Scope

In recent years:
• some European antitrust Authorities have intervened in the wine sector
• the EU sectoral legislation changed significantly as a result of the 2008 reform of the wine market and the 2013 reform of the CAP

The objective of the presentation is to analyze the intersection between antitrust legislation and the sectorial regulation for wine, deriving some competition policy indications on:

1) how to define the “relevant markets” (geographic appellations vs grape varieties)

2) how to assess price and quantity agreements among competitors
• price fixing should always be considered illegal at whatever level of the wine value chain
• supply side restrictions should be rigorously limited to what is allowed under EU legislation

Agenda

Section I describes antitrust legislation and the evolution of EU wine regulation
Section II presents the way relevant markets are defined by competition Authorities
Section III illustrates Italian wine legislation and the ICA’s opinion to the Government
Section IV presents the SCA’s assessment of three illegal agreements among competitors
Section V concludes on the definition of the relevant market and the assessment of price and quantity restrictions

I) Antitrust legislation & wine regulation: antitrust legislation

Antitrust enforcement consists of the ex-ante assessment of M&As, as well as in the ex-post ascertainment of illegal agreements and abuses of dominant position
• focus on M&As and illegal agreements, as abuses of dominant position have, so far, not occurred

All agreements that have as their object or effect the restriction of competition are prohibited (TFEU, article 101.1)
• especially those that “directly or indirectly fix purchase or selling prices” and that “limit or control production”

M&A should not determine a Significant Impediment to Effective Competition (hereinafter, SIEC)
• antitrust Authorities can clear transactions, authorize them subject to conditions or prohibit them (Regulation No. 139/2004)

Antitrust enforcement is normally coupled with advocacy powers that allow antitrust Authorities to indicate to their Governments and Parliaments legislative and administrative measures that may create restrictions on competition
1) Antitrust legislation & wine regulation: appellations

Wine is considered an experience good as it is characterized by relevant information asymmetries between producers and consumers. Regulations sort wines on the basis of presumed quality through a classification, more specifically, “the concept of quality wines in the Union is based, inter alia, on the specific characteristics attributable to the wine’s geographical origin.”

The EU legislation has defined a quality pyramid, the rules being stricter and the expected quality higher, moving upward:
- wines without a geographical indication (hereinafter, WGI), which consist of former table wines that can now be indicated as:
  - generic wines (with possible indication of harvest year)
  - or varietal wines (with possible indication of grape variety and harvest year)
- wines with a geographical indication, including wines with:
  - a protected geographical indication (hereinafter, PGI)
  - and wines with a protected designation of origin (hereinafter, PDO)

  • within each of the PGI and PDO categories are included specific appellations, which are created by a group of producers around a consortium, a collective brand and a set of binding rules.

1) Antitrust legislation & wine regulation: application of competition rules to agriculture (1)

EU regulations in the wine sector are not limited to quality provisions but extend to a wide category of tools used to manage supply in order to address the structural production surplus which has long existed in the EU.

On the basis of the TFEU, the EU legislator determines the extent of the application of competition rules to the agricultural sector:
- taking into account the objectives of the CAP, which shall be - among others - “to stabilize markets”.

The recent reform of the CAP, which established a CMO for agricultural products, states clearly that EU competition rules which prohibit agreements restricting competition and abuses of dominant position apply to the agricultural sector, with some exemptions defined in the regulation itself.

Derogations from competition rules can be either general (articles 209 and 210), subject to the fulfillment of certain conditions, or specific to certain sectors.

1) Antitrust legislation & wine regulation: application of competition rules to agriculture (2)

Focusing on the wine sector, the CMO mostly renews the measures and approaches initiated during the 2008 wine reform:
- it gradually eliminates the previous transitional prohibition on planting vines
- it contains specific provisions concerning marketing rules that can be laid down by Member States, particularly by way of decisions taken by recognized interbranch organizations, to improve and stabilize the operation of the common market in wines, “including the grapes, musts and wines from which they derive”
- these marketing rules for regulating the supply of wines, which have to be notified to the EC
  - should be “proportionate to the objective pursued”
  - do not “allow for price fixing, including where prices are set for guidance or recommendation”
  - do not “render unavailable an excessive proportion of the vintage that would otherwise be available” (article 167)
  - “the scope of such decisions should (...) exclude practices which could distort competition” (recital 137)

2) The definition of the relevant market

The first step in competitive assessments normally consists of the definition of the relevant market, which is functional to the ascertainment of market power:
- tool to identify products and geographic areas that are substitutable from both a demand and supply perspective.

Market definition works best when products are homogenous, while its usefulness in relation to differentiated products is questioned:
- with differentiated products, competing products become imperfect substitutes and it is more difficult to draw the line of a specific market boundary.

In M&A, some tests have been defined in order to move directly to the effects of a transaction, without precisely defining the relevant market:
- however, even when Authorities take into account such tests, they usually do not consider them sufficient to conclude on the effects of a transaction
- such tests are corroborated by other qualitative elements in terms of current and potential competition, barriers to entry and buyer power
- in practice, the definition of a relevant market seems to be still necessary.

In restrictive agreements it is less important, as it is the breadth and the object of each agreement that defines the relevant market.
2) The definition of the relevant market: the EC case law (1)

The EC has cleared several M&As in the wine sector in relation to transactions that did not raise serious competitive concerns.

- the exact definition of relevant markets has been left open

The EC considers each of "still wines (…), champagne, sparkling wines (other than champagne), fortified wines (such as port and sherry) and light aperitifs" as separate relevant product markets.

These markets are defined according to the different methods of wine production, that consist, respectively, of the production of still, sparkling and fortified wines.

They also include some specific wine appellations, such as a sparkling wine ("Champagne") and two fortified wines ("Port" and "Sherry"), all of which - being included in the PDO category -

These relevant markets have been further segmented by taking into account, also cumulatively, the following factors: (i) distribution channels, (ii) appellations and (iii), so far only for still wines, colour.

2) The definition of the relevant market: the EC case law (2)

Distribution channels have been distinguished between on-trade (including bars, clubs and restaurants) and off-trade (consisting of retailers) sales.

Also, appellations may become an important factor in the definition of relevant markets.

- Jerez "Sherry" different from other sherry-style wines, also because of the existence of the specific Spanish "Sherry" PDO

- it could not excluded that the "Saint-Emilion", "Sauternes" and "Pomerol" PDOs, in the Bordeaux area, each constitute a separate product market

- (implicitly) all PDO wines in the Bordeaux region

The third possible segmentation criteria is the distinction based on colour.

- wines of different colour are not seen as substitutes by consumers.
Possible measures are listed from those aimed at increasing supply to those concerned, to implement several tools to manage the available output. National legislation allows Regions, following a proposal by the consortium of producers concerned, to implement several tools to manage supply:

- **for Burgundy PDO wines**
  - for ordinary PGI and WGI wines for everyday consumption
  - competitive analysis for overlaps for PDO wines in the region of Burgundy
    - combined market share post-merger was low (10-20%)
    - even focusing on narrower segments - limited to producers’ labels and by colour of wine - the market share of the parties did not raise concerns

For PDO wines, Patriarche was active only in Burgundy appellations, while Castel was active in all major appellations in the PDO category.

For PGI and WGI wines, included in the same broad market of ordinary wines for everyday consumption:

- the combined market share was (30-40)%
- existence of current competitors, possessing excess bottling capacity

- **2) The definition of the relevant market: FCA’s case law (3)**
- **3) Italian legislation (1)**

In the light of the parties’ activities, the effects of the transaction analyzed mainly on the markets (for still wines sold off-trade in LMS with producer and private labels):

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**3) Italian legislation (1)**

National legislation allows Regions, following a proposal by the consortium of producers concerned, to implement several tools to manage supply:

- Accordingly, Regions can, temporarily or permanently, both increase or reduce supply, with the consequent respective pressure downward or upward on average wholesale prices.

Possible measures are listed from those aimed at increasing supply to those decreasing it, concluding with those that may impact mostly on competition:

- **in climatically favourable years**, Regions can increase the maximum yields allowed by the production code by 20% in order to constitute a harvest stock to be used during subsequent years, in order to integrate possible production shortages.
- or to be released, following a Regional provision, to satisfy market needs

Among the measures that Regions can adopt to manage the available output from a specific year’s harvest:
- the softer one is to implement a **temporary stock** in order to stabilize the functioning of the wine market by providing an evolution of supply more compatible with demand

**3) Italian legislation (2)**

Moving to permanent supply reductions, in climatically unfavourable years, the most obvious one is to reduce production until the real limit of that year’s specific harvest:

- this can happen, for example, as a consequence of heavy hail or frosts

Supply can also be reduced permanently in order to stabilize markets and to reach market balance:

- the reasons for the implementation of this provision can be the need to match a decreasing demand, sometimes coupled with the intention of raising quality
- accordingly, the available production of a specific year's harvest is reduced and the remainder, till the maximum yield allowed by the production code, is reclassified to a lower level in the quality pyramid

Lastly, Regions can regulate the implantation surface in their territory to achieve market balance, by restricting the inscription of new plants in the vineyards register of a specific appellation.

**3) ICA’s advocacy**

ICA took the opportunity, arising from some **interbranch agreements** hosted by the Piedmont Region, to advise the Italian Government and all Italian Regions on the competitive impact of such agreements.

- interbranch organisations are self-organised vertically integrated organisations which comprise representatives of production and at least one partner from another level of the supply chain

The opinion concerned agreements, made between 2010 and 2014, in relation to the sale of “Cortese” grapes used for the production of the “Cortese di Gavi DOCG” and “Piemonte Cortese DOC” appellations (PDO category):

- the agreements not only introduced restrictions on the quantities of the grapes produced, but also set minimum prices for the sale of the grapes

ICA underlined the need to limit interbranch agreements strictly to what is allowed by current legislation:

- with the exclusion of price agreements concerning grapes and, even more, must/bulk wine
- limit the use of supply side measures, because of their impact on retail prices
- although acknowledging that winegrowing activity might endure a high differentiation in quality from year to year depending on the prevailing climate conditions
In 2005 contacts were resumed to find a solution to the lack of barriers to entry leading to breaches of the cartel agreement offering lower prices, causing cartel members to lose part of their business.

The cartel was successful, reaching its objective of raising prices. In the first phase, from 2001 to 2003, the rules of the cartel were created and the sector had seen its fastest growth in the 1970s, but since the 1980s supply had continuously exceeded demand, mainly as exports had been declining due to changes in consumer tastes. The sector had seen its fastest growth in the 1970s, but since the 1980s supply had continuously exceeded demand, mainly as exports had been declining due to changes in consumer tastes. Continuously exceeded demand was consistent with the eight years of the cartel (-29%), almost all of which were concentrated on the export segment, while the national market was rather stable.

Two different time periods were identified, interrupted by the disagreements that arose between some members of the cartel during its development. Two different time periods were identified, interrupted by the disagreements that arose between some members of the cartel during its development. The cartel was composed by nine companies, an industry association (Fedeljerez) and the regulatory board for the “Sherry” PDO (Regulatory Board or CR).

The cartels pushed CR to amend regulation introducing quantity restrictions that would apply no longer on the stocks of each winery, but on their total past sales. Consequently, producers did not have to compete for their main input, while at the same time maintaining a minimum revenue for grape growers.

Horizontal cartels among wine producers can harm both downstream demand, as in the BOB cartel described above, and upstream grape growers. The SCA intervened again in the “Sherry” sector, this time in relation to a vertical agreement to fix the price of grapes and must/bulk wine.

The SCA finally sanctioned the nine wineries, Fedeljerez and the CR.

5) Conclusions: appellations versus grape varieties

Demand side substitution is the starting point in the definition of relevant markets as demand is the most effective disciplinary force.

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- relevant market definition can rely on qualitative evidence, gathered during the market investigations conducted by Authorities, through questionnaires sent to and hearings of competitors and customers of the parties.

- such qualitative evidence can be integrated with quantitative data, for example, gathered through appropriately designed surveys commissioned by Authorities.

- the analysis of the actual responses of consumers can indicate the degree of substitutability between two products.

- an appropriate survey should ask consumers what their behavior would be in response to an increase in the prices of a wine relative to another.

Supply side substitution may be taken into account only if suppliers are able to switch production in the short term, in order to have an impact in terms of effectiveness and immediacy equivalent to the demand substitution effect.

- for example, if they joy a similar manufacturing process.
5) Conclusions: appellations versus grape varieties (2)

Markets based on the different methods of production (still, sparkling and fortified)
- for sparkling (“Champagne”) and fortified wines (“Sherry” and “Port”), specific appellations have been considered as relevant markets
- for still wines this possibility has, so far, only been envisaged
  - EC has considered some specific appellations defined at municipal level (“Saint-émilion”, “Pomerol”, “Sauternes” PDOs in the Bordeaux region)
  - in another decision concerning the Bordeaux region, the EC envisaged a possible relevant market implicitly including all PDOs of the region
- the FCA concluded that all PDOs of Burgundy constitute a relevant market
  - probably the need to define a relevant market has not, so far, arisen because of the lack of overlaps
- Authorities have nevertheless considered the role of geographical indications taking into account a regional dimension of the market

While geographic appellations may be an important factor of choice for quality wines, grape variety seems to be more relevant going down the quality pyramid
- FCA identified a broad market for ordinary wines, comprising both PGI and WGI wines, also because they can both indicate grape varieties
- however, the FCA did not go as far as identifying a market for a specific grape variety

5) Conclusions: assessment of price and quantity restrictions (2)

Some degree of price cooperation existed and might still exist around Europe
- the SCA uncovered three cartels, all of which included a price component
- ICA observed the existence of price agreements, at the grape level, in the context of interbranch agreements of two Piedmont appellations
- similar agreements might exist in relation also to other appellations
  - arrangements concerning musts/bulk wine are more harmful, being more likely to standardize final prices
  - they provide a minimum revenue to the industrial component of the value chain, not that of growers

Interbranch agreements are also diffused in the EU
- among them, the “Comité Interprofessionel du Vin de Champagne”
- cooperation between growers and producers concerned grapes’ prices for a long time (since 1990, indicative non-binding prices have replaced fixed prices)

The sectorial EU legislation does not provide for a derogation for the wine sector from the general prohibition of fixing prices defined by the antitrust legislation
- consequently price fixing should always be considered illegal at whatever level of the value chain, from grapes to bottled wine

5) Conclusions: assessment of price and quantity restrictions (1)

Competition legislation looks unfavorably at cartels (price and output fixing): they achieve the same negative effects as a monopoly
- total surplus is reduced by deadweight loss, causing allocative inefficiency
- at the same time, they can also result in productive inefficiency, as production costs may be higher than those that would result from a more competitive environment
- as well as in a reduction of dynamic efficiency

Difficulties that can emerge in stabilizing a cartel over time:
- in the decision to continue colluding or cheating, each cartel member, indeed, compares the immediate gain it makes from a deviation with the profit it gives up in the future, when rivals react
- in that decision, several structural factors may favour cartel’s instability such as a low level of market concentration, the absence of barriers to entry and the variability of demand

“Sherry” cartel was unstable precisely because of the presence of such factors
- many wineries authorized to bottle and market “Sherry” wine
- no barriers to entry, as any authorized operator could export wine
- demand was very unstable

5) Conclusions: assessment of price and quantity restrictions (3)

Quantity restrictions generally have the same effect as price fixing
However, the CMO allows, under certain conditions, Member States to derogate for the wine sector from the general antitrust prohibition of restricting quantities
- Antitrust Authorities might verify, as did the SCA, the existence, in the specific context analyzed, of the conditions that could justify a derogation

European legislation currently allows Member States to adopt marketing rules to improve and stabilise the operation of the common market in wines
- supply side management measures, both increasing and reducing quantities, appear to be legitimate if aimed at improving quality
  - quality depends also on climatic conditions that prevail in a given year
  - restrictions of supply aimed at stabilizing markets, which not necessarily improve quality, might be considered legitimate provided that they are “proportionate” and do not “render unavailable an excessive proportion of the vintage”, excluding “practices which could distort competition”
- consequently, specific measures restricting quantities to that aim need to be well grounded and motivated, as well as notified to the EC
- the SCA’s “Sherry” cartel was sanctioned because it was implemented through supply side restrictions based on past sales of each operator, a motivation that does not fit within the allowed framework
5) Conclusions: assessment of price and quantity restrictions (4)

More in general, even assuming the compatibility of specific quantity restrictions with EU legislation, matching demand and supply artificially does not appear to solve the surplus issue in the long term.

This is well illustrated by the need of some specific appellation to implement measures to reduce supplies for several consecutive harvests.

On the contrary, the application of the law of supply and demand would progressively drive the most inefficient producers out of the market, increasing the competitiveness of the appellations considered.

As suggested by the ICA in relation to agricultural markets as a whole, “the common research of a conformity of supply to the requests of demand should concentrate on aspects regarding quality of production, without limiting supply from a quantity standpoint.”

Closing remarks

The progressive reform of European wine regulation has introduced a more market-oriented approach, even if quantity restrictions to stabilize markets are still allowed under certain conditions.

Changes in the regulatory framework and the antitrust interventions that have occurred in recent years are aimed at spreading a more pro-competitive spirit in the European wine industry.

Hopefully, quality will become the driver of cooperation among players, overcoming quantity restrictions that have mostly proved unsuccessful.

Thanks for your attention, comments are welcome!

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