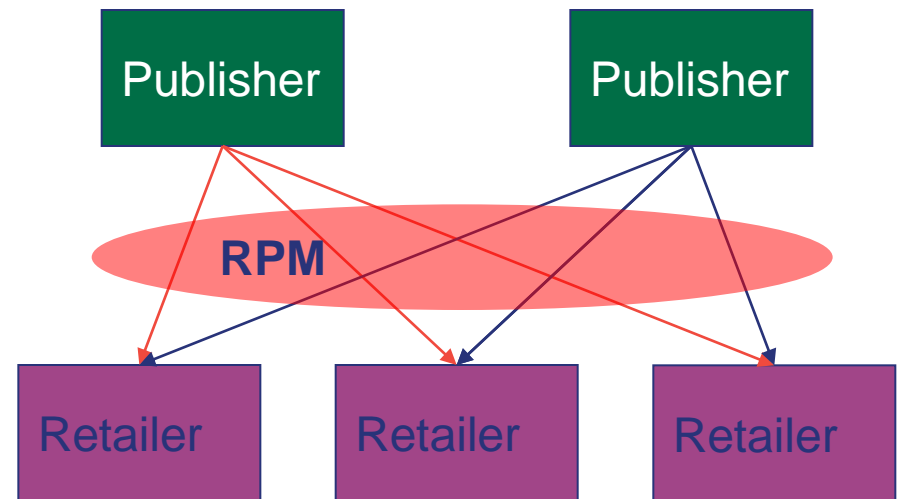
- RPM as a commitment device to protect monopoly rents ?
 - O’ Brien & Schaffer, 1992 (Rand)
 - Rey & Vergé, 2004a (Rand)
- RPM to facilitate upstream collusion x
 - Jullien & Rey, 2007 (Rand)
- Rey & Vergé, 2004b (CMP0) RPM to limit retailer bargaining and thereby dampen upstream competition x
 - Dobson & Waterson, 2007 (IJIO)
- RPM to soften downstream competition ✓
 - Shaffer, 1991 (Rand)
 - Martimort & Stole, 2003 (ATE)
- RPM to inhibit low price downstream entry ✓
 - OFT/UEA, 2007



Removal of RPM for books

- Net Book Agreement (NBA) was removed by OFT
- Retailers became free to discount
- OFT/UEA (2007) evaluates impact

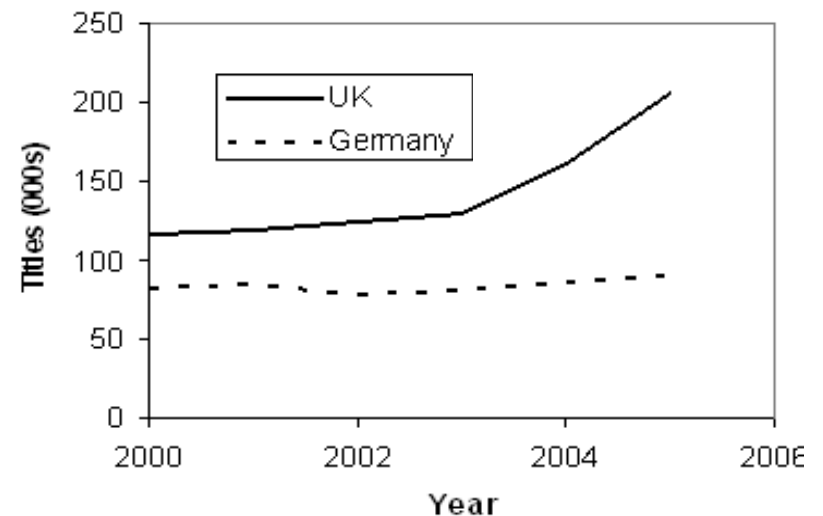
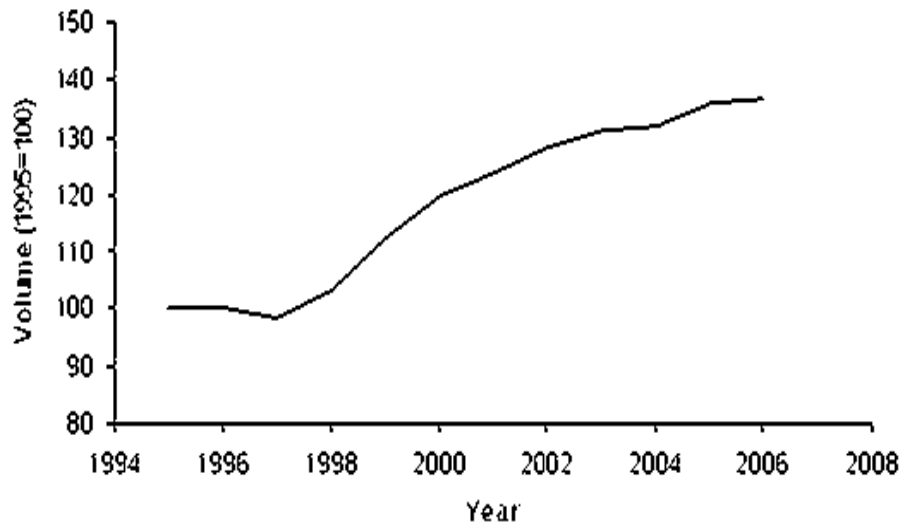
RPM industry-wide





Concerns about removal

- Fewer books would be sold – Wrong!
- Fewer titles would be published – Wrong!





Effects on competition

- Unclear effect on prices
 - Picture muddled by price discrimination
- But allowed new entry





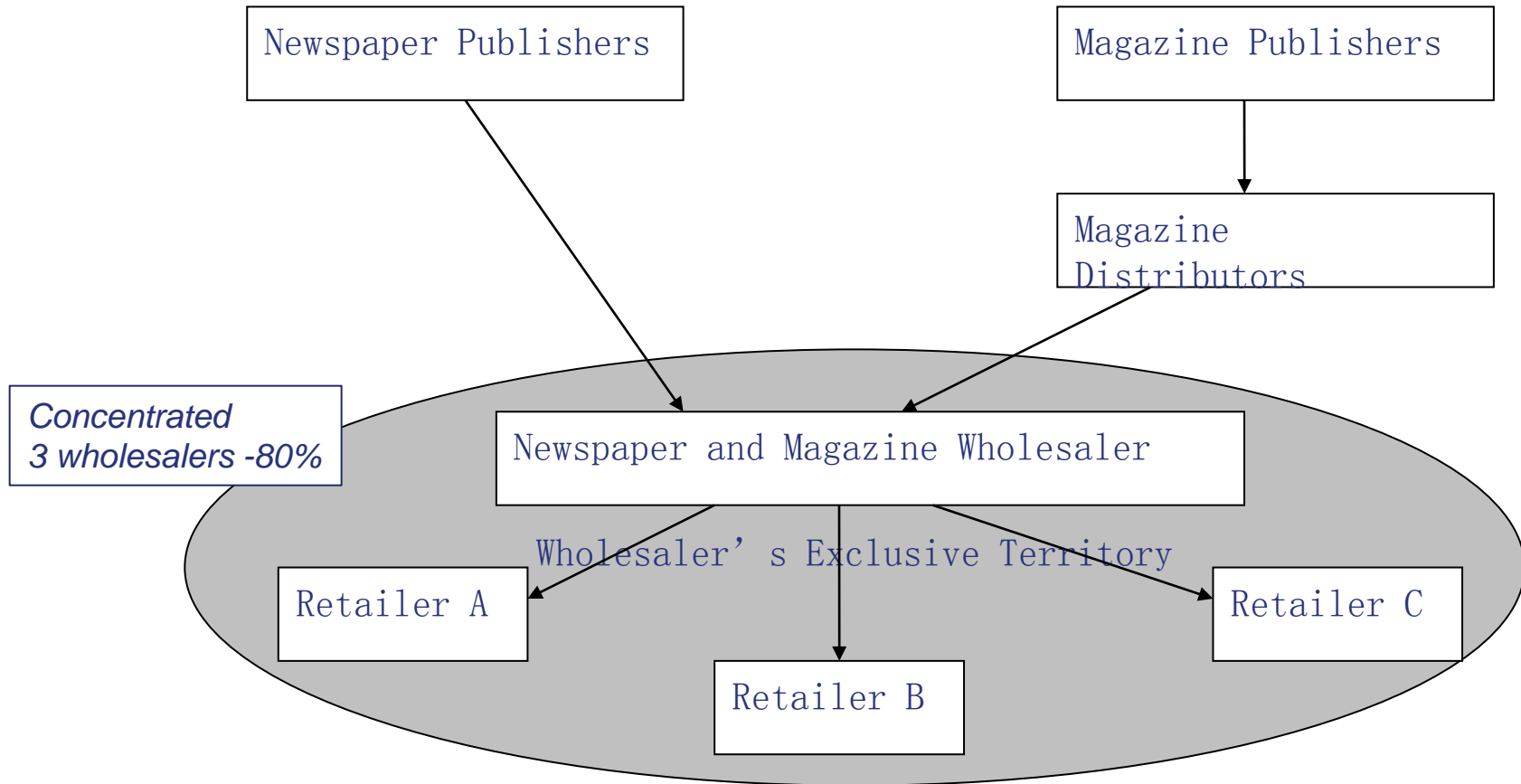
Why?

- Potential/incentives for innovation
 - New pricing models
 - Business stealing by more efficient firms



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Distribution - exclusive territories (2008)



Absolute territorial protection (ATP) bans active and passive selling between territories

Possible Theories of harm

● Publishing

- Contracting between large publishers and wholesalers might be used to foreclose smaller publishers

● Wholesaling

- Elimination of competition in the market between wholesalers. No scope for innovative entry
- Wholesalers local monopoly leads to higher prices, deterioration of wholesaling quality.

● Retailing

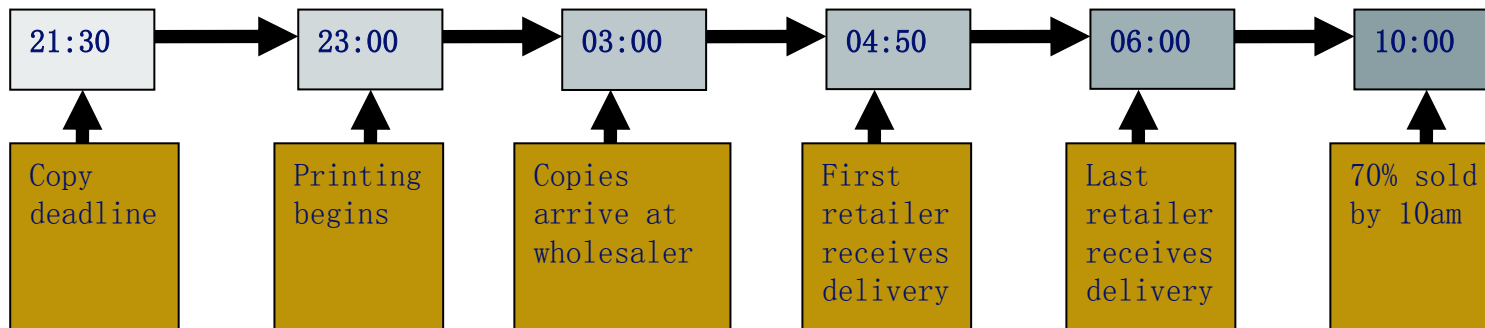
- Local wholesale monopoly squeezes retail margins

● Prioritisation

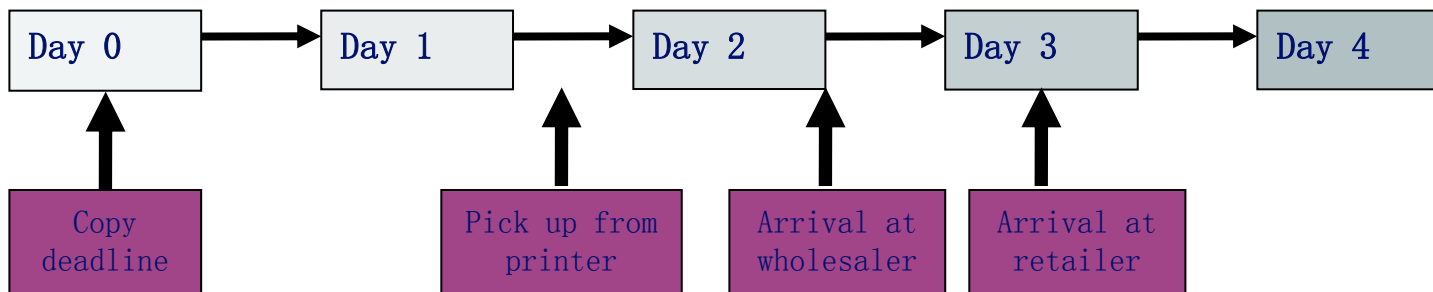
- Scope potentially enormous - many agreements.
- Opinion for self-assessment reduces risk and resources

Supply chain timeline

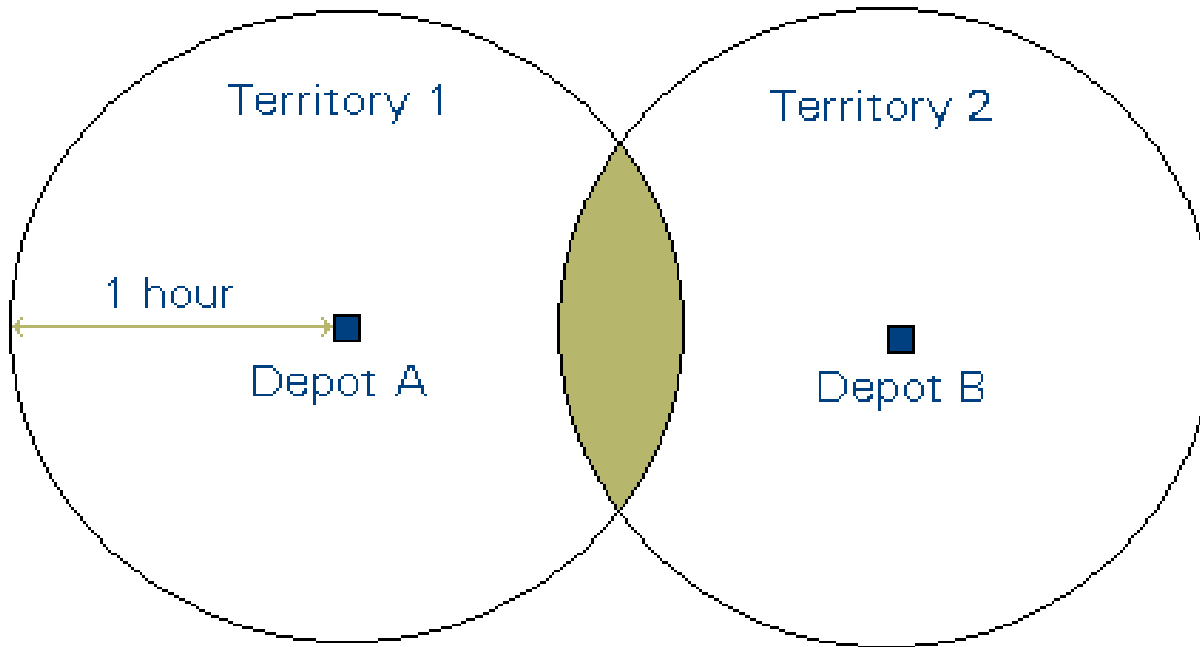
Newspapers



Weekly magazines



Competition in the market – new



- Economies of scale, scope and density – unlikely to have small competing depots . Limited scope for competition in newspaper wholesaling
- Longer time-line makes magazine wholesaling competition possible

Efficiencies passed through to consumers

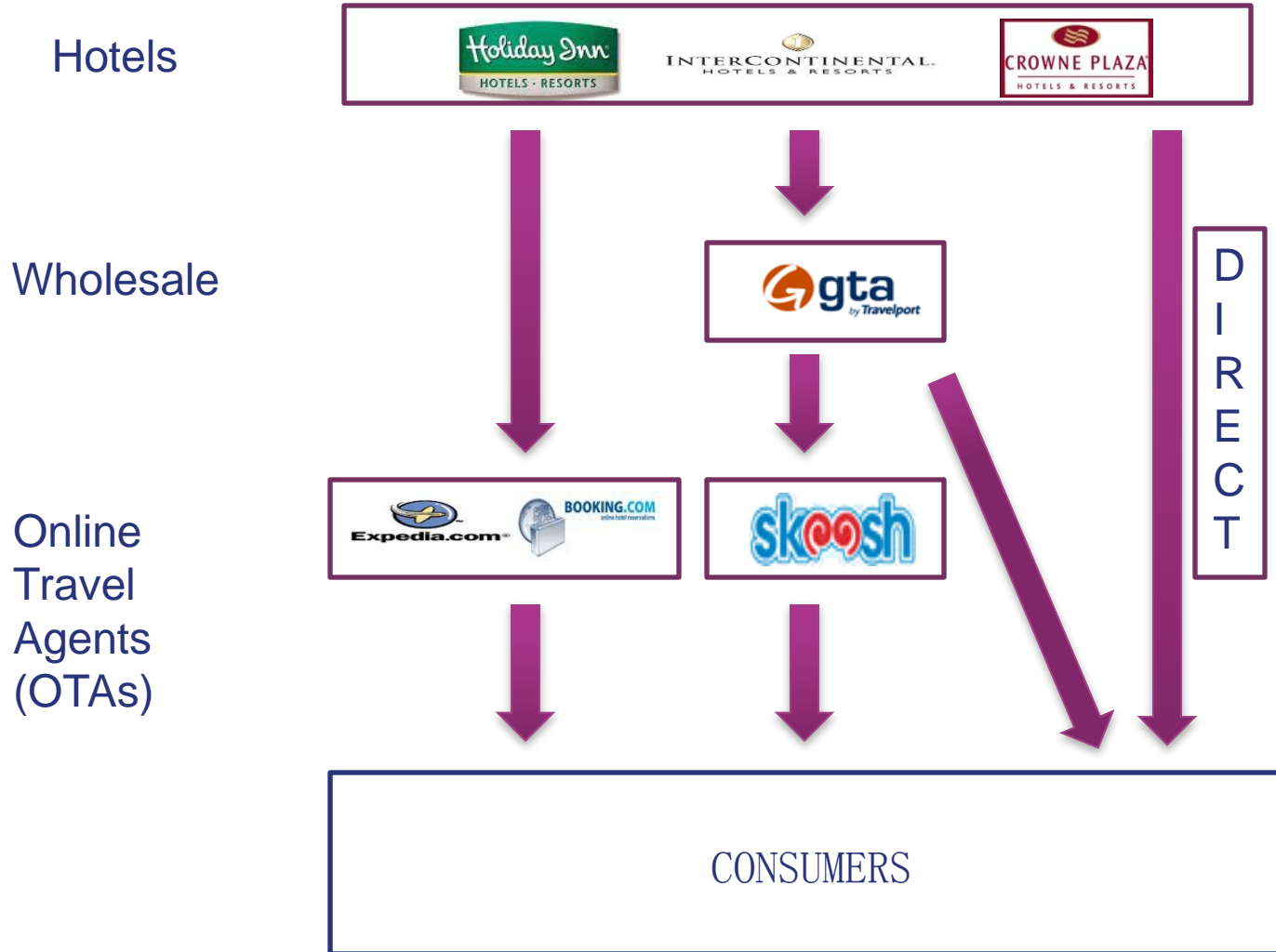
- ATP generates efficiencies for publishers
 - Makes competition for the market more effective
 - Allows for obligation to supply
- Publisher incentive to ‘pass through’ cost savings to consumers
 - Two-sided market
 - Intra-brand competition may be limited
 - Inter-brand competition appears stronger

Conclusions: balancing approach

	Newspapers	Magazines
Effective competition in the market possible?	x	✓
Scope for entry and new innovative methods of supply?	Little/None	More
Competition <u>for</u> the market effective? (<i>Wholesalers compete for tenders</i>)	✓	✓
Publisher-led supply chain delivers benefits for consumers?	More	Less
Likely to be exempt	Yes	No

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Hotel online booking distribution



Hotel online booking – RPM?

- OFT issued a Statement of Objections (SO) alleging that Booking.com, Expedia and IHG infringed competition law in relation to the online supply of room only hotel accommodation by online travel agents.
 - Allegations that Booking.com and Expedia each entered into separate arrangements with IHG which restricted the online travel agent’s ability to discount the price of room only hotel accommodation.
 - OFT’s **provisional** view: these restrictions are by their nature, anti-competitive in that they could limit price competition between online travel agents and increase barriers to entry and expansion for online travel agents that may seek to gain market share by offering discounts to consumers.
 - Parties to make representations; SO not infringement finding

“The online travel market may appear to offer plenty of choice and competition, but the reality is that there are lots of different shop windows selling the same rooms at the same prices.”

● Source: Mark Datta, Blink Booking, Financial Times 31 July 2012)
- General rule: discounting restrictions amount to RPM, unless the intermediary (e.g. the agent) whose ability to determine the sale price is restricted can be regarded as *‘an auxiliary organ forming an integral part of the principal’s undertaking’* .
- Referred to as ‘genuine’ agency – but what makes an agent ‘genuine’ or ‘non-genuine’ ?
 - A variety of factors, but a key factor is level of risk taken on by agent to operate in market

Theories of harm – overview

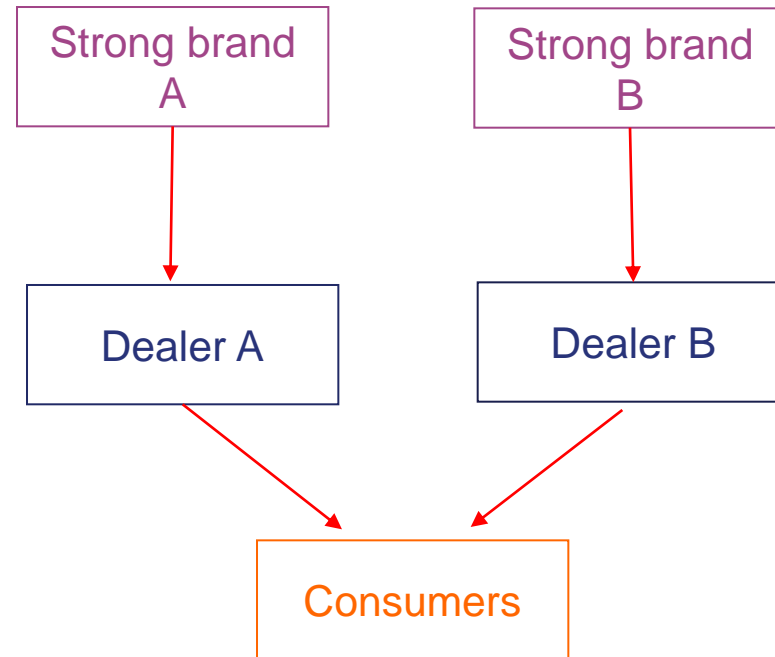
● Two main theories of harm:

1. **Barriers to entry/expansion at retail level:** Discounting restrictions remove the ability for OTAs to compete on price and increase barriers to entry/expansion. A more consolidated OTA market means higher OTA commissions – this increases distribution costs for hotels and so increases retail prices; and
2. **Parities Story:** The rate parity obligations are capable of reinforcing and exacerbating the harm caused by the discounting restrictions, including by softening intra-brand price competition and increasing prices to consumers.

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Effect on retail competition of networks of similar agreements?

'New Cars'



*Exclusive
Dealerships and territories*

New cars: Theories of harm

- Exclusive territories restrict intra brand competition. But do they soften inter brand competition?
 - Theory 1 - strategic delegation:
 - Dealer's local monopoly leads to higher prices
 - Other dealers' best response is to increase prices too
 - Downstream prices move closer to collusive level
 - Manufacturers extract more from negotiations with dealers
 - Theory 2
 - Harder to shop around / find independent advice
 - Insufficient numbers of accessible dealers/other sources of information
- Efficiency explanation:
 - Weaker intra brand competition leads to greater inter brand competition through non price factors
 - Dealers engage in greater promotional effort as no free rider problem

Balancing: Competition Commission 2000

- All sales of new cars fall within selective or exclusive distribution (SED)
- SED restricts intra-brand competition and puts distributors in weak position relative to manufacturers
- SED restricts inter-brand competition by reducing rivalry and price transparency
- Overall prices ~10% higher
- CC dismissed arguments on efficiencies. Consumers need little safety advice to buy cars. Free rider problem limited.
- Strongest argument for exclusivity was independence of sales advice. But CC thought this was limited.
- CC recommended removing the block exemption.