

# Competition Law in the Retail Trade<sup>1</sup>

The German food retail sector

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<sup>1</sup>. Please note that this version is not the transcript of the speech itself as it was given by the speaker on the International Cartel Forum 2011

## **I. Introduction**

Today's programme makes clear the wide range of topics in competition law. My speech will highlight yet another one: Competition in the German food retail sector.

I think it comes as no surprise that I will speak about this issue today: For several years now proceedings of the Bundeskartellamt in food retailing have attracted great public attention. So I am quite optimistic about winning your attention too.

### **A. Focus on cartel prosecution**

First of all, let me give you a small overview about organizational changes at our authority over the last years. This will make it easier to understand the heated discussion in the German retail and food manufacturing sector: the discussion about our enforcement activities.

After years without cartel cases in this area, we carried out several dawn raids in different food manufacturing sectors. We detected longstanding hard core offences. This does not mean that we place a special focus on food manufacturing: We have increased our cartel detection rate in general.<sup>2</sup>

After a long period of merger control as the key focus of our work, we reviewed our priorities and organizational structure. In 2000 we decided to reevaluate and to strengthen our fight against cartels.

In March 2000 we introduced a leniency programme, which was thoroughly overhauled in 2006.<sup>3</sup>

In 2002 we introduced a special unit for combating cartels, SKK: Today the SKK supports our decision divisions in the preparation and execution of proceedings in hard core cartel cases. Another area of its focus is the analysis of evidence seized during searches.

In 2005 and 2008 we established two decision divisions solely concentrating on cartel cases.<sup>4</sup>

We also introduced the possibility for an undertaking to reach a "settlement".<sup>5</sup> In agreement with the undertaking concerned this approach enables the swift closure of proceedings. Especially lengthy court proceedings can be avoided.

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<sup>2.</sup> See the Federal Cartel Office's activity report 2007/2008, Drucks. 16/13500, p. 33 et. seq.

<sup>3.</sup> See Notice no. 9/2006 of the Bundeskartellamt on the immunity from and reduction of fines in cartel cases – Leniency Programme – of 7 March 2006.

<sup>4.</sup> To download our organization chart, go to:  
[http://www.bundeskartellamt.de/wEnglisch/download/pdf/Organigramm/EN-2011-05\\_Organigramm.pdf](http://www.bundeskartellamt.de/wEnglisch/download/pdf/Organigramm/EN-2011-05_Organigramm.pdf).

<sup>5.</sup> See hereto our instructive decision in case B11-18/08 of 18 December 2009 – Kaffeeeroester.

In addition, there has been a legal amendment, which helps us in our endeavours to make cartel prosecution even more effective and efficient. It has replaced the rule of fine assessment based on the additional revenue achieved by a cartel. The new approach now specifies that the total turnover of the cartel undertaking should be used as the basis for assessment, in line with European competition law. Due to this amendment, high fines can be imposed in faster proceedings.

Overall, the deterrent effect of cartel enforcement has increased significantly.

## **B. A view of the fierce competition in the retail sector**

From numerous talks with representatives of undertakings and associations in the food sector as well as from the media, the Bundeskartellamt is fully aware that a widespread way of thinking within the industry is as follows: In Germany we have the lowest consumer prices. These indicate that there must be fierce competition. Another argument is that the typical German customer is highly price sensitive: A smart shopper, always looking for special offers. In the Land of “Aldi” and “Lidl” a serious lack of competition between the retailers would be hard to imagine.

As regards buyer power, the argument often goes: Retail traders are the consumers’ best friends: They struggle with powerful global suppliers for low purchase prices. Savings have to be passed on to the end consumer because of fierce competition.

I have also often heard that there has to be a close partnership between suppliers and traders, to produce efficiencies for everyone’s best. As this partnership is highly complex, distortions from outside should be avoided. They would for certain result in a loss of efficiencies as well as in a loss of consumer welfare.

## **II. Main Part**

There is some truth in every argument. But I think this view doesn’t show the whole picture. I will contrast these arguments with market specifics we have recognized so far:

### **A. Supply side**

Let me start with the supplier side. Of course there are hundreds of independent food suppliers. But if one takes a closer look, then one realizes:

There are some big, internationally active undertakings with well known branded products

and relatively high market shares. And there are a range of small and medium-sized suppliers, with only a national or even regional focus. These undertakings have often only minor market relevance.

In several markets of the food production sector we notice a strong trend towards concentration. But what is more striking is the number of cartel suspicions which we had to examine in these markets in the last years. Here our improved leniency programme and the organizational changes which we have implemented have clearly paid off.

Let me highlight some cases in which the allegations were well-founded:

Last month we imposed fines on three widely known manufacturers of consumer goods: These had violated competition law with their exchange of competition-relevant information.<sup>6</sup> Investigations against a fourth major consumer goods manufacturer are still ongoing. The proceedings were triggered by an application for leniency.

The companies met regularly over several years in a discussion group. In these meetings high-ranking sales executives informed each other on the state of negotiations between their companies and several major retailers. Some of the participants also exchanged information on planned price increases for retailers for some of the product areas.

In various product areas, i.e. confectionery, ice cream, dry ready-to-eat meals, frozen pizzas, pet food and detergents, the main rivals sat face to face at these meetings. Similar proceedings in the confectionery industry are still pending.

In December 2009 the Bundeskartellamt imposed fines totaling approx. €160 million against the leading coffee roasters for price fixing.<sup>7</sup> The aim of the cartel was above all to maintain the “price architecture” of the companies’ final sales prices and special offer prices for their major roasted coffee products. The infringement lasted from at least early 2000 till we searched in 2008.

The year before, i.e. in 2008 we imposed fines against four manufacturers of branded drugstore products and their sales managers.<sup>8</sup> These coordinated price increases and exchanged information about the state of annual talks with retailers. Products affected were dishwashing detergent, shower gel products and toothpaste. In this case, too, proceedings

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<sup>6.</sup> See press release of the Federal Cartel Office of 17.03.2011, [http://www.bundeskartellamt.de/wDeutsch/download/pdf/Presse/2011/2011-03-17\\_PM\\_HEMA\\_\\_FINAL.pdf](http://www.bundeskartellamt.de/wDeutsch/download/pdf/Presse/2011/2011-03-17_PM_HEMA__FINAL.pdf).

<sup>7.</sup> Federal Cartel Office, case B11-18/08 of 18 December 2009 – Kaffeeroester.

<sup>8.</sup> See the Federal Cartel Office’s activity report 2007/2008, Drucks. 16/13500, p. 75 et. seq.

were triggered by a leniency applicant.

There are several other fine proceedings in the food manufacturing sector. I will just mention them briefly because proceedings are still ongoing: We also carried out dawn raids at several sugar producers, grain mills and sausage manufacturers.

The relatively large number of proceedings does not mean that we place a special focus on food manufacturing; rather one proceeding leads to the next. We simply can't close our eyes in the face of clear evidence.

Behind closed doors it is argued: Suppliers only want to defend their undertakings against the massive buyer power of a concentrated retail sector. This argument cannot convince me: If the retail sector is oligopolistic, this might be bad from a welfare point of view. But I am quite sure that, in combination with cartelized supplier markets, the situation will get even worse.

## **B. Retail level**

So let us take a closer look at the retail level: In the last ten years we have seen a strong tendency towards concentration: In 1990 eight retailers together reached a market share of about 70 percent. Today, the combined market share of the four largest undertakings amounts to approximately 85 percent. And we are concerned that the gap between the market leaders and their followers will widen even further.

On the one hand, the number one retailer Edeka showed strong growth of more than 18%<sup>9</sup>: Among others, the merger with the discount food chain Plus plays a prominent role. I will come back to this issue later.

On the other hand there is the former number five retailer, Tengelmann: This undertaking sold the "Plus" supermarket chain and so the majority of the German stores of the group in 2009.<sup>10</sup>

Also today's number five, the metro group's "Real"<sup>11</sup>, has been in a phase of transformation and store disposals since 2009.

Of course, market changes could be an opportunity for the market entry of a newcomer. But in recent years, market entries had little success. For example in 2006 Walmart, though the world's biggest retailer, withdrew from the market after eight years in Germany. The Belgian

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<sup>9</sup>. According to Edeka's latest annual report; turnover in 2009: 38 bn. EUR

<sup>10</sup>. Turnover in 2009: 2.58 bn. EUR – according to annual report

<sup>11</sup>. 11.5 bn. EUR turnover in Germany in 2010 - according to the annual report

Delhaize also launched a small-scale entry but soon withdrew.

### **C. Consumer view**

From a consumer perspective it is far from clear whether fierce competition is really at work.

Maybe we do enjoy the cheapest prices in Europe. But even if prices are lower in Germany than in the rest of Europe, this doesn't prove that our prices meet the competition level. Maybe our European neighbours are not the best peer group: Several of them also express concerns about competition in their food retail markets. I will return to that point later.

In addition, Germany has some logistical advantages which might justify lower prices in comparison with its neighbours: e.g. Germany is for many products the biggest market, which should allow for economies of scale. It has quite a high population density, and geographically, it is in a central position in Europe: Both factors should lower transportation costs.

There were many headlines in German newspapers last year about a discounter price war. But this does not necessarily reflect a low level of prices in general if the price wars only affect a part of the huge range of products typically sold in a supermarket store.

Furthermore, discounters offer only a strictly limited range of products. So their pricing pressure is limited to these product segments.

A market analysis carried out in summer 2010 also points in this direction:<sup>12</sup> It concluded that price competition has to be fierce only in 40 out of 275 "groups of the fast moving consumer goods". Only in these 40 segments, e.g. bread, yogurt, and milk, are consumers familiar with prices and so are aware of price increases. Indeed, these segments cover 50% of the revenue with the 275 groups. But this also means that half of the revenue can be earned without strong price pressure.

Of course, price is not the only parameter of interest:

The product range in the stores seems to be increasing, but the number of independent producers seems to be decreasing. So it is far from clear whether there is an increase in overall product choice.

In the public debate deterioration in quality is another aspect which is mentioned. Several

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<sup>12</sup> Joint survey of GfK and SAP, Preisoptimierung im deutschen Lebensmitteleinzelhandel – von einer wettbewerbs- zur kundenorientierten Preisfindung, 2010, available at: <http://www.sap-nah-am-kunden.de/>.

food quality scandals might be the background to this: Producers argue they are under great pressure by the few remaining retailers. Therefore their argument goes they have to save costs to stay in the market.

This reasoning is not convincing: In light of close interdependence of quality and price of a certain product, retailers always have an incentive to detect quality cuts by producers - independent of their size. This incentive might be stronger for bigger purchasers considering that a scandal damages the retailer's image and has side effects to the whole range of products it offers. For a bigger retailer, the costs of a scandal might outweigh the costs of quality control more easily, which makes controlling attractive. On the producers' side the threat of losing a big client because of quality concerns might discipline the producer more effectively than the risk of losing only a single smaller one.

#### **D. Numerous complaints by food suppliers, sector inquiry**

In the last years we have received numerous complaints by food suppliers. This is nothing specific to Germany: There are similar complaints in a range of EU Member States. These perceive their retail sectors as highly concentrated or oligopolistic.

According to German law, hindrance and discrimination is prohibited not only to dominant undertakings: It is also prohibited to undertakings on which small or medium-sized enterprises depend for certain kinds of input or output. To clarify allegations of unfair hindrance in this respect we initiated investigations concerning two leading retailers.

The one case concerns retroactively demanding "wedding rebates" as part of a merger after having conducted its annual agreements and of demanding unfair terms of payment.

The other case concerns the question to what extent there is a violation of competition law if the retailer immediately retained compensation for damage claims for late or faulty consignments.

As we want to get a better overall picture of the situation in retailing, in February this year, we started a sector inquiry into the food retail sector:<sup>13</sup> The focus lies on the competitive conditions in the markets for the procurement of products by food retailers. The scope of the inquiry will be limited to the clarification of specific questions and on selected product groups.

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<sup>13</sup>. See press release of the Federal Cartel Office of 14.02.2011, [http://www.bundeskartellamt.de/wEnglisch/download/pdf/20110214\\_PRFoodRetailSector.pdf](http://www.bundeskartellamt.de/wEnglisch/download/pdf/20110214_PRFoodRetailSector.pdf).

The aim is to determine whether and, if so, to what extent the leading food retailers enjoy purchasing advantages over their competitors. Furthermore, the effects of such advantages on competition in the sales markets will be examined.

Several other European member states have also used sector inquiries to gain new insights into retailing. I just want to mention that in October 2010 the Italian Competition Authority launched an inquiry into “large food retail distribution“. Also in 2010 the French Autorité de la Concurrence started proceedings in the food retail sector. And already in 2008, the UK Competition Commission completed a market investigation into the wholesale grocery sector.

## **E. Vertical cartel case**

Next I would like to provide you with some details on our investigations in the retail sector into vertical agreements and concerted practices.

At the beginning of 2010, we dawn raided 15 companies, 11 retailers and 4 manufacturers of branded consumer goods.<sup>14</sup> The allegations concerned the fixing of end consumer prices for confectionery, coffee and pet food. We are focusing on vertical price fixing, a clear-cut infringement. But investigations are still ongoing.

In these proceedings several undertakings have applied for leniency. In order to help these undertakings to fulfill the requirement of lawful conduct in the future, the responsible decision division has published a recommendation paper. In this context a lively debate has started: At issue here is the need for collaboration between retailers and producers and the limits which competition law sets.

To take just one point: Manufacturers of branded goods try hard to prevent the sale of their products at “dumping” prices, as they call them. To achieve this goal, it often seems that they prefer to resort to instruments which finally result in resale price maintenance.

Otherwise, they claim, research in and the development of new brands would not pay off anymore. From a competition point of view, however, this is a restriction of intra-brand competition and usually leads to higher prices for the end consumer. I want to point out, that this assessment is widely shared by competition authorities across Europe.

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<sup>14</sup>. See press release of the Federal Cartel Office of 14.01.2010, [http://www.bundeskartellamt.de/wEnglisch/download/pdf/Presse/2010/PM\\_140110\\_-\\_E.pdf](http://www.bundeskartellamt.de/wEnglisch/download/pdf/Presse/2010/PM_140110_-_E.pdf).

Of course we are aware of the discussion about RPM, revitalized by the Leegin-judgment of the US Supreme Court.<sup>15</sup> But in contrast to legal practice in the United States, in Europe we do not acknowledge a per-se ban on vertical price agreements. Under certain circumstances RPM may lead to efficiencies, which can result in an exemption under Article 101(3). But I stress that it is the duty of the parties to convincingly demonstrate this.

To protect their brands, manufactures may resort to other means available under competition law which induce negative side-effects less often. They can e.g. distribute via selective distribution systems.

## **F. Mergers**

In the light of an already high concentration in food retail the Bundeskartellamt looks very carefully at merger projects in this sector. This is necessary even if a single merger may lead to just a small increase in concentration. What should be avoided are kinds of creeping acquisitions: Instead of buying a whole retail store chain, parties could try to split up their acquisitions into several transactions. Every single one might be “too small to fail”.

Maybe the most prominent retail merger case was the already mentioned acquisition of Plus by Edeka in 2008.<sup>16</sup> This could only be cleared subject to the condition that some of the target stores were sold to a third party. A more recent case involves the markets for drinks: Edeka planned to take over trinkgut, one of the biggest drinks store chains in Germany. The case could again be cleared subject to conditions.<sup>17</sup>

In both cases we also had a closer look at procurement markets and the problem of buyer power.

As regards the acquisition of Plus by Edeka, the notified merger would have intensified the already high level of market concentration in the procurement of goods. The result would have been an even greater dependence of the suppliers on their purchasers. Lowered purchasing prices would have further strengthened Edeka’s position on retail markets in comparison to that of its competitors. It was unclear whether cost savings would be passed on

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<sup>15.</sup> In June 2007 the Supreme Court ruled that an agreement of resale price maintenance is not a per-se violation of Section 1, Sherman Act. Rather a violation must be evaluated under the rule of reason approach. With this ruling the court decided against a legal practice lasting for almost 100 years. See *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007).

<sup>16.</sup> See FCO, case B2-333/07 of 30 June 2008.

<sup>17.</sup> See FCO, case B2-52/10 of 28 October 2010.

to the consumer. Consequently, the planned purchasing cooperation between Edeka and Tengelmann, the former parent company of Plus, could not be put into practice.

In Edeka/trinkgut we had some indications that the big retail chains jointly dominate the procurement markets for branded products in the non-alcoholic beverages sector. However, this aspect did not prevent a clearance of the merger.

## **G. European environment**

The above explanations will have illustrated that the food sector in Germany is far from perfect from a competition point of view. In view of this the close supervision by the Bundeskartellamt is more than appropriate. Yet the market situation in other member states in the EU is quite similar. And so the challenges for their competition authorities are just as great as ours.

Let me give you some examples.

Besides Germany a vast majority of EU Member States perceive the retail sector as highly concentrated or oligopolistic. Because of the European dimension of the problem, the Commission set up a “Forum for a Better Functioning Food Supply Chain”. One issue is the concentration and consolidation along the food supply chain and the degree of bargaining power of the actors.

A range of European competition authorities decided to use sector inquiries to cast some light on certain aspects of the retail sector. I have already mentioned some examples.

Cartels in the food sector seem to be quite widespread in Europe:

First of all I would like to dwell on one of the most prominent cases last year: The Office of Fair Trading imposed fines totaling roughly 260 million Euros against two tobacco manufacturers and ten retailers.<sup>18</sup> The manufacturers had individual arrangements with each retailer whereby the retail price of a tobacco brand was linked to that of a competing manufacturer's brand. These arrangements clearly restricted the ability of these retailers to determine their selling prices independently.

The parallels to our retail cartel case mentioned above are quite obvious.

Let me mention only some of the other cases: In February 2009 the Italian Autorità Garante

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<sup>18.</sup> See press release of the Office of Fair Trading of 16.04.2010, <http://www.offt.gov.uk/news-and-updates/press/2010/39-10>.

della Concorrenza e del Mercato fined two associations and 26 companies for having agreed price increases for dry pasta products.<sup>19</sup> In April 2008 the Czech Office for the Protection of Competition<sup>20</sup> imposed a fine for price fixing agreements for chilled and frozen chicken meat. The European Commission has also taken up cartel cases in the food sector: one example is the case concerning the import and marketing of bananas in 2009.<sup>21</sup>

As compared to other European countries, the German food sector does not seem to be special at all. On the contrary - concentration on the retail level and in food production as well as horizontal and vertical cartels seem to be regrettably normal across Europe.

### **III. Outlook/ Conclusion**

Competition concerns in the retail sector will remain an issue this year. We will maintain our dialogue with all the market participants. But I am optimistic: The conclusion of our vertical retail case and the knowledge gained in the course of our sector inquiry will cast more light on this discussion.

Last but not least, I would underline: The food sector does not differ much from any other sector from the point of view of a competition authority. In particular cartel infringements occur in a wide variety of sectors, ranging from ready-mix-concrete over manufacture of steam boilers to ophthalmic lenses. But these sectors were not today's subject. Each of them would provide enough substance for a speech on their own.

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<sup>19.</sup> See press release of the Autorità Garante della Concorrenza e del Mercato of 26.02.2010, <http://www.agcm.it/en/newsroom/press-releases/1600-i694-pricing-of-pasta.html>.

<sup>20</sup> Úřad pro ochranu hospodářské soutěže

<sup>21.</sup> Case COMP/39188 (2008) – Bananas.