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On Efficiencies and Integration

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The New Commission Policy on Vertical Restraints

Master thesis
20 points

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Competition law of the European Union

Spring 2001

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Summary

This thesis discusses two main questions. First, the importance paid to the economic goal and the integration goal respectively in the new Commission policy. Second, I analyse an agreement covered by the new block exemption regulation in order to establish whether or not exempted agreements still prevent or restrict market integration and in addition what economic efficiencies are offered in stead.

The thesis starts with description of the theory of vertical restraints and the case law of exclusive distribution agreements. The core of the thesis is chapters 3 to 5 where I describe the new Commission policy concluded from the different publications of the Commission, i.e. the Green Paper on Vertical Restraints, the Commission Guidelines on Vertical Restraints and the new block exemption regulation on Vertical Restraints 2790/99. Chapter 6 contains a description of the relevant articles of the agreement in question. An analysis and conclusion of what is presented in the previous chapters conclude the thesis. There I emphasise the importance paid to efficiencies, the economic goal and the integration goal in the various publications by the Commission. Finally, I apply the new block exemption regulation to the agreement in order to establish whether the regulation exempts agreements that nevertheless prevent or restrict integration. I also describe the economic efficiencies generated by the agreement.

The new Commission policy with respect to Vertical Restraints has been changed. The policy is not as sceptic as it used to be and there will be a case-by-case assessment of the agreements. The economic aspects shall be considered further but the integration aspect is still equally important. There is a tendency in case law that the Court applies a rule of reason approach. My opinion is that this approach should be questioned. EC competition law is different from other competition law statutes in that EC competition law also takes account of and promotes market integration. The economics based approach is useful and perhaps even beneficial in the assessment of restrictions on competition but definitively not in the assessment of restrictions on market integration. There is a risk that the integration goal becomes secondary in the assessment where this approach is applied.

My personal opinion, shown in this thesis is that the promotion of market integration is a fundamental objective in EC competition law and as such should not be downgraded into a secondary objective following an economics based approach with respect to the assessment under Article 81. Thus, the wording of Article 81 and the additional regulations takes due account of both the economic goal and the integration goal. The emphasis on the economic aspects is still to be made in relation to the application of the rules in Article 81 and the regulations.

Hence, the application of the rules decides the importance to be paid to the economic goal and the integration goal respectively.

As far as the application of the new Commission policy on the agreement is concerned I come to the conclusion that despite the fact that it restricts both competition and market integration there are great benefits from the agreement on both competition and market integration. Thus, the restrictions imposed by the agreement increase and improve market integration in particular. It is therefore possible to state that despite the fact that market integration is restricted by the agreement, it also promotes market integration.

Preface

When I started working on this thesis in the beginning of 2001, I was looking forward to searching for materials and writing during an entire semester. There were many thoughts and ideas on the subject spinning around in my head. Some turned up to be less useful than others. That is only normal and it also helps the development of the thesis and makes it interesting.

The reason I chose to focus on the question of integration is mainly that I take great interest in the process called the EU. The intention that the people within the EU shall be able to purchase their goods from anywhere on the common market without more problems than would be the case if purchased in their country of residence, the intention that the same people shall be free to work or set up undertakings wherever they want on the common market, I could go on forever. The most important is that I find the intention, to provide freedom to the people of the EU as mentioned above, very interesting and I look forward to see what the EU will provide us with in the future. To secure the continuance of the EU it is important that we emphasise and maintain the unique characteristics of EU law. Integration is one of these characteristics.

Several persons have been helpful during these months of writing. I intend to mention them all by thanking the following:

Katarina Olsson, my supervisor at Lund University. Katarina helped me through the initial phase thereby making possible the entire thesis.

Jonas Ågren, lawyer at Glimstedt law firm in Jönköping. Jonas has commented on the thesis and generously contributed with useful material. I also want to thank the entire staff at Glimstedt law firm in Jönköping. They made me feel welcome at all times during the period of practise that I spent there in February and March 2001.

Berga upper secondary school and Henrik Diurhuus who lent me a laptop during the semester. It has been most useful.

Victoria, who bore with me and my endless nagging about the thesis.

I thank you all.

Jönköping 4 September, 2001

Martin Bengtsson

1 Introduction.

The policy on vertical restraints on behalf of the Commission has recently been modified into an even more positive approach, permitting vertical restraints of greater impact on competition and trade between Member States, compared to the situation prior to the new block exemption regulation.¹ This thesis deals with the result of the new policy and the impact thereof on the integration goal in particular.

1.1 General.

Economic analysis has become the topic of discussion even in terms of EC competition law. The analysis is frequently applied in U.S. Antitrust law as well as in any other American law. The Court of Justice and the Court of First Instance have applied economic analysis more frequently during the past years. The Commission, however, has been more hostile towards the application of economic analysis with respect to EC competition law. The Commission has been resisting this application, but now it seems like it has yielded. From the point of view of EC competition law this is negative because one of the objectives of EC competition law is to promote market integration explicitly pursued in inter alia article 81(1) of the EC Treaty.² In the Green Paper on Vertical Restraints³, the Commission states that "... it should always be remembered that the Commission is the only competition enforcement agency in the world that has a market integration objective in addition to that of maintaining a system of undistorted competition. Other models are therefore not necessarily appropriate for the EU."⁴ The Commission continues "The goal of US antitrust law is to promote consumer welfare; it has no goal to promote market integration."⁵ Notwithstanding the fact that this statement was made in the context of comparing national competition law of various Member States as well as other countries, it reaffirms the general principle that EC law in general has a sui generis character.⁶ This principle holds true also with respect to EC competition law.

From my point of view there are a few issues to consider with respect to this policy change. The character of EC competition law, as well as EC law in general, makes it impossible to simply copy the economic analysis applied in U.S. Antitrust law. The notion of integration evinced by the words "... trade between

¹ Commission Regulation 2790/1999/EC on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices. [1999] OJ L 336/21.

² Hereinafter referred to as "the Treaty".

³ Green Paper on Vertical Restraints. COM(96)721 Final.

⁴ Green Paper on Vertical Restraints. Executive summary p. viii. para 30.

⁵ Green Paper on Vertical Restraints. p.60. para 203.

⁶ Sui generis means of its own kind, i.e. EC law cannot be compared to any other legislative system.

Member States...” in Article 81(1) the Treaty is one aspect not considered in U.S. Antitrust law and consequently neither in the economic analysis. The analysis undertaken in economic analysis takes account of the economic value inherent in the specific aspects considered. It is my opinion that there cannot be put a value on the integration pursued by the Treaty. It is sometimes said that the European Union is not an end to itself but rather a process preventing political tension in Europe. Thus, it will be long before we get to a point where market integration is complete and the economic aspects of EC competition will gain priority over the integration goal.

My main theory is that the notion of integration should be given a status equivalent to or better than the notion of efficiencies. I intend to assess whether or not my concerns, i.e. that the economics based approach has downgraded the importance to be paid to the integration goal, are fulfilled in the new policy.

1.2 Purpose.

The purpose of this thesis is to analyse the new Commission policy on vertical restraints from the point of view of EC competition law. I shall analyse whether the legal analysis proposed by the Commission in fact is a step away from the sui generis character of the EC competition law towards an economics based approach. Furthermore, I hope to elucidate whether or not the integration goal has become a secondary objective of EC competition law, not in the Treaty but in the new Commission policy. I will assess the new policy as it is evinced in inter alia the Green Paper on Vertical Restraints⁷, the Commission Guidelines on Vertical Restraints⁸ and new block exemption regulation 2790/99⁹, in order to establish the importance paid to integration and efficiencies respectively. The Commission Guidelines on Vertical Restraints are analysed prior to the analysis of the new block exemption regulation because the policy statements made in the Guidelines are more useful and contains more information than does the new block exemption regulation.

My purpose is also to analyse, by using a practical example in the form of an existing agreement and theoretical examples in the new legislation, whether or not the issue of integration as stated in the Treaty is still fully recognized in the new policy from the Commission. I will assume that the agreement in question will benefit from the block exemption regulation, since it was compatible with the old block exemption regulation¹⁰, and the agreement will be useful to the extent that it contains provisions that, albeit exempted, still – in my opinion - might be harmful to competition and/or integration.

⁷ Green Paper on Vertical Restraints. COM(96)721 Final.

⁸ Commission Guidelines on Vertical Restraints. [2000] OJ C291/3.

⁹ Commission Regulation 2790/1999/EC. [1999] OJ L 336/ 21.

¹⁰ Commission Regulation 1983/83. Block Exemption on Exclusive Distribution Agreements. [1983] OJ L173/1.

1.3 Limitations and material.

The issue that I intend to discuss in this thesis and the practical approach used will restrict the appropriate methods. Furthermore, because of the very recent appearance of the new policy there are limits to the extent of sources from which I can obtain information. The number of cases and regulations regarding vertical restraints is numerous and I will only deal with questions covered by the new block exemption regulation, i.e. other exemption regulations for various agreements will not be dealt with. Furthermore, I will restrict myself to case law on exclusive distribution agreements. Finally, when discussing publications from the Commission I will, where it is appropriate, restrict the discussion to aspects of exclusive distribution. The material used will basically be the Green Paper on Vertical Restraints, the Commission Guidelines on Vertical Restraints and the new block exemption regulation from the Commission. I will also use literature of well-known European writers.

I begin by briefly analysing the notion of vertical restraints. The most important part of the thesis will be the descriptive analysis of the new policy of the Commission evinced in different legislative publications, chapters 3-5. I finally describe an existing agreement, an exclusive distribution agreement, in order to get the practical aspects of the issue.

1.4 Scientific position.

The view on vertical restraints has changed over the years. The Community legislator probably did not, at first, consider vertical restraints to provide the positive effects that some of them do, in fact, provide. The various block exemption regulations produced in the beginning of the 1980's proved the policy change of the Community legislator. Now, once again and perhaps in addition to a desire to facilitate the bureaucracy within the Commission, there is a new policy on vertical restraints on behalf of the Commission. It is important to know that the new policy is in some parts based on the case law of the Court of Justice and the Court of First Instance.

Where case law condemns restrictions on the basis of their object or purpose these restrictions have to be considered as per se illegal. The Court has also engaged in economic analysis in the 81(1)-assessment although the rule of reason approach has not been explicit. There has been balancing of the pro- and anti-competitive effects of the agreement in the assessment of Article 81(1).¹¹ Whish¹² has argued against the rule of reason approach, that in the Remia-case¹³ and the

¹¹ Craig, P and de Búrca, G. EU Law: Text, cases, and materials. p.913.

¹² Whish, R. Competition Law, p. 210 et seq.

¹³ Case 42/84, Remia BV and Verenigde Bedrijven Nutricia NV v Commission [1985] ECR 2545.

Pronuptia-case¹⁴ the restrictions were objectively necessary in order for the agreements to succeed. Furthermore, in the STM-case¹⁵ and Nungesser-case¹⁶ the question concerned whether the commercial risk taken by the distributor justified the exclusivity and protection granted. The market analysis required in order to undertake this assessment resembles the rule of reason. However, the basic question remains the same, i.e. whether or not the agreement provides pro- or anti-competitive effects. The distinction between the two classes of agreements is that in the former there will always be clauses that will be necessary for that type of agreement while in the latter the market analysis is needed in order to determine the degree of exclusivity needed.¹⁷ In short, the issue of this thesis, i.e. the distinction between the integration goal and the economic goal and the importance of economic efficiencies, can be seen in both the literature and case law.

1.5 Content.

Chapter 2 deals with the theoretical context of vertical restraints and case law of the Commission and the Court of Justice.¹⁸ Chapter 3 deals with the development of the new policy on vertical restraints as it has developed through different publications by the Commission. Chapters 4 and 5 are the core of the thesis whereby the question of the treatment of the two notions in the new policy of the Commission is described. Chapter 6 dogmatically describes the relevant provisions of the agreement constituting the practical point of the thesis. Chapter 7 concludes and analyses the facts and conclusions from the previous chapters. The agreement described in chapter 6 is also discussed in chapter 7 where I come to a final standpoint on whether or not it contains any restrictions that should not be exempted. In order to reach this conclusion I shall apply the new Commission policy.

¹⁴ Case 161/84, Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis [1986] ECR 353.

¹⁵ Case 56/65, Société Technique Minière v Maschinenbau Ulm GmbH [1966] ECR 235.

¹⁶ Case 258/78, L.C. Nungesser KG and Kurt Eisele v Commission [1982] ECR 2015.

¹⁷ Craig, P and de Búrca, G. p.914.

¹⁸ “The institution known as the ‘Court of Justice’ consists of two courts, the Court of Justice and the Court of First Instance...” Lenaerts, K and Arts, D. Procedural Law of the European Union. p.4.

2 Vertical Restraints.

2.1 Introduction.

This chapter deals with the basic theory of vertical restraints. Furthermore, the theoretical stand points in case law and the economic analysis of vertical restraints as evinced in the literature is also discussed. To the extent it is possible without neglecting any important aspect I will limit this discussion to exclusive distribution agreements.

2.2 Vertical restraints in theory.

2.2.1 Introduction.

In this section I briefly explain the notion of vertical restraints from a theoretical point of view. I also mention the pro- and anti-competitive effects of vertical restraints as they are recognised by theorists. Finally, I discuss the EC competition law aspects of exclusive distribution agreements and pinpoint the specific pro- and anti- competitive effects from exclusive distribution agreements.

2.2.2 Vertical restraints.

Vertical restraints are theoretically defined as agreements between undertakings at different levels in the production and supply chain including agreements between manufacturers and retailers, manufacturers and distributors, distributors and retailers and so on. In general, vertical agreements are restrictions imposed by one party on the other.¹⁹ This does not necessarily mean that the upstream undertaking imposes obligations on the downstream undertaking. This is shown by the existence of exclusive distribution and exclusive purchasing agreements respectively.

The interest in vertical restraints, from academic as well as practitioner point of view depends on several factors. The first factor is the debate on whether or not vertical restraints are harmful to competition. Another factor is the importance of such restraints to the organisation of business. On the question of whether vertical restraints are harmful or not, the advocates of the non-harmful approach state that where the degree of market power at the production level does not exceed a certain level vertical restraints are not harmful to competition. The vertical restraints will enable the manufacturer to enter a new market using the most

¹⁹ Bishop, S and Walker, M. The Economics of E.C. competition law: Concepts, Application and Measurement. p.86.

proper tool in order to make such entry successful. Where the tool chosen is not efficient enough the market will punish the manufacturer by inter alia low sales or bankruptcy. Competition authorities shall not decide what is the best way of entering a new market. In addition it is argued that the manufacturer will not restrict competition anymore than in the absence of the agreement. Nor will the manufacturer be able to grasp greater monopoly profits than would otherwise be possible. Thus, these advocates assume that the manufacturer has chosen the most efficient tool to enter the market. The pro-competitive effects of the agreement will outweigh the restrictions thereby imposed. Furthermore, the restrictions are necessary to convince the distributor to make the investments and take the risks involved in entering a new market. The fact that intrabrand²⁰ competition is restricted is considered irrelevant as long as there remains sufficient interbrand²¹ competition. Interbrand competition is the most important tool in order to maintain price competition.²²

I think it is regrettable that all these pro-competitive arguments on vertical restraints are concerned with the economic goal and economic efficiencies from vertical restraints. The argument is that as long as the pro-competitive effects outweigh the anti-competitive effects, the restraints are considered permissible. Arguing like this, the advocates tend to forget that there is an additional condition in Article 81, namely the notion of integration, i.e. trade between Member States must not be appreciably restricted, prevented or distorted in or by the agreements. This condition must not be neglected or overlooked because this notion is what separates EC competition law from other statutes of competition law in the world. There is only one way to alter, limit or remove the importance of the notion - namely to amend the Treaty provision. In the absence of such amendment, the provisions of the Treaty must be applied as they are written.

Others assert that vertical restraints are harmful to competition and should be subject to scrutiny. These advocates believe that vertical restraints provide for market foreclosure. Furthermore, consumers will be harmed since vertical restraints create resale price maintenance and because exclusive distribution agreements in particular force a 'package' on consumers including the basic price of the product, plus advertising costs, after-sales service, and the like without asking whether the consumer would want the 'raw' product and worry about after-sales service etc. after the purchase. Another argument from these advocates is that EC competition law is not merely concerned with efficiency with respect to competition law. EC competition law is supposed to promote the creation of the single market as well. This is best shown by the condemnation in case law of agreements explicitly or implicitly dividing the market along national or

²⁰ Intrabrand competition means competition between market operators at the same market level and of the same brand.

²¹ Interbrand competition means competition between different brands, irrespective of the market level.

²² Craig, P and de Búrca, G. pp.920-922.

regional lines. One example of this is the prohibition by object of agreements conferring absolute territorial protection.²³ This policy is affirmed in the Green Paper²⁴ where the Commission states that agreements granting absolute territorial protection will not be accepted, i.e. the agreement will be covered by Article 81(1) and will not be granted individual exemption under Article 81(3). One of the options, suggested in the Green Paper, by the Commission for a changed procedure to vertical restraints, was putting emphasis on the EC's market integration objectives.²⁵ This option was only partially adopted by the 30% market share threshold.

2.2.3 Exclusive distribution agreements.

In theory, an exclusive distribution agreement is an agreement whereby one party, the supplier, agrees to deliver certain products solely to the other party, the distributor, for sale in a particular territory.

Exclusive distribution agreements are covered by Article 81(1) because such agreements reduce the number of distributors in the territory thereby restricting intrabrand competition. It is often argued that exclusive distribution agreements increase interbrand competition by facilitating market entry, but according to the Consten and Grundig-case²⁶, agreements restricting intrabrand competition cannot be exempted merely because they increase interbrand competition. Notwithstanding, exclusive distribution agreements were block exempted in regulation 1983/83 and are block exempted in the new block exemption regulation 2790/99. There are undoubtedly many obtainable economic benefits from exclusive distribution and the general approach shall be to exempt these agreements. As aforementioned, vertical restraints can adversely affect trade between Member States. Thus, exclusive distribution agreements can adversely affect trade between Member States. Where this is the case the agreement will lose the benefit of the block exemption regulation. Under these circumstances the agreement will not satisfy the conditions of Article 81(3) and will therefore be void according to Article 81(2). The territorial protection obtained from exclusive distribution agreements might restrict trade between Member States by preventing or restricting the purchase of the contract goods from other territories. This restriction might, however, provide some benefits from efficiency point of view. But, it is not sufficient to prove that there is territorial protection in order to condemn the agreement. The protection has to be absolute; it has to be impossible to obtain the product in question from resellers other than the exclusive distributor. Thus, where there remains some possibility to obtain the product from e.g. parallel traders, the territorial protection is not absolute and the territorial

²³ Craig, P and de Búrca, G. p.923.

²⁴ Green Paper on Vertical Restraints, p.75. para 276.

²⁵ Craig, P and de Búrca, G. p.926.

²⁶ Joined cases 56 and 58/64. *Établissements Consten S.A R.L. and Grundig-Verkaufs-GmbH v Commission* [1966] ECR 299, 342.

protection, and thus restriction on trade between Member States, will be exempted either under the block exemption regulation or Article 81(3). The conclusion to be drawn is that in those circumstances the economic benefits from the exclusive distribution agreement outweigh the negative effects from the restriction on integration.

2.3 Legal analysis of vertical restraints.

2.3.1 Introduction.

This section contains a discussion on the various legal aspects that might be considered when the Court or the Commission faces an issue of competition law. The aspects mentioned infra might also be referred to in chapter 3.4.

The Treaty-rules on competition are set out in Articles 81-86. In the case of vertical restraints, Article 81 is the most relevant. Henceforward I will only deal with the legal analysis and assessment that has to be undertaken by the Courts, the Commission or the national courts with respect to Article 81.

2.3.2 EC competition law analysis.

Article 81 contains three paragraphs. Article 81(1) prohibits agreements between undertakings, decisions by associations of undertakings and concerted practices, (hereinafter ‘agreements’) which have as their object or effect the prevention, restriction or distortion of competition. The basic rule is that such agreements are void according to Article 81(2). Under certain circumstances the agreements infringing Article 81(1) will be exempted, under Article 81(3), from the prohibition of Article 81(1). Thus, Article 81 contains a prohibition and an exemption. The prohibition is applicable to all levels of distribution from research and development to retailing. In short, there is a three-step procedure under Article 81. First, there has to be a restriction of competition. Second, the restriction on competition has to be appreciable. Third, the restriction has to affect trade between Member States. For Article 81(3) to apply, the agreement has to improve production or distribution of goods or promote technical or economic progress while allowing consumers a fair share of the benefit. Furthermore, the restrictions imposed have to be indispensable to the attainment of the objectives of the agreement, i.e. the improvement of production or distribution or promotion of technical or economic progress. Finally, the restrictions must not provide an opportunity for the undertakings involved to eliminate competition in respect of a substantial part of the products in question.²⁷ Agreements containing clauses imposing absolute territorial protection, resale price maintenance or impairment of

²⁷ Green Paper on Vertical Restraints. p.28. para 87. See also Green Paper on Vertical Restraints. Executive summary p.iv. para 14.

parallel trade, i.e. clauses considered as per se illegal, are excluded from any exemption, both individual and block exemption. The prohibition of absolute territorial protection intends to promote market integration.

According to the Commission, one large advantage of the “old” policy towards vertical restraints was that the wide application of Article 81(1) placed the analysis primarily under Article 81(3) allowing for “...a full economic assessment of the advantages of the agreements, the impact on the structure of competition and consumer welfare.”²⁸ The same policy is applied with respect to the block exemption regulation. The result is that there must not be any impediment to passive trade and parallel trade.²⁹

One of the differences between EC competition law and the competition law statutes of other countries, is the possibility of exemption under Article 81(3). Other competition law statutes do not contain such a possibility to exempt. Therefore, it is necessary to decide what restrictions should fall under the prohibition. Because EC competition law contains a possibility to exempt agreements, the need for economic analysis in order to determine what restrictions shall be covered by the prohibitions is not that great. In EC competition law it is more important to focus on what restrictions shall be exempted. It would be detrimental to implement an economic analysis in Article 81(1) where Article 81(3) is already applied using economic analysis. To implement economic analysis into Article 81(1) or to let economic analysis influence the assessment under Article 81(1) could eliminate or reduce the importance of the integration-aspect. I believe that such a development would be most detrimental to the EU, especially in a situation where the EU is facing the largest enlargement in its history within the next ten years.

2.4 Vertical restraints in case law.

2.4.1 Introduction.

This section deals with the case law of the Commission and Court of Justice. The cases concern exclusive distribution agreements with a focus on the assessment of and importance paid to efficiencies and integration.

2.4.2 Summary of case law.

The creation of the single market plays an important role in the policy of EC competition law. The aim is to prevent borders being raised between the Member States and to encourage the undertakings of the various Member States to

²⁸ Green Paper on Vertical Restraints. Executive summary p. vii. para 25.

²⁹ Green Paper on Vertical Restraints. Executive summary p. vi. paras 21-23.

operate throughout the Community and to consider the common market as their domestic market. Because of the EC competition law's policy objectives, the result of the assessment may vary from case to case depending on the objective chosen. However, these choices are not always made explicitly.³⁰

The general policy of EC competition law is that agreements must not implement measures that prevent the establishment of the common market.³¹ This means that agreements must not prevent or restrict the interpenetration³² sought by the Treaty by reintroducing trade borders that lead to market partitioning.³³

The basic principle under Article 81(1) is that an agreement infringing Article 81(1) by a restriction by object cannot be individually exempted.³⁴ Agreements shall be assessed taking account of their economic and legal context.³⁵ An agreement has to affect trade between Member States in order to be caught by Article 81(1).³⁶ The effect has to be such that market integration is impeded.³⁷ In order to establish the effect on trade between Member States it is necessary to assess "...whether the agreement is capable of constituting a threat, either direct or indirect, actual or potential, to freedom of trade between Member States in a manner which might harm the attainment of the objectives of a single market between States."³⁸ The effect on trade between Member States originates from two ways where the contract goods are subject to significant international trade. The first way is where the agreements bind dealers in a substantial part of the common market contributing to partitioning of the national market. Where the restriction on competition covers the entire Member State the effect will be the reinforcement of the compartmentalisation of market on a national basis. The second way is where the agreement restricts the opportunity for foreign

³⁰ Craig, P and de Búrca, G. p.892.

³¹ See Joined cases 56 and 58/64. *Établissements Consten S.A R.L. and Grundig-Verkaufs-GmbH v Commission* [1966] ECR 299, 326. *Commission Decision Johnson & Johnson*. [1980] OJ L377/16. p. 24 para 35. *Commission Decision Polistil/Arbois*. [1984] OJ L136/9. p.13 para 51. *Case T-77/92 Parker Pen Ltd v Commission* [1994] ECR II-549. p.566 para 46; and *Commission Decision Tretorn and others*. [1994] OJ L378/45. p.49 para 51.

³² See *Case 56/65, Société Technique Minière v Maschinenbau Ulm GmbH* [1966] ECR 235, 249 and *Case 23/67, Brasserie de Haecht SA v Wilkin* [1967] ECR 407, 415.

³³ See *Case 23/67, Brasserie de Haecht SA v Wilkin* [1967] ECR 407, 420. The opinion of AG Roemer. *Commission Decision Tretorn and others*. [1994] OJ L378/45. p.49 para 51; and *Case C-70/93 Bayerische Motorenwerke AG v ALD Auto-Leasing D GmbH*. [1995] ECR I-3439. p. I-3469 para 20, albeit this case concerned selective distribution agreements.

³⁴ See *Commission Decision Polistil/Arbois*. [1984] OJ L136/9. p.12 paras 40-41.

³⁵ *Case 56/65, Société Technique Minière v Maschinenbau Ulm GmbH* [1966] ECR 235, 248.

³⁶ *Case C-306/96 Javico International and Javico AG v Yves Saint Laurent Parfums SA (YSLP)* [1998] ECR I-1983. I-2003 para 15.

³⁷ See *Case 56/65, Société Technique Minière v Maschinenbau Ulm GmbH* [1966] ECR 235, 249. *Commission Decision Johnson & Johnson*. [1980] OJ L377/16. p. 24 para 35. *Commission Decision Hennessey - Henkell*. [1980] OJ L383/11. p.15 para 21. *Commission Decision Polistil/Arbois*. [1984] OJ L136/9. p.13 para 50; and *Commission Decision Gosme/Martell - DMP*. [1991] OJ L185/23. p.29 para 36.

³⁸ See *Joined cases 56 and 58/64. Établissements Consten S.A R.L. and Grundig-Verkaufs-GmbH v Commission*, [1966] ECR 299, 341.

purchasers to purchase the contract goods in the exclusive territory, i.e. export bans.³⁹ The affect on integration has to be appreciable.⁴⁰ Exclusive distribution agreements established in order to identify and prevent parallel exports are contrary to Article 81(1) because the object and effect of the agreements are to restrict or prevent trade between Member States.⁴¹ Although, exclusive distribution agreements shall not automatically fall under the scope of Article 81(1).⁴² The Nungesser-case⁴³ reinforced the importance paid to the creation of the single market and the pursuit of breaking down national barriers. The conditions of Article 81(3) are not fulfilled where the agreement or clauses therein provides for market partitioning.⁴⁴

The notion “trade between Member States” was once easily satisfied, but recent case law indicates this is no longer the case. In Carlo Bagnasco⁴⁵ the Court stated that the mere fact that the agreement covers the entire Member State is no longer sufficient in itself for a finding that trade between Member States has been affected.⁴⁶

Restrictions on integration provided for in agreements make Article 81(1) applicable. There are numerous examples of restrictions in case law. First, absolute territorial protection can be implemented in various ways, e.g. by export bans⁴⁷ and in combination with exclusion of parallel trade such measures are specifically prohibited by Article 81(1).⁴⁸ Second, resale price maintenance is also condemned in case law, e.g. resale price maintenance is not considered as indispensable in the assessment under Article 81(3).⁴⁹ Thus, the distributor has to maintain its freedom to fix resale prices otherwise the agreement will not be eligible for individual exemption.⁵⁰ Third, impairment of parallel trade also restricts integration making the agreement not eligible for individual exemption.⁵¹ Such impairment can be imposed by export prohibitions.⁵²

³⁹ Case C-70/93 Bayerische Motorenwerke AG v ALD Auto-Leasing D GmbH. [1995] ECR I-3439. p. I-3469 para 20.

⁴⁰ Case 56/65, Société Technique Minière v Maschinenbau Ulm GmbH [1966] ECR 235, 249-250.

⁴¹ Commission Decision Gosme/Martell - DMP. [1991] OJ L185/23. p.28 paras 31-32.

⁴² Case 56/65, Société Technique Minière v Maschinenbau Ulm GmbH [1966] ECR 235, 248.

⁴³ Case 258/78, L.C. Nungesser KG and Kurt Eisele v Commission [1982] ECR 2015.

⁴⁴ The restriction imposed in Nungesser was absolute territorial protection. (My own note).

⁴⁵ Joined Cases C-215 and C-216/96 Carlo Bagnasco v Banca Popolare di Novara and Cassa di Risparmio di Genova e Imperia [1999] ECR I-135, paras 47 et seq.

⁴⁶ Faull, J and Nikpay, A. The EC Law of Competition. p.97 et seq.

⁴⁷ Commission Decision Polistil/Arbois. [1984] OJ L136/9. p.12 paras 40-41.

⁴⁸ Commission Decision Tretorn and others. [1994] OJ L378/45. p.49 paras 52-56.

⁴⁹ Commission Decision Hennessey - Henkell. [1980] OJ L383/11. p.16 para 32 and p.17 para 34.

⁵⁰ Commission Decision Hennessey - Henkell. [1980] OJ L383/11. p.17 para 35.

⁵¹ Commission Decision Hennessey - Henkell. [1980] OJ L383/11. p.17 para 35.

⁵² Commission Decision Polistil/Arbois. [1984] OJ L136/9. p.14 para 53.

Restrictions on integration may be exempted where there remains the possibility to obtain the contract goods from distributors in other territories or Member States, i.e. where parallel trade is not restricted. The appreciability requirement is fulfilled where the agreement restricts parallel trade.⁵³ Integration is also restricted where the agreement imposes prohibitions on active sales into other exclusive territories. Such restrictions are exempted where there is parallel trade on that market⁵⁴ and passive sales are not prohibited. Restrictions on parallel trade, without regard to their form, are contrary to Article 81(1).⁵⁵ Parallel trade guarantees overall vitality of the distribution system, at the same time it is beneficial to the final consumer, i.e. one of the objectives of Article 81(1+3).⁵⁶ The obligation to maintain a permission of passive sales protect market integration and "... maintains the freedom of parties to a distribution agreement to respond to third party traders who engage in parallel trade, thereby contributing to the elimination of significant price differences between Member States."⁵⁷

Restrictions on integration can be both pro- and anti-competitive. Exclusive distribution agreements in combination with non-compete clauses might restrict integration but such provisions also improve the distribution of goods.⁵⁸ The same applies to prohibitions on active sales into other exclusive territories imposed in agreements. Such provisions restrict integration but they also improve distribution of goods.⁵⁹

Export bans or prohibitions on export imposed in agreements, by their very nature, affect trade between Member States.⁶⁰ To impose export bans in an exclusive distribution agreement show the objective of restricting competition and providing for absolute territorial protection.⁶¹ Export bans are considered not indispensable and therefore, agreements containing export bans are not eligible for individual exemption.⁶²

According to the Consten-Grundig case⁶³ the application of Article 81(3) shall be determined taking account of the spirit of Article 81. The question of

⁵³ Case 56/65, *Société Technique Minière v Maschinenbau Ulm GmbH* [1966] ECR 235, 249 et seq.

⁵⁴ Commission Decision *Junghans*. [1977] OJ L30/10. p.16 para 37.

⁵⁵ Commission Decision *Gosme/Martell - DMP*. [1991] OJ L185/23. p.28 paras 31-32 and Case T-77/92 *Parker Pen Ltd v Commission* [1994] ECR II-549. p.566 para 46.

⁵⁶ Case C-306/96 *Javico International and Javico AG v Yves Saint Laurent Parfums SA (YSLP)* [1998] ECR I-1983. I-1995 para 18.

⁵⁷ Green Paper on Vertical Restraints. p.53. para 181.

⁵⁸ Commission Decision *Junghans*. [1977] OJ L30/10. p.15 paras 28, 29 and 33.

⁵⁹ Commission Decision *Junghans*. [1977] OJ L30/10. p.15 para 33.

⁶⁰ Commission Decision *Johnson & Johnson*. [1980] OJ L377/16. p. 24 para 35.

⁶¹ Commission Decision *Polistil/Arbois*. [1984] OJ L136/9. p.12 paras 40-41. Commission Decision *Gosme/Martell - DMP*. [1991] OJ L185/23. p.29 paras 35-36.

⁶² Commission Decision *Tretorn and others*. [1994] OJ L378/45. p.51 para 72.

⁶³ Joined cases 56 and 58/64. *Établissements Consten S.A R.L. and Grundig-Verkaufs-GmbH v Commission* [1966] ECR 299, 348.

indispensability has to be determined on objective criteria. The improvements have to be noticeable and objective, outweighing the negative effects on competition from the agreement.

Restrictions that do not contribute to the improvement of distribution or any other requirement will not be individually exempted.⁶⁴ Exclusive distribution agreements are likely to be individually exempted because such agreements generally lead to improvement in distribution and facilitate market entry on new markets.⁶⁵ Restrictions that improve the distribution of goods will be considered to be indispensable and therefore likely to be exempted.⁶⁶ Export bans, absolute territorial protection and impairment of parallel trade are measures that will never contribute to improving the distribution of goods and will therefore never be granted an individual exemption.⁶⁷ Resale price maintenance, surveillance of resale prices and protection against infiltration and parallel imports, are not indispensable and will therefore never be individually exempted.⁶⁸ These restrictions are considered to be restrictive by object. Where there are other restrictions on competition and trade between Member States it seems like the efficiencies of such agreements might outweigh the anti-competitive effects from the restrictions in the agreements. A thorough assessment into this question must be undertaken before individual exemption is granted.

Agreements that would otherwise be exempted either individually or block exempted will be prohibited where they are implemented with the object of conferring absolute territorial protection, resale price maintenance or impairment of parallel trade.⁶⁹

According to the *Volk v Vervaeke*-case⁷⁰, Article 81(1) is not applicable to agreements between parties having market shares close to 0% not even where the restrictions imposed are absolute territorial protection, resale price maintenance or impairment of parallel trade.⁷¹

⁶⁴ Commission Decision *Johnson & Johnson*. [1980] OJ L377/16. p. 25 para 37.

⁶⁵ Commission Decision *Hennessey - Henkell*. [1980] OJ L383/11. p.16 para 27.

⁶⁶ Commission Decision *Junghans*. [1977] OJ L30/10. p.16 para 36.

⁶⁷ Commission Decision *Polistil/Arbois*. [1984] OJ L136/9. p.14 para 58. Commission Decision *Gosme/Martell - DMP*. [1991] OJ L185/23. p.29 para 40 and Commission Decision *Tretorn and others*. [1994] OJ L378/45. p.51 para 72.

⁶⁸ Commission Decision *Hennessey - Henkell*. [1980] OJ L383/11. p.16 para 32 and p.17 para 34.

⁶⁹ *Faull, J and Nikpay, A*. p.462.

⁷⁰ Case 5/69 *Volk v Vervaeke*, [1969] ECR 295.

⁷¹ *Faull, J and Nikpay, A*. p.442.

2.5 Economic analysis of vertical restraints.

2.5.1 Introduction.

This section discusses the various ways in which vertical restraints in general are assessed in economic analysis. First, both pro- and anti-competitive aspects are considered, then various aspects of economic analysis of EC competition law are discussed.

Economic analysis and economic theory should be utilised as a source of policy when developing basic policy and rules for the assessment of vertical restraints. It would be too expensive to evaluate each and every case using economic analysis. However, one must not restrict oneself to economic theory when developing such basic policy. There are other aspects to consider as well. Thus, economic theory cannot and should not be the *only* factor in the development of policy.⁷²

Restrictions on competition and integration are considered anti-competitive effects. This section will only discuss restrictions on competition. Restrictions on integration are discussed in chapter 6.

The basic question in economic analysis of competition issues is whether or not the economic efficiencies obtained are able to outweigh the anti-competitive effects of the agreement.

2.5.2 Economic advantages of vertical restraints.

Vertical restraints are said to improve distribution of goods. The economic gains obtainable through enhanced distribution are that goods now are being pulled down the supply chain due to consumer demand instead of being pushed down from above following the needs of production. The undertakings involved save investments.⁷³ There is no longer any need for large areas to store goods since the goods coming in are immediately passed on from the distributor to the retailer.

Another economic efficiency of vertical restraints is the possibility to prevent double marginalisation. Double marginalisation means that in a situation where both the manufacturer and the distributor have market power⁷⁴ they will both set price above marginal cost⁷⁵ and thus the consumer price will be marked up over

⁷² Green Paper on Vertical Restraints. Executive summary p.iv. para 13.

⁷³ Green Paper on Vertical Restraints. Executive summary p.ii. para 7.

⁷⁴ Market power is defined as the possibility to raise price by decreasing output and yet make a profit, i.e. the decrease in sales is lower than the profit made from the increase in price.

⁷⁵ Marginal cost means that the price of the product is only high enough to cover the cost of production for the producer, i.e. the producer makes no profit from selling the produced-unit

marginal cost twice. Where the manufacturer is allowed to impose vertical restraints, there will be increased profit of both the manufacturer and consumer welfare. The measures available in order to prevent double marginalisation are maximum price cap and quantity forcing on the retailer/distributor. These measures would be pro-competitive but would not assure the price being set at a competitive level. Where these restraints are imposed they lead to a restriction of the market power of the retailer/distributor. Where there is effective competition at the retail level there is no need for any vertical restraints since there would be no double marginalisation problem because the retailer would not be able to price above marginal cost.⁷⁶

The single market creates vast opportunities for undertakings in the Member States to enter markets that previous to membership were more or less closed because of government barriers. There are many advantages with operating on foreign markets. But there are also many problems to overcome. For example, entering new markets requires large investments, which is always risky. To facilitate success, producers conclude agreements with local distributors in order to more easily enter the market and overcome these problems. The local distributor knows what the local consumer needs, he knows local laws and he knows how to maximise profit out of the given situation on the local market. The result is more efficient distribution of products including pre- and after-sales support. These competitive measures on behalf of the producer and the distributor will benefit the consumer.⁷⁷ This is the basic reason why vertical restraints often are believed to be pro-competitive.

In order not to forestall the description of the new policy of the Commission and its approach to vertical restraints, I will not go any further into the advantages of vertical restraints.

2.5.3 Economic disadvantages of vertical restraints.

2.5.3.1 Introduction.

This section is primarily taken from the speech by Mr Monti, Commissioner of the European Commission responsible for Competition: “Who will be in the driver’s seat?”⁷⁸ Although the speech merely dealt with the special block exemption

in question. Once the producer gains some market power there is a possibility to raise price in order to make a profit.

⁷⁶ Bishop, S and Walker, M. p.89.

⁷⁷ Green Paper on Vertical Restraints. Executive summary p.i. para 2.

⁷⁸ Competition Policy Newsletter. Number 2 June 2000. Speech “Who will be in the driver’s seat?” Delivered at “Forum Europe Conference” on 11 May 2000, Brussels.

regulation concerning motor vehicle distribution and servicing agreements,⁷⁹ the speech was delivered with a view to explain the considerations to be taken by the Commission when modifying the regulation when it expires in September 2002.⁸⁰ The disadvantages referred to by Mr Monti are useful to this discussion not only because they are recognised in the literature, but also because they are empirically established by inquiries of the Commission as described infra.

2.5.3.2 Disadvantages of vertical restraints.

The Commission has concluded that manufacturers now turn to the distribution sector to rationalise because of cost savings from suppliers. The number of dealers is reduced.⁸¹ Where the number of market incumbents decreases, there will be less competition on that market. The reduction of distributors is made with the help of e.g. exclusive distribution agreements or selective distribution agreements. Where the exclusive territory covers the entire Member State and where such agreements are concluded with distributors in all Member States the maximum number of distributors on the common market is currently 15. This might benefit the manufacturer who only has to supply one distributor in each Member State and is able to grasp the benefits of economies of scale by making few but large supplies. However, where the distributor faces no national competition and the extent of cross-border trade by independent traders is limited, there are great opportunities for the distributor to increase prices to the detriment of consumers.

E-commerce has increased the possibility for consumers to seek purchases outside their ordinary geographic market.⁸² I believe that this is most welcome from an integration point of view, because this disarms the impact of restrictions on active sales into other exclusive territories. Because of this increased possibility of purchase from other areas than the domestic, manufacturers and exclusive distributors will take measures to stop this trade. It is important to safeguard this parallel trade by consumers and counteract all measures by manufacturers to stop this trade.

The motor vehicle market is an oligopolistic market. Where most products are distributed through exclusive distribution or selective distribution systems the effects of the oligopoly is aggravated. It is also important to maintain competition at the level of manufacturers, i.e. interbrand competition.⁸³ As I stated above, where the number of market operators is reduced there will be less competition

⁷⁹ Commission Regulation 1475/95 on the application of Article 85(3) [now Article 81(3)] of the Treaty to certain categories of motor vehicle distribution and servicing agreements (Motor Vehicle Distribution Block Exemption Regulation) [1995] OJ L145/25.

⁸⁰ Competition Policy Newsletter. Number 2 June 2000. p.1.

⁸¹ Competition Policy Newsletter. Number 2 June 2000. p.2.

⁸² Competition Policy Newsletter. Number 2 June 2000. p.2.

⁸³ Competition Policy Newsletter. Number 2 June 2000. p.3.

and prices will increase. Another important aspect is that not only will prices rise but also the general benefit to consumers from effective competition, e.g. increased and better service, higher quality etc., will decrease. The concerns of the oligopolistic market situation hold true on many markets today, thus not only the motor vehicle market.

Another important disadvantage from vertical restraints is reduced intrabrand competition. Distributors are restricted in their intrabrand competitive activities. The incentives to engage in price competition are reduced by various measures by the manufacturer, e.g. by giving large and small dealers the same margin, by allocation of exclusive sales territories, by exclusion of independent resellers and by banning certain types of active marketing. These measures restrict the distributors from developing their own market strategies.⁸⁴ Notwithstanding, the measures are explicitly permitted by the block exemption regulation. Despite the fact that these measures might be permitted by the block exemption regulation, I believe that they have such large impact on both competition and trade between Member States that they should not be per se legal. There should be a case-by-case analysis where agreements contain these measures.

Intrabrand competition between Member States is limited through various measures by manufacturers. Agreements concluded with distributors contain sales targets in the exclusive territory. These targets focus on national sales since exclusive territories are most often equal to the entire Member State. The supply to the distributor is often based on these targets. Thus, there is little room for response to parallel trade-requests. Should the distributor engage in parallel trade the amount of supply would not suffice to cover national demand. Furthermore, the manufacturer is often able to terminate the agreement with short notice. Because of the short period of time, distributors are not willing to risk their business-relationship with the manufacturer because there would not be any other manufacturer ready to supply that distributor once the first agreement is terminated. All manufacturers on the market will already have exclusive distribution agreement covering that territory. The result will be that the distributor would have to go out of business or entrust its future existence wholly to parallel imports.⁸⁵ This fear of spoiling long-lasting business-relationships is confirmed in the Green Paper where it is stated that this fear prevents private undertakings from taking advantage of the opportunities from parallel trade. The profits from parallel trade are lower because of the introduction of IT and the co-operation in supply. Manufacturers can more easily trace parallel trade and therefore distributors often refer purchasers to the domestic distributor. It is thus no surprise that parallel trade is not attractive.⁸⁶

⁸⁴ Competition Policy Newsletter. Number 2 June 2000. p.3.

⁸⁵ Competition Policy Newsletter. Number 2 June 2000. p.3.

⁸⁶ Green Paper on Vertical Restraints. Executive summary p. ix. para 35 et seq.

Finally I would like to mention some of the disadvantages of vertical restraints as mentioned by the Commission in the Green Paper.⁸⁷ The Commission puts emphasis in the existence of intrabrand competition remaining on the market. Intrabrand competition might be restricted or eliminated by resale price maintenance and/or territorial exclusivity imposed in agreements. Resale price maintenance also enables manufacturers to collude on price. Furthermore, vertical restraints might prevent new market entry. In short this is called market foreclosure. For this effect to occur there has to be entry barriers on the market limiting the number of market incumbents. In oligopolistic markets there is also a risk of reduction of interbrand competition. According to the prisoners dilemma-principle there will be no incentives for any of the market operators on such a market to lower their prices since the rest will soon follow and eliminate the possible sales increase from the price reduction. Thus the conclusion is that vertical restraints might reduce both interbrand and intrabrand competition.

The Commission also points out that vertical restraints provide for partitioning of the market and exclusion of new entrants that would otherwise increase competition on the market and decrease the level of prices. As long as there are price differences between the Member States, there are many incentives that both prevent and encourage market operators from entering new markets.⁸⁸

2.5.4 The economic analysis.

Economic analysis as a tool to assess the facts in competition law cases is becoming more and more frequently applied. The concepts of competition law, e.g. competition, monopoly, oligopoly and entry barriers are all economic concepts. The arguments of economics can be applied in support of both pro- and anti-competitive considerations.⁸⁹

There are two objectives of EC competition law. The first goal is integration⁹⁰, which seeks the promotion of integration between Member States. The Commission has previously shown hostility towards agreements preventing or hindering trade between Member States. Second, there is the economic goal, i.e. the promotion of effective and undistorted competition. The wording of Article 81(1) provides for the pursuit of the economic goal, i.e. prohibitions of agreements "...which have as their object or effect the prevention, restriction or distortion of competition within the common market." Article 81(1) also provides

⁸⁷ Green Paper on Vertical Restraints. pp.18-20. paras 57-64.

⁸⁸ Green Paper on Vertical Restraints. Executive summary p.i. para 2.

⁸⁹ Bishop, S and Walker, M. p.2.

⁹⁰ The integration goal is established in Article 2 of the Treaty stating that "The Community shall have as its task, by establishing a common market and progressively approximating the economic policies of Member States, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, an accelerated raising of the standard of living and closer relations between the States belonging to it."

for the pursuit of the integration goal by the prohibitions of restrictions on trade between Member States. These two goals pursue different results. That is why it is possible to state that there is a fundamental difference between EC competition law and U.S. Antitrust law for instance.⁹¹

Economists have criticised the block exemption policy arguing that there has been too much focus on clauses in stead of the economic impact of the entire agreement. The result has been that agreements meeting the requirements of the block exemption regulation are exempted irrespective of the economic impact of the agreement and agreements having pro-competitive effects have not been exempted because of the agreement not meeting the requirements of the regulation.⁹² One has to keep in mind that in order to benefit from the block exemption regulation the agreement also has to meet the conditions of Article 81(3). That is perhaps why some agreements are not exempted. Furthermore, case law⁹³ provides for the focus on clauses by the principle applicable under Article 81(1) that once the object of the agreement is established there is no need to consider the effect.

According to economics, an undertaking needs market power in order to affect competition. Thus, the existence of market power on behalf of the undertaking determines the question of pro- or anti-competitive effects. The result of the assessment of an agreement might be that the agreement provides for both pro- and anti-competitive effects.⁹⁴

One situation where vertical restraints are pro-competitive is the situation where the undertakings involved in a vertical relationship produce complementary products. Each party wants the other to lower its prices. This will result in lower prices to consumers and improvement of consumer welfare.⁹⁵

Economic analysis has turned from considering vertical restraints as either per se illegal or per se legal. Now economic analysis proposes a case-by-case assessment. Market structure is an important notion to consider in this assessment. Fierce interbrand competition will lead to pro-competitive effects and efficiency effects.⁹⁶ Insufficient interbrand competition will generate competition concerns.⁹⁷ Vertical restraints will result in profits for the parties involved. Only where these parties face sufficient competition on the market will they pass on

⁹¹ Bishop, S and Walker, M. pp.3-5.

⁹² Bishop, S and Walker, M. p.77.

⁹³ Joined cases 56 and 58/64. *Établissements Consten S.A R.L. and Grundig-Verkaufs-GmbH v Commission* [1966] ECR 299, 342.

⁹⁴ Bishop, S and Walker, M. p.77 et seq.

⁹⁵ Bishop, S and Walker, M. p.87 et seq.

⁹⁶ Green Paper on Vertical Restraints. p.17 et seq. para 54. See also Executive summary p.iii. para 10 et seq.

⁹⁷ Green Paper on Vertical Restraints. p.17 et seq. para 54. See also Competition Policy Newsletter. No 2 June 1998. The Economics of Verticals. Luc Peepkorn. p. 10.

these profits to consumers in the shape of lower prices or improved service, technology etc. just as required by Article 81(3).

Luc Peeperkorn holds in relation to this that because economic analysis only takes account of the economic aspects of a given situation, it recognises several economic efficiencies from vertical restraints. First, vertical restraints prevent free riders, but only where the product is new or technically complex and of reasonably high value.⁹⁸ Second, one must also distinguish between what is efficient from a total welfare point of view and such that is privately efficient. This means that improved pre-sales service will increase sales but at the same time this improvement will raise prices.⁹⁹ Third, vertical restraints might be used in order to solve the certification free-rider problem. The duration of the agreement has to be limited in order to prevent the agreement from unduly delay large-scale dissemination.¹⁰⁰ Finally, the hold-up problem is solved. The investor, the distributor, is protected so as to recoup his investment.¹⁰¹ In conclusion, economics requires that once interbrand competition is reduced the competition law authority shall intervene. Thus, it is only necessary to limit the restrictions imposed by vertical restraints where interbrand competition is reduced. Vertical restraints are, however, also necessary to realise efficiencies and to help market entry. Thus, economics states that vertical restraints should only be permitted for "...a limited duration which help the introduction of new complex products."¹⁰²

It has become obvious from my description of economic analysis that the analysis is inadequate in order to exercise a sufficient assessment of the impact of an agreement on both competition and market integration, as required under EC competition law. Economic analysis focuses solely on the question of competition, i.e. the economic goal. EC competition law is furthermore concerned with the promotion of market integration. Economic analysis does not put emphasise on this issue. As I stated in the beginning of this section, economic analysis is useful and necessary in order to establish a competition law policy but not sufficient in order to make a complete assessment of both the economic- and integration-aspects of the agreement.

⁹⁸ Competition Policy Newsletter. Number 2 June 1998. Luc Peeperkorn. p. 14. See also Green Paper on Vertical Restraints. p.39 para 128.

⁹⁹ Competition Policy Newsletter. Number 2 June 1998. Luc Peeperkorn. p. 15.

Compare with the arguing that exclusive distribution forces an entire package on the consumer, making him pay for service he does not require or use.

¹⁰⁰ Competition Policy Newsletter. Number 2 June 1998. Luc Peeperkorn. p. 15.

¹⁰¹ Competition Policy Newsletter. Number 2 June 1998. Luc Peeperkorn. p. 15.

¹⁰² Competition Policy Newsletter. Number 2 June 1998. Luc Peeperkorn. p. 17.

3 The new Commission policy on vertical restraints.

3.1 Introduction.

This chapter deals with the new policy on vertical restraints on behalf of the Commission and discusses the Green Paper on vertical restraints, the Commission Guidelines on Vertical Restraints and the new block exemption regulation 2790/1999.

3.2 The Green Paper on Vertical Restraints.

The Green Paper is important as a starting point. It was published in order for the Commission to obtain comments from market operators giving the Commission useful information about the thoughts of “the market”.¹⁰³

Due to various complaints about the Commissions policy on vertical restraints, it investigated whether or not there should be a policy change. The Green Paper consists of two basic parts. There is first a general explanation of the policy on vertical restraints as outlined in case law and regulations. Second, there are various options from which the Commission considers the policy can develop. The Commission encouraged interested parties to comment on the statements of the Commission in order for it to continue its work towards a policy change.

The Green Paper deals with the various aspects of vertical restraints, both pro- and anti-competitive aspects. The pro-competitive effects being facilitation of market penetration (facilitation of market integration) and minimising of the risks for the investments and time required for market entry (increase of efficiency). The Commission emphasises the anti-competitive effects from vertical restraints as well, i.e. market partitioning (reduced integration) and exclusion of new entry (reduced competition).¹⁰⁴

There were several reasons for the review of the policy towards vertical restraints according to the Commission. The single market was in place. The existing block

¹⁰³ Although the comments of the market, or rather the industry, are not referred to in this thesis, it is interesting to know that market operators having large market shares did not consider that there were any problems from the point of view of market integration. On the other hand, small and medium sized undertakings complained about the reluctance of large undertakings towards parallel trade and passive sale.

¹⁰⁴ Green Paper on Vertical Restraints. Executive summary p. i. paras 1-2. See also Competition Policy Newsletter. Number 3 Volume 2 autumn/end 1996. Commission adopts Green Paper on vertical restraints in EU competition policy. Luc Peeperkorn. p.10.

exemption regulations were about to expire. The methods of distribution had changed. The experience from economics was that there should be more emphasis on market structure in the assessment.¹⁰⁵ Furthermore, retail-markets were still national, and parallel and cross-border trade were also insufficient. This required promotion of integration by explicitly permitting vertical restraints that encourage integration.¹⁰⁶

Since the Green Paper is merely an initiative by the Commission to initiate a dialogue in order to modify the policy towards vertical restraints, it does not make any statements on the importance paid to integration or efficiencies except for what is referred to above.

3.3 Commission Guidelines on Vertical Restraints.

3.3.1 Introduction.

The Commission published the Guidelines on Vertical Restraints in order to enhance legal certainty on behalf of undertakings engaged in vertical agreements that need to know whether or not their agreements were going to be block exempted. The reasoning of the Commission is referred to *infra*.

3.3.2 The Guidelines.

The background of the Guidelines is found in the gigantic backlog of cases of the Commission compelling it, more or less, to issue block exemption regulations. The block exemption regulations would serve no purpose if the undertakings needing exemptions were to notify each and every agreement concluded in order to benefit from the regulation. Thus, there is no obligation to notify agreements in order to benefit from a block exemption regulation. In order for the undertakings concerned to more easily assess whether or not their agreements will be block exempted the Commission issued these Guidelines. The Commission states that the standards of the Guidelines have to be applied on a case-by-case basis, i.e. the Guidelines must not be applied mechanically. The Commission shall apply the Guidelines "...reasonably and flexibly."¹⁰⁷

The first important aspect according to the Commission is whether or not there is insufficient interbrand competition. Where interbrand competition is insufficient, it

¹⁰⁵ Green Paper on Vertical Restraints. p.2. para 7. See also Competition Policy Newsletter. Number 3 Volume 2 autumn/end 1996. Luc Peepkorn. p.10.

¹⁰⁶ Green Paper on Vertical Restraints. Executive summary p. iii. para 9 and Executive summary p. ix. para 36. See also Competition Policy Newsletter. Number 3 Volume 2 autumn/end 1996. Luc Peepkorn. p.10.

¹⁰⁷ Commission Guidelines on Vertical Restraints. [2000] OJ C291/3, para 3.

is even more important to protect both interbrand and intrabrand competition.¹⁰⁸ Vertical restraints will be assessed taking account of their economic and legal context. This is especially important since one of the objectives of EC competition law is to protect competition since efficient competition improves consumer welfare and creates efficient allocation of resources. There is an exception to this general principle, which is also mentioned in Article 4 of the block exemption regulation 2790/99. Where the restrictions mentioned therein are implemented in the agreement the Commission will assess the economic effects and context of the agreement. In addition, market integration is also an important objective for two reasons. First, it enhances competition in the Community. Second, barriers to trade between Member States raised by private undertakings or persons should not be permitted where they have been removed following the single market pursuit.¹⁰⁹ The Commission emphasises both the economic goal and the integration goal.

The Commission assumes that Article 81(1) does not apply to agreements between undertakings whose market shares do not exceed 10%. On the other hand, where the market shares exceed 10% there will be no presumption of infringement of Article 81(1). It must not be assumed that such agreements will fulfil the condition of appreciability. Such agreements will be assessed in their legal and economic context.¹¹⁰ The regulation will apply to agreements between parties whose market shares do not exceed 30%.¹¹¹ Where the market share level is below 10% the effect of the agreement is assumed not to be appreciable.

The basic approach of the Commission in individual cases is that vertical restraints are generally less harmful to competition than horizontal agreements. In vertical relationships, the output of one party is the input of the other. The parties will thus induce each other to lower prices. In a situation where both parties have market power, the vertical restriction will not enable the parties to make any profit. On the other hand, where there is not market power the result could be different.¹¹² The Commission still recognises four different negative effects of vertical restraints. The first is called the single branding group. Single branding means that the distributor/buyer will only sell the products of one supplier, e.g. exclusive distribution and exclusive customer allocation. This would lead to restriction on instore competition, i.e. interbrand competition. The negative effects as seen by the Commission are inter alia market foreclosure and facilitation of collusion.¹¹³ The reduction of interbrand competition is somewhat dampened by the initial phase of competition between suppliers to win the exclusive right to sell in-store. This competitive phase does not suffice to outweigh the longer restriction on

¹⁰⁸ Commission Guidelines on Vertical Restraints. [2000] OJ C291/3, para 6 and [2000] OJ C291/21, para 102.

¹⁰⁹ Commission Guidelines on Vertical Restraints. [2000] OJ C291/3, para 7.

¹¹⁰ Commission Guidelines on Vertical Restraints. [2000] OJ C291/4, para 9.

¹¹¹ Commission Guidelines on Vertical Restraints. [2000] OJ C291/6, para 21.

¹¹² Commission Guidelines on Vertical Restraints. [2000] OJ C291/20, para 100 et seq.

¹¹³ Commission Guidelines on Vertical Restraints. [2000] OJ C291/21, para 106 et seq.

competition.¹¹⁴ In relation to the single branding group, the Commission emphasises the importance of maintained market integration and the pursuit thereof. The Commission states the same with respect to the limited distribution group mentioned *infra*.

The second group is the limited distribution group. Limited distribution means that the manufacturer will sell only to a limited number of buyers. Such restrictions are found in exclusive distribution agreements.¹¹⁵ These restrictions lead to market foreclosure and they also facilitate collusion. The result will be reduced intrabrand competition, i.e. competition between distributors/sellers of the same brand.¹¹⁶ The third group is resale price maintenance group, i.e. "...agreements whose main element is that the buyer is obliged or induced to resell not below a certain price, at a certain price or not above a certain price." Such restrictions might lead to reduced intrabrand price competition and increased transparency on prices.¹¹⁷ These measures, according to Peeperkorn, facilitate market partitioning and leads to lack of integration.¹¹⁸ The importance paid to maintenance of interbrand and intrabrand competition and the importance to counteract market partitioning shows that the Commission still values the pursuit of integration in EC competition law.

The fourth group is the market partitioning group. This means restrictions on where the buyer/distributor may purchase or resell the contract goods, e.g. territorial resale restrictions, restrictions on the location of a distributor and customer resale restrictions. The negative effects of such restrictions are reduced intrabrand competition facilitating market partitioning. The restrictions will therefore restrict market integration.¹¹⁹

The Commission states some general rules of assessment from a competition policy perspective. The first rule states that there will be competitive concerns where there is insufficient interbrand competition. The extent of interbrand competition depends on the degree of market power. Restrictions on interbrand competition are considered as more harmful than restrictions on intrabrand competition. The second rule states that exclusive dealing agreements are more harmful to competition than non-exclusive agreements. The third rule states that restrictions introduced for non-branded goods are less harmful than those for branded goods. The final rule states that combinations of vertical restraints can be

¹¹⁴ Commission Guidelines on Vertical Restraints. [2000] OJ C291/21, para 108. See also Competition Policy Newsletter. Number 2 June 1998. Luc Peeperkorn. p. 12.

¹¹⁵ Commission Guidelines on Vertical Restraints. [2000] OJ C291/21, para 109.

¹¹⁶ Commission Guidelines on Vertical Restraints. [2000] OJ C291/22, para 110. See also Competition Policy Newsletter. Number 2 June 1998. Luc Peeperkorn. p. 12.

¹¹⁷ Commission Guidelines on Vertical Restraints. [2000] OJ C291/22, para 111 et seq.

¹¹⁸ Competition Policy Newsletter. Number 2 June 1998. Luc Peeperkorn. p. 12 et seq.

¹¹⁹ Commission Guidelines on Vertical Restraints. [2000] OJ C291/21, para 113. See also Competition Policy Newsletter. Number 2 June 1998. Luc Peeperkorn. p. 13.

both more pro- and more anti-competitive in relation to the single restraint viewed in isolation.¹²⁰

The Commission policy on exclusive distribution agreements basically states that such agreements reduce intrabrand competition and contribute to market partitioning. This could facilitate price discrimination. The block exemption regulation exempts such agreements in combination with selective distribution only where active selling into another exclusive territory is not restricted or prohibited. The pro-competitive effects of exclusive distribution in combination with single branding are that the distributor will focus his efforts on that particular brand. That is why exclusive distribution in combination with non-compete obligations will be exempted as long as there are no foreclosure effect. There has to be real efficiencies in order for the agreement to be exempted where the agreement reduces intrabrand competition. Furthermore, there will be no foreclosure as long as the exclusive distribution agreement is not combined with single branding. On the other hand, if the market is national in scope and the exclusive distributor is the sole distributor there will be competitive concerns from the point of view of foreclosure. Exclusive distribution and exclusive purchasing might lead to market partitioning. In this case there will be restriction of intrabrand competition and the Commission will not exempt such agreements where the market share exceeds 30%.¹²¹

Considering the four groups of restrictions from vertical restraints as recognised by the Commission in the Guidelines it becomes important that the approach is influenced by the case law on vertical restraints where absolute territorial protection, resale price maintenance and impairment of parallel trade are restrictions that are considered per se illegal. The joint characteristic of the four groups is the importance paid both to restrictions on competition, i.e. both intrabrand and interbrand competition, as well as restrictions on integration such as market foreclosure and market partitioning. It is important and welcome that the Commission persist in making this distinction separating EC competition law from other competition law statutes. The Commission points out that it is aware of that exclusive distribution might reduce intrabrand competition and contribute to market partitioning. In order for exclusive distribution agreements to be exempted the Commission requires real efficiencies to occur. From this it is possible to conclude that the economic goal and the integration goal are equally important and that under some circumstances there are no efficiencies whatsoever enabling exemption of restrictions on integration. Furthermore, merely by emphasising the four different groups the Commission shows that it is aware of the negative effects on market integration by vertical restraints.

¹²⁰ Commission Guidelines on Vertical Restraints. [2000] OJ C291/24-25, para 119.

¹²¹ Commission Guidelines on Vertical Restraints. [2000] OJ C291/33, paras 161-172.

3.4 Block Exemption Regulation 2790/99.

3.4.1 Introduction.

This section presents the reasoning of the exemption policy incorporated in the new block exemption regulation. There will be a dogmatic description of the recitals since that is where the Commission makes its policy statements. The recitals and the articles of the regulation are also dealt with in chapters 5 and 6.

3.4.2 The new Commission policy in regulation 2790/99.

In the recitals to the regulation the Commission sets out the most important considerations leading to the new regulation. This regulation has to be considered as a new approach towards vertical restraints. The recitals have to be considered as part of the regulation although they are not numbered with articles.

The Commission states that it is "...possible to define a category of vertical agreements which can be regarded as normally satisfying the conditions laid down in Article 81(3)."¹²² When the Commission makes individual exemptions it will take account of the market structure on both supply and purchase side.¹²³ The agreement still has to be compatible with Article 81(3) in order to be block exempted.¹²⁴ The most important pro-competitive effect of vertical restraints is the improvement of economic efficiency within a chain of production or distribution.¹²⁵ Whether or not the economic efficiencies will outweigh the anti-competitive effects of the agreement depends on the degree of market power of the parties. The market power depends on the degree of competition from other suppliers, manufacturers and distributors supplying substitutable products.¹²⁶ The Commission assumes that, where the market shares do not exceed 30% and there are no specific severely anti-competitive restraints included in the agreement, the agreement will improve production and/or distribution to the benefit of consumers.¹²⁷ The Commission points out restrictions that shall be considered as not indispensable. These are minimum and fixed resale-prices, resale price maintenance and certain types of territorial protection. Not indispensable restrictions will preclude the application of the regulation to that particular agreement, irrespective of the market share.¹²⁸ The Commission shall be able to withdraw the benefit of the regulation where one of the parties to the agreement have significant market power or where the cumulative effects of a

¹²² Commission Regulation 2790/99. Recital 2.

¹²³ Commission Regulation 2790/99. Recital 4.

¹²⁴ Commission Regulation 2790/99. Recital 5.

¹²⁵ Commission Regulation 2790/99. Recital 6.

¹²⁶ Commission Regulation 2790/99. Recital 7.

¹²⁷ Commission Regulation 2790/99. Recital 8.

¹²⁸ Commission Regulation 2790/99. Recital 10.

network of similar agreements restrict access to a relevant market or the competition on that relevant market. However, the power to withdraw is limited to cases where the agreements create effects that are incompatible with Article 81(3).¹²⁹

¹²⁹ Commission Regulation 2790/99. Recital 13.

4 The notion of “efficiencies”.

4.1 Introduction.

This chapter describes the importance paid to efficiencies in Article 81 and in the literature. It also describes the importance paid to efficiencies by the Commission in its various publications, i.e. the Green Paper on Vertical Restraints, the Guidelines on Vertical Restraints and regulation 2790/99.

4.2 Efficiencies as evinced in Article 81.

4.2.1 Introduction.

This section briefly describes efficiencies as they are evinced and recognised in Article 81 of the EC Treaty. The brief analysis of the provisions of Article 81 is my own.

4.2.2 Efficiencies and Article 81.

Article 81 provides:¹³⁰

1. The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their *object or effect the prevention, restriction or distortion of competition* within the common market, and in particular those which:
 - (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
 - (b) limit or control production, markets, technical development, or investment;
 - (c) share markets or sources of supply;
 - (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
 - (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligation which, by their nature or according to commercial usage, have no connection with the subject of such contracts.
2. (Any agreement or decisions prohibited pursuant to this Article shall be automatically void.)
3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:
 - any agreement or category of agreements between undertakings;
 - any decision or category of decisions by associations of undertakings;
 - any concerted practice or category of concerted practices,

which *contributes to improving the production or distribution of goods or to promoting technical or economic progress*, while allowing consumers a fair share of the resulting benefit, and which does not:

¹³⁰ My italics.

- (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
- (b) afford such undertakings the possibility of *eliminating competition* in respect of a substantial part of the products in question.

The wording of Article 81(1) provides for the pursuit of the economic goal, i.e. prohibitions of agreements "...which have as their object or effect the prevention, restriction or distortion of competition within the common market." The economic goal intends to maintain effective *competition* on the common market.

Article 81(3) recognises the importance of economic efficiencies in order for the agreement to be individually exempted. The conditions being that the agreement either improve the production or distribution of goods or promote technical or economic progress. The improvement and promotion shall benefit the general consumer and not only the parties to the agreement. The extent of the restriction permitted is limited to what is indispensable to the attainment of the objectives of the agreement.

It is important to stress that the economic goal and the notion of economic efficiencies are two different concepts. The economic goal means that EC competition law seeks to maintain competition on the common market. On the other hand, economic efficiencies are the result of an agreement. These results are invoked in order to justify restrictions of the economic goal and the integration goal.

Economic efficiencies come in various shapes. These are discussed *infra* in the remainder of this chapter.

4.3 Efficiencies as evinced in the literature.

4.3.1 Introduction.

This section mentions the various shapes of efficiencies discussed in the literature. The discussion will focus on the assessment under Article 81(3).

4.3.2 Efficiencies in the literature.

Article 81(3) applies to agreements that produce net effects to competition that are beneficial to welfare in general. The net effects required are economic in nature. Where the restrictions infringe the single market objective or risk the competitive process on the market, the agreement will not be considered as

fulfilling the conditions of Article 81(3). Examples of such restrictions are price fixing, quota setting and market sharing.¹³¹

The improvement of the production of goods as required in Article 81(3) is constituted in various ways. For instance, efficiencies and cost reduction will benefit European economy. The introduction of new products on the market will increase and improve quality and choice of goods. Article 81(3) also requires that the agreement improve the distribution of goods. For instance, agreements granting exclusive territories, such as exclusive distribution and -purchasing. These agreements reduce costs and risks of both parties who will increase their marketing efforts.¹³² Article 81(3) further requires that the agreements promote technical progress, such as technical advances and dissemination of existing technology or improvement of safety and consumer protection.¹³³ Finally, Article 81(3) requires that the agreement promote economic progress e.g. rationalisation and cost reduction or improvement of financial systems and co-operation between financial operators in order to facilitate cross-border movement of payments.¹³⁴ The efficiencies thus obtained shall come to the benefit of consumers, i.e. not only consumers covered by the exclusive territory but rather consumers throughout the Community. This depends on the fact that the competition shall be determined with respect to the relevant market. The relevant market often is assessed to be larger than the contract territory.¹³⁵

Vertical restraints are also useful in order to solve problems of economical nature. One example is the free rider problem with respect to pre-sales service. The manufacturer needs to assure the distributor that there will be no other distributor selling the contract goods without offering pre-sales service enabling that distributor to lower its prices and increase its sales. In order to obtain this, the manufacturer must be able to limit the number of distributors in a given territory and the distributor needs some protection granted by the manufacturer. This is solved by vertical restrictions in agreements. Another problem solved using vertical restraints is the problem of free riding where the manufacturer invests in training of the staff in order to improve their selling skills. Since this training will increase the sales of the manufacturer's goods but also competing goods sold in the store there will be little incentives for manufacturers to invest in staff training. The manufacturer is therefore permitted to prohibit the distributor from selling competing goods in order to solve this problem. Exclusive distribution agreements can be used as a way to solve this problem. The result of these measures is that the necessary investments are made but the measures will also reduce instore interbrand competition. These measures will restrict market integration and the free movement of goods between Member States, i.e. the market integration

¹³¹ Faull, J and Nikpay, A. p.103.

¹³² Faull, J and Nikpay, A. pp.104-106.

¹³³ Faull, J and Nikpay, A. p.107 et seq.

¹³⁴ Faull, J and Nikpay, A. p.109 et seq.

¹³⁵ Faull, J and Nikpay, A. p.110 et seq.

objective is infringed.¹³⁶ The benefit to consumers is however considered to outweigh this restriction. That is why exclusive distribution agreements are granted exemption from the prohibition in Article 81(1).

In conclusion, it is possible to say that the economic efficiencies obtainable through vertical restraints are useful and often necessary to promote both competition *and* integration.

As far as the importance of economic efficiencies is concerned there is a distinction between the advocates of the rule of reason approach and the more legalistic approach. The former group advocates the benefit of exemption to any agreement promoting competition, e.g. Bishop and Walker, while the latter emphasises the market integration goal as well. This will be discussed further in 6.3.

4.4 Efficiencies as evinced in the Green Paper.

4.4.1 Introduction.

This section deals with the discussion of the Commission on the notion of efficiencies in the Green Paper and the importance paid to it. The various shapes of efficiencies as recognised by the Commission are also mentioned. The two basic economic efficiency gains from vertical restraints are also explained.

4.4.2 Efficiencies in the Green Paper.

Considering the background of the Green Paper and why it was published it is necessary to refer the view of the Commission in relation to efficiencies. In short, the Commission emphasises the importance of vertical restraints and the economic efficiencies provided by such restraints in the Green Paper. The Commission enumerates several reasons for the need for efficiencies.

The Commission *inter alia* emphasises that manufacturers, in order to obtain economic efficiencies from market integration, need a chain of distribution in order to obtain *efficient* distribution. By limiting the number of distributors in a territory and by concluding agreements with local distributors, the manufacturer obtains economies of scale since the local distributor being granted a large territory takes care of the furthered distribution of the contract goods. The manufacturer only makes one delivery and with the help of the distributor reaches numerous consumers. The local distributor is specialised in distribution and facilitates market entry on behalf of the manufacturer since the distributor has the necessary

¹³⁶ Bishop, S and Walker, M. p.91 et seq.

knowledge of the local market.¹³⁷ Because of efficiency gains due to reduced transport time, retailers now obtain the goods directly from the producer and the role of the wholesaler has become less important.¹³⁸ This is another reason why large distribution chains have become even more important on the distribution market.

Another important benefit from vertical restraints emphasised by the Commission is that vertical restraints reduce transaction costs between the manufacturer and the distributor. They make profit from this co-ordination and this profit is hopefully passed on to consumers by lower prices.¹³⁹

4.5 Efficiencies as evinced in the Guidelines.

4.5.1 Introduction.

This section deals with the discussion of the Commission in the Guidelines to Vertical Restraints with respect to efficiencies and the positive effects mentioned. The Guidelines only provide for an explanation of the interpretation of the block exemption regulation. The Commission does not make any statements therein on the importance to be paid to the positive effects mentioned.

4.5.2 The Guidelines.

First, the Commission recognises that vertical restraints promote non-price competition and quality of service. The pro-competitive and anti-competitive aspects of this have been discussed above in 4.3.2. Second, vertical restraints are used in order to solve free rider problems. This problem has an economic characteristic. Where it is solved there will be economic efficiencies obtainable from the restraint and depending on the measures used there will or will not be restrictions on integration. Third, vertical restraints facilitate market entry. The rationale has been dealt with above. Where the manufacturer wants to enter a new market, vertical restraints are a useful tool to facilitate such entry. Fourth, the Commission also recognises the certification free rider issue, meaning that where the manufacturer is to successfully introduce a new product on the market it is necessary to limit the number of places of sale. Those places of sale shall have a reputation of high quality and high price. This image will influence the reputation of the products sold there. Fifth, the Commission furthermore recognises the possibility to solve hold-up problems, i.e. this problem occurs where the investment undertaken by one contract party can only be used with respect to that specific contract goods. After termination of agreement, the investment can only

¹³⁷ Green Paper on Vertical Restraints. p.1. para 2.

¹³⁸ Green Paper on Vertical Restraints. pp.6-8. paras 20-29.

¹³⁹ Green Paper on Vertical Restraints.p.17 et seq. para 56.

be disposed of with significant loss. Vertical restraints can be used in order to allow the investing party to recoup the investment. Finally, the Commission recognises the fact that vertical restraints can be used in order to obtain benefits from economies of scale in distribution. By supplying few distributors covering large territories the manufacturer can supply many consumers by a few large occasions of supply.¹⁴⁰

The economic efficiencies mentioned might all justify restrictions of both competition and integration. The Commission provides for a useful tool of how to interpret these efficiencies in relation to an agreement.

4.6 Efficiencies as evinced in Regulation 2790/99.

4.6.1 Introduction.

This section deals with the various recitals and articles of regulation 2790/99 where economic efficiencies are considered. As far as the recitals are concerned they are also discussed in 3.4.2. I mention the importance of economic efficiencies as recognised in the regulation.

4.6.2 Efficiencies in the regulation.

The recitals to the old block exemption regulation for exclusive distribution agreements, regulation 1983/83, justified the group exemption policy by stating that exclusive distribution agreements improve distribution by reducing the number of business relations required in order to enter a new market, i.e. they reduce transaction costs. There are also other difficulties with entering new markets that are solved, e.g. linguistic and legal differences. Furthermore, the agreements improve sales and marketing of a product, rationalisation of distribution and they also increase interbrand competition.¹⁴¹ These are the economic efficiencies obtainable through exclusive distribution agreements.

In the new block exemption regulation economic efficiencies are recognised first of all in recital 5 where the Commission states that the regulation shall not apply to agreements not fulfilling the conditions of Article 81(3), meaning that vertical restraints can only be exempted where they show real efficiencies. As stated in 4.2.1. and 4.3.2., Article 81(3) mainly deals with the economic efficiencies from the agreements. The Commission furthermore recognises the economic efficiencies obtainable from vertical restraints¹⁴², e.g. improvement of production

¹⁴⁰ Commission Guidelines on Vertical Restraints. [2000] OJ C291/22-24, para 115.

¹⁴¹ Green Paper on Vertical Restraints. p.36. para 122.

¹⁴² Commission Regulation 2790/99. Recital 6.

or distribution by better co-ordination between the parties including reduction in the transaction and distribution costs and optimisation of sales and levels of investment.

The Commission states that where the market shares of the parties do not exceed 30% the economic efficiencies of the agreement is able to outweigh the anti-competitive effects from the agreement.¹⁴³ I do not think it is possible to assume that it is the opinion of the Commission that once the market share level exceeds 30% the agreement automatically restricts or infringes the integration objective of the Treaty. Nor is competition automatically restricted where the market share exceeds 30% although such large market shares confer great possibilities for the undertaking to affect the market. It is also important to know that where the market share is below 30% the agreement is not automatically pro-competitive. The legality of the agreements depends on the restrictions imposed. As stated above in inter alia the part on case law, agreements conferring absolute territorial protection, resale price maintenance and impairment of parallel trade can never be considered legal no matter how small the market share. Thus, they will never be exempted.

The importance of the agreement providing for economic efficiencies is shown by the possibility of the Commission to withdraw the benefit of the regulation where the agreement does not meet the conditions of Article 81(3).¹⁴⁴ The principle stated by the Commission that in order for the agreement to be exempted it has to provide for real efficiencies is also based on the requirement that the agreement satisfy the conditions of Article 81(3).

¹⁴³ Commission Regulation 2790/99. Recitals 8-9 and Article 3.

¹⁴⁴ Commission Regulation 2790/99. Article 6.

5 The notion of “integration”.

5.1 Introduction.

This chapter describes the importance paid to integration in Article 81 and in the literature. The chapter will furthermore deal with the importance paid to the notion by the Commission in its various publications, i.e. the Green Paper on Vertical Restraints, the Guidelines on Vertical Restraints and regulation 2790/99.

5.2 Integration as evinced in the Treaty.

5.2.1 Introduction.

This section briefly describes the protection of the market integration goal in Article 81 of the EC Treaty.

5.2.2 Integration and Article 81.

Article 81(1) deals with integration by prohibiting agreements that “...may affect trade between Member States...” and which have as their object or effect the prevention, restriction or distortion of competition within the common market. The provision contains examples of restrictions that are prohibited, e.g. restrictions that fix purchase or selling prices or trading conditions, restrictions that limit or control markets or restrictions that share markets. These are all restrictions of integration. Article 81(3) exempts agreements from the prohibition in Article 81(1) except where the agreement contains restrictions that are not indispensable to the attainment of the objectives justifying the exemption. Examples of such restrictions are absolute territorial protection, resale price maintenance and impairment of parallel trade, i.e. restrictions being restrictive by object.¹⁴⁵ Such restrictions can never be granted individual exemption. These measures have at least one thing in common. They restrict market integration.

5.3 Integration as evinced in the literature.

5.3.1 Introduction.

This section describes the debate in the literature on the importance of integration in EC competition law.

¹⁴⁵ Faull, J and Nikpay, A. p.112 et seq.

The importance of integration is almost only emphasised in the literature by writers opposing the development towards economic analysis or an economics based approach of the assessment under Article 81. Therefore, I only refer to these writers in this section.

5.3.2 Integration in the literature.

The notion of integration, i.e. "...trade between Member States...", is mostly concerned with in the context of Community Jurisdiction.¹⁴⁶ But the notion also deals with the impact on trade crossing borders of the Member States.¹⁴⁷

Craig and de Búrca state that EC competition law differs from other competition law statutes. Article 81(3) grants exemption from the prohibition under Article 81(1). U.S. Antitrust rules contain no such provision. Thus, there is greater need for an economic analysis under the prohibition-provision in U.S. Antitrust law in order to prevent all restrictions from being caught.¹⁴⁸ This opinion is supported by Whish¹⁴⁹ who states that "[t]he call for the adoption of a US-style rule of reason should be resisted and, indeed, there is much to be said for dropping this term (and the terms 'ancillary restraint' and 'per se illegality') from EEC antitrust law altogether, on the basis that they do more to confuse than to clarify. EEC competition law requires its own vocabulary, carefully honed to express its own particular tensions...A different reason for abandoning this terminology in EEC competition law is that it invites misleading comparison with antitrust law analysis in the United States... [T]he context of US antitrust law is so dissimilar from that of the EEC that comparative analysis should be undertaken with great caution."¹⁵⁰ Whish¹⁵¹ continues, "It (The Commission) would not uphold price fixing, market sharing, discrimination against Community nationals or the conferment of absolute territorial protection on distributors of licensees except in the most exceptional cases."¹⁵²

The presence of the integration-goal in EC competition law makes it different from other competition law statutes. It is thus important to be careful when applying the reasoning of these statutes with respect to economic analysis in particular. Different terms with respect to competition law developed without the context of integration can only be useful when discussing the competitive aspects. Furthermore, these economic-based terms must not eliminate the importance of integration in the assessment under EC competition law.

¹⁴⁶ It is only where the agreement may affect trade between Member States that Article 81 is applicable and the Commission has jurisdiction. Where that condition is not satisfied the national rules on competition might be applicable in stead.

¹⁴⁷ Faull, J and Nikpay, A. p.96.

¹⁴⁸ Craig, P and de Búrca, G. p.905.

¹⁴⁹ Whish, R. and Sufrin, B. Article 85 and the Rule of Reason, Competition Law. p. 36 et seq.

¹⁵⁰ Craig, P and de Búrca, G. p.906.

¹⁵¹ Whish, R. Competition law. p.235 et seq.

¹⁵² Craig, P and de Búrca, G. p.919.

Faull and Nikpay furthermore states that “The policy issue which needs to be decided is whether the single market is sufficiently well established so that market integration can be downgraded from a primary to a secondary objective of EC competition policy. It is only when this happens that EC competition policy can totally discard its current legalistic form based system for one based on purely economic criteria relating to effects on interbrand competition.”¹⁵³

The conclusion of the opinion of writers is that EC competition law contains an additional objective not pursued by other competition law statutes in the world. Thus, it is dangerous to copy the analysis applied in other competition law statutes. In addition, as long as the market integration within the EU is not complete there must be no abandoning of the market integration objective in EC competition law. I share this opinion.

5.4 Integration as evinced in the Green Paper.

5.4.1 Introduction.

This section describes the discussion of the Commission on the notion of integration in the Green Paper and the importance paid to it. I describe the positive and negative effects of vertical restraints on integration that concern the Commission.

5.4.2 Integration in the Green Paper.

The notion of integration is mentioned very frequently in several aspects of the Green Paper. The Commission especially points out that “The creation of a single market is one of the main objectives of the European Union's competition policy. Whilst great progress has been made further efforts are still necessary if the full economic advantages of integration are to be realised.”¹⁵⁴ This is shown by the fact that from the entry into force of the Treaty in 1958 until the mid 1980's the possible gains from economic integration had not been exhausted. Continued and increased integration is considered to be important since the competition on the common market intends to further strengthen the competitiveness of the undertakings to be able to compete at a global level.¹⁵⁵

The Commission expresses its worries about the lack of integration on the common market especially at the retail level. Many markets are still national in character despite the case law based principle prohibiting restrictions on parallel trade. The Commission is worried about whether the mere possibility to engage in

¹⁵³ Faull, J and Nikpay, A. p.465.

¹⁵⁴ Green Paper on Vertical Restraints. Executive summary p.i. para 1.

¹⁵⁵ Green Paper on Vertical Restraints. p.21. para 70.

parallel trade is sufficient in order to ensure that the positive effects from vertical restraints outweigh the anti-competitive effects thereof.¹⁵⁶

The Commission furthermore states that market integration and the creation of a single market are fundamental political objectives of the EU according to Article 2 of the Treaty. In order to achieve this there has to be a system of undistorted competition following Article 3g.¹⁵⁷ The purposes of the competition rules are "...to safeguard the efficiency of the economic system..." and "...to promote the integration of the national economies so as to establish a single market."¹⁵⁸

The Commission recognises that although parallel trade is still theoretically possible in the common market, modern distribution systems have reduced the scope of parallel trade. The parallel trader has to consider transport, storage capital, administrative costs and delay in supply when returning to the ordinary supplier, when planning to purchase outside the ordinary distribution chain. There is also a reduction in the number of independent wholesalers.¹⁵⁹ I agree with the Commission in this context. The mere protection of the theoretical possibility to engage in parallel trade is not sufficient to protect and promote market integration and trade between Member States. There is a difference between having the theoretical and the practical possibility to engage in such trade.

There are pro-competitive effects obtainable from market integration and economic integration. The Commission mentions *inter alia* that incumbent firms have to be more competitive when competitors enter the market and hence prices will be lower.¹⁶⁰ It is furthermore possible to say that vertical restraints promote market integration when used in order to overcome difficulties when entering new markets by providing for solutions to problems such as marketing research, advertising and infrastructure and local differences not familiar to the manufacturer. On the other hand, vertical restraints restrict market integration where the agreement limits the distributor's possibility of trading in competing products. Such agreements effect both intrabrand and interbrand competition thereby hindering integration.¹⁶¹

Absolute territorial protection restricts market integration the most. The restriction occurs where the contract goods are only obtainable from the exclusive distributor and where there is no other source of supply outside the contract territory. Another way to achieve this situation on behalf of the manufacturer and the distributor is to impair parallel imports into the contract territory.¹⁶² The

¹⁵⁶ Green Paper on Vertical Restraints. Executive summary p.iii. para 9.

¹⁵⁷ Green Paper on Vertical Restraints. p.1. para 1.

¹⁵⁸ Green Paper on Vertical Restraints. p.35. para 118.

¹⁵⁹ Green Paper on Vertical Restraints. p.13 et seq. para 45.

¹⁶⁰ Green Paper on Vertical Restraints. p.22. paras 71-73.

¹⁶¹ Green Paper on Vertical Restraints. p.24 et seq. paras 80-83.

¹⁶² Green Paper on Vertical Restraints. p.41. para 134 et seq. Compare with Commission Decision Gosme/Martell - DMP. [1991] OJ L185/23.

territorial protection is only relative where the contract goods are still obtainable within the contract territory from other suppliers and where parallel trade is still permitted. The restriction would still be permitted if active sales outside the exclusive territory were still prohibited.¹⁶³ In order for this policy to work in the long run it is important to maintain the possibility to engage in parallel trade or even promote it since there is a general tendency of decreasing cross-border trade on the market.¹⁶⁴ The largest barriers to overcome when engaging in parallel trade are national legislation and national cultural differences.¹⁶⁵

As far as exclusive distribution agreements are concerned, the Commission recognises their threats to market integration. Exclusive distribution agreements cause market partitioning and raise entry barriers. This is harmful to market integration.¹⁶⁶ Because of the limited extent of the restrictions mentioned here and the extent of the pro-competitive effects, as well as the promotion of market integration also provided by such agreements, they are exempted.

5.5 Integration as evinced in the Guidelines and Regulation 2790/99.

5.5.1 Introduction.

This section deals with the discussion of the Commission in the Guidelines to Vertical Restraints and regulation 2790/99 with respect to integration and the importance paid to the notion in the Guidelines and the regulation.

5.5.2 The Guidelines and regulation 2790/99.

The Guidelines generally consider market integration in the discussion of hardcore restrictions under the block exemption regulation. That is why I deal with the Guidelines and the regulation in combination with respect to integration.

Article 4 of the block exemption regulation contains a list of hardcore restrictions. Where these restrictions are provided for in the agreement the entire agreement will lose the benefit of the regulation. The Commission considers that such restrictions will also disqualify the agreement from individual exemption.¹⁶⁷ Thus the provisions in Article 4 protect market integration.

¹⁶³ Green Paper on Vertical Restraints. p.42. para 136 et seq.

¹⁶⁴ Green Paper on Vertical Restraints. p.6. para 20.

¹⁶⁵ Green Paper on Vertical Restraints. pp.9-11. paras 33-39.

¹⁶⁶ Green Paper on Vertical Restraints. p.1. para 1.

¹⁶⁷ Commission Guidelines on Vertical Restraints. [2000] OJ C291/11. para 46.

The provision in Article 4(a) of the regulation prohibits resale price maintenance. Article 4(b) prohibits agreements having as their direct or indirect object to restrict the sales of the buyer/distributor relating to the territories into which or customers to whom the buyer may sell the contract products. Such restrictions will provide for market partitioning by territory or by customer.¹⁶⁸ The prohibitions of the restrictions described shall promote the free movement of goods and services across the borders of the Member States. This means that the question of market integration is recognised in these clear-cut cases where the restriction or prevention on trade between Member States is particularly obvious. These restrictions are restrictive by object and the reasons for these restrictions being prohibited have to be considered as unquestionable. On the other hand, it is doubtful whether or not the regulation precludes from the block exemption those situations where the specific market situation in combination with the provisions lead to a situation of restricted market integration without the provisions as such being restrictive by object.

Article 4(b) contains four exceptions permitting some territorial protection. The exceptions are different types of bans on active sales. The reason for permitting bans on active sales is that the agreements would otherwise lose their purpose. Bans on passive sales are still prohibited in order to protect market integration.¹⁶⁹ From my point of view, there are several reasons to re-assess this policy towards bans on active sales since by prohibiting active sales into other exclusive territories the manufacturer can confer absolute territorial protection because the mere theoretical possibility of passive sales and parallel trade is not sufficient to overcome the restriction on market integration. One example of this is where the total lack of parallel trade is well known. By prohibiting active sales into other exclusive territories, as permitted in EC competition law, the manufacturer is able to grant almost absolute territorial protection to the distributor.

Article 4(e) of the regulation deals with direct and indirect restrictions on the freedom of end-users, independent repairers and service providers from obtaining spare parts of the products directly from the manufacturer of the spare parts. If such restrictions were permitted this would reduce the incentives to purchase the products from other territories than the domestic one.

Article 3 limits the application of the regulation to agreements between undertakings whose market shares do not exceed 30%. The restriction on competition and trade between Member States from such agreements are considered not harmful to competition. The Commission believes that where the market share does not exceed 30% the economic efficiencies are likely to outweigh the anti-competitive effect of the agreement especially since a market share of 30% hardly has the required impact on the market.¹⁷⁰ The regulation will

¹⁶⁸ Commission Guidelines on Vertical Restraints. [2000] OJ C291/11. para 49.

¹⁶⁹ Commission Guidelines on Vertical Restraints. [2000] OJ C291/12. paras 50 and 52.

¹⁷⁰ Commission Regulation 2790/99. Recitals 8-9.

not apply where the restrictions imposed are of a certain nature restricting inter alia market integration. The Commission states that where such restrictions are imposed there should not be any exemptions, block exemptions or individual, no matter how small the market shares of the undertakings.¹⁷¹

Furthermore, non-compete clauses are permitted but only for a limited duration. The reason for this is that such limitation is needed "...in order to ensure access to... the relevant market."¹⁷² The pro-competitive effects of non-compete clauses are inter alia that the manufacturer can invest in staff training without running the risk that the investment benefits any competitor since the staff only sells the products of the manufacturer. These measures indirectly promote market integration by facilitating entry of new markets by manufacturers from around the common market. These measures also directly promote better instore service.

The possibility to withdraw the benefit of the regulation also takes account of the market integration objective. Besides the situation where the Commission might withdraw the benefit of the regulation where the conditions of Article 81(3) are not met, withdrawal is also possible where the agreement threatens access to the relevant market or restricts competition.¹⁷³

In conclusion, it is possible to establish that integration is paid great importance to in the Guidelines and the regulation because restrictions of integration will preclude the application of the regulation on the entire agreement. This preclusion, however, is limited to those restrictions that totally eliminate integration, such as absolute territorial protection and impairment of parallel trade. There is a tendency to exempt other restrictions on integration but only where the agreement provides for real efficiencies.

¹⁷¹ Commission Regulation 2790/99. Recital 10 and Article 4.

¹⁷² Commission Regulation 2790/99. Recital 11 and Article 5.

¹⁷³ Commission Regulation 2790/99. Recital 13 and Article 6.

6 The agreement.

6.1 Introduction.

I have chosen a practical example in the shape of an existing agreement, an exclusive distribution agreement, to further elucidate my opinions in this thesis. By using a practical example I hope to be able to provide a more interesting thesis from the point of view of practitioners since that is a group of readers often neglected by thesis-writers. Secondly, I hope that the practical point will make the thesis more interesting for myself to write and at the same time more interesting to any reader.

6.2 Agreement with EC competition law aspects.

The basic facts making the agreement interesting from EC competition law perspective are first of all the fact that the manufacturer and the distributor are established in different Member States and second, the fact that the contract goods are to be supplied across borders within the common market.

6.2.1 Introduction.

The agreement in question was drawn up taking account of the conditions of the block exemption regulation applicable to the agreement, at the time of conclusion, regulation 1983/83.¹⁷⁴

The size of the manufacturer is also important. According to information received¹⁷⁵, the size of the manufacturing undertaking is such that the distribution agreement would not satisfy the conditions of the notice of agreements of minor importance¹⁷⁶, i.e. the manufacturer is larger.

Depending on the assessment of the relevant market, the relevant product- and geographic market, the manufacturer could be dominant or one of many producers of the product in question. For the discussion in this thesis, I assume that the manufacturer is only one of many producers of the product in question, or rather that the product manufactured does not constitute a specific product market. The relevant geographic market is at least a substantial part of the common market.

¹⁷⁴ According to Jonas Ågren.

¹⁷⁵ According to Jonas Ågren.

¹⁷⁶ Notice on Agreements of Minor Importance [1997] OJ C372/1.

I assume that the agreement will benefit from the new regulation, regulation 2790/99, as well since the new regulation is more generous to agreements than was the old regulation, i.e. regulation 1983/83. I will therefore focus on the various clauses of the agreement and discuss whether or not the agreement, exempted or not, actually is beneficial to competition and not sufficiently affecting trade between Member States. In short, I will focus on the efficiencies and integration-aspects of the agreement.

6.2.2 The agreement.

The agreement in question is labelled “DISTRIBUTOR AGREEMENT”. The manufacturer grants to the distributor the exclusive sales right in the territory for the products. The territory is a Member State. The products will be newly manufactured products, accessories and spare parts pertaining thereto and including changes and improvements thereof.

The distributor undertakes, in §2, to inform the manufacturer of all inquiries for the products received by the distributor regarding countries outside the territory. The information shall be supplied solely for information purposes.

There are sales targets imposed in the agreement in §5.A. Where the distributor does not achieve these targets, the manufacturer has a right to terminate the agreement. This does not apply where the shortfall depends on circumstances beyond the control of the distributor.

Furthermore the distributor undertakes, in §5.B.7th paragraph, to create a retail list price(!) in accordance with the market situation in the Member State.

The manufacturer undertakes, in §5.C.2nd paragraph, to grant to the distributor a discount of standard 37,5% on the Swedish list price.

The distributor may not, according to §5.C.4th paragraph, manufacture or distribute, directly or indirectly, goods in the territory, which compete with the contract product.

The distributor undertakes, in §5.C.5th paragraph, to buy the product from the supplier¹⁷⁷ only. This provision precludes purchase from any other seller than the manufacturer.

The distributor must not, according to §5.C.6th paragraph, seek customers outside the territory, establish any branch or maintain any distribution depot there for the distribution of the product.

¹⁷⁷ The manufacturer is occasionally referred to as the supplier in the agreement.

The supplier undertakes, in §5.D.1st paragraph, not to grant the exclusive sales right in the territory to other persons and not to deliver the product to any consumer in the territory. Furthermore, the supplier undertakes to implement prohibitions equal to the provision in §5.C.6th paragraph on other exclusive distributors in other territories.

The distributor undertakes, in §8 1st paragraph, to provide a sales forecast, for the product in the following year, to the manufacturer.

The distributor shall, according to §9, keep the manufacturer currently informed of his and his competitor's activities. The distributor and the manufacturer agree to give each other, when requested, comprehensive reports on all matters that might be of interest for either the manufacturer or the distributor, such as the present market situation as well as forecasts for the products and competitive products, sales prices, other sales conditions and market strategies applied within the EEC.¹⁷⁸ The distributor shall promptly report to the manufacturer any major change in his management, organisation, ownership and capital structure. Upon the request of the manufacturer the distributor shall make available to the manufacturer his detailed calculation of prices of the products.

Whether or not the agreement satisfies the conditions of regulation 2790/99 is dealt with in chapter 7. There I will also deal with those provisions that might be doubtful from an integration point of view and those that might be beneficial to both integration and efficiencies.

¹⁷⁸ European Economic Community.

7 Analysis and conclusion.

7.1 Introduction.

This final chapter contains an analysis and conclusion of the discussion in the previous chapters. I also answer the questions posed in part 1.2. Finally, I apply the new Commission policy on the agreement described in chapter 6.

7.2 On integration and efficiencies.

EC competition law pursues an economic goal along with the integration goal. The economic goal is to promote effective competition. The integration goal is to promote market integration on the common market. The latter is implemented in Article 81(1) through the prohibition on agreements affecting trade between Member States, e.g. price fixing agreements and agreements that share or control markets. The economic goal is implemented in Article 81(1) by the prohibitions on restrictions on competition. The economic efficiencies obtainable through vertical agreements are recognised in Article 81(3), which requires that the agreements generate economic efficiencies in order to be individually exempted. According to case law, Article 81(3) is not applicable to agreements conferring restrictions on integration, e.g. absolute territorial protection, resale price maintenance and impairment of parallel trade. Thus, Article 81(1 and 3) deals with the economic goal, the integration goal, and with efficiencies. There is equal importance paid to the notions, at least from the wording of the Treaty. The difference in importance depends on the analysis undertaken in the assessment of Article 81.

As far as case law is concerned it is often only cases concerning agreements, infringing Article 81(1) and condemned in a Commission-decision, that become well-known. Where the agreement does not satisfy the conditions of Article 81(3), the Commission will condemn it. Agreements being condemned by the Commission contain restrictions on integration that cannot be exempted. Following the Consten-Grundig-case¹⁷⁹, the application of Article 81(3) shall take account of the spirit of Article 81. This precludes the possibility that agreements being exempted still restrict or eliminate market integration on the common market. The efficiencies making an agreement eligible to individual exemption have to be noticeable and objective. The efficiencies also have to outweigh the negative effects on competition from the agreement. An agreement containing restrictions that are restrictive by object cannot be individually exempted. Measures that are considered as restrictive by object are inter alia restrictions on

¹⁷⁹ Joined cases 56 and 58/64. *Établissements Consten S.A R.L. and Grundig-Verkaufs-GmbH v Commission* [1966] ECR 299, 348.

market integration. This is one example of how the integration goal is protected. One might ask whether or not efficiencies outweighing the negative effects on competition but not the negative effects on trade between Member States should be individually exempted. Maybe the integration goal needs to be emphasised in this context. I doubt that mere prohibitions on restrictions by object will suffice to fully protect the integration goal in such a case.

The above-mentioned spirit of Article 81 is according to case law to prevent the establishment of the common market from being impeded or delayed by agreements reintroducing trade-borders.¹⁸⁰ On the other hand, some restrictions on integration are permitted because they improve the distribution of goods, i.e. provide for economic efficiencies.¹⁸¹ Prohibitions on active sales are economically efficient to the manufacturer and the distributor but they also restrict market integration. Such prohibitions do not, in theory, eliminate market integration since passive sales still have to be permitted. The main question is whether or not the extent of passive sales is sufficient to limit the negative effects of the territorial protection, i.e. the restriction on integration. There are, however, some restrictions on integration that can never be individually or block exempted, since they do not contribute to the improvement of distribution or any other requirement of Article 81(3).¹⁸² Export bans, absolute territorial protection, prevention of parallel imports and impairment of parallel trade are examples of measures that do not contribute to the distribution of products and will therefore never be granted an individual exemption.¹⁸³ These are all restrictions or elimination of market integration.

Some types of agreements are in general assumed to improve distribution and to facilitate market entry.¹⁸⁴ Such agreements are covered by one of the many block exemption regulations implemented by the Commission. One condition is that there remains a real possibility of competition and of cross-border trade. This way there is protection of both the economic goal (competition) and the integration goal (trade between Member States).¹⁸⁵

¹⁸⁰ See Case 23/67, *Brasserie de Haecht SA v Wilkin* [1967] ECR 407, 420. The opinion of AG Roemer. Commission Decision *Johnson & Johnson*. [1980] OJ L377/16. p. 24 para 35. Commission Decision *Polistil/Arbois*. [1984] OJ L136/9. p.13 para 51. Case T-77/92 *Parker Pen Ltd v Commission* [1994] ECR II-549. p.566 para 46; and Commission Decision *Tretorn and others*. [1994] OJ L378/45. p.49 para 51.

¹⁸¹ See Commission Decision *Junghans*. [1977] OJ L30/10. p.15 paras 28, 29 and 33; and Commission Decision *Hennessey - Henkell*. [1980] OJ L383/11. p.16 para 27.

¹⁸² See Commission Decision *Johnson & Johnson*. [1980] OJ L377/16. p. 25 para 37. Commission Decision *Hennessey - Henkell*. [1980] OJ L383/11. p.16 para 32 and p.17 para 34. Commission Decision *Polistil/Arbois*. [1984] OJ L136/9. p.14 para 58. Commission Decision *Gosme/Martell - DMP*. [1991] OJ L185/23. p.29 para 40; and Commission Decision *Tretorn and others*. [1994] OJ L378/45. p.51 para 72.

¹⁸³ Commission Decision *Polistil/Arbois*. [1984] OJ L136/9. p.14 para 58.

¹⁸⁴ Commission Decision *Hennessey - Henkell*. [1980] OJ L383/11. p.16 para 27.

¹⁸⁵ Case 170/83 *Hydroterm Gerätebau GmbH v Compact del Dott. Ing. Mario Andreoli & C. Sas*. [1984] ECR-III 2999. p.3017 para 15.

Restrictions on competition are permitted in EC competition law as long as such restrictions are not capable of affecting trade between Member States.¹⁸⁶ This is a peculiarity of EC competition law compared to other competition law statutes. Thus, it is possible to implement agreements that restrict competition on the common market but only where trade between Member States is not affected. But, the latter condition is easily satisfied and the number of agreements escaping the application of Article 81 following this principle is probably very limited.¹⁸⁷ On the other hand, it has become more difficult to consider that an agreement covering an entire Member States automatically affects trade between Member States.¹⁸⁸

Although the Green Paper on Vertical Restraints is not a source of the Commission policy towards vertical restraints, it contains some useful statements by the Commission. Inter alia the Commission states its worries about the lack of integration within the common market and emphasises that the integration goal is a fundamental objective of EC competition law. The Commission also recognises the absence of parallel trade in the common market although it is theoretically possible. It is clear from the wording of the Commission that it is concerned with the market integration objective in its policy. It emphasises the changed market situation with respect to distribution where the number of incumbents have been reduced with the result that the markets are more concentrated and the undertakings more integrated.¹⁸⁹ The increased corporate integration is motivated by efficiency gains, e.g. reduced transport time.¹⁹⁰ Despite the increased efficiencies these measures also restrict market integration and there is not sufficient cross-border trade to counterbalance this increased concentration and reduced market integration.¹⁹¹ The Commission reports on doubts among market operators on the usefulness of the distinction between active and passive sales. The extent of passive sales appears to be both limited and opposed by manufacturers.¹⁹² The Commission recognises the dual benefits from vertical restraints, i.e. promotion of distribution and promotion of market integration by facilitation of market entry.¹⁹³

The importance of market integration in the policy of the Commission is emphasised by the fact that under Article 4 of the regulation the Commission

¹⁸⁶ Case C-306/96 *Javico International and Javico AG v Yves Saint Laurent Parfums SA (YSLP)* [1998] ECR I-1983. I-2003 para 15.

¹⁸⁷ It is questionable whether or not it is possible to implement such agreements in practise because agreements restricting competition on the common market are bound to affect trade between Member States.

¹⁸⁸ *Joined Cases C-215 and C-216/96 Carlo Bagnasco v Banca Popolare di Novara and Cassa di Risparmio di Genova e Imperia* [1999] ECR I-135, para 47 et seq.

¹⁸⁹ Green Paper on Vertical Restraints. p.6. paras 20-22.

¹⁹⁰ Green Paper on Vertical Restraints. p.8. para 28.

¹⁹¹ Green Paper on Vertical Restraints. p.8. para 29.

¹⁹² Green Paper on Vertical Restraints. p.69. para 242.

¹⁹³ Green Paper on Vertical Restraints. p.1. para 1 et seq.

exempts from the benefit of the regulation those provisions that restrict integration. Such restrictions preclude the entire agreement from the application of the regulation. Furthermore, the regulation protects market integration stating that the regulation will not exempt agreements between parties having market shares below 30% (which is otherwise one condition for the application of the regulation) where the agreement imposes restrictions that are restrictive by object. The restrictions referred to are inter alia restrictions on market integration. Finally, the possibility to withdraw the benefit of the regulation only applies where the restriction imposed does not satisfy the conditions of Article 81(3). The general principle in those situations is that restrictions on trade between Member States are not indispensable and thus not eligible to individual exemption. The importance of agreement providing for economic efficiencies is best shown by the fact that economic efficiencies are invoked in order to justify exemption of agreement, either individually or block exemption.

Writers of EC competition law literature are split into two camps. Either they advocate the rule of reason approach with respect to Article 81(1) or they advocate the importance of integration and the peculiarity of EC competition law compared to other competition law statutes. Faull and Nikpay emphasise the importance of the single market being sufficiently established before downgrading the market integration goal from a primary to a secondary objective of EC competition policy. They state that there remain significant price differences between the Member States. Despite the development of the internal market "...it is still too early to relax the objective of integration." In addition, the proposed enlargement of the EU will require a "...further process of market integration."¹⁹⁴ Whish¹⁹⁵ basically agrees with Faull and Nikpay while stating that the analysis undertaken in U.S. Antitrust law and the terms therein should not be copied into EC competition law.¹⁹⁶ I believe that the rationale is that EC competition law contains two additional conditions in comparison to U.S. Antitrust law. First, the pursuit of the market integration goal. Second, the possibility in Article 81(3) to exempt agreements from the prohibition in Article 81(1).

However, Faull and Nikpay are not totally hostile towards vertical restraints. They recognise the benefits where vertical restraints, although restricting competition, increase market integration by facilitating market entry. In such circumstances Article 81(1) should not apply to the agreement.¹⁹⁷

¹⁹⁴ Faull, J and Nikpay, A. p.465.

¹⁹⁵ Whish, R. and Sufrin, B. Article 85 and the Rule of Reason, Competition Law. p. 36 et seq.

¹⁹⁶ Craig, P and de Búrca, G. p.906.

¹⁹⁷ Faull, J and Nikpay, A. p.565.

7.3 Is integration paid less importance than efficiencies in this new policy?

Initially, it seems like the new Commission policy on vertical restraints takes less account of market integration compared to the “old” approach. Although, as concluded above, i.e. the fact that the Commission is aware of the insufficient trade between Member States, the fact that the Commission emphasises the importance of market integration and in particular the fact that Article 4 of the new regulation precludes the application of the regulation to restraints restricting market integration, prove the awareness on behalf of the Commission of the importance of market integration. Since this is also emphasised by the Commission and in case law of both the Commission and the Court, there seems to be sufficient protection of future market integration as well. Thus, the integration goal has not become secondary in the new Commission policy. It is important to stress that this conclusion presupposes that case law is continuously applied as before. Case law provides for a major part of the protection of market integration. Furthermore, because the new Commission policy still puts emphasis in the pursuit of integration it is not possible to state that the new policy is a step away from the *sui generis* character of EC competition law.

I would, however, add an argument in favour of the protection of integration in EC competition law. It seems to me that restrictions on market integration render agreements illegal only in those cases where the restriction is a hard-core restriction or restrictive by object. In all other situations, such as where the restriction on integration is not total, the efficiencies tend to outweigh the restriction on integration. By doing such an assessment the Commission or the Court indirectly says that the efficiencies provide for an economic value to such an extent that the restriction on integration should be, to some extent, sacrificed. My opinion is that there cannot and there should not be put an economic value on integration. Furthermore, the economic goal is already paid importance to as well as economic efficiencies since they permit for the block exemption of various agreements that restrict competition and/or integration.

I believe that it is important to pay attention to what the advocates of market integration in the literature say. EC competition law has a *sui generis* character and the system of assessment of other competition law statutes should not be copied or applied without considering the integration goal distinguishing EC competition law from other competition law statutes. Furthermore, with the continued positive approach towards vertical restraints it is important to promote trade between Member States. The distinction between active and passive sales stated by the Commission does not seem to be sufficient in order to avoid compartmentalisation of the common market. With the extended use of the Internet-advertising and the expected enlargement of the EU, bans on active sales should be prohibited. The findings of the Commission in the Green Paper on the market situation support this conclusion.

7.4 On the agreement.

7.4.1 Generally.

Considering the fact that the agreement is drawn up with the purpose of fulfilling the conditions of Commission regulation 1983/83, there are not any surprising effects from the agreement with respect to EC competition law issues. As far as efficiencies are concerned, the agreement provides for the efficiencies recognised by the Commission when implementing the block exemption. These efficiencies have been dealt with in this thesis and I shall briefly mention these efficiencies in this conclusion. First, although the manufacturer is not a minor undertaking covered by the de-minimis doctrine, it still needs help in order to enter foreign markets. This agreement facilitates market entry on the market of the exclusive territory. Second, the entry on the market of the products of the manufacturer will increase the number of market incumbents thereby benefiting consumers who now have a wider range of brands to choose from. This is labelled increased interbrand competition. These measures increase market integration. Furthermore, because of the increased interbrand competition, prices will be lower.

The agreement might also provide for the general anti-competitive effects from vertical restraints and exclusive distribution agreements dealt with in this thesis. First, the agreement will affect trade between Member States in that the agreement will to some extent limit the amount of purchase of the contract goods from distributors in other exclusive territories on the common market. Second, except for the permitted passive sales and parallel trade that has to be allowed, there is a risk of market foreclosure in that the exclusive distributor is the only one selling the contract goods within the exclusive territory. Potential buyers need to seek their purchase outside the territory if they do not want to purchase from the exclusive distributor or if the exclusive distributor refuses to supply. Other distributors situated in the exclusive territory are not able to sell the contract goods. Finally, the agreement reduces the number of distributors of the specific brand in the territory thereby reducing intrabrand competition. It is important to emphasise that exclusive distribution agreements are subject to block exemption because it has been established that such agreements do more good than harm to competition and market integration on the common market. This particular agreement is no exception to that general principle.

7.4.2 The new policy applied on the agreement.

§2 of the agreement provides for a possibility for the manufacturer to obtain information on the potential existence of parallel trade. However, I am fully aware of the importance to the manufacturer of such information. It is necessary to supervise the commercial activity of the distributor to fully obtain the economic

efficiencies from the exclusive distribution agreement. Where the latter is the only purpose of the request for information, EC competition law raises no concerns. The purpose of §5.B.7th paragraph in combination with the info obtained according to §2 from the distributor, is to enable the manufacturer to supervise the sales efforts and the sales obtained by the distributor. These are justifiable measures to take if the manufacturer is to obtain the economic efficiencies justifying the vertical restraints. Recommended price lists are allowed but they must not provide for resale price maintenance. The latter precludes the application of regulation 2790/99 according to Article 4(a).

The provision in §5.C.2nd paragraph grants a discount compared to Swedish prices. As has previously been established, potential parallel trade could be profitable wherever there are price differences between different geographic markets. The information required in §2 could be a measure to prevent such parallel trade. Taking the entire agreement into account this is hardly likely because there are no prohibitions or sanctions on such trade imposed in the agreement.

The non-compete clause in §5.C.4th paragraph is interesting to the extent that the Commission states in the Guidelines¹⁹⁸, that exclusive distribution in combination with non-compete clauses are exempted on the condition that the restrictions do not confer market foreclosure. Because of the absence of any information concerning this question I will not go any further into this issue.

§5.C.5th paragraph contains an exclusive purchase clause. Such clauses are exempted according to Article 2.1. of the regulation. This clause removes the possibility to purchase the goods from parallel traders. This exclusivity is necessary to protect the market entry of the manufacturer. On the other hand, exclusive distribution and exclusive purchasing might lead to market partitioning. Because of the inherent restriction of intrabrand competition, the Commission will not exempt such agreements where the market share exceeds 30%.¹⁹⁹

§5.C.6th paragraph prohibits active sales outside the exclusive territory. Case law permits such restrictions on integration as long as passive sales are still allowed or not prohibited in the agreement. The request for information according to §2 in the agreement must not provide for any possibility on behalf of the manufacturer to prevent or restrict passive sales. The protection of integration in this case is even more important since the exclusive territory covers the entire Member State.

Furthermore, §5.D.1st paragraph provides that the manufacturer shall not provide the contract goods to any other distributor in the exclusive territory. Nor will the manufacturer supply any consumers in the territory. In addition, the manufacturer undertakes to implement these requirements in agreements with other exclusive

¹⁹⁸ Commission Guidelines on Vertical Restraints. [2000] OJ C291/33, paras 166-172.

¹⁹⁹ Commission Guidelines on Vertical Restraints. [2000] OJ C291/33, paras 161-172.

distributors in other exclusive territories. In a situation like the present it is important that passive sales are permitted. The economic efficiencies obtainable from these restrictions on integration are inter alia that the distributor needs this commercial security to make the necessary investments. It is important to remember that the restrictions must not provide for any market partitioning.

Regulation 2790/99 does not state anything about provisions like §8 1st paragraph. If the manufacturer imposes similar provisions in all its exclusive distribution agreements on the common market there is a risk that the information provided by the sales forecast might provide the manufacturer with enough information to monitor and avoid potential sales between the exclusive territories. On the other hand, this provision might intend to assure the manufacturer that the distributor puts in his best effort in the sale and promotion of the contract goods. The same concerns and arguments in favour of the legality of the provisions can be applied with respect to §9. By knowing the sales forecasts of his distributors the manufacturer is able to foresee any cross-border trade. The manufacturer is hereby enabled to restrict supply to the distributor to the amount predicted by the distributor for its own territory. Sales targets in general might be used in order to limit the practical possibility of the distributor to answer to requests for passive sales or to undertake parallel trade. This situation arises because the sales targets are based on the estimated sales within the exclusive territory, which is often the entire Member State. The sales targets imposed in §5.A. intend to provide for the right of termination on behalf of the manufacturer. There is nothing in the context of the provision that suggests that the purpose of this provision is to restrict passive sales and parallel trade.

The assessment in the new Commission policy emphasises the importance of interbrand competition remaining on the market. The agreement shall be assessed taking account of the economic and legal context. The question of market integration is also important. Since the market share of the manufacturer is not known it is important to state that the mere fact that the market share exceeds 10% does not justify a presumption of infringement of Article 81(1). Since the agreement, in §5C, 4th paragraph prohibits the distributor from selling competing goods the agreement fulfils the conditions in the Commission Guidelines of the single branding group. The main negative effect from such agreements is market foreclosure. The same effect is generated by agreements in the limited distribution group, i.e. where the manufacturer only sells to a limited number of buyers. Such agreements also reduce intrabrand competition. §5D of the agreement contain such a provision. §5C, 6th paragraph limits the territory of active sales of the distributor. Such restrictions fulfil the requirements of the market partitioning group in the Guidelines. These restrictions reduce intrabrand competition and facilitate market partitioning.

The general principle of the Commission is that there has to be real efficiencies in order for the agreement to be exempted if the agreement reduces intrabrand

competition. The main pro-competitive effect of this exclusive distribution agreement is that the distributor will focus his efforts on the manufacturer's brand. The agreement increases market integration by facilitating market entry. In addition, exclusive distribution agreements are likely to be individually exempted because such agreements generally lead to improvement in distribution.²⁰⁰ In addition, since the agreement allows for market entry of yet another distributor there will be increased interbrand competition. The Commission policy is that exclusive distribution in combination with non-compete obligations will be exempted, but only where there is no foreclosure effect. Because there is no foreclosure effect shown by the provisions of the agreement it is likely that the agreement is eligible to block exemption from the new block exemption regulation. I do not raise any EC competition law concerns against the block exemption of the agreement.

Thus, despite the specific restrictions on market integration, there are still advantages to both market integration and competition. These advantages outweigh the disadvantages on market integration. The agreement is therefore beneficial to market integration as well. Hence, there are restrictions on market integration but these are outweighed by the advantages from the agreement of both market integration and competition on the common market.

²⁰⁰ Commission Decision Hennessey - Henkell. [1980] OJ L383/11. p.16 para 27.

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