









# BUYER POWER AND UNFAIR TRADING PRACTICES: THE CASE OF THE EUROPEAN FOOD SUPPLY CHAIN

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# INTRODUCTION

During the last 60 to 70 years, the face of the retail distribution market in Europe has changed significantly. Along with the technological revolution and the progressive abandonment of the traditional retail model, characterized by small family owned shops, came the emergence and diffusion of supermarkets and hypermarkets. These new store formats transformed the retail industry and led to the concentration of buyer power in the hands of few large retail chains, who could benefit from economies of scale and an international reach.

As the competition between retailers diminished, and suppliers faced less alternatives to distribute their products, retailers became necessary intermediaries for suppliers, taking on the role of “gatekeepers” of their access to consumers. Through the control of the access to their shops and shelf space, retailers were able to exercise substantial buyer power towards suppliers, creating a significant power imbalance in relationships with suppliers, which end up being the weaker party in negotiations.

Such differences in bargaining power led to the widespread use of unfair trading practices in contractual relationships in the food supply chain, where, to this day, retailers employ them to their advantage against suppliers. Such abuses of buyer power have led to growing tensions between the actors of the food supply chain and are a growing cause for concern for Competition Authorities and Legislators all over Europe.

Having regard to the size and strategic relevance of the European food supply chain, which employs approximately over 48 million people throughout all Member States,

i.e. almost one in five of the EUs' total workforce<sup>1</sup>, and considering the heightened business risk inherent to the agricultural sector, due to its dependence on biological processes and weather conditions, the protection from unfair trading practices of suppliers in this sector is of particular importance.

Therefore, the objective of this thesis is to analyze the power imbalances in the European food supply chain and their repercussions on the relationship between the suppliers and the retailers, as well as their effects on overall competition in the food sector. Furthermore, this thesis seeks to analyze the legislative framework available both at EU level and at Member States level to tackle such power imbalances and protect weaker suppliers from unfair trading practices.

The first chapter contains a review of the relevant economic theories on buyer power, focusing on the distinction between monopsony power and bargaining power. The aim is to better understand the economic impact of the exercise (or abuse) of buyer power on competition both on the upstream and downstream markets. Although buyer power affects both sides of the market, this thesis will focus mainly on the consequences of buyer power on the upstream supplier market.

Therefore, Chapter 1 will explore the possible anti-competitive or pro-competitive effects of the exercise of buyer power, focusing on the impact on suppliers' capability for innovation and their actual survival on the market, as well as on final consumer prices. Furthermore, this thesis seeks to emphasize the causal link between the exercise of buyer power from retailers, and their imposition of unfair trading practices on suppliers. In fact, an undertaking which holds buyer power is not only capable of obtaining lower purchasing prices, but also favorable contractual terms from their counterpart in negotiations, especially when these are smaller entities such as SMEs.

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<sup>1</sup> See: EUROSTAT, *Food: From Farm to Fork Statistics*, Publications Office of the European Union, Luxembourg, 2011, pp. 15-17.



Chapter 2 of this work discusses the trend towards consolidation that has characterized the European retail market in the last decades and is still ongoing although at a different rate in different Member States. The concentration levels of the European retail market are still progressively increasing, as a consequence of the structural changes witnessed by the market. Furthermore, the growing phenomenon of joint purchasing agreements between retailers has further contributed to the consolidation of the market.

Such buying alliances between retailers constitute a means for distributors to significantly increase their bargaining power vis à vis the suppliers, further diminishing the latter's alternatives on the market due to the standardization of their commercial practices. The second half of Chapter 2 presents an overview on the functioning of these alliances, explaining the mechanisms through which they are able to obtain better pricing and non-pricing conditions from suppliers and their possible effects on both horizontal and vertical competition. Although the main focus lies on the impact of buying alliances on the strained relationships between retailers and suppliers, their effects on retailer competition will also be considered.

In particular, this thesis seeks to demonstrate the close link between the consolidation of the retail market and the widespread use of unfair trading practices in relationships between retailers and suppliers. In fact, as suppliers' alternative business partners on the market decrease, their bargaining power vis à vis large retailers diminishes, making them more vulnerable to the abuses of buyer power by retailers.

Chapter 3 discusses the main unfair contractual terms and business practices imposed upon the sellers by the buyers, which may, for example, be unilaterally and retroactively imposed on suppliers, contrary to the principle of good faith or fair dealing. Such practices, as mentioned before, are enforced by retailers on suppliers on

the basis of the former's stronger bargaining power and are often only indirectly linked with the price negotiations.

Chapter 3 also analyzes the impact on competition of such practices, considering the different schools of thought in the economic debate. This thesis, in particular, seeks to demonstrate that, even though the competitive outcomes are still controversial, unfair trading practices are likely to transfer wealth from producers to distributors in manners and quantities that are generally considered unfair, harming EU suppliers, and especially SMEs. Ultimately, this thesis seeks to demonstrate that such practices are likely to hinder the functioning of the Single Market, having a negative impact on the EU economy as a whole, as well as on final consumers, hence the need to regulate them to protect weaker suppliers in the food supply chain.

Chapter 4 presents a detailed analysis of the evolution of the legal framework available to tackle unfair trading practices, both at EU level and at national Member States level. This final chapter focuses on two main points: the inadequacy of competition law provisions to combat unfair trading practices and the importance of the new EU Directive on unfair trading practices in business to business relationships in the agricultural and food supply chain.

In fact, this thesis seeks to explain how competition law provisions, Art. 101 and 102 TFEU in particular, only partially cover unfair trading practices in the food supply chain, due to their (mostly) unilateral nature and the difficulty of establishing dominance of retailers in this sector. Specific legislation on unfair trading practices is then more adequate and effective to combat the issue. However, the issue has been dealt with, up until the adoption of the aforementioned EU Directive, only at national level, contributing to the divergence of Member States' legislations, which diminished the effectiveness of the protection afforded.

Chapter 4 focuses on the analysis of the new Directive on unfair trading practices, which represents a new cohesive legal framework, and, by establishing a minimum standard of protection against unfair trading practices in all Member States, will hopefully significantly increase the level of protection of suppliers in the European food supply chain.

# 1. BUYER POWER IN THE RETAIL MARKET

## SUMMARY

**1.1.** Introduction – **1.2.** Definitions of Buyer Power – **1.3.** Economic Theories of Buyer Power – 1.3.1. Monopsony Power – 1.3.2. Oligopsony Power – 1.3.3. Bilateral Monopoly – 1.3.4. Bargaining Power – **1.4.** Effects on Competition of Buyer Power – 1.4.1. Effects on Competition of Monopsony Power – 1.4.2. Effects on Competition of Bargaining Power – **1.5.** Conclusions on Buyer Power

## 1.1. INTRODUCTION

Since the 1930s, Buyer power has been perceived as a threat to competition and to the structure of retail markets, especially due to the increased concentration levels these markets have reached in recent years at both national and European level<sup>2</sup>. Giant retail corporations have increasingly substituted traditional and specialized local shops, controlling a large part of the sales, both at national and international level<sup>3</sup>. These giant retail corporations, in fact, often operate internationally and are able to invest large sums in their complex logistics and distribution systems, allowing them to

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<sup>2</sup> Market concentration can be used as a proxy to measure the intensity of competition on the market, measuring the degree to which market shares are concentrated in the hands of a limited number of firms. The concentration of the retail market in Europe will be discussed in further detail in Chapter 2. For further details on the definition of concentration and how it can be measured see: OECD, *Market Concentration*, Issues paper by the Secretariat, Directorate for Financial and Enterprise Affairs Competition Committee, DAF/COMP/WD(2018)46, Paris, 20 April 2018, pp. 1-26.

<sup>3</sup> For a detailed overview and analysis of the existent retailers active in the retail market in Europe see: AREA STUDI MEDIOBANCA, *I maggiori Gruppi Italiani (2011-2015) e Internazionali (2014-2015) della GDO Alimentare*, 2015, pp. 1-27.

benefit from economies of scale and to significantly increase their efficiency. This rapid growth is witnessed by the proliferation of large-store formats, such as superstores and hypermarkets<sup>4</sup>, all over Europe and North America, which in turn have allowed retailers to significantly increase their volume of sales and, most importantly, their buyer power<sup>5</sup>.

Buyer power is typically exercised in the context of vertical relationships, where a buyer procures goods from a supplier, and it can occur at any level of the supply chain. Retail markets are an obvious example of a vertical relation, as the retailer buys input from the supplier on the upstream market, in order to subsequently sell to the consumers on the downstream market. The European Central Bank's study on Structural Features of Distributive Trades and their Impact on Prices in the Euro Area<sup>6</sup> classifies retail trade as part of the distributive trade sector, along with wholesale trade, with the difference between the two being that wholesalers generally sell to businesses and retailers, and retailers sell to final consumers.

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<sup>4</sup> Retail formats are differentiated mainly on the basis of the store's floor space and the predominance of sales of food or non-food products. The smallest retail format is the 'mini-market', or 'superette', which is a retail self-service shop which only sells food, and whose floor space is generally below 400 m<sup>2</sup>. The 'supermarket' is also a retail self-service shop, which predominantly sells food products, although it the sale of non-food products is increasing. Its floor space is generally over 400 m<sup>2</sup> but below 2 500 m<sup>2</sup>. 'Hypermarkets', or 'superstores', offer a wide selection of food and non-food products, usually have car-parking facilities, and their floor space is generally above 2 500 m<sup>2</sup>. 'Discount stores' are retail shops which have almost no floor service and sell low priced goods. For further details see: EUROSTAT, *Retailing in the European Single Market*, Office for Official Publications of the European Communities, Luxembourg, 1993, p. 208.

<sup>5</sup> DOBSON CONSULTING, *Buyer Power and Its Impact on Competition in the Food Retail Distribution Sector of The European Union*, prepared for The European Commission DG Competition, study contract No. IV/98/ETD/078, Office for Official Publications of the European Communities, Luxembourg, May 1999, pp.1-156.

<sup>6</sup> EUROPEAN CENTRAL BANK, *Structural Features of Distributive Trades and their Impact on Prices in the Euro Area*, Occasional Paper Series, No. 128, Task Force of the Monetary Policy Committee of the European System of Central Banks, Frankfurt, September 2011, pp.1-144.

It is then evident that the retail market has witnessed a structural revolution, accompanied by swift technological developments, which have provoked significant changes in the traditional supplier-retailer relations. The power in the supply chain is now increasingly held by the buyer, who replaced the manufacturers role as driver of the chain through the development of brands. Furthermore, the retailers now act as 'gatekeepers', controlling the suppliers' essential access to consumers (in fact, the suppliers can rarely create such large and efficient distribution channels for themselves)<sup>7</sup>. In addition, buyer power and selling power are ever more frequently held by the same entity, the retailer, with buyer power affecting not only the upstream market, but also the downstream one<sup>8</sup>.

This chapter seeks to introduce the reader to the central concept around which this thesis evolves: the exercise of buyer power in the retail market, its consequences and its competitive outcomes. The economic theories of buyer power, monopsony and countervailing buyer power will be briefly explained in the first sections of the chapter, subsequently focusing on the effects on competition and consumer welfare, identifying the circumstances where detrimental effects outweigh the positive effects and vice versa.

For the sake of clarity in this thesis the terms 'manufacturers', 'producers', 'sellers' and 'suppliers' will be used interchangeably to indicate the actors, or firms, active on the upstream market. The terms 'buyers', 'distributors' and 'retailers' will also be used interchangeably to indicate the firms that buy from the suppliers on the upstream market, and sell on the downstream market, to consumers.

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<sup>7</sup> OECD, *Roundtable on Monopsony and Buyer Power*, Directorate for Financial and Enterprise Affairs Competition Committee, DAF/COMP(2008)38, Paris, 17 December 2009, pp.1-25.

<sup>8</sup> P. DOBSON, M. WATERTON, A. CHU, *The Welfare Consequences of the Exercise of Buyer Power*, prepared for the Office of Fair Trading, London, September 1998, pp. 1-55.

## 1.2. DEFINITIONS OF BUYER POWER

This section seeks to collect and illustrate the different definitions of buyer power that can be found in the relevant literature, as the only thing the available sources agree upon, is the fact that a universally accepted definition of buyer power does not exist. Therefore, the aim is to create a comprehensive overview in order to better understand what buyer power entails, as well as its relationship to the concepts of monopsony power and countervailing buyer power.

In general, the literature agrees on the fact that buyer power is a mirror concept of market power<sup>9</sup>, as it actually refers to the exercise of market power by the buyer side<sup>10</sup>. Consequently, if market power consists in the ability of the seller to profitably set prices above competitive levels, buyer power can be defined as the capability of the buyer to profitably fix prices below competitive levels.

The same concept can also be found in Noll's definition<sup>11</sup> which states that: <<Buyer power refers to the circumstances in which the demand side of the market is sufficiently concentrated that buyers can exercise market power over sellers. A buyer has market power if the buyer can force sellers to reduce price below the level that would emerge in a competitive market. Thus, buyer power arises from monopsony (one buyer) or oligopsony (a few buyers), and is the mirror image of monopoly or oligopoly<sup>12</sup>>>.

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<sup>9</sup> Whish and Bailey define market power as following: "Market power presents undertakings with the possibility of profitably rising prices, or keeping them high, over a period of time; the expression 'raising prices' here includes, and is shorthand for, other ways in which competition can be restricted, for example by limiting output or capacity, suppressing innovation, reducing the variety or quality of goods, or services or by depriving consumers of choice, all of which are clearly inimical to consumer welfare". For further details see: R. WHISH, D. BAILEY, *Competition Law*, Oxford University Press, Oxford, 9<sup>th</sup> edition, 2018, p. 25.

<sup>10</sup> Z. CHEN, *Defining buyer power*, in *The Antitrust Bulletin*, Vol.53, Issue 2, Summer 2008, pp. 241-249.

<sup>11</sup> R. NOLL, *Buyer Power and Economic Policy*, in *Antitrust Law Journal*, 72, 2005, p. 589.

<sup>12</sup> *Ibid.*

Chen<sup>13</sup>, instead, considers Noll's aforementioned definition<sup>14</sup> to be tautological, and offers a more complete definition of buyer power, provides also for a synthetic explanation of the concepts of monopsony power and countervailing buyer power (or bargaining power)<sup>15</sup>. According to the author: <<Buyer power is the ability of a buyer to reduce price profitability below a supplier's normal selling price, or more generally the ability to obtain terms of supply more favorable than a supplier's normal terms. The normal selling price, in turn, is defined as the supplier's profit maximizing price in the absence of buyer power. In the case where there is perfect competition among suppliers, the normal selling price of a supplier is the competitive price, and the buyer power is monopsony power. On the other hand, in the case where competition among suppliers is imperfect, the normal selling price is above the competitive price and the buyer power is countervailing power<sup>16</sup>>>.

Furthermore, many authors go beyond Noll's approach, broadening the definition of buyer power to the extent to which buyer power exists also in circumstances in which the buyer does not necessarily have the ability to set lower prices compared to those found in competitive circumstances<sup>17</sup>. In fact, buyer power may be exercised also under the form of non-monetary contractual constraints and other business practices which, as will be discussed in further detail in Chapter 3 and 4 of this thesis may amount to vertical restraints serving anti-competitive purposes.

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<sup>13</sup> Z.CHEN, *Defining Buyer Power*, in *The Antitrust Bulletin*, Vol.53, No.2, Summer 2008, p.247.

<sup>14</sup> R. NOLL, *Buyer Power and Economic Policy*, in *Antitrust Law Journal*, 72, 2005, p.589.

<sup>15</sup> A detailed analysis of the concepts of monopsony power and bargaining power (or countervailing power) will follow in the next paragraphs. See Chapter 1.3.1 and 1.3.4.

<sup>16</sup> Z.CHEN, *Defining Buyer Power*, in *The Antitrust Bulletin*, Vol.53, No.2, Summer 2008, p. 247.

<sup>17</sup> P. DOBSON, M. WATERTON, A. CHU, *The Welfare Consequences of the Exercise of Buyer Power*, prepared for the Office of Fair Trading, London, September 1998, pp. 1-55.



Dobson, Waterson and Chu<sup>18</sup> are amongst the aforementioned authors who link buyer power to business practices, going beyond the sole concept of monetary gain (i.e. the obtainment of lower purchase prices from the seller). These authors refer specifically to the terms of trade, defining buyer power as the power that is exercised when: <<a firm or group of firms obtain from suppliers more favorable terms than those available to other buyers or would otherwise be expected under normal competitive conditions<sup>19</sup>>>. Therefore, obtaining lower purchase prices is not the only indicator of buyer power.

The reference to the achievement of more favorable terms of trade as an indicator of the presence of buyer power, is also found in the reports on the Roundtables organized throughout the years by the Organization for Economic Cooperation and Development (OECD) on the topic of buyer power. In fact, an intricate definition can be found in the OECD's report on the Roundtable on Buyer Power of Large Scale Multiproduct Retailers<sup>20</sup> from 1998, which refers to long-term opportunity costs. According to such report: <<A retailer is defined to have buyer power if, in relation to at least one supplier, it can credibly threaten to impose a long term opportunity cost (i.e. harm or withheld benefit) which, were the threat carried out, would be significantly disproportionate to any resulting long term opportunity cost to itself<sup>21</sup>>>.

The more recent OECD report on the Roundtable on Monopsony and Buyer Power<sup>22</sup> of 2008, refers instead to the terms of trade and offers a similar definition of buyer power to that, already mentioned, of Dobson et al. Such report states that: <<buying

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<sup>18</sup> *Ibid.*

<sup>19</sup> *Id.* p.5.

<sup>20</sup> OECD, *Roundtable on Buying Power of Multiproduct Retailers*, Directorate for Financial, Fiscal and Enterprise Affairs Committee on Competition Law and Policy, DAF/CLP(99)21, Paris, 21 July 1999, p. 281

<sup>21</sup> *Ibid.*

<sup>22</sup> *Id.* p. 21.

power<sup>23</sup> may be defined as the situation which exists when a firm or a group of firms, either because it has a dominant position as a purchaser of a product or a service or because it has strategic or leverage advantages as a result of its size or other characteristics, is able to obtain from a supplier more favorable terms than those available to other buyers<sup>24</sup>>> and: <<buyer power is concerned with how downstream firms can affect the terms of trade with upstream suppliers>>. Likewise, also Inderst and Shaffer state that: << The term buyer power typically refers to the ability of buyers (i.e., downstream firms) to obtain advantageous terms of trade from their suppliers (i.e., upstream firms)<sup>25</sup>.>>.

### 1.3. ECONOMIC THEORIES OF BUYER POWER

Once the literature definitions of buyer power have been examined, the next step is to uncover the economic theory regarding it, answering to the question of what buyer power actually entails. As the OECD's Competition Committee stated, in the aforementioned 2008 report<sup>26</sup>, buyer power can present itself in two forms: monopsony power and bargaining power.

The two types of buyer power substantially differ, and the distinction mainly depends on whether or not the supplier has a significant degree of market power. In fact, if the supplier side of the market is characterized by the presence of perfect competition (i.e. a multitude of suppliers competing amongst themselves), the selling price is set at the competitive level and the buyer power exercised by the retailer constitutes monopsony

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<sup>23</sup> The OECD reports occasionally refer to buying power as a synonym to buyer power.

<sup>24</sup> OECD, *Roundtable on Monopsony and Buyer Power*, Directorate for Financial and Enterprise Affairs Competition Committee, DAF/COMP(2008)38, Paris, 17 December 2009, p. 267.

<sup>25</sup> R. Inderst, G. Shaffer, *Buyer Power in Merger Control*, American Bar Association, Chicago, 2008, p. 2.

<sup>26</sup> OECD, *Roundtable on Monopsony and Buyer Power*, Directorate for Financial and Enterprise Affairs Competition Committee, DAF/COMP(2008)38, Paris, 17 December 2009, pp.1-25.

power. If instead, the supplier side of the market is composed of a few large suppliers who hold market power, the selling price is then set above the competitive level and the buyer power exercised by the retailer constitutes bargaining power (or countervailing power)<sup>27</sup>. In order to facilitate a clearer analysis, monopsony and bargaining power will be discussed separately.

However, the basic assumption to start with is that each market is characterized by a bilateral nature, having both a supply side and a demand side. The conceptual framework developed by Heinrich von Stackelberg in 1934, in Table 1, helps to understand the different market forms and their structures<sup>28</sup>.

Table 1<sup>29</sup>. The Structure of Markets.

<b>Demand Side Form</b>	<b>Supply Side Form</b>		
	Many	Few	One
Many	Perfect Competition	Oligopoly	Monopoly
Few	Oligopsony	Bilateral Oligopoly	Monopoly-oligopsony
One	Monopsony	Oligopoly-monopsony	Bilateral Monopoly

Traditionally, the seller side of the market has been studied more than the demand side, with the most studied market forms being the ones of perfect competition, oligopoly and monopoly. As previously mentioned though, starting from the decades

<sup>27</sup> Z. CHEN, *Buyer Power: Economic Theory and Antitrust Policy*, in *Research in Law and Economics*, Vol. 22, 9 March 2015, pp. 17-40.

<sup>28</sup> P. DOBSON, M. WATERSON, A. CHU, *The Welfare Consequences of the Exercise of Buyer Power*, prepared for the Office of Fair Trading, London, September 1998, p.8.

<sup>29</sup> *Ibid.*

1980s and 1990s, economists have focused their attention on monopsony and oligopsony markets, as well as bargaining power, which comes in play in markets where the agents are few, or one, on both sides. For the most part, economists have agreed that monopoly and monopsony (as well as oligopoly and oligopsony) are symmetrical distortions of competition, therefore market power analysis can be adapted to analyze monopsony and oligopsony power<sup>30</sup>. However, this reasoning does not apply to situations in which bargaining power is involved, such as bilateral oligopoly, monopsony-oligopoly, oligopoly-monopsony and bilateral monopoly, where the welfare implications are less clear-cut<sup>31</sup>.

### 1.3.1. MONOPSONY POWER

As showed above in Table 1, the textbook theory of monopsony power defines it as the situation where a single buyer faces an upstream market characterized by perfect competition, this is to say an upstream market where a multiplicity of suppliers compete among themselves. It is useful to keep in mind that the extent of the buyer's monopsony power is given by the amount of alternatives that sellers have on the market, so monopsony power will be stronger in the hands of a buyer which represents the only viable alternative on the market, and more limited if instead there are a few possible buyers to which the supplier can alternatively choose to sell its products<sup>32</sup>.

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<sup>30</sup> As will be discussed in further detail in the next paragraphs, this does not entail that the effects on welfare or the antitrust treatment of the exercise of buyer power should be necessarily treated as symmetrical to the exercise of market power by the seller side.

<sup>31</sup> P. DOBSON, M. WATERTON, A. CHU, *The Welfare Consequences of the Exercise of Buyer Power*, prepared for the Office of Fair Trading, London, September 1998, pp. 1-55.

<sup>32</sup> Z. CHEN, *Buyer Power: Economic Theory and Antitrust Policy*, in *Research in Law and Economics*, 9 March 2015, Vol. 22, pp. 17-40.

In order to identify monopsony power, the OECD has defined the relevant market as: <<the smallest set of products in the smallest geographic area such that a hypothetical monopsonist of those products in that area would be able to depress prices by a small but significant and non-transitory amount<sup>33</sup>>>. So, going back to the definitions of buyer power presented above, monopsony power can be defined as: <<the ability of a buyer to reduce the price of a purchased item (usually an input) below the competitive level by restricting its purchases of the item<sup>34</sup>>>.

Originally, the theory of monopsony was studied and explained in 1933 by Joan Robinson<sup>35</sup>, where she studied monopsony in relation to the labor market, presenting the example of a small city dominated by only one big employer, which has a large influence on wage levels. A monopsony employer in the labor market hires fewer employees compared to an employer operating in a competitive market, therefore decreasing the level of wages and increasing its profits. A monopsony is therefore defined as a market with one single buyer, who reduces economic activity under the optimal level, causing deadweight losses<sup>36</sup>.

The microeconomic analysis of pure monopsony power concentrates on the direct effects of the exercise of buyer power on quantity and price, illustrating how the exercise of monopsony power results in lower prices, by reducing the quantities purchased. Figure 1 illustrates the upward sloping supply curve  $S$  and the buyer's derived demand curve  $D$ , and their point of contact,  $b$ , represents the equilibrium in a situation of perfect competition, with  $x_c$  representing the quantity bought by the buyer in perfect competition, and  $w_c$  the competitive price. As the buyer (i.e. the retailer)

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<sup>33</sup> OECD, *Roundtable on Monopsony and Buyer Power*, Directorate for Financial and Enterprise Affairs Competition Committee, DAF/COMP(2008)38, Paris, 17 December 200, p.10.

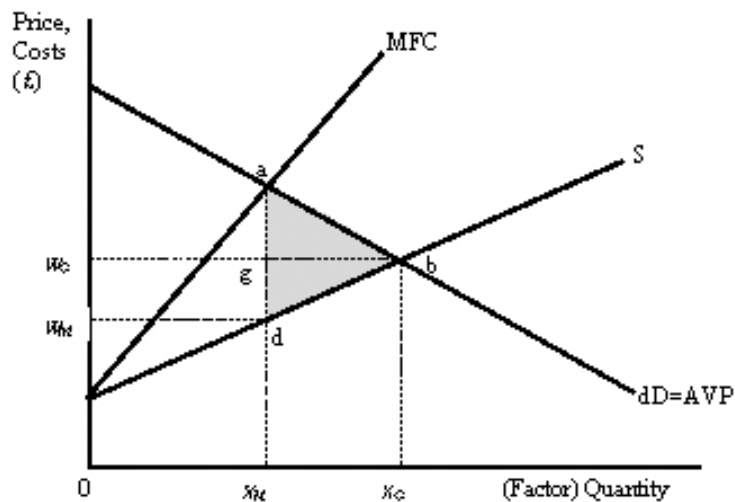
<sup>34</sup> J. JACOBSON, G. DORMAN, *Joint Purchasing, Monopsony and Antitrust*, in *The Antitrust Bulletin*, Federal Legal Publications, Spring 1991, p.5.

<sup>35</sup> G. SHOVE, *The Economics of Imperfect Competition by Joan Robinson*, in *The Economic Journal*, Volume 43, Issue 172, 1 December 1933, pp.657–661.

<sup>36</sup> N. MANKIW, M. TAYLOR, *Economics*, South-Western Cengage Learning, 2<sup>nd</sup> edition, Andover, 2011, p.395.

buys a larger quantity of input, the level of production has to increase in order to satisfy the increase in demand, causing the per-unit price of the input to rise. This is illustrated by the second curve MFC which represents the marginal input cost of each additional unit<sup>37</sup>.

Figure 1<sup>38</sup>. Monopsony welfare loss.



The marginal factor cost curve lies above the supply curve  $S$ , because the marginal input cost is higher than the average cost because the increasing input price is to be paid on all units purchased, not just the last one<sup>39</sup>. The profit maximizing output for the monopsonist,  $x_m$ , is determined by the intersection between the derived demand curve and the marginal factor supply curve,  $a$ . For this output, the supply curve determines the price, which is  $w_m$ , and the equilibrium quantity,  $x_m$ . Compared with a market equilibrium between demand and supply, a monopsony reduces the quantity of input purchased from the sellers below the competitive level in order to reduce also the input price below the competitive level. The monopsonist can therefore influence

<sup>37</sup> P. DOBSON, M. WATERTON, A. CHU, *The Welfare Consequences of the Exercise of Buyer Power*, prepared for the Office of Fair Trading, London, September 1998, pp. 1-55.

<sup>38</sup> *Id.* p.5.

<sup>39</sup> J. JACOBSON, G. DORMAN, *Joint Purchasing, Monopsony and Antitrust*, in *The Antitrust Bulletin*, Federal Legal Publications, Spring 1991, pp.6-7.

the input price by reducing the quantity of input purchased, increasing its profits to the detriment of the supplier and creating a deadweight welfare loss represented by the area abd in Figure 1, due to the inefficient allocation of resources. Welfare loss increases further if the monopsonist retailer is also a monopolist in the downstream market (the retailer is then called a monemporist)<sup>40</sup>.

### 1.3.2. OLIGOPSONY POWER

The aforementioned principles of monopsony power can also apply to situations of oligopsony power, where there are a few buyers on the market, instead of only one single buyer (as illustrated in Table 1), who are able to influence the input price, depressing it below the competitive level. It should be observed that in an oligopsonistic market the few retailers present can act either independently or together. Consequently, the input quantity purchased and the level of prices decrease the more the market is concentrated (so the fewer the alternatives available to the suppliers) and the welfare loss increases the lower the elasticity of supply is<sup>41</sup>. In what follows, monopsony power and oligopsony power will, for reasons of convenience, be dealt with jointly and will both be referred to as monopsony power.

According to Dobson et al.<sup>42</sup>, three conditions appear to be necessary in order to exercise monopsony power. Firstly, the buyers must represent a substantial portion of the total purchases in the market, secondly there must be barriers to entry to the market, and thirdly, the supply curve must be upward sloping (as showed in Figure

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<sup>40</sup> P. DOBSON, M. WATERSON, A. CHU, *The Welfare Consequences of the Exercise of Buyer Power*, prepared for the Office of Fair Trading, London, September 1998, pp. 1-55.

<sup>41</sup> P. DOBSON, M. WATERSON, A. CHU, *The Welfare Consequences of the Exercise of Buyer Power*, prepared for the Office of Fair Trading, London, September 1998, pp. 1-55.

<sup>42</sup> *Ibid.*

1)<sup>43</sup>. The first condition follows the fact that the buyer must be able to significantly influence the market price, and this is more likely to happen when the buyer is responsible for large amounts of purchases.

The second condition reflects the fact that, if entry in the market is relatively easy, monopsony profits would eventually attract new competitors in the market, which would consequently decrease the original buyer's monopsony power. Finally, the third condition is necessary because, if the supply curve were to be horizontal, it would follow that an increase of the quantity of input purchased would not generate an increase in the supply price, and vice versa, a decrease of quantity of input purchased, would not cause the supply price to decrease<sup>44</sup>.

This last point has caused some controversy in the literature, where Dorman and Jacobson amongst others <sup>45</sup> , argue that in many industries, especially the manufacturing one, production of extra units is usually done at a constant per-unit cost, due to economies of scale and factory structures. Per-unit costs do not increase and this causes the long-run supply curve to be, in fact, horizontal, with upward sloping ones constituting a rare exception<sup>46</sup>.

On the contrary, Dobson et al.<sup>47</sup> maintain that most empirical studies on monopsony power regarding the labor and agricultural market show that upward sloping supply

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<sup>43</sup> There is a theoretical possibility of exercising monopsony power in the presence of a downward sloping curve, although it is considered as an extremely rare, if not impossible, circumstance, thus this thesis will not discuss the issue. For further details see: J. JACOBSON, G. DORMAN, *Joint Purchasing, Monopsony and Antitrust*, in *The Antitrust Bulletin*, Federal Legal Publications, Spring 1991, p.10, footnote 16.

<sup>44</sup> P. DOBSON, M. WATERSON, A. CHU, *The Welfare Consequences of the Exercise of Buyer Power*, prepared for the Office of Fair Trading, London, September 1998, pp. 1-55.

<sup>45</sup> For more details on authors and studies which corroborate the thesis that the supply curve is realistically flat, see: J. JACOBSON, G. DORMAN, *Joint Purchasing, Monopsony and Antitrust*, in *The Antitrust Bulletin*, Federal Legal Publications, Spring 1991, p.13.

<sup>46</sup> *Id.* p.13-16.

<sup>47</sup> P. DOBSON, M. WATERSON, A. CHU, *The Welfare Consequences of the Exercise of Buyer Power*, prepared for the Office of Fair Trading, London, September 1998, pp.1-55.



curves are the norm, given the structure of these markets, where the supply side is often characterized by the presence of competition, and the scarcity value associated with the inputs. This seems to be the opinion of the majority of the literature, which argue that capacity constraints and bottlenecks in supply of inputs are likely to result in an upward sloping supply curve in any industry, if output is increased enough<sup>48</sup>.

### 1.3.3. BILATERAL MONOPOLY

As shown in table 1, bilateral monopoly is the situation where a single buyer faces a single seller, so both the upstream and the downstream market are extremely concentrated, presenting one single actor on the market. In theory, the monopolist would then be able to raise prices above the competitive level, however the monopsonist would be able to lower them below the competitive equilibrium threshold.

In this case the economic literature agrees on the fact that there is no general assumption that a bilateral monopoly leads to better welfare outcome compared to a situation of pure monopoly and the impact of such bilateral monopoly on competition is indeterminate, being that it usually depends on the which actor has the strongest bargaining power<sup>49</sup>.

### 1.3.4. BARGAINING POWER

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<sup>48</sup> *Ibid.*

<sup>49</sup> J. JACOBSON, G. DORMAN, *Joint Purchasing, Monopsony and Antitrust*, in *The Antitrust Bulletin*, Federal Legal Publications, Spring 1991, p.19.

As previously mentioned, the literature agrees that buyer power may take different forms depending on the nature of the upstream market and on the number of agents present on both sides of the market. Consequently, it is to be distinguished between the situations where buyer power is exercised against a multitude of perfectly competitive sellers, and the circumstances where instead the number of buyers and sellers on the market is limited. In this last scenario the terms of trade are not unilaterally established by the monopsonist, but on the contrary they are determined by bilateral bargaining between the buyer and the seller, which usually each hold a degree of buyer power and market power<sup>50</sup>.

The theory of countervailing power<sup>51</sup> was first elaborated by Galbraith in 1952<sup>52</sup>, to describe the capability of large retailers, or retail buying organizations, to offset the strong market power of suppliers, in particular of large multi-national suppliers, obtaining price discounts on the purchases, which would not be obtained by smaller buyers.

Amongst the more recent definitions present in the literature, Kirkwood offers a useful and concise one, defining bargaining power as: <<the power to obtain a concession from another party by threatening to impose a cost, or withdraw a benefit, if the party does not grant the concession<sup>53</sup>.>>. The OECD report also offers a detailed definition of bargaining power, stating that: << Bargaining power refers to the bargaining strength that a buyer has with respect to its suppliers [...] and determines the extent to which a buyer is able to extract surplus from a supplier. [...] Therefore identifying

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<sup>50</sup> P. DOBSON, M. WATERSON, A. CHU, *The Welfare Consequences of the Exercise of Buyer Power*, prepared for the Office of Fair Trading, London, September 1998, pp.1-55.

<sup>51</sup> Some authors, such as Galbraith and Chen, refer to bargaining power as countervailing power. In this thesis the term bargaining power will be preferred, following the OECD nomenclature.

<sup>52</sup> J. GALBRAITH, *American Capitalism: The Concept of Countervailing Power*, Houghton Mifflin, Boston, 1952.

<sup>53</sup> KIRKWOOD J., *Buyer Power and Exclusionary Conduct: Should Brooke Group Set the Standards for Buyer-Induced Price Discrimination and Predatory Bidding?*, in *Antitrust Law Journal*, Vol.72, 2005, pp. 638-639.

bargaining power involves determining whether, in a buyer's absence, sellers would exercise market power<sup>54</sup>. >>.

So bargaining power is ultimately conceived as the buyer's position of strength in negotiations with the suppliers. The retailer's advantageous position in negotiations is usually connected to the presence of alternative suppliers on the market, amongst which the retailer can efficiently switch, and its role as necessary intermediary between the supplier and the end consumers on the downstream market<sup>55</sup>.

## 1.4. EFFECTS ON COMPETITION OF BUYER POWER

### 1.4.1. EFFECTS ON COMPETITION OF MONOPSONY POWER

As previously mentioned, the literature agrees that the exercise of buyer power from a retailer who holds monopsony or oligopsony power, against a multitude of suppliers competing amongst themselves, is very likely to have detrimental effects on competition in the market. The buyer, which acts as a monopsonist, obtains discounts and lower prices for the input it purchases from suppliers, and this can actually lead to lower prices for consumers, whenever the retailer does not possess a significant degree of market power in the downstream distribution market and is therefore 'obliged' to pass on the lower prices to consumers. In the short term this obviously appears to be beneficial to consumer welfare, as consumers will pay less for the same products<sup>56</sup>. But what happens when one considers the long run dynamic effects that this mechanism produces?

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<sup>54</sup> OECD, *Roundtable on Monopsony and Buyer Power*, Directorate for Financial and Enterprise Affairs Competition Committee, DAF/COMP(2008)38, Paris, 17 December 2009, pp.8-11.

<sup>55</sup> *Ibid.*

<sup>56</sup> P. DOBSON, M. WATERSON, A. CHU, *The Welfare Consequences of the Exercise of Buyer Power*, prepared for the Office of Fair Trading, September 1998, pp. 1-55.

It is worth reminding that monopsony power achieves lower prices by restricting the amounts purchased on the market. Therefore, the monopsonist retailer obtains its lower prices by buying less products from the supplier, which in turn generates a decrease in the supplier's profits. This can have severe consequences for the sellers, whose volume of sales decreases along with their earnings, forcing the less efficient sellers to exit the market. The margin squeeze results in fewer, or none, investments on the part of suppliers, whose returns cannot cover the costs of investing in products and processes. In the long run, increasing retailer buyer power can also lead the more efficient suppliers to exit the market, where only producers who possess a strong brand power and product identity can resist<sup>57</sup>.

However, such distributional effects of buyer power don't necessarily impact negatively on social welfare as a whole, since the total level of revenue in the market stays the same, but it is distributed in favor of the buyer<sup>58</sup>. Although, the distortion of competition on the producer side generally entails that suppliers reduce the quality or the variety of their products, or even pass on the costs to society by applying for state subsidies or exiting the market. This eventually harms consumer welfare, as the overall incentives and ability to innovate of suppliers is hindered and the consumers' choice of products on the market is reduced.

This may be aggravated by the fact that retailers with strong monopsony power may also reduce investments in efficiency due to their position of strength on the market,

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<sup>57</sup> P. DOBSON, *Buyer Power in Food Retailing: The European Experience*, Conference on Changing Dimensions of the Food Economy, The Hague, 6-7 February 2003, p. 9.

<sup>58</sup> J. JACOBSON, G. DORMAN, *Joint Purchasing, Monopsony and Antitrust*, in *The Antitrust Bulletin*, Federal Legal Publications, Spring 1991, p. 17.

becoming less innovative and less attentive to consumer preferences, ultimately offering lower quality products and services to consumers<sup>59</sup>.

On the other hand, it is to be noted that, as Dobson et al.<sup>60</sup> state: << In the context of developments in retailing, it is clear that consumers have generally gained from increased convenience and product choice as a result of the emergence of large store formats. More generally, efficiency has increased due to economies of scale and scope being realised<sup>61</sup>.>>. So, the effects on efficiency are quite controversial, as economies of scale can actually enhance it.

In addition to the decrease in innovation and efficiency, another negative welfare effect of the exercise of monopsony (or oligopsony) power, is the mis allocation of resources. In fact, by reducing the quantities purchased, the level of input on the market falls below the competitive level as the retailer will produce less output (due to his profits falling below competitive levels), resulting in a loss of allocative efficiency<sup>62</sup>. This eventually determines that the retailer will be able to charge higher prices, depending on the degree of market power it enjoys on the downstream market, ultimately harming final consumers<sup>63</sup>.

On the other hand, this simplified analysis has been criticized by Dobson et al.<sup>64</sup> which note that: <<The conclusion that the exercise monopsony power is socially detrimental needs to qualified in terms of two important caveats. First, there may be off-setting

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<sup>59</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp.1-213.

<sup>60</sup> P. DOBSON, M. WATERSON, A. CHU, *The Welfare Consequences of the Exercise of Buyer Power*, prepared for the Office of Fair Trading, September 1998, London, p.38.

<sup>61</sup> *Ibid.*

<sup>62</sup> J. JACOBSON, G. DORMAN, *Joint Purchasing, Monopsony and Antitrust*, in *The Antitrust Bulletin*, Federal Legal Publications, Spring 1991, p.17.

<sup>63</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp.1-213.

<sup>64</sup> P. DOBSON, M. WATERSON, A. CHU, *The Welfare Consequences of the Exercise of Buyer Power*, prepared for the Office of Fair Trading, September 1998, London, pp.1-55.

efficiency benefits. The market may, for example, be a 'natural' monopsony where productive efficiency requires that there be a single buyer of an input and thus a welfare trade-off results, analogous to that of monopoly, involving productive gains but allocative deadweight welfare loss. For example, network economies may be present in purchasing and collecting, eg: in agricultural markets such as for milk, implying that the activity is most efficiently undertaken by a single firm but such a firm may then have monopsony power.

Similarly, with a buyer cartel there may be cost-savings from joint purchasing behaviour, eg: regarding reduced transaction costs or achieving economies of scale in production and warehousing, and other efficiency benefits. Secondly, if the monopsonist could practice (first degree) price discrimination in making its purchases, ie: pay each unit its exact cost of production rather than setting just a single market price, then the purchaser can obtain the entire economic surplus which would be generated under competitive market conditions (ie: thus eradicating any deadweight welfare loss in the factor market)<sup>65</sup>. >>.

Along with the impact on social welfare from the consumers' and suppliers' point of view, buyer power should be considered also from the perspective of the effects it produces on competition on the downstream market. In fact, buyer power is rarely equally distributed amongst competing retailers, due to size differences for example, causing increased disequilibrium and distortion of competition in the retail market<sup>66</sup>.

The competitors of the retailer who possesses stronger buyer power may see their supply costs raised by sellers which try to compensate for the loss of profits generated by the concessions granted to the monopsonist, or oligopsonist, retailer. Therefore, the largest, or more powerful, retailer obtains lower input prices, to the detriment of its

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<sup>65</sup> *Id.* pp.15-16.

<sup>66</sup> *Id.* pp..1-55.

competitors, whose wholesale prices increase due to the so called 'waterbed effect'<sup>67</sup>. The exercise of buyer power can therefore have this anticompetitive goal, to disfavor and exclude smaller and as efficient rivals from the market by raising their supply costs, i.e. raising rival's costs. This conduct ultimately results in the monopsonist's capacity of raising prices on the downstream market, having consolidated its market power there.

The general counter argument against the validity of the 'waterbed effect' theory is mentioned by Inderst and Valletti<sup>68</sup>: <<Often, the "waterbed effect" is dismissed on the grounds that it would represent only a logically flawed "accounting exercise" as it presumes that the seller insists on collecting from smaller buyers some of the margins lost from larger buyers, which would not stand up to scrutiny under careful modelling. After all, why would a supplier that seemingly can increase the wholesale price to smaller buyers not have already done so in the past?<sup>69</sup>>>. The authors refute this critique with a detailed technical analysis, confirming the relevance and existence of the 'waterbed effect'.

Furthermore, it is to be noted that the abuse of monopsony power, and the resulting oppressive conduct of the monopsonist retailer towards the buyer, is generally considered to distort competition more than the traditional abuse of market power carried out by firms with seller power due to the particularities of the relation between retailers and suppliers. The retailer can represent, in fact, not only a buyer for the supplier, but also a competitor on the market (with its private-label products), a fundamental distribution channel controlling the supplier's access to consumers, and

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<sup>67</sup> R. Inderst, T. Valletti, *Buyer Power and the 'Waterbed Effect'*, Center for Economic and International Studies Tor Vergata, Research Paper Series, Vol. 6, Issue 1, No. 107, January 2008, pp.1-26.

<sup>68</sup> *Ibid.*

<sup>69</sup> *Id.* p.2.

a seller of ancillary services (like shelf space)<sup>70</sup>. The exercise, and abuse, of buyer power, in whichever form, is generally also more difficult to detect and to address with the traditional instruments of competition law, compared to the abuse of market power<sup>71</sup>.

Consequently, the monopsonist retailer is more likely to carry out oppressive and discriminatory conducts, which now go under the name of ‘unfair trading practices’<sup>72</sup>, against suppliers, compared to the monopolist abusing its power against consumers, and can significantly influence prices and quantities. In fact, as previously mentioned, the monopsonist (or oligopsonist) may, thanks to its significant buyer power, impose additional clauses and ancillary restraints on the supplier, which are only indirectly linked with the price negotiations and can have a negative impact on competition and on the efficiency of the producers. For this reason, the effects of buyer power should also be considered from the perspective of the contractual terms and business practices imposed upon the seller by the retailer<sup>73</sup>.

#### 1.4.2. EFFECTS ON COMPETITION OF BARGAINING POWER

As previously mentioned, the welfare implications of the exercise of buyer power are not as clear cut as for the exercise of monopsony or oligopsony power. In some cases, the supply side can be characterized by high levels of concentration, as it can consist of large corporations exercising a significant degree of market power against the

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<sup>70</sup> P. DOBSON, M. WATERSON, A. CHU, *The Welfare Consequences of the Exercise of Buyer Power*, prepared for the Office of Fair Trading, September 1998, London, pp.1-55.

<sup>71</sup> The existent legal framework to address the abuse of buyer power from retailers towards suppliers will be discussed in further detail in Chapter 4.

<sup>72</sup> Such discriminatory clauses and ancillary restraints imposed on suppliers, i.e. unfair trading practices, will be discussed in further detail in Chapter 3.

<sup>73</sup> P. DOBSON, M. WATERSON, A. CHU, *The Welfare Consequences of the Exercise of Buyer Power*, prepared for the Office of Fair Trading, September 1998, London, pp.1-55.



buyers. In these circumstances, the buyers may exercise buyer power under the form of bargaining power, countervailing the sellers' market power<sup>74</sup>, potentially raising the quantity of output on the market and increasing consumer welfare<sup>75</sup>.

The extent to which the exercise of bargaining power can lead to positive welfare effects usually varies depending on the degree of market power that the retailer holds on the downstream market. If the retailer is a price-taker in the downstream market, this usually entails that the lower wholesale prices of the inputs and the benefits obtained in negotiations with the supplier, are passed on to the final consumers, resulting in potential socially beneficial effects. In other words: <<downstream competition is necessary to assure that an upstream discount translates into lower prices downstream<sup>76.>><sup>77</sup>.</sup>

This scenario though still may raise concerns when the price decrease in the downstream market contributes to the consolidation of the retailer's own selling power, due to the exclusionary effect these lower prices may have on the retailer's competitors, who can't compete with them even though they are just as efficient, and ultimately end up leaving the market. In the long run, the retailer's selling power increase would result in less competition on the downstream market and higher prices for consumers therefore impacting negatively on economic welfare<sup>78</sup>.

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<sup>74</sup> Bargaining power may also countervail the increase in market power that may result from a merger between suppliers. For more details see: R. Inderst, G. Shaffer, *Buyer Power in Merger Control*, American Bar Association, Chicago, 2008, pp. 1-27.

<sup>75</sup> Z. Chen, *Buyer Power: Economic Theory and Antitrust Policy*, in *Research in Law and Economics*, Vol. 22, 9 March 2015, pp. 17-40.

<sup>76</sup> D. Mills, *Countervailing Power and Chain Stores*, in *Review of Industrial Organization*, Vol. 42, Issue 3, May 2013, p. 292.

<sup>77</sup> For a detailed analysis of the effects of countervailing power on competition see: D. Mills, *Countervailing Power and Chain Stores*, in *Review of Industrial Organization*, Vol. 42, Issue 3, May 2013, pp. 281-295.

<sup>78</sup> Z. Chen, *Buyer Power: Economic Theory and Antitrust Policy*, in *Research in Law and Economics*, Vol. 22, 9 March 2015, pp. 17-40.

A further element to consider, is the effect that lower input prices for one retailer, which has selling power in the distribution market, can have on other competitors<sup>79</sup>. In fact, the suppliers may consequently raise input prices for the other buyers (to compensate for the loss of profits), which would find themselves in a situation of competitive disadvantage compared to the retailer which possesses bargaining power. This consists in the aforementioned 'waterbed effect' and ultimately results in an increase of the final price for consumers<sup>80</sup>.

On the contrary, Chen<sup>81</sup> argues that the bargaining power possessed by a large retailer, which countervails the supplier's market power, may indeed lead to a decrease of final prices for consumers, as argued by Galbraith<sup>82</sup>. In fact, according to Chen: << A rise in the power of the dominant retailer reduces the share of joint profits accruing to the supplier. In an attempt to make up for lower profits earned from the dominant retailer, the supplier boosts sales to fringe retailers by lowering their wholesale price. The fall in the cost of fringe retailers shifts their supply curve to the right, leading to a lower retail price. Therefore, the fall in retail price is the result not of a dominant retailer passing on cost savings to consumers but of a supplier trying to offset the reduction in profits caused by the rise in countervailing power<sup>83</sup>.>>.

## 1.5. CONCLUSIONS ON BUYER POWER

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<sup>79</sup> P. DOBSON, M. WATERSON, A. CHU, *The Welfare Consequences of the Exercise of Buyer Power*, prepared for the Office of Fair Trading, September 1998, London, pp. 1-55.

<sup>80</sup> R. Inderst, T. Valletti, *Buyer Power and the 'Waterbed Effect'*, Center for Economic and International Studies Tor Vergata, Research Paper Series, Vol. 6, Issue 1, No. 107, January 2008, pp.1-26.

<sup>81</sup> Z. CHEN, *Dominant Retailers and the Countervailing-Power Hypothesis*, in *RAND Journal of Economics*, Vol. 34, No. 4, Winter 2003, pp. 612-625.

<sup>82</sup> J. GALBRAITH, *American Capitalism: The Concept of Countervailing Power*, Houghton Mifflin, Boston, 1952.

<sup>83</sup> Z. CHEN, *Dominant Retailers and the Countervailing-Power Hypothesis*, in *RAND Journal of Economics*, Vol. 34, No. 4, Winter 2003, p. 614.

Finally, the overview on the different types of buyer power brings to the conclusion that the exercise of both monopsony and bargaining power may cause a decrease in input purchase prices paid to the suppliers. The key difference rests on the means by which these lower prices are achieved: monopsony power determines lower prices by reducing the quantities of input purchased, whilst bargaining power determines lower prices only by threatening to decrease the quantity of input purchased. Furthermore, the decrease in input prices obtained can be substantially different too. In fact, monopsony power pushes prices below competitive levels, whilst instead bargaining power may actually drive prices towards the competitive level, when countervailing significant market power possessed by the supplier, which was in turn raising prices above competitive levels<sup>84</sup>.

As discussed in the previous paragraphs, it is evident that also the effects on competition are quite different depending on what type of buyer power is exercised, given that it may have efficiency enhancing effects, as well as anti-competitive ones. It can also depend on whether the analysis is considering static or dynamic conditions, but in general the impact on social welfare of monopsony power exercised against competitive suppliers can significantly differ from the impact of the exercise of bargaining power against large and powerful suppliers<sup>85</sup>. However, it can be concluded that the exercise of buyer power against a competitive upstream market generally has negative effects on social welfare and can have detrimental effects on competition, even though it may benefit consumers in the short run.

Having said this, it is important to keep in mind that, whilst retailer buyer power has a distorting effect on the retail market, the biggest impact and effects are probably on competition at the producer level, which may be aggravated by the presence of buyers

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<sup>84</sup> OECD, *Roundtable on Monopsony and Buyer Power*, Directorate for Financial and Enterprise Affairs Competition Committee, DAF/COMP(2008)38, Paris, 17 December 2009, p. 8-11.

<sup>85</sup> Z. CHEN, *Buyer Power: Economic Theory and Antitrust Policy*, in *Research in Law and Economics*, Vol. 22, 9 March 2015, pp. 17-40.

purchasing jointly to reduce costs<sup>86</sup>. The impact and consequences of the exercise of buyer power by these buying alliances on the upstream market will be discussed in the next chapter.

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<sup>86</sup> P. DOBSON, *Buyer Power in Food Retailing: The European Experience*, Conference on Changing Dimensions of the Food Economy, The Hague, 6-7 February 2003, p. 9.

## 2. THE CONSOLIDATION OF THE EUROPEAN FOOD RETAIL MARKET

### SUMMARY

**2.1.** Introduction – **2.2.** The Consolidation of the European Retail Market – **2.3.** What are Joint Purchasing Agreements? – 2.3.1. International Alliances – 2.3.2. National Alliances – **2.4.** Effects on Competition of Joint Purchasing Agreements – 2.4.1. Anti-Competitive Effects of JPAs – 2.4.2. Risks of Collusion – 2.4.3. Pro-Competitive Effects of JPAs – **2.5.** Conclusions on Joint Purchasing Agreements

### 2.1. INTRODUCTION

As briefly discussed in the previous chapter, in recent years the retail market in Europe witnessed a significant increase of its concentration, mainly due to the expansion of large national and international retailers, whose market shares in the food distribution market have significantly increased. This trend towards a relentless increase of concentration of the retail market has been confirmed by many studies and sector analysis, such as, for example, the European Commission's study on the Economic Impact of Modern Retail on Choice and Innovation in the EU Food Sector<sup>87</sup> and the European Central Bank's study on the Structural Features of Distributive Trades and their Impact on Prices in the Euro Area<sup>88</sup>.

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<sup>87</sup> EUROPEAN COMMISSION, *Economic Impact of Modern Retail on Choice and Innovation in the EU Food Sector*, Final Report, Publications Office of the European Union, Luxembourg, September 2014, pp. 4-206.

<sup>88</sup> EUROPEAN CENTRAL BANK, *Structural Features of Distributive Trades and their Impact on Prices in the Euro Area*, Occasional Paper Series, No. 128, Task Force of the Monetary Policy Committee of the European System of Central Banks, Frankfurt, September 2011, pp. 1-144.

The general assumption is that, as market concentration grows, the intensity of competition in that market decreases<sup>89</sup>. Therefore, as the market shares of large retailers grow, their profits increase, innovation and product variety decrease, and the level of competition in the retail market in Europe is weakened, although there are significant variations in concentration levels amongst Member States.

This chapter seeks to illustrate the recent evolution of the retail market in Europe towards a higher concentration, as well as the differences in Member States' retail markets and their concentration levels, in order to highlight the key features of the sector, such as the transition towards new retail formats and the expansion of retailers' own brands (i.e. private labels).

Furthermore, this chapter focuses on the phenomenon of joint purchasing agreements between retailers, which have further enhanced the market concentration ratios. In fact, such agreements are capable of increasing the buyer power held by the members, which, acting jointly through the buying alliance, increase their bargaining power vis à vis the suppliers. Therefore, such buying alliances strengthen the position of retailers, shifting the power balances in negotiations in their favor, whilst weakening the position of suppliers, causing them to be more vulnerable to the retailers' requests and imposed trading conditions. The origins and characteristics of joint purchasing agreements will be discussed, as well as their potential anti-competitive and pro-competitive effects.

## 2.2. THE CONSOLIDATION OF THE EUROPEAN RETAIL MARKET

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<sup>89</sup> OECD, *Market Concentration*, Issues paper by the Secretariat, Directorate for Financial and Enterprise Affairs Competition Committee, DAF/COMP/WD(2018)46, Paris, 20 April 2018, pp. 1-26.

Until the 1950s, the European grocery distribution sector followed the traditional retail model, with small family-owned stores being generally the only option. Modern retail has expanded rapidly and has witnessed a significant growth in the past 30 or 40 years and has now mostly substituted traditional retailers. In fact, according to the European Commission's study on the Economic Impact of Modern Retail on Choice and Innovation in the EU Food Sector<sup>90</sup>: << Modern retail, as defined by the current study, constitutes a large portion of the grocery retail market in most of the EU markets (greater than 70% in 12 MS, and greater than 50% in 19 MS)<sup>91</sup>.>> and << Modern grocery retail sales account for 54% (in 2012, same in 2004) of the total edible grocery sales in the EU. Edible grocery sales represent 42% (in 2012, 43% in 2004) of total EU retail sales<sup>92</sup>>>.

In order to better understand this trend of increased consolidation that the retail market is facing, it is important to clarify the concepts of 'modern retail' and 'traditional retail' and their differences, although a single definition is difficult to delineate. As mentioned above, the European Commission's study<sup>93</sup> refers to the development of modern retail as the distribution channel emerged over the last three of four decades, characterized by bigger and more diversified store formats, which provide a larger assortment of products compared to the offer of traditional retailers.

The supply chain of modern retailers is generally more sophisticated, and the various stores are often owned by a few national or international groups of retailers. The definition adopted by the study<sup>94</sup> takes into consideration the size of stores, classifying, as different types of modern retailers, hypermarkets, i.e. stores larger than 2500 m<sup>2</sup>,

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<sup>90</sup> EUROPEAN COMMISSION, *Economic Impact of Modern Retail on Choice and Innovation in the EU Food Sector*, Final Report, Publications Office of the European Union, Luxembourg, September 2014, pp.45-46.

<sup>91</sup> *Ibid.*

<sup>92</sup> *Ibid.*

<sup>93</sup> EUROPEAN COMMISSION, *Economic Impact of Modern Retail on Choice and Innovation in the EU Food Sector*, Final Report, Publications Office of the European Union, Luxembourg, September 2014, pp.4-206.

<sup>94</sup> *Ibid.*

supermarkets, i.e. stores with an extension from 400 up to 2499 m<sup>2</sup>, and discount stores, which can be of all sizes<sup>95</sup>. On the contrary, traditional retail is: <<characterised largely as small, independent and often family-owned businesses with non-organised distribution channels<sup>96</sup>.>>.

In 2012 the European Commission, following complaints by stakeholders lamenting abuses of buyer power practiced by the retailers against the suppliers, commissioned a study on the impact of the recent developments in the European food retail sector on consumer welfare<sup>97</sup>. The study states that: <<In the edible grocery market as a whole including modern retail stores as well as smaller independent and traditional stores, a clear trend towards greater retailers' concentration has been observed during the period [from 2004 to 2012] in 22 of 26 MS, pulled by the development of modern retail<sup>98</sup>.>>, confirming the fact that the retail market is facing increased concentration in a significant majority of Member States<sup>99</sup>.

The study<sup>100</sup> also reports that, in the 8 years considered, the market shares of total grocery sales of modern retailers have increase in 24 Member states, as witnessed by the opening of new shops and the increase in floor space operated by these retailers, and that: <<The largest modern retail groups have expanded and increased their market share in many Member States. At pan-European level, the top 10 European food retailers accounted for a 26% market share in 2000, compared to 31% in 2011<sup>101</sup>.>>.

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<sup>95</sup> *Id.* pp. 45-46.

<sup>96</sup> *Id.* p. 45.

<sup>97</sup> *Id.* pp. 4-206.

<sup>98</sup> *Id.* p. 31.

<sup>99</sup> <<Modern retailers' concentration is based on the Herfindahl–Hirschman Index (HHI), calculated as the sum of the squares of the food market shares of each modern retail group and expressed as a value between 0 and 10,000.>>. For further details see: EUROPEAN COMMISSION, *Economic Impact of Modern Retail on Choice and Innovation in the EU Food Sector*, Final Report, Publications Office of the European Union, Luxembourg, September 2014, p.31, footnote 7.

<sup>100</sup> EUROPEAN COMMISSION, *Economic Impact of Modern Retail on Choice and Innovation in the EU Food Sector*, Final Report, Publications Office of the European Union, Luxembourg, September 2014, pp.4-206.

<sup>101</sup> *Id.* p. 25.



To give an idea of the impact of the retail market in the European economy the report states that: << According to the latest figures, the overall retail sector represents 4.3% of the Gross Value Added in the EU economy, over 8% of employment and 3.7 million SMEs<sup>102</sup>>>, amounting to an industry of quite considerable size.

However, measuring and comparing the concentration levels of the different European Member States' retail markets is not an easy task. According to the European Central Bank's study on the Economic Impact of Modern Retail on Choice and Innovation in the EU Food Sectors<sup>103</sup>, the most useful indicators to use are the square meters of the retailers' shops and selling spaces. Germany and France, with an approximate total of respectively 40 million m<sup>2</sup> and 30 million m<sup>2</sup> of selling space, make up the majority of total European retail selling area, which amounts to 150 million m<sup>2</sup>. This is in line with the study's conclusion that concentration is generally higher in northern European countries compared to southern ones<sup>104</sup>.

These differences are mainly due to historical and cultural reasons, by which countries such as Italy, Greece, Portugal and Cyprus present a more fragmented and traditional retail structure, where many small and independent shops still exist, in comparison to countries like Finland, Germany, France and Austria. In fact, the majority of retail stores, out of 850 000 in total on the European territory, are situated in these northern countries, which also represent Europe's biggest economies.

The comparison between the market shares of the three biggest food retailers in the UK, Germany, France and Spain confirm the different concentration of the retail markets in northern European countries compared to southern ones. In fact, as shown

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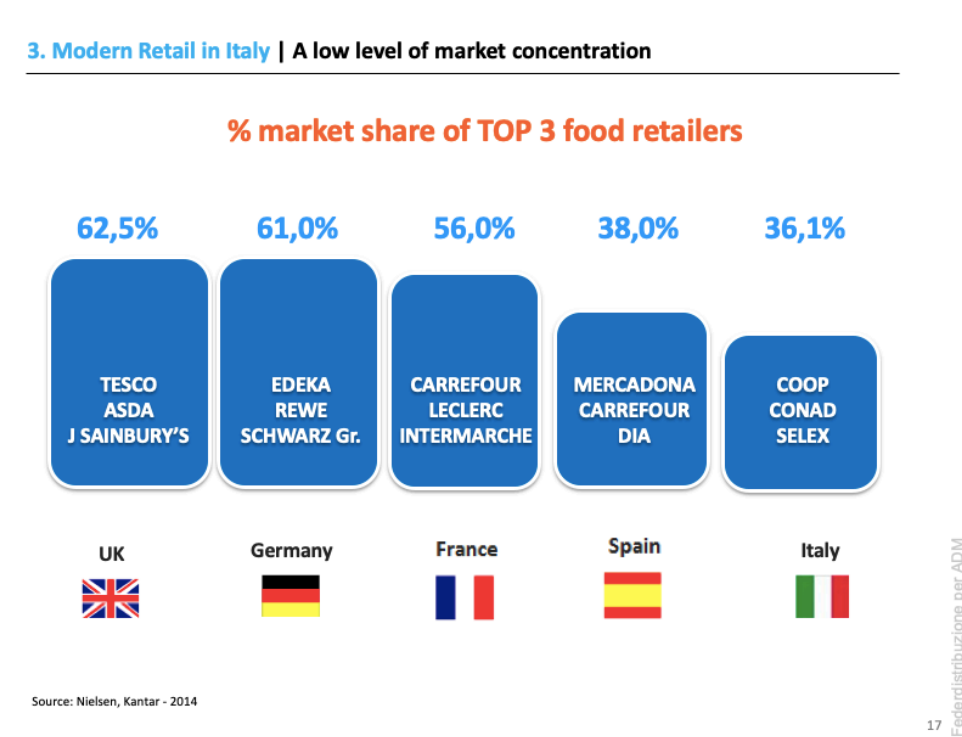
<sup>102</sup> *Id.* p. 45.

<sup>103</sup> EUROPEAN CENTRAL BANK, *Structural Features of Distributive Trades and their Impact on Prices in the Euro Area*, Occasional Paper Series, No. 128, Task Force of the Monetary Policy Committee of the European System of Central Banks, Frankfurt, September 2011, pp. 17-18.

<sup>104</sup> *Ibid.*

in Figure 2<sup>105</sup>, in 2015 the three top retailers in the UK held a cumulative market share of 62.5%, the three top German retailers held a cumulative market share of 61% and the French ones held 56% of the market. The market shares drop substantially when looking at the three top Spanish retailers, who held a market share of 38%, and the three top Italian retailers, which held just 36.1% of the market.

Figure 2<sup>106</sup>. Cumulative market shares held by the three largest retailers in the UK, Germany, France, Spain and Italy.



The aforementioned considerations suggest that economic and geographic differences between the Member States, as well as divergent consumer preferences and national regulations, are also to be kept in mind when analyzing and interpreting these

<sup>105</sup> H. HOTELLIER, *Modern Retail in Italy | Main Features and Latest Trends*, Presentation for Federdistribuzione, Rome, 1 October 2015, p.17.

<sup>106</sup> *Ibid.*

different concentration levels. However, the aforementioned statistics on selling space represent the countries' total selling space on average, overlooking the fact that concentration levels are often different if considering the national level or the local or regional one.

For this reason, effective competition in the retail sector is difficult to measure, since: <<For example, for large producers, competition might be best considered at the national or supranational level. For food and grocery producers, competition might be primarily regional, whereas, for consumers, it might be local. Some markets that appeared to be relatively fragmented at the national level actually turned out to be quite concentrated at the local level and vice versa<sup>107</sup>.>>. The question of whether the relevant market is to be defined at international, national, regional or local level has no definitive answer, as retailers often operate at each of these levels, for example acting jointly at international level, but negotiating some purchases at regional or local level, and for consumers, competition is usually determined upon their catchment area<sup>108</sup>.

Furthermore, although the products sold in different markets are often very similar, if not the same, EU national markets may present significant differences regarding the presence and diffusion of different store formats such as discounters, the penetration of private label products, the internationalization of retailers and the role of buying groups. The study<sup>109</sup> highlights that these structural elements also play an important role when it comes to price determination, resulting in significant price variations across different Member States and store types.

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<sup>107</sup> EUROPEAN CENTRAL BANK, *Structural Features of Distributive Trades and their Impact on Prices in the Euro Area*, Occasional Paper Series, No. 128, Task Force of the Monetary Policy Committee of the European System of Central Banks, Frankfurt, September 2011, p. 9.

<sup>108</sup> *Ibid.*

<sup>109</sup> *Id.* pp. 1-144.

In fact, the retail industry, considered its role as an intermediary between suppliers and consumers, plays a key role in setting the prices of the majority of products on the final downstream market. The European Central Bank's study<sup>110</sup> gives an idea of the importance of the retailers' role as intermediaries between the producers and the consumers of goods, stating that retail trade is a key sector of the economy and accounts for approximately half of total private consumption. The study<sup>111</sup> also underlines the fact that the retail sector holds a significant importance from a monetary point of view, being that the goods' final prices to consumers are set at this stage of the chain.

In fact, the retailers' distribution and intermediation services generally account for up to 25% of final consumer prices, meaning that input purchasing prices can be significantly increased by retailers for their necessary services. Consequently, according to the study in question: <<From a monetary policy point of view, increasing the degree of competition in the distributive trades sector may have effects not only on price levels, but also on price dynamics, via a reduction in mark-ups, an increase in price flexibility and a greater and more rapid pass-through of changes in costs to prices<sup>112</sup>.>>.

It then seems to be apparent that the conclusion to be drawn is that the higher the concentration levels, the higher prices are likely to be. However, this has to be analyzed keeping in mind that a market with only few actors who detain large market shares, i.e. with a high level of concentration, can sometimes be more competitive than

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<sup>110</sup> *Ibid.*

<sup>111</sup> *Ibid.*

<sup>112</sup> EUROPEAN CENTRAL BANK, *Structural Features of Distributive Trades and their Impact on Prices in the Euro Area*, Occasional Paper Series, No. 128, Task Force of the Monetary Policy Committee of the European System of Central Banks, Frankfurt, September 2011, p. 7.

a market on which many actors formally compete, but are in practice acting together or colluding<sup>113</sup>.

### 2.2.1. PRIVATE LABELS

As mentioned above, another element that has a significant impact on price determination in the modern retail market, is the development of private labels, i.e. retailers' own-brand products. These 'own label' brands were born in the decade of 1920 in the United Kingdom and have traditionally been conceived as low-price range and low-quality products. However, private labels have significantly developed in the last three decades, in response to the emergence of discounter type stores, and are now being used by retail chains as instruments to convey to consumers the image they wish to portray of themselves. Therefore, private label products are now the objective of substantial quality and packaging investments, as they represent the retailers' brands and are increasingly being used as instruments to ensure the loyalty of the clients<sup>114</sup>.

Their development and expansion have also been facilitated by the consolidation of the retail market and the large scale that retail operations have reached. In fact, many retailers, in particular international ones, have reached economies of scale of such dimensions that they can now develop and own private label brands. However, the production of the products is usually outsourced to different producers, who usually are the same ones who produce regular industrial brands<sup>115</sup>.

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<sup>113</sup> *Id.* pp. 1-144.

<sup>114</sup> F.CICONTE, S.LIBERTI, *Il Grande Carrello: Chi Decide Cosa Mangiamo*, Editori Laterza, 1<sup>st</sup> edition, Bari, April 2019, pp.1-119.

<sup>115</sup> *Ibid.*

Data from the study on distributive trade by the European Central Bank<sup>116</sup> shows that the market shares of private label products have increased steadily since 2001 in all EU countries, although there are substantial differences between them. On average private labels have a market share of 15%-25%, although their market share in Italy stands at around 10%<sup>117</sup>. This is associated with the fact that Italy, as southern European countries in general, presents a less concentrated retail market with more independent retailers and small grocery shops compared to the other EU countries.

The penetration in the market of private label goods has repercussions mostly on producers of small brands or artisanal products, whose market shares have been reduced, and not on large producers of big brands which have not been impacted significantly. Whilst there is no clear-cut impact on competition, the European Central Bank study suggests that: <<An increase in the market penetration of private label goods is likely to exert downward pressure on price levels, as such goods are generally cheaper (other things being equal)<sup>118</sup>. >><sup>119</sup>.

## 2.3. JOINT PURCHASING AGREEMENTS BETWEEN RETAILERS

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<sup>116</sup> EUROPEAN CENTRAL BANK, *Structural Features of Distributive Trades and their Impact on Prices in the Euro Area*, Occasional Paper Series, No. 128, Task Force of the Monetary Policy Committee of the European System of Central Banks, Frankfurt, September 2011, pp. 24-27.

<sup>117</sup> Market shares of private labels are above average, around 30%-35% in countries like Germany, the Netherlands and Belgium. They are around the average, 15%-25%, in countries such as Spain, France and Portugal, and they stand below average in countries as Italy, Greece and Finland. For more details see: EUROPEAN CENTRAL BANK, *Structural Features of Distributive Trades and their Impact on Prices in the Euro Area*, Occasional Paper Series, No. 128, Task Force of the Monetary Policy Committee of the European System of Central Banks, Frankfurt, September 2011, pp. 1-144.

<sup>118</sup> *Id.* pp.24-27.

<sup>119</sup> For a detailed study on the impact of private labels on competition in the EU see: EUROPEAN COMMISSION, *The Impact of Private Labels on the Competitiveness of the European Food Supply Chain*, DG Enterprise, Publications Office of the European Union, Luxembourg, January 2011, pp. 1-189.

Another structural trend that has been observed all over Europe is the organization of retailers in buying alliances and purchasing groups. The alliances between large retailers are capable of significantly increasing the concentration of the retail market, since retailers join forces and act on the market as one single entity, instead of multiple independent ones<sup>120</sup>. This strengthens the retailers' position on the market and weakens the suppliers' position on the market, whose alternative business partners on the market have decreased<sup>121</sup>.

Joint Purchasing Agreements are arrangements stipulated between two or more retailers, whose objective is to increase their bargaining power against suppliers by joining forces, therefore creating or strengthening the members' buyer power. Retailers (i.e. the buyers) are consequently able to obtain better purchasing conditions in negotiations with suppliers (e.g. lower prices, discounts etc.) compared to what they could have obtained negotiating individually.

As explained in the European Commission Horizontal Guidelines<sup>122</sup>: <<A common form of joint purchasing arrangements is an 'alliance', that is to say an association of undertakings formed by a group of retailers for the joint purchasing of products<sup>123</sup>.>>. Buying alliances are therefore essentially procurement organizations, whose main

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<sup>120</sup> The same cannot be said for the supplier side of the market, which has rarely grouped into proper organizations in order to increase their bargaining power, apart from some exceptions constituted by Producer Organizations (POs) created in the agricultural sector on initiative by the European Union. For more details on Producer Organizations see: EUROPEAN COMMISSION, *Producer Organisations and Associations of Producer Organisations*, in [www.ec.europa.eu](http://www.ec.europa.eu), accessed on 1 June 2019.

(Available at: [https://ec.europa.eu/agriculture/producer-interbranch-organisations/producer-organisations-association\\_en](https://ec.europa.eu/agriculture/producer-interbranch-organisations/producer-organisations-association_en))

However, it is frequently argued that POs are generally not widely used in the EU and are rarely effective. For more details see: CICONTE F., LIBERTI S., *Come il Supermercato è Diventato un'Industria*, in *Internazionale*, 6 March 2017, pp. 1-7.

<sup>121</sup> F.CICONTE, S.LIBERTI, *Il Grande Carrello: Chi Decide Cosa Mangiamo*, Editori Laterza, 1<sup>st</sup> edition, Bari, April 2019, pp.1-119.

<sup>122</sup> EUROPEAN COMMISSION, Guidelines on the applicability of Art. 101 TFEU to horizontal co-operation agreements, OJ [2011] C 11, pp.1-72.

<sup>123</sup> *Id.* p.44.

feature is that the organization itself negotiates and purchases jointly from the suppliers (at a regional, national or international level<sup>124</sup>) on behalf of the members of the group, who remain independent. Furthermore, such procurement alliances may be organized in various forms, from proper joint ventures with own rules and employees, which generally provide additional services such as accounting and distribution, to looser forms of cooperation or contractual arrangements<sup>125</sup>.

The aim of these alliances is usually also to enhance the competitiveness of their members on the market, compared to their competitors, also in order for them to expand successfully in new markets (for example in Central and Easter Europe). Further goals of buying alliances can also be to distribute and promote the members' national or international brands, as well as to allow the exchange of know-how and best practices amongst the retailers who take part in them<sup>126</sup>.

### 2.3.1. INTERNATIONAL ALLIANCES

The phenomenon of purchasing alliances has its origin in the 1930s, but the most significant development has been after the decade 1980-1990, with the birth and expansion of cross-border alliances. The aim of these alliances is usually to enhance retailers' bargaining power through the purchase of higher volumes, reducing total costs, in particular when negotiating with global brands or for private labels. Members to these alliances are generally the largest national retailers, even though smaller actors may often join too. However, these members are usually not direct competitors, as in

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<sup>124</sup> The structure and functioning of national and international alliances will be described in more detail in the following paragraphs.

<sup>125</sup> R.SCIAUDONE, E.CARAVÀ, *Buying Alliances in the Grocery Retail Market: The Italian Approach in a European Perspective*, in *Journal of European Competition Law & Practice*, Vol. 6, No. 6, 2015, pp. 424-431.

<sup>126</sup> C. BALAN, *The Alliances of European Retailers and Their Effects in the Field of Marketing and Supply Chain*, in *The Romanian Economic Journal*, November 2007, pp. 29-48.



one alliance there is typically only one powerful retailer from each member state (membership is geographically dispersed)<sup>127</sup>.

Retailers have come together in cross-border alliances for many reasons. One of the main factors which contributed to the creation of these alliances was the growing power and internationalization of many large suppliers, as well as the need to tackle the rise of discounters and hard-discounters and their aggressive market strategies<sup>128</sup>. International alliances generally obtain additional rebates, from large international manufacturers which provide a wide range of products across several markets<sup>129</sup>. In exchange for these rebates, the retailers, members to the alliances, usually provide additional services<sup>130</sup> to international brand manufacturers, such as additional promotions, data services and listing of brands in their shops<sup>131</sup>. Such rebates, granted by the suppliers on the input purchase price, frequently manifest themselves under the form of up-front payments, and usually alliances negotiate an increase of the rebate every year<sup>132</sup>.

### 2.3.2. NATIONAL ALLIANCES

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<sup>127</sup> T. BJORKROTH, *Joint Purchasing Agreements in the Food Supply Chain: Who's in the Sheep's Clothing?*, in *European Competition Journal*, 9:1, 2013, pp. 175-198.

<sup>128</sup> EUROPEAN COMMISSION, *Economic Impact of Modern Retail on Choice and Innovation in the EU Food Sector*, Final Report, Publications Office of the European Union, Luxembourg, September 2014, pp. 25-53.

<sup>129</sup> A purchasing practice whose use is increasing amongst international buying alliances, and whose aim is to increase the discounts obtained by retailers from suppliers, is the reverse auction. For more details on reverse auctions see: F. CICONTE, S. LIBERTI, *Con le Aste Online i Supermercati Rovinano gli Agricoltori*, in *Internazionale*, 31 March 2017, pp. 1-5.

<sup>130</sup> Many manufacturers though claim that retailers do not effectively deliver the services corresponding to these additional rebates (e.g. listing fees), or that these services are actually imposed on suppliers, which do not actually request them. The issue will be discussed in further detail in Chapter 3.

<sup>131</sup> EUROPEAN COMMISSION, *Economic Impact of Modern Retail on Choice and Innovation in the EU Food Sector*, Final Report, Publications Office of the European Union, Luxembourg, September 2014, pp. 25-53.

<sup>132</sup> These rebates, and consequently the up-front payments, are usually expressed as a percentage of the net sales of a given brand, achieved through all the members of the alliance.

In addition to purchasing alliances that act on a cross-border level, there are numerous national alliances, whose members are all retailers from a sole member state. Generally, these alliances are either composed of two (or more) large members or constitute of a multiplicity of smaller members<sup>133</sup>.

National alliances generally define the assortment of products that retailers will or may buy, they negotiate most components of the wholesale price, including different types of rebates for assortments, for growth targets, for various promotional activities, for product placement and for various services (such as logistics for example). In some cases, the activities at national level are complemented by negotiation at regional and local level, which can, for example, regard specific local promotions and merchandising<sup>134</sup>. National purchasing alliances usually cover all branded products and sometimes also private labels products procured by retailers<sup>135</sup>.

The procurement and delivery of products usually depend on the type of alliances. In case of alliances between independent chains of shops, each member usually orders products independently (this is the case for most Italian retail alliances for example<sup>136</sup>). When instead the alliances are fully integrated, the independent shops that constitute them are grouped under one banner and the group usually has a procurement entity which orders products on behalf of the members (i.e. the independent shops) and usually also organizes the delivery of products to the shops<sup>137</sup>.

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<sup>133</sup> P. DOBSON, *Buyer Power in Food Retailing: The European Experience*, Conference on Changing Dimensions of the Food Economy, The Hague, 6-7 February 2003, pp. 1-12.

<sup>134</sup> National alliances usually procure processed agricultural products, such as dairy products or wine, whilst rarely procuring fresh products, such as fruit, vegetables and meat.

<sup>135</sup> EUROPEAN COMMISSION, Guidelines on the applicability of Art. 101 TFEU to horizontal co-operation agreements, OJ [2011] C 11, pp.1-72.

<sup>136</sup> For a detailed overview of the buying alliances present in Italy see: DISTRIBUZIONE MODERNA, *Guida alle Centrali d'Acquisto e Gruppi Distributivi Alimentari in Italia*, in *DM Magazine*, 2018, pp. 2-81.

<sup>137</sup> EUROPEAN COMMISSION, Guidelines on the applicability of Art. 101 TFEU to horizontal co-operation agreements, OJ [2011] C 11, pp.1-72.

However, in recent years the trend has shown that there no longer is a strict differentiation of activities between national and international alliances, with international alliances extending their scope and covering most procurement activities which were previously dealt with at national level. Therefore, national and international alliances now carry out procurement activities that are generally complementary<sup>138</sup>.

The shifting of procurement to the international level has repercussions on relations between suppliers and retailers, with suppliers de facto losing bargaining power because of international deals which apply consistent conditions across different states. However, this does not always mean that buying alliances act as a single purchaser, as there are various different degrees of collaboration possible between the members and the alliance. Therefore, even when there is a central buying function in place, members can generally enjoy a certain extent of freedom and, in some cases, can also conduct their purchases independently and not through the buying alliance<sup>139</sup>.

## 2.4. EFFECTS ON COMPETITION OF JOINT PURCHASING AGREEMENTS

Having considered the characteristics of the European retail market and the growing phenomenon of buying alliances, this thesis will now discuss the competitive impact of these buying alliances and the reason why they are relevant in the context of this analysis of buyer power in the grocery retail market.

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<sup>138</sup> *Ibid.*

<sup>139</sup> DOBSON CONSULTING, *Buyer Power and Its Impact on Competition in the Food Retail Distribution Sector of The European Union*, prepared for The European Commission DG Competition, study contract No. IV/98/ETD/078, Office for Official Publications of the European Communities, Luxembourg, May 1999, pp.172-175.

Through the aforementioned joint purchasing agreements, single retailers come together to purchase, often larger quantities, together. By joining forces, the buying alliance presents itself as a unitary front and single entity, which possesses stronger buyer power, compared to the individual members. By adding up the buyer power of the single members, the power balances in negotiations with the suppliers can shift in favor of the buying alliance, causing potential distortions of competition, both on the upstream and downstream market. Although, it is to keep in mind that the effects on competition are uncertain, being that joint purchasing agreements may potentially have both positive and negative effects, and the overall impact on welfare is not clear-cut<sup>140</sup>.

In Europe such buying alliances and their restrictive effects on competition are usually scrutinized under Art. 101 of the Treaty on the Functioning of the European Union (TFEU) concerning agreements between undertakings. The European Commission's Guidelines on the applicability of Art. 101 TFEU to horizontal co-operation agreements<sup>141</sup> suggest a 'detailed assessment' of the buying alliances' effects, when considering whether they are likely to damage competition in the market. This 'detailed assessment' should take into account the legal and economic context in which the alliance operates, analyzing elements such as the market concentration, the possible countervailing bargaining power of sellers and the structure of the relevant market<sup>142</sup>.

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<sup>140</sup> *Ibid.*

<sup>141</sup> EUROPEAN COMMISSION, Guidelines on the applicability of Art. 101 TFEU to horizontal co-operation agreements, OJ [2011] C 11, pp.1-72.

<sup>142</sup> The assessment of restrictive effects on competition should be carried out on a case by case basis even in situations where the combined market share of the members to the joint purchasing agreement exceeds the threshold determined by the Guidelines (i.e. 15% in the buying and selling markets) under which it is presumed that no significant restrictive effects are produced. For more details see: EUROPEAN COMMISSION, Guidelines on the applicability of Art. 101 TFEU to horizontal co-operation agreements, OJ [2011] C 11, p.45-46.

Following the aforementioned Commission Guidelines <sup>143</sup>, in 2014 the Italian Competition Authority decided to dissolve the largest Italian buying alliance, i.e. Centrale Italiana<sup>144</sup>, due to competition concerns in the food sector<sup>145</sup>. A detailed assessment was carried out even though the market share of the alliance exceeded 15%, and the main competition concerns identified regarded the alliance's strong buyer power, the elimination of horizontal competition with competing retailers and the likelihood of exchange of sensitive commercial information within the alliance<sup>146</sup>.

#### 2.4.1. ANTI-COMPETITIVE EFFECTS OF JPAS

Dobson<sup>147</sup> presents a very clear panoramic of the possible anti-competitive effects generated by joint purchasing agreements, identifying different types of negative effects. Firstly, buying alliances may facilitate the exercise of monopsony (or oligopsony) power, when retailers create a common organization to purchase together in order to maximize their joint profits.

In this case, two of the three preconditions necessary for the exercise of monopsony power, discussed in Chapter 1, must be present, i.e. the supply curve must be upward sloping and there must be barriers to entry to the market. The forming of the alliance

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<sup>143</sup> *Id.* pp.1-72.

<sup>144</sup> Centrale Italiana, created in 2005, had 5 Italian retail chains as members: Coop Italia, Despar, Il Gigante, Discoverde and Sigma. For more details on the dissolution of Centrale Italiana see: R.SCIAUDONE, E.CARAVÀ, *Buying Alliances in the Grocery Retail Market: The Italian Approach in a European Perspective*, in *Journal of European Competition Law & Practice*, Vol. 6, No. 6, 2015, pp. 428-429.

<sup>145</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 25090 of 17 September 2014, *Centrale d'acquisto per la Grande Distribuzione Organizzata*, I768, in Boll. No 38/2014, pp.8-19.

<sup>146</sup> *Ibid.*

<sup>147</sup> DOBSON CONSULTING, *Buyer Power and Its Impact on Competition in the Food Retail Distribution Sector of The European Union*, prepared for The European Commission DG Competition, study contract No. IV/98/ETD/078, Office for Official Publications of the European Communities, Luxembourg, May 1999, pp.172-175.

satisfies the third condition, i.e. the necessity that the buyer, or buyers, represent a substantial portion of the total input purchases on the market<sup>148</sup>. In this circumstance, the negative distributional effects and welfare dead-weight loss caused by monopsony power, i.e. reduction of input price and of suppliers' profits, are likely to occur, and, according to Dobson, the analysis coincides with that of a cartel with market power which controls sales<sup>149</sup>.

Furthermore, as the European Commission Guidelines<sup>150</sup> state: <<If downstream competitors purchase a significant part of their products together, their incentives for price competition on the selling market or markets may be considerably reduced. If the parties have a significant degree of market power (which does not necessarily amount to dominance) on the selling market or markets, the lower purchase prices achieved by the joint purchasing arrangement are likely not to be passed on to consumers<sup>151</sup>.>>. Therefore, joint purchasing agreements are more likely to negatively impact competition and consumer welfare, if the retailers that are part of them have market power on the downstream market.

Secondly, buying alliances are capable of reaching large dimensions, and are therefore potentially able to exercise excessive buyer power against the suppliers, ultimately promoting retailers' opportunistic behavior against suppliers. This goes to the detriment of small producers in particular, whose long-term viability is threatened by the lower prices achieved by the alliance. Competition can then be distorted also on the producer side, where innovation is hindered, and the variety and quality of

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<sup>148</sup> J. JACOBSON, G. DORMAN, *Joint Purchasing, Monopsony and Antitrust*, in *The Antitrust Bulletin*, Federal Legal Publications, Spring 1991, pp. 19-22.

<sup>149</sup> P. DOBSON, M. WATERTON, A. CHU, *The Welfare Consequences of the Exercise of Buyer Power*, prepared for the Office of Fair Trading, London, September 1998, pp. 1-55.

<sup>150</sup> EUROPEAN COMMISSION, Guidelines on the applicability of Art. 101 TFEU to horizontal co-operation agreements, OJ [2011] C 11, p.45.

<sup>151</sup> *Ibid.*

products offered on the market decreases, causing damage to social welfare. Suppliers may be harmed by buying alliances also because these may be functional to eliminating price discriminations across different Member States, further reducing suppliers' profits<sup>152</sup>.

The creation or strengthening of buying alliances may also have anti-competitive effects regarding retailer competition. In fact, strong buyer power acquired through the alliance, may be used by the members to foreclose their competitors' access to some suppliers, especially if the number of producers on the market is limited, and new suppliers cannot enter the upstream market easily due to barriers to entry in place<sup>153</sup>. It may then happen that, leveraging their strong buyer power, buying alliances may monopolize the most efficient producers, impeding them to trade with their competitors.

Furthermore, as already mentioned, suppliers are pressured into granting more favorable terms and discounts to the members of alliances, due to latter's stronger bargaining power. This can have repercussions on the other competitors of the members, since producers will often try to compensate for their losses by raising prices for the other retailers, i.e. raising rival's costs<sup>154</sup>. The members of buying alliances would then benefit from competitive advantages that are not due to their superior efficiency, to the detriment of smaller retailers which may eventually be forced to leave the market.

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<sup>152</sup> DOBSON CONSULTING, *Buyer Power and Its Impact on Competition in the Food Retail Distribution Sector of The European Union*, prepared for The European Commission DG Competition, study contract No. IV/98/ETD/078, Office for Official Publications of the European Communities, Luxembourg, May 1999, pp.172-1

<sup>153</sup> EUROPEAN COMMISSION, Guidelines on the applicability of Art. 101 TFEU to horizontal co-operation agreements, OJ [2011] C 11, pp.1-72.

<sup>154</sup> P. DOBSON, *Buyer Power in Food Retailing: The European Experience*, Conference on Changing Dimensions of the Food Economy, The Hague, 6-7 February 2003, pp. 1-12.

This so called ‘waterbed effect’<sup>155</sup>, as discussed in the previous chapter, substantially favors retailers which are members of powerful buying alliances, that can obtain the most favorable terms from suppliers. Dobson argues that: << this distortion could be neutralized if all retailers joined (broadly equal-sized) alliances. However, given the start-up costs of organizing and running buyer groups, non-members may view access to an existing buyer group as preferable to starting a new group, so that an existing group takes on the characteristics of an “essential facility”<sup>156</sup>.>>. Therefore, there seems to be a virtuous circle, by which the power of buying alliances further increases, increasing also the competitive advantages of their members, which may use it to access new markets, also internationally, contributing to the further consolidation of the retail market<sup>157</sup>.

Other negative effects on competition stem from the fact that retail alliances often promote the development of private brands, amplifying their anti-competitive effects. In fact, as mentioned before, the rise of private labels causes for concerns from the producers, due to the reduction of intra-brand competition caused. Through the development of private label brand, retailers often free ride on the product investments made by the producer of the original branded good, imitating a successful product on the market. Private labels may then substitute smaller brands which would end up being de-listed, distorting competition<sup>158</sup>.

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<sup>155</sup> For an exhaustive technical analysis of the ‘waterbed effect’, see: R. Inderst, T. Valletti, *Buyer Power and the ‘Waterbed Effect’*, Center for Economic and International Studies Tor Vergata, Research Paper Series, Vol. 6, Issue 1, No. 107, January 2008, pp.1-26.

<sup>156</sup> DOBSON CONSULTING, *Buyer Power and Its Impact on Competition in the Food Retail Distribution Sector of The European Union*, prepared for The European Commission DG Competition, study contract No. IV/98/ETD/078, Office for Official Publications of the European Communities, Luxembourg, May 1999, pp.174.

<sup>157</sup> P. DOBSON, *Buyer Power in Food Retailing: The European Experience*, Conference on Changing Dimensions of the Food Economy, The Hague, 6-7 February 2003, pp. 1-12.

<sup>158</sup> DOBSON CONSULTING, *Buyer Power and Its Impact on Competition in the Food Retail Distribution Sector of The European Union*, prepared for The European Commission DG Competition, study contract No.



Buying alliances can also contribute to the fossilizing of the structure of national markets, due to their policy of geographical dispersion, by which the members to a single alliance are usually not national competitors, i.e. only one powerful retailer per Member State can join one alliance. This fossilizing effect is clearly described by Dobson: <<A policy of one-firm-per-member-state may ossify national market share rankings by acting as a barrier to mobility when late comers and new entrants are unable to join alliances with the larger firms from other member states (i.e. denial of access to benefits of large alliances and their consequent buying power - that is, a second-mover disadvantage)<sup>159</sup>.>>.

#### 2.4.2. RISKS OF COLLUSION

Probably one of the most controversial issues raised over joint purchasing agreements by antitrust authorities, is the fact that buying alliances can, in some cases, constitute a cover for cartel-type activities and prohibited practices, such as agreeing on sales, prices and volumes<sup>160</sup>.

Buying alliances between retailers necessarily entail a higher degree of transparency and sharing of information amongst the members, compared to what would happen between competing retailers. In fact, these alliances often play important roles in the definition of marketing, distribution and promotion strategies of their members,

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IV/98/ETD/078, Office for Official Publications of the European Communities, Luxembourg, May 1999, pp. 172-175.

<sup>159</sup> *Id.* p. 175.

<sup>160</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp.1-213.

which contributes to an increased transparency on price comparisons and operations carried out by the members<sup>161</sup>.

In particular, buying alliances may facilitate collusive behavior amongst the retailers on the downstream market, especially in cases of large alliances where the members hold significant market power, generating the anti-competitive effects of a monopolist (mentioned in Chapter 1)<sup>162</sup>. The potential coordinated behavior on the downstream market can be further facilitated if the retailers, members of an alliance, are active on the same relevant retail market and purchase large quantities of their inputs through the alliance.

Another phenomenon which characterizes buying alliances is the fact that retailers periodically switch from one alliance to the other, passing not only from national to international ones, but also amongst different international alliances, whose composition constantly changes. These membership changes determine a significant increase of transparency in the retail market, further facilitating the exchange of sensitive information amongst the retailers and dampening competition on the downstream market<sup>163</sup>.

As the European Commission notes, in its Guidelines on the applicability of Art. 101 TFEU to horizontal co-operation agreements<sup>164</sup>, a degree of transparency and exchange of information is inherent to the structure and purposes of joint purchasing agreements, and it does not necessarily lead to restrictive effects on competition,

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<sup>161</sup> C. BALAN, *The Alliances of European Retailers and Their Effects in the Field of Marketing and Supply Chain*, The Romanian Economic Journal, November 2007, pp. 29-48.

<sup>162</sup> P. DOBSON, M. WATERSON, A. CHU, *The Welfare Consequences of the Exercise of Buyer Power*, prepared for the Office of Fair Trading, London, September 1998, pp. 1-55.

<sup>163</sup> EUROPEAN COMMISSION, Guidelines on the applicability of Art. 101 TFEU to horizontal co-operation agreements, OJ [2011] C 11, pp.1-72.

<sup>164</sup> *Id.* 44-45.

unless it exceeds the amount of data necessary to the correct functioning of the alliance. Furthermore, the Guidelines note that: <<Spill-over effects from the exchange of commercially sensitive information can, for example, be minimised where data is collated by a joint purchasing arrangement which does not pass on the information to the parties thereto<sup>165</sup>.>>, and state that joint purchasing agreements have to be assessed on the basis of overall effects, indicating they are not per se detrimental to competition.

### 2.4.3. PRO-COMPETITIVE EFFECTS OF JPAS

Having analyzed the anti-competitive effects generated by joint purchasing agreements, it is important to keep in mind that, just as mentioned in the Commission Guidelines<sup>166</sup>, these alliances can have pro-competitive effects too, and their overall impact on competition is to be assessed on a case by case basis. Therefore, when the positive effects outweigh the negative ones, alliances are not to be hindered or restricted. For example, the increased buyer power derived from the grouping of retailers in buying alliances, may also contribute to countervail large multinational suppliers' market power in negotiations.

These alliances may especially help smaller retailers to survive and lower their input costs. Provided retailers do not hold excessive market power in the downstream market, the cost savings generated by the countervailing power of the alliances could be passed on to consumers under the form of reduced retail prices, to the benefit of social welfare<sup>167</sup>. Furthermore, a concentrated buyer side may reduce the likelihood of

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<sup>165</sup> *Id.* p. 46.

<sup>166</sup> *Id.* pp. 44-45.

<sup>167</sup> DOBSON CONSULTING, *Buyer Power and Its Impact on Competition in the Food Retail Distribution Sector of The European Union*, prepared for The European Commission DG Competition, study contract No. IV/98/ETD/078, Office for Official Publications of the European Communities, Luxembourg, May 1999, pp. 172-175.

collusion on the upstream market, which is assumed to be favored by a fragmented demand side<sup>168</sup>.

In general, buying alliances are also likely to generate efficiency gains for the retailers who take part in them, not only by lowering purchasing costs, but also by reducing transaction costs, improving the rationalization of logistics with the sharing of deposits and storage costs, and improving quality controls, facilitating economies of scale. These efficiency benefits may also mean that the retailers, members of alliances, save on the aforementioned costs and can invest the 'unlocked' resources into innovation and growth, enhancing their productivity<sup>169</sup>.

Competition amongst retailers may be stimulated also by the exchange of know-how between members of the alliances, which may lead to the implementing and improvement of retail best practices, for example regarding distribution networks or IT systems. The aforementioned efficiency gains derived from joint purchasing, may also be beneficial for social welfare if the cost-savings are passed on to the final consumers, for example under the form of lower prices or increased variety of products on the market<sup>170</sup>.

Dobson<sup>171</sup> cites another possible pro-competitive effect of retailer buying groups, which is the facilitation of the European Single Market. In fact, the exchange of pricing information between the members of the alliances ultimately can determine a

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<sup>168</sup> T. BJORKROTH, *Joint Purchasing Agreements in the Food Supply Chain: Who's in the Sheep's Clothing?*, in *European Competition Journal*, 9:1, 2013, pp. 175-198.

<sup>169</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp. 120-121.

<sup>170</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp. 120-121.

<sup>171</sup> DOBSON CONSULTING, *Buyer Power and Its Impact on Competition in the Food Retail Distribution Sector of The European Union*, prepared for The European Commission DG Competition, study contract No. IV/98/ETD/078, Office for Official Publications of the European Communities, Luxembourg, May 1999, pp.172-175.

reduction of the price discrimination between the different Member States, practiced by suppliers.

The reduction or eradication of price discrimination entails an increase of allocative efficiency, in fact: << From the European Commission's perspective, single market facilitation is an end in itself as well as a means to greater competition. In practice this means that the Commission will give all benefit of any doubt to the above effects being desirable<sup>172</sup>>>. Furthermore, buying alliances are likely to promote and accelerate the exchange of goods and new products amongst different Member States, and facilitate the development of retailers' private labels, reducing entry barriers to markets and enhancing competition amongst European producers<sup>173</sup>.

Whilst it stands true that joint purchasing agreements are significantly beneficial for retailers, they may generate efficiency gains for suppliers too. For example, by negotiating with alliances supplying agreements concerning larger quantities, producers may substantially increase their turnover and take advantage of economies of scale. This may cause for an improvement in suppliers' efficiency and an increase in investments as well as the possibility for smaller suppliers to penetrate in larger markets.

A more concentrated demand side of the market could then push suppliers to invest more in innovation, improving the quality and variety of products and reducing production costs, boosting competition in the upstream market and improving suppliers' productivity<sup>174</sup>. Buying groups can also represent an opportunity for suppliers, due to their aforementioned role of speeding up the development of

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<sup>172</sup> *Id.* p.173.

<sup>173</sup> *Id.* pp.172-175.

<sup>174</sup> EUROPEAN CENTRAL BANK, *Structural Features of Distributive Trades and their Impact on Prices in the Euro Area*, Occasional Paper Series, No. 128, Task Force of the Monetary Policy Committee of the European System of Central Banks, Frankfurt, September 2011, pp. 1-144.

retailers' private labels. In fact, Balan<sup>175</sup> notes that: <<The actual advantage consists in the pan-European reach of the alliances, in the significant market potential that may be tapped by manufacturers even under the brand names owned by the alliances<sup>176</sup>.>>, so producers may tap into the development of private labels, and also benefit from them when producing the retailers' private label goods, which will then be distributed across multiple Member States.

## 2.5. CONCLUSIONS ON JOINT PURCHASING AGREEMENTS

Finally, this chapter sought to illustrate the evolution of the retail market in Europe, which, in the last 40 years, witnessed a structural shift from the traditional retail model, characterized by small independent family-owned shops, to the modern retail structure, characterized by large, often multi-national retailers. This change in format and structure has caused the retail market to be increasingly concentrated, phenomenon which has been further aggravated by the development of procurement alliances between retailers.

In particular, procurement alliances may be able to exercise excessive buyer power against the suppliers, abusing their position of strength in negotiations, especially when they reach large dimensions and operate internationally. Ultimately, buying alliances may be capable not only of promoting collusion between their members, but also of promoting retailers' opportunistic behavior against suppliers.

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<sup>175</sup> Retail alliances can also represent an opportunity for manufacturers, which can produce their private labels. See C. BALAN, *The Alliances of European Retailers and Their Effects in the Field of Marketing and Supply Chain*, The Romanian Economic Journal, November 2007, p. 32.

<sup>176</sup> *Ibid.*

The most damaged by this are likely to be small and medium enterprises suppliers, whose long term viability may be threatened. Therefore, even though it has been considered that buying alliances are capable of generating efficiency enhancing effects as well, and that their effects on welfare as a whole are to be assessed on a case by case basis, this thesis supports the view that joint purchasing agreements are often likely to alter supplier-retailer relationships, distorting competition in the food supply chain.

Finally, one of the main conclusions that may be drawn, is that the increased concentration of the retail market, as well as the shifting of procurement, from the single retailers, to the buying alliances, significantly weaken the position of suppliers in the food supply chain, making them more vulnerable to abuses of buyer power and the imposition of unfair trading conditions by retailers, which will be discussed in the next chapter.

## 3. UNFAIR TRADING PRACTICES

### SUMMARY

**3.1.** Introduction – **3.2.** What are Unfair Trading Practices – **3.2.1.** Different Kinds of Unfair Trading Practices – **3.3.** Effects on Competition of Unfair Trading Practices – **3.3.1.** Pro-Competitive Effects of Up-Front Payments – **3.3.2.** Anti-Competitive Effects of Up-Front Payments – **3.4.** Conclusions on Unfair Trading Practices

### 3.1. INTRODUCTION

Having analyzed buyer power, joint purchasing agreements between retailers, and their effects on competition, we have a theoretical basis to approach the next topic of this thesis, which are unfair trading practices adopted by retailers against suppliers.

As discussed in the previous chapters, the growing concentration of the retail sector and the consequent increase of the buyer power held by the main retail chains, aggravated by the growing phenomenon of retail buying alliances, have led to significant imbalances in the food supply chain in Europe. This asymmetry in bargaining power has significant consequences on the negotiations between suppliers and retailers, where practices and contractual clauses deemed unequal and unfair are ever more frequently imposed on the suppliers by the retailers, or their alliances, as a result of the latter's stronger buyer power.

These contractual terms usually regard not only the determination of the purchase price or the discounts, but also the determination of large payments, which the



suppliers must pay as compensation for various services provided by the retailers. Large retailers are then able to coerce suppliers into contributing to the costs of additional services, rarely requested by the suppliers, which are often used to transfer the retailers' commercial risk onto the suppliers. The fees for these additional distribution services go under the name of "trade spending", which comprises access fees, contributions for promotional services, marketing and advertising, to payments for stocking, listing and displaying of products and so on<sup>177</sup>.

The above mentioned complex contractual relations have contributed to the growing tensions between increasingly large retailers and the supplier side of the food supply chain<sup>178</sup>. In fact, numerous complaints from producers and actors operating in the food supply chain have been received by National Competition Authorities and the European Commission, in Italy and all over Europe, regarding alleged unfair and exploitative practices employed by retailers to the detriment of suppliers<sup>179</sup>.

In 2009, for the first time, unfair trading practices have been the object of discussions at European level due to the risk of potential anti-competitive effects on the European food supply chain of these conducts and contractual terms. In fact, in 2008 the price of food had increased by more than 3%, bringing attention to the margin squeeze operated by retailers to the detriment of farmers, and suppliers in general<sup>180</sup>. In 2010 an 'Expert Platform on Business to Business Contractual Practices' was formed in the existent 'High Level Forum for a Better Functioning Food Supply Chain', with the objective to analyze the presence of unfair trading practices in the food sector<sup>181</sup>.

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<sup>177</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp.1-213.

<sup>178</sup> See, for example: L. ASNAGHI, *Lettera di un Buyer Pentito: Prima Complice, Poi Vittima "Di Logiche Commercial-Estortive"*, in *Corriere Ortofrutticolo*, 10 June 2016, pp. 1-3.

<sup>179</sup> EUROPEAN COMMISSION, *Green Paper on Unfair Trading Practices in The Business-To-Business Food and Non-Food Supply Chain in Europe*, COM(2013) 37 final, Brussels, 31 January 2013, pp. 1-22.

<sup>180</sup> *Ibid.*

<sup>181</sup> *Ibid.*

Since then, numerous sector inquiries and surveys have been carried out by the European Commission and by National Competition Authorities from numerous Member States<sup>182</sup>. Many of these confirmed the presence of unfair trading practices in the food supply chain, and generally identified them as a threat to competition in the sector<sup>183</sup>. Amongst those who identified unfair trading practices as an issue in the food supply chain, there is the Italian 'Autorità Garante della Concorrenza e del Mercato', which conducted, in 2014, a thorough sector inquiry on the functioning of the food supply chain and the complex relations between retail chains and suppliers in Italy, i.e. the 'Indagine Conoscitiva sul Settore della GDO –IC43'<sup>184</sup>.

Furthermore, from these surveys and sector inquiries it has appeared that unfair trading practices have been recorded as a widespread issue in many sectors other than the food supply chain, although, for the purpose of this thesis, the phenomenon will be discussed only regarding the European food supply chain. The first part of the present chapter will discuss the definition of unfair trading practices, and the different forms, contractual clauses or non-written practices, these may manifest themselves through.

The second part of the chapter will focus on the possible competitive outcomes of unfair trading practices. The analysis will focus on the conditions under which the single practices and fees may have a negative impact on competition, both at retailer

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<sup>182</sup> This topic will be addressed in further detail in Chapter 4.

<sup>183</sup> Member States whose National Competition Authorities came to these conclusions are Italy, Czech Republic, Spain, the UK, France, Germany, Bulgaria, the Czech Republic, Finland, Ireland, Lithuania, Poland and Romania. For further details on inquiries conducted by national Competition Authorities of these Member States, see: EUROPEAN COMMISSION, *Green Paper on Unfair Trading Practices in The Business-To-Business Food and Non-Food Supply Chain in Europe*, COM(2013) 37 final, Brussels, 31 January 2013, pp. 7-8.

<sup>184</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp.1-213.

level and on the upstream supplier market. In particular, an overview of the different economic theories which have developed on the phenomenon of “trade spending” will be presented.

This section seeks to highlight how unfair trading practices have a high cost on social welfare as a whole, and not only on suppliers. Even though these practices are enforced on suppliers, and not end consumers, they discourage supplier investments and endanger their long-term viability. As a result, it is highly likely that the market will be characterized by lower levels of innovation and lower quality of products, to the detriment of consumer welfare as well<sup>185</sup>.

### 3.2. WHAT ARE UNFAIR TRADING PRACTICES

As mentioned in Chapter 1 of this thesis, retailers can use buyer power to unilaterally impose on suppliers, conditions and practices which are only indirectly linked to the negotiations of purchases, even though, ultimately, they usually result in better economic conditions for the retailers. In fact, such practices or contractual clauses can be of various types and may have nothing to do, officially, with the determination of the input purchase price. They usually regard contributions for services allegedly provided by the distributor, i.e. the so-called ‘trade spending’, or payment and delivery terms.

The European Commission’s Green Paper on Unfair Trading Practices in the Business-to-Business Food and Non-Food Supply Chain in Europe<sup>186</sup>, defines unfair trading

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<sup>185</sup> B. YOUNG, *Estimated costs of Unfair Trading Practices in the EU Food Supply Chain*, Europe Economics, May 2014, pp. 1-2.

<sup>186</sup> EUROPEAN COMMISSION, *Green Paper on Unfair Trading Practices in The Business-To-Business Food and Non-Food Supply Chain in Europe*, COM(2013) 37 final, Brussels, 31 January 2013, pp. 1-22.

practices as: << Practices that grossly deviate from good commercial conduct and are contrary to good faith and fair dealing. UTPs are typically imposed in a situation of imbalance by a stronger party on a weaker one and can exist from any side of the B2B relationship and at any stage in the supply chain.<sup>187</sup>>>.

As mentioned before, retailers are able to impose terms and conditions which exclusively serve their own best interests due to their position of strength in negotiations vis à vis their weaker counter-parts, i.e. the suppliers, who hold less bargaining power. Unfair trading practices are therefore usually utilized in situations where there is a power imbalance between the negotiating parties<sup>188</sup>.

As the European Commission's definition states, it is important to note that unfair trading practices can be imposed by the stronger party in negotiations, whichever this may be. In fact, it may be the case that large international suppliers impose unfair and exploitative terms on weaker retailers, such as for example, territorial constraints, which prevent retailers from distributing goods sourced in a Member State, into another. However, for the purpose of this thesis, only unfair trading practices in the food sector, imposed on suppliers by retailers, will be discussed.

A key element which enables the imposition of unfair clauses in contracts and exploitative practices on the part of retailers, is the fact that suppliers may have a limited choice of alternative business partners. As well as the lack of viable alternatives, the manufacturer might not be able to refuse the application of unfavorable clauses for many other reasons. For example, there may be significant costs implied in switching to supplying another retailer, due to specific investments

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<sup>187</sup> *Id.* p. 3.

<sup>188</sup> F. CICONTE, S. LIBERTI, *Supermercati, il Grande Inganno del Sottocosto*, in *Internazionale*, 27 February 2017, pp. 1-9.

and sunk costs which the supplier cannot recover, or, when the supplier is a farmer whose goods are quickly perishable, it may not have the time, or means, to find another retailer willing to purchase the products. Manufacturers often accept unfair trading terms as they are afraid of otherwise not being able to conclude contracts at all, or, in addition, they might not have the specific legal competencies to identify unfavorable contract clauses or anticipate unfair conducts<sup>189</sup>.

The increasing concentration of the European retail market, further enhanced by the growing phenomenon of buying alliances, is a factor which many link to the expansion of the use of unfair trading practices<sup>190</sup>. As analyzed in more detail in the previous chapter, as retailers conclude joint purchasing agreements amongst themselves, their bargaining power increases, strengthening their position in negotiations vis à vis the suppliers. In addition, as retailers join buying alliances, their practices become more homogeneous and suppliers' choice of alternative trading partners further diminishes.

The shifting of procurement towards the buying alliances, the way in which standardized contracts have evolved, as well as the increased transparency and exchange of information between members, are elements which increase the likelihood of unfair trading practices being imposed upon suppliers.

Another element to consider, contained in the definition given by the European Commission's Green Paper<sup>191</sup>, is that unfair trading practices can manifest at any stage of the relationship between businesses. They can occur during the negotiation phase of a contract, they can be included in contracts, i.e. contractual clauses, or they can even be employed after the contract has been concluded.

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<sup>189</sup> EUROPEAN COMMISSION, *Green Paper on Unfair Trading Practices in The Business-To-Business Food and Non-Food Supply Chain in Europe*, COM(2013) 37 final, Brussels, 31 January 2013, pp. 1-22.

<sup>190</sup> Ø. FOROS, H. KIND, *Do Slotting Allowances Harm Retail Competition*, CESifo Working Paper No.1800, September 2006, pp. 1-32.

<sup>191</sup> EUROPEAN COMMISSION, *Green Paper on Unfair Trading Practices in The Business-To-Business Food and Non-Food Supply Chain in Europe*, COM(2013) 37 final, Brussels, 31 January 2013, p. 3.

### 3.2.1. DIFFERENT KINDS OF UNFAIR TRADING PRACTICES

Unfair trading practices imposed by retailers on suppliers, may manifest under many different forms, varying from the request of contributions for services that may not have been requested or not useful to the supplier, requests for payments which may be disproportionate compared to the services provided, retroactive modifications of contractual terms and conditions, and many more<sup>192</sup>.

Amongst these, vague and unclear contract terms are one of the most frequently used practices. Ambiguous and non-transparent clauses in contracts enable retailers to then impose additional conditions on suppliers, such as sanctions or variations in costs, which were not clearly foreseeable by the supplier at the moment of conclusion of the contract. Unfair trading practices are usually easily imposed by stronger retailers on their weaker counterparts especially when the supplying contracts have not been stipulated in written form. Oral agreements, with no subsequent written confirmation, can give way to exploitative behaviour<sup>193</sup>.

The retroactive modifications of contractual terms and the delays in payments can also constitute unfair trading practices, as they exacerbate the contractual disadvantage of the counterpart, i.e. the supplier. Unilateral and arbitrary contractual modifications lead to legal uncertainty, which hinders the suppliers' developments and can put at risk the livelihood of small businesses, which cannot face financial delays. Furthermore, the unjustified de-listing of products, i.e. the interruption of a supplying contract without justification or sufficient notice, as well as unjustified refusals to deal,

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<sup>192</sup> *Id.* pp. 1-22.

<sup>193</sup> EUROPEAN COMMISSION, *Green Paper on Unfair Trading Practices in The Business-To-Business Food and Non-Food Supply Chain in Europe*, COM(2013) 37 final, Brussels, 31 January 2013, pp. 1-22.

or short-notice cancellations of purchases, can be used as retaliation practices by retailers, to the detriment of suppliers<sup>194</sup>.

Another widespread conduct which may amount to an unfair trading practice is the transfer, upon the suppliers, of the retailers' commercial risks. Clauses which provide that suppliers should pay for their products to have access to the retailer's catalogue, i.e. listing fees, or which require the suppliers to contribute to the opening of new shops, or even to bear the costs of their unsold, damaged, or stolen products, fall under this category<sup>195</sup>.

Retailers may also impose contractual clauses which oblige the supplier to guarantee them the best trading conditions. These 'most favoured customer' clauses provide the retailer, which is concluding the contract, with the lowest purchasing prices, prohibiting the supplier from offering lower prices to any competing buyer. These clauses further reduce the suppliers' bargaining power, increase their vulnerability in negotiations and likelihood of exploitative behaviour from retailers<sup>196</sup>.

The misuse of commercial secrets regarding suppliers' products by the retailers may also amount to an unfair practice. The unfair use of trade secrets, uncovered due to the exchange of information during negotiations and the conclusion of the contract, can cause significant damage to suppliers, especially when retailers are also potential competitors. In fact, retailers may use the information regularly collected when listing suppliers' products to copy the successful ones, developing their own private label products<sup>197</sup>. Suppliers may suffer major damages in this case, as their revenues from

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<sup>194</sup> *Ibid.*

<sup>195</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp.1-213.

<sup>196</sup> *Ibid.*

<sup>197</sup> For more details on the phenomenon of private labels see Chapter 2.2.1.

sales decrease and they can't collect the profits of their investments in research and innovation<sup>198</sup>.

The conclusion of supplying contracts may also be subordinated to the acceptance, and payment, of additional services provided by retailers, which, as mentioned before, are often imposed on suppliers and their cost is usually disproportionate compared to the actual value of the service provided. The abuse of this type of bundling favors retailers, which de facto obtain discounts on purchase prices, which are instead recorded as payments for services<sup>199</sup>. These additional services may regard transport, storage, promotional or marketing activities concerning the supplier's products or even the allocation of their products on certain shelf spaces<sup>200</sup>.

The term 'trade spending' indicates all the fees which suppliers pay to retailers for additional services, which are usually paid ahead of the purchase of goods, i.e. they are up-front payments. These fees are generally negotiated privately between the parties, and the terms are not communicated or made public. Amongst these fees, slotting allowances and listing fees are of widespread use in retailers' business practices<sup>201</sup>. The former indicates the contributions paid for the access to the distributor's shelf space, whilst the latter indicates the fees paid by the suppliers for their products to be distributed by the retailers<sup>202</sup>.

In particular, according to Bloom, Gundlach and Cannon: << The terms *slotting allowances* and *slotting fees* describe a family of marketing practices that involve

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<sup>198</sup> EUROPEAN COMMISSION, *Green Paper on Unfair Trading Practices in The Business-To-Business Food and Non-Food Supply Chain in Europe*, COM(2013) 37 final, Brussels, 31 January 2013, pp. 1-22.

<sup>199</sup> As will be explained in further detail in the next paragraphs.

<sup>200</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp.1-213.

<sup>201</sup> P. BLOOM, G. GUNDLACH, J. CANNON, *Slotting Allowances and Fees: Schools of Thought and the Views of Practicing Managers*, in *Journal of Marketing*, Vol. 64, Issue 2, April 2000, pp. 92-108.

<sup>202</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp.1-213.



payments by manufacturers to persuade downstream channel members to stock, display, and support new products<sup>203</sup>.>>. One of the main characteristics of these up-front payments is the fact that such fees remain unvaried, whatever the retailer sales of the products may be<sup>204</sup>.

This business practice of retailers, of bundling fixed up-front payments for their services to their purchases from suppliers, started in the late 1980s and rapidly became widespread in the 1990s. The development and broad use of trade spending fees coincided with the increased concentration of the retail market and the retailers' increased buyer power.

Furthermore, the diffusion and strengthening of buying alliances between retailers, has played a major role in the increased use of slotting allowances and listing fees, and often these are negotiated from the buying group itself<sup>205</sup>. Overall, trade spending represents a significant cost for suppliers, reducing their profits from sales of 11%, and a considerable gain for retailers<sup>206</sup>.

### 3.3. EFFECTS ON COMPETITION OF UNFAIR TRADING PRACTICES

As previously mentioned, unfair trading practices have attracted the attention of Competition Authorities all over Europe, due to the risks they pose to the regular functioning of the food supply chain, and their possible distortive effects on

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<sup>203</sup> P. BLOOM, G. GUNDLACH, J. CANNON, *Slotting Allowances and Fees: Schools of Thought and the Views of Practicing Managers*, in *Journal of Marketing*, Vol. 64, Issue 2, April 2000, p 92.

<sup>204</sup> G. SHAFFER, *Slotting Allowances and Resale Price Maintenance: A Comparison of Facilitating Practices*, in *RAND Journal of Economics*, Vol. 22, No. 1, Spring 1991, pp. 120-135.

<sup>205</sup> Ø. FOROS, H. KIND, *Do Slotting Allowances Harm Retail Competition*, CESifo Working Paper No.1800, September 2006, pp. 1-32.

<sup>206</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp.1-213.

competition in the sector<sup>207</sup>. An important element of uncertainty to keep in mind is the difficulty to assess the impact of these practices on competition, due to the nature of the phenomenon which is difficult to quantify and measure<sup>208</sup>.

Although there are different schools of thought, the relevant literature generally agrees that the competitive outcome of practices and contractual clauses imposed by retailers on suppliers is rather unclear<sup>209</sup>. The element of legal uncertainty, generally caused by the imposition on suppliers of unfair trading practices, is one of the main causes of disruption in the supply chain. In fact, retroactive contract changes and unfair use of commercial secrets, as already mentioned, are capable of disrupting the manufacturers' business planning and can hinder investments in new products, growth and innovation<sup>210</sup>.

Unfair trading practices may also hinder trade between Member States, as the fear of non-familiar exploitative behavior from retailers can inhibit suppliers from entering cross-border supplying contracts, partitioning the European Single Market<sup>211</sup>.

The biggest repercussions and damages generally fall on manufacturers which are small or medium enterprises (SMEs). They are the most vulnerable to contract changes and unfair behavior from retailers, as they generally have few alternative business

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<sup>207</sup> P. BLOOM, G. GUNDLACH, J. CANNON, *Slotting Allowances and Fees: Schools of Thought and the Views of Practicing Managers*, in *Journal of Marketing*, Vol. 64, Issue 2, April 2000, pp. 92-108.

<sup>208</sup> EUROPEAN COMMISSION, *Green Paper on Unfair Trading Practices in The Business-To-Business Food and Non-Food Supply Chain in Europe*, COM(2013) 37 final, Brussels, 31 January 2013, pp. 1-22.

<sup>209</sup> P. BLOOM, G. GUNDLACH, J. CANNON, *Slotting Allowances and Fees: Schools of Thought and the Views of Practicing Managers*, in *Journal of Marketing*, Vol. 64, Issue 2, April 2000, pp. 92-108.

<sup>210</sup> EUROPEAN COMMISSION, *Green Paper on Unfair Trading Practices in The Business-To-Business Food and Non-Food Supply Chain in Europe*, COM(2013) 37 final, Brussels, 31 January 2013, pp. 1-22.

<sup>211</sup> The impact of the fragmented national legal frameworks on unfair trading practices on the Single Market will be discussed in more detail in Chapter 4.3.

partners, their switching costs are significant, and they usually don't have the logistic capacity to file complaints or protect themselves from abusive behavior<sup>212</sup>.

Along with the aforementioned anti-competitive effects, the practices and terms in question may also generate efficiency gains, such as reducing transaction costs or contributing to a fairer distribution of commercial risks, amongst others<sup>213</sup>. In order to present a clear and comprehensive panoramic of the possible welfare effects of unfair trading practices, this thesis will present both the arguments in favor of a pro-competitive outcome, as well as the arguments in favor of an anti-competitive outcome.

This section will focus on the competitive effects of trade spending, slotting allowances and listing fees in particular<sup>214</sup>, and seeks to align with the literature defending the thesis that such fixed fees contribute to distorting competition in the food supply chain, hindering supplier investments and innovation in the market.

The analysis of the potential welfare effects of up-front payments, such as slotting allowances or listing fees, has attracted numerous authors, and a significant literature has developed on the issue. These practices, as already discussed in the previous paragraphs, were generally unheard of until 1984<sup>215</sup>, and became widespread in retailers' business practices starting from the 1990s, coinciding with the consolidation

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<sup>212</sup> EUROPEAN COMMISSION, *Green Paper on Unfair Trading Practices in The Business-To-Business Food and Non-Food Supply Chain in Europe*, COM(2013) 37 final, Brussels, 31 January 2013, pp. 1-22.

<sup>213</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp.1-213.

<sup>214</sup> Effects on Competition will be analyzed considering the set of practices which go under the name of trade spending, focusing on slotting allowances and listing fees, as they are the practices which have received significantly more attention by the relevant literature. However, the same discussion and principles are valid when considering other types of up-front payments.

<sup>215</sup> M. SULLIVAN, *Slotting Allowances and the Market for New Products*, in *The Journal of Law and Economics*, Vol.40, No. 2, October 1997, pp. 461-494.

of the European retail market and the diffusion of joint purchasing agreements between retailers<sup>216</sup>.

In the 1990s, two opposing schools of thought developed in the economic theory, on the impact of slotting allowances on competition in the food sector. The efficiency school defended the legitimacy of such practices, highlighting the significant efficiency gains which are likely to be generated by up-front payments, as opposed to the market power school, according to which slotting allowances and listing fees are used by retailers to strengthen their buyer power and reduce horizontal competition, by raising end prices to consumers<sup>217</sup>.

### 3.3.1. PRO-COMPETITIVE EFFECTS OF UP-FRONT PAYMENTS

Amongst the authors supporting the efficiency school of thought<sup>218</sup>, Sullivan<sup>219</sup> elaborated the demand-supply hypothesis, according to which slotting allowances have developed in response to the increased offer of new products. Slotting allowances are thereby employed by distributors to compensate the costs they have to bear for the increased supply of new products. The growing number of products introduced on the market by suppliers has caused the retailers' stocking costs to increase, and, according to the retailers, slotting allowances are necessary to bear the costs of storing

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<sup>216</sup> Ø. FOROS, H. KIND, *Do Slotting Allowances Harm Retail Competition*, CESifo Working Paper No.1800, September 2006, pp. 1-32.

<sup>217</sup> P. BLOOM, G. GUNDLACH, J. CANNON, *Slotting Allowances and Fees: Schools of Thought and the Views of Practicing Managers*, in *Journal of Marketing*, Vol. 64, Issue 2, April 2000, pp. 92-108.

<sup>218</sup> For a detailed overview of the authors supporting the efficiency school of thought see: AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp.128-130. See also: K. SUDHIR, V. RAO, *Do Slotting Allowances Enhance Efficiency or Hinder Competition?*, in *Journal of Marketing Research*, Vol. 43, Issue 2, May 2006, pp. 137-155.

<sup>219</sup> M. SULLIVAN, *Slotting Allowances and the Market for New Products*, in *The Journal of Law and Economics*, Vol.40, No. 2, October 1997, pp. 461-494.

new products in the warehouses, positioning them on the shelf space and updating product information<sup>220</sup>.

Sullivan also argues that: <<Slotting allowances can be used as a risk sharing mechanism, whereby all new products pay a fee, and the successful products subsidize the failed ones<sup>221</sup>>>. In fact, retailers claim that these fixed fees are also necessary to fairly share the commercial risk of the launch of a new product. The manufacturers producing the new products are better informed on them than retailers and should participate in the economic risks of introducing them on the market, which would otherwise be borne by the retailers only. Listing fees and slotting allowances also constitute an incentive for retailers to stock and distribute new products, boosting supplier's investments and innovation, and in return for the payment of these fees, retailers commit themselves to keeping the product in stock, usually for a six-months test period<sup>222</sup>.

Another argument in favor of the pro-competitive effects of slotting allowances is based on the fact that retailers' shelf space is limited, therefore, such fees are comparable to an auction system, by which the best shelf spaces go to the best bidder. The payment of slotting allowances then represents a physiological trait of the normal competitive process for the acquisition of retailers' shelf space. In addition, by renting out shelf space, the retailer can allegedly filter out those products whose success rate is not high enough for the manufacturer to pay the requested slotting fee<sup>223</sup>.

The abovementioned arguments have been upheld by the more recent economic literature which supports the thesis that up-front payments are not anti-competitive,

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<sup>220</sup> K. SUDHIR, V. RAO, *Do Slotting Allowances Enhance Efficiency or Hinder Competition?*, in *Journal of Marketing Research*, Vol. 43, Issue 2, May 2006, pp. 137-155.

<sup>221</sup> M. SULLIVAN, *Slotting Allowances and the Market for New Products*, in *The Journal of Law and Economics*, Vol.40, No. 2, October 1997, pp. 461-494.

<sup>222</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp.1-213.

<sup>223</sup> *Ibid.*

even in situations where the retailer enforcing them holds a dominant position on the market. In fact, according to this school of thought, slotting allowances, and up-front payments in general, are not capable of increasing the retailers' profits to the expenses of the suppliers.

What these fees produce is instead a more efficient allocation of scarce resources, such as shelf space, and an increase of social welfare and of consumer surplus, since they reduce input purchase prices by eliminating externalities and overall contribute to improving horizontal competition in the distribution market<sup>224</sup>.

### 3.3.2. ANTI-COMPETITIVE EFFECTS OF UP-FRONT PAYMENTS

The aforementioned market power school of thought adheres to the position that up-front payments are likely to harm competition in the food supply chain. According to this school of thought, up-front payments are exploitative measures employed by retailers, who leverage their stronger buyer power, against suppliers. For the authors that support this thesis, such fees are instruments used by large distributors to increase their market power against competitors, weakening retailer competition and deteriorating relations in the food supply chain as a whole. For example, the tensions and disagreements generated by the negotiation, and imposition, of up-front payments, hinder the exchange of information between the different levels of the supply chain, and a constructive cooperation between the actors<sup>225</sup>.

Up-front payments are also capable of exacerbating the differences and disparities between large multi-national producers and local, smaller, ones. In fact, large

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<sup>224</sup> B. DONG, *Retail Power, Slotting Allowances and the Countervailing Power Hypothesis*, The Hong Kong Polytechnic University Departmental Research Seminar, Hong Kong, 16 May 2011, pp. 1-2.

<sup>225</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp.1-213.

suppliers hold stronger bargaining power, compared to smaller ones, and have a stronger position in negotiations vis à vis the retailers.

Therefore, large suppliers are able to negotiate better deals and lower fees with the retailers, whilst instead smaller suppliers, which have very low bargaining power compared to the retailers, find themselves having to pay disproportionate fees which they often cannot afford. In addition, large suppliers are capable of investing larger sums of money in acquiring shelf spaces from the retailers, compared to smaller competitors, and they may use this leverage to exclude smaller suppliers from the market<sup>226</sup>.

Furthermore, the fact that fees are negotiated more or less secretly between the parties, with no public communication to external actors, may increase the disparities and differences regarding the entity of the up-front payments. Therefore, weaker suppliers may not be able to obtain the more favorable conditions negotiated by larger and more powerful suppliers, as they may not even be aware of them, paying higher fees for the same services<sup>227</sup>.

This physiological mechanism damages competition in the upstream supply market and can be used by large suppliers to damage competitors with less financial means, raising their slotting fees, or costs in general, reducing their revenues and possibly excluding them from the market. As a study from Europe Economics<sup>228</sup> points out: <<UTPs limit the extent to which suppliers can invest back in their businesses and they create a degree of uncertainty (and some analysts have reported fear) which discourages long-term commitment. Over time this will reduce the ability of

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<sup>226</sup> L. MARX, G. SHAFFER, *Slotting Allowances and Scarce Shelf Space*, in *Journal of Economic and Management Strategy*, Vol. 19, No. 3, Fall 2010, pp. 575-603.

<sup>227</sup> EUROPEAN COMMISSION, *Green Paper on Unfair Trading Practices in The Business-To-Business Food and Non-Food Supply Chain in Europe*, COM(2013) 37 final, Brussels, 31 January 2013, pp. 1-22.

<sup>228</sup> B. YOUNG, *Estimated costs of Unfair Trading Practices in the EU Food Supply Chain*, Europe Economics, May 2014, pp. 1-2.

competent suppliers to survive and will show through as lack of innovation and of quality improvement. In these ways UTPs harm consumers too<sup>229</sup>.>>.

Therefore, social welfare as a whole ends up being reduced too, as slotting allowances and listing fees can constitute barriers to entry in the market for smaller competitors and the presence of fewer suppliers on the market results in reduced choice and possibly higher final prices for consumers<sup>230</sup>.

Slotting fees may contribute to the increase of final consumer prices for other reasons too. For example, slotting allowances paid by suppliers for non-requested or non-proportionate services, generally constitute a hidden discount on the purchase price of the products bought by the retailers. These discounts are registered under the form of fees paid by the suppliers, whilst the wholesale price formally paid by the retailer stays the same. Considering that retailers set the final prices of goods on the basis of their wholesale price, these hidden discounts allow them to raise, or not to reduce, final consumer prices. Retailers' profits are then assured by up-front fees, even in situations where the final prices of goods are very close to the wholesale prices<sup>231</sup>.

Furthermore, to face the financial burden of such up-front fees, which, as said before, have become extremely frequent in retailers' business practices, suppliers are usually forced to raise their wholesale prices. This means that retailers can count on the fact that their competitors will face an increase in wholesale prices, and will consequently be likely to raise, or at least not reduce, final consumer prices, so if the former do raise their final prices, they are unlikely to lose market shares. Therefore, competition

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<sup>229</sup> *Ibid.*

<sup>230</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp.1-213.

<sup>231</sup> EUROPEAN COMMISSION, *The Impact of Private Labels on the Competitiveness of the European Food Supply Chain*, DG Enterprise, Brussels, January 2011, pp. 1-170.



between retailers on final prices is hindered and this may result in a general increase of final consumer prices<sup>232</sup>.

Up-front payments may also be used as instruments to facilitate collusion on prices between retailers, especially in situations where below-cost selling is forbidden<sup>233</sup>. In fact, as discounts on purchased goods are usually formally registered as fees for services offered by the retailer, the wholesale price appears to be higher than what actually paid by the retailer. According to a study commissioned by the European Commission<sup>234</sup>: <<These fees represent a means by which retailers signal to other retailers that they will not compete aggressively on the retail price as they have taken their profits upfront<sup>235</sup>.>>, and: <<Off-invoice fees are merely creative ways of implementing two-part, discriminatory pricing schemes among cartels of retail buyers and are rarely uniform among suppliers<sup>236</sup>>>.

On the contrary, one of the main assumptions made by the authors who support the predominance of pro-competitive effects of up-front payments, is that up-front fees are negotiated secretly between the parties and are unobservable from competitors

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<sup>232</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp.1-213.

<sup>233</sup> Some Member States, such as France and Belgium for example, have prohibited below cost selling of food products. The aim is to defend both weaker competitors, i.e. smaller retailers, from predatory pricing tactics employed by large retailers, as well as manufacturers, whose selling prices might be reduced under the production costs of the goods. France, with the Loi n° 2018-938 du 30 octobre 2018 pour l'Equilibre des Relations Commerciales dans le Secteur Agricole et Alimentaire et une Alimentation Saine, Durable et Accessible à Tous, has, for example, prohibited retailers from selling products at a price which is inferior to the invoice price, comprised of transport costs and taxes, and generally prohibits the sale of goods with less than a 10% profit margin. Other Member States, such as Italy, emanated legislation which limits and regulates below cost selling, i.e. D.P.R. 6 aprile 2001, n. 218, "Regolamento recante disciplina delle vendite sottocosto". For more details on Member States' legislation on sales below costs see: B. KEIRSBILCK, *Does Eu Economic Law Preclude National Prohibitions of Sales Below Cost?*, in *Erasmus Law Review*, Vol.5, Issue 4, 2012, pp. 253-266.

<sup>234</sup> EUROPEAN COMMISSION, *The Impact of Private Labels on the Competitiveness of the European Food Supply Chain*, DG Enterprise, Brussels, January 2011, pp. 1-170.

<sup>235</sup> *Id.* p. 34.

<sup>236</sup> *Ibid.*

and third parties<sup>237</sup>. The general idea is that such fees would not cause for the weakening of competition on prices amongst competitors, given that competing retailers have no knowledge of the use, and the entity, of such fees<sup>238</sup>.

Authors Foros and Kind<sup>239</sup> strongly criticize this assumption, which is based on the lack of consideration of the real structure of the food market, and, in particular, ignores the fact that retailer buying alliances play a major role in the food chain, so the market is more concentrated for procurement than for distribution<sup>240</sup>. The aforementioned authors demonstrate that the growth of buying alliances, and their ever-changing composition and memberships, has further facilitated the possible price coordination amongst retailers, as the market transparency on contractual terms has significantly increased.

In fact, they show that: <<Slotting allowances have become more widespread at the same time as large retailer groups have started to operate several sub-chains as buyer groups or as divisionalized companies<sup>241</sup>.>>, and that: << Each buyer group will use slotting allowances to dampen intra-retailer competition even if rival retail chains cannot observe the wholesale contracts. As long as the procurement contracts can be observed within each buyer group, which is a plausible assumption, they can transfer their buying power into the retail market by using slotting allowances<sup>242</sup>.>>.

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<sup>237</sup> See for example: G. SHAFFER, *Slotting Allowances and Resale Price Maintenance: A Comparison of Facilitating Practices*, in *RAND Journal of Economics*, Vol. 22, No. 1, Spring 1991, pp. 120-135.

<sup>238</sup> Ø. FOROS, H. KIND, "Do Slotting Allowances Harm Retail Competition", CESifo Working Paper n.1800, September 2006, pp. 1-32.

<sup>239</sup> *Ibid.*

<sup>240</sup> As discussed in more detail in Chapter 2, trade spending fees are usually negotiated at the buying alliance level, although a second negotiation at retailer chain level often follows. Procurement is usually dealt with at alliance headquarter level, whilst single retail chains generally have more autonomy regarding the determination of final consumer prices.

<sup>241</sup> Ø. FOROS, H. KIND, "Do Slotting Allowances Harm Retail Competition", CESifo Working Paper n.1800, September 2006, p. 5.

<sup>242</sup> *Ibid.*

Even if the specifics of procurement contract and up-front fees are not of public domain, it is safe to say that each buying alliance knows that their competitors are likely to use slotting fees in order to coordinate on prices and dampen competition between their members. Therefore, the aforementioned authors<sup>243</sup> demonstrate the anti-competitiveness of up-front payments, which may serve to raise the official wholesale purchase prices of goods, as well as the end prices for consumers.

In addition, up-front fees may be employed by dominant retailers, or non-dominant retailers who hold a significant amount of market power, to exclude smaller or weaker competitors from the market. This exclusionary effect of slotting fees may arise because the stronger retailer imposes fees on its suppliers which they cannot recover if they were to switch distributors. As a result, up-front fees constitute an incentive for suppliers to distribute large amounts of products with one, or few, retailers, in order to recover the fees paid<sup>244</sup>.

However, as the Italian Competition Authority notes in its sector inquiry<sup>245</sup>, this exclusionary effect which arises when suppliers distribute all their products through the main retail chains, ignoring the weaker competitors, depends on the characteristics of the national food chain. In Italy, for example, the supply side of the market is very fragmented, and it is characterized by an excess of offer. Retailers facing a fragmented upstream market are presented with a very high degree of supply-side substitutability, which generally allows them to have a multiplicity of possible alternative business partners. As a result, weaker competitors are rarely excluded from the business as they are usually able to find alternative suppliers for similar goods.

What holds true even in highly fragmented markets such as the Italian one, is that weaker retailers may have a disadvantage when it comes to negotiating purchase

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<sup>243</sup> *Id.* pp. 1-32.

<sup>244</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp.1-213.

<sup>245</sup> *Ibid.*

prices and discounts, as happens with weaker and stronger suppliers too. As mentioned before, up-front payments may be used as a way to obtain indirect discounts on the purchase of goods, and the larger the retailer, or retail chain, the larger the discounts it is able to negotiate with suppliers<sup>246</sup>. Consequently, retailers which hold more bargaining power, and even more so retailer buying alliances, are able to negotiate higher fees for the same services, obtaining better discounts on their purchases, due to the bigger volume of sales they can offer to producers<sup>247</sup>.

The final effect of the aforementioned conducts is likely to be the foreclosure of the market, where less competitors compete with each other, especially on prices, and there are less incentives to invest and innovate, both on the supply side and the distribution side. As a result, products' quality and variety diminishes and consumers' choices are more limited, therefore social welfare as a whole is harmed.

The aforementioned anti-competitive effects of up-front payments hold true in particular regarding those types of up-front fees for which efficiency justifications have been hard to find. For example, whilst it may be argued that slotting allowances may contribute to a more efficient allocation of resources, the same cannot be said, for example, for those fees required as contributions for new store openings, for the listing of products, or as contributions for services provided by the buying alliances, or even as compensation for the weak sale of products. In fact, no efficiency gains have been associated with these fees, which are generally imposed by retail chains onto producers, with the only objective of passing onto them the risks and costs associated with the distribution activity<sup>248</sup>.

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<sup>246</sup> Many National Competition Authorities, as the UK Competition Commission for example, agree that empirical findings confirm that larger retailers, with higher market shares, obtain bigger discounts from producers. For more details see: EUROPEAN COMMISSION, *The Impact of Private Labels on the Competitiveness of the European Food Supply Chain*, DG Enterprise, Brussels, January 2011, pp. 1-170.

<sup>247</sup> *Ibid.*

<sup>248</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp.1-213.

Suppliers are unlikely to benefit from the alleged services these fees pay or contribute too. The opening of a new flag shop, for instance, may cause an increase in sales and profits for the concerned retailer, to the detriment of its competitors' sales and revenues. However, even when followed by intense promotional activities, the openings rarely increase suppliers' profits, as they generally supply different retail chains, so their total revenue stays the same. The same principle applies to listing fees, whose pro-competitive effects are very difficult to establish, especially when the goods concerned are not new products, but are instead well established in the market. The payment requested to list existing products do not correspond to any actual service provided by the retailer, and do not contribute to the efficient allocation of a scarce resource, as could be the case for slotting allowances and shelf spaces<sup>249</sup>.

Such up-front payments then essentially constitute a way to transfer the retailers' business risks on to the producers, to raise retailers' profits. For the suppliers, these fees represent fixed cost which they cannot recover, therefore representing an incentive for suppliers not to interrupt their business relations with the retailers to whom they pay these fees. As said before, suppliers are then less likely to switch distributors and are more vulnerable to the imposition or unilateral modification of contract terms from the retailers<sup>250</sup>.

### 3.4. CONCLUSIONS ON UNFAIR TRADING PRACTICES

In light of the dynamics and conducts discussed in this chapter, it appears evident that a clear and unequivocal assessment of the effects on competition, and social welfare,

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<sup>249</sup> EUROPEAN COMMISSION, *Green Paper on Unfair Trading Practices in The Business-To-Business Food and Non-Food Supply Chain in Europe*, COM(2013) 37 final, Brussels, 31 January 2013, pp. 1-22.

<sup>250</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp.1-213.

of unfair trading practices hardly exists. In particular, the diversity of characteristics between the different types of unfair trading practices, considered above, does not allow for a uniform evaluation of their competitive effects on the food supply chain. The debate on the net prevalence of either efficiency enhancing effects or rather of anti-competitive effects of the aforementioned business practices seems to be still open-ended, with many acknowledging the fact that efficiency gains and distortions of competition might coexist, especially regarding listing fees and slotting allowances<sup>251</sup>.

However, this chapter sought to demonstrate that, overall, unfair trading practices are ultimately likely to distort competition. In fact, this thesis supports the view expressed by Anchustegui<sup>252</sup>, who argues that: << The fact that UPPs'<sup>253</sup> tend to mostly impact contractual fairness and profit distribution between parties with a reduced effect on allocative efficiency does not mean that suppliers should be left unprotected against behaviours of buyers that are contrary to ethical business practices.

This is so not only due to the moral component of the action, but because a widespread use of UPPs can, in the long run and from a dynamic efficiency perspective, adversely affect the competition conditions by compromising the viability and profitability of suppliers, conditioning entry and exit conditions from the market, and also unduly restricting the market participant's economic freedom<sup>254</sup>.>>.

Therefore, unfair trading practices, despite potential efficiency enhancing effects, are most likely to harm the EU economy and the Single Market, affecting small and

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<sup>251</sup> EUROPEAN COMMISSION, *The Impact of Private Labels on the Competitiveness of the European Food Supply Chain*, DG Enterprise, Brussels, January 2011, pp. 1-170.

<sup>252</sup> I. ANCHUSTEGUI, *Buyer Power in EU Competition Law*, Concurrences - Institute of Competition Law, Paris, October 2017, pp. 416-454.

<sup>253</sup> The term "unfair purchasing practices (UPPs)" utilized by Anchusetgui refers to the same concept as unfair trading practices (UTPs).

<sup>254</sup> *Id.* p. 426.

medium enterprises in particular<sup>255</sup>. The total cost of unfair trading practices on food producers in Europe has been estimated between €30 billion and €40 billion per year<sup>256</sup>, and the differences in Member States' legislations aimed at tackling these business practices further contribute to the fragmentation of the Single Market.

Although these conducts may be tackled under existing competition law, this cannot cover all unfair and anti-competitive conducts, as many are adopted by actors who fall below the thresholds required by competition law<sup>257</sup>. Combating and disciplining unfair trading practices with a cohesive and specific legal framework would favor the economic integration and cross-border trade in Europe<sup>258</sup>. The analysis of the existent legal framework on unfair trading practices will be carried out in the next chapter.

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<sup>255</sup> EUROPEAN COMMISSION, *Green Paper on Unfair Trading Practices in The Business-To-Business Food and Non-Food Supply Chain in Europe*, COM(2013) 37 final, Brussels, 31 January 2013, pp. 1-22.

<sup>256</sup> B. YOUNG, *Estimated costs of Unfair Trading Practices in the EU Food Supply Chain*, Europe Economics, May 2014, pp. 1-2.

<sup>257</sup> EUROPEAN COMMISSION, *Study on the Legal Framework Covering Business-To-Business Unfair Trading Practices in the Retail Supply Chain*, DG MARKT/2012/049/E, Brussels, 26 February 2014, pp. 1-468.

<sup>258</sup> EUROPEAN COMMISSION, *Green Paper on Unfair Trading Practices in The Business-To-Business Food and Non-Food Supply Chain in Europe*, COM(2013) 37 final, Brussels, 31 January 2013, pp. 1-22.

## 4. LEGAL FRAMEWORK ON UNFAIR TRADING PRACTICES

### SUMMARY

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### 4.1. INTRODUCTION

As previously mentioned, the growing phenomenon of unfair trading practices has raised concerns amongst both national and European Competition Authorities over the possible effects on competition in the food supply chain, leading to the need to analyze the functioning of the food sector. Thus, sector inquiries and surveys have been carried out by the European Commission and by National Competition Authorities from various Member States (such as Italy, The Czech Republic, Spain, the UK, France, Germany, Bulgaria, the Czech Republic, Finland, Ireland, Lithuania, Poland and Romania)<sup>259</sup>. The results of these inquiries highlighted how unfair commercial practices have been found to be employed quite commonly in business to

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<sup>259</sup> EUROPEAN COMMISSION, *Green Paper on Unfair Trading Practices in The Business-To-Business Food and Non-Food Supply Chain in Europe*, COM(2013) 37 final, Brussels, 31 January 2013, pp. 1-22.



business relationships along the food supply chain and have been identified as a problematic aspect in the sector<sup>260</sup>.

This chapter seeks to discuss what legal instruments are available to tackle such conducts in the food sector, starting from a mention to the traditional antitrust approach, which, to the extent possible, tackled the power imbalances in the food sector, qualified (today) as unfair trading practices, through the instruments of competition law. However, this thesis supports the opinion that unfair trading practices in business to business relationships are covered only in part by competition law, which is insufficient to effectively combat them. Specific trading rules are instead more suitable to capture the problematics caused by unfair trading practices, which affect areas and actors that are not easily captured by the protection afforded by competition rules.

Whilst a cohesive and uniform European legal framework on unfair trading practices has been adopted only very recently, many Member States already had specific legislation aimed at complementing the existent competition rules to tackle unfair commercial conducts. In fact, most Member States have introduced ways to counteract such practices, with national ad hoc legislation or through voluntary self-regulatory mechanisms. However, this causes for the level and form of protection against unfair trading practices to be extremely diversified and incoherent amongst the different Member States, potentially contributing to the fragmentation of the Single Market.

Therefore, this chapter argues that, for the scale and effect of the phenomenon, protection against unfair trading practices can be better achieved at EU level. The European Commission, the European Council and the European Parliament, have all drawn attention to the issue of unfair commercial practices, at first studying the sector

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<sup>260</sup> EUROPEAN COMPETITION NETWORK, *Report on Competition Law Enforcement and Market Monitoring Activities by European Competition Authorities in the Food Sector*, Subgroup Food, May 2012, pp. 116-120.

and issuing best practices and recommendations on how to tackle them, and subsequently calling for a cohesive European legal framework to be created. These calls for action resulted in the adoption, on 17 April 2019, of the new Directive on unfair trading practices in business-to-business relationships in the agricultural and food supply chain<sup>261</sup>, which provides for a minimum standard of protection against unfair practices, and the harmonization of national legislations.

The Directive bans a series of unfair trading practices, dividing them in two categories, black and grey, for which different levels of protection apply, and provides Member States with a more efficient way of combating these practices, also thanks to the establishment of minimum rules regarding the enforcement of the prohibitions and the coordination amongst their enforcement authorities.

## 4.2. COMPETITION LAW – ANTITRUST LEGAL INSTRUMENTS

As briefly mentioned in the introduction, the traditional approach to unfair trading practices has been to attempt to address them, where possible and within their scope, through existent competition law provisions. All Member States have legislation in place, transposing EU competition law provisions, such as Article 101 and Article 102 of the Treaty on the Functioning of the European Union (TFEU), respectively regarding restrictive agreements between undertakings and the abuse of a dominant position. These provisions may be suitable, in theory, to address certain unfair commercial practices in business to business relations, although the argument

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<sup>261</sup> Directive 2019/633/EU of The European Parliament and of the Council of 17 April 2019 on unfair trading practices in business-to-business relationships in the agricultural and food supply chain (OJ L111, 25.04.2019).

sustained in this thesis is that such competition law provisions generally fall short of an adequate protection against such conducts.

Art. 102 TFEU, or Art. 3 of law 10.10.1990, n. 287 “Norme per la tutela della concorrenza e del mercato” as transposed in Italian law, is in general, the provision which is most used to tackle unfair commercial practices, in particular since it provides for protection against unilateral conducts and abuses which may affect trade between Member States <sup>262</sup> and against exploitative abuses <sup>263</sup>. Furthermore, some unfair commercial practices, such as up-front payments imposed on suppliers by retailers may fall within the prohibition set forth in Art. 102 (d) TFEU, which states that abuses such as: <<making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.>>, are prohibited.

However, Art.102 TFEU, by its very definition, only addresses situations of significant market power, the requirement for its application being that the undertaking responsible for the abuse holds a dominant position in the market. According to the case law of the Court of Justice of the European Union, market dominance, as required in Art. 102 TFEU, is generally defined as the: <<position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of consumers<sup>264</sup>>>. This

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<sup>262</sup> As mentioned in the previous chapter, unfair trading practices are likely to have a negative effect on cross-country trade, contributing to the partitioning of the European Single Market. For more details see Chapter 3.3.

<sup>263</sup> EUROPEAN COMMISSION, *Study on the Legal Framework Covering Business-To-Business Unfair Trading Practices in the Retail Supply Chain*, DG MARKT/2012/049/E, Brussels, 26 February 2014, pp. 1-468.

<sup>264</sup> Case C-85/76 *Hoffmann-La Roche v Commission* [1979] ECR 461, paragraph 38, and Case C-280/08 P *Deutsche Telekom v Commission* [2010] ECR I-0000, paragraph 170, and Case C-52/09 *Konkurrensverket v TeliaSonera Sverige AB* [2011] ECR I-527, para. 23.

definition suggests that dominance is assessed in relation to all competitors on the market, referring then to a situation of absolute dominance<sup>265</sup>.

Yet, in the context of the European retail market, such absolute market dominance is virtually impossible to establish in practice. In fact, as stressed in the previous chapters, the large majority of European retailers are in a position of superior bargaining power and contractual strength vis à vis the suppliers but are not dominant on the market<sup>266</sup>. For this reason, Art. 102 TFEU can rarely address unfair trading practices in business to business relations in the food supply chain, as the abuse of superior bargaining power beneath the threshold of dominance falls outside its scope<sup>267</sup>. However, this does not entail that unfair practices imposed by an undertaking, which is not strictly dominant under competition law, but nonetheless has significant buyer power, are less harmful to competition<sup>268</sup>.

In the absence of dominance, certain unfair trading practices may fall under Art.101 TFEU, or Art. 2 of law 10.10.1990, n. 287 “Norme per la tutela della concorrenza e del mercato” as transposed into Italian national law, which, amongst other things, provides for protection against vertical agreements, i.e. between undertakings at different levels of the supply chain (such as suppliers and retailers), which restrict competition. However, this provision affords protection against restrictive vertical agreements, only covering those unfair trading practices which have actually been

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<sup>265</sup> J. GLÖCKNER, *Unfair Trading Practices in the Supply Chain and The Co-Ordination of European Contract, Competition and Unfair Competition Law in their Reaction to Disparities in Bargaining Power*, in *Journal of Intellectual Property Law & Practice*, Vol. 12, No. 5, 2017, pp. 416-434.

<sup>266</sup> EUROPEAN COMMISSION, *Report from the Commission to the European Parliament and the Council on Unfair Business-To-Business Trading Practices in the Food Supply Chain*, COM(2016) 32 final, 29 January 2016, pp.1-13.

<sup>267</sup> J. GLÖCKNER, *Unfair Trading Practices in the Supply Chain and The Co-Ordination of European Contract, Competition and Unfair Competition Law in their Reaction to Disparities in Bargaining Power*, in *Journal of Intellectual Property Law & Practice*, Vol. 12, No. 5, 2017, pp. 416-434.

<sup>268</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp.1-213.

agreed upon between the parties, with unilateral conducts falling outside its scope<sup>269</sup>. In addition: <<the exposure of inferior contracting parties to unfavorable contractual obligations as such is not an issue under Art. 101 TFEU<sup>270</sup>.>>.

Furthermore, another limitation to the practical applicability of this provision to unfair commercial conducts, lies in the fact that this applies only to agreements which do not fall under the Vertical Block Exemption Regulation<sup>271</sup>. This regulation exempts certain vertical agreements from the application of general EU competition law, in particular Art.101 TFEU, when each of the parties' market share is below 30%, and no hardcore restrictions to competition are provided in the agreement. As mentioned before, most undertakings active in the food sector, be it suppliers or distributors, rarely reach dominant positions nor high market shares, and such agreements rarely contain hardcore restrictions<sup>272</sup>. Therefore, most vertical agreements between actors of the food supply chain benefit from this exemption, escaping scrutiny under competition law<sup>273</sup>.

Lastly, unfair trading practices often don't even fall under the scope of competition laws, since, as Glöckner explains: <<The simple exercise of economic pressure in an upstream or downstream vertical relationship is not caught by the requirement of any

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<sup>269</sup> *Ibid.*

<sup>270</sup> J. GLÖCKNER,, *Unfair Trading Practices in the Supply Chain and The Co-Ordination of European Contract, Competition and Unfair Competition Law in their Reaction to Disparities in Bargaining Power*, in *Journal of Intellectual Property Law & Practice*, Vol. 12, No. 5, 2017, p. 418.

<sup>271</sup> Commission Regulation No 330/2010/EU of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices (OJ L102, 23.4.2010).

<sup>272</sup> The Vertical Block Exemption Regulation classifies as hardcore restrictions for example clauses which provide for resale price maintenance or territorial restrictions. For further details see: MOTTA M., REY P., VERBOVEN F., VETTAS N., *Hardcore Restrictions Under the Block Exemption Regulation on Vertical Agreements: An Economic View*, note for European Competition - DG Competition– Vertical Restraints Subgroup, September 2009, pp. 1-6.

<sup>273</sup> I. ANCHUSTEGUI, *Buyer Power in Agreements and Abuse of Market Power Cases: An Overview of EU and National Case Law*, in *Concurrences e-Competitions Bulletin Buyer power in agreements and abuse of market power*, 19 April 2018, pp.1-14.

restraint of competition<sup>274</sup>,>>. In fact, because such conducts appear (in the short run) to be harmful only for producers and not for consumers, they are frequently considered as not damaging to competition, therefore not falling within the scope of competition law<sup>275</sup>. However, this presumption is to be reconsidered, since, as discussed in the previous chapter, in the long run, unfair trading practices are capable of having negative effects on competition, distorting the functioning of the food supply chain and ultimately resulting in reduced choice and higher prices for consumers.

Therefore, in order to tackle competition distortions produced by the exercise of buyer power, competition rules are not as adequate and as effective as specific unfair trading rules, in particular given the fact that dominance is the prerequisite in order to investigate unilateral conducts under competition law<sup>276</sup>. Specific regulations on unfair trading practices are instead more fitted for the job, prohibiting specific unfair practices and contractual clauses and regulating the contractual relationships between suppliers and buyers, regardless of how competition could possibly be affected.

### 4.3. NATIONAL LEGISLATIONS ON UNFAIR TRADING PRACTICES IN MEMBER STATES

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<sup>274</sup> J. GLÖCKNER, *Unfair Trading Practices in the Supply Chain and The Co-Ordination of European Contract, Competition and Unfair Competition Law in their Reaction to Disparities in Bargaining Power*, in *Journal of Intellectual Property Law & Practice*, Vol. 12, No. 5, 2017, p. 418.

<sup>275</sup> EUROPEAN COMPETITION NETWORK, *Report on Competition Law Enforcement and Market Monitoring Activities by European Competition Authorities in the Food Sector*, May 2012, pp.116-120.

<sup>276</sup> Dehdashti maintains a slightly different position, arguing that EU Competition law is a “reliable and efficient legal basis for tackling various types of B2B UTPs”. For a detailed analysis on which UTPs are caught within the scope of EU competition law as well as the relevant EU competition cases on UTPs see: S. DEHDASHTI, *B2B Unfair Trade Practices and EU Competition Law*, in *European Competition Journal*, 8 September 2018, pp. 1-37.

As mentioned in the previous chapter, inquiries and surveys on the functioning of the food supply chain have been carried out by National Competition Authorities from various Member States, such as Italy, The Czech Republic, Spain, the UK, France, Germany, Bulgaria, the Czech Republic, Finland, Ireland, Lithuania, Poland and Romania<sup>277</sup>. The results of these surveys highlighted how unfair commercial practices have found to be quite commonly employed in business to business relationships along the food supply chain and have been identified as a problematic aspect in the sector<sup>278</sup>.

These investigations have prompted many National Competition Authorities, as well as Member States' legislators, to propose alternative solutions to counteract unfair commercial practices, as the traditional antitrust approach, where unfair practices are tackled with the provisions of competition law, has, in many cases, proven to be ineffective. In fact, in recent years, most Member States have taken action in order to protect suppliers from unfair commercial practices, in a variety of different ways, ranging from adopting specific regulation to implementing codes of conducts or voluntary self-regulatory systems<sup>279</sup>.

To this day, 20 Member States have so far adopted regulation on unfair trading practices in business to business relationships, other 4 Member States have a legislation which is very limited in scope, i.e. Belgium, Denmark, Finland and Sweden,

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<sup>277</sup> EUROPEAN COMMISSION, *Green Paper on Unfair Trading Practices in The Business-To-Business Food and Non-Food Supply Chain in Europe*, COM(2013) 37 final, Brussels, 31 January 2013, pp.1-22.

<sup>278</sup> EUROPEAN COMPETITION NETWORK, *Report on Competition Law Enforcement and Market Monitoring Activities by European Competition Authorities in the Food Sector*, May 2012, pp.116-120.

<sup>279</sup> EUROPEAN COMMISSION, *Study on the Legal Framework Covering Business-To-Business Unfair Trading Practices in the Retail Supply Chain*, DG MARKT/2012/049/E, Brussels, 26 February 2014, pp. 1-468.

and only 4 Member States, i.e. The Netherlands, Malta, Luxembourg and Estonia still do not have any legislation in place<sup>280</sup>.

However, whilst most Member States have national frameworks specifically addressing unfair practices, these regulations differ significantly in scope, from one country to another. For example, some Member States, such as the United Kingdom<sup>281</sup>, Portugal, Spain, Belgium and Slovenia, have opted for codes of conduct that apply to unfair trading practices in the retail sector, or in the retail supply chain in particular. Others, like Italy<sup>282</sup>, the Czech Republic and Hungary, have opted for legislation that tackles unfair commercial practices in the whole agro-food sector<sup>283</sup>.

On the contrary, countries such as France and Germany, have adopted law provisions on the abuse of economic dependence, through which unfair commercial practices in business to business relations are tackled, irrespective of the sector in which they occur<sup>284</sup>. In France in fact, the discipline of the abuse of economic dependence is provided by a disposition of the commercial code (Art. L420-2 du Code de Commerce), which can be considered as a provision of competition law on the abuse of dominant position. Similarly, in Germany the provision used to address the issue is the one on

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<sup>280</sup> EUROPEAN COMMISSION, *Report from the Commission to the European Parliament and the Council on Unfair Business-To-Business Trading Practices in the Food Supply Chain*, COM(2016) 32, Brussels, 29 January 2016, pp.1-13.

<sup>281</sup> In February 2010 the UK adopted a new Groceries Supply Code of Practices (GSCOP), which regulates relations between retailers and suppliers, identifying a series of damaging practices employed by large retailers which are prohibited, for example retroactive modifications to supply contracts. For more details see: EUROPEAN COMPETITION NETWORK, *Report on Competition Law Enforcement and Market Monitoring Activities by European Competition Authorities in the Food Sector*, Subgroup Food, May 2012, pp.116-120.

<sup>282</sup> The existent legal framework in Italy, to address unfair trading practices, will be discussed in further detail in the next paragraph. See Chapter 4.3.1.

<sup>283</sup> EUROPEAN COMMISSION, *Green Paper on Unfair Trading Practices in The Business-To-Business Food and Non-Food Supply Chain in Europe*, COM(2013) 37 final, Brussels, 31 January 2013, pp.1-22.

<sup>284</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp.1-213.



the abuse of economic dependence, contained in the Acts against Restraints of Competition (Art. 20 - Competition Act GWB).

Regarding the enforcement mechanisms for these rules on unfair trading practices, different Member States have adopted different approaches. Judicial redress is probably the most common amongst enforcement mechanisms, followed by enforcement from National Competition Authorities, which have been awarded a key role in many countries (such as Italy, Germany, Austria and Hungary for example) and administrative redress (such as in France)<sup>285</sup>. The powers conferred to the enforcement authorities vary depending on the Member State but are generally considered to be insufficient to tackle commercial practices due to the fear factor, which comes into play when suppliers refrain from taking action against larger buyers imposing unfair conditions, for fear of retaliation.

For this reason, the issue of confidentiality is crucial when considering the effectiveness and appropriateness of these enforcement mechanisms in the protection of the weaker party, although it is not always guaranteed. In those Member States which provide for judicial redress, for example, confidentiality is not provided for, as courts cannot accept anonymous complaints. Similarly, many National Competition Authorities (as the Italian one for example), cannot guarantee confidentiality throughout the whole process, discouraging small suppliers from taking action and drastically reducing the efficacy of the protection provided by national legislation<sup>286</sup>.

As shown in Figure 3<sup>287</sup>, overall, considering both the effectiveness of regulations and the strength of enforcement mechanisms, the Member States which provide for a

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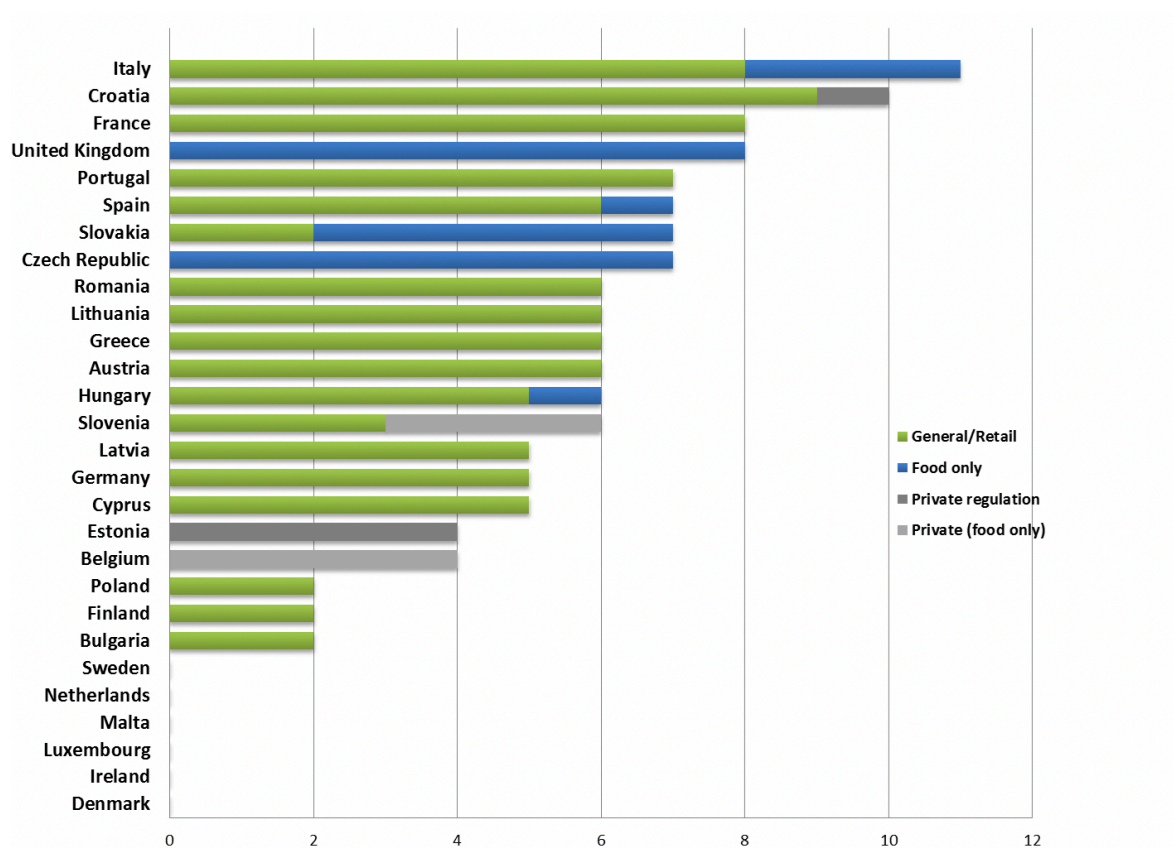
<sup>285</sup> EUROPEAN COMMISSION, *Green Paper on Unfair Trading Practices in The Business-To-Business Food and Non-Food Supply Chain in Europe*, COM(2013) 37 final, Brussels, 31 January 2013, pp.1-22.

<sup>286</sup> *Ibid.*

<sup>287</sup> EUROPEAN COMMISSION, *Study on the Legal Framework Covering Business-To-Business Unfair Trading Practices in the Retail Supply Chain*, DG MARKT/2012/049/E, Brussels, 26 February 2014, p.104.

stronger coverage of unfair trading practices are Italy, Croatia, France, and the United Kingdom<sup>288</sup>.

Figure 3<sup>289</sup>. Unfair trading practices that are covered by national, general or sector specific, regulation in Member States.



#### 4.3.1. LEGAL FRAMEWORK IN ITALY

As illustrated in the previous paragraph, Italy not only falls within the category of Member States which have adopted national legislation that covers unfair trading practices in business to business relations, but it is considered to be the one with the

<sup>288</sup> *Ibid.*

<sup>289</sup> *Ibid.*

highest coverage<sup>290</sup>. In fact, Italy features comprehensive legislation on unfair trading practices, which has, up until recently, mainly pertained to contract law and was not sector specific.

In particular, most unfair trading practices contained in the Commission's Green Paper<sup>291</sup> are directly covered by the discipline on the abuse of economic dependence, contained in Art. 9 of L. 18.06.1998, n. 192 ( L. 18 giugno 1998, n. 192, in materia di "Disciplina della subfornitura nelle attività produttive"), which generally targets vertical sub-supply relationships in productive activities, and which will be discussed in further detail in the next paragraph. Subsequently, after many attempts to find an agreement between the actors of the food supply chain to adopt a code of conduct and best practices, specific legislation was adopted in 2012<sup>292</sup>. Art. 62 of Law 24.3.2012, n° 27 (L. 24 marzo 2012, n. 27, in materia di "Disciplina delle relazioni commerciali in materia di cessione di prodotti agricoli e agroalimentari") regards business to business commercial transactions in the sector of cession of agricultural or agro-food products, therefore regulating vertical relations specifically along the food supply chain.

Furthermore, it is worth mentioning that in 2012 Italy has transposed Directive 2005/29<sup>293</sup>, concerning unfair commercial practices in business to consumer relations<sup>294</sup>, in Artt. 18-27 of the national consumer code (D.L. 6 settembre 2005, n. 206, "Codice del

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<sup>290</sup> EUROPEAN COMMISSION, *Study on the Legal Framework Covering Business-To-Business Unfair Trading Practices in the Retail Supply Chain*, DG MARKT/2012/049/E, Brussels, 26 February 2014, pp. 1-468.

<sup>291</sup> EUROPEAN COMMISSION, *Green Paper on Unfair Trading Practices in The Business-To-Business Food and Non-Food Supply Chain in Europe*, COM(2013) 37 final, Brussels, 31 January 2013, pp.1-22.

<sup>292</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp.1-213.

<sup>293</sup> Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market (OJ L 149, 11.6.2005).

<sup>294</sup> Directive 2005/29/EU on unfair commercial practices will not be discussed further as it falls outside the scope of this thesis. In fact, the scope of application of the Directive on unfair commercial practices is limited to business to consumer commercial practices and does not address unfair practices in business to business relations.

consumo”) extending its scope of application to include commercial relations between businesses and micro-enterprises<sup>295</sup>. Although the practices addressed by the Directive are mostly distant from those which characterize business to business relationships in the food supply chain (and therefore will not be analyzed further in this thesis), Artt. 18-27 of the national consumer code do provide for additional protection of weaker counterparts against certain unfair practices.

#### 4.3.1.1. Prohibition of Abuse of Economic Dependence

The discipline on the abuse of economic dependence, contained in Art. 9 of L. 192/1998 on industrial subcontracting, and entered into force on 20 October 1998, represented, up until 2012, the most common legal answer to the issue of unfair trading practices in vertical relationships in the food supply chain<sup>296</sup>. The article in question prohibits abuses from undertakings which are in a position of power towards a client or supplier undertaking, which is in a position of economic dependence from the former.

The scope of application of this provision has been quite controversial in Italy, although the majority of the doctrine support the view that Art. 9 of L. 192/1998 is applicable to any abuse of economic dependence in vertical business to business relations, notwithstanding the limit of industrial subcontracting. This theory is sustained also by the national Supreme Court (Corte di Cassazione<sup>297</sup>), which clarified that: <<L'abuso di dipendenza economica di cui all'art. 9 della legge n. 192 del 1998 configura una fattispecie di applicazione generale, che può prescindere dall'esistenza di uno specifico rapporto di subfornitura<sup>298</sup>>>.

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<sup>295</sup> EUROPEAN COMMISSION, *Study on the Legal Framework Covering Business-To-Business Unfair Trading Practices in the Retail Supply Chain*, DG MARKT/2012/049/E, Brussels, 26 February 2014, pp. 1-468.

<sup>296</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp.1-213.

<sup>297</sup> Cass., sez. un., n. 25 novembre 2011, n.24906, in *Il Foro*, 2012, parte I, col. 805.

<sup>298</sup> *Ibid.*

Art. 9 (1) provides for a legal definition of the concept of economic dependence, stating that: <<Si considera dipendenza economica la situazione in cui una impresa sia in grado di determinare, nei rapporti commerciali con un'altra impresa, un eccessivo squilibrio di diritti e di obblighi.>>. Consequently, a situation of economic dependence occurs when, in a commercial relation between two undertakings, one is capable of establishing an “excessive imbalance” (“eccessivo squilibrio”) regarding the rights and duties weighing on both parties. The client or supplier undertaking is then in a position of economic dependence when the duties and obligations imposed on it are disproportionate compared to the ones imposed on their counterpart. Furthermore, to assess economic dependency of a supplier from its buyer, Art. 9 also states that the supplier’s effective possibilities of finding a satisfactory alternative business partner on the market have to be considered.

Even though these two requirements have been set by the law, it is to be noted that an “excessive imbalance” in relations between undertakings is difficult to measure in absolute terms and to assess in practice. It is generally considered that the imbalance should be tangible and recognizable but does not necessarily have to imply the disappearance from the market of the weaker counterpart<sup>299</sup>. This difficulty in assessing the prerequisite for the application of the protection conferred by this provision has made such protection vastly ineffective in practice<sup>300</sup>.

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<sup>299</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp.1-213.

<sup>300</sup> EUROPEAN COMMISSION, *Study on the Legal Framework Covering Business-To-Business Unfair Trading Practices in the Retail Supply Chain*, Final Report, DG MARKT/2012/049/E, Brussels, 26 February 2014, pp. 1-468.

This provision, as mentioned before, covers most unfair trading practices listed in the Commission's Green Paper<sup>301</sup>. Art. 9 (2) in fact, specifies that the prohibited conducts, i.e. the abuses, can consist in refusals to deal, unjustified terminations of commercial relations and in unfair, disproportionate or discriminatory contractual conditions.

The enforcement of the prohibition contained in Art. 9 was originally assigned to the competence of ordinary courts, and subsequently extended to the National Competition Authority (Autorità Garante della Concorrenza e del Mercato) with the reform of the law operated by Art. 11 of L. 05.03.2001, n. 57 ( L. 5 marzo 2001, n. 57, in materia di "Disposizioni in materia di apertura e regolazione dei mercati"), which added the sub-paragraph (3-bis) to Art. 9 of L. 192/1998. Art. 9 (3-bis) then establishes that the Italian Competition Authority can investigate, initiate proceedings, both on complaints or ex officio, and prosecute abuses of economic dependence when these are relevant to the protection of markets and competition. Therefore, the Autorità Garante della Concorrenza e del Mercato may prosecute the abuse of economic dependence when it is carried out by a dominant undertaking (therefore treating it as a regular abuse of dominance case) or when it is relevant to the protection of markets and competition, even though the undertaking is not dominant<sup>302</sup>.

#### 4.3.1.2. Specific Legislation on the Agro-Food Sector

As previously mentioned, the legal coverage of unfair trading practices in business to business relationships in the food supply chain in Italy, significantly increased with the adoption of specific legislation in 2012. Art. 62 of L. 27/2012, concerning

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<sup>301</sup> EUROPEAN COMMISSION, *Green Paper on Unfair Trading Practices in The Business-To-Business Food and Non-Food Supply Chain in Europe*, COM(2013) 37 final, Brussels, 31 January 2013, p. 7.

<sup>302</sup> EUROPEAN COMMISSION, *Study on the Legal Framework Covering Business-To-Business Unfair Trading Practices in the Retail Supply Chain*, DG MARKT/2012/049/E, Brussels, 26 February 2014, pp. 1-468.

commercial business to business transactions in the field of cession of agricultural or agro-food products, was adopted specifically to address the growing tensions which characterize negotiations between the actors of the food supply chain in Italy, in particular between producers and distributors<sup>303</sup>.

Such provision disciplines contractual relations, exclusively pertaining to the agro-food sector, establishing precise obligations as regards to the form of the contracts employed and expressly prohibiting certain conducts deemed as unfair. Art. 62 (1) of L. 27/2012 states that all contracts concerning the supply of agricultural or food products should be compulsorily concluded in written form and should clearly state the duration of the contract, the quantity and characteristics of the sold products, the price and the payment and delivery methods. Furthermore, all contracts should generally be guided by the principles of transparency, fairness and proportionality. Sub-paragraph (3) of the same article also provides for the regulation of payments terms, establishing a maximum deadline of 30 days, from the last day of the month in which the receipt was given, for the payment of perishable products, and a deadline of 60 days for the payment of all other products.

The provision also prohibits certain unfair practices such as imposing retroactive or excessively burdensome contractual conditions on the counterpart, applying objectively different conditions to equivalent transactions and conditioning the conclusion of contracts to unilateral obligations which are not strictly connected to the transaction. The list is not close-ended since sub-paragraph (2) let. e) of the Article provides for the general prohibition of every other unfair commercial conduct.

As for the scope of application of such provision, Art. 62 of L. 27/2012 does not differentiate between business size, implying that the protection is afforded to both

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<sup>303</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp.1-213.

small and large undertakings<sup>304</sup>. Furthermore, Art. 62 was implemented by the Decree of the Ministry for farming, food and forestry policies 19.10.2012, n. 199 (D.M. del Ministero delle Politiche Agricole e Forestali 19 ottobre 2012 n. 199 in materia di “Attuazione dell'articolo 62 del D.L. 24 gennaio 2012, n. 1, convertito, con modificazioni, dalla Legge 24 marzo 2012, n. 27”), which specifies and limits the scope of application of Art. 62 of L. 27/2012. Such implementing decree establishes that Art. 62 applies to commercial transactions concerning the cession of agro-food products, whose delivery takes place on Italian territory, and also applies to supply contracts with retailer buying alliances.

Art. 4 of the implementing decree also integrates the prohibited conducts provided for in Art. 62 L. 27/2012, adding other four. The list of prohibitions is then further integrated by Art.4 (1) of D.M. 19.10.2012, n. 199, which states that: <<rientrano nella definizione di “condotta commerciale sleale” anche il mancato rispetto dei principi di buone prassi e le pratiche sleali identificate dalla Commissione europea e dai rappresentanti della filiera agroalimentare a livello comunitario nell’ambito del Forum di Alto livello per un migliore funzionamento della filiera alimentare<sup>305</sup> (High level Forum for a better functioning of the food supply chain), approvate in data 29 novembre 2011>>. Therefore, the good practices and unfair conducts identified by the European Commission and the High Level Forum for a better functioning food supply chain<sup>306</sup> have been integrated, and fall within, the general prohibition of unfair commercial conducts contained in lett. e) of Art. 62 (2) of L. 27/2012.

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<sup>304</sup> *Ibid.*

<sup>305</sup> B2B PLATFORM OF THE HIGH LEVEL FORUM FOR A BETTER FUNCTIONING FOOD SUPPLY CHAIN, *Vertical relationships in the Food Supply Chain: Principles of Good Practice*, 29 November 2011, pp.1-5.

<sup>306</sup> The good practices and the unfair commercial conducts identified by the European Commission, as well as the composition and functioning of the High Level Forum for a better functioning food supply chain will be discussed in further details in Chapter 4.4.



Most importantly, the implementing decree limits the scope of application of Art. 62 to those commercial relations in the food supply chain which are characterized by a “significant power imbalance” (“significativo squilibrio”) between the parties. In fact, Art. 1 (1) of the implementing decree states that Art. 62 applies: <<con particolare riferimento alle relazioni economiche tra gli operatori della filiera connotate da un significativo squilibrio nelle rispettive posizioni di forza commerciale.>>. This entails that the protection provided by Art. 62 does not apply to those vertical relationships which are not characterized by a significant power imbalance between the parties, so as to direct the protection towards those situations where there is a weaker party that needs protection<sup>307</sup>.

This limitation to the scope of application of Art. 62, provided by the implementing decree, establishes a direct connection between the discipline on commercial business to business transactions in the field of cession of agro-food products, set forth by Art 62 of L. 27/2012, and the discipline of abuse of economic dependence, set forth by Art. 9 of L. 192/1998. In fact, the two texts refer to similar concepts, respectively to a “significant power imbalance” (“significativo squilibrio”) and to an “excessive imbalance” (“eccessivo squilibrio”).

In the first case the emphasis is on the existent power imbalances between the parties of the commercial relationship, whilst in the second one, the emphasis is on the possibility for one undertaking to establish an excessive imbalance of rights and obligations within a commercial relation with another undertaking. In general, Art. 62 of L. 27/2012 specifies and integrates the discipline on economic dependence established by Art. 9 of L 192/1008, specifically for the food sector<sup>308</sup>.

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<sup>307</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No 31/2013, pp.1-213.

<sup>308</sup> *Ibid.*

The elements referred to above, allow for a harmonizing interpretation of the two aforementioned disciplines. Similarly to Art. 9 (3-bis) of L. 192/1998, Art. 62 (8) of L. 27/2012 empowers the Italian National Competition Authority, i.e. the Autorità Garante della Concorrenza e del Mercato, to enforce the discipline on commercial business to business transactions in the field of cession of agro-food products.

Therefore, there is a twofold competence shared between the ordinary courts, who are tasked with the enforcement of the provision in cases of private complaints, and the Autorità Garante della Concorrenza e del Mercato, which can initiate investigations, both on complaints or ex officio, and prosecute violations to such provision as administrative offences<sup>309</sup>. Therefore, under Art. 62 (8), the Italian Competition Authority can now act on behalf of an additional instrument, i.e. Art. 62, to investigate and prosecute unfair unilateral conducts which represent an abuse of bargaining power, but not necessarily an abuse of dominant position<sup>310</sup>.

Although this new discipline on commercial business to business transactions in the field of cession of agricultural or agro-food products provides for significant additional protection for suppliers against unfair practices enforced by retailers, there are some difficulties in its application which reduce the protection. For example, there is concern that the drafting requirements provided by the provision are very difficult to ensure, given the fast rate at which supply contract are negotiated, or that the provision is redacted in a too generic manner, making it difficult to implement it in

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<sup>309</sup> *Ibid.*

<sup>310</sup> The Italian Competition Authority first enforced Art. 62 of L. 27/2012 in a case concerning Coop, i.e. a major Italian retailer, Centrale Adriatica and Celox Trade, i.e. a supplier of pears. In December 2015 the Italian Competition Authority found a violation of Art. 62 L. 27/2012 and of Art. 4 of D.M. 199/2012 (the implementation decree) and fined both Coop and Centrale Adriatica. For further details see: AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, *Relazione Annuale sull'Attività Svolta: Articolo 62 - Relazioni commerciali in materia di cessione di prodotti agricoli e agroalimentari*, 31 March 2016, pp. 117-119.

practice<sup>311</sup>. Furthermore, the effectiveness of the protection afforded by the provision is further reduced by the fact that many suppliers are deterred from presenting complaints to the Italian Competition Authority due to the fact that the latter cannot accept confidential complaints (i.e. the aforementioned fear factor).

#### 4.3.2. WHY THE NEED FOR A HARMONIZING EUROPEAN FRAMEWORK ?

As mentioned in the previous paragraphs, the lack, until very recently, of an EU-wide framework and the consequent adoption of national legislations to protect weaker suppliers against stronger buyers enforcing unfair commercial conditions on them, led to a significant heterogeneity in the ways in which these were addressed. In fact, most Member State took actions to tackle such practices in the different ways, as discussed before, leading to significant disparities regarding the legal forms, the nature and the level of protection afforded against them.

This fragmentation of legal frameworks reduces legal certainty and predictability for the actors of the sector, therefore constituting an obstacle to cross-border trade between different Member States. In fact, suppliers may be deterred from engaging in activities in another Member State where the protection afforded against unfair commercial practices is radically different, and at times unclear.

This is aggravated by the fact that legislation on these practices is often reviewed and reformed, with significant modifications being quite frequent. Suppliers, especially when they are small or medium enterprises, often do not have the resources needed to follow such developments and identify their rights and legal remedies available in

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<sup>311</sup> EUROPEAN COMMISSION, *Study on the Legal Framework Covering Business-To-Business Unfair Trading Practices in the Retail Supply Chain*, DG MARKT/2012/049/E, Brussels, 26 February 2014, pp. 1-468.

each Member State they wish to trade with. Therefore, the different national approaches may result in the fragmentation of the Single Market<sup>312</sup>.

In addition, the divergence of national legislations impacts negatively also on the effectiveness of the enforcement mechanisms provided by each Member State. These are often deemed insufficient and do not provide adequate protection, due, in particular, to the lack of confidentiality and impossibility to file anonymous complaints. The absence of a European framework or coordination system further weakens the practical protection of suppliers from unfair trading practices<sup>313</sup>.

In fact, the scarce coordination between Member States' enforcement authorities aggravates the so-called fear factor, by which suppliers rarely file formal complaints for fear of commercial retaliation from larger retailers, or direct termination of their supply contracts. In fact, the European Commission's Green Paper estimates that: <<87% of suppliers take no action beyond a discussion with their customer. Almost two thirds (65 %) of these take no action due to fear of retaliation and 50% doubt the effectiveness of public remedies<sup>314</sup>>>.

The new aforementioned European Directive on unfair trading practices in business to business relationships in the agricultural and food supply chain, which will be analyzed in detail in the following paragraphs, seeks to address and find a solution to the aforementioned issues, in order to drastically raise the level of protection for the weaker counterpart in negotiations in the food supply chain.

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<sup>312</sup> EUROPEAN COMMISSION, *Green Paper on Unfair Trading Practices in The Business-To-Business Food and Non-Food Supply Chain in Europe*, COM(2013) 37 final, Brussels, 31 January 2013, pp.1-22.

<sup>313</sup> *Ibid.*

<sup>314</sup> EUROPEAN COMMISSION, *Green Paper on Unfair Trading Practices in The Business-To-Business Food and Non-Food Supply Chain in Europe*, COM(2013) 37 final, Brussels, 31 January 2013, p. 7.

#### 4.4. EUROPEAN UNION RULES ON UNFAIR TRADING PRACTICES

So far, as mentioned in the previous paragraph, the issue of unfair trading practices has mostly been dealt with at national level, contributing to the fragmentation of the Single Market and the divergence between different Member States' legislations. The persistent power imbalances between suppliers and buyers in the food supply chain, and the need to harmonize national approaches, have attracted attention also at EU level<sup>315</sup>.

With the goal to ultimately create a common legal framework to tackle unfair trading practices and harmonize national legislations and practices, reducing the burden faced by the players in the supply chain, unfair trading practices in business to business relations were discussed for the first time at EU level in 2009<sup>316</sup>. Since then, the European Commission has published several papers and reports on the results of its studies on the functioning of the food supply chain in Europe and the occurrence of unfair trading practices and their distortive effects.

In 2009 the Commission adopted a Communication on a Better Functioning Food Supply Chain in Europe<sup>317</sup>, where it acknowledged the serious impact of unfair trading practices, which result from an imbalance in the parties' bargaining power in negotiations. The Communication highlighted how contractual imbalances deteriorate relationships between the actors of the food supply chain, and how: <<In the longer run, a better functioning food supply chain is crucial for consumers and for ensuring

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<sup>315</sup> T. BJORKROTH, *Joint Purchasing Agreements in the Food Supply Chain: Who's in the Sheep's Clothing?*, *European Competition Journal*, 9:1, 2013, pp. 175-198.

<sup>316</sup> EUROPEAN COMMISSION, *Green Paper on Unfair Trading Practices in The Business-To-Business Food and Non-Food Supply Chain in Europe*, COM(2013) 37 final, Brussels, 31 January 2013, pp.1-22.

<sup>317</sup> EUROPEAN COMMISSION, *A Better Functioning Food Supply Chain In Europe*, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, COM(2009) 591, 28 October 2009, pp.1-13.

a sustainable distribution of value added along the chain, thus contributing towards raising its overall competitiveness<sup>318</sup>.>>.

This Communication led the European Commission to establish, in 2010, a High Level Forum for a Better Functioning Food Supply Chain<sup>319</sup>, as well as an Expert Platform, within the Forum, specifically dedicated to the issue of business to business contractual practices<sup>320</sup>. The Forum was composed of representatives of the Member States, representatives of the private sector, i.e. companies active in the food sector, as well as organizations and associations which are active in the food supply chain across Europe<sup>321</sup>. The aim of the Forum was to identify the issues capable of distorting competition in the European food supply chain, and to issue recommendations, addressed both to public institutions and private actors, on how to tackle them<sup>322</sup>. Furthermore, the Expert Platform advised the Commission on the development of policies in the food sector<sup>323</sup>.

In 2013 the Forum supported the launch of the Supply Chain Initiative, i.e. a voluntary code of conduct aimed at establishing good practices which would increase fairness in relations between the actors of the food supply chain, also increasing the

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<sup>318</sup> EUROPEAN COMMISSION, *A Better Functioning Food Supply Chain In Europe*, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, COM(2009) 591, 28 October 2009, p. 2.

<sup>319</sup> Commission Decision 2010/C 210/03 establishing the High Level Forum for a Better Functioning Food Supply Chain.

<sup>320</sup> EUROPEAN COMMISSION, *Study on the Legal Framework Covering Business-To-Business Unfair Trading Practices in the Retail Supply Chain*, DG MARKT/2012/049/E, Brussels, 26 February 2014, pp. 1-468.

<sup>321</sup> EUROPEAN COMMISSION, *Forum for a Better Functioning Food Supply Chain*, in [www.ec.europa.eu](http://www.ec.europa.eu), Available at: [https://ec.europa.eu/growth/sectors/food/competitiveness/supply-chain-forum\\_en](https://ec.europa.eu/growth/sectors/food/competitiveness/supply-chain-forum_en) (accessed on 06 May 2019).

<sup>322</sup> The High Level Forum for a Better Functioning Food Supply Chain was established to replace the High Level Group on the Competitiveness of the Agro-Food Industry. The four year mandate terminated in 2014, although on 1 June 2015 a new Commission decision provided for a new mandate, from 2015 to 2019. See: Commission Decision 2015/C 179/03 establishing the High Level Forum for a better functioning food supply chain.

<sup>323</sup> EUROPEAN COMMISSION, *Green Paper on Unfair Trading Practices in The Business-To-Business Food and Non-Food Supply Chain in Europe*, COM(2013) 37 final, Brussels, 31 January 2013, pp.1-22.

competitiveness of the sector<sup>324</sup>. This Initiative was based on a document, agreed upon by organizations representing the European food sector, which contained examples of unfair trading practices as well as principles and good practices to implement in commercial relations along the food chain<sup>325</sup>. The Supply Chain Initiative had been welcomed as an important voluntary mechanism to counteract unfair commercial practices, although its limitations were significant. For example, no penalties are provided for non-compliance and no mechanism to file complaints anonymously or confidentially is available either, making it rather a weak tool to tackle unfair trading practices in an effective manner<sup>326</sup>.

Subsequently, in 2014, another Communication<sup>327</sup> was adopted by the European Commission, this time specifically focusing on unfair trading practices occurring in business to business relationships, their impact on small and medium enterprises and their negative effects on the producers' financial viability and ability to organize business.

In 2015, the debate on unfair trading practices intensified, as farmers all over Europe faced significant difficulties due to the fall in prices of agricultural products. Although the fall in prices was not caused by the contractual imbalances, it made producers and farmers weaker and more vulnerable to unfair conditions being imposed on them by their contractual counterparts. The European Commission then took steps to analyze the national legislative framework and enforcement processes in place in the Member

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<sup>324</sup> For more details on the EU Supply Chain Initiative see: I. ANCHUSTEGUI, *Buyer Power in EU Competition Law*, Concurrences - Institute of Competition Law, Paris, October 2017, pp. 450-451.

<sup>325</sup> B2B PLATFORM OF THE HIGH LEVEL FORUM FOR A BETTER FUNCTIONING FOOD SUPPLY CHAIN, *Vertical relationships in the Food Supply Chain: Principles of Good Practice*, 29 November 2011, pp.1-5.

<sup>326</sup> European Parliament, Resolution on Unfair Trading Practices in the Food Supply Chain, 2015/2065(INI), 7 June 2016.

<sup>327</sup> EUROPEAN COMMISSION, *Tackling Unfair Trading Practices in The Business-To-Business Food Supply Chain*, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, COM(2014) 472, Brussels, 15 July 2014, pp.1-14.

States to tackle such practices, publishing the results of the study in the Report on Unfair Business-To-Business Trading Practices in the Food Supply Chain<sup>328</sup>, in 2016, which also contained recommendations for the improvement of the effectiveness of national measures.

Despite the aforementioned sector studies, reports and documents (issued by the European Commission as well as associations and organizations active in the sector), and the efforts to construe a series of recommendations and good practices to improve the fairness of commercial relations between suppliers and retailers, in 2016 there was still no EU wide legislation specifically targeting unfair trading practices occurring in the food supply chain<sup>329</sup>.

The need for a European legislative framework, as the most effective manner to counteract unfair commercial practices, was at that time very clear, to the point that also the European Parliament pronounced itself in favor of such legislation. In fact, in its resolution of 7 June 2016, the European Parliament appealed to the Commission to submit a proposal for an EU wide framework, in order to: <<ensure that European farmers and consumers have the opportunity to benefit from fair selling and buying conditions<sup>330</sup>>>. The European parliament also highlighted how competition law covered unfair trading practices in the food sector only in part, and how the European framework should take into account the different national approaches and must not lower the protection afforded by them.

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<sup>328</sup> EUROPEAN COMMISSION, *Report from the Commission to the European Parliament and the Council on Unfair Business-To-Business Trading Practices in the Food Supply Chain*, COM(2016) 32, Brussels, 29 January 2016, pp.1-13.

<sup>329</sup> Even though the Common Agricultural Policy (CAP) did establish some EU wide rules regarding certain parts of the food sector, which aim at strengthening the position of suppliers in relations with distributors, reducing the imbalance in their bargaining power, for example by supporting the creation of Producer Organizations, or by providing the possibility of requiring written contracts to be compulsory in certain sectors (i.e. milk for example). For more details see: *Ibid*.

<sup>330</sup> European Parliament, Resolution on Unfair Trading Practices in the Food Supply Chain, 2015/2065(INI), 7 June 2016.



In addition, following the publication of the Report on Improving Market Outcomes<sup>331</sup> by the Agricultural Markets Task Force set up within the Commission, the Council of the European Union adopted conclusions, in 2016, on strengthening the position of farmers in the food supply chain and tackling unfair trading practices<sup>332</sup>. In its conclusions, the Council called on the Commission to undertake an impact assessment in order for it to propose a European legislative framework on unfair trading practices, highlighting the importance of an EU-wide uniform and homogeneous regulatory approach to the issue<sup>333</sup>.

Consequently, in April 2018, the European Commission presented a proposal for a Directive on Unfair Trading Practices in Business to Business Relationships in the Food Supply Chain<sup>334</sup>, with the purpose to ensure a minimum level of harmonization across the EU. The proposal introduced an outright prohibition of clearly inefficient and unfair trading practices and maintained the possibility for retailers and their suppliers to agree on most terms, particularly rebates, differentiating unfair conducts based on their gravity.

Following the aforementioned Commission's proposal, the Council and the European Parliament agreed their negotiation positions on the proposal, respectively on 1 October 2018 and on 25 October 2018, and an informal agreement between the two co-legislators was reached on 19 December 2018. Directive 2019/633 on Unfair Trading Practices in Business-to-Business Relationships in the Agricultural and Food Supply

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<sup>331</sup> AGRICULTURAL MARKET TASK FORCE, *Improving Market Outcomes: Enhancing the Position of Farmers in the Supply Chain*, Report for the European Commission, Brussels, 14 November 2016, pp.1-73.

<sup>332</sup> Council of the European Union Conclusions on strengthening farmers' position in the food supply chain and tackling unfair trading practices, 15508/16, 16 December 2016, pp.1-7.

<sup>333</sup> *Ibid.*

<sup>334</sup> European Commission's proposal for a directive of the European Parliament and of the Council on unfair trading practices in business-to-business relationships in the food supply chain, COM(2018) 173 final, 12 April 2018.

Chain<sup>335</sup>, as resulted from the compromise between the European Parliament and the Council, was formally endorsed by the former on 12 March 2019, and by the latter on 9 April 2019<sup>336</sup>. The text of the new Directive was published in the Official Journal of the European Union on 25 April 2019, entering into force on the fifth day following the publication<sup>337</sup>.

#### 4.4.1. DIRECTIVE 2019/633 ON UNFAIR TRADING PRACTICES IN BUSINESS-TO-BUSINESS RELATIONSHIPS IN THE AGRICULTURAL AND FOOD SUPPLY CHAIN

The new Directive acknowledges, as fundamental principle, that the suppliers' economic dependence from buyers, which corresponds to a bargaining power imbalance, is very frequent in the agricultural and food supply chain, and that this phenomenon facilitates the occurrence of unfair trading practices in negotiations between the actors of the chain. In these circumstances, the larger actors, which frequently correspond to the buyers, i.e. the retailers, are likely to impose on their weaker counterparts, i.e. the suppliers, unfair trading conditions, due to the latter's weaker bargaining power.

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<sup>335</sup> Directive 2019/633/EU of The European Parliament and of the Council of 17 April 2019 on unfair trading practices in business-to-business relationships in the agricultural and food supply chain (OJ L111, 25.04.2019).

<sup>336</sup> COUNCIL OF THE EUROPEAN UNION, *Tackling unfair trading practices in the agricultural and food supply chain*, in [www.consilium.europa.eu](http://www.consilium.europa.eu), 09 April 2019. Available at: <https://www.consilium.europa.eu/en/press/press-releases/2019/04/09/tackling-unfair-trading-practices-in-the-agricultural-and-food-supply-chain/>, (accessed 06 May 2019).

<sup>337</sup> For simplicity reasons, Directive 2019/633 on Unfair Trading Practices in Business-to-Business Relationships in the Agricultural and Food Supply Chain will, from now on, simply be referred to as the 'Directive'.

The Directive also recognizes the likelihood that such unfair practices have a negative impact on competition in the food supply chain, as well as negative effects on the living standards of the producers, in particular the agricultural community<sup>338</sup>. Therefore, the aim of the Directive is to create an EU-wide minimum standard of protection for the weaker players against such unfair commercial practices, to reduce their manifestation<sup>339</sup>.

Article 1 provides for the subject matter of the Directive, taking over the definition of unfair trading practices from the European Commission's Green Paper<sup>340</sup>, and establishes the scope of application of the Directive. The protection afforded by the Directive is aimed at: <<agricultural producers and natural or legal persons that supply agricultural and food products, including producer organisations, whether recognised or not, and associations of producer organisations, whether recognised or not, subject to their relative bargaining power<sup>341</sup>.>>.

#### 4.4.1.1. The Dynamic Approach

Furthermore, in order to direct the protection towards the most vulnerable subjects of the supply chain, who need it the most, the new rules adopt a dynamic approach,

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<sup>338</sup> Directive 2019/633/EU of The European Parliament and of the Council of 17 April 2019 on unfair trading practices in business-to-business relationships in the agricultural and food supply chain (OJ L111, 25.04.2019).

<sup>339</sup> The Directive only applies to commercial agreements between businesses, not to relations between businesses and consumers. However, it does cover commercial agreements between businesses and public authorities, whenever the latter are acting as buyers.

<sup>340</sup> Unfair trading practices are defined as: << practices that grossly deviate from good commercial conduct, that are contrary to good faith and fair dealing and that are unilaterally imposed by one trading partner on another.>>.

See: EUROPEAN COMMISSION, *Green Paper on Unfair Trading Practices in The Business-To-Business Food and Non-Food Supply Chain in Europe*, COM(2013) 37 final, Brussels, 31 January 2013, p.3.

<sup>341</sup> Directive 2019/633/EU of The European Parliament and of the Council of 17 April 2019 on unfair trading practices in business-to-business relationships in the agricultural and food supply chain (OJ L111, 25.04.2019, p.60).

which aims to cover micro, small and medium-sized enterprises (SMEs), as well as all larger ones, on the condition that their annual turnover does not exceed €350 million<sup>342</sup>. The underlying principle of such dynamic approach is that smaller suppliers are protected from unfair trading practices imposed on them by buyers, only if the latter are larger than the suppliers, in terms of annual turnover. In practice, this entails for example that sellers which constitute small and medium enterprises, with a turnover of less than €350 million, will be protected against buyers which are larger than an SME and have an annual turnover which exceeds the aforementioned threshold, but will not be protected against unfair trading practices imposed on them by a buyer which is a micro enterprise and has a lower turnover.

More specifically, the Directive provides five categories of subjects based on the relative turnover of suppliers and buyers, as it considers that the annual turnover is an accurate way of estimating the relative bargaining power between the parties, as well as guaranteeing predictability with regards to the relevant category each supplier and buyer may fall into. The upper limit of €350 million<sup>343</sup>, over which the supplier whose annual turnover is higher does not fall under the protection afforded by the Directive in question, has been established in order to prevent that entities which are not as vulnerable to unfair trading practices as their competitors may benefit from the Directive as well.

Article 1 of the Directive also specifies that these rules are applicable to situations where either one, or both, of the parties are established in the European Union. This is

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<sup>342</sup> COUNCIL OF THE EUROPEAN UNION, *Tackling Unfair Trading Practices in the Agricultural and Food Supply Chain*, in [www.consilium.europa.eu](http://www.consilium.europa.eu), 09 April 2019. Available at: <https://www.consilium.europa.eu/en/press/press-releases/2019/04/09/tackling-unfair-trading-practices-in-the-agricultural-and-food-supply-chain/>, (accessed 06 May 2019).

<sup>343</sup> In order to better understand the upper limit that has been imposed, it is to be considered that a large number of producer organizations and farmer cooperatives are of considerable size, often larger than SMEs, although their annual turnover is not higher than €350 million.

to say, if the agricultural or food products are sold into European Union territory, suppliers are afforded the protection provided by the Directive. So, EU established suppliers are protected against non-EU established retailers, and non-EU established suppliers are protected when selling their products to an EU established buyer. This provision was added as an effort to counteract the possible downsides that would otherwise have manifested, such as enterprises choosing their location of establishment on the basis of the applicable rules, choosing non-EU countries, or EU retailers choosing non-protected non-EU suppliers as their trading partners.

#### 4.4.1.2. Definition of Terms

Article 2 goes on to provide definitions to some of the main terms used in the Directive, such as supplier and buyer for example. For the purpose of the Directive, a supplier is << any agricultural producer or any natural or legal person, irrespective of their place of establishment, who sells agricultural and food products<sup>344</sup>>>, and this does not only include single entities, but also groups of agricultural producers, producer organizations or associations of suppliers, which, as long as they trade agricultural and food products, are also protected by the Directive. The same applies for the definition of buyer, which subsumes also group of buyers, such as retailers' buying alliances, as long as they purchase agricultural and food products, and also producer organizations, when they buy food products from their farmer members.

#### 4.4.1.3. Black and Grey Practices

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<sup>344</sup> Directive 2019/633/EU of The European Parliament and of the Council of 17 April 2019 on unfair trading practices in business-to-business relationships in the agricultural and food supply chain (OJ L111, 25.04.2019, p.66).

Regarding the prohibited conducts, the Directive does not ban unfair trading practices in general, banning instead 16 conducts that were identified as the most damaging, distinguishing between “black” and “grey” practices. The black unfair trading practices are considered manifestly unfair by nature and are not submitted to the parties’ contractual will, being banned no matter the circumstances. Grey practices, instead, are allowed only if the buyer and the supplier agree to them beforehand in a clear and unambiguous manner, in order to ensure transparency and legal predictability for the parties.

Conducts such as late payments, short notice cancellations, retroactive or unilateral contract changes, commercial retaliation against suppliers, transfer of the economic risk of loss or deterioration of products on the supplier, requests for payments not related to specific transactions, refusal of written confirmation, misuse of trade secrets and transferring the cost of examining customer complaints to the suppliers, all fall under the black list category and are completely prohibited under Article 3.

In particular, the Directive provides that payments for perishable products should be made within 30 days after the end of the agreed delivery date, where a product is considered to be perishable <<if it can be expected to become unfit for sale within 30 days from the last act of harvesting, production or processing by the supplier, regardless of whether the product is further processed after sale, and regardless of whether the product is handled after sale in accordance with other rules, in particular food safety rules<sup>345</sup>>>. For non-perishable products, the payment of products should instead be made within 60 days of the agreed delivery date, in order to protect the supplier’s economic viability.

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<sup>345</sup> Directive 2019/633/EU of The European Parliament and of the Council of 17 April 2019 on unfair trading practices in business-to-business relationships in the agricultural and food supply chain (OJ L111, 25.04.2019, p.61).

The same principle applies for short notice cancellations, which are, according to Article 3, forbidden if they are made less than 30 days in advance for perishable products, as the supplier would not have a reasonable amount of time at disposal to seek new buyers for those products. However, the provision states that Member States may, in some cases, provide for shorter minimum notice periods for cancellation, when there is a justified cause for it.

Regarding the prohibition of the buyers' refusal to provide written confirmation of the contractual terms agreed with the supplier, it has been inserted amongst the black practices in the effort to increase the level of legal certainty for the suppliers, avoiding certain ex post unfair practices. Although there is no obligation for supply contracts between the parties to be in written form, producers, or their organizations, should be able to ask for the confirmation in written form of what has been agreed in other forms.

Furthermore, the commercial retaliation towards a supplier which has filed a complaint against unfair trading practices being implemented against him, is clearly forbidden by the Directive. This aims at eliminating the fear factor, which is one of the main reasons why suppliers rarely file formal complaints or address the issue with enforcement authorities. Retailers are then banned from delisting the producer's products, reducing the quantities purchased or halting promotional or marketing activities on their products, as retaliation.

Article 3 also provides for 6 grey practices, which are allowed under the condition that they are clearly agreed upon ex ante between the parties. Conducts that fall within the grey practices list are the return, without payment, of unsold products to the supplier, the request, by retailers to suppliers, for payments for stocking, listing, display, promotions, marketing, advertising and for the fitting out of the retailer's new premises. Where these payments, which may be listing fees, slotting fees etc., have been agreed in a clear and unambiguous manner, they should still be based on

objective and reasonable estimates, to comply with the provision and escape prohibition.

#### 4.4.1.4. Enforcement of the Rules

In order to ensure the effective enforcement of the rules envisaged by the Directive, Article 4, 5 and 6 lay down the framework of the enforcement mechanism for the prohibitions contained. Each Member State should designate an authority<sup>346</sup> which is responsible for enforcing the prohibitions and receiving the complaints by the parties. Suppliers can either choose to file complaints to the authority of the Member State where they are established, which may be easier for language reasons for example, or alternatively to file the complaint to the authority of the Member State where the buyer is established.

Particular attention has been put on the fear factor and the issue of possible commercial retaliations being carried out by the retailers against the suppliers which file complaints. Therefore Article 5 provides that enforcement authorities should adopt every necessary measure to effectively protect the supplier's identity or any other confidential information, and it has been ensured that producer organizations or suppliers' associations may file complaints on behalf of their members, helping with the protection of their single identity. In addition, Article 6 stipulates that enforcement authorities may initiate investigations not only on the basis of complaints, even anonymous ones, but also by their own initiative<sup>347</sup>.

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<sup>346</sup> Article 4 states that each Member State can alternatively select multiple authorities as enforcement authorities but has to designate a single contact point for cooperation with the Commission and other national authorities.

<sup>347</sup> The Directive also provides, under Article 7 that Member States may promote the use of voluntary independent dispute resolution mechanism.



In order for the protection to be effective, national enforcement authorities must have the necessary expertise and resources carry out investigations, also through on-site inspections if needed, publish the results and enforce adequate penalties, usually fines, or order the termination of the prohibited unfair conduct. In addition, the Directive provides for national enforcement authorities to cooperate, sharing information and with mutual assistance, between them and with the Commission, exchanging best practices and developments in order to reach a level of integration and a common approach that would benefit the end goal of combating unfair trading practices, especially in cross-border cases.

A significant aspect of this Directive is that it establishes a minimum standard of protection, which aims at harmonizing the different national legislations of Member States. In fact, the Directive follows a minimum harmonization approach, by which Member States are allowed, and encouraged, to adopt stricter rules, exceeding the protection afforded by it. Article 9 also states that Member States are allowed to maintain national legislation regarding unfair trading practices which do not fall under the scope of the Directive, such as those applicable to different sized entities for example.

The present Directive will have to be transposed into national law by all Member States within 24 months from the date of adoption, i.e. 1 May 2021, and will have to be applied by 1 November 2021<sup>348</sup>. In addition, Article 12 establishes that the implementation in Member States and the effectiveness of the aforementioned measures, as well as of the enforcement mechanism provided, shall be evaluated by the Commission by 1 November 2025.

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<sup>348</sup> According to Article 288 of the Treaty on the Functioning of the European Union (TFEU), which disciplines EU's secondary legal sources.

## 4.5. CONCLUSIONS ON THE EXISTENT LEGAL FRAMEWORK ON UNFAIR TRADING PRACTICES

In view of the analysis, carried out in this chapter, on the legal frameworks available to combat unfair commercial practices in business to business relationships along the food supply chain, some concluding remarks should be highlighted.

Firstly, the inadequacy of competition law provisions to effectively tackle unfair trading practices. As discussed in this chapter, amongst all antitrust provisions, Art. 102 of the Treaty on the Functioning of the European Union (or the equivalent national provision in Member States) is probably the most employed when addressing unfair practices, which often constitute unilateral conducts. The strongest limitation to the application of such provision to unfair commercial practices lies in the definition of the concept of dominance, which is a prerequisite to its application. In fact, unfair trading practices often arise as a consequence of imbalances in contractual power, which exceed the competition law concept of dominance, as the stronger undertakings (i.e. the retailers) usually hold significant market power but are rarely dominant.

Therefore, the threshold of dominance, as defined by competition law, is too high in terms of market shares for it to be able to catch, in practice, the distortions of competition caused by the exercise of buyer power on the demand side of the market (i.e. by the retailers), which can, at times, be even more harmful than those caused by abuses on the offer side of the market<sup>349</sup>. This thesis supports the argument that the traditional competition law definition, and assessment, of dominance should be amended, reducing the importance of market shares detained by the undertaking

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<sup>349</sup> EUROPEAN COMMISSION, *Study on the Legal Framework Covering Business-To-Business Unfair Trading Practices in the Retail Supply Chain*, DG MARKT/2012/049/E, Brussels, 26 February 2014, pp. 1-468.

responsible for the conduct, and focusing primarily on the effects on competition of the conduct itself<sup>350</sup>.

In order to address the aforementioned deficiencies of competition law provisions, most Member States have adopted more specific national legislation to address unfair trading practices. Italy, in particular, features a comprehensive legal framework and an extensive protection against unfair trading practices, especially after the adoption of Art. 62 of L. 27/2012, concerning commercial business to business transactions in the field of cession of agricultural or agro-food products. In addition, Italy presents a two-fold enforcement system, where both the Italian Competition Authority and the ordinary courts (only in private instances) are empowered to enforce either Art. 62 of L. 27/2012, or Art. 9 of L. 192/1998, regulating economic dependence.

The introduction of national provisions, in the absence of a homogeneous European framework, led to a significant fragmentation of the legislative landscape on unfair commercial practices, weakening the protection afforded against them. This chapter highlights the negative effects on the functioning of the Single Market caused by such fragmentation, and the consequent need for a harmonizing legal framework at EU level to improve the protection against unfair practices in Member States.

Therefore, this thesis seeks to stress the importance of the new European Directive 2019/633 on unfair trading practices in business to business relationships in the agricultural and food supply chain, adopted on 17 April 2019, which lies precisely in its harmonizing role. In fact, the Directive establishes a consistent minimum standard of protection for all Member States, who must adapt their national provisions accordingly, transposing the Directive within May 2021. Since Member States may increase the level of protection against unfair trading practices afforded by the

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<sup>350</sup> AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO, Decision No 24465 of 24 July 2013, *Indagine Conoscitiva sul Settore della GDO*, IC43, in Boll. No. 31/2013, pp.1-213.

Directive, but not reduce it, the expected final result will be that of a general improvement in the standard of protection of suppliers from unfair commercial practices throughout the European Union. The final goal is thus to curb the use of unfair trading practices in the food supply chain, in order to contribute to a fairer standard of living for the producers and the agricultural community in general.

## CONCLUSIONS

Finally, this thesis sought to demonstrate that the food supply chain in Europe is characterized by significant power imbalances which hinder its correct functioning, focusing on the tense relationships between suppliers and retailers which have developed as a result of the concentration of buyer power in the hands of few large retailers, or groups of retailers.

In particular, Chapter 1 sought to illustrate the economic theory on buyer power, focusing on the difference between monopsony power and bargaining power, which represent two different ways for retailers to obtain better pricing and non-pricing conditions in negotiations with their suppliers. The key difference rests on the means by which these lower prices are achieved: monopsony power may determine lower prices by reducing the quantities of input purchased, whilst bargaining power may determine lower prices only by threatening to decrease the quantity of input purchased.

Therefore, the exercise of both monopsony and bargaining power are likely to reduce the purchasing prices paid to the suppliers, squeezing their profit margins and further weakening their position in negotiations. As a consequence, producers have less resources for investments and their long-term viability on the market is threatened, ultimately causing for a reduction of innovation on the market and of choice of products for final consumers. In particular, this thesis comes to the conclusion that such lower prices and favorable conditions obtained by retailers, are rarely passed on to final consumers, especially if the retailer holds market power in the downstream market. Therefore, this thesis supports the argument that the exercise of buyer power against a competitive upstream market is likely to harm both vertical and horizontal competition in the food supply chain, as well as social welfare as a whole.

Chapter 2 dealt with the elements and circumstances which are capable of aggravating the concentration and the exercise of buyer power by powerful retailers. In particular, procurement alliances may be able to exercise excessive buyer power against the suppliers, abusing their position of strength in negotiations and promoting retailers' opportunistic behavior against suppliers. Therefore, even though it has been considered that buying alliances are capable of generating efficiency enhancing effects, and are not to be prohibited per se, this thesis argues that such alliances are often likely to alter supplier-retailer relationships, distorting competition in the food supply chain. Competition authorities should closely monitor such procurement alliances, especially large international ones, due to their capability of increasing market transparency and circulating sensitive commercial information amongst the members, facilitating collusive behavior amongst them.

One of the main conclusions drawn by this thesis is the fact that the aforementioned differences in bargaining power between the actors of the food supply chain are likely to lead to unfair trading practices being imposed by the larger retailers on the smaller suppliers. In light of the analysis on such practices, conducted in Chapter 3, this thesis concludes that, even though the diversity of characteristics between the different types of unfair trading practices make it hard to unequivocally evaluate their competitive effects, these are likely to harm competition in the food supply chain. In fact, the element of legal uncertainty, generally caused by the imposition on suppliers of unfair trading practices, is one of the main causes of disruption in the supply chain.

Unfair trading practices generally have harmful consequences particularly for farmers and SMEs, which, in order to survive on the market, may cut back on investments on the quality of products and on the workforce, and especially their working conditions. Ultimately, as effectively explained by Ciconte and Liberti: << Dietro la passata di pomodoro venduta in 3x2 ci potrebbe essere un'industria di trasformazione che ha

accettato una commessa poco vantaggiosa pur di non perdere l'accesso al mercato, e che cercherà poi di pagare meno la materia prima a un produttore agricolo che a sua volta proverà magari a risparmiare sulla forza lavoro, pagando i braccianti il meno possibile. C'è insomma tutta un'economia che boccheggia, stritolata dalla trappola della commodity e dei prezzi bassi con cui le aziende della GDO cercano di irretire continuamente i propri clienti<sup>351</sup>. >>.

Furthermore, such practices are likely to discourage trade between Member States, hindering the correct functioning of the internal market and harming the entire EU economy, in addition to final consumers whose choice of products on the market is limited. Therefore, the analysis conducted in Chapter 3 suggests that regulating unfair trading practices, in order to reduce unfairness in the food supply chain, is functional both to the obtainment of a more efficient economy and long-term consumer welfare.

Chapter 4 discussed the existent legal framework to tackle unfair trading practices, focusing on the regulatory failure connected to the inadequacy of EU competition law for this role, the divergence of legislations in different Member States and the insufficiency of enforcement mechanisms. In fact, this thesis concludes that unfair trading practices in the food supply chain are difficult to translate into the infringement of EU competition law, because, Artt. 101 and 102 TFEU in particular, do not cover the simple exercise of economic pressure in vertical relationships, which exceeds the competition law concept of dominance.

The introduction of national provisions based on “relative dominant positions” have attempted to solve this issue, although, due to the absence, up until very recently, of a homogeneous European framework, they led to a significant fragmentation of the legislative landscape, which ultimately weakens the protection afforded against unfair

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<sup>351</sup> F. CICONTE, S. LIBERTI, *Il Grande Carrello: Chi Decide Cosa Mangiamo*, Editori Laterza, 1st edition, Bari, April 2019, pp. 38-39.

trading practices. In fact, such fragmentation of legal provisions causes for significant legal uncertainty for suppliers who wish to trade in different Member States, aggravating the 'fear factor'. This phenomenon is further exacerbated by the insufficiency of national enforcement mechanisms, which for example usually do not provide for the possibility of anonymous complaints, and the lack of coordination at EU level.

Therefore, this thesis seeks to stress the importance of the new European Directive 2019/633 on unfair trading practices in business to business relationships in the agricultural and food supply chain, adopted on 17 April 2019, which adopts a dynamic approach to prohibit the most common unfair trading practices and establishes a uniform enforcement mechanism, providing for better protection for the entities which need it the most.

The Directive represents a turning point in the fight against unfair trading practice in that it adopts a minimum harmonization approach, establishing a consistent minimum standard of protection for all Member States, who must adapt their national provisions accordingly, transposing the Directive within May 2021. Since Member States may increase the level of protection against unfair trading practices afforded by the Directive, but not reduce it, the expected result is a general improvement in the standard of protection of suppliers from unfair commercial practices throughout the European Union. The final goal is thus to curb the use of unfair trading practices in the food supply chain, in order to contribute to a fairer standard of living for the producers and the agricultural community in general.



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