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**Brands, Product Differentiation and EU  
Competition Law**

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# Brands, Product Differentiation and EU Competition Law

Ioannis Lianos

## Abstract

*The paper explores how EU competition law has integrated so far the concept of brands in different areas of enforcement. Although EU competition law has engaged in multiple instances with branding and product differentiation, brands do not yet constitute an operational concept in EU competition law. This is due to an important uncertainty as to the normative choices that need to be made with regard to the relation between brands and the formation of consumer preferences. The concerns raised by retailer power and the development of private labels also indicate that the existing economic theory on product differentiation may not also provide a complete picture on the effects of brands on the competitive process and ultimately on consumers. Competition law will also need to tackle the issues raised by the development of 'social branding' and the dialogic interaction between brand owners and consumers in the constitution of their brand identity.*

**Keywords:** Brand, Product Differentiation, Advertising, Branding, Social Brands, Monopolistic Competition, Imperfect Competition, Consumer Choice, Consumer Welfare, Private Labels, Veblen Goods, Market Power, Franchise, Selective Distribution, Competition, Antitrust, Brand Loyalty

**JEL Classification:** K21, L4, L42

# Brands, Product Differentiation and EU Competition Law

Ioannis Lianos<sup>1</sup>

## INTRODUCTION

The term of the art 'brands' is often used in EU Competition law with the aim of providing factual information on the competitive, or not, relation between products or services provided by different economic actors. The Commission often refers in its merger or antitrust decisions to the products (or services) of brand X that enter in competition on a relevant market with the products (or services) of brand Y. The term brand used in this context aims to provide a factual observation on the operation of the specific relevant market. No further inferences are made. Inquiring into the role of brands in this context is a simple exercise and offers little to the research question explored in this volume. The issue becomes, however, more complex if one engages with the use of brands as an *operational concept* in EU competition law. Operational concepts connect theoretical concepts to simple factual observations. For instance, the operational concept of 'market power' connects a fact over the level of prices in a specific market at a certain point in time, which is partially an observable fact, with the theoretical construction of price theory, say for instance the theoretical concept of monopoly or its antithesis, that of perfect competition, from which market power is a departure. These operational concepts help decision-makers to make inferences (they serve as analytical shortcuts) about the relation between the different facts they observe in order to assess causal relations and make predictions.

It is now accepted that competition law makes an extensive use of operational concepts transplanted from the discipline of economics, in particular neoclassical price theory<sup>2</sup>. Yet, its receptivity to operational concepts developed in other disciplines, management studies in particular, has been relatively limited. And here lies the core of the problem with regard to the engagement of EU competition law with the *concept* of 'brands'. Although the discipline of economics and in particular neoclassical price theory perceives brands as a *fact* of economic life, price theory has not made use until recently of the term as an operational concept. Instead, economists prefer to focus on

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<sup>1</sup> Professor of Global Competition Law and Public Policy; Director, Centre for Law, Economics and Society, UCL Faculty of Laws; I would like to thank Nick Economides, Peter Davis and Spencer Weber Waller for their insightful comments on an earlier version of this paper. Any errors or omissions are of the sole responsibility of the author. This chapter was written while on leave from UCL with support from the Leverhulme Trust. I also benefitted from the support of the Laboratory on Law and Development at the National Research University, Higher School of Economics.

<sup>2</sup> See, I. Lianos, 'Lost in Translation' Towards a Theory of Economic Transplants, (2009) 62(1) *Current Legal Problems*, 346–404.

the semi-operational concept of product differentiation<sup>3</sup>, advertising<sup>4</sup> or that of barriers to entry, which describe the consequences of the existence of brands, but do not engage directly with the concept of brand. However, marketing studies use 'brands' as an operational concept. Brands also extend to more than *product* differentiation, as they may be used by brand-owners in order to reinforce the "emotional and cognitive appeal" of a certain brand to consumers, as this is well explained in several of the contributions to this volume<sup>5</sup>.

One of the possible reasons of this relatively low analytical value of the concept of brand in neoclassical price theory comes from the relative ambiguity of the policy prescriptions of the theoretical models of 'imperfect competition' and 'monopolistic competition' which were the first to fully engage with product differentiation in the welfare economics tradition and to discuss the role of brands in the competitive process.

Although not ignored by Marshall, product differentiation really became the focus of economic inquiry starting in the 1930s. Two positions emerged in the literature. Relying on the welfare economics paradigm and having as a starting point for the analysis the concept of 'industries' producing a single/homogeneous commodity, Robinson's *Economics of Imperfect Competition* viewed product differentiation as a departure from the ideal of perfect competition, hence the use of the term 'imperfect' to qualify the situation of product heterogeneity, the term 'imperfect' indicating the direction to go (that of 'perfect' competition)<sup>6</sup>. In his *Theory of Monopolistic Competition*, Chamberlin took a different perspective, focusing on the concept of firm, rather than that of industry and viewing product differentiation as a normal fact of economic life, the concept of monopolistic competition describing the process of many sellers who produce heterogeneous products in response to divergent demands and preferences of consumers<sup>7</sup>. Chamberlin noted that

the consequences of product heterogeneity for welfare economics have been either ignored or seriously misunderstood. Monopoly elements are built into the economic system and the ideal necessarily

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<sup>3</sup> Semi-operational as it describes an observable fact as well as serving the function of an operational concept.

<sup>4</sup> Which includes money spent on brands. It is also recognized that brands can be a source of across sub-market 'linkage'. See, J. Sutton, *Technology and Market Structure – Theory and History* (MIT Press, 2001), chapters 11 and 12.

<sup>5</sup> See, for instance, Chapter 12 by Andrew Griffiths, noting that "the identity that a brand confers on products gives a context to an individual act of consumption which may increase its emotional impact and turn it into the basis of a continuing relationship" and that "branding can transform a product into a source of self-assurance or a means of self-expression or a symbol of status or of adherence to certain values".

<sup>6</sup> J. Robinson, *The Economics of Imperfect Competition* (London: Macmillan, 1933).

<sup>7</sup> E.H. Chamberlin, *The Theory of Monopolistic Competition* (Cambridge, MA: Harvard University Press, 1933).

involves them. Thus wherever there is a demand for diversity of product, pure competition turns out to be not the ideal but a departure from it<sup>8</sup>.

According to Chamberlin, ‘if heterogeneity is part of the welfare ideal, there is no prima facie case for doing anything at all’, the choice to be made being ultimately that of a ‘less heterogeneous output as against a smaller, more heterogeneous one’<sup>9</sup>. This brings to the fore the idea that price is not the only, or the most important, parameter of competition and that quality and variety may also constitute important parameters one should take into account<sup>10</sup>.

These contrasting views over product differentiation reflect the difficulties of ‘brands’ and ‘brand theory’ to gain acceptance as a useful operational concept in competition law<sup>11</sup>. This chapter aims, first, to discuss the difficult normative choices that would entail the integration of ‘brands’ in the toolbox of competition authorities and the courts, in particular in view of the goals pursued by EU competition law, and, second, to describe instances in which the concept of brands played an important role in the competition assessment conducted under EU competition law, and the limits it faced.

## **NORMATIVE CHOICES**

One of the most difficult issues to resolve when discussing about the added value offered by the concept of brand in competition law has to do with the role of consumers in the process of product differentiation that is inherent in the existence of brands. In competition law, the aim of protecting consumers implies that the outcome/consequences of a specific practice on consumers matters, before any decision on the lawfulness or unlawfulness of this practice has been reached. A different approach would take a deontological perspective and would emphasize competitive rivalry, irrespective of any

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<sup>8</sup> E.H. Chamberlin, Product Heterogeneity and Public Policy, *The American Economic Review*, 40(2) (1950), 85-92, 92.

<sup>9</sup> E.H. Chamberlin, Product Heterogeneity and Public Policy, *The American Economic Review*, 40(2) (1950), 85-92, 89-90. Two basic formalizations of product heterogeneity emerged in economics. The spatial model, which treats competition as a localized phenomenon, the assumption being that ‘consumers purchase a limited number of brands (often one) from a small subset that are most preferred’ and the representative consumer model, according to which ‘a representative consumer purchases many brands, varying the proportions of each according to their prices and exogenously given utility weights’: J.M. Perloff and S.C. Salop, Equilibrium with Product Differentiation, *Review of Economic Studies*, (1985), 107-20.

<sup>10</sup> Despite the different focus and policy prescriptions, Chamberlin’s theory forms nevertheless part of the neoclassical price paradigm and shares with perfect competition “the common neoclassical hard core”: see S. J. Latsis, “Situational Determinism in Economics”, *The British Journal for the Philosophy of Science*, 23(3) (1972), 207-245.

<sup>11</sup> Although one should note the considerable progress that product differentiation based oligopoly models brought to merger control and all other areas of competition law from the early 1980s on. Yet, these models do not engage systematically with the psychological aspect of consumer behaviour and the formation of consumer preferences, for instance the emotional and cognitive appeal of brands.

actual or potential consequences of the specific practice/conduct on consumers or other protected interests, or some other 'political objective', such as in the EU context, the construction of an Internal Market. So the question one should ask how the constitution of brands and branding in general affects the interests that the specific competition law aims to protect.

Taking, for the benefits of comparison with other competition law regimes, the interests of consumers as a starting point<sup>12</sup>, one needs to take into account that there are various possible normative assumptions as to the relation between brands and consumer interest in this context.

If one takes the perspective of price theory, the protection of consumer surplus, the consumer part of the deadweight loss suffered as a result of the restriction of competition, will constitute the main focus of the analysis. As the development of a brand involves fixed costs that need to be recuperated over time, firms will not invest on it unless they are able to charge higher than competitive prices<sup>13</sup>. A price increase might lead to a volume effect that would be suffered by a certain category of consumers: because of the price increase some consumers will not be able to buy the product anymore, although past consumption patterns (revealed preferences) indicate that they would have preferred to do so, had the price not increased. Under this narrow definition of consumer surplus, the overcharge paid by the consumers, as a result of the price increase, should not be of concern for competition law enforcement, as it constitutes a wealth transfer from the buyers to the sellers. The suppliers may be in a position to compensate (hypothetically, not actually) the loss that consumers have suffered while still being able to compensate with this wealth transfer their own losses following the volume effect (producer surplus). Hence, if branding provides opportunities for more intensive product differentiation, this should not necessarily be a concern for competition law, even if that product differentiation leads to higher prices for certain categories of consumers, when, after factoring in the volume effect, it has also the effect to increase the profits of the brand owners to an extent that any loss of consumer surplus could be (hypothetically) covered. This is not the approach taken by EU Competition Law, in view of the emphasis it puts on the fact that, to be justified, restrictions to competition should at least be neutral from the point of view of those consumers directly or likely affected by the restrictive agreement<sup>14</sup>. One may also advance that product differentiation may reduce

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<sup>12</sup> I. Lianos, Some reflections on the objectives of EU competition law, in I. Lianos, and D. Geradin (Eds.), *Handbook in EU Competition Law: Substantive Aspects* (Cheltenham, UK: Edward Elgar), 1-85.

<sup>13</sup> This is an assumption that may not always prove correct, as I will show later with the discussion over private labels, as in reality as the introduction of a new brand may allow all firms to raise prices but an increase in competing brands of products may also tend to lower prices, as the firm would lose sales to the new brand (cannibalize its sales) and rival's promotional activities may increase demand for the category or steal customers.

<sup>14</sup> Commission Guidelines on the application of Article 81(3) of the Treaty [2004] OJ C 101/97, paras 85. Although the Commission accepts that consumer harm assessed under Article 101(1) TFEU (e.g. higher prices) might be compensated by some benefits provided by the



output, the classic dilemma being that of a 'less heterogeneous output as against a smaller, more heterogeneous one', in which case a total welfare standard approach would view branding with suspicion.

The matrix changes if we move beyond consumer surplus and include in the analysis the wealth transfer that consumers may have incurred because of the overcharges that resulted from the development of brands and increased product differentiation. These may not only relate to higher prices but could also cover any other parameter of competition, such as quality, variety, innovation. In this case, both the loss of consumer surplus and wealth transfers will be compared to the total efficiency gains pertaining to the supplier(s), thus enabling a cost benefit analysis of the effect of the conduct on the welfare of a specific group of market actors, direct and indirect consumers. In this case, one may argue that branding and the product differentiation that ensues may enable the brand owner to increase the price of the branded good and thus to collect additional rents from the consumers that continue purchasing her products. The implicit counterfactual is that, in the absence of the brand and product differentiation, this price increase and the exploitation of this category of consumers would not have been possible. The assumption here is that brands and product differentiation lead to an increased ability and incentive for brand owners to increase prices for consumers that do not switch to other brands or competing products (inframarginal consumers).

Some authors also argue that competition authorities should aim to preserve an optimal level of 'consumer choice', defined as 'the state of affairs where the consumer has the power to define his or her own wants and the ability to satisfy these wants at competitive prices'<sup>15</sup>. They use interchangeably the term of 'consumer sovereignty', which is defined as 'the set of societal arrangements that causes that economy to act primarily in response to the aggregate signals of consumer demand, rather than in response to government directives or the preferences of individual businesses'<sup>16</sup>. Consumer sovereignty may be preserved as the ability of consumers to influence the characteristics of the product bundle according to their own "hypothetical" revealed preferences. Hypothetical revealed preference theory defines an agent's preferences in terms of what she would choose if she were able to choose, thus switching from actual to hypothetical choice<sup>17</sup>. The way this theory will work in practice is still a matter of speculation. It is clear that

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anticompetitive agreement assessed under Article 101(3) ('efficiency gains'), they require that these benefits *effectively* (and not only hypothetically) and *fully* compensate the consumer harm in a way or another.

<sup>15</sup> R.H Lande, Consumer Choice as the Ultimate Goal of Antitrust, *University of Pittsburgh Law Review*, 62(3) (2001), 503-25, 503.

<sup>16</sup> N.W. Averitt and R. H. Lande, Consumer Sovereignty: A Unified Theory of Antitrust and Consumer Protection Law, *Antitrust Law Journal*, 65 (1997) 713-56, 715 .

<sup>17</sup> For a critical analysis see, D.M. Hausman *Preference, Value, Choice, and Welfare* (Cambridge University Press, 2012), 31-3.

consumers are influenced in their decisions by 'the context of choice, defined by the set of options under consideration. In particular, the addition and removal of options from the offered set can influence people's preferences among options that were available all along'<sup>18</sup>. The firms with their marketing activities may, for example, shape endogenously consumer preferences by establishing an artificial selection process, 'preferences are actually constructed—not merely revealed'<sup>19</sup>. A greater focus on consumer sovereignty may thus, in some cases, lead to more intensive competition law intervention to establish the parameters of independent consumer choice and specific presumptions against commercial practices that deny the sovereignty of consumer choice. The consumer choice or consumer sovereignty standard may also accommodate the psychological aspect of the formation of these preferences, which is usually ignored in neoclassical price theory.

Transposing this debate over the issue of branding, it becomes essential to explore the origins of product differentiation. If product differentiation constitutes a natural outgrowth of consumer preferences, to which firms tend to respond by developing different brands, then one may argue that brands promote consumer choice<sup>20</sup>. If, however, product differentiation constitutes a way to manipulate consumer preferences, this may contradict the consumer sovereignty principle and brands may be perceived as limiting consumer choice; hence, the need to understand how brands relate to consumer preferences, should the aim of competition law be the protection of the interest of consumers.

Similar concerns have also been expressed for another technique of product differentiation: advertising. As Kyle Bagwell argues in his study over the *Economic Analysis of Advertising*, advertising was 'almost entirely a 20<sup>th</sup> century project', in view of the focus of economic theory in the nineteenth century on the development of the perfect competition theory, which suggests no role for product differentiation<sup>21</sup>. Economic theory on advertising emerged

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<sup>18</sup> E. Shafir, I. Simonson and A. Tversky, Reason-Based Choice, (1993) 49 *Cognition* 11-36, 21.

<sup>19</sup> *Ibid.*, p. 34.

<sup>20</sup> This seems to have been the view of E.H. Chamberlin, Product Heterogeneity and Public Policy, *The American Economic Review*, 40(2) (1950), 85-92, 86, according to whom "monopoly is necessarily a part of the welfare norm. In abstract terms it seems to follow very directly from the recognition that human beings are individuals, diverse in their tastes and desires, and moreover widely dispersed spatially. Insofar as demand has any force as a guide to production, one would expect entrepreneurs to appeal to them in diverse ways, and thus to render the output of the economy correspondingly heterogeneous, using this term in its broadest sense to embrace not only the qualitative aspects of the product itself, but also the conditions surrounding its sale, including spatial location. And since what people want—an elaborate system of consumers' preferences—is the starting point in welfare economics, their wants for a heterogeneous product would seem to be as fundamental as anything could be. Heterogeneity as between producers is synonymous with the presence of monopoly; therefore monopoly is necessarily a part of the welfare ideal'.

<sup>21</sup> K. Bagwell, *The Economic Analysis of Advertising*, Discussion paper No. 0506-01, Columbia University, Department of Economics, August 2005, pp. 1-2. See, for instance,

with Marshall in the late decade of the nineteenth century and early twentieth century and later developed in three distinct periods, depending on the dominant conception of the function advertising plays in relation to consumer preferences<sup>22</sup>.

During the first period, economists perceived advertising as a tool to alter consumer preferences and to create product differentiation and brand loyalty, driving the demand curve of the advertised product to become more inelastic and thus leading to higher prices for consumers. The dominant perception at the time was that advertising led to a waste of resources, and had an 'entry-deterrence effect', as it aimed to manipulate the preferences of the consumers in favour of the products of a particular firm ('the persuasive view')<sup>23</sup>. Consumer preferences were thus endogenously determined. Joan Robinson represented this view when she argued that 'the customer will be influenced by advertisement, which plays upon his mind with studied skill, and makes him prefer the goods of one producer to those of another because they are brought to his notice in a more pleasing or more forceful manner'<sup>24</sup>. Empirical work has confirmed some of the intuitions of the 'persuasive view'. Comanor and Wilson performed a multi-variate regression analysis of the averaged profits of manufacturers in 41 consumer-good industries for a period of three years and found 'empirical support for the conclusion that the heavy volume of advertising expenditures in some industries serves as an important barrier to new competition in the markets served by these industries'<sup>25</sup>. More recently, with regard to product differentiation Bronnenberg *et al* highlighted that brands, advertising, or other past experiences and social milieu, such as childhood, lead to 'preference capital', which could be a valuable asset for incumbent firms and a source of long-term economic rents for them<sup>26</sup>. This

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<sup>22</sup> K. Bagwell, *The Economic Analysis of Advertising*, Discussion paper No. 0506-01, Columbia University, Department of Economics, August 2005, p. 3.

<sup>23</sup> K. Bagwell, *The Economic Analysis of Advertising*, Discussion paper No. 0506-01, Columbia University, Department of Economics, August 2005, p. 9.

<sup>24</sup> J. Robinson, *Economics of Imperfect Competition* (London, Macmillan 1933), p. 90. Among the different authors listed in the 'persuasive view' K. Bagwell, *The Economic Analysis of Advertising*, Discussion paper No. 0506-01, Columbia University, Department of Economics, August 2005, includes D. Braithwaite, The Economic Effects of Advertisement, *Economic Journal*, 38 (1928), 16-37 (arguing that advertising may help to create 'reputational monopolies' while it has a modest quality-guarantee effect); N.V. Kaldor, The Economic Aspects of Advertising, *Review of Economic Studies*, 18 (1950), 18, 1-27 (arguing that advertising provides a modest degree of information while wasting resources and that it also enhances concentration, as because of the economies of scale in advertising only the most profitable and larger firms are able to finance larger advertising expenditures and to develop direct connection with the consumers, by-passing other middlemen, such as retailers); J.S. Bain, *Barriers to New Competition: Their Character and Consequences in Manufacturing Industries* (Cambridge, MA: Harvard University Press, 1956), (noting that product differentiation constitutes the most important entry barrier and that advertising is the primary source of product differentiation); J.K. Galbraith, *The Affluent Society*, (Boston, MA: Houghton-Mifflin Co., 1958) (criticizing the passive role of consumers in the process).

<sup>25</sup> W.S. Comanor and T. A. Wilson, *Advertising and Market Power* (Cambridge, MA: Harvard University Press, 1974), p. 239.

<sup>26</sup> Bart J. Bronnenberg, J.-PH. Dubé, M. Grentzkow, The Evolution of Brand Preferences: Evidence from Consumer Migration, *American Economic Review*, 102(6) (2012), 2472–2508.

explains, according to these authors, why consumers have high willingness to pay for particular brands, even when the alternatives are objectively similar<sup>27</sup>. This evidence indicates that brand loyalty may not always be a natural outgrowth of consumer preferences and that there is value for firms to use advertising, branding or other forms of product differentiation in order to establish some form of 'preference capital'. This strategy may generate high willingness to pay for consumers and presumably steady economic rents for the incumbents in the future, without that being justified by the objective characteristics of their product/or service in comparison to the products/services of a new entrant. In other words, incumbent firms may have the incentives and the ability to alter the utility function of consumers in order to increase their profits. From this may result possible distortions of competition, which according to Nick Economides may fall into three categories:

(f)irst competition in perception advertising may result in a larger number of brands at equilibrium than is optimal. Second, the tie in produces an allocative distortion. Third, resources are wasted in the effort to link desired mental images with advertised goods<sup>28</sup>.

A different approach is advanced by the proponents of the 'informative view'<sup>29</sup>, which consider that the principal function of advertising is to convey information to consumers, and from that perspective, to help them choose the products/services that correspond the best to their preferences<sup>30</sup>. This view has been advanced by authors close to the Chicago School of economics<sup>31</sup>. Telser, a proponent of that view, argued that 'advertising is frequently a means of entry and a sign of competition', in view of its role as 'an important source of information' for consumers<sup>32</sup>. More importantly, although Telser recognizes that 'firms which have some monopoly power are more likely to advertise because they can obtain most of the increased sales stimulated by their advertising', he also finds a weak correlation between concentration or stable market shares and advertising, thus questioning the causal link earlier

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<sup>27</sup> Ibid. See also, B.J. Bronnenberg, S.K. Dhar, J.-P.H. Dubé, Brand History, Geography, and the Persistence of Brand Shares, *Journal of Political Economy*, 117(1) (2009), 87–115. Yet, these preferences are shaped during a considerable period of time.

<sup>28</sup> N. Economides, The Economics of Trademarks, *Trademark Reporter*, vol. 78 (July-August 1988), 523-539.

<sup>29</sup> Although one should also note that even under the informative view, advertising can be a barrier to entry, as in any case it involves firms spending a lot of money to "inform" customers rather than "persuade" them. Yet, this approach acknowledges the social value of these additional expenses, thus attempting to justify the possible barriers to entry that may emerge from advertising.

<sup>30</sup> K. Bagwell, *The Economic Analysis of Advertising*, Discussion paper No. 0506-01, Columbia University, Department of Economics, August 2005, p. 16.

<sup>31</sup> G.J. Stigler, The Economics of Information, *Journal of Political Economy*, 69 (1961), 213-25.

<sup>32</sup> L.G. Telser, L. G., Advertising and Competition, *Journal of Political Economy*, 72 (1964), 537-62, 558.

made by the proponents of the persuasive view<sup>33</sup>. Nelson also advances an informative view argument by distinguishing between search goods (whose quality can be determined prior to purchase, even if at high costs) and experience goods (whose quality can only be determined after consumption) and observing the benefits of advertising (and enhanced product differentiation) for experience goods (through the provision of indirect information on the product)<sup>34</sup>. Advertising constitutes a way for the firms to signal to consumers that they are the most efficient (low-cost) firms, since they seek demand expansion (the 'signalling-efficiency effect' of advertising). Furthermore, '(a)dvertising increases the probability of a consumer's remembering the name of a brand', and therefore advertising assists the consumer by informing his choice ('the match-products-to-buyers effect'). Hence, advertising, as well as any mechanism of product differentiation (such as branding) stimulate price comparisons and therefore price competition. Finally, advertising, and brands in general, assist the consumer to draw positive associations between specific products and quality, reminding them of their previous experience with the product ('the repeat-business effect')<sup>35</sup>.

The 'complementary view' represents the third tradition in the economics of advertising, of relevance to our study<sup>36</sup>. Under this view, 'consumers possess stable preferences, and advertising directly enters these preferences in a manner that is complementary to the consumption of the advertised product', as consumer values 'social prestige' and 'advertising by a firm may be an input that contributed toward the prestige that is enjoyed when the firm's products is consumed'<sup>37</sup>. Inspired by the Chicago School 'informative view', the 'complementary view' takes for granted the preferences of consumers for 'social prestige' and argues that consumer utility in this case derives from the consumption of various commodities, advertising or brand image being one of them. Advertising does not alter consumer preferences but 'instead enters as an argument in a stable utility function'<sup>38</sup>. Hence, it is possible that 'firms may compete in the same commodity (e.g. prestige) market even though they produce different market goods (e.g. jewelry and fashion) and advertise at different levels'<sup>39</sup>. Hence, even uninformative advertising or branding may be

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<sup>33</sup> Ibid., 544.

<sup>34</sup> P. Nelson, P, Advertising as Information, *Journal of Political Economy*, 82 (1974),, 729-54, 732-34.

<sup>35</sup> Ibid.

<sup>36</sup> K. Bagwell, *The Economic Analysis of Advertising*, Discussion paper No. 0506-01, Columbia University, Department of Economics, August 2005, p. 20, citing the work of G.J. Stigler and G. S. Becker, De Gustibus Non Est Disputandum, *American Economic Review*, 67 (1977), 76-90; L.M. Nichols, Advertising and Economic Welfare, *American Economic Review*, 75 (1985), 213-8.

<sup>37</sup> K. Bagwell, *The Economic Analysis of Advertising*, Discussion paper No. 0506-01, Columbia University, Department of Economics, August 2005, pp. 20-1.

<sup>38</sup> K. Bagwell, *The Economic Analysis of Advertising*, Discussion paper No. 0506-01, Columbia University, Department of Economics, August 2005, p. 143.

<sup>39</sup> K. Bagwell, *The Economic Analysis of Advertising*, Discussion paper No. 0506-01, Columbia University, Department of Economics, August 2005, p. 21. Households act in order to maximize their utility. This involves the reconciliation of their preference ordering (or utility

beneficial to consumers, as consumers value directly the 'social prestige' image that this generates, which is part of their utility function.

Yet, one may advance the familiar distinction between marginal and inframarginal consumers to partly counter this argument<sup>40</sup>. Marginal consumers value the additional 'social prestige' provided by the manufacturer's expenses on advertising or more generally the branding of the product, hence they may switch to the specific product/service from other products/services with which the specific supplier competes in the market for 'social prestige'. Inframarginal consumers do not value these additional expenses and the additional 'social prestige' these may generate, as they value the product as such more than the commodity of 'prestige'. Manufacturers may thus consider only marginal consumers and ignore inframarginal consumers, depending on whether the demand curve shifts with this additional investment on the prestige commodity and whether that consumer surplus generated is captured by the consumers that value 'social prestige'<sup>41</sup>. Consequently, for inframarginal consumers, the additional 'social prestige' investment will not correspond to their preferences. However, the use of large amounts of data created on the Internet, including to some extent revelation of consumer preferences, can increase the category of marginal consumers, as opposed to that of inframarginal consumers<sup>42</sup>.

One could also refer to the issues raised by Veblen goods. Veblen, among others, has put emphasis on the phenomenon of 'conspicuous consumption'<sup>43</sup>, which brings attention to the role interpersonal effects have on utility functions or the need to focus on the inner motivations of consumers<sup>44</sup>. Leibenstein proceeded to a classification of consumer demand for goods and services according to the motivation behind consumer's demand. He distinguished between 'functional demand', which refers to the 'part of the demand for a commodity which is due to the qualities inherent in

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function) with their given budget (income). The budget constraint, along with the agent's preferences, provide the necessary information required to determine the consumption bundle that would maximize the agent's utility up to a tangency point, which indicates that there is no possibility of increasing utility by moving along the budget constraint. Taking into account this budget constraint, a 'social prestige' preference may be satisfied by different products, associated with social prestige because of their brand, advertising etc, the idea here being that 'preference are ordered over characteristics, not over goods': L.M. Nichols, Advertising and Economic Welfare, *American Economic Review*, 75 (1985), 213-8, 213.

<sup>40</sup> W. S. Comanor, Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy, *Harvard Law Review*, 98 (1985) 983. One should not however ignore the possibility that firms make investments on advertising in order to credibly 'signal' product quality where this is hard to observe.

<sup>41</sup> Although one should also take into account instances of non-functional demand, such as "bandwagon effects" and "snob effects", which may relativize the importance of the distinction between marginal and inframarginal consumers in certain contexts. These effects are explored in the next paragraph.

<sup>42</sup> I am indebted to Nick Economides for making this last point.

<sup>43</sup> T. Veblen, *The Theory of the Leisure Class* (New York: Macmillan, 1899).

<sup>44</sup> H. Leibenstein, Bandwagon, Snob, and Veblen Effects in the Theory of Consumers Demand, *Quarterly Journal of Economics*, 64 (1950), 183-207.

the commodity', and 'non-functional demand', which is 'the portion of the demand for a consumers' good which is due to factors other than the qualities inherent in the commodity'<sup>45</sup>. This relates to 'utility derived from the commodity is enhanced or decreased owing to the fact that others are purchasing and consuming the same commodity, or owing to the fact that the commodity bears a higher rather than a lower price tag'<sup>46</sup>. This non-functional demand may take different forms: (i) the 'bandwagon effect', which refers to 'the extent to which the demand for a commodity is increased due to the fact that others are also consuming the same commodity'; (ii) the 'snob effect', which refers to the 'extent to which the demand for a consumers' good is decreased owing to the fact that others are also consuming the same commodity (or that others are increasing their consumption of that commodity)' and finally, (iii) the 'Veblen effect' which refers to 'the phenomenon of conspicuous consumption, to the extent to which the demand for a consumers' good is increased because it bears a higher rather than a lower price', which is different from the 'snob effect' in the sense that it is a function of price, and not of the consumption of others<sup>47</sup>. Typical Veblen goods are luxury products for which brand differentiation constitutes an important asset. Leibenstein found that if 'the Veblen effect is the predominant one, the demand curve is less elastic than otherwise, and some portions of it may even be positively inclined'<sup>48</sup>, hence showing that higher prices may in some instances correspond to the preferences of consumers.

The decision to intervene in this context will therefore depend on the view one takes of product differentiation and its relation with the *real* preferences of the consumers. Those adept of the informative and/or the complementary view(s) will emphasize the value of product differentiation as an instrument to promote consumer welfare and consumer choice. The positive stance of the 'informative' and the 'complementary' views over advertising and brand differentiation was also echoed by other work focusing on the fact that product differentiation often responds to the heterogeneity of consumer demand<sup>49</sup> and on the need to reward 'pioneering brands' for risk bearing innovation<sup>50</sup>. Those adept of the persuasive view will be more reticent to intervene in order to ensure that consumer welfare is preserved and that consumers are offered a choice that corresponds to their individual preferences. Behavioural economics or neuro-economics research has also highlighted how 'affective/hot-mode' decision-making, encompassing emotions and motivational drives may alter consumers' tastes and create brand loyalty, in comparison to a counterfactual where decision-making would have been

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<sup>45</sup> Ibid., 189.

<sup>46</sup> Ibid., 189.

<sup>47</sup> Ibid., 189.

<sup>48</sup> Ibid., 207.

<sup>49</sup> K.J. Lancaster, Socially Optimal Product Differentiation, *The American Economic Review*, 65(4), 567-85.

<sup>50</sup> R. Schmalensee, Product Differentiation Advantages of Pioneering Brands, *The American Economic Review*, 72(3) (1982),, 349-65.

entirely based on the deliberative effort of consumers to maximize their objective function, as this derives from their 'cold-state' preferences<sup>51</sup>. A regulator inspired by paternalistic objectives would strive in this case to ensure that brand differentiation responds to the 'cold-state' preferences of the consumers rather than instigated by 'hot-mode' decision-making. However, it remains difficult to distinguish, outside the laboratory, what constitutes a 'hot-state' or a 'cold-state' preference. Furthermore, a systematic reliance on some form of objective list of preferences that might reasonably be expected to promote an agent's well-being may be antithetical to the theoretical premises of mainstream competition law to rely on markets and revealed preferences through market behaviour, unless one takes a different paradigm relying on some form of soft paternalism, which is still uncharted territory in the area of competition law<sup>52</sup>.

Addressing the issue of consumer preferences does not constitute the only challenge that brand differentiation sets to competition law. The development of brands was initially instrumental to the emergence of manufacturer market power, as through the constitution of brand loyalty manufacturers were able to foster direct relations with the consumers, without the intermediary of the middlemen (e.g. wholesalers, retailers), thus reversing the balance of power between the two poles of the vertical/distribution chain in favour of the manufacturers. Previously, products sold in retail stores were most often non-branded, access to a well-known retailer being the only way for a specific supplier to reach the consumers. Advertising and other tools of product differentiation may thus be perceived as an effort to re-balance the relationship between manufacturers and retailers, shifting power to the manufacturers<sup>53</sup>. The growth in manufacturer advertising, by substituting for retail service, and the associated phenomenon of the multiplication of brands, has nevertheless facilitated over time the emergence of a more concentrated retail market<sup>54</sup>. Multi-brand retailers have emerged as a focal point of distribution in certain product categories<sup>55</sup>. Furthermore, retailers have developed private labels, which have increased their retail gross margins and have eaten market share from some national brand owners, thus intensifying the "vertical competition" between the two poles of the vertical chain<sup>56</sup>.

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<sup>51</sup> K. Bagwell, *The Economic Analysis of Advertising*, Discussion paper No. 0506-01, Columbia University, Department of Economics, August 2005, pp. 143-46.

<sup>52</sup> R.A. Thaler and C. Sunstein, Libertarian Paternalism, *The American Economic Review*, 93(2) (2003), 175-79. Most of the work on soft paternalism is in the area of regulation.

<sup>53</sup> See, for instance, the work of R. Steiner, The Inverse Association Between Margins of Manufacturers and Retailers, *Review of Industrial Organization*, 8 (1993), 717-40.

<sup>54</sup> R.L. Steiner, Marketing Productivity in Consumer Goods Industries - A Vertical Perspective, *Journal of Marketing*, 42 (1978), 60-70.

<sup>55</sup> W. Comanor and P. Rey, Vertical Restraints and the Market Power of Large Distributors, *Review of Industrial Organization*, 17 (2000), 135.

<sup>56</sup> Retailers with strong private labels have more leverage with manufacturers and this helps them to increase their gross margins. Private labels may also enhance consumer loyalty to retail brands and therefore reinforce the horizontal market power of the retailers. This will in turn strengthen the retailers' vertical bargaining power against national brand manufacturers and will enable them to obtain better deals that will increase their profits; R L Steiner, The



Contrary to what was usually the case with the use of brands in the past, private labels often indicate the presence of a lower-price substitute to national brands. They illustrate that brands and product differentiation may take two different directions: either enable the firm to increase the price of the product and indicate higher quality for consumers likely to value this parameter of competition, or to signal the presence of a low-cost alternative, for consumers that are more attentive to the price parameter of competition. The development of brands linked to low-cost retail products (e.g. Lidl, Aldi), low-cost airlines (e.g. Ryanair), or more generally the launching of 'fighter brands' indicate the multiple uses and effects of brands in a business context.

Last but not least, the emergence of 'social branding', promotes the idea that brands communicate vital consumer meaning and that consumers and brand owners are interdependent to the extent that brands are connected, networked and socialized. The result is that people and communities identify with the brands they use and become co-creators to a certain extent of the brand meaning, along with the brand owner. This perception of branding breaks with the 'broadcast' or 'one-way information transmission model' of the persuasive/informative/complementary views and perceives branding as a 'dialogic and iterative' interaction between active consumers and brand owners<sup>57</sup>. Iconic brands resonate with the identity of large groups of consumers and lead to the formation of 'brand communities' that display brand loyalty but which also expect that this loyalty will not be betrayed by the brand-owner, whose discretion as brand manager is restricted by the broader values and reference points of the specific brand community<sup>58</sup>. The perception that brands are co-created by consumers and manufacturers or retailers renders more complex the discussion over the correspondence of product differentiation to consumer preferences and the complex interaction between consumer preferences and brand management by the brand owner.

This complexity may explain the ambiguity of competition law, in particular EU competition law, to the phenomenon of branding and product differentiation. If one may find some illustrations of a hostile rhetoric of competition law to branding, it is also possible to uncover instances where the value of brands for consumer welfare and other objectives of EU competition law, in general,

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Nature and Benefits of National Brand/Private Label Competition, *Review of Industrial Organization*, 24 [2004], 105, 106 (distinguishing between vertical competition, the competition between the different levels of the vertical structure, such as suppliers versus retailers over the sharing of the profits of the vertical chain, and horizontal competition, the competition between different vertical chains).

<sup>57</sup> See, for instance, D.R. Desai, From Trademarks to Brands, *Florida Law Review*, (2012) 981-1044, (noting the 'noncorporate dimension of branding' which 'involves consumers and communities as stakeholders in brands'); D.S. Ganjee, Property in Brands, in H. Howe and J. Griffiths (eds.) *Property Concepts in Intellectual Property Law* (Cambridge: CUP 2013), Forthcoming. Available at SSRN: <http://ssrn.com/abstract=2235721>;

<sup>58</sup> A.M. Munir, Jr and T.C. O'Guinn, Brand Community, *Journal of Consumer Research*, 27 (2001), 412-31; D. Holt, *How Brands Become Icons* (Cambridge, MA: Harvard University Press, 2004).

was duly recognized. It remains however that instances of the former are more numerous than instances of the latter, although one has to take into account the fact that product differentiation is prevalent in European markets and that *in fine* few competition cases investigated are selected on this basis.

## IMPLEMENTING THE OPERATIONAL CONCEPT OF BRANDS IN EU COMPETITION LAW

At several occasions, the European Commission and the EU courts have made use of the concept of brand in order to derive specific inferences in the context of the competition assessment of business conduct. Confirming our earlier findings as to the ambiguous effects of branding and more generally product differentiation on competition, the inferences made were not always going to the same direction. In some cases, product differentiation was perceived as a positive development that had to be preserved, by enabling undertakings to protect the value of their brand (brands operating as a competition law defence). In most cases relating to product differentiation, however, product differentiation was viewed with suspicion and led to findings of anticompetitive effects or raised concerns over restrictive to competition practices that had to be tackled (brands operating as a sword). Most recently, the phenomenon of brands came to the epicentre of the competition law discourse with the focus on private labels, in particular in the food sector industry.

### *Brands, product differentiation and market power*

In theory, by driving the demand curve of branded product or service to become more inelastic, brands, and more generally product differentiation, may be considered as a source of market power, in the economic sense of the word: the ability to raise prices profitably and reduce output<sup>59</sup>. Yet, the development of low-cost brands in different economic sectors (e.g. air transport, clothing, food, retail services) may raise doubts as to the validity of this correlation. Michael Porter has observed that product differentiation and cost leadership 'are usually inconsistent, because differentiation is usually costly'<sup>60</sup>. He remarked that firms may pursue both low cost leadership and product differentiation as strategy only in specific, and temporary circumstances, when all competitors are stuck in the middle, where cost is strongly affected by market shares, or when a firm introduces a major innovation. Other researchers have nevertheless emphasized the sustainability of the strategy of combining product differentiation and low cost leadership, thus explaining the successful emergence of low-cost brands<sup>61</sup>. Hill has shown the benefits of differentiation as a way of achieving a low-cost position in certain market configurations, such as high growing emerging industries that have significant learning and scale economies and the potential to differentiate the product, or mature industries experiencing significant

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<sup>59</sup> This does not mean that branding will always drive the demand curve to become more inelastic. It may also increase demand.

<sup>60</sup> M. Porter, *Competitive Advantage* (New York: Free Press, 1985), 18.

<sup>61</sup> Charles W. L. Hill, Differentiation versus Low Cost or Differentiation and Low Cost: A Contingency Framework, *The Academy of Management Review*, 13(3) (1988), 401-12;

technological change, which gives rise to new learning economies<sup>62</sup>. Major traditional 'quality-focused' brands are also launching low-cost 'no-frills' brands as a way to compete with mono 'low-cost' brands<sup>63</sup>. This increased product or service differentiation augments the elasticity of the demand curve and increases consumer choice.

The complex interrelation between low-cost and 'quality-focused' brands has not yet been thoroughly considered in EU competition law, which adheres to the assumption that brands and product differentiation lead to a more inelastic demand curve<sup>64</sup>. The objective of the firm may indeed be to use product differentiation (in variety or quality) to create a firm-specific demand curve that is more inelastic than the industry-wide demand curve. Competition authorities have relied occasionally on the inelastic demand curve of after-sales services or replacement equipment markets to define the brand as the relevant market, with the aim to protect from exploitation consumers that were 'locked in' the specific brand. Although these cases concern after-markets, with the presence of information imperfections and asymmetries between sellers and purchasers, and the brands involved are not household names, they illustrate that in certain circumstances, competition authorities and courts may define brands as a relevant market in order to protect consumers "locked in" a specific brand in certain contexts.

For instance, in *Hugin* a Swedish company having at the time 13 percent of the United Kingdom market for such registers was found by the Commission to have abused its dominant position for refusing to supply spare parts to its former exclusive distributor in the UK, which were needed to repair and maintain the large numbers of Hugin cash registers that it rented. Hugin had argued that the relevant market was to be 'cash registers' as a whole. The Court rejected this view and held instead that spare parts were separate products from the original equipment supplied, with the result that the relevant market was found to comprise only Hugin spare parts required by the independent undertakings repairing and servicing Hugin cash registers. By distinguishing the secondary market of spare parts from the primary market of the cash registers, the Court was able to ignore the possible competitive constraints that could be exercised on the conduct of the undertaking by its competitors on the primary market to which the independent retailers may have shifted their business. No justification was provided for such finding and

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<sup>62</sup> Charles W. L. Hill, Differentiation versus Low Cost or Differentiation and Low Cost: A Contingency Framework, *The Academy of Management Review*, 13(3) (1988), 401-12, 411.

<sup>63</sup> In the air transport sector, see, for instance, the plans of German carrier Lufthansa to launch in collaboration with Turkish Airlines a low-cost long haul carrier: [www.bloomberg.com/news/2014-07-09/lufthansa-to-expand-low-cost-push-as-spoehr-mulls-long-haul-model.html](http://www.bloomberg.com/news/2014-07-09/lufthansa-to-expand-low-cost-push-as-spoehr-mulls-long-haul-model.html)

<sup>64</sup> See, for instance, the classic CJEU judgment in Case C-27/76 *United Brands v. Commission* (Chiquita) E.C.R., 1978, I-207 (where the brand was considered as enhancing United Brands' dominant position).

the Court did not elaborate further as it found that the conduct did not affect trade between Member States.

The Commission set the principles of its aftermarkets analysis in its *Pelikan/Kyocera*, *Info-Lab/Ricoh* and *EFIM* decisions, relating to complaints regarding the market for toners for printers and toners for photocopiers<sup>65</sup>. In its Notice on market definition the Commission explained this approach by noting the need when defining a market not only to assess the responses of customers based on their purchasing decisions when relative prices change, but also constraints on substitution imposed by conditions in the connected markets<sup>66</sup>. If the issue of compatibility between the spare parts and the primary product is important for consumers and the primary product has a long lifespan, there might be the risk that charging higher prices to the ‘locked in’ the brand customers may be a profitable strategy, hence leading to the definition of a narrow secondary product market (e.g. spare parts, after-sales services). However, according to the Commission’s Notice, ‘a different market definition may result if significant substitution between secondary products is possible or if the characteristics of the primary products make quick and direct consumer responses to relative price increases of the secondary products feasible’. As it is further explained in the Commission’s vertical restraints guidelines,

(i)n practice, the issue to decide is whether a significant proportion of buyers make their choice taking into account the lifetime costs of the product. If so, this indicates there is one market for the original equipment and spare parts combined<sup>67</sup>.

Traditionally economic analysis on after-markets has emphasized whether consumers ‘full cost’ at the outset in order to distinguish between the different cases<sup>68</sup>. A similar approach was adopted by the US Supreme Court in

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<sup>65</sup> Case No. IV/34.330 - *Pelikan/Kyocera*, (1995) para. 6, (noting that the Commission will consider the following four elements: “the extent that a customer (i) can make an informed choice including lifecycle-pricing, knowing of the warranty restrictions of the various manufacturers, that he (ii) is likely to make such choice accordingly, and that, in case of an apparent policy of exploitation being pursued in one specific aftermarket, a (iii) sufficient number of customers would adapt their purchasing behavior at the level of the primary market (iv) within a reasonable time”; Case No. IV/E 2?36.431 – *Info-Lab/Ricoh* (1999), paras 37 *et seq.*; Case Case COMP/C-3/39.391 *EFIM*, C(2009) 4125, para. 16; For cases where similar issues were raised see, Commission Decision 91/595/EEC in Case No IV/M.12 — *Varta/Bosch*, OJ L 320, 22.11.1991, p. 26, Commission Decision in Case No IV/M.1094 — *Caterpillar/Perkins Engines*, OJ C 94, 28.3.1998, p. 23, and Commission Decision in Case No IV/M.768 — *Lucas/Varity*, OJ C 266, 13.9.1996, p. 6.

<sup>66</sup> Commission Notice on the definition of the relevant market for the purposes of Community competition law, [1997] OJ C 37/5, para. 56.

<sup>67</sup> Commission Guidelines on Vertical Restraints, [2010] C 130/1, para. 91. See also, DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses (2005), paras 257-258 (focusing on switching costs for customers to shift their demand to another primary product).

<sup>68</sup> See, P. Davis, L. Coppi and P. Kalmus, “The Economics of Secondary Product Markets”, OFT Discussion. Paper (2012).

*Eastman Kodak*, which has been perceived as animated by post-Chicago principles that market imperfections (e.g. information imperfections) may lead ‘unsophisticated’ market participants to be exploited in aftermarket for products they are locked in, even if the primary market is competitive<sup>69</sup>. In its most recent case law, the CJEU confirmed the approach followed by the Commission in after-market cases<sup>70</sup>.

Because of their characteristics and lifespan, some products may be particularly conducive to such form of exploitation of market power. In this context, the EU Courts and the Commission have either found that the specific brand may constitute the relevant market, or have examined thoroughly the anticompetitive effects on the ‘locked-in’ customers, the brand therefore becoming an operational concept in the competition law assessment. For instance, one may understand the *Volvo* and *Renault* judgments of the CJEU as relying on the assumption that the spare parts of each of these automobile manufacturers could be considered as a separate relevant market from that of the primary product, the automobile, the refusal to deliver by Volvo and Renault of these spare parts to independent repairers constituting an abuse of a dominant position<sup>71</sup>. More importantly, in its Motor Vehicle Distribution Regulation and guidelines, the Commission defines a separate relevant market for the repair and parts of each brand, thus conceiving the after-sales market as a separate market than the primary one<sup>72</sup>. According to the Commission, ‘(b)ecause of the generally brand-specific nature of the markets for repair and maintenance services and for the distribution of spare parts, competition on those markets is inherently less intense compared to that on the market for the sale of new motor vehicle’<sup>73</sup>. Furthermore, concerns over the exploitation of locked in consumers may also be justified by the fact that ‘repair and maintenance as a whole represent a

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<sup>69</sup> *Eastman Kodak Co v. Image Technical Services, Inc*, 504 US 451 (1992). The judgment of the Supreme Court was criticized by some scholars, e.g. Herbert Hovenkamp, *The Antitrust Enterprise Principle and Execution* 310 (Harvard 2005) (calling for the overruling of the Kodak precedent) and lauded by others (e.g. W.S. Grimes, *Antitrust Tie-in Analysis After Kodak: Understanding the Role of Market Imperfections*, *Antitrust law Journal*, 62 (1994), 263). Controversy withstanding, the *Eastman Kodak* precedent seems still to be good law, at least for some district courts, see, most recently, *Avaya, Inc. v. Telecom Labs, Inc.*, 1:06-cv-2490(JEI) (D.N.J., 2006) (27 March 2014). For a brief commentary see, Nicholas Economides, *Avaya v. TLI Gives New Life to Aftermarket Monopolization Litigation A-La-Kodak*, (8 August 2014), available at <http://competitionacademia.com/2014/08/avaya-v-tli-gives-new-life-to-aftermarket-monopolization-litigation-a-la-kodak-2/>

<sup>70</sup> Case C-56/12 P, *European Federation of Ink and Ink Cartridge Manufacturers (EFIM) v European Commission*. [September 19<sup>th</sup>, 2013] ECLI:EU:C:2013:575, para. 37.

<sup>71</sup> Case C-238/87, *AB Volvo v. Eric Veng*; 1988] ECR 6211; Case 53/87, *CICRA and Maxicar v. Renault* [1988] ECR 6039 decided the same day

<sup>72</sup> Commission Regulation (EU) No. 461/2010 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 in the motor vehicle sector, [2010] OJ L 129/52.

<sup>73</sup> Commission Notice, *Supplementary Guidelines on vertical restraints in agreements for the sale and repair of motor vehicles and for the distribution of spare parts for motor vehicles*, [2010] OJ C 138/6, para. 15.

very high proportion of total consumer expenditure on motor vehicles, which itself accounts for a significant slice of the average consumer's budget<sup>74</sup>.

The vertical restraints guidelines summarize this tradition of hostility of EU competition law towards branding power by stipulating that

(v)ertical restraints agreed for non-branded goods and services are in general less harmful than restraints affecting the distribution of branded goods and services. Branding tends to increase product differentiation and reduce substitutability of the product, leading to a reduced elasticity of demand and an increased possibility to raise price<sup>75</sup>.

Brands are considered in several parts of the guidelines as indicating the existence of market power of the brand-owner and as barriers to entry<sup>76</sup>.

EU competition law has not, however, gone as far as developing a full-fledged theory of relational (or superior bargaining) market power, on the basis of the 'economic dependence' that some retailers may have on a well-known strong brand or group of brands, even if the supplier does not dispose of a high enough market share to be found in a dominant position or providing him the ability to exercise market power, as it is the case in the competition law of some Member States (e.g. in German competition law: *'sortimentsbedingte Abhängigkeit'* or brand dependence)<sup>77</sup>. For instance, in the famous *Rossignol* case, the German Federal Court (BGH) found that because of its commercial value and its market prestige, there were not sufficient switching possibilities for the customers of Rossignol ski equipment, here a leading specialised sport retailer, even if there was considerable competition between Rossignol skis and other suppliers<sup>78</sup>. In particular, the Federal Court noted that, in addition to their price, the actual value of particular goods is determined by their quality and the producer's advertising activities, hence hinting to the role of product differentiation in providing some degree of (relative) market power. Although brands have been considered as reinforcing the finding of a dominant position, the European Commission and EU courts do not apply Article 102 TFEU on the simple basis of switching costs for consumers engendered by the appeal and reputation of a brand, in the absence of a dominant position on the relevant market.

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<sup>74</sup> Commission Notice, Supplementary Guidelines on vertical restraints in agreements for the sale and repair of motor vehicles and for the distribution of spare parts for motor vehicles, [2010] OJ C 138/6, para. 15.

<sup>75</sup> Commission Guidelines on Vertical Restraints, [2010] C 130/1, para. 104.

<sup>76</sup> See, for instance, Commission Guidelines on Vertical Restraints, [2010] C 130/1, paras 114, 117, 180

<sup>77</sup> For a critical analysis of the superior bargaining power approach, see F. Jenny, The 'Coming Out' of Abuse of Superior Bargaining Power in the Antitrust World [2008] available at [http://unctad.org/sections/ditc\\_ccpb/docs/ditc\\_ccpb0008\\_en.pdf](http://unctad.org/sections/ditc_ccpb/docs/ditc_ccpb0008_en.pdf). See also, I. Lianos, *La Transformation du droit de la concurrence par le recours à l'analyse économique* (Brussels: Bruylant, 2007).

<sup>78</sup> German Federal Court, *Rossignol* (1976) WuW/E 1391, 1393 *et seq.*

Product differentiation plays nevertheless a more active role in EU merger control, in view of the recent emphasis put on unilateral (non-coordinated) effects theory and a significant impediment of effective competition below the levels of dominance<sup>79</sup>. In all these cases the merging firms may find it profitable to alter their behaviour unilaterally, following the acquisition, by elevating the price and suppressing output and by acting independently of the remaining firms. Econometric techniques used in the context of differentiated products in order to assess these effects take also into account the multiple dimensions of consumer choice, as the parameters of the choice increase with the number of products considered. The literature provides different solutions regarding the existence of various dimensions of product competition (the dimensionality problem)<sup>80</sup>: (i) multi-level demand models, (ii) spatial models, and (iii) discrete choice models. Multi-level demand models, as well as spatial models, attempt to solve the dimensionality problem by dividing the products into smaller groups or sub-groups. The demand system applied has the Almost Ideal Demand System (AIDS) model formulation, under which it is assumed that consumers employ a multi-level decision making process when purchasing a product. The actual application usually involves a three stage system (although it is possible to have as many levels as necessary)<sup>81</sup>: the top level corresponds to overall demand for the product (for example, ready-to-eat cereal); the middle level involves demand for different market segments (for example, family, kids and adults cereal); and the bottom level involves a flexible brand demand system corresponding to the competition between the different brands within each segment. The discrete choice models take a more fundamental approach and project consumer preferences over the products' characteristics rather than the products themselves.

Nested logit models have also been used in order to examine the competitive interaction between brands in markets with differentiated products. In *Unilever/Sara Lee*, which concerned the sale of branded deodorants in a range of EU countries, the Commission estimated one and two-level nested logit models for deodorants, with nests for male and non-male deodorants, and sub-nests depending on whether the deodorant was presented as skin friendly. The Commission then combined the estimated elasticities of demand with standard supply-side assumptions (i.e., static Bertrand competition) to

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<sup>79</sup> Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings [2004] OJ L 24/1. For a recent account, see T. Mäger, Unilateral Effects in European Merger Analysis, in (B.E. Hawk, ed.) *Annual proceedings of the Fordham Corporate Law Institute 2010*, v. 37 (Juris Pub., 2011), p. 123-34; I. Kokkoris and H. Shelanski, *EU Merger Control: a Legal and Economic Analysis* (Oxford University Press, 2014), pp. 221-60.

<sup>80</sup> The brief analysis below draws on I. Lianos and C. Genakos, Econometric Evidence in EU Competition Law: An Empirical and Theoretical Analysis, in (I. Lianos and D. Geradin eds.), *Handbook in European Competition Law: Enforcement and Procedure* (Edward Elgar, 2013), pp. 1-137, p. 15-23.

<sup>81</sup> I. Small, Econometric Analyses of Unilateral Effects in Merger cases, (2009) 2 *Concurrences* 1-8.



simulate the price effects of the merger. The nested logit model used relied overall on simplifying assumptions, a crucial feature of which is that within each nest, switching between individual brands is proportional to brand market share. Hence, the Commission employed in this case a two-level nest structure, which subdivided the male and non-male deodorants according to some further product characteristic, that is whether or not the male or non-male deodorants are branded as being 'skin-friendly', thus reducing reliance on market shares, as the assumption that consumers switch between products in proportion to market shares is limited to a narrower product set (e.g. non-male skin friendly deodorants). Yet, even with this modification, the nested logit model failed to take into account important aspects of differentiation across brands (such as the format of the deodorant roll-on versus aerosol, fragrance etc)<sup>82</sup>. The model could not thus identify the competitive interaction between brands within each category, as the simulation relied on estimates of substitution across all brands. It did not also include elements of dynamic competition, such as entry, product repositioning or retailer buyer power. The Commission recognized these limitations of the simulation method, yet it considered that the 'estimated effects are consistent with the rest of the available evidence and of a sufficient magnitude to be assigned a certain weight in the analysis'<sup>83</sup>. It is noted in the decision that given the time frame of the investigation, it would have been prohibitively complex to introduce these additional factors into the model and the assessment was carried out by using the other qualitative and quantitative evidence on file<sup>84</sup>. Hence, there may be limits to a more systematic analysis of brands and their competitive interaction in this context.

One may conclude from the above that EU competition law seems to perceive branding as reducing elasticity of demand (and consumer switching), establishing barriers to entry and thus facilitating the exercise of market power to the detriment of consumers' welfare or choice. Yet, this tradition co-exists with a more positive perspective on the role of brands in promoting competition and the interest of consumers.

### *Product differentiation and brands as a defence tool*

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<sup>82</sup> These are standard limitations of the standard nested logit model and may be overcome if one uses the random coefficients logit model (or BLP) developed by S.T. Berry, J. Levinsohn, and A. Pakes, 'Automobile Prices in Market Equilibrium', (1995) 63(4) *Econometrica*, 841-90. According to this model random coefficients are incorporated 'for continuously measured product characteristics (and not just for the group dummy variables in the nested logit model)', thus creating more flexible substitution patterns, where products tend to be closer substitutes as they have more similar continuous characteristics. Yet, these models are 'computationally more demanding': for a comparison, see L. Grigolon and F. Verboven, *Nested logit or random coefficients logit? A comparison of alternative discrete choice models of product differentiation*, Center for Economic Studies Discussion Paper Series (DPS) 11.24 (September 2011), available at [www.econ.kuleuven.be/ces/discussionpapers/default.htm](http://www.econ.kuleuven.be/ces/discussionpapers/default.htm)

<sup>83</sup> Case No. COMP M.5658, *Unilever/Sara Lee* (2010), para. 182, available at [http://ec.europa.eu/competition/mergers/cases/decisions/m5658\\_20101117\\_20600\\_2193231\\_EN.pdf](http://ec.europa.eu/competition/mergers/cases/decisions/m5658_20101117_20600_2193231_EN.pdf).

<sup>84</sup> *Ibid.*, para. 10.

The *Metro I* judgment of the CJEU is particularly significant for emphasizing the important role of competition on quality and variety, rather than competition only based on the parameter of price. The Court held compatible to Article 101 TFEU the constitution of selective distribution networks, to which only dealers satisfying some objective, qualitative and proportional criteria will be accepted<sup>85</sup>. The CJEU declared that ‘although price competition is so important that it can never be eliminated it does not constitute the only effective form of competition or that to which absolute priority must in all circumstances be accorded’<sup>86</sup>. Following this judgment, as a matter of principle, product differentiation leading to higher prices would not be deemed anticompetitive in EU competition law if it has the effect to increase the level of competition on other parameters than price, such as quality, product variety and innovation<sup>87</sup>. This hospitable tradition to product differentiation and consequently branding may lead to the finding that some restrictions of price competition may not infringe Article 101 TFEU if they aim to promote the brand image of the product (thus increasing product variety) and its overall quality.

The CJEU has accepted that restricting the number or types of retailers in a selective distribution framework may be a necessary evil in order to create a brand image, should the nature of the product justify such investment<sup>88</sup>. Similarly, the Court recognized the specific characteristics of franchise agreements in *Pronuptia*<sup>89</sup>, where it held that a franchisor should have the freedom to select his franchisees and to impose on them the obligation to obtain the contract products only from a designated source when it is not possible to formulate objective quality specifications, or more generally obligations as to the nature of any advertising and promotion of the products. These restraints broadly rely on the need to protect the brand reputation of the franchise network. Indeed, a common feature of franchise contracts is the transfer of intellectual property rights (trademark) and know-how from the franchisor to the franchisee. This may create a risk of *ex post* opportunism.

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<sup>85</sup> Case 26/76, *Metro SB-Großmärkte GmbH & Co. KG v. Commission* [1977] ECR 1875.

<sup>86</sup> Case 26/76, *Metro SB-Großmärkte GmbH & Co. KG v. Commission* [1977] ECR 1875, para. 21

<sup>87</sup> See, more generally, Commission, Guidelines on the application of Article 101(3), [2004] OJ C 101/97, paras 16, 24, 69-72 & 86 (noting that ‘(i)f a restrictive agreement is likely to lead to higher prices, consumers must be fully compensated through increased quality or other benefits’). Qualitative selective distribution systems do not infringe article 101(1) TFEU and quantitative restrictions may be justified under Article 101(3) TFEU: Case T-19/92 *Leclerc v. Commission* (‘YSL’) [1996] ECR II-1851; Case T-88/92 *Leclerc v. Commission* (‘Givenchy’) [1996] ECR II-1961.

<sup>88</sup> This is the most controversial aspect of the EU case law on selective distribution, as it accepts the constitution of selective distribution systems only for certain types of products, in essence luxury, complex, experience and credence goods. Commission, Guidelines on Vertical Restraints, [2010] C 130/1, para. 185. For a critical discussion of the guidelines and the case law of the EU Courts, see T. Buettner, A. Coscelli, T. Vergé and R. A. Winter, An economic analysis of the use of selective distribution by luxury goods suppliers, *European Competition Journal*, 5(1) (2009), 201.

<sup>89</sup> Case 161/84, *Pronuptia de Paris GmbH v. Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 414.

Indeed, ‘if one franchisee allows the quality of his establishment to deteriorate, he benefits by the full amount of the savings from reduced quality maintenance’ but ‘he loses only part of the costs, for part is borne by other franchisees’<sup>90</sup>. It follows that the franchisor will have to select his franchisees carefully, institute a quality control mechanism, introduce early termination clauses in the franchising agreement and impose further restrictions necessary for the protection of the identity and reputation of the network and the value of the assets, such as the trademark, which are also used by the other members of the franchise network.

More generally, EU competition law recognizes that

(a) vertical restraint may help to create a brand image by imposing a certain measure of uniformity and quality standardisation on the distributors, thereby increasing the attractiveness of the product to the final consumer and increasing its sales<sup>91</sup>.

This does not go, however, as far as accepting that the protection of brand image and the promotion of the brand constitutes a justification for any type of anticompetitive conduct. Already in *Consten & Grundig*, the CJEU ignored the possible positive effects to inter-brand competition of the strategy of the German brand of electrical equipment Grundig to offer an exclusive distributions agreement to French distributor Consten, coupled with a trademark license agreement for France, because of its potential to affect intra-EU trade and parallel imports with the establishment of an absolute territorial protection<sup>92</sup>. The Court did not consider the possibility that such territorial protection<sup>92</sup> could be the only way for a not well-known brand to gain access to the market of another Member State<sup>93</sup>. The possibility for new, not so well-known, brands to impose restrictions of passive sales by other distributors into an exclusive territory or to an exclusive customer group, has nevertheless been accepted by both the CJEU<sup>94</sup> and the European Commission<sup>95</sup>, when it is necessary for the distributor to recoup the substantial investments that need to be made, where there was previously no demand for that type of product in general or for that type of product from that producer in particular.

However, the recent case law of the CJEU and the decisional practice of some national competition authorities on the prohibition of online sales in the

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<sup>90</sup> P. H. Rubin, *The Theory of the Firm and the Structure of the Franchise Contract*, *Journal of Law and Economics*, 21 (1978), 223, 227.

<sup>91</sup> Commission, *Guidelines on Vertical Restraints*, [2010] C 130/1, para.107 (i).

<sup>92</sup> Case 56 & 58/64, *Etablissements Consten S.A. and Grundigverkaufs-GmbH. V. E.E.C. Commission* [1966] ECR 419. Contrast the Opinion of Advocate General Roemer.

<sup>93</sup> V Korah and D O’Sullivan, *Distribution and the EC Competition Rules* (Hart Publishing, 2002)

<sup>94</sup> Case 161/84, *Pronuptia de Paris GmbH v. Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 414, para. 24 (interpreted *a contrario*).

<sup>95</sup> Commission, *Guidelines on Vertical Restraints*, [2010] C 130/1, para. 61.

context of a selective distribution network reminds us that, in the presence of hardcore restrictions, it is not possible to successfully rely on the need to protect brand image as a competition law defence<sup>96</sup>. More generally, the CJEU held in *Pierre Fabre*, that '(t)he aim of maintaining a prestigious image is not a legitimate aim for restricting competition and cannot therefore justify a finding that a contractual clause pursuing such an aim does not fall within Article 101(1) TFEU'<sup>97</sup>. One may think these broad restrictions as based on some form of industrial policy aims to develop an e-commerce or m-commerce that is not entirely at the hands of brand manufacturers and to provide possibilities for innovative, low-cost, distributors emerging, or more simply as a way to enhance the opportunities of parallel trade. The vertical restraints guidelines attempt nevertheless to reach a balance between these different objectives by recognizing the possibility of a supplier to require that its distributors have one or more brick and mortar shops or showrooms as a condition for becoming a member of its distribution system<sup>98</sup>.

### *Private labels and the emergence of a new rhetoric on brands*

The development of private labels, as well as that of 'low-cost' brands, challenges the premise that branding and product differentiation render the demand more inelastic and hence lead to higher prices for consumers. Private label is a term referring to all products sold under a retailer's brand, which could be the retailer's own name (store brands) or a brand created by a manufacturer exclusively for the retailer, who defines the characteristics of the product (generic brands). Private label products are generally exclusively distributed by the retailer along with national brand products, which are marketed by manufacturers throughout the national market, not only in the specific retailers' outlets. Private labels usually appeal to consumers because of their lower price. Hence, product differentiation by private labels may counteract the effect of differentiation strategies employed by national brands suppliers who aim to increase their prices and improve their profitability. This brings a horizontal dimension in the relationship between suppliers and retailers, as private labels may compete for market share with national brands<sup>99</sup>. Private label brands' market share has been constantly growing, in

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<sup>96</sup> For a recent discussion, see G. Monti, Restraints on Selective Distribution Agreements, *World Competition Law and Economic Review*, 36(4) (2013), 489 – 511; A. Font Galarza, E. L. Dziadykiewicz, A. Guerrero Perez, Selective Distribution and e-Commerce: An overview of EU and national case law, (2012) 2 *Concurrences* 2-8.

<sup>97</sup> C-439/09, *Pierre Fabre Dermo-Cosmétique SAS v. Président de l'Autorité de la concurrence and Ministre de l'Économie, de l'Industrie et de l'Emploi* [2011] ECR I-9419, para. 46.

<sup>98</sup> Commission, Guidelines on Vertical Restraints, [2010] C 130/1, para.54.

<sup>99</sup> Although the issue of private labels being in the same market than national brands depends on a number of circumstances, recent case law has not excluded that private labels may be in the same relevant market than national brands at the retail level but not at the wholesale level because of differences in the functioning of the markets for national and private labels: Case IV/M.623, 16 January 1996; Case COMP/M.2097, *SCA / Metsä Tissue*, 31 January 2001, available at [http://ec.europa.eu/comm/competition/mergers/cases/decisions/m2097\\_en.pdf](http://ec.europa.eu/comm/competition/mergers/cases/decisions/m2097_en.pdf) , para 20-8

particular in the food sector<sup>100</sup>, and represents a significant volume of retail sales in Europe. From simple generics in the 1970s, private labels' quality has considerably improved in the late 1980s and early 1990s.

Private labels are generally perceived by consumers as being of lower price and quality than national brands. In addition, national labels benefit from a 'reputation premium', as a result of more extensive advertising than private labels and brand loyalty building. This leads to lower prices for private labels than equivalent, in terms of quality, national brand products. Despite this retail price differential, retailer's gross margins for private labels are more important in comparison to national brand products<sup>101</sup>. It follows that the commercialisation of private labels is more profitable for the retailers, in comparison to national brands.

This constitutes the main reason for the introduction of private labels by retailers and leads often to the exclusion of second-tier national brands from the market<sup>102</sup>. Two reasons explain the higher retail gross margins for retailers. Steiner notes that retailers with strong private labels have more leverage with manufacturers and this helps them to increase their retail gross margins, compared to what they would have been in the absence of strong private labels<sup>103</sup>. Private labels may also enhance consumer loyalty to retail brands and therefore reinforce the horizontal market power of the retailers. This will in turn strengthen the retailers' vertical bargaining power against national brand manufacturers and will enable them to obtain better deals that will increase their profits<sup>104</sup>. These distributional effects are ambiguous from the point of view of the consumers. Steiner observes the generally positive

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<sup>100</sup> M B Ward and others, Effects of the Private-Label Invasion in Foods Industries, *American Journal of Agricultural Economics*, [2002] 844 961-73; This is also highlighted in the recent UK Competition Commission report into the grocery sector: UK Competition Commission, Final report, Grocery's Market Investigation 30.4.2008, available at [www.competitioncommission.org.uk/rep\\_pub/reports/2008/538grocery.htm](http://www.competitioncommission.org.uk/rep_pub/reports/2008/538grocery.htm) (hereinafter, Grocery's Market Report). Some retailers have also developed a strong private-label identity as they sell only own-label goods (e.g. Aldi, Marks & Spencer) and the development of private labels constitutes an important aspect of their commercial strategy against other retailers. It seems that the development of private labels is an important aspect of horizontal competition between retailers: Grocery's Market Report, at p. 71, footnote 2. See also Appendix 9.10 ('consumer research indicates that around 20 per cent of shoppers choose their grocery retailer on the basis of own-label ranges').

<sup>101</sup> In addition to these higher gross margins, private labels also create loyalty to the supermarket chain.

<sup>102</sup> M B Ward and others, Effects of the Private-Label Invasion in Foods Industries, *American Journal of Agricultural Economics*, 84 [2002], 961, at 963.

<sup>103</sup> R L Steiner, The Nature and Benefits of National Brand/Private Label Competition, *Review of Industrial Organization*, 24 [2004], 105, at 113-14. Retail gross margins are defined as 'the difference between the brand's retail price and its factory, or manufacturer's price—which difference is its dollar retail gross margin (\$RGM)—divided by its retail price and expressed as a percent': R L Steiner, Intra-brand Competition-Stepchild of Antitrust (1991) 36 *The Antitrust Bulletin* 155, 162.

<sup>104</sup> R L Steiner, The Nature and Benefits of National Brand/Private Label Competition, *Review of Industrial Organization*, 24 [2004], 105, at 112-13.

effect of competition between private labels and national brands, what he calls the 'mixed regimen':

(i)n this structure a group of (national brands) receive vigorous competition from the (private labels) of the major chain retailers—contest that tends to maximize social welfare in consumer goods industries. That is, it brings about a high level of total surplus while also stimulating innovation by manufacturers. It produces these benefits because of a combination of horizontal and vertical relationships that are unique to this structure<sup>105</sup>.

The commercialization of private labels obviously increases consumer choice by offering a lower price substitute to the consumers. The system may also introduce an effective countervailing power for retailers against the market power of national brand owners. Nevertheless, private labels may also produce important anti-competitive effects, in particular if they finish by dominating the market. First, they may increase retail prices for consumers. Private labels will increase search costs for consumers and will therefore offer the opportunity for a higher mark-up at the supply or retail level.

Empirical studies have also showed that competition from private labels might not lead to lower prices for national brand products<sup>106</sup>. Consumers with a high degree of loyalty to the manufacturer's brand will not benefit from the introduction of private label products:

(t)he trade-off for the national brand producer facing a private label is between exploiting the loyal consumers with a high price and competing for the switching consumers with a lower price. When the fraction of loyals is high, the national brand will concentrate on the loyal segment and a private label will be introduced at a lower price. On the other hand, when the fraction of loyals is relatively low, the national brand finds it optimal to offer an exclusivity contract to the retailer at a low price and no private label is introduced . . . If the national brand producer serves both loyal and switching consumers initially, the price of the national brand will be relatively low. In such a situation private label competition would lead to an increase in the price of the national brand. The reason is that the national brand producer decides not to serve the switching consumers to which the private label is offered and instead sets a high price to serve only loyal consumers . . . Loyal consumers are worse off due to a higher price on the national brand, while switching consumers are better off when offered a low-price private label. It turns out that in some cases consumers on aggregate

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<sup>105</sup> Ibid., at 105.

<sup>106</sup> T Staahl Gabrielsen and L Sørsgard, 'Private Labels, Price Rivalry, and Public Policy, *European Economic Review*, 51 [2007], 403, 404

benefit from private label introduction, in other cases they are worse off<sup>107</sup>.

It follows that the effect of private labels on consumers is ambiguous and largely depends on the characteristics of consumer demand for the specific product. Restricting the commercial freedom of retailers may have, depending on the circumstances, a positive or a negative welfare effect for consumers.

Second, because of the gatekeeper role of the retailers, consumer choice and product variety may be affected if private labels exclude all but the leading national brands. As the European Commission remarked in its merger decision *Procter & Gamble/Gillette*,

(i) if a retailer refused to carry a brand of the parties, the brand would risk disappearing from the customers' awareness. As a consequence, it would be detrimental to a leading brand of the parties to be excluded from a major retailer for a longer period, as it would entail significant losses in customer awareness, whilst the costs would be relatively minor for the retailer (whose sales with this brand represent only a small fraction of its turnover). It should also be noted that the parties' overall sales represent on average not more than 2% of the retailers' sales, while for the parties certain retailers represent 10% and more of the sales in a given country.

The Commission, however, also noted that this is unlikely to happen in practice as leading national brands ('must-stock brands') may play a role of quality certification for the retailer in inter-store competition. Private labels change the power relation between suppliers and retailers to the benefit of the latter. The retailers establish their control over the suppliers, which see no reason to develop their own brands and finally are marginalised as independent players in the market (they could still supply goods for the retailers' private labels).

It is not clear what will be the effects of private labels for innovation. Copycat packaging is an important concern for suppliers of national brands and may lead to fewer investments for R&D and less innovation. Private labels may also be a source of buyer power, which in certain circumstances, if it is associated with selling power, may produce anticompetitive effects.

Commission Regulation 330/2010 on vertical agreements applies only in situations where the undertakings are competing distributors, for example independent retailers competing with supplier-owned outlets, but does not cover the situations where the supplier and the retailer are competing manufacturers. This excludes from the scope of the block exemption

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<sup>107</sup> Ibid., at 406.

situations where the retailer sells private labels that compete with the national brand of a supplier, except in circumstances where the distributor provides specifications to a manufacturer to produce particular goods under the distributor's brand name and both parties conclude a sub-contracting agreement. The existence of own brands including private labels and the brand image of the undertaking concerned amongst final consumers are elements to be considered in assessing if one of the undertaking's customers possess buyer power<sup>108</sup>. Buyer power is viewed positively, as it 'may prevent the parties from exercising market power and thereby solve a competition problem that would otherwise have existed', which 'is particularly so when strong customers have the capacity and incentive to bring new sources of supply on to the market in the case of a small but permanent increase in relative prices'. Private labels are also mentioned a second time with regard to category management agreements that may lead to distortions of competition, as 'in most cases the distributor may not have an interest in limiting its choice of products, when the distributor also sells competing products under its own brand (private labels), the distributor may also have incentives to exclude certain suppliers, in particular intermediate range products'<sup>109</sup>.

The issue of private labels has, and will continue to be, a central issue of the recent national and EU initiatives with regard to the retail supply chain and the emerging bargaining power gap between retailers and suppliers, in particular in the food-sector<sup>110</sup>. The European Commission has commissioned research on the effect of private labels on competitiveness, innovation and choice<sup>111</sup>, following up the work undertaken by some national competition authorities on this issue<sup>112</sup>. A 'Task Force Food' was put in place at the DG Competition at the European Commission in 2012, hinting to the possibility of competition law

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<sup>108</sup> Commission, Guidelines on Vertical Restraints, [2010] C 130/1, para. 116.

<sup>109</sup> Commission, Guidelines on Vertical Restraints, [2010] C 130/1, para. 210.

<sup>110</sup> Commission Communication 'A better functioning food supply chain in Europe', COM(2009) 591; Commission Staff Working Document, Competition in the food supply chain, (28 October 2009), available at [http://ec.europa.eu/economy\\_finance/publications/publication16065\\_en.pdf](http://ec.europa.eu/economy_finance/publications/publication16065_en.pdf); Commission Decision of 30 July 2010 establishing the High Level Forum for a Better Functioning Food Supply Chain (2010/C 210/03); Commission Decision of 19 December 2012 amending the Decision of 30 July 2010 as regards its applicability and the composition of the High Level Forum for a Better Functioning Food Supply Chain, [2012] OJ C396/17; ECN Report on competition law enforcement and market monitoring activities by European competition authorities in the food sector, May 2012.

<sup>111</sup> See, for instance, the DG Enterprise and Industry commissioned report on The Impact of Private Labels on the Competitiveness on the European Food Supply Chain (Luxembourg: Publications Office of the European Union, 2011), available at [www.vmt.nl/Uploads/2011/3/Bunte-platform-contractual-studies-finalversion10-01-2011--.pdf](http://www.vmt.nl/Uploads/2011/3/Bunte-platform-contractual-studies-finalversion10-01-2011--.pdf); The DG Competition has also recently launched a study on choice and innovation in the food sector focusing on the shift of bargaining power from suppliers to retailers, following the introduction of private labels: see, European Commission – Press Release, IP/12/1356 (December 2012).

<sup>112</sup> See, for instance, in the UK, the Competition Commission investigation on the supply of groceries in the UK market investigation, 30 April 2008, which was followed up by the implementation of the UK Groceries Code Adjudicator Act 2013.



investigations and eventually a sector enquiry in this sector. However, the complexity of the problems raised by unequal bargaining power between retailers and suppliers cannot only be solved by competition law and a more integrated framework is needed<sup>113</sup>, combining the enforcement of competition law, when there is conduct that enters its scope, including provisions on abuse of economic dependence in some Member States, but also unfair trading practices laws<sup>114</sup>, provisions of contract law and more generally civil law (tort law, European sales law), which aim to deal with abusive use of unequal bargaining power, and finally, soft law and self-regulatory initiatives by the industry that have emerged in several Member States<sup>115</sup>.

It seems therefore that private labels and their competitive relation with national brands may lead to some cross-fertilization between these different areas of law and the development of a more holistic paradigm of retail regulation that will engage more closely with the concept of brand, than what is currently on offer. While there are significant differences between the objectives of each of these different areas of law and their instruments, their current emphasis on retailer power, in particular its relational dimension of 'bargaining power, offer real opportunities to the concept of 'brand' to gain operational concept status in various areas of the law, including competition law.

## CONCLUSIONS

While not adopting a clear and unambiguous perspective on the concept of brand, EU competition law has engaged in multiple instances with branding and product differentiation. It is, however, too early to conclude if brands will gain operational concept status in EU competition law and if the multiple understandings of branding, developed by management or business studies, will finally make their entry in EU competition law's sources of wisdom. The concerns raised by retailer power and the development of private labels indicate that the existing economic theory on product differentiation may not provide the complete picture on the effects of brands on the competitive process and ultimately on consumers. Competition law will also need to tackle

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<sup>113</sup> On the interrelation between the different approaches, in particular competition law, unfair commercial practices legislation and soft law, see I. Lianos, *New Kids on the Block- Retail Driven Practices and the New Regulation of Vertical Restraints in EU Competition Law*, (2010) June Competition Policy International, available at [www.competitionpolicyinternational.com/new-kids-on-the-block-retailer-driven-vertical-practices-and-the-new-regulation-of-vertical-restraints-in-eu-competition-law/](http://www.competitionpolicyinternational.com/new-kids-on-the-block-retailer-driven-vertical-practices-and-the-new-regulation-of-vertical-restraints-in-eu-competition-law/)

<sup>114</sup> Green Paper on unfair trading practices in the business-to-business food and non-food supply chain in Europe COM(2013) 37; Communication of the Commission, *Tackling unfair trading practices in the business-to-business food supply chain*, COM(2014) 472 final;

<sup>115</sup> On a discussion of the possible combinations between these different tools across Member States, see Final Report, *Study on the Legal Framework Covering Business – to Business Unfair Trading Practices in the Retail Supply Chain*, Final Report (26 February 2014), available at [http://ec.europa.eu/internal\\_market/retail/docs/140711-study-utp-legal-framework\\_en.pdf](http://ec.europa.eu/internal_market/retail/docs/140711-study-utp-legal-framework_en.pdf)

the issues raised by the development of 'social branding' and the dialogic interaction between brand owners and consumers in the constitution of their brand identity, which breaks with a unidirectional view of the power relations between brand owners and consumers. The importance of normative choices and assumptions on the interaction between brands and the formation of consumer preferences will also be a key parameter in the integration of the concept of brands in EU competition law and other related areas of law (e.g. unfair trade practices law).