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HEARING ON ACROSS PLATFORM PARITY AGREEMENTS

-- Note by the Netherlands --

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ACM'S STRATEGY AND ENFORCEMENT PRIORITIES WITH REGARD TO 'ACROSS PLATFORM PARITY AGREEMENTS'

-- The Netherlands --

Introduction

1. In May 2014 the Netherlands Authority for Consumers and Markets published a document titled "ACM's strategy and enforcement priorities with regard to vertical agreements". In that document ACM sets out to provide insight into its strategy and enforcement priorities with regard to vertical agreements between suppliers and distributors. This document also deals with Across Platform Parity Agreements (APPAs) and as such will serve as the basis for this OECD contribution.

2. Section one of this paper describes the background for ACM's activities, detailing the regulatory framework and (international) market developments. In section two, ACM's strategy and enforcement priorities with regard to vertical agreements in general are outlined. Finally, section three deals with APPAs in particular and describes the practice of evaluating these agreements, applying ACM's priorities and assessment factors to a specific scenario.

1. Background

1.1 *The regulatory framework*

3. APPAs are subject to Dutch and European competition law, and the Dutch law is mirrored on the EU law (resp. section 6(1) Dutch Competition Act (Mw) and Article 101(1) Treaty on the Functioning of the European Union (TFEU)). These laws prohibit agreements between undertakings that have as their object or effect the prevention, restriction or distortion of competition in the market. If certain criteria are fulfilled, this 'cartel prohibition' is declared inapplicable to these agreements. These criteria are stated in Section 6(3), Mw and Article 101(3), TFEU. Alongside this exception, there is also a block exemption for certain categories of vertical agreements¹. The block exemption applies, for example, if the market share of each of the undertakings involved in the vertical agreement in the relevant market does not exceed 30%.² When market shares exceed 30%, an individual assessment as to whether the restriction meets the Article 101(3) criteria is required. The competition rules are based on a system in which undertakings must assess themselves whether or not agreements violate the cartel prohibition ("self-assessment"). As part of this self-assessment, undertakings must assess whether or not the general exception or the block exemption applies to their vertical agreements.

¹ Commission Regulation (EU) No 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices.

² See for more information on the relevant market the Commission Notice on the definition of relevant market for the purposes of Community competition law 97/C 372/03, and sections 86 through 95 of the Guidelines on Vertical Restraints, 2010/C 130/01.

4. ACM has had no competition-law investigation into APPA clauses, but it has investigated other kinds of broader vertical agreements in the past. In both 2002 and 2013, the NMa (one of ACM's predecessors) and ACM respectively looked into the distribution of beer to businesses in the hospitality industry.³ Breweries made use of vertical agreements with businesses in the hospitality industry for the purchase of beer from a single brewery ("exclusive purchasing agreements"). As a result, the businesses could only sell that particular brewery's brands to consumers. Following this market analysis, ACM saw no grounds to prohibit breweries from including this type of "exclusive purchase agreements" in their contracts. The dynamics of the beer market, mainly the sufficiently strong level of competition between brewers for sales outlets, were a significant argument for this conclusion.

1.2 *Developments in markets and in international enforcement relating to APPAs*

5. In recent years, the online sales of goods and services have developed significantly alongside the sales in brick-and-mortar shops.⁴ ACM observes examples of undertakings that make use of vertical agreements in response to these market developments. An example is a selective distribution system for brand-name products. The rise of online distribution also leads to new types of vertical agreements such as restrictions on the use of third party platforms, parity agreements or other restrictions on online sales.⁵

6. In the case of online platforms (such as comparison sites or hotel booking platforms) for example, we observe the use of so-called "across platform parity agreements".⁶ These agreements mandate providers to use in a specific sales channel, for example a booking website, a consumer price that is at least as favorable as the consumer price in other sales channels. This way, it is possible that sales channels offer a "lowest price guarantee". Competition authorities deal with the question of assessing the consequences of these market developments for the enforcement practice. In that context, a recurring question is whether or not the laws that competition authorities enforce and their enforcement activities are tailored to this development of online sales. This has also been the subject of studies and debates in scientific circles.⁷ Investigations into APPAs have recently become more common in the enforcement activities of other competition authorities. Indeed developments in international enforcement were among the reasons that prompted ACM to provide more insight into its strategy and enforcement priorities with regard to vertical agreements.

7. Creating a single internal digital market in Europe is one of the European Commission's priorities. In that context, Commissioner Vestager, EU Commissioner for Competition, plans to give special attention in competition policy to online sales (e-commerce).⁸ Commissioner Vestager mentioned, among other things, restrictions to e-commerce that are the result of contractual arrangements between producers and distributors (vertical agreements). Developments in digital markets follow each other in rapid succession. That is why the Commissioner believes that 'more meat on the bones' of the general

³ See the decisions in NMa case 2036 dated 28 May 2002 and 1 April 2003 at www.acm.nl and "ACM Analysis of the beer market in the hospitality industry" dated 7 June 2013 and the ACM newsletter of the same date: <https://www.acm.nl/nl/publicaties/publicatie/11543/Analyse-ACM-horeca-biermarkt/> and <https://www.acm.nl/nl/publicaties/publicatie/11542/Meer-duidelijkheid-in-brouwerijcontracten-gewenst/>.

⁴ See "ACM's strategy and enforcement priorities with regard to vertical agreements", p. 7.

⁵ See the ruling from the Court of Justice dated 13 October 2011 in the case C-439/09 (Pierre Fabre). In this ruling, the Court ruled that a general prohibition on online sales within a selective distribution system has the purpose of restricting competition except when this condition is objectively justified.

⁶ Also referred to as "retail MFN".

⁷ See among others: <http://www.oecd.org/daf/competition/VerticalRestrainsForOnlineSales2013.pdf>.

⁸ See: http://europa.eu/rapid/press-release_SPEECH-15-4704_en.htm.

framework is needed, which can be achieved by (1) assessing individual cases, and (2) better understanding digital markets, as well as their evolution. As a result, Commissioner Vestager announced a sector inquiry into the e-commerce sector. Among other objectives, she hopes it will strengthen and make more uniform the action that the Commission and Europe's national competition authorities take against restrictions of online sales. In addition, the findings will also give better guidance to firms. The inquiry's preliminary findings are expected in mid-2016.

8. ACM supports this initiative of the European Commission, and recognizes the added value of more detailed knowledge about the e-commerce sector for the regulatory efforts of the European Commission and of the national competition authorities. ACM looks forward to the publication of the findings of the inquiry, and will include them in its enforcement priorities with regard to vertical agreements.

2. ACM's strategy and enforcement priorities with regard to vertical restraints

9. The most important basic principle in ACM's strategy and enforcement priorities with regard to both vertical agreements in general and APPAs specifically, is the expected effect that practices of undertakings in the market have on consumer welfare.⁹ ACM sets priorities, and consciously focuses on effects. "Focusing on effects" means that ACM selects cases in which ACM believes the harm to consumer welfare is the highest. The section below offers a further explanation of the ACM strategy, followed by an explanation of the way ACM sets its priorities.

2.1 ACM strategy: effect on consumer welfare

10. ACM designs its strategy and enforcement priorities with regard to APPAs on the basis of the general ACM strategy, in which consumer welfare is central.¹⁰ ACM's desired result is the sustainable welfare growth in the broadest sense of the word. This includes welfare growth as a result of both financial and qualitative effects for consumers in the short term and in the long term. ACM takes a broad perspective, and does not merely investigate the alleged violation, but also determines the root cause of the market or consumer problem in question. ACM subsequently selects the instrument or a combination of instruments that offers the highest probability of producing a structural solution to the problem. Economic insights help in the estimation of the expected effect on consumer welfare of a given agreement, in the market context in which the practices (actual or potential) take place. Below an overview of these insights is presented.¹¹

⁹ This possible effect can be either direct or indirect. Undertakings' practices can harm consumers directly, for example, because undertakings conclude cartel agreements and subsequently charge excessive prices or restrict consumers' choices. Consumers can also be harmed indirectly, for example, if undertakings make arrangements among themselves about the costs of products or services that they charge other undertakings, or if undertakings share work among themselves in government tenders.

¹⁰ See "ACM strategy document", page 2.

¹¹ In this document, ACM will not deal with specific theories on efficiencies and the harmful effects of vertical agreements, except for a few examples. The EC Guidelines in paragraphs 100-109 provide a detailed overview of the possible effects of vertical agreements. Also see Massimo Motta, "Vertical Restraints and Vertical Mergers", in *Competition Policy: Theory and Practice*, ed. Massimo Motta (New York: Cambridge University Press, 2004), Patrick Rey and Thibaud Vergé, "Economics of Vertical Restraints", in *Handbook of Antitrust Economics*, ed. Paolo Buccirossi (Cambridge, MA: the MIT Press, 2008) and Paolo Buccirossi, "Vertical Restraints for Online Sales," OECD Policy Roundtables Background Note, 2013.

2.1.1 *The effects of vertical agreements from an economic perspective*

11. A vertical agreement is an agreement between two or more undertakings that are active in different levels of a distribution chain. Undertakings within a distribution chain produce goods or services that complement one another. This means that each undertaking within a distribution chain contributes to the value of the end product for consumers. However, this mutual dependence does not mean that the undertakings always act in the interests of the distribution chain as a whole. The reason for this is that companies are first and foremost focused on their own profitability. Undertakings may therefore take decisions that are optimal from the perspective of their own profits, but that do not contribute to the performance of the distribution chain as a whole. As a result consumers may not be served optimally. The classic example of a situation like this is the free-riding problem on pre-sales services. In this example, a retailer does not provide pre-sales services, even though they are valuable to the consumer. The reason is that the consumer may enjoy the pre-sales services but subsequently buy the product from a cheaper retailer that does not provide costly pre-sales services. In such cases, the producer may restore retailer incentives to provide pre-sales services by forbidding retailers to price below a minimum price level. Alternatively, the producer may impose territorial restrictions or use selective distribution contracts. In general, various vertical agreements are conceivable that may improve efficiency more or less to the same extent.

12. Generally, the stronger the competition between distribution chains (“interbrand competition”), the more consumers benefit from vertical agreements. The reason is that, when there is more competition between distribution chains, firms have a greater incentive to act in consumers’ interests. However, vertical agreements, including the ones referred to above, can also harm consumer welfare. An undertaking can use a vertical agreement simply and only to restrict competition within the distribution chain. In addition, vertical agreements can also contribute to a restriction of competition between distribution chains. The latter is possible as vertical agreements may support collusion (tacit or explicit) between producers¹² and because vertical agreements can reduce producers’ incentives to compete.

13. The theoretical economic literature on vertical agreements is extensive, and puts forward several pro-competitive and anti-competitive explanations for vertical agreements. Lafontaine and Slade conclude in their 2008 overview article of the empirical literature that vertical agreements usually generate efficiencies that are often passed on to consumers.¹³ A more recent study by MacKay and Smith looks into the effects of the Leegin ruling¹⁴, in which the US Supreme Court replaced the per se illegality of minimum resale price maintenance with a rule-of-reason standard.¹⁵ The results can be interpreted as evidence that a more relaxed legal standard with regard to resale price maintenance more often has

¹² In this context, see for example: Luc Peeperkorn, “Resale Price Maintenance and its Alleged Efficiencies”, *European Competition Journal* 4 (2008): 201-212.

¹³ In their review of the empirical literature, Francine Lafontaine and Margaret Slade conclude that “[..] the empirical evidence concerning the effects of vertical restraints on consumer well-being is surprisingly consistent. Specifically, it appears that when manufacturers choose to impose such restraints, not only do they make themselves better off but they also typically allow consumers to benefit from higher quality products and better service provision.” Francine Lafontaine and Margaret Slade, “Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy”, in *Handbook of Antitrust Economics*, ed. Paolo Buccirossi (Cambridge, MA: The MIT Press, 2008), pp. 408 and 409.

¹⁴ *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007).

¹⁵ Alexander MacKay en David Aron Smith, “The Empirical Effects of Minimum Resale Price Maintenance”, Kilts Booth Marketing Series, Paper No. 1-009, 2014.

negative effects on consumer welfare than positive effects. However, critics point out that the combination of a significant price increase and a significant volume drop only occurs in very few product groups.¹⁶

14. Based on the above, ACM concludes that i) the effects of vertical agreements on consumer welfare can be both positive and negative, and can differ from case-to-case, and ii) that vertical agreements, generally speaking, and especially in the absence of market power, more often than not benefit consumer welfare. Vertical agreements therefore differ from horizontal agreements. These insights form the basis of the legal framework, which is particularly evidenced by the existence of the block exemption.

2.2 *ACM's priorities*

15. Given its limited capacity, ACM must always choose what market problems and consumer problems it will tackle. The effect on consumer welfare is one of the three criteria which ACM uses to set its priorities.¹⁷ The other criteria are public interest (for example, taking away consumer concerns or creating clarity regarding a legal standard), and whether ACM is able to take action effectively and efficiently.

16. When choosing whether to carry out further investigation into a vertical agreement, the expected effect on consumer welfare is central. This means that, following indications and complaints about vertical agreements, ACM makes an initial assessment of the possible harmful effects on consumer welfare. Based on economic insights, the expected effects of vertical agreements can be either positive or negative given the market context in which the practices (actual or potential) take place. ACM therefore ascertains on a case-by-case basis whether there is a plausible “theory of harm,” and accords a case a higher or lower priority. In practice, ACM’s other prioritization criteria, which are the public interest and the effectiveness and efficiency of any action by ACM, are also taken into account in the decision to carry out a further investigation into a vertical agreement. Moreover, ACM looks at each case in relation with other types of behavior into which ACM could launch investigations (such as cartels, and abuse of dominant positions).

17. ACM’s prioritization also dovetails with another basic principle of the regulatory framework, namely that of “self-assessment”. The legal framework stipulates that the burden of proving an efficiency defense falls on companies. When using a vertical agreement, undertakings are required to take into account the agreement’s effects, and have to ask themselves whether the efficiency improvements outweigh possible harm resulting from the agreement, to such a degree that the agreement improves consumer welfare. Should it come to a proceeding (legal or otherwise), they will bear the burden to prove the legality of the agreement.

¹⁶ Thomas Lambert en Michael Sykuta, “Why the New Evidence on Minimum Resale Price Maintenance Does Not Justify a Per Se or “Quick Look” Approach”, *Competition Policy International Antitrust Chronicle*, November 2013 (1).

¹⁷ See “ACM strategy document”, page 11. In decision requests, ACM takes into account the basic principles of the CBb in the VVR case in which the NMa had rejected a request for enforcement. These basic principles are: (1) always carrying out an initial substantive investigation; (2) assessing ex-officio investigations and complaint-driven investigations using the same criteria, and (3) taking into account the complainant’s individual interests. See: <http://uitspraken.rechtspraak.nl/>, enter “ECLI:NL:CBB:2010:BN4700” in the search field.

3. Assessing APPAs in practice

18. ACM provides further insight below into how it would in practice estimate the expected effects of vertical agreements on consumer welfare.¹⁸ This is followed by a description of a scenario in which ACM explains as concretely as possible how it assesses the effects of APPAs in particular.

3.1 *Relevant factors for assessing the effects on consumer welfare*

19. In the preliminary substantive investigation, in every case, ACM uses the following factors to estimate the effects of a vertical agreement on consumer welfare.

3.1.1 *Level of market power*

20. In the case of a vertical agreement in a single distribution chain, the more market power undertakings have, the more possibilities there are to impose unfavorable conditions on consumers or other undertakings. This means that a vertical agreement can also be harmful as soon as at least one of the undertakings involved has market power. In this situation, market power is a necessary condition for harm, but is not sufficient on its own.¹⁹

21. In this context, when determining market power, the level of competition between distribution chains (interbrand competition) is important. The reason is that competition from other brands acts as an incentive for undertakings within a distribution chain to conclude vertical agreements that promote consumer interests, or at least not harm them. Furthermore, when interbrand competition is strong, consumers generally have more opportunities to switch to products that are not affected by any harmful vertical agreements.

3.1.2 *Broad (or market-wide) application of similar agreements*

22. In addition, it is also important to ascertain whether the vertical agreement is applied within several distribution chains. As a result, the agreement may cover a large part of the market without the individual distribution chains having any market power. Together, the distribution chains involved may have market power. In that case, consumers have fewer options to purchase products that are not affected by any harmful vertical agreements (cumulative effects).²⁰ In addition, a broad application of a vertical agreement can also indicate collusion between producers or retailers.²¹

¹⁸ The Guidelines, in paragraphs 111-127, list relevant factors that are used in the assessment of vertical agreements. ACM may also use these factors when estimating the expected effects of vertical agreements in a preliminary substantive investigation.

¹⁹ In this context, ACM applies the concept of ‘market power’ in an economic sense. ACM does not refer to market power within the meaning of Article 102 TFEU or Section 24 Mw, nor to the 30% market share threshold in the Regulation. See also section 2.1.

²⁰ In this context, see point 105 of the Guidelines, in which it is stated that the possible negative effects of vertical restraints are amplified if multiple manufacturers and their retailers do business in the same manner, as a result of which so-called cumulative effects arise.

²¹ However, this is not direct actual proof of any collusive practices.

3.1.3 *Vertical agreements imposed by retailers*

23. If a vertical agreement is imposed by retailers against the producer's wish, this could be an indication that the vertical agreement is harmful to consumer welfare. The reason is that retailers have an incentive to restrict competition among themselves irrespective of whether this restriction of competition also generates efficiency improvements for the producer or consumer. The producer however has no interest in a vertical agreement of which the only effect is the restriction of competition between retailers. A vertical agreement forced by retailers against the producer's wish is therefore more likely to be harmful to consumer welfare.

3.1.4 *Possible efficiency improvements*

24. ACM assesses whether efficiency improvements may apply in a concrete case, based on, for example, market circumstances and product features. Possible efficiency improvements include: (a) the prevention or reduction of a "free-riding problem" on service, as a result of which retailers would have no incentive to invest in service, (b) the stimulation of opening up new markets, (c) preventing a so-called "hold-up" problem as a result of which undertakings are not prepared to make valuable investments, (d) protecting the product's image by setting quality standards, and (e) achieving economies of scale in distribution.²²

3.2 *APPA scenario*

25. ACM describes a scenario below in order to give more insight into the facts and circumstances that indicate the expected effects of an APPA on consumer welfare. In the description of the scenario, the following aspects are discussed: the practice, the theory of harm, possible efficiency improvements, and ACM's considerations.²³ 'ACM's considerations' should be understood as considerations which are part of the 'initial substantive investigation', on the basis of which ACM determines whether or not it should launch a full investigation.

3.2.1 *Scenario: Lowest price guarantee on platforms*

26. Producers offer a similar product through various online platforms. One platform lays down (or more platforms lay down) the condition that producers do not advertise their products through other sales channels at a lower price.²⁴ Such vertical agreements are also referred to as "Most Favored Nation clauses" (MFNs) or more specifically, for platforms, "Across Platform Parity Agreements" (APPAs).²⁵ Such a condition guarantees that the lowest price in the market is available on the platform. The implication is that the APPA enables the platform to offer consumers a lowest price guarantee. Another implication is that APPAs impede producers from charging lower prices when selling through their own sales channels to buyers.

²² For an extensive overview of possible efficiencies as a result of vertical agreements, ACM refers to the EC Guidelines, in particular to sections 106 through 109 of the [Guidelines](#).

²³ The assessment based on other prioritization criteria (as mentioned in 2.2.) are not discussed here.

²⁴ Well-known examples of platforms are Booking.com and Marktplaats.nl.

²⁵ See for example Matthijs Visser and Jan Kees Winters, "Apple's APPA: Nieuwe wijn in oude zakken of oude wijn in nieuwe zakken? Een economisch commentaar", *Markt en Mededinging*, June 2014, No. 3.

27. *Theories of harm:* (1) APPAs impede entry to the platform market since lower product prices than on existing platforms cannot be used on an entering platform. As a result, it may be difficult for a new platform to acquire market share; (2) APPAs can increase the commissions that platforms charge producers for using the platform. The idea is that, with an APPA, an increase in the commission for producers does not lead to higher prices on the platform than through other platforms. After all, the APPA requires producers to charge the most favorable price.²⁶

28. *Possible efficiency improvements:* (1) APPAs protect platforms against “free riding” by producers on the platform. Without APPAs, producers can advertise their products on the platform, and reach buyers that way, but subsequently complete transactions at a lower price through their own sales channels. (2) APPAs can promote price competition between producers. The reason is that consumers are able to compare prices of many producers on a single platform, and thus search for the lowest price.

29. *ACM’s considerations:* In a preliminary substantive investigation, ACM would take into account the concrete circumstances in which the APPA is applied such as the product market and consumer behavior. Another possible point for attention in this context is whether or not there are market-wide clauses, also called “wide APPAs.” A “wide APPA” implies price parity with all other platforms and sales channels. This could make the harm to consumer welfare more plausible than with a so-called “narrow APPA” where price parity is only negotiated for the producer’s own sales channel. After all, in the case of a “narrow APPA”, consumers can choose the sales channel or platform with the lowest price. In addition, it can be important whether platforms are able to bind consumers to the platform in other ways than low product prices, for example through discount coupons. If such options do exist, there may be sufficient opportunities for entry despite the presence of an APPA. Another important aspect could be whether producers use one or more platforms. If producers only use a single or a few platforms, then platforms may compete with one another in order to bind as many producers as possible to the platform. In that case, platforms can only increase their commissions to a limited extent, as producers will otherwise switch to an alternative platform. Finally, ACM would estimate the value of the efficiency arguments. For this question, one of the relevant aspects is whether consumers take the trouble to compare products within several sales channels. If consumers actively compare products, the free-rider argument gains in strength. In addition, it must be assessed whether and to what extent APPAs promote competition between producers.

30. *Conclusion:* It is quite conceivable that, in practice, APPAs are both potentially harmful and able to produce efficiency improvements. The more plausible it is that an APPA impedes entry to the platform market permanently or that it increases platform commissions, and the less plausible it is that efficiencies occur, the more reason there is for ACM to launch a further investigation. The considerable amount of public attention for APPAs may also play a role in that assessment of whether or not to launch a further investigation. However, the fact that other competition authorities are active in this area does not automatically mean that ACM will take action. Finally, the fact that the market conditions of a specific case probably determine whether the likely overall effect of an APPA is pro- or anti-competitive means that care should be taken not to simplify their legal assessment. For example, it is not at all clear that wide MFN’s will always be more harmful than narrow MFN, or that a narrow MFN will never have a negative impact. Furthermore, market dynamics in rapidly evolving online markets over time may imply that the assessment may vary over time.

²⁶ See for a more extensive discussion of the possible harmful effects of APPAs, for example, Amelia Fletcher and Morten Hviid, “Retail Price MFNs: Are they RPM “at its worst?”, CCP Working Paper 14-5. See also a report issued by the Office of Fair Trading (OFT) by Lear (*Laboratorio di economia, antitrust, regolamentazione*): “Can ‘Fair’ Prices Be Unfair? A Review of Price Relationship Agreements”, OFT1438, 2012.

4. Concluding remarks

31. The scenario described by ACM shows that the assessment of the expected effects of APPAs depends greatly on the circumstances of the concrete case. There can be cases in which, based on a preliminary substantive investigation, on balance, harm to consumer welfare is plausible, which gives ACM reason to launch further investigation, and possibly to take enforcement action. There can however also be cases in which efficiency improvements are likely to outweigh the possible harm to consumer welfare. In such a case, ACM could conclude that the expected harm to consumer welfare is too small to prioritize it.

32. The scenario also reveals that ACM uses several factors that are generally helpful in estimating the effects of an APPA on consumer welfare: i) the extent of market power, ii) the extent to which the agreement covers the market, iii) whether retailers forced the agreement and iv) the possible efficiency improvements. Information about these four factors enables ACM to carry out a preliminary substantive investigation into the possible effects of the agreement effectively.