

# P&H/MAKRO JOINT PURCHASING AGREEMENT

Short-form Opinion of the Office of Fair Trading - guidance to facilitate self-assessment under the Chapter I prohibition of the Competition Act 1998 and/or Article 101 of the Treaty on the Functioning of the European Union

27 April 2010

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Please note that square brackets indicates figures or text which have been deleted or replaced at the request of the parties for reasons of commercial confidentiality

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## 1 EXECUTIVE SUMMARY

- 1.1 This Short-form Opinion provides guidance to facilitate self-assessment by Makro Self-Service Wholesalers Limited (**Makro**) and Palmer & Harvey McLane Limited (**P&H**, and together with Makro, the **Parties**) under the Competition Act 1998 (**CA98**) of a prospective joint purchasing agreement in the wholesale grocery market (the **agreement**). It may also provide wider guidance to other parties contemplating joint purchasing arrangements in the same or other industries.
- 1.2 This Short-form Opinion should be read in conjunction with the Office of Fair Trading's (**OFT**) approach to Short-form Opinions, set out in **Annexe 1**. It should also be read in conjunction with the Parties' Statement of Facts at **Annexe 2**. The OFT has not verified or market tested the statements and assessments made by the Parties in the Statement of Facts.
- 1.3 The OFT was asked to consider three key issues relating to the agreement.
  - The identification of a downstream market share safe harbour.
  - The degree of transparency of input costs that would give rise to an adverse effect on downstream competition.

- Whether in principle, joint negotiation of promotional contributions may give rise to competition issues.
- 1.4 Horizontal purchasing cooperation between competitors can in many cases lead to economic benefits; conversely it can also lead to competition law concerns. The EU Horizontal Guidelines state that where the parties' combined upstream (purchasing) and downstream (selling) market shares do not exceed 15 per cent, it is unlikely that an agreement will give rise to restrictive effects.
- 1.5 This Short-form Opinion provides the OFT's view where parties' combined market shares exceed 15 per cent. In these circumstances an agreement does not necessarily fall within section 2 CA98 and/or Article 101(1) Treaty on the Functioning of the European Union (TFEU). Instead, a more detailed market impact assessment is required.
- 1.6 The conclusions of this Short-form Opinion are as follows.
- In general, in the absence of parallel networks of similar agreements in the relevant market, joint purchasing agreements are unlikely to cause harm where the parties have no downstream market power. The Parties in this case have asserted that they do not have downstream market power.
  - The OFT would generally be concerned about the cost commonality only to the extent that full coordination between members of the purchasing agreement (that is, as if the buyer group was a single entity) would significantly reduce competition downstream or if it raised the possibility of coordination across the downstream market (for example by increasing cost symmetry among the purchasing group and its competitors). The Parties in this case have asserted that they do not have downstream market power.
  - On the basis of the information provided, the promotional contributions are unlikely to raise competition concerns under section 2 CA98 in this case for two main reasons. First, the information exchanged would be aggregated, which makes coordination between the Parties less likely. Second, even if the Parties were able tacitly to coordinate, effective downstream competition should ensure that any

effect from this coordination on customers is minimal. Naturally, if explicit downstream coordination were to emerge, this would fall within section 2 CA98 or Article 101 TFEU.

## **2 SHORT-FORM OPINION REQUEST**

2.1 On 4 February 2010, the OFT received a request from the Parties to provide guidance on the compatibility of a proposed joint purchasing agreement with competition law. In particular, the Parties requested a Short-form Opinion from the OFT regarding:

- the identification of a downstream safe harbour for purchasing cooperations
- the degree of transparency of input costs in purchasing cooperation which may give rise to adverse effects on downstream competition, and
- whether, in principle, joint negotiation of promotional contributions may give rise to competition issues.

2.2 The OFT considers that the conditions set out at paragraphs 7.5 to 7.7 of its Modernisation guideline<sup>1</sup> are met, such that the OFT may consider the request for a Short-form Opinion.<sup>2</sup> The OFT has also considered its prioritisation principles<sup>3</sup> before deciding to issue this Short-form Opinion.

## **3 BACKGROUND FACTS PROVIDED BY PARTIES**

### **The Parties and Industry Background**

3.1 Makro is a membership-only, business-to-business, cash & carry supplier with a national network of 30 store locations, and is part of Metro Group AG, an international group in the wholesale sector. It is active in the supply of fresh, chilled and frozen foods, confectionery, soft drinks, crisps and snacks, grocery, alcohol, clothing, toys, furniture, and related goods. As part of its normal operations, Makro is in the process of setting up a delivery service that will deliver to foodservice customers.

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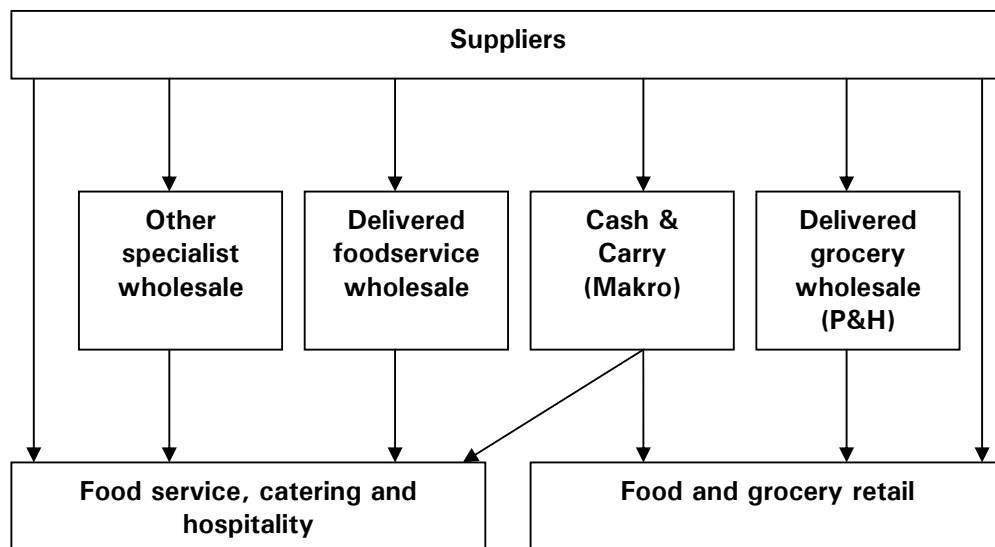
<sup>1</sup> OFT442 (December 2004).

<sup>2</sup> See also the OFT's approach to Opinions, set out in **Annexe 1**.

<sup>3</sup> OFT953 (October 2008).

- 3.2 P&H is the largest independent wholesale supplier in the UK. It is active in the distribution and delivered wholesaling of tobacco, confectionery, soft drinks, crisps and snacks, grocery, alcohol, chilled and frozen foods and related goods, to independents, multiple retailers, forecourts and mini-multiples, delivering to customers from a national network of 13 delivery locations.
- 3.3 As set out in **Figure 1** below, the wholesale grocery industry consists of four principal sales channels: (1) **cash & carry wholesalers** (such as Makro, Costco, Booker and Bestway), which operate from depots and provide access to goods for customers on a self-service basis; (2) **delivered grocery wholesalers** (such as P&H, Spar and Musgrave), which are full service wholesalers specialising in supply to retail outlets/customers – in contrast to cash & carry operators, their depots operate as dedicated distribution centres; (3) **delivered foodservice wholesalers**, which are full service wholesalers specialising in the foodservice, catering and hospitality trade (including Brakes and 3663 – and Makro intends to enter this channel); and (4) **other specialist wholesale**, which include beer, wine and spirit specialists (such as Matthew Clark and Waverley TBS).

**Figure 1 – Structure of the wholesale grocery industry<sup>4</sup>**



<sup>4</sup> Based on the schematic at page 19 of the IGD's report on 'UK Grocery and Foodservice Wholesaling Outlook 2009', April 2009.

## **The Joint Purchasing Agreement**

- 3.4 According to the Parties, the agreement would cover selected products in the UK.<sup>5</sup> It would be implemented through a jointly-owned service company (**PalMak**), which would be supported by funding and seconded employees from the Parties.<sup>6</sup>
- 3.5 Through PalMak, the Parties would jointly negotiate purchase conditions with certain agreed suppliers, for food and other products, including the joint negotiation of discounts and overall promotional contributions. The agreement would seek initially to ensure that both Parties benefited from the best terms offered to either of the Parties individually by each of a number of selected suppliers and, thereafter, to improve those terms. The overall benefit of the initial harmonisation of buying terms would be [ ] between the Parties.
- 3.6 Each Party would remain free to conduct additional negotiations with the selected suppliers on matters outside the scope of the agreement, or to conduct purchase negotiations with any other supplier, independently of PalMak. The outcomes of any such negotiations would be kept confidential from the other Party.
- 3.7 Further details of the terms of the agreement can be found in the Parties' Statement of Facts, in **Annexe 2**.

## **The Relevant Market and Parties' Positions**

- 3.8 The Parties stated that they both operate in the wholesale grocery market.
- 3.9 In relation to the upstream (purchasing) markets, the Parties stated that the European Commission had previously considered the product market to comprise the sale of daily consumer goods by producers to customers such as wholesalers, retailers and other firms purchasing directly from the industry, segmented into broadly food products and non-food

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<sup>5</sup> See footnote 36 below.

<sup>6</sup> The agreement does not qualify as a relevant merger situation under the Enterprise Act 2002, as no enterprises will cease to be distinct.

products.<sup>7</sup> Whilst the Parties did not conclude on market definition, they submitted that the agreement would have no effect on competition because their combined share would be substantially below the 15 per cent threshold set out in the EU Horizontal Guidelines on the basis of any relevant market.

- 3.10 In relation to the downstream (selling) markets, the Parties stated that the relevant product market should not be limited either on the demand-side to independent and convenience retailers in the UK or on the supply-side to independent wholesalers. Rather, they considered that the demand-side should include other types of customer (such as foodservice companies) supplied as part of the same business activity, and that the supply-side should include other companies performing a wholesale function and competing with independent wholesalers at customer level (including subsidiaries performing a wholesale function).
- 3.11 The Parties referred to an independent report prepared by the Institute of Grocery Distribution (**IGD Report**),<sup>8</sup> stating that their overall combined share of independent wholesale grocery sales would be [10-15] per cent (and should sales by subsidiaries of suppliers fulfilling wholesale functions be included, as per paragraph 3.9 above, this share would be lower). In addition, the Parties submitted that their combined share of the activities that would be subject to the agreement is lower still.<sup>9</sup>
- 3.12 However, the Parties stated that the narrowest possible downstream frame of reference was the wholesale supply by independent wholesalers to independent and convenience retailers.<sup>10</sup> On this basis, the Parties' combined share would be [15-20] per cent.

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<sup>7</sup> See Rewe/Meinl, Case M.1221, decision of 3 February 1999, where the Commission considered that the market could be broken down into the following groups of products: Meat, sausages, poultry and eggs; Bread and Pastries; Dairy products; Fresh fruit and vegetables; Beer, wines, spirits & soft drinks; Hot Beverages; Basic foodstuffs and preserved food; Frozen food (including ice cream); Baby food; Pet foods; Body care products; Detergents, polishes, and cleaning products; Other drugstore products; and Other non-food products normally found in supermarkets.

<sup>8</sup> IGD's report on 'UK Grocery and Foodservice Wholesaling Outlook 2009', April 2009.

<sup>9</sup> Under 10 per cent of wholesale grocery sales as defined by the IGD Report.

<sup>10</sup> The OFT notes that the relevant market may, for example, be narrower with respect to perishable product categories, where customers may require a delivery service. In these circumstances, delivered grocery wholesalers could constitute a separate relevant market. However, in that case the Parties' activities would not overlap and the OFT has therefore left this issue open for the purpose of this Short-form Opinion. For the reasons set out in the

3.13 The OFT has not market-tested the Parties' assertions on the upstream or downstream market definitions in this case, nor verified the Parties' market share estimates. Therefore, for the purposes of this Short-form Opinion, the OFT has conducted its analysis on the basis of the approach submitted by the Parties, that:

- the relevant upstream (purchasing) market is the sale of daily consumer goods by producers to customers such as wholesalers, retailers and other firms purchasing directly from the industry, segmented into food products and non-food products, and
- at its most narrow, the relevant downstream (selling) market is the wholesale supply by independent wholesalers to independent and convenience retailers in the UK.

#### 4 THE LEGAL FRAMEWORK

4.1 Section 2 CA98 prohibits agreements or concerted practices between undertakings and decisions of associations of undertakings which have as their object or effect an appreciable<sup>11</sup> prevention, restriction or distortion of competition within the UK (or a part of it) and may affect trade within the UK (or a part of it), unless they fall within an excluded category or are exempt in accordance with section 9 CA98. The prohibition in section 2 is referred to as 'the Chapter I prohibition'. Any agreement which falls within the Chapter I prohibition and is not exempt is void and unenforceable.<sup>12</sup>

4.2 The European equivalent of the Chapter I prohibition is Article 101 TFEU. When the OFT applies national competition law to an agreement or concerted practice that has the potential to affect trade between EU Member States, it is required also to apply Article 101 TFEU to that agreement or concerted practice.<sup>13</sup>

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OFT's approach to Short-form Opinions, set out in **Annexe 1**, the OFT has adopted the market definition as expressed by the Parties.

<sup>11</sup> As to the requirement for appreciability, see Agreements and concerted practices (OFT401, December 2004), at paragraphs 2.15 to 2.21.

<sup>12</sup> Section 2(4) CA98.

<sup>13</sup> Article 3 of the Modernisation Regulation (Regulation 1/2003).

- 4.3 In addition, in this case, the OFT considers it appropriate to have regard to the Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 101(1) TFEU<sup>14</sup> (**De Minimis Notice**), Commission Notice Guidelines on the application of Article 101(3) of the Treaty<sup>15</sup> (**Article 101(3) Notice**) and Commission Notice: Guidelines on the applicability of Article 101 TFEU to horizontal cooperation agreements<sup>16</sup> (**EU Horizontal Guidelines**).
- 4.4 Under Section 60 CA98, when determining a question arising under Part 1 of the CA98, the OFT must ensure that (having regard to any relevant differences between the provisions concerned) there is no inconsistency with the principles laid down by the TFEU and the European Court<sup>17</sup> and any relevant decision of the European Court. It must also have regard to any relevant decision or statement of the European Commission.

## 5 IMPACT OF HORIZONTAL COOPERATION

- 5.1 Increased bargaining power through purchasing cooperation is generally acknowledged to generate pro-competitive and pro-consumer benefits when there is downstream competition.<sup>18</sup> Such cooperation can:
- lower consumer prices through negotiating better terms of supply or creating efficiencies that are passed on to final consumers
  - generate upstream pro-competitive effects, as the increased ability of purchasers to switch supplier - or sponsor a new entrant - can intensify rivalry among suppliers
  - generate downstream pro-competitive effects, as smaller businesses joining a purchasing group might compete more effectively with their rivals, and

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<sup>14</sup> OJ 2001/C368/07.

<sup>15</sup> OJ 2004/C101/97.

<sup>16</sup> OJ 2001/C3/02.

<sup>17</sup> The European Court comprises the Court of Justice and the General Court (previously the Court of First Instance).

<sup>18</sup> For a more detailed discussion of the benefits and theories of harm, see, for example, 'The competitive effects of buyer groups', OFT Economic Discussion Paper 863 (January 2007), available at [http://www.of.gov.uk/shared\\_of/economic\\_research/oft863.pdf](http://www.of.gov.uk/shared_of/economic_research/oft863.pdf) (RBB Report).

- increase innovation or investment. Cooperation between purchasers can solve purchaser coordination problems which result in underinvestment or reduced innovation; or suppliers' incentives to innovate could increase as they seek to improve their bargaining position when faced with a purchasing group.

5.2 These benefits and efficiencies, gained through increased bargaining power from the purchasing group, will generally be passed on to consumers in the form of lower prices (assuming there is downstream competition).

5.3 Nevertheless, purchasing groups are not unambiguously favourable, and in certain circumstances they can be harmful to competition and consumers. The main theories of harm concern:

- demand withholding, where downstream prices to final consumers increase as a result of reduced quantity. Purchasers agree to withhold their joint demand upstream in order to generate greater profits by restricting quantity in the downstream (selling) market
- increased likelihood of tacit collusion in the downstream market among members of the purchasing group (for example, by facilitating detection of deviation)
- reduced rivalry between members of the purchasing group (for example, reduced incentives to grow organically or to innovate), and
- reduction of the competitive constraint from rival buyers by:
  - deliberately raising non-members' costs (for example, by agreeing exclusive contracts with important suppliers making it more difficult for rivals to secure alternative sources of supply at competitive terms)
  - deterring entry/expansion (for example, by limiting access to upstream suppliers through the existence of a parallel network of similar purchasing agreements).<sup>19</sup> Potential/existing

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<sup>19</sup> The saturation of the supply-side may also occur where there are a few large purchasers operating alongside the purchasing group.

competitors who are unable to join any of the existing purchasing groups may be deterred from entering/expanding downstream if worse supply terms are available on a standalone basis<sup>20</sup>

- o creating a so-called 'waterbed effect' (for example, by negotiating down their own prices from suppliers who then, in turn, push up the prices of their rivals).<sup>21</sup>

## 6 ASSESSMENT OF JOINT PURCHASING AGREEMENTS

6.1 Although a joint purchasing agreement is an agreement between competing undertakings, it would be unlikely to have as its 'object' the restriction of competition.<sup>22</sup> However, it may constitute an object restriction where it facilitates a cartel among the parties to the agreement (and, potentially, upstream suppliers). An object restriction of this sort might take the form of output limitation (demand withholding), market sharing/allocation (for example, through purchasing quotas), price fixing or 'rent sharing' with upstream suppliers. Based on the information supplied by the Parties, the OFT has no reason to believe that the agreement in this case would constitute an object infringement.

6.2 In circumstances where a joint purchasing agreement does not have as its 'object' the restriction of competition, it is necessary to consider whether it may have an appreciable 'effect' on competition.<sup>23</sup> The EU Horizontal Guidelines indicate that joint purchasing agreements are unlikely to be restrictive of competition (and therefore caught by Article 101(1) TFEU or the Chapter I prohibition) where the parties' combined market share is under 15 per cent in both the upstream and downstream market.<sup>24</sup>

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<sup>20</sup> The probability of this type of input foreclosure resulting in anti-competitive effects on the downstream (selling) market is low.

<sup>21</sup> However, there is some economic debate as to the validity of such an effect. See, for example, the RBB Report at footnote 18.

<sup>22</sup> See paragraph 124 of the EU Horizontal Guidelines.

<sup>23</sup> See the De Minimis Notice and OFT401 at paragraph 2.18. Under the De Minimis Notice, the European Commission's view is that an agreement will not restrict competition to an appreciable extent if the aggregate market share of the parties does not exceed 10 per cent of the relevant market affected by the agreement. However, it should be noted that this approach does not apply to 'hard-core' cartel infringements.

<sup>24</sup> See paragraph 130 of the EU Horizontal Guidelines.

- 6.3 In general, joint purchasing agreements are unlikely to have an adverse effect on competition or cause consumer harm when the parties have no downstream market power and/or when they are not close competitors, as in this case.<sup>25</sup> One exception to this would be where there are parallel networks of similar joint purchasing agreements. Such parallel networks of agreements could dampen competition.<sup>26</sup>
- 6.4 The Parties submitted that the agreement has no appreciable effect on competition. Indeed, they argued that the agreement would be pro-competitive, to the benefit of the Parties' customers and therefore consumers. In particular, the Parties stated that there would be no effect on upstream (purchasing) markets because their combined share on all such markets is [ $< 10$ ] per cent. This is substantially below the 15 per cent threshold set out in the EU Horizontal Guidelines. The Parties have not asked for guidance on assessment of effects on the upstream market.

#### **Downstream safe harbour**

- 6.5 In the current case, the Parties have stated that their combined market share for the wholesale supply by independent wholesalers to independent and convenience retailers is above the 15 per cent threshold set out in the EU Horizontal Guidelines. Given this, the Parties have requested guidance on whether a downstream market share safe harbour applies to joint purchasing agreements and, if so, at what level.
- 6.6 Where the parties' combined upstream and downstream market shares are greater than the 15 per cent threshold, this does not necessarily indicate that the agreement falls within the scope of the Chapter I prohibition and/or Article 101(1) TFEU. Instead, a more detailed market impact assessment is required.<sup>27</sup>

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<sup>25</sup> Under specific circumstances it may be possible for there to be harm to consumers when there is market power on the upstream market but not on the downstream market. For example, in a market where there is intense downstream competition, buyers may focus on short term goals such as reducing prices. This in turn might deter upstream suppliers from pursuing product improvement/innovation. A purchasing group with buyer power may be able to negotiate further price reductions, and this will further reduce suppliers' incentives to innovate/invest. These theories can be ruled out entirely by looking at the upstream purchasing market power as well as the downstream market power.

<sup>26</sup> See paragraph 5.3.

<sup>27</sup> See paragraph 131 of the EU Horizontal Guidelines.

- 6.7 In general, in the absence of parallel networks of similar joint purchasing agreements in the relevant market, as in this case, joint purchasing agreements are unlikely to cause harm when the parties have no downstream market power.
- 6.8 However, the OFT does not consider it appropriate to stipulate a clear threshold above that of the 15 per cent threshold set out by the European Commission in the EU Horizontal Guidelines, as each case requires an individual analysis of its facts.
- 6.9 An analogy can be made in this case between the economic effects of a joint purchasing agreement and the economic effects of a merger.<sup>28</sup> In both cases an assessment requires examining both the unilateral and coordinated effects<sup>29</sup> as well as any vertical issues. However, it is worth noting that this analogy is not perfect for two reasons. First, a purchasing group will typically be less harmful to competition than a merger, because coordination is inherently more difficult.<sup>30</sup> Second, joint purchasing arrangements will typically result in fewer efficiencies than a merger. In other words, harm is less likely in a purchasing agreement than in a merger, but benefits are also less likely to arise. However, the first point implies that if no anti-competitive effects would arise from a full merger (even absent any off-setting benefits), it is unlikely that they would arise under a purchasing agreement.
- 6.10 On the basis of the Parties' claim that they do not have downstream market power, the agreement would be unlikely to raise concerns under section 2 CA98 or Article 101(1) TFEU. Accordingly, there would be no need to consider the exemption criteria set out in section 9 CA98 or Article 101(3) TFEU.

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<sup>28</sup> However, from a legal standpoint, the tests are different, one requiring an 'appreciable effect on competition', and the other a 'substantial lessening of competition'. Further, the stages at which efficiencies are taken into consideration can also be different.

<sup>29</sup> Similar joint purchasing agreements totalling a large proportion of the downstream market would raise concerns about coordinated effects to the extent that symmetry among purchasing groups is increased.

<sup>30</sup> This is due to the fact that there are difficulties in coordinating the commercial conduct of each member.

## Cost commonality and cost transparency

- 6.11 The Parties have requested guidance on what degree of cost commonality and transparency of input costs would be likely to lead to an adverse effect on downstream competition. Here, the issue is the potential impact on price coordination between the members of the purchasing agreement.<sup>31</sup>
- 6.12 The EU Horizontal Guidelines state that the more combined power the parties have on their downstream (selling) markets, the higher the incentive for the parties to coordinate their behaviour as sellers. One way in which coordination may be facilitated is if the parties achieve a high degree of commonality of costs through joint purchasing. For instance, if a group of large retailers purchases a high proportion of their products together, they will have a high proportion of their variable costs in common.<sup>32</sup> Such commonality could provide members of a joint purchasing agreement with the ability accurately to predict each other's prices.
- 6.13 The Parties stated that the degree of cost commonality and therefore transparency between them is limited, pointing to the fact that they pursue different business models, with P&H incurring higher variable costs because of its delivery service.<sup>33</sup> Nevertheless, the costs affected by the proposed cooperation account for approximately [45-55] per cent of total variable costs incurred by both Parties.
- 6.14 An element of cost commonality, which is inherent in all types of joint purchasing agreements, can lead to efficiencies.<sup>34</sup> The OFT would generally be concerned about the cost commonality only to the extent that full coordination between members of the purchasing agreement (that is, as if the buyer group were a single entity) would significantly reduce competition downstream or if it raised the possibility of

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<sup>31</sup> Coordination across the downstream market would be captured through an assessment of the purchasing group as if it were in fact a full merger. See paragraph 6.9 above.

<sup>32</sup> See paragraph 128 of the EU Horizontal Guidelines.

<sup>33</sup> Further, cost commonality will be delayed until the Parties reach full harmonisation of their buying terms. [ ].

<sup>34</sup> Where the joint purchasing agreement covers a significant proportion of variable costs in the relevant downstream market, better terms of supply will entail a reduction in the marginal costs of production in the downstream market, which is more likely to be passed on to final consumers.

coordination across the downstream market (for example by increasing cost symmetry among the purchasing group and its competitors). By way of sense check, a merger-type approach to the analysis looking at both the unilateral and coordinated consequences of the joint purchasing agreement, as set out in paragraph 6.9 above, should help to capture both of these potential economic issues.

- 6.15 As such, even a high degree of cost commonality should generally not be a concern if the joint purchasing arrangement would not lead to market power downstream. This is because the risk of coordinated (price) effects downstream would be prevented by the structure of the market itself. Further, provided there is no risk of price coordination downstream, this would apply regardless of the 15 per cent threshold set out in the EU Horizontal Guidelines.
- 6.16 On the basis of the Parties' claim that they do not have downstream market power, the degree of commonality and transparency envisaged by the Parties would be unlikely to raise concerns under section 2 CA98 or Article 101(1) TFEU. Accordingly, there would be no need to consider the exemption criteria set out in section 9 CA98 or Article 101(3) TFEU.

#### **Inclusion of promotional contributions in the proposed cooperation agreement**

- 6.17 It is a common feature of purchasing groups to negotiate the contributions that suppliers will make to promotional activities and to pursue common promotional programmes.
- 6.18 PalMak will negotiate annually a contribution to promotional activities on behalf of both Parties in the form of a percentage discount [ ]. This discount [ ]. The Parties will then individually decide how this discount is to be used for their own promotions, that is, the number, type or timing of any promotions. All matters, other than the overall size of the discount, would thus be discussed bilaterally between the supplier and the individual purchaser.
- 6.19 The Parties have requested guidance on whether, as a matter of principle, the OFT considers that joint negotiation of promotional contributions, of the sort contemplated by the Parties, may raise competition issues.

6.20 Given the information provided by the Parties in this case, such promotional contributions are unlikely to raise competition concerns under section 2 CA98 for two main reasons. First, the information exchanged is aggregated, which makes the possibility of coordination between the Parties less likely. Second, even if the information did allow the Parties tacitly to coordinate with each other, effective downstream competition should ensure that any effect from this coordination on customers is minimal.<sup>35</sup> Naturally, if explicit downstream coordination were to emerge, this would fall within section 2 CA98 or Article 101 TFEU.

## **7 OTHER ISSUES IDENTIFIED**

7.1 Although not expressly requested by the Parties, the OFT considers that information provided in the Parties' Statement of Facts concerning two aspects of the agreement is integral to the agreement and therefore merits further comment.

### **Exclusion of certain suppliers**

7.2 The Parties initially intended, on a precautionary basis, to exclude from the agreement any suppliers who rely on the Parties for more than 22 per cent of their turnover, on the basis that they could (by analogy with merger control analysis) be deemed to be economically dependent on the Parties.<sup>36</sup>

7.3 The fact that an individual supplier is heavily dependent on the purchasing group need not raise competition concerns, unless the supplier in question is of particular importance (for example, because it sells the most popular brand) so that its individual dependence on the purchasing group may lead to market-wide effects on the downstream (selling) side.

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<sup>35</sup> This is assuming that there are no wider coordination effects across the downstream market.

<sup>36</sup>The Parties have stated that the joint purchasing agreement will exclude all tobacco suppliers (in view of P&H's significant position in that sector) and all other suppliers that could be deemed to be economically dependent on the Parties. It will therefore exclude any suppliers who rely on the Parties for more than 22 per cent of their turnover. The Parties state that this figure is based upon the European Commission's evaluation of dependency in the past merger case, Rewe/Meinl, Case M.1221.

7.4 In relation to the Parties' use of a 22 per cent limit, the OFT considers that the appropriate threshold would need to be assessed on a case-by-case basis. The Parties stated that the 22 per cent threshold was only chosen as a precautionary operational measure without conceding that economic dependency would in fact arise in any case at that level. The OFT nonetheless considers that such a threshold may, in fact, potentially chill competition amongst suppliers who will not compete to gain further business with PalMak so as not to exceed the 22 per cent limit. Moreover, the same chilling effects may potentially keep the members of the joint purchasing agreement from striving to expand their business so as to avoid crossing the cumulative threshold and losing the group's favourable terms of supply.<sup>37</sup> Whilst the Parties maintained that the threshold would not give rise to competition concerns, in view of the OFT's comments, they have decided to dispense with a specific threshold of the kind originally proposed.

#### **Information Exchange**

7.5 The OFT considers it useful to provide some clarification in relation to exchanges of information in the context of joint purchasing agreements.

7.6 The implementation of a joint purchasing agreement may require the exchange of commercially sensitive information. The competitive outcome of the information exchanged depends, inter alia, on the characteristics of the market, as well as the type and detail of information exchanged between competitors. Therefore, information exchange can lead to efficiency gains and increased competition, but can also lead to restrictive effects on competition, such as facilitating coordination downstream. In some circumstances, the information exchange may amount to an 'object' restriction of competition.

7.7 The agreement originally provided for payments<sup>38</sup> to be made between the Parties on the basis where calculations were to be made by the

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<sup>37</sup> Furthermore, the common adoption of such upstream supplier thresholds across all competitors might lead to market-wide effects where rivalry is reduced in the downstream (selling) market. The unilateral adoption of such a threshold effectively amounts to a commitment by the Parties not to compete fiercely to expand sales downstream. Where this commitment is reciprocal among competitors it may lead to a restriction of competition in the downstream (selling) market.

<sup>38</sup> It should be noted that these are separate to the promotional contributions discussed above. [ ].

Parties themselves on a quarterly basis based on the Parties' purchases **disaggregated** by supplier.<sup>39</sup>

7.8 Whilst the OFT recognises that this [ ] system will provide strong incentives to negotiate better supply terms, given the common buying terms, this exchange could allow the receiving Party to reverse-engineer the level of purchases achieved with a particular supplier.<sup>40</sup> This could aid coordination between the Parties, as the ability to monitor the members' recent level of purchasing activity on a regular basis could potentially support an agreement to limit output (for example, demand withholding). Such an explicit agreement would of course fall within the Chapter I prohibition and/or Article 101(1) TFEU.

7.9 In light of this potential concern, the Parties have agreed to make a modification to the agreement stipulating that the [ ] payments would be calculated by an independent consultant, thereby ensuring that any data exchanged between the Parties would be aggregated across all suppliers.

**Clive Maxwell**  
**Senior Director, Services, Office of Fair Trading**

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<sup>39</sup> The information would be further disaggregated by product only to the extent necessary for the effective operation of the agreement. For example, in relation to invoice pricing, where a manufacturer price list is not available, average invoice prices by stock keeping unit would have to be compared although the price difference would be aggregated at the key product category level (rather than by product line or stock keeping unit).

<sup>40</sup> The Parties explained that the possibility of monitoring the level of activity of a [ ] party is limited as the [ ] payment only reflects the level of purchase achieved with a particular supplier in aggregate. Therefore, to the extent that one [ ] party purchases multiple products from the supplier, the other party will not be able to monitor the former purchasing patterns disaggregated at a single product level. Nevertheless, the Parties elsewhere have argued that their purchasing patterns are stable historically, which may indicate that monitoring at an aggregate level is sufficient. Further, monitoring is still possible in relation to suppliers from whom the [ ] party purchases only one product.