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Destroying Competition In The Name Of Competition,

Part I: The Coca-Cola Case Masquerading The Truth By Changing The Meaning Of Words

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CÉCILE PHILIPPE

When the European Commission verdict fell against Microsoft, Competition Commissioner Mario Monti did not shy away from the fact that the decision was aimed at creating a “strong precedent”. In other words, the Commission, by attacking one of the largest multinationals, was sending a strong signal to all present or future industrial giants established in Europe or aiming to do so.

The fact that Microsoft can be penalized for anti-competitive practices is sufficient proof that no private firm can play with European competition rules in all impunity. In all likelihood, this is what has brought the management of Coca-Cola to submit to the “voluntary restricting agreement” offered by the Commission and obtain the close of the investigation it was under since 1999 .

Five years ago, Pepsi-Cola filed a complaint against its main rival, Coca Cola, which stood accused of “abuse of dominant position” because of suspicious sales activities with regard European anti-trust legislation. On 19th October in front of the Commission, Neville Isdell, President of Coca-Cola, formerly abandoned the company’s sales policy which included practices such as signing exclusivity contracts, giving the most faithful clients targeted reductions and forcing clients to purchase slower-selling products alongside its key brands.

Following the anti-trust ruling of May 2004, a “voluntary restricting agreement” allows a company to avoid the sentence and the related fine by submitting to the requirements of the European Commission, which is then assured that the decision will not be challenged in a court. If the company does not respect the agreement, the Commission can impose a fine without a further investigation.

Competition related discussions are made more difficult by a rather ambiguous use of specialised vocabulary. Beyond the rather vague concepts that prevail in what are abstract debates by nature, it is not exaggerated to claim that the press releases from the Commission add to the confusion by using a non-language which describes forceful debates as voluntary agreements and contractual relations as hostage taking

In the press release announcing the close of the Coca-Cola case, with the end of exclusivity contracts, “clients are now free to buy and sell carbonated drinks from the supplier of their choice”.

In other words, this would not be the case if the exclusivity contracts were allowed. Clients would not be “free” to violate their contracts by buying Pepsi and Coca-Cola.

The word “free” is ambiguous because it suggests that refusing to sell Coca Cola to a shop owner who would also like to buy Pepsi is similar to threatening to demolish the shop if he dared sell Pepsi, certainly an attack on personal freedom.

Traditionally, freedom means an absence of aggression, no invasion of individual property or possible threat thereof. In this sense, Coca-Cola gives its clients complete freedom to choose between exclusive or not exclusive contracts. They can refuse to sign with Coca-Cola and buy any other product suppliers will want to sell them. Of course Coca-Cola is not stopping anyone from purchasing Pepsi bottles because it does not obtain the signature of contracts through threats of violence in case of refusal.

Conversely, it should be clear that the “voluntary agreement” between the Commission and Coca-Cola is reached only through the menace of court action or fines

The Commission is therefore carrying out an exercise in “double thought”, phrase coined by George Orwell in his novel “1984”, whereby one is lead to believe that an idea means its opposite such as “freedom is slavery” or “war is peace”.

Freedom is slavery when deceptive analogies suggest that accepted clauses in contracts without violent intimidation are not freely granted. War is peace when an agreement obtained under the threat of state coercive force is assimilated to a peaceful conflict resolution.

As much as relativists may see this as boring and conventional, freedom remains freedom. However, the question of economic consequences of contractual freedom, including the right to sign exclusive contracts, is still open.

If according to the Commission’s non-language, Coca-Cola has neither coerced its clients nor its competitors, will consumers have to bear the consequences of these practices?

Nothing is less sure! To be continued

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Destroying Competition In The Name Of Competition,

Part II: vertical integration in question

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Coca-Cola presented its mea culpa to the European Commission and its “restrictive” commercial practices belong to the past. European competition policy tends to forbid exclusivity contracts perceived as anti-competitive even though contractual freedom is not hindered by these, as demonstrated in my last column. Restrictive practices are only a particular facet of contractual freedom. Their ban is not related to the protection of goods and persons but is a hindrance to the sovereignty each person can exercise over their own property. It is worthwhile noting that the Commission does not defend property rights in particular but its decisions often have far-reaching consequences. As Mario Monti declared at the time of the Microsoft verdict, the role of the Commission is “to decide what is best for competition and consumers in Europe”. However many totalitarian overtones this statement may have, this article will only demonstrate that the ban on exclusive contracts cannot help to promote interests of consumers

Firstly a few theoretical elements, Production takes time and follows certain stages. From the extraction of raw materials to a drink of Coca-Cola on a terrace, several tasks have to be carried out one after the other. Vertical integration means that different stages of production are carried out within one company. Typically, the link between two branches of a company working on successive stages of production is exclusive. Exclusivity contracts between a firm like Coca-Cola and distributors represent a partial vertical integration process, an intermediary situation between a complete separation of companies and complete integration - for instance if Coca-Cola bought a distributor This has practical implications for competition policy. According to the Commission, the existence of exclusivity contracts hinders competition and harms the rights of consumers, and therefore how can vertical cooperation between companies not be seen as suspicious? The mere existence of this type of relation within a firm should be seen as much more harmful since they are the culmination of cooperation between several companies. Pushing this argument to the extreme, competition policy should purely and simply ban vertical integration. The activity of a company should not include consecutive stages of production. As far as we know, no such policy has ever been suggested. However, rejecting “restrictive” commercial activities could lead to this kind of suggestion.

There are good reasons to believe that partial or complete vertical integration can serve consumers. A typical raison d’être of exclusivity contracts is to over come the problem of “free rider” competitors who may choose to under-invest in production of said products and only offer limited availability and at higher prices. Importantly, a product cannot be sold if no one knows about its main characteristics and availability. Promoting a product is therefore as much about its production process as about its actual manufacturing which can unfortunately benefit gratuitously competitors, especially when in the consumer’s mind, the product can easily be substituted by another. Bar owners may be tempted to use free Coca-Cola advertising material such as notice boards and fridges[1], thereby presenting the merits of cola drinks, but not only the Coca-Cola brands, especially if the fridges are used to store competing products. In this case, competitors can count on Coca-Cola to bear costs they should have incurred otherwise and lower their prices sufficiently so that consumers substitute their product for Coca-Cola. Consequently, in as much as all external factors have an influence, the profitability of the investment is that much lower than if they were internalised. The company invests less, production is lower and prices are higher than they would be otherwise

Contractual freedom does provide solutions to this problem. Exclusive contracts can reduce or eliminate this leak. Production will be extended to the maximum by granting delivery of fridges under the condition that they are reserved for Coca-Cola, that the bar owner undertakes not to sell Pepsi and so forth. The loss and profit account of companies who have chosen to refuse or accept this kind of contract illustrates how they have matched their strategies to the preferences of consumers.

Commission decisions restricting contractual freedom only stop consumers from deciding. When “restrictive” contracts are in clear contradiction with the preferences of most consumers, this simply means that companies using them also leave the door open for profits to be made by their competitors. Let them decide whether they should seize them or not

[1] According to the agreement between the Commission and Coca-Cola, the fridges provided will no longer be used exclusively for Coca-Cola products, 20% of the volume can be used at the client’s discretion.

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