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LATIN AMERICAN COMPETITION FORUM

Session III - Competition Issues in the Groceries Sector: Focus on Conduct

-- Contribution from Spain --

23-24 September 2015, Montego Bay, Jamaica

The attached document from Spain is circulated to the Latin American Competition Forum FOR DISCUSSION under Session III at its forthcoming meeting to be held on 23-24 September 2015 in Jamaica.

Contact: Ania Thiemann, Global Relations Manager, OECD Competition Division,
Tel: +33 1 45 24 98 87, Email: Ania.Thiemann@oecd.org.

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Session III - Competition Issues in the Groceries Sector: Focus on Conduct

POSSIBLE ANTI-COMPETITIVE BEHAVIOUR AND PRACTICES

-- CONTRIBUTION FROM SPAIN --

1. Introduction

1. Over the last few decades, commercial food distribution has been the subject of several rulings and reports from the Spanish Competition Authority with regard to the enforcement and promotion of competition. The Spanish Competition Authority conducted an analysis of commercial practices between the major distributors and their suppliers, mainly in terms of promotion. The purpose of this contribution is to review the most recent actions taken in this area and assess specific regulations introduced in the sector relating to commercial relationships in the food supply chain in general, and between distributors and their suppliers in particular.

2. The contribution will be structured as follows: firstly, the analysis conducted by the Spanish Competition Authority on the negotiating powers of large distributors in the food sector and the commercial practices most extensively used in the relationship between them and their suppliers will be presented. A particular emphasis will be placed on commercial payments and brand management. Secondly, taking the view of the Spanish competition authority as a starting point, recent specific regulations introduced in the sector aimed at regulating some of these practices will be analysed.

2. Market studies on the commercial relationship between distributors and manufacturers in the food sector

3. Commercial food distribution in Spain has undergone significant transformation in recent decades, as it has in other countries. The role of traditional commerce is no longer what it was in the past, with the supermarkets and hypermarkets of large distribution groups dominating the market. Online sales of food products do not currently present a credible or effective alternative. With this transformation has come an increase in the negotiating power of distributors, as a result of three main structural changes. Firstly, there was an increase in consolidation within retail distribution. Secondly, medium-sized and large supermarkets increased their dominance in the market. Thirdly, there was the growth of the distributor brand.

4. In October 2011, the former National Commission for Competition (CNC) published their *Report on the relationship between manufacturers and distributors in the food sector* that analysed a specific market context, namely the relationship between manufacturers and large distributors in the food sector, against a backdrop of general concern across Europe, and the impact of the negotiating power of large distributors on competition. At that time, most of the competition authorities in the European Union were conducting, or had already conducted, market studies on negotiating power in commercial food distribution.

5. The aim of the CNC was to analyse the risks presented by the increase in the negotiating power of the large distributors, and in particular, a series of commercial practices in the food supply chain.¹ The report looked at the extent of these practices and the risks they presented in terms of competition and economic efficiency. The conclusions reached in the report on commercial payments and brand management were as follows:

- Commercial payments can increase efficiency in several ways; they can lead to an efficient sharing of risks between distributors and suppliers, allowing shelf space for product lines to be allocated more efficiently, or allow the external vertical costs of promotion and marketing to be managed effectively between suppliers and distributors. Nevertheless, they can also have negative consequences on competition, especially if sums are fixed and they are widely used.

According to the evidence gathered by the CNC for the report, the use of commercial payments is frequent and the amounts involved can be high in relation to amounts invoiced by the supplier. Additionally, commercial payments are occasionally set without first clearly determining what is expected in return. In these circumstances, commercial payments might not produce all the positive effects mentioned and could lead to an adjustment in profit margins, greater uncertainty, an inefficient transfer of risk from the distributors to the suppliers, and a possible reduction in intra-brand competitiveness.

- In most cases, brand management agreements between distributors and manufacturers do not present issues of competitiveness and allow the distributor to benefit from the manufacturers' better understanding of demand and of the market. In certain cases, however, these agreements could have negative effects on competition; firstly, if they discriminate between some manufacturers and others, particularly between the brand leader and the other competitors in the product line, secondly, if generalised use of these agreements leads to excessive market transparency and collusion between manufacturers, reducing incentives to introduce price-reduction strategies, and thirdly, if the distributors ask the manufacturers for information about their relationships with other competing distributors – particularly if it relates to purchasing prices charged to other distributors or promotional policies. In such cases both inter-brand and intra-brand competition can be weakened and exchanges of information can lead to collusive practices between the distributors and the manufacturers and to the emergence of “hub & spoke” rings.

According to the evidence gathered by the CNC for this report, brand management is usually carried out by the distributors themselves in Spain, although occasionally they will ask the manufacturers, brand leaders or otherwise, for information to guide them in the management of specific brands. Information exchanged between distributors and suppliers mainly relates to

¹ The following practices were considered: commercial payments, brand management, use of the supplier's image and inside information from the manufacturer to the benefit of the distributor Brand, lack of written contractual terms and retroactive changes to terms or breach of contract, establishment of “most favoured customer” clauses, selling at a loss, blind auctions, exclusive supply clauses, compulsory requirement to buy goods or services offered by a third party, and the linking of the commercial relationship of the manufacturer's brand to the additional requirement to produce the distributor's brand.

market trends. Responses from the manufacturers show that demands by them for information from distributors are rare.

6. The report's overall conclusion with regard to all of the commercial practices between manufacturers and distributors that were analysed was that said practices could have positive and negative effects on competition and efficiency, and that within the market context analysed in the report, most practices did not present associated risks. Only some of the practices analysed presented a greater risk in terms of competition and the CNC² made specific recommendations in relation to these.

7. In light of their analysis, the CNC presented two sets of recommendations:

8. Firstly, the organisation listed a series of proposals to change regulations aimed at liberalising the commercial distribution sector. Regulatory restrictions existed, and still exist, in this sector that limit the entry of new operators in the market and the competition between them, reinforce the market power of existing operators, contribute to the increase in operators' negotiating power with regard to manufacturers, and favour the implementation of certain commercial practices that may be damaging for all concerned.

9. Secondly, the organisation proposed a series of measures and principles regarding practices described as more problematic, including introducing effective mechanisms to keep track of these practices, reinforcing options for reporting their occurrence, and establishing a series of principles designed to limit the potentially negative effects that some of these practices may present in the specific market context analysed in the report. The report particularly recommended formalising commercial relationships between large distributors and manufacturers in writing, establishing limits to retroactive changes to contractual conditions, ensuring that commercial payments between large distributors and manufacturers are transparent and predictable, and limiting demands by large distributors for information from the manufacturer to the commercial context and the requirements of their commercial relationship.

10. It is important to underline the fact that the principles and measures relating to certain commercial practices were recommended without a change to the regulations. The CNC never recommended increasing the burden of government legislation, extending the system of penalties, increasing public intervention, or introducing new regulations applicable to the commercial practices analysed.

3. Recent changes to regulations relating to commercial practices in the food supply chain and an assessment from the perspective of the promotion of competition

11. In 2013, the Spanish Parliament passed Law 12/2013 of 2 August pertaining to measures to improve the functioning of the food supply chain (LCA), the declared objective of which was to "improve the functioning and structure of the food supply chain in order to increase efficiency and competitiveness in the Spanish food industry and reduce imbalances in the commercial relationships between the various operators in the value chain". The law established the following basic measures for that purpose: (i) a list of requirements relating to regulations governing contracts applicable to all commercial relationships meeting certain conditions; (ii) a list of practices considered "abusive" and prohibited in the commercial relationships of all operators in the food supply chain and (iii) a set of infringements and government penalties applicable in the event of a failure to comply with the terms of the LCA.

² These included the following practices: commercial payments, lack of written contractual conditions and unforeseen retroactive changes not previously agreed, information on specific product features demanded by the distributors too far in advance, "most favoured client" clauses, and demands for commercially sensitive information from suppliers about their commercial relationships with other distributors.

12. After the LCA was passed, the regulations to implement the law were approved, in particular with regard to a new agency created as a result of LCA, the Food Industry Information and Control Agency (AICA)³, which now employs 85 people. This new regulation framework for the food sector was assessed by the Spanish Competition Authority in various reports on draft regulations⁴, which highlighted the problematic aspects identified in the LCA in relation to competition in the food industry. Some of these problematic aspects will be considered below.

13. Firstly, public intervention in the food supply chain proposed in the LCA with the aim of reducing imbalances between operators and increasing equality, is excessive, particularly in the relationship between distributors and their suppliers. Achieving a better balance, however, may not be compatible with promoting effective competition and economic efficiency, and therefore may not be in the interest of all concerned. Moreover, the legislator has not justified the new regulations by the existence of a failure in the market. The LCA alludes to imbalances in the food chain and the need to reduce these but the imbalances are inherent to the market, rather than an anomaly or a failure in the market. The operators in the market responded to these imbalances dynamically by adapting the organisation of their production and improving efficiency – to the benefit of consumers. Constraining this response by public intervention is not desirable.

14. Secondly, the LCA includes a list of requirements relating to regulations governing private sector contracts and establishes a list of practices considered “abusive” and which are prohibited in the commercial relationships of all operators in the food supply chain. In general terms, these requirements and prohibitions do not adhere to the principles of efficient economic regulation:

- The first set of obligations establishes that contracts will be formalised in writing. This measure complies with the requirement as it allows legal security to be strengthened and illegal activities to be pursued. However the requirement to formalise agreements in writing applies generally to almost the whole food supply chain and therefore requiring all operators to comply could result in a disproportionate and inefficient measure.
- In the second set of requirements, the LCA includes a general prohibition relating to a series of commercial practices, with a certain emphasis on practices between distributors and their suppliers that can be targeted by the AICA in the framework of the new proposed regime of inspections and penalties. Specifically these refer to unilateral changes in contractual terms, commercial payments, the supply of commercially sensitive information and the management of brands.

Including this list of “abusive” practices is not necessary. In effect, all types of behaviour included on this list that could potentially be described as “abusive” from a legal perspective were already identified in the legislation in force, specifically in the Law of Unfair Competition, No 3/1991, of 10 January. If the fundamental problem, as recognised by many agents in the sector, is the absence of

³ The purpose of the AICA is to monitor compliance with the terms of the LCA with regard to the regulation of commercial relationships between operators in the food supply chain.

⁴ [Informe de Proyecto Normativo sobre el Anteproyecto de Ley de medidas para mejorar el funcionamiento de la cadena alimentaria](#) (2012) [Report on proposed regulations relating to draft measures to improve the functioning of the food supply chain]; [Informe de Proyecto Normativo sobre el Proyecto de Real Decreto por el que se aprueba el régimen de controles de la Agencia de Información y Control Alimentarios](#) (2014) [Report on proposed regulations to be included in the Royal Decree approving the set of controls by the Food Industry Information and Control Agency]; [Informe de Proyecto Normativo sobre el Proyecto de Real Decreto por el que se aprueba el Reglamento de la Ley 12/2013, de 2 de agosto de medidas para mejorar el funcionamiento de la cadena alimentaria](#) (2014) [Report relating to proposed regulations to be included in the Royal Decree approving the regulations in Law 12/2013 of 2 August pertaining to measures to improve the functioning of the food supply chain].

incentives for agents to report these practices to the Spanish Competition Authority, it would therefore be more important to strengthen the options for reporting and pursuing cases in which this were relevant. Consequently, it would not be necessary to incur the costs of introducing new regulations or a new institution, the AICA, part of the Ministry of Agriculture, Food and the Environment. Lastly, many of the commercial practices considered “abusive” by the LCA are quite the opposite; they are efficient and pro-competition in many circumstances. By preventing the emergence of competitive, commercial and incentivising dynamics by imposing general prohibition measures, the LCA is distorting competition in commercial food distribution, and in the food supply chain as a whole, damaging its ability to function.

15. Thirdly, the LCA regulates the legal authority to apply penalties in the event of a failure to comply with the terms of the LCA, particularly in relation to commercial practices, identifying infringements and penalties and establishing the competent legal authority in each case. The Spanish Competition Authority believes that several problematic elements exist. On the one hand, it is not necessary, given that sufficient coercive mechanisms already existed in regulations prior to the LCA, including rules to defend competition in the event that effective competition was affected. On the other hand, the system adds to the duplication of efforts between government departments responsible for implementing penalties and the competition authorities. This can increase legal insecurity and “forum shopping”. Duplication can exist specifically between the actions of the AICA, the new public agency created by the LCA, and part of the Ministry responsible for the sector, and the Spanish Competition Authority. Lastly, the set of infringements and penalties can lead to an increase in bureaucracy with regard to commercial relationships, and to an increase in the regulatory burden for companies. This in turn will reduce companies’ productivity, affect their ability to function correctly, and negatively affect their competitiveness as a result, in terms of prices, quality and innovation.

3. Conclusions

16. Commercial practices between large distributors and manufacturers can have positive and negative effects on competition and efficiency. In the market context analysed in the 2011 report published by the Spanish Competition Authority, most of the practices under consideration did not present associated risks in general terms. With the aim of ensuring that commercial practices between large distributors and their suppliers are not detrimental to the well-being of either, competition rules must be applied efficiently, with additional legal instruments made available where required, creating incentives for operators and encouraging efficient and rigorous use of them.

17. Recent regulations introduced in the sector relating to commercial practices in commercial food distribution, driven by the aim of “correcting imbalances”, are not justified by the principles of promoting effective competition or efficient economic regulation. The imbalances in the food supply chain do not represent a failure in the market that justifies an intervention as proposed by the LCA. The LCA will increase bureaucracy and legal insecurity in commercial relations in the food sector and will negatively affect business competition and efficiency. In contrast to its ultimate aim, the result of the LCA will be a predicted worsening in the functioning of the food supply chain. Commercial practices likely to be described legally as “abusive” in commercial relationships were already prohibited in legislation in force before the LCA was passed. Such practices were controlled by legal instruments that were less restrictive of the contractual parties’ freedom, made more efficient use of public resources, and adhered better to the principles of economic freedom and effective competition.