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Distribution Agreements under EC Competition Law

Discourse on the adoption of a truly more economic
approach in the assessment of vertical restraints for
the sake of businesses and consumers

Working Paper

*Rossella Incardona**

Introduction

The aim of any economic system is to optimize the economic welfare¹ of all persons within the system leading to improvements in the standard of living. A secondary aim is to foster a distribution of economic benefits that allows all citizens to achieve a lifestyle consistent with the norms of the society. Laws and regulations can advance these aims or impede them, depending on how they are structured, implemented, and enforced.

It is a premise of this paper that history has shown free competition, subject to social (and legal) constraints fostering fairness and market integrity, to be the best means to improve economic welfare across varying categories of consumers, various kinds of economic entities, various ethnic categories, and nationalities. While the question of wealth distribution is more contentious, this paper argues that freedom of economic choice (in the form of freedom of contract), within a system of rules aimed at protecting public interests and at promoting competition in the market, may foster a just distribution of economic benefits.

In this paper I will deal specifically with these principles as they apply to the treatment of distribution agreements under EC competition law.

In a more mature phase in the development of EC competition policy, characterised by attention to "a more economic analysis", the decentralized enforcement of EC competition rules, the substantial harmonization of national competition rules, and the effective creation of the internal market, the analysis of distribution agreements may not be neglected. The new block exemption

* PhD candidate, *Università degli studi di Palermo*. The Author is grateful to Jack Cumming for his precious comments and his support in writing this paper.

¹ For an explanation of the concept of "welfare" in economics see M. MOTTA, *Competition Policy - Theory and Practice*, Cambridge University Press, Cambridge, 2004, at 18 ff.

regulations have made progress in allowing a more sensible approach toward distribution agreements relative to the previous EC approach. Nevertheless, still more reflection, more legislative reform and more economic analysis is required before EC competition rules affecting distribution agreement will be effective in raising the economic welfare of firms and consumers. As will be clear from the analysis in this paper, more reform is needed before the EU will be in position to make the most of the internal market, without over-regulating, in name of legal certainty, thereby excessively inhibiting the economic freedom of the parties. Such freedom to act is essential if the EC is to optimize the European economy.

This paper is structured as follows:

1. in the first part, I define the nature of distribution agreements and vertical restraints and provide some insights concerning alternative economic theories relating to vertical restraints;
2. in the second part, I summarise the EC competition rules applicable to distribution agreements, with an eye to the European case-law, economic analysis and the American antitrust experience; and
3. in the third part, I show the drawbacks of the current rules governing vertical restraints and develop my own conclusions concerning a possible way forward that may better satisfy the commercial needs of business, improve consumer welfare, and encourage new, more effective forms of distribution.

PART I: Distribution agreements: concepts and economic theories

1. Distribution agreements

It is very rare for manufacturers to sell their products² directly to final consumers.³ The traditional practice has been for manufacturers to work through specialized dealers, wholesalers and retailers, to market their products (indirect distribution).⁴ Increasingly today, large retailers (superstore or supermarket chains) have sufficient market presence to deal directly with manufacturers for the products they want to market. Both avenues connecting end consumers with manufacturers are characterized by a multiplicity of stages beginning with the manufacturer and extending to wholesalers and/or to retailers and ultimately to the final consumers. They are also characterized by the coordination agreements between manufacturers and distributors who may, and usually do, enter into long-term commitments. These agreements are known as distribution agreements.⁵

Distribution agreements fall in the category of vertical agreements, which are marketing agreements entered into between enterprises located at different levels of the production or distribution chain. Vertical agreements usually entail clauses which limit the contractual freedom of the parties (vertical restrictions). The manufacturer may require the dealer to agree to purchase a certain product volume (*i.e.* there may be a minimum sales quota), or the dealer may be required to resell at a certain minimum or maximum price (resale price maintenance - RPM) or the dealer may only be authorized to operate within an appointed territory (territorial restrictions) or the dealer may be limited to a given set of consumers (customer restrictions) or the dealer may be limited to certain qualitative or quantitative criteria (selective distribution). The retailer may negotiate with the manufacturer to gain exclusive distribution rights for certain products (exclusive supply) or the retailer may demand that the products be withheld from certain competitors.

Vertical restrictions limit the autonomous freedom of action of the parties and thus appear, *prima facie*, to affect the competitive conditions of the market. Yet, despite this initial impression, vertical restrictions are freely entered into by the parties because they have salutary economic benefits for the contracting parties and can be considered themselves as an attribute of a free market. Absent a distorting imbalance of market power⁶ enjoyed by one party to a distribution agreement, vertical restraints may bring economic benefits also to the market as a whole.

Vertical restraints allow manufacturers to control the entire process of production and distribution of the product and to adapt or shape the distribution to the product, the market or the image of the firm. Vertical restrictions may guarantee to the distributors more sales or an evident positive brand visibility to consumers or a certain protection from competitors, which allows them to invest in growth and to harvest the fruits of that growth more effectively. Vertical restrictions implemented along a chain of distribution (and efficiencies or inefficiencies brought by it) may impede

² In this paper, with the term "manufacturer(s)" I also include referentially supplier(s) of services and with the terms "product" or "good" I also include referentially service(s). The terms "manufacturer", "seller", or "upstream-company" are generally used interchangeably to indicate the enterprise located at the top of the vertical relationship; the terms "purchaser", "buyer", "down-stream company", "retailer", "wholesaler", "distributor" are generally used to indicate the enterprise(s) at the "lower level" of the distribution chain.

³ A relevant exception is distance selling by mail, telephone or internet which has accelerated as the internet has gained wider acceptance.

⁴ On indirect distribution see R. PARDOLESI, *I contratti di distribuzione*, Editore Jovene, Napoli, 1979, at 6.

⁵ On the concept of distribution agreements see G. CERIDONO, *I contratti di distribuzione in Diritto private europeo* (ed. LIPARI), II, Cedam, Padova, 1997, at 931.

⁶ According to § 15 of the Commission Notice "Guidelines on the application of article 81 of the EC Treaty to technology transfer agreements, OJ C101, 27.04.2004, p. 2 (TTBER Guidelines), "market power is the ability to maintain prices above competition levels or to maintain output in terms of products quantities, product quality and variety or innovation below competitive levels for a not insignificant period of time. The degree of market power normally required for a finding of infringement under Article 81(1) is less than the degree of market power required for a finding of dominance under Article 82".

competitors (in the case of efficiencies) or allow a competing chain to offer its products at better prices/services condition, or to develop new way of distribution (in the case of inefficiencies).

This is one of the strengths of a free market structure which maximizes undistorted competition: new more efficient market actions supplant less efficient outdated products and processes, benefiting end consumers in a way that is impossible with monopoly structures or in unrestrained *laissez faire* economies. Effective and restrained state intervention, which optimizes private action while setting rules to keep such action balanced, open, fair and efficient, has proven to be the most effective public system for fostering general prosperity and enhancing consumer welfare.

1.1. Intra-brand, inter-brand and vertical competition

Traditionally, vertical restraints affect both inter-brand and intra-brand competition. The interrelation between inter-brand and intra-brand competition is relevant to determine and assess the effects of a vertical restriction in the relevant market. Inter-brand competition is the competition among the suppliers (or the dealers) of a given brand (e.g. Acer hardware against sellers of Compaq and Toshiba computers). Intra-brand competition is the competition among the dealers of a given brand (e.g. among all the dealers of Acer computers).

Interestingly, according to Robert L. Steiner, competition is not only “horizontal”, between firms at the same level of the production and distribution chain, but also “vertical”. The relationship between manufacturer and retailers, apart from being cooperative, can also be competitive, when manufacturers and retailers “can take sales, margin or market shares from each other”.⁷ Vertical competition takes place, in consumer goods markets, every time the two parties exercise a different level of **market power**. The changing relationships between manufacturers and retailers (even if not based on the Steinerian “dual stage model”) are a subject of study by the Commission,⁸ but have not yet been adequately dealt with legislatively.⁹

2. *Distribution Agreements: Some Economic Insights*

Up to the seventies, antitrust authorities in the US and the European Union, supported by the then dominant stream of economic thought, adopted a strict approach to vertical restraints, considering them anticompetitive because, in short, they impede the ability of retailers to set their own prices or to sell competing products.

Beginning in the 1960s, however, some economists¹⁰ began to rethink this school of thought and to espouse an alternative view of vertical restraints, recognizing that vertical restrictions are very common **in the production and distribution chain, and that, in the real world, as opposed to the academic world of perfect competition, “distribution matters”**¹¹ and has a cost. Today, **the prevalent concept is a belief that a careful balancing of both the anti- and pro-competitive effects**

⁷ R.L. STEINER, *The evolution and applications of dual-stage thinking*, 49 *Antitrust Bulletin*, 2004, 877, p. 895. Steiner backs up his theory with different studies which outline the inverse association between the manufacturer and the retailer margins, *ib.*, p. 880.

⁸ See the study commissioned by the Commission (P. DOBSON, *Buyer Power and its impact on competition in the food retail distribution sector of the European Union*, 1999) and the studies of the OFT (P. DOBSON, M. WATERSON, A. CHU, *The Welfare Consequences of the Exercise of Buyer Power*, (OFT) Research paper No. 16, 1998), OECD (*Buying power of multi-product retailers*, 1999; O. BOYLAND - G. NICOLETTI, *Regulatory Reform in Retail Distribution*, 2001) and of the UK Competition Commission (*Supermarkets: A Report on the supply of groceries from multiple stores in the United Kingdom*).

⁹ See J. STUYCK - T. VAN DICK, *EC Competition Rules on Vertical Restrictions and the Realities of a Changing Retail Sector on National Contract Law in The Forthcoming EC Directive on Unfair Commercial Practices*, (ed. H. COLLINS), Kluwer Law International, The Hague, 2004, 131 - 186.

¹⁰ See L. TELSER, *Why should Manufacturers Want Free Trade?*, 3 *J.L. & Econ.*, 1960, 86.

¹¹ So H.P. MARVEL, summarizing the theories of Steiner in “*Distribution Matters*”, 49 *The Antitrust Bulletin*, 2004, 955.

of privately contracted vertical restraints is essential to their evaluation. This requires a more subtle and sophisticated approach to these restraints than the application of abstract rules which set fixed rules independent of the economic context of the market at issue.¹²

2.1.1. Pro-competitive effects of vertical restraints

The supporters of the pro-competitive view of the effects of vertical restrictions, guided by the economists of the Chicago School,¹³ observe that vertical restraints increase inter-brand competition and are, generally, efficiency-enhancing, e.g. a manufacturer can use restraints to ensure that the consumer experience throughout reflects the same care and quality inherent in the original product. For instance, a car manufacturer may constrain its dealers to maintain standards of sales integrity and service consistent with the image which the manufacturer is seeking to forge for its vehicles. Such vertical restraints can greatly improve the product experience of consumers who buy cars from dealers affiliated with that manufacturer. With an extremely simple and logical reasoning Robert H. Bork, explained that “*when a manufacturer imposes resale price maintenance or vertical division of reseller markets, or any other restraints upon the rivalry of resellers, his motive cannot be the restriction of output and, therefore, can only be the creation of distributive efficiency*”.¹⁴

Vertical restraints are not generally aimed at increasing price, but at minimizing the free rider problem, or at avoiding the double monopoly margin, or at allowing a better organization of production and distribution, counterbalancing the effects of demand uncertainty.¹⁵ Therefore, in cognizance of the observation that “*no court is likely to make a more accurate assessment than does a businessman with both superior information and the depth of insight that only self-interest can supply*”,¹⁶ pure vertical restraints should be “*per se legal*”¹⁷ (without prejudice to horizontal collusion expressed by vertical restraints or conducts in abuse of dominant position). These economists have generally examined vertical restraints from the view point of manufacturers, though they proceed from the premise that manufacturers behave in a way that satisfies the interests of consumers as well.

¹² According to M. MOTTA, “it would be largely useless, for instance, to outlaw a certain type of clause while allowing others that achieve the same objective”, in *Competition Policy - Theory and Practice*, fn. 1 above, at 305. For an overview of economic theories on vertical restraints see R. BOSCHECK, *The EU Policy Reform on Vertical Restraints - An Economic Perspective*, 23/4 *World Competition*, 2000, 3.

¹³ On the Chicago School see, *inter alia*, F.H. EASTERBROOK, *Workable Antitrust Policy*, 84 *Mich. L. Rev.*, 1986, 1696; R.A. POSNER, *The Chicago School of Antitrust Analysis*, 127 *U. Pa. L. Rev.*, 1979, 925 and R.H. BORK, *The Antitrust Paradox: A Policy At War With Itself*, The Free Press, New York, 1993.

¹⁴ R. H. BORK, *The Antitrust Paradox: A Policy At War With Itself*, The Free Press, New York, 1993, p. 289.

¹⁵ Paragraph 116 of the Commission Notice “Guidelines on Vertical Restraints”, OJ C 291, 13.10.2000, p. 1 (VABER Guidelines) recall eight reasons that may justify the imposition of vertical restraints: (1) to ‘solve a “free rider” problem’, (2) to ‘open up or enter new markets’, (3) the “certification free-rider issue”, (4) the ‘hold-up’ problem, (5) the ‘specific hold-up’ problem that may arise in the case of transfer of substantial know-how’, (6) ‘economies of scale in distribution’, (7) ‘capital market imperfections’ and (8) ‘uniformity and quality standardisation’.

¹⁶ R. H. BORK, *The Antitrust Paradox: A Policy At War With Itself*, fn. 14 above.

¹⁷ R.A. POSNER, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 *Un.Ch.L.Rev.*, 1981, 6, at 8. According to F. H. EASTERBROOK, *Vertical Arrangements and the Rule of Reason*, 53 *Antitrust L.J.*, 1984, 135, a 159, “vertical arrangements should be deemed lawful, without further inquiry, if any one of the following five things is true: (1) the firm employing the arrangement lacks market power; (2) firms use different methods of distribution; (3) the arrangement in question has led to an increase in output by the defendants; (4) the arrangement in question has been in use longer than five years; or (5) the firm cannot increase its profits by harming consumers”.

2.1.1.1. Avoiding the free rider problem

Vertical restraints may eliminate, or at least reduce, the *free rider* problem among retailers, ensuring that retailers provide promotion or customer assistance or point-of-sale services (e.g. pre-sale information, on-site demonstration, trained shop assistants, parking spaces for clients, central sales premises, advertising and promotion).¹⁸ The concept of *free riding* is simple.¹⁹ In purchasing a technologically complex product or a product newly introduced in the market, the potential consumer may obtain pre-sale services from one retailer and buy the product from another retailer, who offers few or no services at all but who is thereby able to maintain lower prices. In the short term, the manufacturer is satisfied because its product is sold and the consumer is satisfied because he/she has purchased the product at a lower price; in the long term, however, if both retailers and consumers behave rationally, no thinking retailer will offer pre-sale shopping services lest an unearned advantage be given to those retailers with offer minimal service. In consequence, the demand for the product will fall, which will ultimately rebound contrary to the longer term interests of the manufacturer, and will adversely affect the retailers and the consumers who will thus be deprived of the widespread market availability of a valuable product. A vertical restraint, such as a minimum resale price or the granting of exclusive territory or sales quota, can efficiently solve the free-rider problem, eliminating or limiting price competition and so encouraging retailers to increase their sales efforts and to compete on services.

The free rider problem also occurs among manufacturers. A manufacturer may offer services (e.g. training of its retailers on the functioning, sale, service, and maintenance of a product) which might then be exploited by other manufacturers for similar competing products, thereby avoiding the cost of these essential services. Thus, the copycat manufacturers may seek to benefit from a free-ride on the originating full-service manufacturer by selling competing products at a lower price, unfairly undercutting the innovative manufacturer of first instance. The first manufacturer may be discouraged by its loss and decide not to offer such services anymore. The free-rider problem among manufacturers can be addressed by an exclusive supply clause.²⁰

Today, the free rider problem may also occur between retailers and manufacturers. This phenomenon occurs when retailers act like double agents (simultaneously selling branded products and producing and selling their own lower cost, competing private label products). Retailers may take advantage of the pre-launch information about a brand product to manufacture a similar product and then to sell it at a price lower than the branded one. In the long run, the manufacturers of branded products will lose profits and will lose the incentive to research and develop new or better products. A vertical restriction like the maximum resale price can avoid this problem so that the manufacturer-retailer may not set a too high for the branded product, thus minimising the free rider problem.²¹

2.1.1.2. Avoiding the double-margin problem

A monopoly margin is the positive difference between price and marginal costs. A manufacturer with sufficient market power can and may sell a product at a price which exceeds the marginal costs. The price paid by distributors is an important component of the final price to consumers. If the distributors also have sufficient market power, they can raise the resale price of the product

¹⁸ As F. H. EASTERBROOK explains "*there is no such thing as a free lunch*"- quoting M. Friedman who was, in turn, quoting A. Smith - "*the manufacturer can't get the dealer to do more without increasing the dealer's margin*", in *Vertical Arrangements and the Rule of Reason*, 53 *Antitrust L.J.*, 1984, 135, at 156.

¹⁹ On free riding see V.P. GOLDBERG, *Free riding on hot wheels*, 47 *Antitrust Bull.*, 2002, 603 and *The Free Rider Problem, Imperfect Pricing, and the Economics of Retailing Services*, 79 *Nw. U.L Rev.*, 1984, 736; K. KELLY, *The Role of the Free Rider in Resale Price Maintenance: The Loch Ness Monster of Antitrust Captured*, 10 *Geo. Mason U. L. Rev.*, 1988, 327.

²⁰ See P. ZWEIFEL - R. ZÄCH, *Vertical restraints: the case of multinational*, 48 *Antitrust Bulletin*, 2003, 271 a 275.

²¹ See D. HILDEBRAND, *Thirty Years Prohibition of Resale Price Maintenance - Germany on the Verge of Change*, 26(4) *E.C.L.R.*, 2005, 232, at 234-236.

above the theoretical supply and demand crossover, thus gaining double monopoly margin²². The double monopoly margin increases prices, diminishes the welfare of consumer, and in the long run, that of manufacturers and retailers as well, since their sales are reduced by resistance to the consumer overcharge. A vertical restriction, such a maximum resale price or sales quota or a mechanism of rebates imposed by the manufacturer, can avoid this problem and increase distribution and production efficiency.

2.1.1.3. Reduction of externalities due to the lack of coordination between manufacturer and retailers

Vertical restraints allow manufacturers to enlist and reward the loyalty and collaboration of their retailers, allowing their products to be more efficiently distributed with a correspondingly lower cost. The assignment of territorial exclusivity, for example, allows manufacturers to cover and serve different areas in the same way, optimally allocating inventory to retailers and more fairly meeting the needs and expectations of consumers. The logical outgrowth of this reasoning is a conclusion that improved coordination between manufacturer and retailers should, in turn, increase *inter-brand* competition as well.²³

Vertical restraints allow point-of-sale selling and marketing decision-making to be decentralized from manufacturers to retailers, providing retailers an incentive to optimize local strategies for promotion and sales.²⁴

Vertical restraints may further encourage the downstream company to invest substantially in support of the upstream company. This is most clearly true in the case of *franchising* or forms of territorial restriction, which enable retailers to take risks on behalf of the manufacturer, with the resulting melded joint effort improving product distribution and promotion, to the sake of consumers.

2.1.1.4. Reduction of transaction costs

Agreements and vertical restraints are instruments able to reduce transaction costs and maximise manufacturers' and distributors' welfare. Vertical restraints enable businesses to better control the distribution process at a lower cost than would be required by direct distribution, with a resulting advance in efficiency which benefits the end consumers. Moreover, these circumstances allow manufacturers to promote their products more efficiently, even when, as in oligopolistic markets, or when one party has dominant market power, vertical restrictions may appear to have anticompetitive effects.²⁵

²² The problem of the double monopoly margin was first outlined by J.J. SPENGLER, *Vertical Integration and Anti-trust Policy*, 58 *Journal of Political Economy*, 1950, 347. On the double monopoly margin see P. REY, *The Economics of Vertical Restraints*, in *Handbook of Industrial Organization* (ed. M. ARMSTRONG, R. PORTER), vol. III, 2003, available at http://esnie.u-paris10.fr/pdf/textes_2004/rev_vertical-res.pdf, as of 16.8.2005, 6:13 p.m., at 2-4; S. VILLAS-BOAS, *Vertical Contracts Between Manufacturers and Retailers: Inference With Limited Data— The Case of Yogurt*, http://repositories.cdlib.org/are_ucb/943/ as of 16.8.2005 6:13 p.m.

²³ See R.H. BORK, *The Antitrust Paradox: A Policy At War With Itself*, fn. 14 above, pp. 295-296; R.A. POSNER, *The rule of reason and the Economic Approach: Reflections on the Sylvania Decision*, 45 *U. Ch. L. Rev.*, 1977, 1, pp. 18-19; L. TELSER, *Why should Manufacturers Want Free Trade?*, fn. 10 above; F. H. EASTERBROOK, *Vertical Arrangements and the Rule of Reason*, ft. 17 above, at 159 according to whom "vertical arrangements should be deemed lawful, without further inquiry, if any one of the following five things is true: (1) the firm employing the arrangement lacks market power; (2) firms use different methods of distribution; (3) the arrangement in question has led to an increase in output by the defendants; (4) the arrangement in question has been in use longer than five years; or (5) the firm cannot increase its profits by harming consumers".

²⁴ See A. J. MEESE, *Property Rights and Intra-brand Restraints*, 89 *Cornell L. Rev.*, 2004, 553.

²⁵ See O.E. WILLIAMSON, *Assessing Vertical Market Restrictions: Antitrust Ramifications and the Transaction Cost Approach*, 127 *U. Pa. L. Rev.*, 1979, 953, at 958-60 and 993.

2.1.1.5 Ease of entry of new manufacturers into the market

Vertical restraints are often fundamental to the entrance of a manufacturer into a new market. Absent some kind of exclusivity protection, or without revenue support from a minimum resale price clause, a retailer may not be willing to risk investing in the promotion and sale of a new product.

2.1.1.6. Certification argument

Certain luxury products (perfumes, fashion items) are bought by consumers drawn by their *allure*, which also depends on high price and on the high priced, chic, tony stores where they are sold. In this case, the high price and the high-fashion store attest to the quality of the products in the eyes of the target consumers.²⁶ To maintain this “snob appeal”, the fixing of minimum resale price is justified and even essential to success. The risk is exemplified by the Pierre Cardin *griffe*. The brand lost cachet and dropped in “desirability” once the manufacturer allowed it to be merchandised and sold in stores that were viewed as more plebeian and less upscale.

2.1.2. Anticompetitive effects of vertical restraints

The supporters of the view that vertical restraints are anticompetitive observe that they may facilitate collusive behaviour between retailers, aid cartels among manufacturers, reduce or eliminate *intra-brand* competition, increase the product price to the detriment of consumers,²⁷ sometimes fail to ensure adequate dealer support or the avoidance of the free-rider problem, and hinder the introduction of more efficient or less costly forms of distribution.²⁸ These are valid concerns and vertical restraints need to be evaluated as to whether they produce a positive or a negative outcome.²⁹ Still, it is wrong to assume *a priori* that some vertical restraints (e.g. minimum RPM) hinder competition and restrain trade.

²⁶ On the certification argument see H. MARVEL - S. MCCAFFERTY, *Resale Price Maintenance and Quality Certification*, 15 *Rand Journal of Economics*, 1984,346; see also the “Shelf Space Rental” argument from V. P. GOLDBERG, *The Free Rider Problem, Imperfect Pricing, and the Economics of Retailing Services*, fn. 19 above, pp. 738-48.

²⁷ Some Authors contest that vertical restraints may increase the margin of distributors, but do not always increase the consumer price. The manufacturer, in front of a decrease in the demand of product, could, in fact, reduce the price of the product to the dealer, maintaining the promised dealer’s margin but also the price to consumers. So H.P. MARVEL, *The Resale Price Maintenance Controversy: Beyond the Conventional Wisdom*, 63 *Antitrust L.J.*, 1994, 59, at 67-69. Other Authors observe that the price increase due to increased costs does not reflect market power nor cause a damage to consumer welfare, but it is a mere economic truism: the production of services costs, and the companies who supply these services must return their investment to continue their activity, see A. J. MEESE, *Property Rights and Intra-brand Restraints*, fn. 24 above, at 567.

²⁸ See R.B. KLEIN - K. MURPHY, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 *J. L. STEINER, How Manufacturers Deal With the Price-Cutting Retailer: When are Vertical Restraints Efficient?*, 65 *Antitrust L. J.*, 1997, 407. & *Econ.*, 1988, 265, 265-66.

²⁹ According to the 103 VABER Guideline, fn. 15 above, the negative effects on the market which EC competition law aims at preventing are: (i) foreclosure of other suppliers or other buyers by raising barriers to entry; (ii) reduction of inter-brand competition between the companies operating on a market, including facilitations of collusion among suppliers or buyers; (iv) reduction of intra-brand competition between suppliers of the same brand; and (v) the creation of obstacles to market integration, including, above all, limitations on the freedom of consumers to purchase goods or services in any Member States they may choose.

2.1.2.1. Reduction of intra-brand competition

According to these alternative theories critical of vertical restraints, *intra-brand* competition is to be preserved and encouraged.³⁰ Competition among retailers is important for the efficient allocation of goods and for keeping the consumer price low and ought not to be lessened by vertical restraints unless such restraints bring offsetting pro-consumer effects.

Distribution is not determined by the manufacturers' decisions alone, but also depends on consumers' and distributors' choices. The Chicago School is too narrow in focusing only on inter-brand competition and in assuming that there is "atomistic competition at the distribution stage".³¹ *Intra-brand* competition can counterbalance the market power existing at the manufacturing level and contribute to the efficient allocation of products. For branded products, or for products sold based on the reputation of the retailer, or for heavily promoted products, intra-brand competition may reduce the resale margins of retailers, who will compete on price, to the benefit of consumers and manufacturers themselves.³²

2.1.2.2. Price discrimination

Vertical restraints allow manufacturers and/or retailers to benefit from price discrimination, taking advantage of information asymmetries among consumers (*arbitration function*)³³ or from their varying attitudes toward the purchase of a product. A manufacturer of mobile phones may be able to sell a mobile at a high price to Italian consumers but be forced to accept a lower price in another county where the consumer demand is lower or consumers are more discerning. Some economists view this kind of price discrimination as anticompetitive as it may increase the monopoly margin of manufacturers at the expense of unwitting consumers.³⁴ Consumers as well may view such price differences as unfair, especially when they appear to favour consumers in one Member State over those in another.

³⁰ W. GRIMES, *The Life Cycle of a Venerable Precedent: GTE Sylvania and the future of Vertical Restraints Law*, 17-FALL *Antitrust*, 2002, 27 so summarises "Efficient retailers are rewarded and inefficient rivals driven from the market. So whether interbrand competition is more important than intra-brand competition must depend on the context. Without vigorous intra-brand competition, efficiency in the all important retail sector would suffer and consumers would pay more". On the importance of intra-brand competition see also W. GRIMES, *Brand Marketing, Intra-brand Competition, and the Multibrand Retailer: the Antitrust Law of Vertical Restraints*, 64 *Antitrust L.J.*, 1995, 83, pp. 96-99; L.R. STEINER, *Sylvania Economics - A Critique in Antitrust L.J.*, 1991, 41; R.L. STEINER, *Exclusive Dealing + Resale Price Maintenance: A Powerful Anticompetitive Combination*, 33 *Sw. U. L. Rev.*, 2004, 447.

³¹ See W.S. COMANOR, *The Two Economics of Vertical Restraints*, 21 *Sw. U.L.Rev.*, 1992, 1265, pp. 1282-1283.

³² R. L. STEINER suggests a "rule of thumb" to assess the market power of manufactures and retailers "...if consumers are more disposed to switch brands within store than stores within brand, retailers dominate manufacturers...when consumers are more disposed to switch stores within brand than brands within stores, the above market power and margin relationship are reversed", so in *The Nature of Vertical Restraints*, 30 *Antitrust Bull.*, 1985, 143, at 157-158. W. S. GRIMES, *The Seven Myths of Vertical Price Fixing: the Politics and Economics of a Century - Long Debate*, 21 *Sw. U. L. Rev.*, 1992, 1285, p. 1305.

³³ W. GRIMES, *Brand Marketing, Intra-brand Competition, and the Multibrand Retailer: the Antitrust Law of Vertical Restraints*, *supra* fn. 30, at 97.

³⁴ Others observe that that segmenting consumers and charging them different prices according to their willingness to pay is not only a rational strategy for companies to maximise profits but it also can raise economic welfare. P. ZWEIFEL - R. ZÄCH, *Vertical restraints: the case of multinational*, 48 *Antitrust Bulletin*, 2003, 271, at 275, observe that if the total quantity of sales increases due to the price discrimination, total welfare of consumers increases, and the vertical restraints become efficient. On price discrimination and article 82 EC, see M. LORENZ, M. LUBBIG, A. RUSSELL, *Price Discrimination, a Tender Story*, 26(6) *E.C.L.R.*, 2005, 355.

2.1.2.3. Collusive behaviour between manufacturers and retailers

Some vertical restraints can facilitate anti-consumerist collusive behaviour, at the manufacturers' or retailers' level, amplified if similar restrictions are adopted by other competing manufacturers.³⁵ Some vertical restrictions, such as the most favourite customer-clause, may serve to implement horizontal collusive behaviour among manufactures, in the form of anticompetitive price cartels.³⁶ Vertical restraints, including the setting of minimum price, may also have been forced upon manufacturers by a retailer cartel and be an expression of the market power of retailers.³⁷

2.1.2.4. Raising prices for the inframarginal consumers

Other economists observe that vertical restraints may increase the price of the product for the inframarginal consumer, the consumer who would have bought the product even without any promotion or sale service provided by retailers.³⁸ This is true, for instance, where vertical restraints are used to make it economic for retailers to provide presale services, by requiring all customers to pay a price that covers the cost of such services. Obviously, this disadvantages those consumers who do not want such service but are thereby forced to pay for them. Some manufacturers address this problem by offering selective post-sale rebates for which such low maintenance customers can qualify.

2.1.2.4. Raising entry barriers

Some vertical restraints may raise or increase entry barriers to potential competitors, e.g. competing manufacturers of a new product or to new retailers for an existing product.³⁹ A chain of distribution costs, and this cost can be increased by existing vertical restraints which a newcomer cannot circumvent (e.g. exclusive agreements, sales quota, most-favoured customer clause) and inhibit new manufacturers or new retailers from entering a given market.⁴⁰

³⁵ See F. SCHERER - D. ROSS, *Industrial Market Structure and Economic Performance*, III edition, Boston, 1990, p. 555. In this case however, the collusive horizontal agreement should be considered in itself, independently of the fact that it is expressed or implemented through clauses which are used in the vertical agreements. In this case is not the vertical restraints which is anticompetitive but the horizontal restraint between manufacturers or dealers, see R. POSNER, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, above fn. 17, p. 25

³⁶ See W.S. BOWMAN, *The Prerequisite and Effects of Resale Price Maintenance*, 22 *U. Chi. L. Rev.*, 1955, 825, at 826-832; J. KASTL - S. PICCOLO, *Collusive Effects of Vertical Restraints under Asymmetric Information*, <http://www.dise.unisa.it/WP/wp113.pdf>, January 2004, as of 16.8.2005, 6:13 p.m.; J. B. BACKER, *Vertical Restraints with Horizontal Consequences: Competitive Effects of 'Most Favored-Customer' Clause*, 64 *Antitrust L.J.*, 1996, 517, at 520-523.

³⁷ Other Authors deem highly unlikely that vertical restraints may camouflage an horizontal collusion at distributors level, due to the variety of distribution channels and the consequent difficulties for distributors to agree on price, see BORK, *The Antitrust Paradox: A Policy at War With Itself*, fn. 14 above, at 292.

³⁸ W.S. COMANOR, *Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy*, 98 *Harv. L. Rev.*, 1985, 983, at 990-1000.

³⁹ See R.L. STEINER, *The Nature of Vertical Restraints*, fn. 32 above, 160-162, T. G. KRATTENMAKER - S. C. SALOP, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price*, 96 *Yale L.J.*, 1986, 1986.

⁴⁰ T. SCHEFFMAN, *Raising Rivals' Costs*, 73 *Am. Econ. Rev.*, 1983, 267; See W.S. BOWMAN, *The Prerequisite and Effects of Resale Price Maintenance*, 22 *U. Chi. L. Rev.*, 1955, 825, at 826-832; J. B. BACKER, *Vertical Restraints with Horizontal Consequences: Competitive Effects of 'Most Favored-Customer' Clause*, 64 *Antitrust L.J.*, 1996, 517, at 523-528.

2.1.2.5. Hindrance to the development of new distribution techniques

Vertical restraints may be used to extend the life of certain outmoded distribution channels, even if these channels are less efficient or more expensive than are newer channels. Consider how an agreement concerning resale price maintenance or sales quotas or most favoured customer clauses, could discourage a manufacturer from selling to *discount stores*. These vertically restraints can be efficient for the incumbent producers or retailers but may have “longer-term adverse social welfare consequences by retarding the entry of new, more-efficient types of retailers whose service package often has been different but not inferior overall to those of the incumbent high-price stores”.⁴¹

2.1.2.6. Limits of the free rider argument

Many economists also outline the limits of the free rider argument. Many consumable products do not need product-trained staff as part of the sales process (e.g. a tooth paste). RPM may be replaced with advertising implemented by the manufacturer and post-sale services may be charged separately based on usage, thus maintaining intrabrand competition on price, strengthening the product identity and avoiding the *free-riding* problem.⁴²

⁴¹ See R. L. STEINER, *How Manufacturers Deal With the Price-Cutting Retailer: When are Vertical Restraints Efficient?*, fn. 26 above, at 407-408; J. B. BACKER, *Vertical Restraints with Horizontal Consequences: Competitive Effects of 'Most Favored-Customer' Clause*, 64 *Antitrust L.J.*, 1996, 517, at 528-530.

⁴² For a synthesis of these arguments, see M. GOGESHVILI, *Resale Price Maintenance - A Dilemma in EU Competition Law in Georgian Law Review*, 2002, http://www.geplac.org/publicat/law/glro2n2-3e/p_281e.pdf, as of 16.8.2005, 6:13 p.m., at 295.

PART II: Distribution Agreements under EC Competition Law

1. Distribution Agreements under EC Competition Law: Articles 81 and 82 EC, BERs, the modernization process

EC competition law applicable to vertical restraints is established by articles 81 and 82 CE, the relevant block exemption regulations⁴³ and regulation n. 1/2003.⁴⁴ Companies entering into a vertical agreement, apart from their natural business attention to the commercial aims of the arrangement, including financial and strategic issues, are required to “self-assess” the validity of the vertical agreement under EC competition law. The requirement of self-assessment of vertical agreements places a heavy burden on the companies, which are understandably eager to avoid uncertainty and to protect their corporate investment in the venture. These considerations and the commercial aims may cause the enterprise to draft vertical agreement narrowly following the provisions of the relevant block exemption regulations, thus foregoing opportunities that might otherwise be inherent in the relationship that could have improved distribution efficiency and resulted in lower prices, or an improved service experience, or other benefits for consumers.

1.1. Articles 81 and 82 EC

Article 81(1) prohibits agreements between undertakings⁴⁵ which have as their object or effect the prevention, restriction or distortion of trade between Member States. These agreements are considered to be null and void from their inception (81(2)), and companies found to be in violation of this prohibition may be subject to fines up to 10 per cent of their companies’ turnover, unless the agreements are exempted under article 81(3). Article 81(3) provides that agreements may be exempted if they meet four cumulative conditions. To be exempt the agreement must (1) contribute to production or distribution of goods or to promoting technical or economic progress, while (2) allowing consumers a fair share of the resulting benefit and while not (3) imposing on undertakings restrictions that are not indispensable to the attainment of these objectives and also while not (4) allowing such undertakings the possibility of eliminating competition with respect to a substantial part of the products in question. Until 30 April 2004, the Commission was the only authority competent to grant exemptions. To gain an exemption an agreement had to be notified to the Commission in advance.

Vertical agreements may also be subject to article 82 EC, which prohibits the abuse of a dominant position by a company enjoying market power. Article 82 EC only covers unilateral conduct.

1.2 Block Exemption Regulations

From 1965 on, to lighten the workload caused by the notification and exemption system by which article 81(3) exemptions had previously been granted, the Commission issued the so called “block exemption regulations”⁴⁶ which provide a safe harbour from article 81(1) EC to certain categories of agreements satisfying certain requirements (BERs). Agreements complying with the BERs are valid and enforceable without any need for them to be individually evaluated as meeting the four conditions of article 81(3). The following BERs currently apply to vertical agreements:

⁴³ See Part II, § 0 below.

⁴⁴ Under US antitrust law, vertical restraints are subject to s. 1 (and occasionally 2) of the Sherman Act and s.3 of the Clayton Act.

⁴⁵ The term “undertaking” refers to an autonomous economic entity, independently from the form adopted by this entity (which may also be an individual person). See *Hydrotherm Gerätebau GmbH/ Ditta Compact del Dott. Ing. Mario Andreoli & C SAS*, C-170/83 [1984] ECR 2999, para. 1.

⁴⁶ The Commission had power to do so under Council Regulation n. 19/65, later amended by Council Regulation 1215/99, OJ L 148, 10.06.1999, p. 1.

- (i) Commission Regulation 2790/99 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices⁴⁷ (VABER);
- (ii) Commission Regulation no. 1400/2002 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices in the motor vehicle sector;⁴⁸ (MVBBER);
- (iii) Commission Regulation no. 772/2004 on the application of article 81(3) of the Treaty to categories of technology transfer agreements⁴⁹ (TTBER).

To facilitate the appraisal of vertical restrictions by companies, the BERs are accompanied by interpretative Guidelines (for the VABER and TTBER) or by an explanatory brochure⁵⁰ (for the MVBBER).

The VABER is an umbrella regulation which is applied when no other sector specific regulation applies, as in the case of the motor vehicle sector or of the transfer of technology agreements. Transfer of technology may, however, be ancillary to an ordinary supply and distribution agreement and then it can also be evaluated under the VABER (e.g. supply and distribution of cloth under a franchise agreement which entails a know-how transfer). The VABER and the TTBER might also find combined application for vertical agreements regarding certain products (e.g. a distribution of pharmaceuticals⁵¹).

⁴⁷ OJ L 336, 29.12.1999, p. 21. The VABER is in force from 1 June 2000 to 31 May 2010. The VABER replaces the expired BERs on exclusive distribution (Regulation no. 1983/83, OJ L173, 22.06.1983, 1); exclusive purchasing (Regulation no. 1984/83, OJ L 173, 22.06.1983, p. 5) and franchising agreements (Regulation no. 4087/88, OJ L 359, 30.11.1988, p. 1). For an analysis of the VABER see, *inter alia*, G. GINEVRA, *Riforma della politica comunitaria in materia di intese verticali in 1 Mercato Concorrenza e Regole*, 2000, 11; V. KORAH - D. O'SULLIVAN, *Distribution Agreements Under the EC Competition Rules*, Oxford/Portland, 2002; P. MAGNANI, *I nuovi principi di valutazione delle restrizioni verticali in ambito comunitario in 8 Concorrenza e mercato*, 2000, 309; M. MENDELSON - S. ROSE, *Guide to the EC Block Exemption for Vertical Agreements*, the Hague/London, Kluwer Law International, v. 4, 200; J. NAZERALI - C. DAVID, *Unlocking E.U. Distribution Rules - Has the European Commission Found the Right Key?* in 1 *E.C.L.R.*, 2000, 55; L. PEEPERKORN, *E.C. Vertical Restraints Guidelines: Effects - Based or Per Se Policy? - A Reply in E.C.L.R.*, 2002, 38; RINALDI RAIMONDO-RAPUANO RITA, *La politica comunitaria della concorrenza e le intese verticali: un nuovo approccio, Diritto del commercio internazionale*, 1999, 423; R. SUBIOTTO - F. AMATO, *Preliminary Analysis of the Commission's Reform Concerning Vertical Restraints in 23/2 World Competition*, 2000, 5; G. TERHORST, *LL.M Perspective: The Reformation of the EC Competition Policy on Vertical Restraints*, 21 *NW. J. Int'l L. & Bus.*, 2000, 343.

⁴⁸ OJ L 203, 1.8.2002., p. 30. The MVBBER is valid from 1 October 2002 to 31 May 2010. For an analysis of the MVBBER see, *inter alia*, M. L. CRISERA, *The New Motor Vehicle Regulation: More Flexibility for Car Manufacturers?*, 2 *I.B.L.J.*, 2003, 201; AUTOMOTIVE SECTOR GROUPS OF HOUFTHOFF BURUMA - LIEDEKERKE WOLTERS WAELBROECK KIRKPARTICK, *Flawed Reform of the Competition Rules for the European Motor Vehicle Distribution Sector*, 6 *E.C.L.R.*, 2003, 254.

⁴⁹ OJ L 123, 27.4.2004, p.11. The TTBER is valid from 1 May 2004 to 30 April 2014. For an analysis of the TTBER see, *inter alia*, M. HANSEN - O. SHAH, *The new technology transfer block exemption - Out of the Straitjacket into the Safe Harbour*, 25(8) *ECLR*, 2004, 465; M. DOLMANS - A. PILOLA, *The New Technology Transfer Block Exemption - A Welcome Reform, After All*, 27(3) *World Competition*, 2004, 351; J. NIEBLING, *Die aktuelle Entwicklung im Vertriebsrecht - Am Beispiel des Automobilsvertriebs*, 6 *WRP (Wettbewerb in Recht und Praxis)* 2005, 717; H. WISSEL - J. EICHOFF, *Die neue EG-Gruppenfreistellungsverordnung für Technologietransfer-Vereinbarungen*, 12 *WuW* 2004, 1244. In the US legal framework, see the *Antitrust Guidelines for the Licensing of Intellectual Property* (1995). For a comparison of the US and EU approach see M. DELRAHIM, *The US and EU Approaches to the Antitrust Analysis of Intellectual Property Licensing: Observations from the Enforcement Perspective*, paper presented at the American Bar Association, Section of Antitrust Law, Spring Meeting, Washington, D.C., 1 April 1, 2004, available at <http://www.usdoj.gov/atr/public/speeches/203228.htm>, as of 16.8.2005, 6:13 p.m.

⁵⁰ For the VABER Guidelines see fn. 15 above. For the MVBBER the Commission issued an Explanatory Brochure, OJ L 203, 1.8.2002, p. 30 (Explanatory Brochure). For the TTBER Guidelines, see fn. 6 above.

⁵¹ See S. PAUTKE S. - K. J ONES, *Competition Law Limitations for the Distribution of Pharmaceuticals - Rough Guide to the Brave New World*, 26 (1) *ECLR*, 2005, 24.

The VABER and the MVBBER apply, in general, to agreements concluded between (non-competing) parties at different levels of the distribution chain. The TTBER apply to agreements concerning software copyright, patent and know-how licences⁵² concluded by both non-competing and competing undertakings.⁵³

The BERs (*rectius*, article 81(1) EC) do not apply to the so called "agreements of minor importance" and to agreements entered into between small and medium enterprises (SMEs),⁵⁴ on condition that such agreements do not contain provisions allowing fixed or minimum RPM, the limitation of output or sales or absolute territorial protection. Agreements of minor importance are those with only negligible effect on commerce between the Member States.⁵⁵ According to the *De minimis* Notice,⁵⁶ they include:

- (a) agreements concluded between competing enterprises, where the combined market share held by the parties to the agreement does not exceed 10% in of any of the relevant markets affected by the agreement, and for which the agreement either fixes the resale price or establishes territorial protection for a retailer; and
- (b) agreements between non-competing enterprises in none of the affected markets, where the market share held by each of the parties to the agreement does not exceed 15% on any of the relevant markets affected by the agreement.

The 15% threshold applies generally to vertical agreements. A lower threshold of 5% per cent applies where the competition in the relevant market is limited by the cumulative foreclosure effect of a parallel network, or networks, of agreements having similar effects on the market, entered into by different suppliers or distributors. The *De minimis* Notice, however, specifies that it is improbable

⁵² The licence of other IPRs (eg. trademark, merchandise agreements and database rights) is excluded from the TTBER, unless they are ancillary to the main transfer of technology agreement, see *Métropole Télévision (M6) v Commission II*, Y-112/99 [2002] ECR-2549.

⁵³ Article 1(1)(j) TTBER defines competing "undertakings" as "undertakings which compete on the relevant technology market and/or the relevant product market, that is to say: (i) competing undertakings on the relevant technology market, being undertakings which license out competing technologies without infringing each others' intellectual property rights (actual competitors on the technology market); the relevant technology market includes technologies which are regarded by the licensees as interchangeable with or substitutable for the licensed technology, by reason of the technologies' characteristics, their royalties and their intended use; (ii) competing undertakings on the relevant product market, being undertakings which, in the absence of the technology transfer agreement, are both active on the relevant product and geographic market(s) on which the contract products are sold without infringing each others' intellectual property rights (actual competitors on the product market) or would, on realistic grounds, undertake the necessary additional investments or other necessary switching costs so that they could timely enter, without infringing each others' intellectual property rights, the(se) relevant product and geographic market(s) in response to a small and permanent increase in relative prices (potential competitions on the products which are regarded by the buyers as interchangeable with or substitutable for the contract products, by reason of the products' characteristics, their prices and intended use". On the notion of competing undertakings in the TTBER see V. KORAH, *An Introductory Guide To EC Competition Law and Practice*, Hart Publishing, Oxford and Portland, 2004, at 325.

⁵⁴ To SMEs applies the Commission Recommendation no. 96/280/CE, according to which SMEs are the enterprises with less than 250 employees and with either an annual turnover not exceeding Euro 40 million, or a annual balance-sheet total not exceeding EUR 27 million and are not controlled from other companies. See the Annex to the Recommendation no. 96/289/CE, OJ L 107, 30.04. 1996, p. 4, recalled by the 11 VABER Guidelines and § 3 of the Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty establishing the European Community (*De minimis* Notice), OJ C368, 22.12.2001, p. 13.

⁵⁵ See *Völk/Vervaecke*, C-5/69 [1969] ECR 295, para. 3.

⁵⁶ Fn. 52 above.

that such a foreclosure effect occurs when less than 30% of the relevant market is covered by parallel networks of agreements having similar effects.⁵⁷

Under the MVBBER the Commission is required to monitor the operation of the MVBBER on a regular basis, with regard to the competition in the retail markets and in the provision of after-sale services and to the level of concentration in the motor vehicle market. The Commission is required to prepare report on the working and effectiveness of MVBBER by 31 May 2008.⁵⁸ No similar requirement has been established for either VABER or TTBER.

1.3 The Modernization of EC competition law: Regulation 1/2003

Since May 1, 2004, EC competition law has new garb reflecting an intention to give a more mature (*rectius*, economic) image of itself. Council Regulation no. 1/2003 on the implementation of the rules on competition laid down in Article 81 and 82 of the Treaty (Regulation 1/2003) and its many interpretative notices and guidelines⁵⁹ contributed to the modernization of EC competition law and set the course for its decentralised application throughout the internal market.

Regulation 1/2003 replaced a system of prior notification and authorization based on *ex ante* control of the agreements falling under the prohibition of article 81(1) with a direct exemption based on *ex post* review. The Commission lost its sole authority to govern the application of article 81(3) and national competition authorities and national courts may now apply article 81 in full.

As a result of this, vertical agreements not automatically exempted under the BERs need not be submitted in advance to the Commission, nor to the NCAs, to enjoy individual exemption pursuant to article 81(3), as it was before.⁶⁰ Those undertakings taking advantage of a BER are required to comply with it themselves without any third party regulatory involvement before they enter into such agreements.

The modernization requires more responsibility of undertakings, NCA and national Courts and presents them with new challenges. Article 81(3) is now to be directly applied by the economic operators, before any review by a competition authority or Court of any Member States.

Only in those cases in which there arises a dispute between the parties to a distribution agreement, or in which a competitor or a consumer complains to the Commission or to the national competition authorities, is the validity of a distribution agreement put at risk. The *onus probandi* rests on the party, or the authority, alleging the infringement of article 81(1) or of any of the relevant provisions of the BERs. The party claiming the benefit of the exemption bears the burden of proving that the agreement meets the conditions of article 81(3) or complies with the BER.

⁵⁷§ 8 of the *De minimis* Notice, fn. 52 above. See *Delimitis/Henninger Bräu*, C- 234/89, ECR [1991], paras. 11-13.

⁵⁸ Article 9 MVBBER. See the annual reports on car prices, available at http://europa.eu.int/comm/competition/car_sector/.

⁵⁹ Regulation 1/2003, 4.1.2003,

OJ L1, p. 1; Regulation 773/2004 relating to proceedings by the Commission pursuant to Article 81 and 82 (OJ L 123, 7.04.2004, p. 18); Notice on the handling of complaints (OJ C 101/65, 27.04.2004, p. 65); Notice on informal guidance relating to novel questions concerning article 81 and 82 that arise in individual cases (Notice on guidance letters) (OJ C 101/78, 7.04.2004, p. 78); Notice on the cooperation within the network of Competition Authorities (European Competition Network - ECN) (OJ C 101, 7.04.2004, p. 43); Notice on the Cooperation between the Commission and the Courts of the EU Member States (OJ C101, 7.04.2004, p. 54); guidelines on the effect on trade concept contained in Article 81 and 82 of the Treaty (OJ C 101/81, 27.04.2004, p. 87) and guidelines on the application of Article 81(3) of the Treaty (OJ C101, 27.04.2004, p.97).

⁶⁰ Before Regulation 1/2003, however, article 2(a) of Council Regulation n. 1216/99 amending Regulation 17, OJ L148, 10.6.1999, p. 5, allowed the Commission to exempt vertical agreements retrospectively to a period before notification.

According to the Commission,⁶¹ “undertakings are generally well placed to assess the legality of their action in such a way to enable them to take an informed decision on whether to go ahead with an agreement or practice and in what form. They are close to the facts and have at their disposal the framework of block exemption regulations, case law and case practice as well as extensive guidance in Commission guidelines and notices”.

At the same time, the NCA and the national courts will be able to apply article 81(3) exempting distribution agreements which might otherwise have fallen within the prohibitions of article 81(1), though they are not to take decisions which conflict with decisions of the Commission or with decisions that might be envisaged by pending proceedings, *i.e.* there is a prohibition against pre-emptive decisions.⁶²

The decentralised application and enforcement of EC competition law may give rise to an increase in litigation between the parties before the national courts and the NCAs. Contractual problems may be masked, and recast as competition problems. Still, it is desirable that there be some litigation in the field of distribution agreements to ensure enforcement and to develop a judicial record developing ‘common culture’ concerning the legal and economic problems arising out of distribution relationships.

1.4 Common features of the BERs

Following the VABER, which anticipated the modernization process, all the subsequent BERs adopt, at least in principle, a more economic approach and exempt all agreements which do not exceed a given market share and do not contain “hard-core restrictions”. Hard-core restrictions (*i.e.* minimum RPM and certain forms of customer and territorial protection) derive no protection from the BERs. The BERs define also some restrictions (excluded restrictions) which may not be exempted as such but do not preclude the application of the relevant BER to the rest of the agreement (*e.g.* non-compete clauses exceeding a certain duration).

This new “black-list” regime,⁶³ in principle, reflects the modern economic thinking that vertical restraints are not *per se* anticompetitive and “can improve economic efficiency within a chain of production or distribution by facilitating better coordination between the participating undertakings; in particular, they can lead to a reduction in the transaction and distribution costs of the parties and to an optimisation of their sales and investment levels”.⁶⁴ The Commission concedes that for most vertical restraints competition concerns arise only when there is insufficient inter-brand competition (*i.e.* if there is some level of market power at the level of the supplier or the buyer or at both levels). The impact on competition and on the efficiency of vertical agreements and distribution systems depends to a great extent on the market context and barriers to entry. The new BERs aim at reducing industry costs, providing greater legal certainty, increasing legal security for enterprises, and fostering effective competition.

Vertical agreements which do not comply with the BERs (or which cannot avail themselves of the BERs protections because the market share of the contracting undertaking exceeds the regulatory thresholds) are not automatically prohibited (*per se* illegal to use the American terminology), and are to be individually evaluated, to ascertain whether they distort competition in the internal market or, conversely, have overriding pro-competitive effects which made them valid and enforceable under article 81(3).⁶⁵

⁶¹ § 3 of the Notice on guidance letter, fn. 59 above.

⁶² Article 16 of Regulation 1/2003.

⁶³ The old BERs adopted a “white-list” approach instead, indicating mechanically the provisions which were allowed in the distribution agreements (white list), the provisions which were not allowed (black list) and the provisions normally not restricting competition (grey list).

⁶⁴ Recitals 6 of VABER and 5 of MVBER.

⁶⁵ Recitals 9 of the VABER, 8 of the MVBER and 12 of TTBER.

The BERs may be individually withdrawn by the Commission⁶⁶ or by the NCAs (though only where an agreement has effects incompatible with article 81(3) in its jurisdictional territory or part of it, which territory has the characteristics of a distinct geographic market)⁶⁷ or it can be found not to apply where parallel networks of similar vertical restraints cover more than 50% of a relevant market and the vertical agreement impacts that market.⁶⁸

1.4.1. Categories of agreements covered by the BERs

The parties to an agreement must first assess what kind of agreement they are entering into and whether this agreement may be subject to a BER.

The term “agreement between undertakings” has been broadly interpreted in EC case-law and expresses the common intention of the parties to adopt an economic behaviour in the market, independent of the form that concerted behaviour may take, and regardless of whether the agreement is written or oral, express or tacit, or the means by which the parties pursue their common will.⁶⁹ In the vertical agreements context, the notion of agreement has been recently defined by the Court of First Instance (CFI) in *Bayer v Commission*⁷⁰ (which has overruled the Commission decision in *Adalat*⁷¹), confirmed by the European Court of Justice (ECJ) in *Bayer*,⁷² and in *Volkswagen Passat*.⁷³ Unilateral conduct carried out by a party to a distribution agreement, without implied or express acquiescence by the other party, does not suffice to give rise to an agreement.⁷⁴ In *Bayer*⁷⁵ the ECJ explained that:

⁶⁶Articles 6 VABER, 6 MVBER, and 6 TTBER. In the German ice cream saga (see cases *Langnese - Iglo GmbH*, OJ L 183/19, 1993 and *Schöller Lebensmittel GmbH & Co. KG*, OJ L 183/1, 1993), the Commission withdrew the benefit of the (expired) exclusive purchasing block exemption n. 84/83, fn. 42 above.

⁶⁷ Articles 7 VABER, 6(2) MVBER and 6(2) TTBER.

⁶⁸ Articles 8 VABER, 7 MVBER and 7 TTBER.

⁶⁹ In *Sandoz Prodotti Farmaceutici SpA v Commission*, C- 277/87 [1990] ECR. I-45, para. 13, the ECJ ruled that “the systematic dispatching by a supplier to his customers of invoices bearing the words “Export prohibited” constitutes an agreement under article prohibited by Article 81 [was 85] (1)of the Treaty, and not unilateral conduct, when it forms part of a set of continuous business relations governed by a general agreement drawn up in advance, based on the consent of the supplier to the establishment of business relations with each customer prior to any delivery and the tacit acceptance by the customers of the conduct adopted by the supplier in their regard, which is attested by renewed orders placed without protest on the same conditions”.

⁷⁰ *Bayer/Commission*, T-41/96 [2000] ECR I-0000, paras. 67-69.

⁷¹ *Adalat*, IV/34.279/F3 [1996] OJ 201, paras. 155-199.

⁷² *Bayer*, joined cases C-2/01 P - C-3/01 P [2004] ECR 00000, para. 141.

⁷³ *Volkswagen Passat*, T-208/01 [2003] ECR 00000, 3.12.2003. In this case, the CFI quashed the decision of the Commission which had considered an Volkswagen unilateral instruction of resale price maintenance for the Passat model to its dealers as an agreement. The CFI held that there must be evidence of acquiescence by the dealers and there wasn't any. The CFI explained, para. 58, that “a call forms part of a preexisting contract, that is to say forms an integral part of that contract, where it is intended to influence the dealers in the performance of the contract, but above all where that call is, in some way or other, actually accepted by the dealer”.

⁷⁴ In *AEG Telefunken v. Commission*, C-107/82 [1983] ECR. 351, para. 38, the ECJ confirmed the Commission view that the AEG refusal to supply distributors operating at low margins in long term distribution relationships, was not a unilateral conduct but was part of the agreement between the parties, as the distributors were aware they would have been excluded by the distributors network not complying with the supplier policy. *Contra*, see the US cases *Monsanto Co. v. Spray-Rite Service Corp.*, 465 US 752 (1984) and *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 US 717 (1988), according to which a supplier is free to refuse supplies to distributors failing to comply with the supplier policy, unless the terminated supplier proves collusion among the supplier and the other distributors on specific price or some other vertical restraints.

⁷⁵ *Bayer*, fn. 72 above, para. 36. In *Adalat*, the Commission found that Bayer refused to supply the dealers in Spain and France (where the Adalat price was low due to State regulation) with as much Adalat (a cardiovascular drug) as they wanted and considered this refusal as a concerted practice, due to the long term relationship with each distributor. With its conduct, Bayer sought to diminish parallel imports from

“the Commission cannot hold that apparently unilateral conduct on the part of a manufacturer, adopted in the context of the contractual relations which it maintains with its dealers, in reality forms the basis of an agreement between undertakings within the meaning of Article 81(1) EC if the Commission does not establish the existence of an acquiescence by the other partners, express or implied, in the attitude adopted by the manufacturer”.

The scope of application of article 81(1) seems now to be restricted, even though the existence of ‘pure’ unilateral conduct will be hard to prove. The following table shows the distribution agreements covered by the BERs.

Block-exempted Agreements		
VABER	MVBER	TTBER
Vertical agreements ⁷⁶ (containing restriction of competition falling within the scope of article 81(1)) related to the conditions under which the parties may purchase, sell or resell certain goods or services (article 2);	Vertical agreements ⁷⁷ (containing restriction of competition falling within the scope of article 81(1)) related to the condition under which the parties may purchase, sell or resell new motor vehicles, spare parts for motor vehicles or repair and maintenance services for motor vehicles (article 2 (1));	Technology transfer agreements ⁷⁸ (containing restriction of competition falling within the scope of article 81(1)) entered into between two undertakings permitting the production of contract products.
Vertical agreements between association of undertakings and its members, or between such an association and its suppliers, only if all its members are resellers of goods (motor vehicles or spare parts or repairers I the MVBER) and if no individual member of the association, together with its connected undertaking, has a total annual turnover exceeding Euro 50 million (article 2(2) VABER and article 2(a) MVBER).		The exemption apply for as long as the IP rights have not expired or the know-how is still secret (article 2).
Vertical agreements containing ancillary provisions on the assignment or use of intellectual property rights (article 2(3) VABER and 2(c) MVBER).		

Spain and France to England (where the price of Adalat was much higher), but it had not imposed an export ban, nor there was an agreement between Bayer and the English dealers.

⁷⁶ Vertical agreements are agreements entered into by two or more undertakings, each of which operates, for the purpose of the agreement, at a different level of the production or distribution chain (article 2 (1) VABER and article a(c) MVBER).

⁷⁷ See footnote 74 above.

⁷⁸ Technology transfer agreement are patent, know-how or software copyright (or a mix of them) licensing agreement, including any such agreement containing provisions which relate to the sale and purchase of products or which relate to the licensing of other IP rights, provided that those provisions do not constitute the primary object of the agreement and are directly related to the production of the contract products; assignments of patents, know-how, software copyright or a combination of them, where part of the risk associated with the exploitation of the technology remains with the assignor (...) (article 1(b) TTBER).

<p>Non-reciprocal agreements between competing undertakings, where:</p> <ul style="list-style-type: none"> a. the buyer has a total annual turnover not exceeding euro 100 million, or b. the supplier is a manufacturer and a distributor of goods, while the buyer is a distributor not manufacturing goods competing with the contract goods, or c. the supplier is a provider of services at several level of trade, while the buyer does not provide competing services at the level of trade where it purchases the contract services (articles 2(4) of the VABER and 2(3)MVBBER). 	
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1.4.2 Market share

BERs apply only on condition that the parties hold a market share not exceeding a given threshold (generally 20% to 40% of the supplier's market share). Once the parties to a distribution agreement have determined which BER potentially applies to their agreement, they must assess the market share they (or the supplier or buyer alone) enjoy(s) in the relevant product and geographic market to assess whether their agreement falls within the scope of the BER or not.

The Commission believes that vertical restraints may be efficiency-enhancing where there is inter-brand competition and the parties do not have a strong market power. Because market power is difficult to assess,⁷⁹ and *a fortiori*, to self-assess, the Commission decided to rely on market share thresholds.

The following table shows the relevant market share ceiling for each BER.

⁷⁹ A theoretical measure of market power is the *Lerner Index*, defined as the firm's mark up (that is, difference between the price and the marginal cost) over price ratio. See A. P. LERNER, *The Concept of Monopoly and the Measurement of Monopoly Power*, 1 *Rev. Econ. Studies* 157 (1934). Assessing market power through the Lerner Index is difficult because "determining the impact of a marginal change in the quantity produced by a firm on the total cost of production is often beyond practical feasibility even with the best knowledge of the technological conditions under which a firm operates", so M. MOTTA, *Competition Policy - Theory and Practice*, fn. 1 above, at 116. On other methods suggested by economists to measure market power see L.A. SULLIVAN - W.S. GRIMES, *The Law of Antitrust: an Integrated Handbook*, Hornbook Series, West Group, St. Paul, Minn., 2000, at 68 ss.

Market-share threshold		
VABER	MVBER	TTBER
<u>30% of the supplier's market share</u> on the relevant market in which it sells the contract goods or services (article 3(1));	<u>30% of the supplier's market share</u> on the relevant market in which it sell new motor vehicles, spare parts for motor vehicles or repair and maintenance services (article 3(1)first indent);	<u>20% of the combined market share</u> of the undertakings on the market, where the parties are <u>competing undertakings</u> (article 3(1));
<u>30% of the purchaser's market share</u> on the relevant market on which it purchases the contract goods or services in case of exclusive supply ⁸⁰ (article 3(2)).	<u>40% of the supplier's market share</u> for agreement establishing selective distribution systems for the sale of new motor vehicle (article 3(1) second indent);	<u>30% of each of the parties</u> on the relevant market, if the parties are <u>not competing undertakings</u> (article 3(2)).
	<u>30% of the buyer's market share</u> in the relevant market in case of exclusive supply (article 3(2);	
	<u>No thresholds</u> apply to agreements establishing qualitative selective distribution systems.	

In order to calculate their market share in the market, the parties must identify the relevant product and geographic market affected by their agreement, relying on the Commission notice on market definition,⁸¹ the Guidelines, or the Explanatory Brochure⁸² and previous Commission's decisions in merger cases.

The product market includes goods which are regarded by the buyer as interchangeable with or substitutable for the contract goods or services, by reason of the products' characteristics, their prices and their intended use. In the TTBER, the product market comprises the contract products produced by the licensors and its licensee (Article 3(3) TTBER).

Problems may arise when the same distribution agreement covers the supply of many products which fall in different product markets (e.g. a distribution agreement of an appliances manufacturer may cover the supply of television sets, washing machines and lawnmowers) where the supplier holds different market shares (e.g., respectively, 38%, 29% and 3%).⁸³ This raises the question whether a supplier in this circumstance is required to enter into different agreements for each product (or at least category of products) or whether the strictures can apply to all the products covered by a single contract, despite differing market shares, thereby risking the

⁸⁰ Exclusive supply obligation under the VABER (article 1(c) and MVBER (1(1(3))) means any direct or indirect obligation causing the supplier to sell the goods or services specified in the agreement only *to one buyer inside the Community* for the purpose of a specific use or for resale.

⁸¹ Commission Notice on the definition of the relevant market for the purposes of Community competition law, OJ C 372, 9.12.1997, p. 5 (Notice on market definition). On the Notice on market definition see P. D. CAMESASCA -- R.G. VAN DEN BERGH, *Achilles uncovered: revisiting the European Commission's 1997 market definition notice*, 47 *Antitrust Bulletin*, 2002, 143.

⁸² Guidelines VABER 89-95, Explanatory Brochure 4.3 and Guidelines TTBER 19-25.

⁸³ E. GENTILE, *Il problema degli «accordi verticali» per la distribuzione o per la fornitura congiunta di famiglie complete di prodotti*, 2 *Contratto e impresa - Europa*, 1999, 2, p. 611.

invalidation of the entire contract merely because the market share of one of the covered products or product categories exceeds the BER thresholds. The VABER Guideline 91 suggests that an entire portfolio of products from a single supplier may constitute the relevant market when the portfolio and not the individual products are regarded as substitutable by the buyer.

A difficult assessment of the product market share may also arise for spare parts.⁸⁴

The geographic market is the geographic area in which the undertakings concerned are involved in the supply and demand of products, in which the conditions of competition are relatively homogeneous, and which can be distinguished from neighbouring areas reflecting differing competitive conditions.

Once the parties have identified the relevant market, they may calculate their market share within it. According to the VABER and the TTBER the market share is calculated on the basis of the value of market sales data of the contract products or other product sold by the supplier or, if such data are not available, on the basis of estimates based on reliable market information or market sales volumes, relating to the preceding calendar year (articles 9(1) VABER and 8(1) TTBER).

In the MVBER, the market share is calculated on the basis of the total annual turnover figures achieved by the relevant party to the agreement (included its connected undertakings) in respect of all goods and services, excluded all taxes and duties (article 9(1) MVBER).

Above the market shares thresholds, the vertical restraints prohibited under article 81(1) may still satisfy the conditions of article 81(3) and be exempted. In this case the parties, the Commission or and the NCA or the national courts, shall consider different factors, e.g. the market position of the supplier, competitors and buyers, the entry barriers, the maturity of the market, the level of trade, the nature of the product, and any other relevant elements.⁸⁵

1.4.3. Hard-core restrictions

The BERs contain a black-list of hard-core restrictions whose presence prevents the application of the BERs in respect of the entire agreement. In the Commission's view, the hard-core restrictions are provisions which directly or indirectly, in isolation or in combination with other factors under the control of the parties, have the object of restricting a certain ability or a certain type of sale.

The following table show the hard-core restrictions for each BER:

⁸⁴ According to the VABER Guideline 94 "where a supplier produces both original equipment and the repair or replacement parts for this equipment, the supplier will often be the only or the major supplier on the after-market for the repair and replacement parts. This may also arise where the supplier (OEM supplier) subcontracts the manufacturing of the repair or replacement parts. The relevant market for application of the Block Exemption Regulation may be the original equipment market including the spare parts or a separate original equipment market and after-market depending on the circumstances of the case, such as the effects of the restrictions involved, the lifetime of the equipment and importance of the repair or replacement cost". See also § 56 of the Notice on market definition. In EC case-law, see the Commission decisions *Varta/Bosch*, IV/M.12, OJ L 320, 22.11.1991, p. 26, *Caterpillar/Perkins Engines*, IV/M. 1094, OJ C 94, 28.3.1998, p. 23; *Lucas/Varity*, IV/M.768, OJ C 266, 13.9.1996, p. 6 and the case *Volvo AB / Eirk Veng (UK) Ltd.*, C- 238/87 [1988] ECR 6211. In the US case law, see *Eastman Kodak Co. v. Image Technical Services, Inc et al.*, Supreme Court of the United States, n. 90 1029, which subject maximum RPM to the rule of reason.

⁸⁵ See Guidelines VABER 121-133.

VABER black-list

VABER
a. Minimum or fixed RPM (article 4(a));
<p>b. Restrictions of the territory into which, or of the customers to whom, the buyer may sell the contract goods or services, except:</p> <ul style="list-style-type: none"> - The restriction of active sales into the exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another buyer, where such a restriction does not limit sales by the customers of the buyer; - The restriction of sales to unauthorised distributors by the members of a selective distribution system; - The restriction of the buyer's ability to sell components, supplied for the purposes of incorporation, to customers who would use them to manufacture the same type of goods as those produced by the supplier (article 4(b));
c. The restriction of active or passive sales ⁸⁶ to end users by members of a selective distribution system operating at the retail level, without prejudice to the possibility of prohibiting a member of the system from operating out of an unauthorised place of establishment (article 4(c));
d. The restriction of cross-suppliers between distributors within a selective distribution system;
e. The restriction agreed between a supplier of components and a buyer who incorporates those components, which limits the supplier to selling the components as spare parts to end-users or to repairers or other service providers not entrusted by the buyer with the repair or servicing of its goods (article 4(e)).

⁸⁶ For a definition of active and passive sales see the VABER Guidelines 50 and the Explanatory Brochure, p. 30.

MVBER black-list

MVBER		
Sale of new motor vehicles, repair and maintenance services or spare parts	Sale of new motor vehicles	Sale of repair and maintenance services and spare parts
a. Minimum or fixed resale price maintenance (article 4(a);	a. The restriction of the distributor's ability to sell any motor vehicle which correspond to a model within its contract range(article 4(1)(f);	a. The restriction of the authorised repairer's ability to limits its activities to the provision of repair and maintenance services and the distribution of spare parts (article 4(1)(h));
b. Certain restrictions to the territory or the customers to whom the distributor or repairers may sell the contracts goods (article 4(b);	b. The restriction of the distributor's ability to subcontract the provision of repair and maintenance services to authorised repairers (article 4(1)(g).	b. The restriction of the sales of spare parts for motor vehicles by members of a selective distribution system to independent repairers (article 4(1)(i);
c. The restrictions of cross-suppliers between distributors or repairers within a selective distribution system (article 4(c));		c. The restriction agreed btw a supplier of original spare parts or spare parts of matching quality, repair tools or diagnostic or other equipment and a manufacturer of motor vehicle, which limits the supplier's ability to sell these goods to authorised or independent distributors or to authorised or independent repairers or end users (article 4(1)(j)
d. The restrictions of active or passive sales to end-users by members of a selective distribution system operating at the retail level in markets where selective distribution is used, without prejudice to the ability of the supplier to prohibit a member of that system from operating out of an unauthorised place of establishment for new motor vehicles other than passenger car or light commercial vehicles (article 4 (d) and (e)).		d. The restriction of a distributor's or authorised repairer's ability to obtain original spare parts or spare parts of matching quality from a third undertaking (without prejudice to the ability of a supplier of new motor vehicles to require the use of original spare parts supplied by it for repairs under warranty, free servicing and vehicle recall work (article 4(1)(k);
		e. The restriction agreed between a manufacturer of motor vehicles which uses components for the initial assembly of motor vehicles and the supplier of such components which limits the latter's ability to place its trade mark or logo effectively and in an easily visible manner on the components supplier or on spare parts (article 4(1)(j)).
The supplier refuses to give independent operators access to any technical information, diagnostic and other equipment, required for the repair and maintenance of these motor vehicles or for the implementation of protection measures (article 4(2)).		

The MVBBER is also subject to “general conditions”. The MVBBER only applies on condition that the vertical agreement provides:

- (i) the consent of the supplier to the transfer of the rights and obligations resulting from the agreement to another distributor or repairer within the distribution system and chosen by the former distributor or repairer (article 3(3));
- (ii) a written termination notice, including the reasons for the termination, in the case of termination of the agreement by the supplier (article 3(4));
- (iii) a duration of five years (and a termination notice of six months) or an indefinite duration (and a termination notice of two years or one year, under certain circumstances) (article 3(5)); and
- (iv) for an arbitration clause (without prejudice to either party's right to seek redress before a national court) (article 3(6)).

These general conditions obviously relate more directly to the contractual relationship between the parties than to any effect the agreement(s) may have on market competitiveness. By introducing these general conditions, the Commission seeks to protect the capital investment of the dealers by reducing the power of the supplier, and to grant more independence to the dealers to promote “safeguarding a relatively stable contractual framework”.⁸⁷ The general conditions, however, make the application of the MVBBER cumbersome. The parties to a motor-vehicle distribution agreement are required to check too many clauses (and to draft them in accordance with the MVBBER) before they are able to enter into a contract. They risk having to negotiate their way through a gymkhana instead of focusing on the substance of drafting a contract that mirrors their business strategy and their commercial needs. One is forced to wonder if the Commission realises the extent to which it risks immobilizing the parties freedom to act (and contract), instead of devoting itself to the more constructive course of pursuing (and realising) the overriding public interest.

TTBER black-list

TTBER	
Agreement between competing undertakings (article 4(1))	Agreement between not competing undertakings (article 4(2))
a. RPM;	a. Minimum or fixed RPM;
b. Certain output limitation imposed on licensee;	b. Certain restrictions to the territory or customers to which the licensee may sell the contract products;
c. certain restrictions to the market or customers allocation imposed on the licensee or the licensor;	c. the restriction of active or passive sales to unauthorised distributors by the members of a selective distribution system.
d. the restriction to the licensee's ability to exploit its own technology or the restriction of the ability of any of the parties to the agreement to carry out research and development, unless such latter restriction is indispensable to prevent the disclosure of the licensed know-how to third parties.	

⁸⁷Explanatory Brochure, fn. 50 above, pp. 24 and 55-60.

1.4.4. RPM

The BERs, the *de minimis* Notice, and likely, the individual need to evaluate the potential that the vertical agreements will be judged to fall outside the protective scope of the BERs, have the effect of *de facto* prohibiting minimum resale price maintenance in distribution agreements. This seemingly unintended, but nonetheless effective, prohibition is at odds with the Commission's move toward a more thoughtful economic basis for its actions. The *de facto* prohibitions place a chill on business action even aside from any consideration of the market context and the market share of the parties. According to the Commission, minimum resale price maintenance may have two negative effects: reduction in intra-brand price competition and increased price transparency. "Increased transparency on price and responsibility for price changes makes horizontal collusion between manufacturers or distributors easier, at least in concentrated markets. The reduction in intra-brand competition may, as it heads to less downward pressure on the price for the particular goods, have as an indirect effect a reduction of inter-brand competition".⁸⁸

The ban refers to any direct or indirect mean to fix minimum resale price (e.g. fixing the distribution margin, fixing the maximum level of discounts the distributors may grant, making the grant of rebates or reimbursement of promotional costs by the supplier subject to the observance of a given price level).⁸⁹

Maximum and recommended RPMs (not corresponding to fixed RPMs), leaving the retailer free, up to a certain extent, to determine the resale price, are allowed.⁹⁰ For those undertakings not protected by the BERs, because their turnover exceeds the 30% market share, however, article 81(1) may be infringed if the maximum or recommended price is uniformly implemented by resellers and if the undertaking's actions, especially in a narrow oligopoly, facilitate collusion among suppliers by exchanging information on the preferred price level and by reducing the likelihood of lower prices.⁹¹

A similar approach is adopted in US antitrust law which considers minimum resale price maintenance *per se* illegal⁹² but evaluates maximum RPMs by applying the rule of reason.⁹³

The Commission finds that price fixing falls into article 81(1) even if it might be justified by overriding reasons of public interests (such as to cover R&D investment of a firm and to further total consumer welfare).

In *Glaxo Wellcome*, the Commission did not exempt a system of dual pricing adopted by Glaxo Wellcome in Spain for certain prescription drugs subject to regulated prices by the Spanish health authorities.⁹⁴ GW asked its Spanish wholesalers to pay a higher price for the products they wanted to resell outside Spain (especially in Great Britain). GW admitted that this system was aimed at reducing parallel imports, but not at protecting distributors operating outside of Spain. According to GW, price differentials in the Member States were determined by different regulations and by currency fluctuations; the loss caused by parallel imports seriously impacted that part of its budget that it was able to dedicate to research for the development of new pharmaceuticals; the dual

⁸⁸ See VABER Guideline 112.

⁸⁹ See VABER Guideline 47.

⁹⁰ See, *inter alia*, SABA, IV/29.598, OJ L376, 31.12.1983, p. 41 and *Pronuptia de Paris GmbH c. Irmgard Schillgali*, C- 161/84, para. 26 e 37; *Repsol*, Commission notice pursuant to Article 27(4) of Council Regulation (EC) No 1/2003 concerning Case COMP/B-1/38348 - Repsol CPP SA, OJ C258, 20.10.2004, p. 7, http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/c_258/c_25820041020en00070011.pdf, as of 16.8.2005, 6:13 p.m., paras. 18-20. On the *Repsol* decision see § 3, Part II, below.

⁹¹ See the 225-228 VABER Guidelines.

⁹² *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373, 31 S.Ct. 1515, 99 L.Ed. 502 (1911).

⁹³ See *State Oil Co v Khan* (1997) 118 S.Ct. 275, on which, *inter alia*, P. CARSTENSEN - D. HART, *Khaning the Court: How the Antitrust Establishment Obtained an Advisory Opinion Legalising "Maximum" Price Fixing*, 34 U. Tol. L. Rev., 2003, 241.

⁹⁴ *Glaxo Wellcome*, OJ L 202, 17.11.2001, p. 1. GW had notified its system for exemption in 1998 (IV, 36.957/F3). Glaxo Wellcome appealed the decision of the Commission, T-168/01 (pending).

pricing did not restrict competition in the internal market. GW invited the Commission to assess the economic effects of this restriction and explained that the combination of low price and parallel imports could prove detrimental to Spanish consumers, giving rise to a strong negative incentive inhibiting the introduction of innovative medicines in Spain. Its dual pricing was aimed at correcting a distortion of competition created by different national regulations. In the Commission's view, the system interfered with the Community's objective of integrating national markets and restricted price competition for GW products, in contravention of the conditions set out under article 81(3). The Commission also concluded that the dual pricing system cannot be justified on economic grounds, denied that parallel trade negatively impacted the R&D budget and observed that it determined market portioning.

Is market integration only measured by the price the consumers in the different Member State pay for the same product? Is consumer welfare enhanced only by low prices?

According to Ginsburg, the "antitrust's focus on price is like the drunk's search for his keys, not where he dropped them, but down the block where the street lamp sheds its light. Because price seems less intractable, it is virtually the exclusive focus - one might even say the price fixation - of antitrust analysis. There is simply no reason to believe, however, that what the antitrust agency perceives to be the public interest - lower nominal prices-will accord with what the diverse public itself desires. Insofar as consumer value nonprice aspects of the goods they buy, the government's attitude is, in effect, the consumer be damned!...Consumers purchase from whichever producer offers the mix of quality, price, and ancillary features that best suits their diverse tastes...Given that firms may compete in a variety of ways, we must ask when, if ever, there is reason to believe that the government can identify a particular means of competing as being contrary to the interests of consumers...The government would not try to prohibit a manufacturer from requiring a retailer to display its product in a certain way...why then should the government insist that retailers rather than manufacturers have control over pricing policy?"⁹⁵

1.4.5. Absolute territorial and customer protection

The hard-core restraints prohibit absolute territorial protection.

EC case-law has always been severe in adjudicating absolute territorial protections because they limit intra-brand competition and may impede the integration of the internal market. Territorial exclusivity is possible but passive sales and parallel trade must be permitted. The aim of the EC legislation is to guarantee that there will always be an alternative source of supply for consumers and to allow distributors and consumers to take advantage of price differentials among the Member States,⁹⁶ independent of the overriding competitive effects that absolute territorial protection might bring under certain circumstances or for particular products.

The *Grundig & Costen* case⁹⁷, a landmark decision on exclusive distribution, studied, criticized⁹⁸ but still cited,⁹⁹ shows how the objective of market integration in the EC policy prevails over other aims. In 1957, before the ratification of the EC Treaty, Grundig, a German manufacturer of consumer electronics equipment, entered into an exclusive distribution agreement with Consten, a French company, appointing Consten as its sole distributor in France. Grundig ensured this exclusivity by prohibiting its other distributors from making sales in France and by granting to Consten the use of the trademark "Gint" (Grundig International), registered in France. Consten undertook, as the other sole distributors outside France, not to sell products competing with

⁹⁵ See D.H. GINSBURG, *Antitrust as Antimonopoly*, 14/3 *Regulation*, 1991, <http://www.cato.org/pubs/regulation/regv14n3/reg14n3-ginsburg.html>, as of 16.8.2005, 6:13 p.m.

⁹⁶ See § 21 of the Green Paper on Vertical Restraints in European Competition Policy, COM 96, 721 final [1997].

⁹⁷ *Grundig & Costen*, G.U. n. 161, 20.10.1964, p. 2545.

⁹⁸ See, *inter alia*, R. JOLIET, *The Rule of Reason in Antitrust Law*, Dordrecht, Nijhoff, 1967.

⁹⁹ See *Glaxo Wellcome*, fn. 94 above, para. 130.

Grundig products, to promote a network of distribution, customer assistance, and repair services and not to sell the contract products outside its territory. The investment and sunk-cost anticipated from Consten in consequence of its entering into the contract would then have been very high, given that they still had to pay for export licenses for products from Germany. In 1961, when the export license requirement no longer applied due to the Treaty of Rome, parallel importers started to purchase Grundig products in Germany and to resell them in France, at a price significantly lower than the Consten price. Grundig and Consten moved against the parallel importers under the French unfair competition rules on the basis of the breach of the IPRs regarding the trademark Gint. In the meanwhile, the parties notified the agreement to the Commission. The Commission ruled that the agreement between Consten and Grundig infringed article 81 [which was then numbered 85] (1) in relation to the territorial exclusivity, reinforced by the export ban and the registration of the trademark Gint, and the exclusive purchase obligation on Consten.

In its decision, the Commission did not analyse the situation *ex ante*, *i.e.* whether Consten would have taken on the necessary investment and accept the risk of promoting and selling Grundig products without the absolute territorial protection¹⁰⁰ nor did the Commission consider the potentially positive effects of the agreement on inter-brand competition. Moreover, the Commission did not take into consideration the seeming inequity that the parallel importers did not have to bear any cost for promotional activities or assistance and repair services. On appeal¹⁰¹, the ECJ, confirmed the decision of the Commission, explaining that:

“an agreement between producer and distributor which might tend to restore the national divisions in trade between Member States might be such as to frustrate the most fundamental objections of the Community: the Treaty, whose preamble and content aim at abolishing the barriers between States, and which in several provisions gives evidence of a stern attitude with regard to their reappearance, could not allow undertakings to reconstruct such barriers. Article 85(1) is designed to pursue this aim, even in the case of agreements between undertakings placed at different levels in the economic process” (p. 340).

Recently the Commission has inflicted a very high fine on Nintendo¹⁰², a Japanese video games producer, and seven of its official distributors in Europe, for having blocked parallel trade of its products from low-priced countries to high-priced ones and having maintained artificially high price differences in the EU between January 1991 and 1998. Prices for play consoles and games differed widely from one European Union country to another during the period investigated by the Commission, with the United Kingdom up to 65 percent cheaper than Germany and the Netherlands. From 1995, the Commission investigated the distribution system of Nintendo, based on distributor companies directly controlled by Nintendo and independent exclusive distributors in the Member States. The exclusive distribution agreements between Nintendo and its exclusive dealers provided that the distributors' customers could sell only to final consumers and not to wholesalers (so limiting their capability to export) and prohibited active sales outside of the assigned exclusive territory (corresponding generally to a State). While parallel trade was possible in principle, in practice it was subject to prohibitive limits and controls. The price differentials among Member States however, provided an incentive for exports from lower price countries to higher price ones. The official distributors and Nintendo collaborated to identify those exporters thus seeking to benefit from this price arbitrage, collecting information, statistics, making sample marker sales, and implementing a system of labels able to individually identify the provenience of the products. Once Nintendo and its distributors identified a company which practiced parallel imports, they 'punished' it with supply reductions or boycott. As a result of this policy, according to the Commission,

¹⁰⁰ On the importance of initial sunk investment, see § 44 of the Guidelines on the application of article 81(3), fn. 59 above.

¹⁰¹ *Grundig & Consten v Commission*, C-56 & 58/64 [1966] ECR 299.

¹⁰² *Nintendo*, (COMP/35.587 PO Video Games, COMP/35.706 PO Nintendo and COMP/36.321 Omega-Nintendo) OJ L 255, 8.10.2003, p. 33, appeal pending, case T 13/03. The highest ever in vertical agreements cases, see para. 384. The fine on Nintendo alone was calculated at €149 million to reflect its size in the market concerned, the fact that it was the driving force behind the illicit behavior and also because it continued with the infringement even after it knew the investigation was going on.

“intra-brand competition was severely restricted and the single market was portioned”¹⁰³. The ECJ restated that:

“enhancing the exclusivity granted by virtue of distribution agreements, to a state of absolute territorial protection, by completely prohibiting distributors from making any sales outside the territories assigned to them or from selling to customers who intend to export, is not indispensable to realize the potential benefits of an exclusive distribution system. Instead, in regard to the goods in question, territories are hermetically sealed off, making interpretation of national markets impossible, thereby, bringing to nought economic integration”.¹⁰⁴

A similar approach has been adopted in the motor vehicle sector, in the *Volkswagen*,¹⁰⁵ *Opel Nederland BV*¹⁰⁶ and *Mercedes-Benz* cases,¹⁰⁷ all interestingly raised by complaints from consumers which led the Commission to investigate anticompetitive practices of car manufacturers and their importers.

In contrast, the American case-law has been more indulgent with restraints which affect intra-brand competition. In the famous case *GTE Sylvania Inc.*¹⁰⁸ the Supreme Court, overruling the previous case-law,¹⁰⁹ held that vertical non-price restrictions should be considered under a rule of reason.

1.4.6 Excluded restrictions

Each article 5 of the BERs contains specific provision for cases which do not benefit from the block exemption, although they do not affect the validity of the rest of the agreement.

¹⁰³ Fn. 102 above, para 331.

¹⁰⁴ Fn. 102 above, para 338.

¹⁰⁵ See *Volkswagen AG v Commission*, Case C-338/00 [2003] ECR I-09189, in this case Volkswagen was fined for having contractually discouraged sales from Italy (where the price were lower) to Germany.

¹⁰⁶ *General Motors Nederland BV and Opel Nederland BV v Commission*, T-368/00 [2003] ECR 00000, appeal pending, C-551/03. In this case Opel Nederland adopted a strategy (comprising reductions of supplies and a policy of premium and discounts) to impede exportation of vehicles from Holland to other Member States.

¹⁰⁷ Commission Decision of October 10, 2001 in Case COMP/36.264, 2002, OJ L257/1; pending case *DaimlerChrysler/Commission*, T-325/01. In this case Mercedes-Benz AG, fully controlled by DaimlerChrysler AG, imposed export bans restrictions, prohibited sales to leasing companies for stock in Germany and Spain, set sales price in Belgium, in the view of the Commission, affecting trade between the Member States appreciably and depriving consumers of the possibility of exploiting the benefits of the Single market.

¹⁰⁸ 694 F 2d 1132 (9 Circ. 1982).

¹⁰⁹ *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 87 S.Ct. 1856, 18 L.Ed. 2d 1949 (1967).

Not-exempted clauses		
VABER	MVBER	TTBER
	Sales of new motor vehicles, repair and maintenance services or spare parts	Competing undertakings
a. Non-compete obligation ¹¹⁰ with indefinite duration or duration exceeding 5 years (unless the buyer sell the products from premises owned by the supplier) (article 5(a));	a. Non-compete obligation ¹¹¹ (article 5(1)(a));	a. Any obligation on the licensee to grant an exclusive licence to the licensor in respect of its own severable improvements or new applications of the licensed technology (article 5(1)(a));
b. Any obligation causing the buyer, after termination of the agreement, not to manufacture, purchase, sell or resell goods or services, unless such obligation: <ul style="list-style-type: none"> a. relates to products competing with the contract products; b. is limited to the premises from which the buyer has operated in the contract period; c. is indispensable to protect know-how transferred by the supplier to the buyer; d. does not exceed one year after termination of the agreement (article 5(b)). 	b. Any obligation limiting the authorised repairer's ability to provide repair and maintenance services for vehicles from competing suppliers (article 5(1)(b));	b. Any obligation on the licensee to assign rights to the licensor in respect of its own severable improvements or new applications of the licensed technology (article 5(1)(b));
c. Any obligation causing the member of a selective	c. Any obligation causing the members of a distribution	d. Any obligation to the licenses not to challenge

¹¹⁰ According to article 1(1)(b) of the VABER, "'non-compete obligation' means any direct or in direct obligation causing the buyer not to manufacture, purchase, sell or resell goods or services which compete with the contract goods or services, or any direct or in direct obligation on the buyer to purchase from the supplier or from another undertaking designated by the suppliers more than 80% of the buyer's total purchases of the contract goods or services and their substitutes on the relevant market, calculated in the basis of the value of its purchases in the preceding calendar year".

¹¹¹ According to article 1(1)(b) of the MVBER, "'non-compete obligation' means any direct or in direct obligation causing the buyer not to manufacture, purchase, sell or resell goods or services which compete with the contract goods or services, or any direct or in direct obligation on the buyer to purchase from the supplier or from another undertaking designated by the suppliers more than 30% of the buyer's total purchases of the contract goods, corresponding goods or services and their substitutes on the relevant market, calculated in the basis of the value of its purchases in the preceding calendar year (...)". The MVBER seeks to promote "multi-branding", giving dealers and repairers the opportunities to sell and repair from different suppliers. Article 5(1)(a) does not apply, however, where the dealer or the repairer freely choose to sell goods from a single repairer. See the Explanatory Brochure at § 4.5.1., p. 31 ff.

distribution system not to sell the brands of particular competing suppliers (article 5(c)).	system not to sell motor vehicles or spare parts of particular competing suppliers or not to provide repair and maintenance services for motor vehicles of particular competing suppliers (article 5(1)(c));	the validity of IPRs of the licensor in the common market (without prejudice to the possibility to provide for termination of the agreement in the event that the licensee challenge the validity of one or more of the licensed IPRs) (article 5(1)(c))
	d. Any obligation causing the distributor or authorised repairer, after termination of the agreement, not to manufacture, purchase, sell or resell motor vehicles or not to provide repair or maintenance services (article 5(1)(d)).	
	Sale of new motor vehicles	
	a. Any obligation causing the retailer not to sell leasing services relating to contract goods or corresponding goods (article 5(2)(a));	
	b. (from 1 October 2005) any obligation on any distributor of passenger cars or light commercial vehicles within a selective distribution system, which limits its ability to establish additional sales or delivery outlets at other locations within the common market ('location clause') where selective distribution is applied ¹¹² (article 5(2)(b)).	
	Repair and maintenance services or sale of spare parts	Not-competing undertakings
	Obligation as to the place of establishment of an authorised repairer where selective distribution is applied (article 5(3)).	Any obligation limiting the ability of any of the parties to carry out research and development, unless such latter restriction is indispensable to prevent the disclosure of the licensed know-how to third parties (article 5(2)).

¹¹² Location clauses are allowed, in selective distribution systems, for dealers in medium and heavy trucks, buses and coaches and in exclusive distribution systems.

2. *Guidance letters*

Notwithstanding the end of the notification system, undertakings are not left entirely on their own if they need some clarification and guidance on the implementation of their distribution strategies and are uncertain about the legal evaluation of a new issue (or an old issue in a new context). Firms may ask guidance concerning how articles 81 and 82 will apply in specific circumstances and the Commission will respond, consistent with its enforcement priorities, by issuing "guidance letters".¹¹³ Guidance letters can only be validly requested when the following cumulative conditions are met:¹¹⁴

1. there is a substantial problem in assessing a question of law and no answer or clarification can be found in the EC legal framework, including case law, Commission notices and previous guidance letters.

The question of law posed may not be subject to judgment before any national authority.¹¹⁵

2. the clarification of the legal issue is useful, taking into consideration, various elements, like:
 - the economic importance, in light of the consumers' interest, of the goods or services covered by the agreement or the practice, and/or
 - the extent to which the agreement or the practice may be economically beneficial to consumers' interests in the market, and/or
 - the importance of the investments connected with the operation in relation to the dimension of the undertakings concerned and the extent to which the operation is a structural operation.

According to the Commission, "guidance letters are in the first place intended to help undertakings carry out themselves an informed assessment of their agreements and practices".¹¹⁶ The guidance letters do not bind the EC courts, nor the Commission, nor the NCA and the national courts, in the case of a subsequent investigation, following a complaint, but such authorities may consider the guidance letter in their evaluation of a given case.

3. *Commitment decisions*

Article 9 of Regulation 1/2003 allows the Commission to interrupt a proceeding against an undertaking if the undertaking commits to meet the Commission's concerns and bring the infringement to an end. The Commission can thereafter adopt a decision that makes the commitments binding for the undertaking for a specified period of time and that specifies that there are no longer grounds for action by the Commission.

The Commission may however re-open the proceeding where (a) there is a material change in any of the facts on which the decision is based; (b) the undertaking concerned acts contrary to its commitments or (c) the decision was based on incomplete, incorrect or misleading information provided by the parties.

¹¹³ § 5 of the Notice on guidance letters, article 27(4) of Regulation 1/2003 and Recital 38 of Regulation 1/2003.

¹¹⁴ § 8 of the Notice on guidance letters, fn. 59 above.

¹¹⁵ Article 9 of Regulation 1/2003, fn. 59 above.

¹¹⁶ § 22 of the Notice on guidance letters, fn. 59 above.

The undertakings committed are exposed to fines if they do not comply with the commitment decision.

The commitment decisions are indeed welcome. They allow firms to avoid fines; permit the joint examination of the practical workings of the market and its competitive conditions by the undertakings concerned, the Commission and other interested parties; and offer guidance to other undertakings who may have similar problems in assessing the validity of their vertical restraints.

In the distribution agreements context, the Commission has already adopted two such commitment decisions, one operating in the market for retail distribution of fuel in Spain (the *Repsol* decision),¹¹⁷ the other operating in the European market for carbonated soft drinks (the *Coca-Cola* decision).¹¹⁸

- In 2001 Repsol CPP, a supplier of petrol and diesel fuel operating mainly in Portugal and Spain, notified to the Commission agreements detailing its exclusive purchase of motor vehicle fuel products and including model contracts setting forth the conditions under which it intended to distribute (or had already distributed) motor vehicle fuel products through service station in Spain. Repsol CPP had a market share ranging from 35 to 50% in the retail market for diesel and a similar market share in retail in the market for petrol. The Commission was concerned that the network of agreements entered into by Repsol CPP, due to their duration, Repsol CPP's market shares and the conditions of the market (*i.e.* saturation of the market, the nature of the product, significant vertical integration, the cumulative effect of the parallel networks of vertical restraints), might foreclose the market and weaken inter-brand competition. Repsol CPP committed, until 31 May 2010, to give the option to the service station operators, who granted to Repsol CPP a usufruct or tenancy on their service station and then became temporary lessees, the chance to buy back their right *in rem*, under certain conditions (thus making it easier for service station operators to change supplier);
- to set a five-year maximum duration for new fuel distribution agreements with the operators of service stations which Repsol does not own (the possible entry barriers are thus limited in time);
- to advertise in advance the expiry of fuel distribution agreements (thus allowing alternative suppliers to offer their fuel); and
- to forego until the end of December 2006 the purchase from their operators of existing service stations not supplied exclusively by Repsol (the temporary restraints on the vertical integration allows other suppliers to operate in the market).

The compliance with the commitments will be verified by independent auditors who will report annually to the Commission on their findings.

In the *Coca-Cola* decision, the Commission accepted the Coca-Cola Company's commitments in relation to its distribution agreements in the carbonated soft drinks in the European Union, bringing to an end the investigation of Coca-Cola that had been underway for 5 years. Coca-Cola undertook, for a period of five years, the following commitments:

¹¹⁷ See fn. 90 above.

¹¹⁸ See the undertaking, Case COMP/39.116/B-2-2-Coca-Cola, published on the Commission web-site, <http://europa.eu.int/comm/competition/antitrust/cases/decisions/39116/commitments.pdf>, as of 16.8.2005, 6:13 p.m. According to the then Competition Commissioner Mario Monti, "the commitments entered into by Coca-Cola will level the playing field in the carbonated soft drinks markets in Europe. Thanks to the Commission's action consumers will generally have more choice at cafés, pubs and shops and will, therefore, be in a position to choose on the basis of price and personal preferences rather than pick up a Coca-Cola product because it's the only one on offer", see the press release <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/05/775&format=HTML&aged=0&language=EN&guiLanguage=en>, as of 16.8.2005, 6:13 p.m.

- to desist from entering into exclusive purchase agreements with its customers (thus allowing other suppliers to find distribution channels);
- to offer no further rebates that reward its customers purely for purchasing the same amount or more of Coca-Cola's products than in the past (thus allowing Coca-Cola's distributors to buy from other suppliers if they so wish);
- to desist from the practice of tying the purchase of Coca-Cola's strongest brands to less popular products (such as its Sprite or its Vanilla Coke), and to offer no rebate to its buyers for buying these other products in addition to its best-selling products or to reward them for reserving shelf space for the entire group of products; and
- to allow outlet operators to use at least 20% of the cooler provided by Coca-Cola for any product of its choosing, in those instances in which Coca-Cola provides a free cooler and there is no other chilled beverage capacity in the outlet.

PART III: Limitations of the Current European Approach and the Quest for a Way Forward

1. The current European approach to distribution agreements

In the second part of this paper, we have reviewed the main characteristics of the regulatory process determining how distribution agreements are treated in Europe, and we have sketched some of the challenges posed by the modernization process to undertakings, national courts and NCAs in assessing distribution agreements under EC competition law.

This is a transitional and settling phase for EC competition law as a whole, particularly as it relates to distribution agreements. There are new BERs. Article 81(3) is applied directly. There is a system of legal exception replacing the more cumbersome system of prior notification and authorization. The integration of the internal market is increasingly emerging as a reality. The need for an economic value approach toward competition law issues has at last been openly recognised and will slowly evolve at the EC and national level. Much of this is positive.

The new BERs have undoubted advantages in comparison to the old ones. They incorporate a system of "black list" practices instead of a "white list" system. They aim more effectively than did the prior system at ensuring effective competition and providing needed legal certainty to undertakings. The Guidelines and the Explanatory Brochure help the undertakings to assess their agreements themselves and give them tools so they can consider the competition effects of their planned agreements on the market when their agreements exceed the BERs thresholds, which has the consequence of making them more responsible and sensitive to competition law issues.

The VABER has the benefit of applying to a vast category of agreements and of not distinguishing among the forms of distribution (e.g. franchising, selective distribution, exclusive distribution, exclusive supply, single branding, tying), as was the case under the previous BERs.

The MVBER aims to give more freedom and independence to dealers and repairers, to boost parallel trade in the motor vehicle sector, to enhance intra-brand competition among dealers, and to foster new methods of distribution such as those emerging in the form of multi-brand dealerships, internet sales and sales through intermediaries.¹¹⁹

The TTBER has a broader scope than the previous BER and embraces licences not only of patent and similar product and process know-how but also of copyrights of intellectual property such as that in software and designs. It is more permissive than the VABER in exempting restrictions on active and passive sales to protect the greater sunk costs normally accepted by licensees.¹²⁰

Outside the application of the BERs, undertakings are responsible for the assessment of their agreements under EC competition law and may find help in the EC law and practice, in the Commission Guidelines and, in those cases in which a novel issue of law arises, in the Commission guidance letters.

Still, the system remains less than perfect. More work is needed if Europe is to thrive consistent with its potential as a continental market. The current BERs, with their black-listed practices and their market share thresholds, remain detrimentally rigid and can have the unintended consequence of impeding the parties to a distribution agreement from organising distribution as efficiently as possible, thereby depriving consumers of the benefits that can follow from a more efficient, more consumer responsive distribution system. The BERs are careful not to diminish intra-brand competition, but the imposition of uniform rules may in turn impede inter-brand competition to the disadvantage of consumers.

¹¹⁹See Recitals 14-15 and § 5.2, p. 45 of the Explanatory Brochure.

¹²⁰ See Article 4(2)(b) TTBER and the Guideline TTBER 99.

The BERs affect not only the behaviour of parties which have a market share below the relevant threshold, but also that of the undertakings exceeding this market threshold. A minimum RPM, not allowed under the BER, is unlikely to be exempted in an agreement which does not fall within the scope of the BER, and the undertakings concerned are aware of this and that awareness puts a chill on their freedom to act optimally.

The result is that the current EC competition approach to distribution agreements has a straitjacket effect on the parties and, *de facto*, may hinder competition in the internal market, even in the absence of an undertaking with a dominant position or, more irrationally, in the absence of any sound economic reason for prohibiting vertical restraints in those cases in which they are positive for the public interest.

2. *Criticism of the market share thresholds*

The market share ceilings are the only workable tool the Commission was willing to adopt in its search for a middle ground between the need to grant some degree of certainty to firms and the need to introduce a (limited) block exemption to vertical restraints entered into by undertakings not enjoying market power. It is a suboptimal compromise between a more economic approach and a persistent tendency to (over)regulate competition policy and to pursue the integration of the internal market through the application of article 81. This seeming prudence on the part of the Commission may appear to be justified in light of the decentralization of the application of EC competition policy and the need to ensure rules applicable to all Member States, especially now that the European Union is made by 25 Member States, and many of the new entrants have not a tradition of competition law and enforcement. Still, we ought not to let these practical considerations blind us to the unintended negative economic consequences that may thus result.

Many have criticised the Commission's choice to use market share ceilings in the BERs. Some have observed that market share does not always mirror the market power of a firm.¹²¹ Others have said that with such low market share thresholds, the Commission should have provided broader exemptions for most forms of vertical restraint.

Market shares are difficult and costly to assess, precision may elude the quantifying observer, and the consequence may be debilitating legal certainty for the undertakings who are then called on to bear the onerous burden to prove the correctness of their assessments.

The market shares of the firms may deviate from the original determinations and estimates after the conclusion of a long term distribution agreement. In the case in which the market share of the relevant firm rises after the conclusion of the agreement, the BER continues to apply for a period of one or two consecutive years after the relevant threshold is first exceeded (within certain limits).¹²² This places the parties in the difficult and problematic position of having to constantly monitor and constrain their sales to ensure the market share limit is not exceeded with the consequence that they might risk losing the protection of the relevant BER. A regulatory framework that might constrain an undertaking from succeeding is clearly inconsistent with efforts to promote a thriving economy.

With regard to the TTBER, it has been observed that "market shares are backward looking, whereas analysis on technology and innovative markets should be forward-looking. Yesterday's high market share may not reflect tomorrow's market power, and may be out of date by the time the market share data are available. What matters is not how many firms currently sell products, but how many firms can challenge the licensor's position".¹²³ Another objection to the TTBER is that the permissible market shares are low. "Where R&D are expensive, they may be commercially

¹²¹ L.A. SULLIVAN - W.S. GRIMES, *The Law of Antitrust: an Integrated Handbook*, fn. 79 above, at 60.

¹²² Articles 9(2) VABER, 9(2) MVBER and 8(2) TTBER.

¹²³ M. DOLMANS - A. PILOLA, *The New Technology Transfer Block Exemption - A Welcome Reform, After All*, supra at fn.49, at 361.

worthwhile only if a large part of the market can be suppliers. Consequently many technology markets are concentrated...many fear that in the pharmaceutical industry these limitations to the safe harbour of the Regulation will cause firms to carry on their R&D and productions outside Europe, supplying Europe by export. This may endanger many good quality jobs in the Common market".¹²⁴

3. Criticism of the hard-core restrictions

The hard-core restrictions do grant legal certainty to undertakings, which know thereby what they may not include in their agreements in order to ensure that they are exempted under the BER. Nevertheless, while the hard-core restrictions serve as a guide to the drafter of a distribution agreement, they also have the unfortunate consequence of constraining parties to limit their actions to exempted provisions and those that avoid black listed elements, without considering alternatives that might work better for their market, their product and their customers.

A more economic approach would include fewer hard-core restrictions, more principles and less regulation. According to Korah "minimum resale price maintenance and territorial restraints relate only to intra-brand competition, and such restraints may be justified as necessary to protect against free riders. With market share ceilings there should be sufficient inter-brand competition to make intra-brand competition unnecessary. The power to withdraw the benefit of the regulation provides a safety net".¹²⁵

The hard-core restrictions, themselves intended to reduce uncertainty, do just the opposite in those instances in which they state a general prohibition but then confuse the application of the prohibition by allowing many specified exceptions.¹²⁶ It would be more 'user-friendly,' to specify clearly what is prohibited, instead of fixing rules and then listing confusing exceptions to these rules.

Though the black list applies only to the distribution agreements concluded between parties whose market share(s) fall within the limits of the relevant BER threshold, the hard-core restraints will as a practical matter be considered *per se* as prohibitions in all other vertical agreements regardless of the market share of the parties. The parties to an agreement exceeding the BER threshold will naturally look at the BER for guidance concerning how they can shape their agreement. Thus, the hard-core restraints will have a chilling effect on these agreements as well.

The hard-core restrictions stifle change, negate the reliance on a truly economic approach, hinder the emergence of new consumer-beneficial forms of distribution, and similarly preclude the creative combination of different restraints which may be beneficial for the parties, the market and the consumers.

4. Conclusions

It is true that a case by case analysis is more costly, time-consuming, uncertain and demanding for both undertakings and competition authorities but I'm not sure that a black list, accompanied by (relatively) low market share ceilings, meets the needs of the market and foster consumer welfare more effectively. How can a "more economic approach" be applied to distribution agreements when a long list of hard-core restraints is provided? The very rigidity of the listing belies the essence of an optimizing economic approach. Are minimum resale price maintenance and absolute territorial protection always anticompetitive when the parties do not enjoy market power and there is some inter-brand competition? On the contrary such practices can be used for very valid purposes to ensure effective distribution and to provide needed and desirable support to consumers. Why should suppliers have to use their intelligence to circumvent the black listed and excluded clauses instead

¹²⁴ V. KORAH, *An Introductory Guide To EC Competition Law and Practice*, fn. 33 above, at 324.

¹²⁵ V. KORAH, *An Introductory Guide To EC Competition Law and Practice*, fn. 33 above, at 395.

¹²⁶ *I.e.* articles 4(b) VABER, 4(1)(b) MVBER and 4(1)(c) TTBER.

than concentrate on finding better forms of distribution? Intelligent regulation should not invite circumvention because is principle based and reflects the consensus values of the community.

All these questions arise in reaction to the present-day regulatory framework surrounding EC competition law, but the aims of that law are still unclear. One cannot deduce today from the existing regulatory structure whether the EC competition law is intended to protect consumers, competition, competitors or market integration.¹²⁷ There is a clear need to focus on the protection of competition and on consumer welfare, the efficient allocation of resources, the protection of (efficient) competitors and market integration will follow in the natural course of events. There is a saying that "the devil is in the details." That certainly applies to the details of the current set of regulations which are devilish for those who seek to comply with them.

In a period of change and decentralization legal certainty is welcome, but an excess of rules makes it impossible for firms to draft contract clauses that are truly efficiency-enhancing while avoiding the risk of seeing their contracts invalidated with severe economic consequences. Regulation needs to serve flexibility and innovation as well as providing legal certainty to those who are regulated.

Both inter-brand and intra-brand competition are important and deserve attention in the assessment of distribution agreements. In the near future, we can hope that a more economic approach will be pursued in fact as well as in appearance. As that day dawns, and we hope that is soon, and as the decentralization and uniform application of EC competition law becomes a reality, the black-list approach, absent true concentrated market power, should be abandoned. Maybe, vertical restraints might be relevant only under article 82 EC relating to instances in which a dominant position is abused to benefit an unethical giant to the clear detriment of the economy and market as a whole.

Others have suggested a European rule of reason in which vertical restraints would not be prohibited *per se* but would instead be individually examined under article 81(3), or equivalent provisions, to measure economically their overall effect on trade and competition.¹²⁸ This will happen in the natural course of events since the BERs are scheduled eventually to expire, leaving article 81(3) to apply directly. Still, it is too long for Europe to have to wait for 2010 or 2014 before a more reasoned regulatory structure is implemented.

As a lawyer, I lack the economic training be able to find a proven theorem or a scientific method that can be applied mathematically to measure with unimpeachable certainty the competitive effects of a vertical restraint in the market. Still, as an interested layperson who has read widely in the field, it seems clear that such a method is elusive, and may be impossible, in light of the many variables that affect the analysis of a market.¹²⁹

¹²⁷ For a review of the EC literature on the matter see, *inter alia*, EHLERMANN - LAUDATI (eds), *The objective of Competition Policy*, Oxford, Hart, 1998, G. MONTI, *Article 81 and Public Policy*, 39 *C.M.L.R.*, 2002, 1057. On the "battle for the soul of antitrust" in the US literature see R. DIBADJ, *Saving Antitrust*, 75 *U. Colo. L. Rev.*, 2004, 745; J. F. BRODLEY, *The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress*, 62 *N.Y.U. L. Rev.*, 1987, 1020; E.M. FOX, *The Battle for the Soul of Antitrust*, 75 *Cal. L. Rev.*, 1987, 917; E. M. FOX - L. A. SULLIVAN in *Antitrust-Retrospective and Perspective: Where are we Coming From? Where are we Going?*, *NYU L. Rev.*, 1987, 942; W.J. KOLASKY, *What is competition? A comparison of U.S. and European perspectives*, 49 *Antitrust Bulletin*, 2004, 29.

¹²⁸ For a rule of reason in the assessment of vertical restraints under US competition law see J. TIROLE, *The Theory of Industrial Organization*, MIT Press, Cambridge, MA; 1988, saying, at 188, "theoretically, the only defensible position on vertical restraints seems to be the rule of reason. Most vertical restraints can increase or decrease welfare, depending on the environment. Legality or illegality *per se* thus seems unwarranted. At the same time, this conclusion puts far too heavy burden on the antitrust authorities. It seems important for economic theorists to develop a careful classification and operative criteria to determine in which environments certain vertical restraints are likely to lower social welfare" (quoted by R. BOSCHECK, *The EU Policy Reform on Vertical Restraints - An Economic Perspective*, fn 12 above).

¹²⁹ According to Steiner, "it is... time that the competition agencies ask not whether a restraint is horizontal or vertical but how it will affect social welfare, probably best approximated by the change in total surplus (the sum of manufacturer, distributor, and consumer surplus in a dual-stage world)", in *The evolution and applications of dual-stage thinking*, 49 *Antitrust Bulletin*, fn. 7 above, at 897 and at 900, "to reiterate, judging the welfare consequences of a vertical restraints (or any other marketing policy)

What my research helped me to understand is that competition law, helped and supported by the insights offered by sound economic theories, requires a constant attention on the part of the regulator to the constantly shifting characteristics of the markets and of products, and to developments in business, in consumer needs, and in the forms of production and distribution. Sound regulation is responsive to change and does not hinder positive advances. "Competition conditions may be changing, so that what appeared to be sensible legislation at one period of time may not be sensible at another. Many facts change and technical evolutions occur... regulation tends to freeze present relationships and does not enable manufacturers to adapt their networks to these market evolutions. Antitrust, on the other hand, has an evolutionary character..."¹³⁰

Training and education of national judges and competition authorities in economic issues is fundamental to ensure that EC competition law stays current with business progress to sustain it rather than to hinder it.

The approach of EC and national authorities and courts to distribution agreements, both those covered and those not covered by the BER, needs to respond to their market effects and not to chill innovation by finding comfort in the regulatory certainty of fixed rules mechanically applicable to every situation. Article 81(3) and Regulation 1/2003 allow authorities the latitude to thus fashion a constructive regulatory framework. Firms and their advisors should be able to proceed with the assurance that competition rules do not obstruct their growth and oppose the enactment of efficient strategy. Such rules need to be fashioned instead so that they enhance consumer welfare and maintain a constructively competitive market. Firms should be encouraged to deviate from the BERs when they deem that a restraint (apparently falling into article 81(1) EC) is useful for improving their distribution system and fostering consumer welfare (according to article 81(3) EC). Economists and lawyers need to work together to shed light to foster better understanding of the dynamics of vertical restraints and to suggest efficiency enhancing options to innovative, consumer-oriented firms while not eliminating (or not for a long time), or appreciably reducing, inter-brand or intra-brand competition. Scholars need to dedicate further attention to studying the effects of vertical restraints and to suggest to lawyers, competition authorities and judges, useful (and not "too" theoretical) criteria enabling them to assess the circumstances (e.g. for which markets or which products) under which vertical restraints are likely to be economically beneficial and under which circumstances they are likely to be detrimental.

The problem with the current BERs may be as simple as that the new system is derived from the old. The old system, requiring advance approval, may have led regulators to adopt a set of internal, rigid rules to simplify their case-by-case review efforts and to ensure that their approvals were consistently granted. Such a set of rigid standards also frees regulators from the responsibility of having to make true case-by-case judgments. A mechanistic approach helps regulators to avoid criticism or to justify their actions on the grounds that they have merely followed the rules. Hence, the call to allow undertakings to be able to know in advance the likely results of the approval process may have simply led the regulators to release their internal rules to the outside world in the form of the BERs and then to simplify their own work processes by requiring undertakings to self-evaluate their compliance. My conclusion is that this approach, maybe necessary when it was introduced, may today result in sub-optimization of economic and business development.

Going forward we Europeans need a clear consensus about our economic values and the aims of our competition policy and regulation and our commercial laws. Paragraph 13 of the Guidelines on the application of article 81(3) makes a good beginning toward such a consensus when it posit the protection of competition "as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources"¹³¹. The Guidelines continue to advance "[c]ompetition and market integration" as the means to those ends, "since the creation of an open single market promotes efficient allocation of resources throughout the Community for the benefit of consumers".

requires estimating its effects on industry output and on costs and margins at both stages in order to make an informed total surplus calculation".

¹³⁰ D. GERARD, *Regulated Competition' in the Automobile Distribution Sector: A Comparative Analysis of the Car Distribution System in the US and the EU*, 24(10) *E.C.L.R.*, 2003, 518.

¹³¹ § 13 of the Guidelines on the application of article 81(3), fn. 59 above. See also the 7 VABER Guideline and the 5 TTBER Guideline.

I do not disagree with this point of view though I believe that it needs to be conditioned on the European social and economic values. I believe that reasoned debate that delves below the comfortable superficiality of commonly held opinion is likely to deflect attention from size-defined competition policy or from excessive fear of market segmentation and price restraints to what defines business ethics and effective competition. I expect that instead the focus will shift to how such ethics and such effective competition can be encouraged and rewarded, promoting technological developments, social prosperity, business and consumer welfare, a true feeling of operating in a common market and living in a (the) European Union. I believe further that we can evolve a more refined sense of what market dynamics truly lead to economic optimization for all and that we can derive a regulatory structure consistent with the insights resulting from this dialogue. Europe deserves to have principled regulation meeting (and anticipating) the needs of business, consumers and citizens.