CCP CENTRE FOR COMPETITION POLICY

Vertical Agreements Between Suppliers and Retailers with Horizontal Effects

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Vertical agreements – horizontal effects

- Increasing use of agreements between two vertically related firms which link prices on horizontally related products
  - These have been challenged by competition authorities in the EU, US and elsewhere
- Focus on cases where a Retailer restricts the behaviour of a Producer

Case law

- Set of cases in which the retailer says to the producer: "you must not sell your goods at a lower price or more enticing conditions through another retailer"
  - the ebook cases;
  - the on-line hotel booking (or online travel agent) cases;
  - the Amazon Marketplace case; and
  - the UK motor insurance case

Key: retailers match prices of rival products

- In all the four cases, the horizontal link is between the price of the same product at rival outlets
  - Can be interpreted as a classic price guarantee offered by a retailer to a consumer
  - Could be interpreted as a variant of a most favoured nation (MFN) promise by a producer to a consumer that no consumers will be offered a lower price anywhere
- EXCEPT that the consumer is not necessarily aware of this promise

The restrictions create partial linkages between prices

	Product 1	Product 2
Retail Platform 1		
Retail Platform 2		

Terminology: Across Platform Parity Agreements

- Because the cases all involve electronic retail platforms, I will settle on:
  - ACROSS PLATFORM PARITY AGREEMENTS [APPA]
- Key reason that this gets us away from the use of the term MFN which is misleading on two counts
  - The horizontal element is not really an MFN
  - The defences to MFN do not really carry over

Pure horizontal effects – welfare decreasing

- Extensive literature identifying both pro- and anti-competitive effects of price guarantees
- BUT literature in which consumer activity is crucial is not relevant
  - As consumers are not aware of the agreements
- Leaves two potential effects:
  - Reducing the incentive to compete directly as rival response guaranteed
  - Affect entry decisions: Foreclosure or over-entry
- Both lead to adverse effects on consumers
- The literature does not offer any mitigating factors
  - However, the literature on MFN does
    - Of possible relevance: free riding

What then is added by the vertical element?

- The difficulty in answering this question arises from several things going on at the same time. In particular:
  - Move from wholesale to agency
    - Especially books
  - Move from per unit transfer fee [commission fee] to revenue share
    - How widespread?
  - Changes in technology
    - In the book case, compatibility
  - Complementarities
    - Books: reference pricing and e-readers
    - PCW: evaluations and consumer [big] data

Move from Wholesale to Agency: Where should the consumer price be set?

- Robust result that the price to consumers is highest if this price is set at the level where there is the least competition
    - Johnson (2013); Foros, Kind and Shaffer (2014); Liu and Shuai (2015); Lu (2015)

What does APPAs add to the mix?

- Acts as the worst element of an RPM
    - While RPM is purely vertical most actual cases and theories of harm implicitly assume that the upstream firm sets the same price at all downstream retailers.
    - This horizontal element is equivalent to APPA – hence APPA should be treated no less harshly than RPM
        - Fletcher and Hviid (2015)
- Can encourage adoption of Agency model [which then raise prices]
    - Foros, Kind and Shaffer (2014)
- Can directly raise prices
- Can deter [or encourage] entry or investment

APPA increase prices directly

- For the agency model, the APPA enhances the anti-competitive price raising effect
  - Johnson (2014) who adds an APPA to his previous paper on Agency vs wholesale
- And not just to the joint collusive level, but potentially beyond
  - Boik and Corts (2015)

The logic behind the price raising effect

- Without APPA
  - Retailer increases fee
  - Producer responds by increasing the price through that retailer
  - Reduces sales given substitution to other retail outlet and to competing products
- With APPA
  - Retailer increases fee
  - Producer responds by increasing the price through that retailer <u>and</u> all other retailers covered by APPA
  - Reduces sales given substitution to competing products
- Hence higher fees and higher prices under APPA

Increasing levels of entry

- Entry may be deterred
- But show that the additional profit generated by APPA may encourage rather than deter entry
- Illustrate the importance of assumptions about consumer behaviour
  - Can an entrant get traction without offering a significant price reduction relative to incumbents?
    - See Boik and Corts (2015) who consider the effect on entry directly

Issues for later in the morning

- The anti-competitive effects may be balanced out by possible benefits:
  - Magnitude of the anti-competitive effects
  - Free riding
  - Incentives to invest
- This assessment may depend on how all-encompassing the APPAs are

Conclusion

- Competition enforcement has been far ahead of economics theory on the effect of APPA
- Economic theory generally support the agencies in their intervention against APPAs
  - The agreements have anti-competitive effects
- Strong reasons to scrutinise APPA including arguments about free-riding and investment incentives
  - Based on a correct description of the industry and products
- Case within an EU type competition law to make APPA a violation by object
  - Remember we do have article 101(3) so that if firms can demonstrate that the APPA benefits consumers and is indispensable to achieve this, it would be exempted