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Law Concerning Vertical Distribution
Agreements

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Summary

EC competition policy has different objectives, for instance to create the single market and keep it open and competitive. Article 81 EC provides an effective instrument in order to ensure that competition is not distorted. Article 81 EC catches and prohibits anti-competitive agreements, decisions and concerted practices but where the positive effects of an agreement outweigh the negative effects there is a possibility to obtain an exemption under article 81(3). Such an exemption can either be obtained individually or by a block exemption regulation. The Commission has the sole power to grant individual exemptions under Regulation 17/62. This regulation also empowers the Commission to ensure that EC competition law is followed by means of investigations, inquiries and heavy fines. Block exemptions can be received if the agreement is in compliance with any of the block exemption regulations that the Commission has adopted. The Commission has adopted these block exemption regulations in order to decrease its workload and to enforce EC competition law in the most efficient way.

Vertical distribution agreements are entered into by parties operating at different levels of the production process, for example a distribution agreement between a manufacturer of a product and a retailer. The reasons why these agreements are entered into are many. For example, the agreement may reduce transaction costs between the parties or the co-ordination can help undertakings to increase their profits.

Vertical distribution agreements may have both advantages and disadvantages. The anti-competitive effects that may be seen are market foreclosure by raising barriers to entry, reduction of inter-brand competition, reduction of intra-brand competition and the creation of obstacles to market integration. Vertical distribution agreements may have pro-competitive effects such as to promote non-price competition and improve the quality of services. They are likely to help realise efficiencies and the development of new markets. Vertical restraints may be used for a limited duration, which helps to introduce new complex products or protect relationship-specific investments.

Under the former system there was three block exemption regulations that were applicable to certain vertical distribution agreements. Exclusive distribution agreements, exclusive purchasing agreements and franchise agreements could be covered by the block exemption regulations but selective distribution agreements were not covered by any regulation. These block exemption regulations covered only vertical agreements concerned with the resale of final goods and not intermediate goods. Therefore the majority of vertical agreements were not covered by any block exemption regulation. This resulted in legal uncertainty for a large number of vertical restraints.

The change in structure of distribution and other developments led to that the Commission got a growing feeling of unease with the effectiveness of its own competition policy concerning vertical restraints. As a consequence the Commission started a thorough review of its policy. The commencement of this review was the adoption of the Green Paper on Vertical Restraints in EC Competition policy.

The Green Paper recognised a number of shortcomings in the competition policy. The block exemption regulations then in force comprised rather strict form-based requirements and as a result they were considered too legalistic and worked as a strait-jacket. This was seen in the light of the major changes in distribution that had taken place. Undertakings with no market power suffered unnecessary regulation and this may have prevented the parties from using vertical restraints to improve their competitive position.

There was a risk that agreements falling within the scope of the block exemption regulations were distorting competition. The block exemption regulations were form-based instead of effect-based and did not contain any market share limit. This gave rise to the risk that companies with significant market power could benefit from the different block exemption regulations.

The Commission therefore adopted Regulation 2790/1999 on Vertical Agreements and Concerted Practices. This regulation is a very wide block exemption regulation that covers all vertical agreements concerning intermediate and final goods and services, except for a limited number of hardcore restraints. The regulation is based mainly on a black-clause approach, i.e. defining what is not exempted instead of defining what is exempted. A market share cap of 30% is used to link the exemption to market power. The market share threshold creates a safe harbour to distinguish the agreements that are presumed to be legal from those which are not legal. If the market share threshold is exceeded negative clearance, individual exemption or prohibition can be received.

The new block exemption regulation has only been in force for one year and there has not been any decisions from the Commission or judgments from the Court which give guidance on the interpretation and applicability of the regulation. Therefore it is difficult to predict the impact of the regulation on vertical restraints and if it realises the Commission's new approach towards vertical restraints efficiently. Certainly the new regulation will have several advantages compared to the old regulations but there is still the question whether the regulation will achieve the Commission's objectives concerning competition policy in the most satisfactory way.

Abbreviations

CFI	Court of First Instance
CMLR	Common Market Law Report
CMLRev	Common Market Law Review
EC	European Community
ECJ	European Court of Justice
ECLR	European Competition Law Review
ECR	European Court Report
ECSC	European Coal and Steel Community
EDA	Exclusive Distribution Agreement
EEC	European Economic Community
EPA	Exclusive Purchasing Agreement
IPR	Intellectual Property Rights
JIT	Just In Time
NW J Int. L and Bus.	Northwestern Journal of Law and Business
OJ	Official Journal
RPM	Resale Price Maintenance

1 Introduction

1.1 Purpose

Vertical agreements having anti-competitive effects have always been caught by article 81, but in special circumstances where the anti-competitive effects have been out-weighted by positive effects those agreements have been considered to be lawful. As a consequence, block exemption regulations have been adopted in order to make article 81 inapplicable to certain vertical agreements having positive effects. The block exemption regulations have also made the enforcement of EC competition law more efficient and reduced the workload of the Commission. Recently the block exemption regulations have been replaced by a wider block exemption regulation.

The purpose with this master thesis is to examine the development in EC competition law concerning vertical distribution agreements. Persons who are not familiar with the subject, should be enabled to gain a wide knowledge by reading this thesis.

1.2 Method and material

I have been reading a lot of books dealing with the subject, in order to write this master thesis. It has also been of great importance to read all the documents adopted by the Council and the Commission. EC competition law is to a great extent developed and enforced by these institutions. Those who are familiar with EC competition law also know that this area as well as all the other areas is developed by judgments from the ECJ and the CFI. The case-law is very important and there is a great amount of cases dealing with EC competition law. I have been reading many of these and I often refer to the important and interesting cases which have played an important role. I have also been reading a lot of articles where EC competition law is discussed by the authors. The articles are very interesting to read since they express the authors' different subjective opinions.

1.3 Disposition

As a background I very briefly describe EC competition policy and the different purposes that lie behind this policy. Then article 81 EC is examined. Article 81 prohibits anti-competitive agreements, decisions and concerted practices. This article is one of the most important in EC competition law and in order for it to be applicable certain criteria have to be fulfilled. These criteria are dealt with one by one.

Thereafter the enforcement of EC competition law is scrutinised. The Commission has been given extensive powers in Regulation 17/62 in order to make the enforcement effective.

Then attention is paid to vertical distribution agreements and which negative and positive effects those may have. The former system of block exemption regulations is presented. This is followed by an explanation why it was necessary to reform the block exemption regulations. The new approach towards vertical agreements is put forward and then the emphasis is laid on the new block exemption regulation concerning vertical agreements and concerted practices.

Finally, there are a number of comments.

2 EC competition policy

Competition law has since the creation of the Community played an important part in Community law. The competition policy is based on Articles 3(g) and 81-99 EC. Article 3(g) requires 'a system ensuring that competition in the internal market is not distorted'. Competition policy is an essential complement to the other fundamental provisions of the EC Treaty designed to establish the internal market. The Community's competition policy is one of the most developed policies and has a great impact on undertakings.

There are many purposes that lie behind EC competition policy. To encourage economic activity and maximise efficiency are two of the most important. By maximising efficiency, consumer welfare can be enhanced and the optimal allocation of resources can be achieved. Goods and resources are enabled to flow freely between Member States according to the operation of normal market forces.

Another purpose of EC competition policy may be to protect consumers and smaller firms from undertakings having large economic power, either separately or jointly. Small and medium-sized undertakings are given greater opportunity to enter the market without being wiped out by other stronger competitors.

The competition policy also has the purpose to contribute to create the single market. Community law prohibits governmental measures such as tariffs, quotas and quantitative restrictions that can be detrimental to the creation of a single market. The effectiveness of those Community rules would be weakened if private undertakings could by themselves divide the Community market along national borders.

The competition policy is also meant to increase the competitiveness of European industry in the world market.

The competition rules can be divided into those which focus upon activities of different governments and those which deal with the actions of private undertakings. This thesis exclusively deals with private actions and particularly anti-competitive agreements or concerted practices between undertakings.

After the changes brought in by the Maastricht Treaty, EC competition law has to be balanced with other competing Community interests such as environment and the need to protect cultural diversity. The Commission acknowledged this in its 23rd Report on Competition Policy.¹

¹ European Commission, XXIIIrd Report on Competition Policy 1993.

3 Anti-competitive agreements, decisions and concerted practices

Article 81 EC is the most efficient instrument in EC law to control anti-competitive behaviour between undertakings.

Article 81 states the following:

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 obligations 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:
 - (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 different necessary conditions that make article 81 EC applicable will now be examined.

3.1 Undertakings

Article 81 deals with agreements, decisions and concerted practises between undertakings. However, the EC Treaty does not provide a definition of the term and therefore the word undertaking has been interpreted as wide as possible by the competition authorities.

The Commission stated in a decision that the term undertaking covered any entity which was engaged in commercial activity and not only those entities which possessed legal personality.²

The definition undertaking was later by the ECJ, declared to cover any entity engaged in an economic activity regardless of its legal status and the way in which it is financed.³ A non-profit-making organisation is considered to be an undertaking within the meaning of article 81.⁴ Even if an organisation is a non-profit-making body it carries on with an activity considered to be of economic character. Individuals, in the form of an opera singer and a footballplayer have also been found to be undertakings.⁵

The term applies to undertakings in the public as well as the private sector. The important condition is that the undertaking is engaged in commercial activity. Therefore public entities carrying out their public-law powers are not considered to be undertakings when they are exercising these powers.

Sometimes legally distinct firms may be treated as on single economic unit. This presupposes that there is a close commercial link between the firms, for instance between a parent company and subsidiary company. If these two companies enter into agreements and the competition authorities consider them to be one economic unit, article 81 is not applicable since that article deals with agreements between undertakings. In this case an action based on article 82 may be appropriate in certain circumstances.

To escape liability it may happen that undertakings change their legal forms. This action is not enough to escape liability if there still is a functional and economic continuity between the original undertaking and the new created one.

² Decision *Polypropylene* [1986] OJ L230/1, [1988] 4 CMLR 347.

³ Case C-41/90, *Höfnér and Elser v. Macrotón GmbH* [1991] ECR I-1979, [1993] 4 CMLR 306.

⁴ Case C-244/94, *Fédération Française des Sociétés d' Assurance v. Ministère de l' Agriculture et de la Pêche* [1995] ECR I-4013, [1996] 4 CMLR 536.

⁵ Decision *Re UNITEL* [1978] OJ L157/39, [1978] 3 CMLR 306 and Case C-415/93, *Union Royale Belge des Sociétés de Football Association ASBL v. Jean-Marc Bosman* [1995] ECR I-4921, [1996] 1 CMLR 645.

3.2 Agreements, decisions and concerted practices

Article 81 requires that there is an agreement, decision or concerted practices between undertakings. An agreement can be caught under article 81 irrespective of if it is oral or written. It is possible to consider that a gentleman's agreement is sufficient. ECJ has stated that the existence of a gentleman's agreement guaranteeing protection of each domestic market for the producers in the various Member States can be caught under article 81.⁶ The ECJ confirmed in the above-mentioned case that informal agreements can be caught and it does not matter if the parties claim that the agreement has been terminated. The Court considers whether the agreement still exists.

Also the Commission which makes the initial examination of an infringement of article 81 has taken a broad view of the word 'agreement'. In a decision dealing with firms in the petrochemical industry, the Commission held that there was an agreement even though it was oral, there were no sanctions for breaches and it was not legally binding.⁷

Even if the competition authorities fail to show an agreement they will often be able to prove that the undertakings are engaged in concerted practices.

The term 'decisions by associations of undertakings' have been interpreted widely. The ECJ has declared that even a non-binding recommendation from a trade association which was normally complied with could constitute a decision within article 81.⁸ The provision is therefore not confined to binding decisions.

'Concerted practices' are wider than 'agreements' and 'decisions by associations of undertakings'. The reason why the term exists in the article is that it should be possible to catch collusive behaviour even where the paper evidence is destroyed. Sometimes there may not even exist any paper evidence. The parties may instead rely on understandings and verbal exchanges. The construction of the term must therefore be flexible.

The ECJ referred to the term in *Dyestuff*,⁹ where it stated that concerted practices is a form of co-ordination between undertakings which, without having reached the stage where an agreement properly so-called has been concluded, knowingly substitutes practical co-operation between them for the risks of competition.

⁶ Cases 41, 44 and 45/69, *ACF Chemiefarma NV v. Commission* [1970] ECR 661.

⁷ Decision *Polypropylene* [1986] OJ L230/1, [1988] 4 CMLR 347.

⁸ Case 96/82, *NV IAZ International Belgium v. Commission* [1983] ECR 3369, [1984] 3 CMLR 276.

⁹ Case 48/69, *Imperial Chemical Industry Ltd v. Commission* [1972] ECR 619, [1972] CMLR 557.

3.3 The object or effect of prevention, restriction or distortion of competition

EC competition law is not concerned with the question of increase on trade between Member States but with whether there is a distortion of the normal competition which should exist within the common market. Article 81 catches both horizontal agreements (i.e. between competing manufacturers, or competing wholesalers) and vertical agreements (i.e. between manufacturer and distributor, between distributor and retailers, parties not competing with each other).

For an agreement to be caught by the provision in the article it must have as its object or effect the prevention, restriction or distortion of competition. These requirements are not cumulative but alternative. If the object of an agreement is to prevent, restrict or distort competition, for example an absolute territorial protection agreement, there is no need to prove its effect. Unless the agreement is clearly incapable of affecting trade between Member States, an anti-competitive effect will be presumed.

Where an agreement does not have as its object to restrict competition, for example a standard distribution agreement, a detailed economic analysis of its effects on the particular market will be necessary before a breach of the article can be established.

The Court held in *Société Technique Minière v. Maschinenbau Ulm GmbH*,¹⁰ that when considering whether an agreement has the object or effect to prevent, restrict or distort competition a number of factors must be examined. 'It is appropriate to take into account in particular the nature and quantity, limited or otherwise, of the products covered by the agreement, the position and importance of the grantor and the concessionaire on the market for the products concerned, the isolated nature of the disputed agreement or, alternatively, its position in a series of agreements, the severity of the clauses intended to protect the exclusive dealership or, alternatively, the opportunities allowed for other commercial competitors in the same products by way of parallel re-exportation and importation.'¹¹

In *Consten & Grundig*,¹² the Court dealt with the issue whether the exclusive dealership agreement between the parties was prohibited. Consten was appointed

¹⁰ Case 56/65, *Société Technique Minière v. Maschinenbau Ulm GmbH* [1966] ECR 235, [1966] CMLR 357.

¹¹ Craig P. and De Búrca G. *EU Law, text, cases and materials* [1998] 2nd edition, Oxford University Press, Oxford, p. 908.

¹² Cases 56 and 58/64, *Etablissements Consten SARL and Grundig-Verkaufs-GmbH v. Commission* [1966] ECR 299, [1966] CMLR 418.

Grundig's sole distributor in France and granted exclusive rights to Grundig's trademark, GINT, in France. In the agreement Consten agreed not to re-export the products to other EC countries. Grundig agreed to obtain similar assurances from its other distributors in other Member States. The agreement established a total ban on parallel imports and exports, so-called absolute territorial protection. The ECJ confirmed that the agreement might harm the object of the Treaty, namely the creation of the single market since the trade between Member States was affected. Even if the agreement did not restrict competition between competing manufacturers (inter-brand competition), it had the object to eliminate competition between wholesalers selling Grundig's products (intra-brand competition). To use the trademark rights merely in order to partition the market constituted an abuse of such rights. However, the Court did not declare the whole agreement void. Only the offending clauses were nullified.

The Commission and the Court are likely to condemn naked restraints on prices, market sharing and some kinds of collective boycott with fairly short reasoning if they are found capable of restricting trade between Member States. In the case of ancillary restraints, more market analysis is required.

In *Consten & Grundig*, the Court seems to have developed a per se rule against absolute territorial protection. For other restraints the Court seems to apply a rule of reason, requiring an analysis of the actual or intended effects in the light of market conditions.¹³

The Court stated in *L. C. Nungesser and Kurt Eisele v. Commission*¹⁴ that the grant of an open exclusive licence is not in itself incompatible with article 81(1). It is required that the licence does not affect the position of third parties such as parallel importers and licensees for other territories. However, those clauses of the agreement which conferred absolute territorial protection were held to be illegal. The Court continued to follow the judgment in *Consten & Grundig*.

3.4 The effect on trade between Member States

An agreement which is not capable to affect trade between Member States to an appreciable extent is not caught under article 81. Such an agreement should be examined on the basis, and within the framework of national legislation alone. This is also the case for agreements whose actual or potential effect remains limited to the territory of only one Member State or one or more third countries.

¹³ Korah V. *The Rise and Fall of Provisional Validity – The Need for a Rule of Reason in EEC Antitrust*, [1981] 3 NW J Int. L and Bus. p. 320.

¹⁴ Case 258/78, *L.C. Nungesser KG and Kurt Eisele v. Commission* [1982] ECR 2015, [1983] 1 CMLR 278.

It has not been very difficult for the Court to surmount the hurdle to prove that an agreement has an effect on trade between Member States. ECJ held in *STM*,¹⁵ that the test was whether it was possible to foresee with a sufficient degree of probability on the basis of a set of objective factors of law or of fact that the agreement in question may have an influence, direct or indirect, actual or potential, on the pattern of trade between Member States. This effect does not have to be harmful or negative.

This test means that the Court very rarely will lack jurisdiction, since there is an ability to focus on potential or indirect effects on trade. The application of article 81 is not precluded even if all parties to an agreement are from one Member State. Such an agreement may partition the market along national lines and may hinder undertakings from other Member States to enter that national market.¹⁶ If an agreement relates to trade outside the EC it may have an impact on trade within the Community and therefore the Court will have jurisdiction.

An agreement, decisions of associations of undertakings or concerted practices will not be caught under article 81 if it does not affect trade between Member States to an appreciable extent. This principle was introduced in *Völk v. Établissements Vervaecke Sprl*.¹⁷ These parties were seeking absolute territorial protection in their exclusive distribution agreement. Mr Völk's company represented 0.08% of the total production of washing machines of the common market. Its market share of sales in Belgium and Luxembourg, the territory of its exclusive distributor Vervaecke, was approximately 0.6%. The Court ruled that competition must be affected to an appreciable extent in order to be caught under article 81 and in this case this requirement was not fulfilled. The share in the relevant product market and the size of the parties are essential factors when determining if the article is applicable.

The Court declared in another case that article 81 was applicable when there was a territorial restriction by object and the market share of the German market varied between 5-6%.¹⁸

It is suggested that below 1% market share the effect on the market is not enough to affect trade to an appreciable extent and make article 81 applicable. However, above 5% the effect is likely to be appreciable and the article is likely to apply. There is a grey area between 1% and 5%.

¹⁵ Case 56/65, *Société Technique Minière v. Maschinenbau Ulm GmbH* [1966] ECR 235, [1966] CMLR 357.

¹⁶ Case 8/72, *Vereeniging van Cementhandelaren v. Commission* [1972] ECR 977, [1973] CMLR 7.

¹⁷ Case 5/69, *Völk v. Établissements Vervaecke Sprl* [1969] ECR 295, [1969] CMLR 273.

¹⁸ Case 19/77, *Miller International Schallplatten GmbH v. Commission* [1978] ECR 131, [1978] 2 CMLR 334.

The Commission has issued a *Notice*,¹⁹ which offers little comfort to undertakings in this grey area. This notice provides that an agreement will be ‘de minimis’ where the total market share of all businesses involved is not more than 5% in the case of a horizontal agreement or 10% in the case of a vertical agreement. Agreements between small and medium-sized undertakings will be treated as de minimis even if over the market threshold.²⁰

The notice states that de minimis agreements do not have to be notified and generally the Commission will not open proceedings against firms covered by the notice. Where undertakings have failed to notify an agreement falling within the scope of article 81 because they assumed in good faith that the agreement was covered by the *Notice*, the Commission will not consider imposing fines.

If the agreement has the object to fix prices, share markets or to confer territorial protection, the applicability of article 81 can not be ruled out even where the aggregate market shares held by all the participating undertakings remain below the thresholds. However, it is very rarely that the Commission challenges such agreements. The Commission rather wants the national authorities to take action against these infringements.

3.5 International jurisdiction

In accordance with international law, EC competition law has established three ways, any one of which is sufficient as a ground of jurisdiction.

The *single entity doctrine* means that the presence and activities of a subsidiary in the European Community bring the entire group to which it belongs under EC jurisdiction as a single undertaking.²¹

The *implementation doctrine* means that the European Community has jurisdiction over a non-Community company when the agreement, decisions of associations of undertakings or concerted practices is implemented within the Community.²²

¹⁹ Commission Notice on agreements of minor importance which do not fall within the meaning of Article 85(1) of the Treaty establishing the European Community, 9 December 1997, [1997] OJ C 372/13, (‘de minimis Notice’).

²⁰ Commission Recommendation concerning the definition of small and medium sized firms, [1996] OJ L 107/4.

²¹ Case 48/69, *Imperial Chemical Industry Ltd v. Commission* [1972] ECR 619, [1972] CMLR 557, Case 15/74, *Centrafarm v. Sterling Drug* [1974] ECR 1147, [1974] 2 CMLR 480 and Case C-73/95, *Viho Europe BV v. Commission* [1996] ECR I-5457, [1997] 4 CMLR 419.

²² Joined cases 89, 104, 114, 116, 117 and 125 to 129/85, *A. Ahlström Osakeyhtiö and others v. Commission* [1988] ECR 5193, [1988] 4 CMLR 901.

The *effects doctrine* means that the European Community has jurisdiction over a non-Community company when the agreement, decisions of associations of undertakings or concerted practices conceived abroad produces effects felt within the Community.²³

3.6 Agreements capable of preventing, restricting or distorting competition

In article 81(1)(a) to (e) there are examples of what is to be considered to be in breach of the article. Every agreement falling within these categories will be considered to be in breach, provided that it is not caught under *de minimis* principle and competition is affected between Member States.

Certain types of agreements are found to be inexcusable by the Commission and the Court and are unlikely to obtain exemption under article 81(3). Other types of agreements are considered to be excusable and either they are found to not be in breach of article 81(1) or they are found to be in breach but exemption under article 81(3) is possible.

Price-fixing agreements are almost always inexcusable, because of their obvious anti-competitive effects. Minimum prices have been regarded as prohibited according to a decision from the Commission and to obtain an exemption under article 81(3) was not possible.²⁴ The Court has stated that recommended prices circulating amongst dealers which are used to enable the parties to engage in concerted practices are incompatible with article 81(1).²⁵ However, in *Pronuptia v. Schillgalis*,²⁶ the Court declared that recommended prices circulating in a distribution franchising system were not prohibited as long as they did not lead to concerted practices and each franchisee remained free to fix his own selling prices. Recommended maximum prices have been found to be acceptable according to the Commission's decision on the *Pronuptia* agreement.²⁷

When it comes to other trading conditions it is worth to mention selective distribution systems. Selective distribution agreements are compatible with article 81(1), 'provided that the resellers are chosen on the basis of objective criteria of a qualitative nature relating to the technical qualifications of the reseller and his staff and the suitability of his trading premises and that such conditions are laid down uniformly for all potential resellers and are not applied in a discriminatory

²³ Case T-102/96, *Gencor Ltd v. Commission* [1999] ECR II-753, para. 90-92.

²⁴ Decision *Hennessy/Henkell* [1980] OJ L383/11, [1981] 1 CMLR 601.

²⁵ Case 107/82, *AEG-Telefunken v. Commission* [1983] ECR 3151, [1984] 2 CMLR 325.

²⁶ Case 161/84, *Pronuptia de Paris GmbH v. Pronuptia de Paris Irmgard Schillgalis* [1986] ECR 353, [1986] 1 CMLR 414.

²⁷ Decision *Pronuptia* [1987] OJ L13/39, [1989] 4 CMLR 355.

fashion'.²⁸ In a later case the ECJ stated that the qualitative criteria must not go beyond what is necessary.²⁹

Requirements that the distributor should guarantee a minimum turnover and hold minimum stocks, so-called quantitative criteria, have been held to exceed the requirements of a selective distribution system and are caught under article 81(1). It has been suggested that such requirements might be exempted under article 81(3).³⁰

In *Pronuptia*,³¹ a requirement that the franchisee should buy 80% of its products from Pronuptia and 20% from suppliers approved by Pronuptia was found to be compatible with article 81(1) by the Court. This requirement existed to protect know-how and the reputation of the franchisor. Certain quantitative restrictions, such as an obligation to hold minimum stocks, were permissible as essential to the franchising agreement, the Commission stated in its decision.³² The Commission also concluded that retail franchising agreements were different from other distribution agreements. It seems that apart from franchising agreements, quantitative restrictions will still require individual exemption.

Agreements may consist of import and export restrictions. Such conditions are designed to partition the market and protect the distributor from intra-brand competition within his particular territory. These restrictions will always be in breach of article 81(1), as the Court stated in *Consten & Grundig*,³³ unless it falls within de minimis-principle, and they will rarely qualify for an exemption.

Agreements which control production, markets, technical developments or investments and agreements to share markets or sources of supply are normally horizontal agreements and will be incompatible with article 81(1). Some of these agreements are likely to qualify for an exemption, either individual exemption or block exemption, for example research and development agreements.

Prohibited by article 81(1) are also agreements which apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage. An agreement to charge different prices to different

²⁸ Case 26/76, *Metro-SB-Grossmarkte GmbH & Co KG v. Commission and SABA* [1977] ECR 1875, [1978] 2 CMLR 1.

²⁹ Case 31/80, *L'Oréal v. De Nieuwe AMCK* [1980] ECR 3775, [1981] 2 CMLR 235.

³⁰ Steiner J. and Woods L. *Textbook on EC Law* [2000] 7th edition, Blackstone Press Limited, London, p. 230.

³¹ Case 161/84, *Pronuptia de Paris GmbH v. Pronuptia de Paris Irmgard Schillgalis* [1986] ECR 353, [1986] 1 CMLR 414.

³² Decision *Pronuptia* [1987] OJ L13/39, [1989] 4 CMLR 355.

³³ Cases 56 and 58/64, *Etablissements Consten SARL and Grundig-Verkaufs-GmbH v. Commission* [1966] ECR 299, [1966] CMLR 418.

customers is compatible with the article if the different prices charged genuinely reflect different costs.

Article 81(1) prohibits agreements which make the conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts. Such agreements can be subject to individual exemption under article 81(3).

The Court decided in *Remia*,³⁴ that a non-competition clause included in the sale of an undertaking was necessary to give effect to the sale. However, the non-competition clause must be limited in time and scope. Therefore the restriction of ten years on competition was reduced to four years. In *Reuter/BASF*,³⁵ a non-competition clause of eight years' duration and extending to non-commercial research was found to be incompatible with article 81(1) and exemption under article 81(3) was not possible.

3.7 The rule of reason

When article 81 was adopted it was clearly intended that the weighing of the pro- and anti-competitive effects of an agreement was to take place not under article 81(1) but under article 81(3). Article 81(3) gives the Commission the sole power to grant exemption.³⁶ The reason why the Commission was given exclusive power to apply article 81(3) was that it would guarantee uniformity of interpretation and maximum supervision and control. The fact that the Commission has sole power led to much workload and long delays since every agreement had to be notified to obtain an exemption. It also created difficulties for national courts since they were required to apply article 81(1) but they could not apply article 81(3) and grant exemption. Nor could national courts ask for a preliminary ruling from ECJ under article 234 EC, if the Commission had not adopted a decision.

The Commission adopted block exemptions to reach a solution for the problem and decrease its workload. Another solution was to apply a rule of reason.

Under the rule of reason, 'only restrictions which constitute an essential element of the agreement, without which the agreement would be emptied of its substance, and which pose no real threat to competition or to the functioning of the single

³⁴ Case 42/84, *Remia BV and Verenigde Bedrijven Nutricia NV v. Commission* [1985] ECR 2545, [1987] 1 CMLR 1.

³⁵ Decision *Reuter/BASF AG* [1976] OJ L254/40, [1976] 2 CMLR D44.

³⁶ Council Regulation No 17 of 6 February 1962. First Regulation implementing Articles 85 and 86 of the Treaty, OJ 13/204, 21 February 1962, special edition 1959-62, p. 87, art. 9(1).

market, are deemed compatible with article 81(1)'.³⁷ This means that clauses which are to a certain extent restrictive of competition are compatible with article 81(1) as necessary to the agreement as a whole. For non-essential restrictions or restrictions which might interfere with the functioning of the single market article 81(3) is applicable.

3.8 Article 81(2)

According to article 81(2) any agreements or decisions prohibited pursuant to the article shall be automatically void. The agreements and decisions as a whole are void and unenforceable unless the restrictive clauses in an agreement prohibited by article 81(1) and not exempted by article 81(3) can be separated from the remainder. If the restrictive clauses can be separated from the remainder only those restrictive elements are void and unenforceable.

3.9 Exemption under article 81(3)

An agreement considered to be incompatible with article 81(1) can gain exemption under article 81(3). However, in order to gain exemption the agreement must satisfy certain conditions. The agreement 'must improve the production or distribution of goods or promote technical or economic progress; consumers must receive a fair share of the resulting benefit; it must only contain restrictions which are indispensable to the attainment of the agreement's objectives; and it can not lead to the elimination of competition in respect of a substantial part of the products in question'.³⁸

The first condition for an exemption to be granted is that the agreement, decision or concerted practice must contribute to improving the production or distribution of goods or to promoting technical or economic progress.

Research and development agreements have often been considered to improve the production. Agreements which have led to cost reductions and efficiency increases have often gained exemption.³⁹ Specialisation agreements are examples of agreements that improve production. These agreements enables each party to make their efforts more concentrated and achieve economies of scale. If an agreement improves the quality of existing products it can be exempted.⁴⁰

³⁷ Steiner J. and Woods L. *Textbook on EC Law* [2000] 7th edition, Blackstone Press Limited, London, p. 235.

³⁸ Craig P. and De Búrca G. *EU Law, text, cases and materials* [1998] 2nd edition, Oxford University Press, Oxford, p. 916.

³⁹ Decision *Vacuum Interrupters Ltd* [1977] OJ L48/32, [1977] 1 CMLR D67.

⁴⁰ Decision *Soplem/Vickers* [1978] OJ L70/47, [1978] 2 CMLR 146.

In *Ford/Volkswagen*,⁴¹ the Commission considered the important social aspect and exempted a joint venture to produce a new vehicle in Portugal. The creation of jobs in a quite poor area contributed to the exemption.

Benefits in distribution often occur through vertical agreements. The agreements can for example take the shape of exclusive supply, exclusive distribution, selective distribution and franchising. In the *Transocean Marine Paint Association decision*,⁴² the Commission granted an exemption. The parties collaborated to produce and market marine paints to identical standards and to organise the sale on a world-wide basis. The Commission stated that the collaboration improved distribution since it streamlined the service to the customers and led to a more specialised knowledge of the market.

When it comes to technical progress it often deals with specialisation agreements. Licences of new technology and joint research and development agreements may lead to improvements and may be exempted.⁴³

In *ACEG/Berliet*,⁴⁴ the parties intended to collaborate to produce a new bus. The Commission granted exemption even though the collaboration contained many restrictions. The collaboration gained production and technical progress.

There is also a condition that the agreement may promote economic progress. According to this criteria the Commission has found that co-operation between two banks could lead to an improvement in cross-border payment systems and constitute economic progress.⁴⁵ To improve the security and effectiveness of the Eurocheque payments system has also been held to constitute economic progress.⁴⁶

For an agreement to be exempted it must allow consumers a fair share of the resulting benefit. The parties must show a reasonable probability that at least some of the benefit received will be passed on to the consumers.⁴⁷ The transmission of the benefit will be dependent upon whether there is competition within the relevant market or not. If the competition is intense it is more likely that

⁴¹ Decision *Ford/Volkswagen* [1993] OJ L20/14, [1993] 5 CMLR 617.

⁴² Decision *Transocean Marine Paint Association* [1967] JO 163/10, [1967] CMLR D9.

⁴³ Decision *Olivetti/Canon* [1988] OJ L52/51, [1989] 4 CMLR 940 and Decision *Carbon Gas Technologie* [1983] OJ L376/17, [1984] 2 CMLR 275.

⁴⁴ Decision *ACEG/Berliet* [1968] OJ L201/7, [1968] CMLR D35.

⁴⁵ Decision *Banque Nationale de Paris/Dresdner Bank* [1996] OJ 188/37, [1996] 5 CMLR 582.

⁴⁶ Decision *Uniform Eurocheques* [1985] OJ L35/43, [1985] 3 CMLR 434 and Decision *Uniform Eurocheques Manufacturing* [1989] OJ L36/16, [1989] 4 CMLR 907.

⁴⁷ Korah V. *An Introductory Guide to EC Competition Law and Practice* [2000] 7th edition, Hart Publishing Limited, Oxford, p. 69.

the benefit will be passed on to the consumers since various undertakings then compete for business.

The word 'consumer' is widely interpreted. It covers private individuals acting as end-users and undertakings purchasing in the course of their own trade or business.⁴⁸

In article 81(3) there is also a requirement that the agreement must not impose on the undertakings concerned restrictions which are not indispensable to the attainment of the objectives. The Commission examines each clause to see if it is necessary to the agreement as a whole. It is in many areas of competition law very difficult to determine whether a clause would be considered to be indispensable or not. Even very restrictive clauses may under certain circumstances be indispensable. However, there are restrictions that will almost always be considered not indispensable, for example absolute territorial protection and clauses which appear on the black lists in the various block exemptions the Commission has adopted.

In the *Computerland decision*,⁴⁹ the Commission stated that the restrictive clauses were indispensable in the franchise agreement concerned. Without these clauses potential franchisees would not have made the necessary investments for opening up a new outlet.

Also the *Carlsberg Beers agreement*⁵⁰ was exempted by the Commission. The co-operation agreement was of eleven years' duration and the distributor agreed to buy 50% of its lager supplies from Carlsberg. The Commission declared that the agreement was necessary to enable Carlsberg to be established in the UK market and create its own distribution network.

The agreement must not afford undertakings the possibilities of eliminating competition in respect of a substantial part of the products in question. In most of the cases in which exemption has been granted the parties have encountered substantial inter-brand competition.⁵¹ The market will not be too narrowly defined when new products enter.

⁴⁸ Faull J. and Nikpay A. *The EC Law of Competition* [1999] Oxford University Press, Oxford, p. 111.

⁴⁹ Decision *Computerland* [1987] OJ L222/12, [1989] 4 CMLR 259.

⁵⁰ Decision *Carlsberg Beer* [1984] OJ L207/26, [1985] 1 CMLR 735.

⁵¹ Decision *Vacuum Interrupters Ltd* [1977] OJ L48/32, [1977] 1 CMLR D67 or Steiner J. and Woods L. *Textbook on EC Law* [2000] 7th edition, Blackstone Press Limited, London, p. 239.

3.9.1 Individual exemptions

In order to receive an individual exemption the parties must notify their agreement to the Commission. In the absence of notification exemption will not be given. When the Commission has received a notification it will examine whether the agreement can be granted an exemption or not. The examination involves a lengthy investigation and consultation with the parties concerned. Irrespective of the Commission's answer it must issue a decision stating if an exemption is given or not. The decision must be published in the Official Journal and since it is a binding act it may be challenged by the parties before the ECJ⁵². Before a decision is taken the parties and persons who can show a sufficient interest have a right to be heard. If essential procedural requirements are infringed the decision may be nullified. An individual exemption may be revoked or amended if certain conditions are fulfilled.⁵³

3.9.2 Block exemptions

Under article 81(3) the Commission can declare article 81(1) inapplicable to a category of agreements. Article 81(3) is the foundation for a wide range of block exemption regulations which the Commission has adopted. The Commission has received these delegated powers from the Council.⁵⁴

The object of these block exemptions is to exclude a certain type of agreements from the ambit of article 81(1). The Commission adopts block exemptions in order to avoid the need for individual exemptions. The evolution of block exemptions is quite similar to the evolution of per se rules. Individual agreements lead to the conclusion that generic types of agreements warrant exemption provided that they contain particular terms. A block exemption embraces this conclusion.

The different block exemptions give undertakings and legal advisors guidance. They can be sure that an agreement that complies with a block exemption will not be caught by article 81(1). An agreement that falls within a block exemption does not have to be notified to the Commission. However, if the Commission considers that the agreement has certain effects which are incompatible with article 81(3) it

⁵² Council Regulation No 17 of 6 February 1962. First Regulation implementing Articles 85 and 86 of the Treaty, OJ 13/204, 21 February 1962, special edition 1959-62, p. 87, art. 21 and Art. 230 EC.

⁵³ Council Regulation No 17 of 6 February 1962. First Regulation implementing Articles 85 and 86 of the Treaty, OJ 13/204, 21 February 1962, special edition 1959-62, p. 87, art. 8.

⁵⁴ Council Regulation No 19/65/EEC of 2 March 1965 on the application of Article 85(3) of the Treaty to certain categories of agreements and concerted practices, OJ 36/533, 6 March 1965, special edition 1965-66, p. 35.

may withdraw the benefit of the block exemption. The block exemptions are enacted by regulations and where relevant, national court must apply them.⁵⁵

The Commission has adopted block exemptions covering many agreements, for example specialisation, research and development, technology transfer, motor vehicle distribution and servicing, exclusive distribution, exclusive purchasing and franchising.⁵⁶ The three last mentioned block exemptions have now expired and are replaced by a regulation applicable to categories of vertical agreements and concerted practices.⁵⁷ This new regulation will be examined thoroughly.

Many of the original block exemptions follow the same pattern. First there is a 'white' list stipulating the restrictions which are deemed essential for the agreement and permitted. Then there is a 'black' list which lay down the restrictions which will not be permitted. Also 'grey' restrictions have been introduced. These 'grey' restrictions are subject to a special procedure called the 'opposition' procedure. The restrictions must be notified to the Commission and they are deemed exempted if there is no opposition within a specific time limit.⁵⁸

3.9.3 Comfort letters

The Commission has introduced block exemptions and applied although limited the rule of reason to reduce its workload. The Commission has attempted to reduce its workload further and to speed up the decision-making processes by issuing comfort letters. A comfort letter is a communication from the Commission to the effect that the agreement does not infringe article 81(1) or that it infringes the article but it qualifies for exemption.

⁵⁵ Steiner J. and Woods L. *Textbook on EC Law* [2000] 7th edition, Blackstone Press Limited, London, p. 241-242.

⁵⁶ Commission Regulation (EEC) No 417/85 of 19 December 1984 on the application of Article 85(3) of the Treaty to categories of specialisation agreements, OJ L 53/1, 22 Februari 1985, Commission Regulation (EEC) No 418/85 of 19 December 1984 on the application of Article 85(3) of the Treaty to categories of research and development agreements, OJ L 53/1, 22 Februari 1985, Commission Regulation (EC) No 240/96 of 31 January 1996 on the application of Article 85(3) of the Treaty to certain categories of technology transfer agreements, OJ L 31/2, 9 February 1996, Commission Regulation (EC) No 1475/95 of 28 June 1995 on the application of Article 85(3) of the Treaty to certain categories of motor vehicle distribution and servicing agreements, [1995] OJ L 145/25, Commission Regulation (EEC) No 1983/83 of 22 June 1983 on the application of Article 85(3) of the Treaty to categories of exclusive distribution agreements, OJ L 173/1, 30 June 1983, Commission Regulation (EEC) No 1984/83 of 22 June 1983 on the application of Article 85(3) of the Treaty to categories of exclusive purchasing agreements, OJ L 173/5, 30 June 1983 and Commission Regulation (EEC) No 4087/88 of 30 November 1988 on the application of Article 85(3) of the Treaty to categories of franchise agreements, OJ L 359/46, 28 December 1988.

⁵⁷ Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices, OJ L 336/21, 29 December 1999, [2000] 4 CMLR 398.

⁵⁸ Craig P. and De Búrca G. *EU Law, text, cases and materials* [1998] 2nd edition, Oxford University Press, Oxford, p. 920.

Undertakings which seek either negative clearance or individual exemption are asked if they would be satisfied with a comfort letter. If the answer is affirmative the Commission issues the comfort letter and the file is closed. Issuing a comfort letter is a rapid and informal way to offer the parties of an agreement assurance. Since comfort letters are issued outside the framework of Regulation 17/62⁵⁹ and considered only to be administrative letters they are not binding on national courts. This may lead to that a third party and even the parties of the agreement can challenge the agreement before a national court. The national court may however take the comfort letter into account when to give a judgment. As a non-binding measure the comfort letter can not be challenged before the ECJ by the parties or by a third person who is directly and individually concerned. Therefore a comfort letter deprives parties of both the procedural safeguards to which they are entitled under Regulation 17/62 and the chance of judicial review by the Court.

⁵⁹ Council Regulation No 17 of 6 February 1962. First Regulation implementing Articles 85 and 86 of the Treaty, OJ 13/204, 21 February 1962, special edition 1959-62, p. 87.

4 Enforcement of EC competition law

Under Regulation 17/62 the Commission has been entrusted the enforcement of EC competition law. The Council adopted this regulation under article 87 ECC Treaty (now 83 EC). This regulation makes articles 81 and 82 implemented and the Commission plays a central role in enforcing these articles. Even if the Commission has substantial powers in order to fulfil its tasks it has to comply with the procedural requirements in the regulation and a general duty of confidentiality.⁶⁰ It is also essential to comply with general principles of law. If there is an infringement of these obligations the decision can be challenged and annulled before the Court.⁶¹ It is even possible to receive damages for an infringement.⁶²

The Commission's task is to supervise agreements and to grant negative clearance and exemption. As told before the Commission has the exclusive power to grant exemptions under article 81(3) but there must be a notification by the parties of the agreement. Negative clearance means that there are no grounds under articles 81(1) and 82 for action by the Commission in respect of an agreement, decision or practice. All decisions made by the Commission have to be published in the Official Journal.

The Commission has wide investigative powers under the regulation. These powers are used when the Commission examines whether a notified agreement can be granted exemption or negative clearance. However these powers are most important when the Commission examines whether a non-notified agreement infringes articles 81(1) or 82.

According to the regulation the Commission may request for all necessary information from the governments and competent authorities of the Member States and from undertakings and associations of undertakings to enable it to carry out its tasks.⁶³ The Commission shall state the legal basis, the purpose of the request and the penalties provided for supplying incorrect information. If there are suspicions that competition is restricted or distorted in any sector of the economy in the common market, the Commission may decide to conduct a general inquiry into that whole sector.⁶⁴

⁶⁰ Case 53/85, *AKZO Chemie BV v. Commission* [1986] ECR 1965, [1987] 1 CMLR 231.

⁶¹ Art. 230 EC.

⁶² Case 145/83, *Adams v. Commission* [1985] ECR 3539, [1986] 1 CMLR 506.

⁶³ Council Regulation No 17 of 6 February 1962. First Regulation implementing Articles 85 and 86 of the Treaty, OJ 13/204, 21 February 1962, special edition 1959-62, p. 87, art. 11.

⁶⁴ Council Regulation No 17 of 6 February 1962. First Regulation implementing Articles 85 and 86 of the Treaty, OJ 13/204, 21 February 1962, special edition 1959-62, p. 87, art. 12.

The Commission may also carry out investigations.⁶⁵ These investigations empower the Commission to examine books and business records and take copies, ask for oral explanation on the spot and to enter premises.⁶⁶ Investigations can be either voluntary or mandatory.⁶⁷ Where there is a voluntary investigation the Commission's officials must produce an authorisation in writing specifying the subject matter and purpose of the investigation and the penalties the undertaking may be subject to if the required books and records are incomplete. The mandatory investigation is based on a decision that specifies the subject matter and purpose of the investigation. This decision shall also appoint the date on which it is to begin and indicate the penalties the undertaking may be subject to and the right to have the decision reviewed by the ECJ. The provision has been the legal base for the well-known dawn raids against suspected undertakings.

Undertakings can be liable to penalties if they do not comply with the demands of the Commission under articles 11, 12 and 14 and these penalties can be considerable. This can be the case if undertakings intentionally or negligently fail to supply the information requested or when they supply information but it is false or misleading.⁶⁸

The Commission may also request the competent authorities of the Member States to undertake investigations which the Commission considers to be necessary under article 14(1) or which it has ordered by decision pursuant to article 14(3).⁶⁹

The Commission is bound by a duty of confidentiality. In article 20(1) in the regulation it is stated that information acquired as a result of the application of articles 11, 12, 13 and 14 shall be used only for the purpose of the relevant request or investigation. The Court has held that this provision not only implies a prohibition on the disclosure of confidential information. It is also impossible for authorities holding the information to use it for a purpose other than that for which it has been acquired.⁷⁰ The Commission is also under a duty not to disclose

⁶⁵ Council Regulation No 17 of 6 February 1962. First Regulation implementing Articles 85 and 86 of the Treaty, OJ 13/204, 21 February 1962, special edition 1959-62, p. 87, art. 14.

⁶⁶ Council Regulation No 17 of 6 February 1962. First Regulation implementing Articles 85 and 86 of the Treaty, OJ 13/204, 21 February 1962, special edition 1959-62, p. 87, art. 14(1).

⁶⁷ Council Regulation No 17 of 6 February 1962. First Regulation implementing Articles 85 and 86 of the Treaty, OJ 13/204, 21 February 1962, special edition 1959-62, p. 87, art. 14(2) voluntary and art. 14(3) mandatory.

⁶⁸ Council Regulation No 17 of 6 February 1962. First Regulation implementing Articles 85 and 86 of the Treaty, OJ 13/204, 21 February 1962, special edition 1959-62, p. 87, art. 15(1).

⁶⁹ Council Regulation No 17 of 6 February 1962. First Regulation implementing Articles 85 and 86 of the Treaty, OJ 13/204, 21 February 1962, special edition 1959-62, p. 87, art. 13.

⁷⁰ Case C-67/91, *Dirección General de Defensa de la Competencia v. Asociación Española de Banca Privada* [1992] ECR I-4785.

business secrets.⁷¹ However, the Court has declared that the question whether a document consists of business secrets or not is up to the Commission to decide.⁷² In addition to article 20(2), there is a general duty in article 287 EC for the Commission not to disclose information of the kind covered by the obligation of professional secrecy. Even if information is supplied on a voluntary basis the Commission is still under this duty of confidentiality according to article 287 EC.⁷³

Article 15(2) empowers the Commission to impose heavy fines for an infringement of articles 81(1) and 82 EC. The fines are very powerful since they can amount to 10% of the turnover of an undertaking. The size of the fines will depend for instance on the gravity and duration of the infringement. The Commission has adopted *Guidelines*⁷⁴ to calculate fines and those serve as guidance. Article 229 EC gives ECJ jurisdiction in regard to fines imposed by the Commission.

Where the Commission finds that there is an infringement of articles 81(1) or 82 it may require the undertakings concerned to bring such infringement to an end, according to article 3(1). This provision also gives the Commission power to issue interim measures provided that it is indispensable, urgent and necessary to avoid serious or irreparable damage. The Commission must observe essential procedural requirements and the interim measure can be challenged before the Court.⁷⁵

Since articles 81 and 82 are directly effective, national courts are competent to apply these articles.⁷⁶ Regulation 17/62 also gives the authorities of the Member States competence to apply articles 81 and 82 as long as the Commission has not initiated procedure under articles 2, 3 and 6.⁷⁷ Where parallel proceedings are instituted by the Commission, a national court faced with problem under article 81 or 82 may stay the proceedings until the Commission has adopted a decision, but there is not obligation to do so. National courts have been encouraged to apply EC competition law both by the Commission and the ECJ since it would lessening the Commission's workload. This encouragement led to that the Commission issued a *Notice on co-operation*⁷⁸ where it stated that the national courts have

⁷¹ Council Regulation No 17 of 6 February 1962. First Regulation implementing Articles 85 and 86 of the Treaty, OJ 13/204, 21 February 1962, special edition 1959-62, p. 87, art. 19(3).

⁷² Case 53/85, *AKZO Chemie BV v. Commission* [1986] ECR 1965, [1987] 1 CMLR 231.

⁷³ Case 145/83, *Adams v. Commission* [1985] ECR 3539, [1986] 1 CMLR 506.

⁷⁴ Commission Guidelines on the method of setting fines imposed pursuant to Article 15(2) of Regulation No 17 and Article 65(5) of the ECSC Treaty, 14 January 1998, [1998] OJ C 9/3.

⁷⁵ Case 792/79R, *Camera Care Ltd. v. Commission* [1980] ECR 119, [1980] 1 CMLR 334.

⁷⁶ Case 127/73, *Belgische Radio en Televisie and Société Belge des Auteurs, Compositeurs et Editeurs (BRT) de Musique v. SV SABAM and NV Fonior* [1974] ECR 51, [1974] 2 CMLR 238.

⁷⁷ Council Regulation No 17 of 6 February 1962. First Regulation implementing Articles 85 and 86 of the Treaty, OJ 13/204, 21 February 1962, special edition 1959-62, p. 87, art. 9(3).

⁷⁸ Commission notice on cooperation between national courts and the Commission in applying Articles 85 and 86 of the EEC Treaty, 13 February 1993, [1993] OJ C39/6.

the central role to safeguard directly effective rights of individuals in their relation with one another.

National courts have the competence to examine whether an agreement infringes articles 81 or 82 or not. When doing so they can obtain some guidance by decisions of the Commission and the Court. They can also rely on comfort letters. National courts can also come to the conclusion that an agreement is exempted under a block regulation. However, they have a lack of competence when it comes to granting individual exemptions under article 81(3). If the Commission grants an individual exemption the national courts may apply that decision. Pending that decision the national courts may grant interim relief.

If national courts have difficulties in applying articles 81 and 82 they can ask the Commission for assistance. Both the Commission and the Member States have a duty of co-operation under article 10 EC. Also the *Notice of co-operation* outlines some ways in which the Commission may help national courts. If a national court is unable to take a decision it may stay proceedings and ask the Commission for information. The national court can ask for instance whether the agreement is notified, whether there is a decision or a comfort letter, whether a decision or a comfort letter is likely to be issued or whether the agreement is likely to obtain negative clearance or exemption.⁷⁹ The answers given by the Commission is not binding on the courts which have requested them but it may be presumed that the guidance is given on the understanding that it will be followed.

A court which finds an infringement of articles 81 or 82 may declare the agreement void but it has no power to order fines according to EC competition law. In the absence of remedies in Community law the ECJ has held that the Member States must make available the same remedies for breaches of EC law compared with breaches of national law.⁸⁰

When a national court examines whether there is a breach of articles 81 or 82 there has to be an economic assessment in many cases. If it is difficult to collect all the necessary factors for the assessment the national court can ask the Commission for information dealing with for instance market studies and statistics.⁸¹

As a result of the Commission's increased workload there has been a wish that the national competition authorities would be more involved in the enforcement of EC competition law. Therefore the Commission has introduced a *Notice on co-*

⁷⁹ Commission notice on cooperation between national courts and the Commission in applying Articles 85 and 86 of the EEC Treaty, 13 February 1993, [1993] OJ C39/6, para. 37-38.

⁸⁰ Case 33/76, *Rewe-Zentralfinanz eG and Rewe-Zentral AG v. Landwirtschaftskammer für das Saarland* [1976] ECR 1989, [1977] 1 CMLR 533.

⁸¹ Commission notice on cooperation between national courts and the Commission in applying Articles 85 and 86 of the EEC Treaty, 13 February 1993, [1993] OJ C39/6, para. 40.

*operation*⁸² to parallel that already in existence in respect of national courts. The notice gives guidance where it is appropriate for the national authorities to deal with cases. There are three conditions which should be met, including that the case essentially involves one Member State, there is a clear breach of competition law and that there is not a chance of receiving an exemption by the Commission. However, the Commission can still deal with cases provided that there is a sufficient Community interest.

Individuals have different choices to act where they discover infringements of articles 81 and 82. They may invoke these provisions before the national court since these are directly effective. They are also entitled to apply to the Commission to investigate and terminate alleged infringements, since article 3(2b) in Regulation 17/62 states that natural or legal persons who claim a legitimate interest are entitled to apply. This way may be insecure since the Commission after the introduction of the *Notice of co-operation* may refuse to consider complaints on the grounds that the matter lacks political, economic or legal significance for the Community.⁸³ Where a complainant can be secured protection for his directly effective rights in national courts the Commission will close the file.

The Commission has recently reviewed the application of competition policy in its *White Paper on Modernisation*.⁸⁴ In this paper the Commission discusses several options for reform. It proposes 'a system which meets the objectives of rigorous enforcement of competition law, effective decentralisation, simplification of procedures and uniform application of law and policy development throughout the EU'.⁸⁵ The most revolutionary in the paper is the proposal that the Commission will not have monopoly on granting exemption under article 81(3). Article 81, as a whole would be applied by the Commission, national competition authorities and national courts.

⁸² Commission notice on cooperation between national competition authorities and the Commission in handling cases falling within the scope of Articles 85 or 86 of the EC Treaty, 15 October 1997, [1997] OJ C 313/3.

⁸³ Commission notice on cooperation between national courts and the Commission in applying Articles 85 and 86 of the EEC Treaty, 13 February 1993, [1993] OJ C39/6, para. 14.

⁸⁴ Commission White Paper on modernisation of the rules implementing Articles 85 and 86 of the EC Treaty, Commission programme No 99/027, adopted 28 April 1999, [1999] OJ C 132/1, 12 May 1999.

⁸⁵ Commission White Paper on modernisation of the rules implementing Articles 85 and 86 of the EC Treaty, Commission programme No 99/027, adopted 28 April 1999, [1999] OJ C 132/1, 12 May 1999, Executive summary para. 11.

5 Vertical distribution agreements

Vertical distribution agreements are entered into by parties operating at different levels of the production process, for example a distribution agreement between a manufacturer of a product and a retailer. The reasons why these agreements are entered into are many. For example, the agreement may reduce transaction costs between the parties or the co-ordination can help undertakings to increase their profits and those efficiency gains may be passed on to consumers.

The manufacturer of a product will have to decide in which way it is preferable to market a product. There are a number of options available for the undertaking. It may decide to establish its own outlets or be engaged in a joint venture with a company which has the expertise required. It may choose to market the product through any outlet willing to sell them or there is an option to sell through certain specialised shops if the product requires that. These different options are not exhaustive.⁸⁶

As already seen, vertical distribution agreements may have both advantages and disadvantages. These will be examined below. However, there are some authors claiming that distribution agreements are in every case beneficial to consumers. Bork is one of them:

‘We have seen that vertical price fixing (resale price maintenance), vertical market division (closed dealer territories), and, indeed, all vertical restraints are beneficial to consumers and should for that reason be completely lawful. Basic economic theory tells us that the manufacturer who imposes such restraints cannot intend to restrict and must (except in the rare case of price discrimination, which the law should regard as neutral) intend to create efficiency. The most common efficiency is the inducement or purchase by the manufacturer of extra reseller sales, service or promotional effort.

The proposal to legalise all truly vertical restraints is so much at variance with conventional thought on the topic that it will doubtless strike many readers as troublesome, if not bizarre. But I have never seen any economic analysis that shows how manufacturer-imposed resale price maintenance, closed dealer territories, customer allocation clauses, or the like can have the net effect of restricting output. We have too quickly assumed something that appears untrue.’⁸⁷

⁸⁶ Craig P. and De Búrca G. *EU Law, text, cases and materials* [1998] 2nd edition, Oxford University Press, Oxford, p. 921.

⁸⁷ Bork R. *The Antitrust Paradox, A Policy at War with Itself* [1978] Basic Books, New York, p. 297-298.

Other authors take up a more cautious attitude:

‘When vertical restraints are used to promote the provision of distribution services, the critical issue for antitrust purposes remains whether consumers are better served by lower prices and fewer services or by higher prices and more services. In its *Spray-Rite* brief, the Department of Justice suggested that pure vertical restraints always lead to increased consumer welfare. This position is unfounded, and a more hostile treatment of vertical restraints is appropriate.’⁸⁸

5.1 EC competition policy concerning vertical distribution agreements

EC competition policy concerning vertical distribution agreements has two principal objectives. Other competition law systems usually have one principal objective. The first objective is to keep the markets open and competitive. The second objective is to create the single market. The Community has been forced to break down trade barriers created by the governments in the Member States to achieve these objectives. To prohibit such governmental measures would be meaningless if it was not possible to prohibit agreements between undertakings that hinder or delay market integration. There is normally no contradiction between the objectives but they lead to the same policy outcome.⁸⁹

The economic analysis of vertical agreements has been subject of heated debate in the past.⁹⁰ In the early 1980’s an alteration could be noticed. Before that moment vertical restraints were regarded as suspect for competition and afterwards there was a general perception that they were harmless for competition (the Chicago school).

Nowadays it seems like there is some sort of consensus and economics are making a more cautious assessment of vertical agreements. The assessment is based with respect to competition policy and no sweeping statements are made. All vertical restraints can not be regarded as per se beneficial for competition. The current economic thinking focuses upon the importance of the market structure when to determine the impact of vertical agreements.⁹¹ If there is strong inter-brand competition it is more likely that vertical distribution agreements have pro-competitive and efficiency effects that outweigh anti-competitive effects. If inter-

⁸⁸ Comanor W. *Vertical Price-fixing, Vertical Market Restrictions, and the New Antitrust Policy*, 1985, 98 *Harv. LRev.* 983, 1001-1002.

⁸⁹ Faull J. and Nikpay A. *The EC Law of Competition* [1999] Oxford University Press, Oxford, p. 565.

⁹⁰ Commission’s Green Paper on Vertical Restraints in EC Competition Policy, 22 January 1997, COM (96)721 Final, [1997] 4 CMLR 519, chapter II, para. 54.

⁹¹ Commission’s Green Paper on Vertical Restraints in EC Competition Policy, 22 January 1997, COM (96)721 Final, [1997] 4 CMLR 519, chapter II, para. 54.

brand competition is weak and there are significant barriers to entry it is more likely that the anti-competitive effects outweigh the pro-competitive effects.

5.1.1 Vertical versus horizontal agreements

There has been a policy change concerning vertical distribution agreements versus horizontal agreements just recently.⁹² The underlying reason is that vertical agreements are recognised to be generally less harmful for competition than horizontal agreements. Vertical agreements are therefore treated more leniently than horizontal agreements. Horizontal agreements can be entered into by parties that in fact are competitors producing identical or substitute goods. In such an agreement the exercise of market power may be beneficial to its competitors, i.e. higher price of its product. This may be an inducement for competitors to behave anti-competitively. Concerning vertical agreements the product of the manufacturer or supplier is the input for the wholesaler or retailer. If market power were used in a chain like this either upstream or downstream the other undertaking would be hurt since the demand for the product would be lower. The undertakings engaged in vertical distribution agreements therefore usually have an incentive to prevent the exercise of market power by the other undertakings in the supply chain.

This self-restraining character should not be overestimated according to the Commission. Efficiency gains arising from vertical agreements are likely to be passed on to the consumer where there is sufficient inter-brand competition. If inter-brand competition is weak and an undertaking has market power vertical agreements can also be used to increase the profit. This behaviour can be detrimental to competitors and consumers and may occur when the upstream or downstream undertaking share the extra profit or when just one of the parties uses the vertical agreement to appropriate all the extra profit.⁹³

This more lenient approach towards vertical restraints can be seen in the new Regulation 2790/1999⁹⁴ applicable to vertical agreements, where the market share threshold is 30%. This market share threshold is appreciably higher than the threshold considered being appropriate for horizontal agreements.

⁹² Faull J. and Nikpay A. *The EC Law of Competition* [1999] Oxford University Press, Oxford, p. 560.

⁹³ Faull J. and Nikpay A. *The EC Law of Competition* [1999] Oxford University Press, Oxford, p. 560.

⁹⁴ Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices, OJ L 336/21, 29 December 1999, [2000] 4 CMLR 398, art. 3.

5.2 Negative effects of vertical agreements

EC competition law aims to prevent certain negative effects on the market that may result from vertical distribution agreements. The negative effects might according to the *Guidelines on vertical restraints*⁹⁵ consist of:

- foreclosure of other suppliers or other buyers by raising barriers to entry;
- reduction of inter-brand competition between the companies operating on a market, including facilitation of collusion amongst suppliers or buyers; by collusion is meant both explicit collusion and tacit collusion;
- reduction of intra-brand competition between distributors of the same brand;
- the creation of obstacles to market integration, including, above all, limitations on the freedom of consumers to purchase goods or services in any Member State they may choose;

These negative effects may be the result from various vertical restraints. Even if agreements are different in form they may have the same effect on competition. The *Guidelines* divide vertical restraints into four groups, when to examine whether they have negative effects or not. Each group has largely similar negative effects on competition. The classification is based on fundamental components of vertical restraints and in practise many agreements consist of more than one of these components.

5.2.1 Single branding group⁹⁶

Agreements entered into under this group aim at induce the buyer to concentrate his orders for a special type of product with one supplier. This component can be composed of non-compete obligation and quantity-forcing on the buyer. These components between the buyer and supplier makes the former obliged or encouraged to purchase his requirements for a product and its substitutes from only one supplier. This component can also be noticed in tying. In tying there is an obligation or incentive on the buyer that he is required to purchase a product as a condition of purchasing another particular product. The first product is the 'tied' product and the last is the 'tying' product.

Four negative effects can be found on competition. There can be foreclosure of the market since other suppliers can not sell to the particular buyers. In the case of tying, the market for the tied product can be foreclosed.

⁹⁵ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter VI, para. 103.

⁹⁶ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter VI, para. 106-108.

Market shares may be more fixed and this may lead to collusion when a number of suppliers apply these components in agreements with buyers.

An agreement of this type leads to that the retailer will only sell one brand and there will not be any inter-brand competition in their stores.

In the case of tying, the buyer may pay a higher price for the tied product than he would do if he had a choice to buy it from another supplier. Under these circumstances inter-brand competition may be reduced.

If there is strong competition between suppliers to obtain the single branding contracts, the reduction in inter-brand competition may be mitigated. However, the longer the duration of the non-compete clause, the more likely it will be that the effect will not be strong enough to compensate the inter-brand competition reduced.

5.2.2 Limited distribution group⁹⁷

Agreements entered into under this group have the main element that the manufacturer only sells to one or a limited number of buyers. These agreements may restrict the number of buyers for a specific group of customers or a territory. This kind of vertical restraint may also be used to select a particular group of buyers.

The component can be found in a number of agreements such as exclusive distribution and exclusive customer allocation, where the supplier limits his sales to only one buyer within a specific territory or class of customers. It can also be found in exclusive supply and quantity-forcing on the supplier, where there is an incentive or obligation on the supplier to sell only or mainly to the buyer. In selective distribution the components can be found, where the conditions imposed on or agreed with the selected dealers make them limited in number. After-market sales restrictions contain the same element where the original supplier's sales possibilities are limited.

Three main negative effects on competition can be felt. Particularly in the case of exclusive supply there is a risk of foreclosing the purchase market where certain buyers within the market can not buy products from the specific supplier.

There is a risk for collusion either at distributor's level or supplier's level where the competing suppliers limit the number of retailers.

⁹⁷ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter VI, para. 109-110.

It will also lead to a reduction in intra-brand competition since fewer distributors offer the product. In certain cases there may be total elimination of intra-brand competition as a result of wide exclusive territories or exclusive customer allocation. If intra-brand competition is reduced this may lead to a weakening of inter-brand competition.

5.2.3 Resale price maintenance group⁹⁸

This heading (RPM) includes agreements whose main element is that the buyer is induced or obliged to resell not below a certain price, at a certain price or not above a certain price. Minimum, fixed, maximum and recommended prices are comprised in this group. Maximum and recommended prices not considered to be hardcore restrictions may nevertheless also lead to a restriction of competition by effect.

Two main negative effects on competition can be felt. There may be a reduction in intra-brand prices and increased transparency on prices.

In the case of fixed or minimum prices there is a total elimination of intra-brand price competition since distributors can not compete on price for that brand. Maximum or recommended prices may lead to uniformity for resellers and in the end a more or less uniform price level.

Horizontal collusion between manufacturers and distributors are easier, in at least concentrated markets, where there are increased transparency on price and responsibility for price changes. The reduction in intra-brand competition may have an indirect negative effect on inter-brand competition.

5.2.4 Market partitioning group⁹⁹

Agreements under this heading have a main element in that the buyer is restricted in where he either sources or resells a specific product. This component can be found in exclusive purchasing, where a buyer is under an obligation or encouraged to purchase his requirements for a particular product exclusively from the supplier, for instance beer of brand X, but leaves the buyer free to purchase or sell other competing products, for instance beer of brand Y. Included is also territorial resale restrictions, the allocation of an area of primary responsibility, restrictions on the location of a distributor and customer resale restrictions.

⁹⁸ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter VI, para. 111-112.

⁹⁹ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter VI, para. 113-114.

The negative effects on competition such element may have is the reduction of intra-brand competition. This may help the supplier to partition the market and hinder market integration. Price discrimination is facilitated. It may also lead to collusion either at the distributor's level or at the supplier's level, where most or all of the competing suppliers limit the sourcing or resale possibilities of their buyers.

5.3 Positive effects of vertical restraints

The Commission states in the *Guidelines*¹⁰⁰ that vertical restraints may have certain positive effects on competition. Vertical restraints can promote non-price competition and improve the quality of services. They are likely to help realise efficiencies and the development of new markets. Vertical restraints may be used for a limited duration, which helps to introduce new complex products or protect relationship-specific investments.

When a company has no market power, the only way to increase its profits is to optimise its manufacturing or distribution processes. Vertical restraints may in a number of circumstances be helpful in this respect since the usual arm's length dealings between supplier and buyer, determining only quantity and price of a particular transaction, can lead to a sub-optimal level of investments and sales.

Following subheadings deals with reasons that may justify vertical restraints.

5.3.1 To solve the free-rider problem¹⁰¹

The free-ride problem is most common at the wholesale or retail level, enabling the distributor to free-ride on the promotion efforts of another distributor. To avoid such free-riding exclusive distribution or similar restrictions may be helpful. Non-compete type restraints can also prevent free-riding between suppliers. Free-riding between suppliers may occur where one invests in promotion at the buyer's premises, in general at the retail level, that may also attract customers for its competitors.

There must be a real free-rider issue if the problem will occur. Free-riding between buyers occur on pre-sales services and not on after-sales services. The product's characteristics needs to be quite new or technically complex, as the customer otherwise may know what he or she wants, based on past experiences. The product must also be of reasonably high value, otherwise the customer will

¹⁰⁰ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter VI, para. 115.

¹⁰¹ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter VI, para. 116(1).

not pay attention to receive information in one shop and buy it in another. It must not be practical for the supplier to impose on all buyers effective service requirements concerning pre-sales services.

Free-riding between suppliers occurs in cases where the promotion takes place at the buyer's premises and is generic, not brand specific.

5.3.2 To open up or enter new markets¹⁰²

A manufacturer which wants to enter a new geographic market, for instance by exporting, may want to use a local distributor in that country. Sometimes the entry of a market may involve special first time investments by the distributor to establish the brand in the market. In order to persuade a local distributor to make these investments it may be necessary for the supplier to provide territorial protection to the distributor, thereby enabling him to recoup his investments by charging a higher price temporarily. The territorial protection in this case means that distributors based in other markets are restrained for a limited time period from selling in the new market. This is a special case of the free-rider problem discussed under 5.3.1 above.

5.3.3 The 'certification free-rider issue'¹⁰³

Certain retailers have in some sectors a reputation for stocking only quality products. It may be important for the introduction of a new product to sell through these retailers. If the manufacturer does not have the possibility to sell its products initially through this quality stores, he runs the risk to have the products de-listed and the introduction may fail. This scenario shows that there may be a reason to allow a restriction such as exclusive distribution or selective distribution if the duration is limited. It should be possible to guarantee the introduction of the product but there must not be any obstacle to large-scale dissemination.

5.3.4 To solve the so-called 'hold-up' problem¹⁰⁴

Sometimes an agreement requires the supplier or the buyer to make client-specific investments, for instance special equipment or training. This may be the case where a component manufacturer has to build new machines or tools in order to

¹⁰² Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter VI, para. 116(2).

¹⁰³ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter VI, para. 116(3).

¹⁰⁴ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter VI, para. 116(4).

satisfy a customer's particular requirements. Before the particular supply arrangement is fixed the investor may not undertake the necessary investments.

Precisely, as in the other free-riding examples, there are a number of conditions that have to be met before there is a real or significant risk of under-investment. Firstly, the investment must be brand specific and sunk. An investment is brand specific if it only can be used to store that particular brand or to produce that particular component and thus can not be used to produce or resell alternatives profitably. An investment is considered to be sunk where, upon exiting the market or after termination of the agreement, the investment can not be sold unless at a significant degree of loss. Secondly, it must be a long-term investment that in the short run is not recouped. Thirdly, the investment must be asymmetric, i.e. one of the two parties in an agreement must invest more than the other.

When these above-mentioned conditions are met, it is usually suitable to have a vertical restraint for the duration it takes to depreciate the investment. Where the supplier makes the investment it is appropriate to use a non-compete type or quantity-forcing agreement and where the buyer makes the investment it is appropriate to use an exclusive distribution, an exclusive customer-allocation or an exclusive supply agreement.

5.3.5 To solve the specific 'hold-up' problem that may arise in the case of transfer of substantial know-how¹⁰⁵

In the case where the supplier has provided know-how to the buyer it can not be taken back and therefore the supplier may not want it to be used for or by his competitors. In as far as the know-how is substantial and indispensable to the agreement and not readily available to the buyer, such a transfer of know-how may justify a non-compete type of restriction.

5.3.6 Economies of scale in distribution¹⁰⁶

The manufacturer may want to concentrate the resale of his products on a limited number of distributors in order to have scale economies exploited and thereby see a lower retail price of the goods produced. To benefit by economies of scale there is an incentive to use vertical restraints, such as exclusive distribution, quantity forcing in the form of a minimum purchasing requirement, selective distribution containing such a requirement or exclusive purchasing.

¹⁰⁵ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter VI, para. 116(5).

¹⁰⁶ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter VI, para. 116(6).

5.3.7 Capital market imperfections¹⁰⁷

Banks and other capital providers often provide capital sub-optimally when they do not have perfect information on the quality of the borrower or there is not an adequate basis to secure the loan. Through an exclusive agreement the supplier or the buyer may have better information and are thereby in a better position to obtain extra security for his investment. A non-compete or quantity-forcing restraint may be used where the supplier provides the loan to the buyer. Exclusive supply or quantity forcing restraint may be used where the buyer provides the loan to the supplier.

5.3.8 Uniformity and quality standardisation¹⁰⁸

A vertical restraint may be used to impose a certain measure of uniformity and quality standardisation on the distributors. This may lead to increased sales by creating a brand image and increase the attractiveness of the product. Selective distribution and franchising can help to attain this object.

5.3.9 To solve the hypothetical ‘double marginalization’ problem¹⁰⁹

This problem has a hypothetical character. Where the manufacturer and the distributor have market power each of them will set its price above marginal cost. They add their margin above the one that would have existed if there was competition. This behaviour may result in a retail price higher than the monopoly price an integrated undertaking would have charged. Consumers may suffer from this behaviour. Quantity-forcing on the buyer or maximum resale price maintenance can be used by the manufacturer to bring the price down to monopoly level.

¹⁰⁷ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter VI, para. 116(7).

¹⁰⁸ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter VI, para. 116(8).

¹⁰⁹ Faull J. and Nikpay A. *The EC Law of Competition* [1999] Oxford University Press, Oxford, p. 572.

6 Vertical agreements and block exemptions under the former system

In accordance with article 87 EEC Treaty (now 83 EC) the Council adopted Regulation 19/65.¹¹⁰ Under this Regulation the Commission is empowered to adopt block exemption regulations which define certain categories of agreements which generally fulfil the conditions of article 81(3). The Commission therefore adopted a number of block exemptions which covered different types of vertical agreements. As already told the block exemptions are an efficient instrument to reduce the Commission's workload.

The following block exemptions covering vertical agreements were adopted:

- exclusive distribution, where a supplier agreed to appoint only one distributor in a territory;¹¹¹
- exclusive purchasing including special provision for beer and petrol, where the reseller agreed to purchase the goods in question only from one supplier;¹¹²
- franchising, where a franchisee was allocated an exclusive territory in which to exploit the know-how and intellectual property rights of the franchiser and sell the product or service in a standardised format;¹¹³

These block exemptions contained, according to Regulation 19/65, lists of conditions which had to be fulfilled, the types of agreements covered, restrictive clauses which were exempted and clauses which were not allowed.

Selective distribution agreements were not covered by any block exemption regulation but individual exemptions were possible.

¹¹⁰ Council Regulation No 19/65/EEC of 2 March 1965 on the application of Article 85(3) of the Treaty to certain categories of agreements and concerted practices, OJ 36/533, 6 March 1965, special edition 1965-66, p. 35.

¹¹¹ Commission Regulation (EEC) No 1983/83 of 22 June 1983 on the application of Article 85(3) of the Treaty to categories of exclusive distribution agreements, OJ L 173/1, 30 June 1983.

¹¹² Commission Regulation (EEC) No 1984/83 of 22 June 1983 on the application of Article 85(3) of the Treaty to categories of exclusive purchasing agreements, OJ L 173/5, 30 June 1983.

¹¹³ Commission Regulation (EEC) No 4087/88 of 30 November 1988 on the application of Article 85(3) of the Treaty to categories of franchise agreements, OJ L 359/46, 28 December 1988.

All these types of vertical agreements and the block exemptions which were adopted in this area will now be scrutinised.

6.1 Exclusive distribution

The purpose with an exclusive distribution agreement (EDA) is that the supplier agrees to supply only to a particular distributor within a particular territory. This type of agreements may be the only way to persuade a distributor to market an existing product in a new area or to market a new product. An EDA may also be beneficial to the supplier since such an agreement facilitates an efficient distribution of the product. Transport costs are reduced etc.

EDAs have been considered both by the Commission and the Court to fall within the ambit of article 81(1). In *Consten & Grundig*,¹¹⁴ the Court stated that an EDA which restrict intra-brand competition does not escape prohibition of article 81(1) even if it increases inter-brand competition. However, the Commission has acknowledged that an EDA may be a very efficient form of distribution and therefore these agreements are likely to qualify for an exemption, subject to the condition that they do not establish absolute territorial protection.¹¹⁵ In accordance with this position the Commission issued Regulation 1983/83¹¹⁶ which on the basis of article 81(3) made article 81(1) inapplicable to certain formats of exclusive distribution agreements.

This regulation covered an EDA where one party, the supplier agreed to supply certain goods exclusively to the other party, the distributor, within a given territory.¹¹⁷ There were also other requirements which had to be fulfilled if the regulation would be applicable. The regulation was only applicable if only two undertakings were party to the agreement. The limitation of the number of undertakings only applied to individual agreements and that allowed the supplier to set up an exclusive distribution network without losing the benefit of the block exemption.

Another limitation could also be seen regarding exclusive distribution agreements between competitors. The block exemption covered an EDA entered into

¹¹⁴ Cases 56 and 58/64, *Etablissements Consten SARL and Grundig-Verkaufs-GmbH v. Commission* [1966] ECR 299, [1966] CMLR 418.

¹¹⁵ Commission Regulation (EEC) No 1983/83 of 22 June 1983 on the application of Article 85(3) of the Treaty to categories of exclusive distribution agreements, OJ L 173/1, 30 June 1983, recitals 5-7 and 11.

¹¹⁶ Commission Regulation (EEC) No 1983/83 of 22 June 1983 on the application of Article 85(3) of the Treaty to categories of exclusive distribution agreements, OJ L 173/1, 30 June 1983.

¹¹⁷ Commission Regulation (EEC) No 1983/83 of 22 June 1983 on the application of Article 85(3) of the Treaty to categories of exclusive distribution agreements, OJ L 173/1, 30 June 1983, art. 1.

between competitors only if it was non-reciprocal and if the total annual turnover of at least one of the parties did not exceed ECU 100 million.¹¹⁸

The block exemption covered only agreements concerning the distribution of goods for resale. This led to that agreements relating primarily to services were not covered, but the borderline between goods and services could be unclear in certain cases.¹¹⁹ Goods which the purchasing party did not transform or process into other goods, which he did not use or consume in manufacturing other goods, or which he did not combine with other components into a different product were considered to be goods for resale.¹²⁰

The agreement had to provide that the supplier would only supply the contract goods exclusively to the distributor in the contract area, otherwise the block exemption was not applicable. From that followed that a distribution agreement which directly appointed more than one distributor in the same territory could not be exempted by the regulation, but there was a possibility for an individual exemption.

Regulation 1983/83 also contained additional obligations which the parties could undertake without losing the benefit of the block exemption. Article 2(1) of the regulation stipulated that apart from the obligation referred to in article 1 no restrictions on competition could be imposed on the supplier other than the obligation not to supply the contract goods to users in the contract territory.

Article 2(2) and (3) provided the list with additional obligations which could be imposed on the distributor without losing the benefit of the block exemption. The distributor could be obliged not to manufacture or distribute goods which competed with the contract goods. Due to this provision the supplier was given the possibility to set up a single-branded distribution network. The duration of the non-compete obligation was however limited to the duration of the EDA.

The distributor could also be imposed the obligation to obtain the contract goods for resale only from the supplier or the obligation to refrain, outside the contract territory and in relation to the contract goods, from seeking customers, from establishing any branch and from maintaining any distribution depot. This means that the supplier could impose on the distributor a ban on active sales outside the

¹¹⁸ Commission Regulation (EEC) No 1983/83 of 22 June 1983 on the application of Article 85(3) of the Treaty to categories of exclusive distribution agreements, OJ L 173/1, 30 June 1983, art. 3(a)-(b).

¹¹⁹ Commission Notice concerning Commission Regulations 1983/83 and 1984/83, 22 June 1983, [1984] OJ C101/02 as amended by Commission Notice [1992] OJ C121/2, para. 12.

¹²⁰ Commission Notice concerning Commission Regulations 1983/83 and 1984/83, 22 June 1983, [1984] OJ C101/02 as amended by Commission Notice [1992] OJ C121/2, para 9.

contract territory. For the first time in the European Community's history there was a distinction between active and passive sales.¹²¹

Other additional obligations which could be imposed on the distributor were the obligation to purchase complete ranges of goods or minimum quantities and the obligation to sell the contract goods under trade marks, or packed and presented as specified by the supplier. The distributor could also be under a duty to take measures for promotion of sales in particular to advertise, to maintain a sales network or stock of goods, to provide customer and guarantee services or employ staff having specialised or technical training.

Article 3(c) and (d) stipulated the conditions where the block exemption did not apply. The block exemption was inapplicable where the users could obtain the contract goods in the contract territory only from the exclusive distributor and had no alternative source of supply outside the contract territory. This provision prohibited absolute territorial protection and made parallel import possible. Obligations which limited the exclusive distributor's choice of customers or his freedom to determine his prices were not covered by the regulation.¹²²

The Commission had a possibility to withdraw the benefit of the block exemption by means of an individual decision under Regulation 17/62. That decision could not have retroactive effect.

6.2 Exclusive purchasing

The purpose with an exclusive purchasing agreement (EPA) is that a distributor agrees to buy all it needs of a particular product from a particular supplier. EPAs are common in the petrol stations sector and public houses selling only one general brand of beer.

An EPA may be beneficial to the supplier since it enables him to plan production and create a more efficient system of distribution. The purchaser is ensured the supply of the goods in question and he is also induced to promote the sales of the goods. These agreements can however foreclose a section of the market, by making it more difficult for other suppliers to find a distributor for their goods.

EPAs may fall within the ambit of article 81(1) but they may be exempted either individually or by a block exemption. The Commission issued Regulation

¹²¹ Faull J. and Nikpay A. *The EC Law of Competition* [1999] Oxford University Press, Oxford, p. 481.

¹²² Commission Regulation (EEC) No 1983/83 of 22 June 1983 on the application of Article 85(3) of the Treaty to categories of exclusive distribution agreements, OJ L 173/1, 30 June 1983, recitals 8.

1984/83¹²³ which on the basis of article 81(3) made article 81(1) inapplicable to certain formats of exclusive purchasing agreements.

There was only a substantial difference between Regulation 1983/83 and 1984/83. In the former regulation there was a possibility provided to the supplier to grant an exclusive territory to the distributor. Regulation 1984/83 may be seen as a diminished version of Regulation 1983/83. The partial overlap between the two block exemptions can be explained because of that the regulations should be used at different levels in the supply chain.¹²⁴

Article 1 in Regulation 1984/83 stipulated that the regulation was only applicable to agreements to which only two undertakings were party and whereby one party, the reseller, agreed with the other, the supplier, to purchase certain goods specified in the agreement for resale only from the supplier or from a connected undertaking or from another undertaking which the supplier had entrusted with the sale of his goods. However, the block exemption would not be applicable to EPAs entered into by competitors unless non-reciprocal and unless the turnover of at least one of the parties did not exceed ECU 100 million.¹²⁵

Requirements relating to 'goods for resale', 'two undertakings' and the inapplicability to agreements between competitors were the same in this regulation as in the regulation dealing with EDAs.

In order for the regulation to apply there had to be an exclusive purchasing obligation in the agreement. This obligation was defined as an obligation by which one party undertook to purchase certain goods only from the other party. The reseller had to purchase all his requirements for the contract goods from the supplier. If the purchasing obligation related to only part of such requirements, the regulation was not applicable. However, there were limited derogations from the above-mentioned principle. The parties could introduce an 'English clause', which allowed the reseller to obtain the contract goods from alternative sources of supply, if these sold them more cheaply or on more favourable terms than the other party. The parties could also introduce a clause in the EPA where the distributor was allowed to obtain the contract goods from alternative sources of supply when the supplier was not able to supply.¹²⁶

¹²³ Commission Regulation (EEC) No 1984/83 of 22 June 1983 on the application of Article 85(3) of the Treaty to categories of exclusive purchasing agreements, OJ L 173/5, 30 June 1983.

¹²⁴ Faull J. and Nikpay A. *The EC Law of Competition* [1999] Oxford University Press, Oxford, p. 489.

¹²⁵ Commission Regulation (EEC) No 1984/83 of 22 June 1983 on the application of Article 85(3) of the Treaty to categories of exclusive purchasing agreements, OJ L 173/5, 30 June 1983, art. 3(a)-(b).

¹²⁶ Commission Notice concerning Commission Regulations 1983/83 and 1984/83, 22 June 1983, [1984] OJ C101/02 as amended by Commission Notice [1992] OJ C121/2, para. 35.

In Regulation 1984/83 there was an absence of an exclusive territory. Where the distributor was granted an exclusive territory in an EPA the regulation was not applicable.¹²⁷ In such case, the agreement may be qualified as an EDA and may fall within the scope of Regulation 1983/83.

In the regulation there were additional obligations that could be imposed on the parties to an EPA without losing the benefit of the block exemption. The only obligation that could be imposed on the supplier was the obligation not to distribute the contract goods or goods which competed with the contract goods in the reseller's principal sales area and at the reseller's level of distribution.¹²⁸ This provision did not prevent the supplier from supplying other distributors located in the distributor's principal area even if they operated at the same level of trade. The supplier was only prevented from selling directly to his reseller's customers.¹²⁹

The distributor could accept an obligation not to manufacture or distribute goods which were in competition with the contract goods.¹³⁰ Such a non-compete obligation allowed the supplier to obtain a high degree of control over the distributor. Due to this provision the supplier was given the possibility to set up a single-branded distribution network. However, the regulation limited to five years the duration for the exclusive purchasing and non-compete obligations that fell within its scope of application.¹³¹ Such a limitation could not be found in Regulation 1983/83.

Article 2(3) contained some further additional obligations the distributor may undertake without losing the benefit of the block exemption. The distributor could agree to purchase complete ranges of goods or minimum quantities or to sell the contract goods under trademarks, or packed and presented as specified by the supplier. He could also undertake to take measures for the promotion of sales, in particular to advertise, to maintain a sales network or stock of goods, to provide customer and guarantee services or to employ staff having specialised or technical training.

¹²⁷ Commission Regulation (EEC) No 1984/83 of 22 June 1983 on the application of Article 85(3) of the Treaty to categories of exclusive purchasing agreements, OJ L 173/5, 30 June 1983, art. 16.

¹²⁸ Commission Regulation (EEC) No 1984/83 of 22 June 1983 on the application of Article 85(3) of the Treaty to categories of exclusive purchasing agreements, OJ L 173/5, 30 June 1983, art. 2(1).

¹²⁹ Commission Notice concerning Commission Regulations 1983/83 and 1984/83, 22 June 1983, [1984] OJ C101/02 as amended by Commission Notice [1992] OJ C121/2, para 37.

¹³⁰ Commission Regulation (EEC) No 1984/83 of 22 June 1983 on the application of Article 85(3) of the Treaty to categories of exclusive purchasing agreements, OJ L 173/5, 30 June 1983, art. 2(2).

¹³¹ Commission Regulation (EEC) No 1984/83 of 22 June 1983 on the application of Article 85(3) of the Treaty to categories of exclusive purchasing agreements, OJ L 173/5, 30 June 1983, art. 3(d).

The block exemption was not applicable where the exclusive purchasing obligation was agreed for more than one type of goods where these were neither by their nature nor according to commercial usage connected to each other. The reason why such a clause prevented the application of the block exemption was due to the fact that the Commission did not desire to exempt tying.

The regulation also stipulated a duration limit beyond which EPAs were not covered by the block exemption. Where the agreement was concluded for an indefinite duration or for a period of more than five years the block exemption was inapplicable. The Commission wanted to limit the impact EPAs may have at intra-brand and inter-brand level and the foreclosure effect.

The Commission had power to withdraw the benefit of the block exemption under certain circumstances stipulated in article 14.

It is also worth to mention that this regulation contained special provisions for beer supply and service-station agreements. However, these provision will not be analysed.

6.3 Franchising

A franchising agreement is an agreement between a franchisor and a franchisee, whereby the franchisor allows the franchisee to use certain intellectual property rights which belong to the former. These intellectual property rights may consist of trademarks, trade names and logos etc. The franchisee pays a royalty to the franchisor for the use of the intellectual property rights and he is for instance able to open up an own business and is assured that the goods and sales method has been tried and tested before. A franchise agreement also benefits the franchisor since he receives payment for the use of the intellectual property rights.

Franchising can be divided into three different forms according to the ECJ.¹³² These are service franchises, production franchises and distribution franchises. The Commission's decision in *Campari*¹³³ was addressed to production franchising. The legal status of distribution and service franchises was unclear until the Court delivered the *Pronuptia case*¹³⁴ in 1986.

The *Pronuptia* case was the first franchising case which was submitted to the ECJ for a preliminary ruling. The case arose before a national court in Germany in which Mrs Shillgalis, a Pronuptia franchisee, was sued for non-payment of

¹³² Case 161/84, *Pronuptia de Paris GmbH v. Pronuptia de Paris Irmgard Schillgalis* [1986] ECR 353, [1986] 1 CMLR 414, para. 13.

¹³³ Decision *Campari* [1978] OJ L70/69, [1978] 2 CMLR 397.

¹³⁴ Case 161/84, *Pronuptia de Paris GmbH v. Pronuptia de Paris Irmgard Schillgalis* [1986] ECR 353, [1986] 1 CMLR 414.

royalties. She argued that the franchise agreements were anti-competitive and the duty to pay royalties was void. This case related to distribution franchises but it was confirmed that the Commission in Regulation 4087/88¹³⁵ applied the same principles to service franchises.

The Court ruled that the question whether a franchise agreement was compatible with article 81(1) or not was dependent on the provisions in the agreement and on their economic context. Franchising was a method for an undertaking to derive financial benefit from its expertise without investing its own capital. The system gave traders without the necessary expertise access to methods which they could not have learned without considerable effort and allowed them to benefit from the reputation of a business name. A franchising system which allowed the franchisor to profit from his success did not interfere with competition.

Two conditions had to be met in order for the system to work. These conditions were set out in paragraphs 16 and 17 of the judgment. First, the franchisor had to communicate his know-how to the franchisees and provide them with necessary assistance in order to enable them to apply his methods, without running the risk that know-how and assistance might benefit competitors, even indirectly. Provisions which were essential in order to avoid that risk did not constitute restrictions on competition for the purposes of article 81(1). It was also justified to have restrictions on the franchisee to open a shop during the period of validity of the contract and after its expiry. Restrictions concerning transfer of a shop was also lawful. Secondly, the franchisor was able to take the necessary measures for maintaining the identity and reputation of the network bearing his business name or symbol. Provisions which established the means of control was not incompatible with article 81(1). Provisions which gave the franchisees a degree of territorial protection from each other were found to restrict competition for the purposes of article 81(1).

The Commission issued Regulation 4087/88¹³⁶ on the basis of the *Pronuptia* judgment. This regulation covered franchise agreements which were in compliance with the block exemption. For the purposes of the regulation 'franchise' meant a package on industrial or intellectual property rights relating to trade marks, trade names, shop signs, utility models, designs, copyrights, know-how or patents, to be exploited for the resale of goods or the provision of services to end users.¹³⁷

¹³⁵ Commission Regulation (EEC) No 4087/88 of 30 November 1988 on the application of Article 85(3) of the Treaty to categories of franchise agreements, OJ L 359/46, 28 December 1988.

¹³⁶ Commission Regulation (EEC) No 4087/88 of 30 November 1988 on the application of Article 85(3) of the Treaty to categories of franchise agreements, OJ L 359/46, 28 December 1988.

¹³⁷ Commission Regulation (EEC) No 4087/88 of 30 November 1988 on the application of Article 85(3) of the Treaty to categories of franchise agreements, OJ L 359/46, 28 December 1988, art. 1.3(a).

The regulation defined a ‘franchise agreement’ for the purpose of the block exemption as an agreement whereby one undertaking, the franchisor, granted the other, the franchisee, in exchange for direct or indirect financial consideration, the right to exploit a franchise for the purpose of marketing specified types of goods and/or services. It included at least obligations related to:

- the use of a common name or shop sign and a uniform presentation of contract premises and /or means of transport,
- the communication by the franchisor to the franchisee of know-how,
- the continuing provision by the franchisor to the franchisee of commercial or technical assistance during the life of the agreement¹³⁸

Only franchises which related to the sale of goods and/or supply of services to end users were exempted by the regulation. The payment of financial consideration for the right to use the franchise was something considered to differentiate from other distribution formats. The franchise network had to have a uniform and common network which the consumers could easily identify.

Article 2 in the regulation exempted certain restrictions which could be imposed on the franchisor or the franchisee. The franchisor was permitted to undertake not to grant the right to exploit all or part of the franchise to third parties in the contract territory. The franchisor could also undertake not to exploit the franchise himself or supply the franchisor’s goods to third parties in the contract area. The franchisee could be obliged to exploit the franchise only from the contract premises and to refrain, outside the contract territory, from seeking customers for the goods or the services which were the subject-matter of the franchise. Also a non-compete obligation for goods competing with the franchisor’s goods could be imposed on the franchisee.

The franchisee was also permitted to undertake certain obligations according to article 3, if it was necessary to protect the franchisor’s industrial or intellectual property rights or to maintain the common identity and reputation of the franchised network. It could for instance deal with obligations to sell or use goods which met minimum quality specifications laid down by the franchisor, not to engage in business which competed with the franchisor, to offer minimum ranges of goods, keep minimum stocks or achieve minimum turnover.

Article 3(2) listed further obligations which could be imposed on the franchisee. These included obligations not to disclose to third parties the know-how provided by the franchisor, to attend training courses and not to use the know-how licensed by the franchisor for purposes other than the exploitation of the franchise etc.

¹³⁸ Commission Regulation (EEC) No 4087/88 of 30 November 1988 on the application of Article 85(3) of the Treaty to categories of franchise agreements, OJ L 359/46, 28 December 1988, art. 1.3(b).

Certain conditions established in article 4 had to be met if the block exemption would be applicable. The franchisee had to be free to obtain the franchise goods from other franchisees, the franchisee was obliged to indicate its status as an independent undertaking and any guarantee for the goods should be applied irrespective of which member of the franchise network it was purchased from.

The 'black' list could be found in article 5. The regulation was not applicable if a franchise agreement was entered into by competitors or if the franchisee was prevented from obtaining supplies of goods of a quality equivalent to those offered by the franchisor and this was not warranted as a means to protect the franchisor's reputation or know-how. It was also prohibited to oblige the franchisee to sell goods made by the franchisor or someone designated by him if there was no objective justification. Fixed resale prices introduced by the franchisor was prohibited. The franchisee could not be imposed an obligation not to use the licensed know-how after termination of the agreement where the know-how had become generally known or easily accessible.

The regulation contained an article concerning the opposition procedure.¹³⁹ 'Grey' restrictions could be exempted by the block exemption if they were notified to the Commission and it did not oppose the application of the exemption within six months.¹⁴⁰

The Commission had power to withdraw the benefit of the block exemption under certain circumstances stipulated in article 8.

6.4 Selective distribution

Selective distribution can be defined as a distribution system whereby the supplier limits the number of dealers distributing his product. The selected dealers are prevented from selling to other dealers not belonging to the selective network. The reason why a supplier may choose this distribution system may be the assurance that there are qualified staff at the distribution level, that there is a high standard of after-sales service or that the exclusive image of the product can be upheld.

In order to achieve these goals, the supplier must have a certain degree of control and prevent unsuitable distributors from entering the distribution network. The supplier can obtain this control over the distribution of his product by the selective criteria for authorised dealers and the prohibition on sales to non-authorised dealers. This selection policy results in a reduction of dealers that distribute the

¹³⁹ Commission Regulation (EEC) No 4087/88 of 30 November 1988 on the application of Article 85(3) of the Treaty to categories of franchise agreements, OJ L 359/46, 28 December 1988, art. 6.

¹⁴⁰ Read more about this under subheading 3.9.2.

supplier's goods and this reduction establishes concerns for competition authorities.

Unlike the other distribution systems (EDA, EPA and franchising), selective distribution systems were not covered by any block exemption. Only individual exemptions could be granted by the Commission. The compatibility with competition rules had to be inferred by judgments from the Court and decisions from the Commission.

The view taken by the Court and Commission was that only certain categories of products deserved the applicability of a selective distribution system. These categories were clocks and watches,¹⁴¹ jewellery,¹⁴² personal computers,¹⁴³ dinner services,¹⁴⁴ cosmetics¹⁴⁵ and photographic products¹⁴⁶ etc. It seems like the selective distribution system was permitted primarily to consumer durables characterised by certain elements such as luxury and sophisticated image, technological complexity and high quality.

There was a distinction between four different forms of selective distribution and the distinction was very important when to determine whether these formats were compatible with EC competition rules.

The first form was unilateral selective distribution. The distributors were by the supplier simply unilaterally chosen to undertake the distribution of his products and the supplier did not impose any restraints concerning sales activity and he did not assume any obligation other than to supply the contract goods. This kind of selective distribution was not considered to be incompatible with article 81(1).

The second form was qualitative selective distribution. The process for selecting dealers was based on objective qualitative criteria. The supplier examined objectively whether the dealers were suitable to distribute the particular goods. These objective qualitative criteria were considered to be compatible with EC competition rules on condition that the principle of necessity and the principle of proportionality were respected. The compatibility of objective qualitative criteria with article 81(1) could also be dependent on the market structure. Where there was numerous parallel networks article 81(1) could be infringed.

The third form was qualitative selective distribution which imposed on the dealer additional promotional obligations. This led to a concentration of the dealers' efforts on the distribution of the supplied product. By accepting the promotional

¹⁴¹ Decision *Junghans* [1977] OJ L30/10, [1977] 1 CMLR D82.

¹⁴² Decision *Murat* [1983] OJ L348/20, [1984] 1 CMLR 219.

¹⁴³ Decision *IBM* [1984] OJ L118/24, [1984] 2 CMLR 342.

¹⁴⁴ Decision *Villeroy & Boch* [1985] OJ L376/15, [1988] 4 CMLR 461.

¹⁴⁵ Case T-19/91, *Vichy v. Commission* [1992] ECR II-415.

¹⁴⁶ Decision *Kodak* [1970] OJ L147/24, [1970] CMLR D19 and Decision *Dupont de Nemours Deutschland* [1973] OJ L194/27, [1973] CMLR D226.

obligation the agreement could fall within the scope of article 81(1) but they were likely to qualify for an individual exemption if they could result in economic advantages.

The last form was quantitative selective distribution whereby the supplier was engaged in a selection process which not only aimed to identify the most suitable dealers but also to predefine the global number of distributors which would be admitted to the distribution network. The Commission has always considered that quantitative selective distribution infringes article 81(1) and it can not be qualified for exemption.

Discriminatory application of selection criteria would result in the incompatibility of the selective distribution agreement with article 81, irrespective of its qualitative or quantitative nature. Discriminatory applications occurred for instance where the selection criteria was not applied uniformly to selection process.

In the *Metro*¹⁴⁷ case the Court stipulated that selective distribution agreements were compatible with article 81(1), provided that the resellers were chosen on the basis of objective criteria of a qualitative nature relating to the technical qualifications of the reseller and his staff and the suitability of his trading premises and that such conditions were laid down uniformly for all potential resellers and were not applied in a discriminatory fashion.

The supplier was allowed to impose on the distributors an obligation not to sell to non-approved distributors. The Commission has treated further resale restrictions very strictly. This approach taken by the Commission meant that approved distributors were free to supply the contract goods from other network distributors, (i.e. horizontally) not only vertically. Accordingly, an obligation imposed in the agreement on the distributor to source the contract goods only from the supplier would have infringed article 81.¹⁴⁸

Article 81 could also be infringed by resale restrictions which limited the ability of the appointed distributor to choose its customers. In this case the supplier imposed on the distributor an obligation to supply only customers located in a given territory. Such restrictions have always been considered prohibited by the Commission.

A non-compete obligation imposed on the distributor in a selective distribution agreement has been considered to infringe article 81 according to the Commission. The reason why the Commission has adopted this negative approach was that the ability of the distributor to sell competing products may

¹⁴⁷ Case 26/76, *Metro-SB-Grossmarkte GmbH & Co KG v. Commission and SABA* [1977] ECR 1875, [1978] 2 CMLR 1.

¹⁴⁸ Faull J. and Nikpay A. *The EC Law of Competition* [1999] Oxford University Press, Oxford, p. 505.

represent an efficient tool to counterbalance the reduction of intra-brand competition arising from a selective distribution system.

7 The new approach towards vertical restraints

The change in structure of distribution and other developments led to that the Commission got a growing feeling of unease with the effectiveness of its own competition policy concerning vertical restraints. As a consequence the Commission started a thorough review of its policy. The commencement of this review was the adoption of the *Green Paper on Vertical Restraints in EC Competition policy*.¹⁴⁹

The *Green Paper* recognised a number of shortcomings in the competition policy. The block exemption regulations then in force comprised rather strict form-based requirements and as a result they were considered too legalistic and worked as a strait-jacket. This was seen in the light of the major changes in distribution that had taken place. Undertakings with no market power suffered unnecessary regulation and this may have prevented the parties from using vertical restraints to improve their competitive position.

There was a risk that agreements falling within the scope of the block exemption regulations were distorting competition. The block exemption regulations were form-based instead of effect-based and did not contain any market share limit. This gave rise to the risk that companies with significant market power could benefit from the different block exemption regulations.

The block exemption regulations covered only vertical agreements concerned with the resale of final goods and not intermediate goods or services.¹⁵⁰ Therefore the majority of vertical agreements were not covered by any block exemption regulation. This resulted in legal uncertainty for a large number of vertical restraints.

To remedy these shortcomings the Commission required a more economic based approach. Vertical agreements should be analysed in their market context.

The Commission suggested a number of options in order to realise its new approach. They were not exhaustive and the Commission welcomed comments and submissions from interested parties. The options were:

- Option I, maintain the current system

¹⁴⁹ Commission's Green Paper on Vertical Restraints in EC Competition Policy, 22 January 1997, COM (96)721 Final, [1997] 4 CMLR 519.

¹⁵⁰ Only under Commission Regulation (EEC) No 4087/88 of 30 November 1988 on the application of Article 85(3) of the Treaty to categories of franchise agreements, OJ L 359/46, 28 December 1988, were services covered.

- Option II, wider block exemptions without a market share cap
- Option III, more focused block exemptions with a market share cap of [40%]
- Option IV-I, negative clearance presumption up to [20%] and above wider block exemptions without a market-share cap
- Option IV-II, negative clearance presumption up to [20%] and above wider block exemptions with a market share cap of [40%]

After further considerations the Commission issued a *Follow-up to the Green Paper on Vertical Restraints*.¹⁵¹ The Commission gave a summary of the reactions to the *Green Paper* and made a policy proposal.

The new policy proposal was based on a more economic approach in order to remedy the shortcomings of the policy in force. First and foremost competition and market integration should be protected. A reasonable level of legal certainty for business should be provided and this would result in acceptable enforcement costs for industry and the competition authorities and increase decentralisation.

The basis of the new policy was one very wide block exemption regulation that would cover all vertical agreements concerning intermediate and final goods and services, except for a limited number of hardcore restraints. The regulation should be based mainly on a black-clause approach, i.e. defining what was not exempted instead of defining what was exempted. Market share caps should be used to link the exemption to market power. The question was whether one or two market share thresholds should be used. The market share threshold(s) would create a safe harbour to distinguish the agreements that would be presumed to be legal from those which would not be legal. If the market share threshold(s) was/were exceeded negative clearance, individual exemption or prohibition could be received.¹⁵²

The Commission also suggested that national courts and national competition authorities would be able to apply the block exemption and if above the market share threshold(s) apply article 81(1). The national competition authorities should also be able to withdraw the benefit of the block exemption in respect of their territory. Guidelines would be adopted for the guidance of the new regulation.¹⁵³

¹⁵¹ Commission Communication on the application on the Community competition rules to vertical restraints, *Follow-up to the Green Paper on Vertical Restraints*, 26 November 1998, [1998] OJ C 365/3.

¹⁵² Commission Communication on the application on the Community competition rules to vertical restraints, *Follow-up to the Green Paper on Vertical Restraints*, 26 November 1998, [1998] OJ C 365/3, page 28.

¹⁵³ Commission Communication on the application on the Community competition rules to vertical restraints, *Follow-up to the Green Paper on Vertical Restraints*, 26 November 1998, [1998] OJ C 365/3, page 29.

The competition policy review was welcomed by many since the old system had been very criticised. Especially the Commission was the main target of the criticism:

‘The most fundamental, and the most trenchant, criticism is that the Commission too broadly applies Article 85(1) to agreements having little or no anticompetitive effects. This criticism rests on three pillars: 1) an inadequate economic analysis under Article 85(1); 2) an unpersuasive rationale for this overbroad application of 85(1), notably the ‘economic freedom’ notion; and 3) the Commission’s historical and continuing resistance to Court judgments evidencing a more nuanced economics-based interpretation of 85(1).’¹⁵⁴

Many persons were involved in the debate concerning the Commission’s new approach towards vertical restraints and its *Green Paper*. A number of articles were published which dealt with this subject.¹⁵⁵

¹⁵⁴ Hawk B. *System Failure: Vertical Restraints and EC Competition Law*, [1995] 32 CMLRev. p. 973-989, p. 974-975.

¹⁵⁵ See Biro Z. and Fletcher A. *The E.C. Green Paper on Vertical Restraints: An Economic Comment*, [1998] ECLR p. 129-138, de la Cruz P. *Vertical Restraints: U.S. and E.U. Policy Toward Manufacturer – Retailer Relationships*, [1997] 5 ECLR p. 292-299, Korah V. *The Future of Vertical Agreements under E.C. Competition Law*, [1998] ECLR p. 506-513, Lugard H.H.P. *Vertical Restraints under EC Competition Law: A Horizontal Approach?*, [1996] 3 ECLR p. 166-177, Murray F. and MacLennan J. *The Future for Selective Distribution Systems: The CFI Judgments on Luxury Perfume and the Commission Green Paper on Vertical Restraints*, [1997] 4 ECLR p. 230-233, Nazerali J. and Cowan D. *Reforming E.U. Distribution Rules – Has the Commission Found Vertical Reality?*, [1999] ECLR p. 159-168, Nazerali J. and Cowan D. *The Commission’s Draft Communication on Distribution Agreements – Market Shares are Predictably Back on the Table!* [1998] ECLR p. 409-413, Nazerali J. and Cowan D. *Unlocking E.U. Distribution Rules – Has the European Commission Found the Right Keys?*, [2000] ECLR p. 50-56, O’Toole F. *The E.C. Green Paper on Vertical Restraints: Option IV Defended*, [1999] ECLR p. 5-8, Pheasant J. and Weston D. *Vertical Restraints, Foreclosure and Article 85: Developing an Analytical Framework*, [1997] 5 ECLR p. 323-328, Riley A.J. *Vertical Restraints: A Revolution?*, [1998] ECLR p. 483-492, Schroeder D. *The Green Paper on Vertical Restraints: Beware of Market Share Thresholds* [1997] 7 ECLR p. 430-434.

8 Council Regulations 1215/99 and 1216/99

In order to prepare for the new policy approach, significant changes to two old regulations were required. Therefore the Council adopted two new Council regulations on 10 June 1999 which entered into force on 18 June 1999. Council Regulation 1215/99¹⁵⁶ amends Regulation 19/65¹⁵⁷ and Council Regulation 1216/99¹⁵⁸ amends Regulation 17/62¹⁵⁹.

Regulation 1215/99 extended the legislative powers granted to the Commission by Regulation 19/65. Such extension was considered necessary because Regulation 19/65 was 'restricted to a limited number of vertical restraints, namely, exclusive distribution of goods for resale, exclusive purchase of goods for resale, obligations in respect of exclusive supply and exclusive purchase for resale, and restrictions imposed in relation to the assignment or use of industrial property rights'.¹⁶⁰ The amendment enabled the Commission to adopt a much broader block exemption regulation, covering all vertical agreements affecting finished or intermediate goods or services, including vertical agreements concluded by certain associations of retailers.

Regulation 1215/99 amended Regulation 19/65 in such a way that the Commission is no longer obliged to specify a so-called 'white' list of clauses that may be contained in the agreement. As a result the new block exemption regulation only contains a so-called 'black' list.

The amendment in Regulation 19/65 also gives the Commission the possibility to adopt a regulation declaring that the block exemption will not apply to certain parallel networks of similar agreements or concerted practices on a particular market. Article 8 in the new regulation is an expression of this new power which enables the Commission to adopt a regulation where parallel networks of similar vertical restraints cover more than 50% of a relevant market.

¹⁵⁶ Council Regulation (EC) No 1215/1999 of 10 June 1999 amending Regulation No 19/65/EEC on the application of Article 85(3) of the Treaty to certain categories of agreements and concerted practices, OJ L 148/1, 15 June 1999.

¹⁵⁷ Council Regulation No 19/65/EEC of 2 March 1965 on the application of Article 85(3) of the Treaty to certain categories of agreements and concerted practices, OJ 36/533, 6 March 1965, special edition 1965-66, p. 35.

¹⁵⁸ Council Regulation (EC) No 1216/1999 of 10 June 1999 amending Regulation No 17: first Regulation implementing Articles 81 and 82 of the Treaty, OJ L 148/5, 15 June 1999.

¹⁵⁹ Council Regulation No 17 of 6 February 1962. First Regulation implementing Articles 85 and 86 of the Treaty, OJ 13/204, 21 February 1962, special edition 1959-62, p. 87.

¹⁶⁰ Commission Communication on the application on the Community competition rules to vertical restraints, Follow-up to the Green Paper on Vertical Restraints, 26 November 1998, [1998] OJ C 365/3, page 35.

Regulation 1215/99 amended Regulation 19/65 in the way that enables a Member State to withdraw the benefit of the block exemption from agreements having certain effects which are incompatible with article 81(3) on the territory of a Member State which has all the characteristics of a distinct market.

Regulation 1216/99 amended Regulation 17/62. Under the former system of Regulation 17/62 many vertical agreements falling under article 81(1), despite fulfilling the requirements for exemption under article 81(3), were automatically void under article 81(2) until they had been notified to the Commission. The amendment of Regulation 17/62 enables vertical agreements to be exempted retroactively when they are 'entered into by two or more undertakings, each operating for the purposes of the agreement, at a different level of the production or distribution chain, and relate to the conditions under which the parties may purchase, sell or resell certain goods or services'.¹⁶¹ More about this amendment can be read under subheading 9.3.4.

¹⁶¹ Council Regulation (EC) No 1216/1999 of 10 June 1999 amending Regulation No 17: first Regulation implementing Articles 81 and 82 of the Treaty, OJ L 148/5, 15 June 1999, art. 1.

9 The new block exemption regulation concerning vertical agreements and concerted practices

The Commission adopted Regulation 2790/1999¹⁶² on Vertical Agreements and Concerted Practices on 22 December 1999. The regulation entered into force on 1 January 2000 and the new block exemption applies with effect from 1 June 2000. It is only applicable to agreements falling within the scope of article 81(1). The former block exemptions covering EDAs, EPAs and franchise agreements which would expire before the new regulation came into force were prolonged until 31 May 2000.¹⁶³ The regulation consists of 17 recitals and 13 articles. In addition to the survey below more can be read about this regulation in an article written by Whish.¹⁶⁴

9.1 Article 1: definitions

Article 1 consists of different definitions which are relevant when the regulation is applicable. Article 1(a) provides that ‘competing undertakings’ means actual or potential suppliers in the same product market. The product market includes goods or services which are regarded by the buyer as interchangeable with or substitutable for the contract goods or services, by reason of the products’ characteristics, their prices and their intended use.

Article 1(b) explains ‘non-compete obligation’ as any direct or indirect obligation causing the buyer not to manufacture, purchase, sell or resell goods or services which compete with the contract goods or services. It may also be any direct or indirect obligation on the buyer to purchase from the supplier or from another undertaking designated by the supplier more than 80% of the buyer’s total purchases of the contract goods or services and their substitutes on the relevant market, calculated on the basis of the value of its purchases in the preceding calendar year.

¹⁶² Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices, OJ L 336/21, 29 December 1999, [2000] 4 CMLR 398.

¹⁶³ Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices, OJ L 336/21, 29 December 1999, [2000] 4 CMLR 398, art. 12(1).

¹⁶⁴ Whish R. *Regulation 2790/99: The Commission’s “new style” block exemption for vertical agreements*, [2000] CMLRev. No 4, p. 887-924.

The terms ‘exclusive supply obligation’, ‘selective distribution system’, ‘intellectual property rights’, ‘know-how’ and ‘buyer’ are also explained.

9.2 Article 2: scope of the block exemption regulation

9.2.1 Article 2(1): Vertical agreements

Article 2(1) stipulates that article 81(1) is not applicable to agreements or concerted practices entered into between two or more undertakings each of which operates, for the purpose of the agreement, at a different level of the production or distribution chain, and relating to the conditions under which the parties may purchase, sell or resell certain goods or services.

There are three elements which can be found in this definition. The first is that the agreement or concerted practice has to be entered into between two or more undertakings. This means that the block exemption is not applicable where one of the parties is a final consumer not operating as an undertaking.

The second element is that each of the undertakings must, for the purpose of the agreement, operate at a different level of the production or distribution chain. This means for instance that one undertaking is a manufacturer, the second a wholesaler and the third a retailer. The element does not preclude an undertaking from acting on different levels in the production or distribution chain.

The third element is that the agreement relates to the conditions under which the parties may purchase, sell or resell certain goods or services. Consequently all agreements relating to final and intermediate goods or services are covered by the block exemption. The only exception is agreements in the automobile sector as long as this sector is covered by Regulation 1475/95.¹⁶⁵ Goods sold and purchased for renting to third parties are covered by the block exemption but rent and lease agreements as such are not covered since no goods or services are sold in that case.¹⁶⁶

¹⁶⁵ Commission Regulation (EC) No 1475/95 of 28 June 1995 on the application of Article 85(3) of the Treaty to certain categories of motor vehicle distribution and servicing agreements, [1995] OJ L 145/25.

¹⁶⁶ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 25.

9.2.2 Article 2(2): Associations of retailers

Article 2(2) of the regulation stipulates that vertical agreements are exempted if entered into between an association of undertakings and its members, or between such an association and its suppliers, only if all its members are retailers of goods and if no individual member of the association, together with its connected undertakings, has a total annual turnover exceeding EUR 50 million. Retailers are distributors which resell goods to final consumers.

However, an association of undertakings may involve both horizontal and vertical agreements. In this case the horizontal agreements have to be assessed first. Only if the horizontal agreements are permitted it is relevant to assess the vertical agreements between the association and its members or between the association and its suppliers.¹⁶⁷

9.2.3 Article 2(3): Vertical agreements containing provisions on intellectual property rights (IPRs)

The block exemption regulation includes in its application vertical agreements containing certain provisions which relate to the assignment to the buyer or use by the buyer of intellectual property rights. All other vertical agreements containing IPR provisions are excluded from being exempted.

Five conditions must be fulfilled if the block exemption shall be applicable to vertical agreements containing IPR provisions. Firstly, the IPR provisions must be a part of a vertical agreement, i.e. the parties may purchase, sell or resell goods or services. The first condition makes clear that the regulation is not applicable to:

- agreements where a party provides another party with a recipe and licences the other party to produce a drink with this recipe,
- agreements under which one party provides another party with a mould or master copy and licences the other party to produce and distribute copies,
- the pure licence of a trade mark or sign for the purposes of merchandising,
- sponsorship contracts concerning the right to advertise oneself as being an official sponsor of an event,
- copyright licensing such as broadcasting contracts concerning the right to record and/or the right to broadcast an event,¹⁶⁸

¹⁶⁷ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 29.

¹⁶⁸ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 32.

Secondly, the IPRs must be assigned to, or for use by, the buyer. The second condition makes clear that the regulation is not applicable where the IPRs are provided by the buyer to the supplier.

Thirdly, the IPRs must not constitute the primary object of the agreement. This makes clear that the primary object for an agreement has to be the purchase or distribution of goods or services in order for the block exemption to apply. IPR provisions must only serve the implementation of the vertical agreement.

Fourthly, the IPR provisions must be directly related to the use, sale or resale of goods or services by the buyer or its customers. The fourth condition requires that the IPRs must facilitate the use, sale or resale of goods or services by the buyer or his customers.

Fifthly, the IPR conditions must not, in relation to the contract goods or services, contain restrictions of competition having the same object or effect as vertical restraints which are not exempted under the regulation. This condition stipulates that IPRs must not have the same object or effect as any of the hard-core restrictions listed in article 4 or any of the restrictions excluded from the coverage of the block exemption by article 5.

These five conditions ensure that where the main object of an agreement is the purchase or distribution of goods or services, restrictions concerning the assignment or use of IPRs can be covered by the block exemption regulation.

9.2.4 Article 2(4): Vertical agreements between competitors

Article 2(4) of the regulation explicitly stipulates that the regulation is not applicable to vertical agreements entered into between competing undertakings. The definition ‘competing undertakings’ can be found above under subtitle 8.1 and in paragraph 26 in the *Guidelines*.

However, there are three exceptions to the general exclusion of vertical agreements between competitors and these relate to non-reciprocal agreements. A non-reciprocal agreement means for instance that two manufacturers enter into an agreement whereby one party undertakes to distribute the products of the other party. The other party does not become distributor of the products of the first party.¹⁶⁹

Non-reciprocal agreements between competing undertakings are covered by the block exemption if:

¹⁶⁹ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 27.

- the buyer has a total annual turnover not exceeding EUR 100 million, or
- the supplier is a manufacturer and a distributor of goods, while the buyer is a distributor not manufacturing goods competing with the contract goods, or
- the supplier is a provider of services at several levels of trade, while the buyer does not provide competing services at the level of trade where it purchases the contract services.

The second exception deals with situations of dual distribution of goods and the third exception deals with dual distribution of services.

9.2.5 Article 2(5): Agreements within the scope of another block exemption

Article 2(5) states that the regulation shall not apply to vertical agreements the subject matter of which falls within the scope of any other block exemption regulation. It is important to notice that the regulation does not apply to agreements which generically are of a kind covered by another regulation. The regulation is therefore not only inapplicable to agreements which are exempted under another regulation.¹⁷⁰

The regulation is not applicable to agreements falling within the scope of Commission Regulation 240/96¹⁷¹ on technology transfer, Commission Regulation 1475/95¹⁷² for car distribution or Commission Regulations 417/85¹⁷³ and 418/85¹⁷⁴ for vertical aspects of specialisation and R&D or any future regulations.

¹⁷⁰ Whish R. *Regulation 2790/99: The Commission's "new style" block exemption for vertical agreements*, [2000] CMLRev. No 4, p. 887-924, p. 907.

¹⁷¹ Commission Regulation (EC) No 240/96 of 31 January 1996 on the application of Article 85(3) of the Treaty to certain categories of technology transfer agreements, OJ L 31/2, 9 February 1996.

¹⁷² Commission Regulation (EC) No 1475/95 of 28 June 1995 on the application of Article 85(3) of the Treaty to certain categories of motor vehicle distribution and servicing agreements, [1995] OJ L 145/25.

¹⁷³ Commission Regulation (EEC) No 417/85 of 19 December 1984 on the application of Article 85(3) of the Treaty to categories of specialisation agreements, OJ L 53/1, 22 February 1985.

¹⁷⁴ Commission Regulation (EEC) No 418/85 of 19 December 1984 on the application of Article 85(3) of the Treaty to categories of research and development agreements, OJ L 53/1, 22 February 1985.

9.3 Article 3: The market share cap

9.3.1 The reasons why there is a market share test

The market share cap is one of the key features of the block exemption regulation. The inclusion of a market share cap is the result of the economics-oriented approach that the Commission wished to adopt in the new regime. The Commission made an attempt to introduce a market share cap in Regulation 240/96 but the proposal was eventually dropped since the idea was criticised. Therefore a market share test was included for the first time in the block exemption regulation.

There are various reasons why a market share cap was introduced in the block exemption regulation. First, there was dissatisfaction because of the over-application of article 81(1) to vertical agreements. Vertical agreements were considered to be detrimental to competition only if the parties to them possessed market power.¹⁷⁵ Secondly, understanding of market definition has developed in recent years, first and foremost by advisors and their clients. The *Commission's Notice on the definition of the relevant market for the purposes of Community competition law*¹⁷⁶ has contributed to this understanding. Lawyers and economists are involved in market definitions on a daily basis.

Market share is discussed in recitals 8 and 9 in the regulation. Recital 8 states that it can be presumed that where the share of the relevant market of the supplier or the buyer does not exceed 30%, there will be an improvement in production or distribution and the consumers will derive a fair share of the benefit, unless the agreement contains severe anti-competitive restraints. However, recital 9 states that there can be no presumption that vertical agreements above the market share threshold of 30% will give rise to such objective advantages as to compensate for the disadvantages.

9.3.2 What and whose market share

In the *Green Paper* the Commission suggested at one point that certain vertical restraints should be permitted if the market share was 40% or less, but vertical restraints which could give rise to greater concern would only be permitted if the market share was below 20%. Instead of adopting this proposal which would have caused unnecessary complexity, there was a compromise of a market share cap of 30%.

¹⁷⁵ Whish R. *Regulation 2790/99: The Commission's "new style" block exemption for vertical agreements*, [2000] CMLRev. No 4, p. 887-924, p. 907.

¹⁷⁶ Commission Notice on the definition of the relevant market for the purposes of Community competition law, 9 December 1997, [1997] OJ C 372/5.

The inclusion of a market share cap in the new block exemption regulation means that undertakings which were exempted under the old regulations, and whose market share exceeds 30%, will be ineligible for block exemption under the new regulation.

The block exemption regulation confers a presumption of legality for vertical agreements depending on the market share of the supplier or the buyer. Article 3(1) provides that an agreement benefits from the block exemption where the market share held by the supplier does not exceed 30% of the relevant market on which it sells the contract goods or services. There is only one exception to this. Article 3(2) provides that a vertical agreement which contains exclusive supply obligations benefits from the block exemption where the market share held by the buyer does not exceed 30% of the relevant market on which it purchases the contract goods or services. The term 'exclusive supply obligation' is defined in article 1(c) and covers only the situation where the supplier is obliged to sell the goods or services only to one buyer inside the Community for the purposes of a specific use or for resale.

In the case where a Chinese undertaking appoints one distributor in Sweden and one in Denmark and another one for the rest of the Community, there is not an exclusive supply obligation and therefore the Chinese supplier's market share is relevant. Where the supplier appoints only one undertaking for the entire Community market the latter's market share is relevant. It is the buyer's share of the purchase market that is calculated and relevant, not the market share on which it sells.¹⁷⁷

Even if a vertical agreement may have effects not only on the market between the supplier and the buyer but on markets downstream of the buyer, the block exemption regulation only takes into account the market shares of the parties to the agreement itself. The Commission states that below the threshold of 30% the effects will in general be limited on downstream market. The fact that it is only necessary to consider the market between the supplier and the buyer makes the application of the block exemption regulation easier and enhances the level of legal certainty.¹⁷⁸ In the case where a vertical agreement creates problems in related markets, there is a possibility for the Commission to withdraw the benefit of the block exemption according to article 6.¹⁷⁹

¹⁷⁷ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter V, para. 92.

¹⁷⁸ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 22.

¹⁷⁹ Whish R. *Regulation 2790/99: The Commission's "new style" block exemption for vertical agreements*, [2000] CMLRev. No 4, p. 887-924, p. 909.

9.3.3 No presumption of illegality

Where a vertical agreement exceeds the market share cap and therefore falls outside the block exemption regulation there will not be a presumption of illegality.¹⁸⁰ However, there may be a need for individual examination. Undertakings are encouraged to make their own assessment without notification. In the case where the Commission makes the individual examination the latter bears the burden of proof that the agreement infringes article 81(1).

9.3.4 No need for precautionary notification due to Council Regulation 1216/99

Regulation 1216/99¹⁸¹ introduced a very important procedural change in relation to notification of agreements for individual exemption. As a general proposition an agreement can only be granted individual exemption where it has been notified to the Commission pursuant to article 4(1) of Regulation 17/62. However, there has always been a narrow exception to this rule pursuant to article 4(2) of Regulation 17/62.

When the new block exemption regulation was to be adopted, there was a fear that the inclusion of a market share cap and uncertainty may cause a spate of precautionary notifications. Therefore the Commission proposed that the Council should broaden the scope of application of article 4(2) of Regulation 17/62. All vertical agreements should be exempted from the requirement that they be notified prior to individual exemption. The Council followed the Commission's proposal and adopted Regulation 1216/99. The Commission's view is that Regulation 1216/99 has retroactive effect.¹⁸²

The practical advantage of the adoption of Regulation 1216/99 is that the Commission in the future will, even in the event of late notification or no notification at all, be able to adopt an exemption decision taking effect from the date on which the agreement was concluded, rather than from the date it was notified.¹⁸³ As a consequence no precautionary notifications need to be made.

In the case of a dispute, an undertaking can still notify and where the four conditions of article 81(3) are fulfilled, the Commission can not deny retroactive

¹⁸⁰ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 62.

¹⁸¹ Council Regulation (EC) No 1216/1999 of 10 June 1999 amending Regulation No 17: first Regulation implementing Articles 81 and 82 of the Treaty, OJ L 148/5, 15 June 1999.

¹⁸² Whish R. *Regulation 2790/99: The Commission's "new style" block exemption for vertical agreements*, [2000] CMLRev. No 4, p. 887-924, p. 894.

¹⁸³ Council Regulation (EC) No 1216/1999 of 10 June 1999 amending Regulation No 17: first Regulation implementing Articles 81 and 82 of the Treaty, OJ L 148/5, 15 June 1999, recital 5 and 8.

exemption simply because the undertaking did not notify earlier. The notifying party does not have to explain why the agreement was not notified earlier.

The amendment of article 4(2) of Regulation 17/62 will strengthen the civil enforceability of agreements. A party to an agreement who seeks to avoid a contractual obligation will not be able to argue that the agreement is unenforceable solely on ground that it was not notified. However, there is nothing that says that undertakings can not notify, only that they need not notify in order to claim exemption.

The Commission will not impose fines, where the undertakings have not notified an agreement because they assumed that the market share cap was not exceeded.¹⁸⁴ The new amendment of article 4(2) of Regulation 17/62 will cease to have effect if the proposal in the *Commission's White Paper on Modernisation*¹⁸⁵ is implemented. In that case notification for individual exemptions will be abandoned altogether.

9.3.5 Portfolio of products distributed through the same distribution system

A supplier may use the same distribution agreement to distribute several goods or services. Some of these goods or services may be covered by the block exemption regulation where the market share threshold is not exceeded, but some may not. The block exemption regulation applies to the goods or services for which the conditions of application are fulfilled. In relation to the goods or services which are not covered by the block exemption regulation, there is no presumption of illegality, and the Commission will consider whether any infringement of article 81(1) could be resolved by alterations to the existing distribution system.¹⁸⁶

9.4 Article 4: Hard-core restrictions

Article 4 contains a list of hard-core restrictions. An agreement containing any of these hard-core restrictions leads to the exclusion of the whole vertical agreement from the scope of application of the block exemption regulation. The *Guidelines* stipulates that there is no severability for hard-core restrictions.¹⁸⁷ Even if the

¹⁸⁴ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 65.

¹⁸⁵ Commission White Paper on modernisation of the rules implementing Articles 85 and 86 of the EC Treaty, Commission programme No 99/027, adopted 28 April 1999, [1999] OJ C 132/1, 12 May 1999.

¹⁸⁶ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 68-69.

¹⁸⁷ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 66.

article states that the agreement can not be block exempted if it contains restrictions by object, and not by effect, the block exemption regulation is not applicable where the agreement directly or indirectly, in isolation or in combination with other factors, has one of the prohibited objects. So even if the word ‘effect’ can not be found in the article, the scope of the exclusion of the block exemption is extensive.¹⁸⁸

If an agreement contains any of these hard-core restrictions, the parties may apply for an individual exemption. However, it is unlikely that the agreement will be granted an individual exemption.¹⁸⁹

9.4.1 Article 4(a): Resale price maintenance (RPM)

Article 4(a) concerns resale price maintenance, which are agreements or concerted practices having as their object the establishment of a fixed or minimum resale price or a fixed or minimum price level to be observed by the buyer. RPM can be established directly in an agreement or concerted practice and then there is no doubt about the restriction. However, RPM can be established through indirect means, for instance in agreements fixing the distribution margin, fixing the maximum level of discount the distributor can grant from a prescribed price level, threats, intimidation, warnings, penalties or contract terminations in relation to observance of a given price level.¹⁹⁰

To make direct or indirect price fixing more effective it may be an inducement to combine it with other measures, such as implementation of a price monitoring system, the supplier printing a recommended resale price on the product or to oblige the buyer to apply a most-favoured-customer clause.¹⁹¹

However, the *Guidelines* makes it clear that the imposition of maximum sale prices or a list of recommended prices is permitted. It does not in itself lead to RPM.¹⁹²

9.4.2 Article 4(b): Territorial and customer restrictions

Article 4(b) contains a hard-core restriction relating to market partitioning by territory or by customers. This provision concerns agreements or concerted

¹⁸⁸ Whish R. *Regulation 2790/99: The Commission’s “new style” block exemption for vertical agreements*, [2000] CMLRev. No 4, p. 887-924, p. 912.

¹⁸⁹ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 46.

¹⁹⁰ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 47.

¹⁹¹ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 47.

¹⁹² Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 47.

practices which direct or indirect have the object to restrict the sales by the buyer, in as far as the restrictions relate to the territory into which or the customers to whom the buyer may sell the contract goods or services.

The restriction may be achieved by direct means such as an obligation not to sell to certain customers or to customers in certain territories. Also indirect measures such as refusal or reduction of bonuses or discounts, refusal to supply or reduction of supplied volumes can establish a restriction.¹⁹³

There are restrictions that are not regarded as hard-core under article 4(b) according to the *Guidelines*. The supplier can impose on all the distributors a prohibition to sell to certain end users if there is an objective justification related to the product. The justification may be health, safety or an obligation on the reseller relating to the display of the supplier's brand name.¹⁹⁴

There are four exceptions to the prohibition in article 4(b). The first exception allows the supplier to impose on the buyer a restriction on active sales into the exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another buyer. It is allowed to sign an agreement whereby the supplier combines the allocation of an exclusive territory and an exclusive customer group. Passive sales to such a territory or customer group must however be permitted.¹⁹⁵

The distinction between 'active' and 'passive' sales is clear in the *Guidelines*. 'Active' sales mean actively approaching individual customers inside another distributor's exclusive territory or exclusive customer group by for instance direct mail or visits'.¹⁹⁶ 'Passive' sales mean responding to unsolicited requests from individual customers including delivery of goods or services to such customers'.¹⁹⁷

The *Guidelines* also discuss how the use of Internet should be dealt with. It begins by stating that every distributor has to be free to use the Internet to advertise or to sell products. The use of Internet for selling is generally not regarded as active sales since it is a reasonable way to reach many customers. However, active sales takes place where the distributor sends unsolicited e-mails to individual customers or specific customer groups. The supplier may impose on

¹⁹³ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 49.

¹⁹⁴ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 49.

¹⁹⁵ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 50.

¹⁹⁶ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 50.

¹⁹⁷ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 50.

the distributor quality standard requirements for the use of the Internet site to resell his goods.¹⁹⁸

There are three other exceptions to the hard-core restriction in article 4(b). Concerning these exceptions it is allowed to restrict both active and passive sales. It is permissible to restrict sales to end users by a buyer operating at the wholesale level and to restrict sales to unauthorised distributors by the members of a selective distribution system. It is also allowed to impose a restriction of the buyer's ability to sell components, supplied for the purposes of incorporation, to customers who would use them to manufacture the same type of goods as those produced by the supplier.

9.4.3 Article 4(c): The restriction of active or passive sales to end users by members of a selective distribution system operating at the retail level of trade

Article 4(c) makes the block exemption regulation inapplicable where there are restrictions on active or passive sales by selected distributors at the retail level of trade to end users. An end user may be a professional buyer or a final consumer.

Selective distribution may be combined with exclusive distribution on condition that active or passive selling must not be restricted anywhere. If there is such a combination the supplier is only obliged to supply one distributor or a limited number of distributors in a specific territory.¹⁹⁹

Where there is a selective distribution agreement the supplier may impose a restriction on the distributor's ability to determine the location of the business premises. The distributor may be prohibited from operating out of an unauthorised place of establishment.

9.4.4 Article 4(d): Restrictions on cross-supplies within a selective distribution system

The hard-core restriction in article 4(d) concerns agreements whose direct or indirect object is the restriction of cross-supplies between distributors within a selective distribution system, including between distributors operating at different level of trade. The purpose behind this hard-core restriction is that selective distributors must remain free to purchase the contract goods from any approved distributor, operating either at different or the same level of trade. To impose an

¹⁹⁸ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 51.

¹⁹⁹ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 53.

obligation on the distributor to purchase the contract goods solely from one source is therefore prohibited.²⁰⁰

9.4.5 Article 4(e): Restrictions on the supplier's ability to supply components to third parties

This hard-core restriction makes the block exemption regulation inapplicable where an agreement between a manufacturer of spare parts and a buyer who incorporates these parts into his own products, either directly or indirectly, prevent or restrict sales by the manufacturer of these spare parts to end users, independent repairers or service providers.

End users and independent service providers should be free to obtain spare parts. However, an original equipment manufacturer can insist that repairers and service providers within its network should buy the spare parts from him.²⁰¹

9.5 Article 5: Obligations in vertical agreements that are not exempted

Article 5 contains a list with certain obligations which are excluded from the coverage of the block exemption regulation. These obligations are excluded even though the market threshold is not exceeded. However, the block exemption regulation continues to apply to the remaining parts of the vertical agreement if they are severable from the obligations which are not exempted.²⁰²

9.5.1 Article 5(a): Non-compete obligations

Article 5(a) contains the first exclusion from the block exemption regulation. It stipulates that the block exemption regulation is not applicable to 'any direct or indirect non-compete obligation, the duration of which is indefinite or exceeds five years'. The definition of a non-compete obligation was explained above under subheading 9.1.

Non-compete obligations are covered by the block exemption regulation if their duration is limited to five years or less. Non-compete obligations are also permissible when renewal beyond five years requires explicit consent of both parties and no obstacles exist that hinder the buyer from effectively terminating the

²⁰⁰ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 55.

²⁰¹ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 56.

²⁰² Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 57 and 67.

non-compete obligation at the end of the five-year period. A non-compete obligation which is tacitly renewable beyond a period of five years is to be deemed to have been concluded for an indefinite duration and is therefore not exempted under the regulation.²⁰³

This five-year duration limit does not apply where the contract goods or services are sold by the buyer from premises and land owned by the supplier or leased by the supplier from third parties not connected with the buyer. However, the duration of the non-compete obligation must not exceed the period of occupancy of the premises and land by the buyer. Constructions intended to avoid the five-year limit, for instance artificial ownership, can not benefit from this exception. The reason why this exception is exempted is that would normally be unreasonable to expect the supplier to allow competing products to be sold from premises and land owned by the supplier without his consent.²⁰⁴

9.5.2 Article 5(b): Post-term non-compete obligations

Article 5(b) contains the second exclusion from the block exemption regulation. This article deals with post-term non-compete obligations, which means ‘any direct or indirect obligation causing the buyer, after termination of the agreement, not to manufacture, purchase, sell or resell goods or services’.

Such obligation does not normally fall within the scope of the block exemption regulation, unless the obligation relates to a post-term ban on sales of competing goods or services from the point of sale at which the buyer operated during the contract period which is necessary to protect know-how transferred from the supplier to the buyer. This post-term non-compete obligation is limited to a period of one year after termination of the agreement.²⁰⁵

The term ‘know-how’ is defined in article 1(f). It means a package of non-patented practical information, resulting from experience and testing by the supplier, which is secret, substantial and identified. ‘Secret’ means that the know-how is not generally known or easily accessible. ‘Substantial’ means that the know-how includes information which is indispensable to the buyer. ‘Identified’ means that the know-how must be described in a sufficiently comprehensive manner so as to make it possible to verify that it fulfils the criteria of secrecy and substantiality.

²⁰³ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 58.

²⁰⁴ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 59.

²⁰⁵ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 60.

9.5.3 Article 5(c): Competing products in a selective distribution system

The third exclusion from the block exemption regulation can be found in article 5(c). This exclusion concerns the sale of competing goods in a selective distribution system. The combination of selective distribution with a non-compete obligation, obliging the dealers not to resell competing brands in general is covered by the block exemption regulation, according to article 5(a).

However, the block exemption regulation does not cover an obligation whereby the supplier prevents his appointed dealers, either directly or indirectly, from buying products for resale from particular competing suppliers. The reason why this obligation is not exempted is to prevent the exclusion of one specific competitor or certain specific competitors from the distribution system.²⁰⁶

9.6 Article 6: Withdrawal of the block exemption by the Commission

The block exemption regulation confers a presumption of legality but the Commission may in certain circumstances withdraw the benefit of the block exemption under article 6. This may be the case where a vertical agreement, considered either in isolation or in conjunction with similar agreements infringes article 81(1) and does not fulfil all the conditions of article 81(3).

This withdrawal procedure may be used, where an vertical agreement does not give rise to objective advantages such as to compensate for the damage which it causes to competition, even if the market threshold is not exceeded by the supplier or the buyer. The disadvantages caused by a vertical agreement which relate to the sale of final goods to consumers often have a stronger impact than the disadvantages in a vertical agreement concerning the sale of intermediate goods.²⁰⁷

Recital 13 states that the Commission may withdraw the benefit of the block exemption in particular cases where the vertical agreements have effects which are not exempted under article 81(3). This may be the case in particular where the buyer has significant market power in the relevant market in which it resells the goods or provides the services. It may also occur where parallel networks of vertical agreements have similar effects which significantly restrict access to a relevant market or competition therein.

²⁰⁶ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 61.

²⁰⁷ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter IV, para. 71.

Parallel networks of vertical agreements are regarded as similar if they contain restraints which produce similar effects on the market. Cumulative effects may arise in the case of selective distribution or non-compete obligations.

Where the Commission applies the withdrawal procedure it bears the burden of proof that the agreement infringes article 81(1) and does not fulfil the conditions of article 81(3). The withdrawal can only have ex nunc effect, so that exemption will persist until the time of the withdrawal.²⁰⁸

Article 6 should be distinguished from article 8. Under article 6 the block exemption is withdrawn in any particular case where agreements have effects incompatible with article 81(3). Under article 8 the block exemption may be withdrawn from all vertical agreements in a particular relevant market.

9.7 Article 7: Withdrawal of the block exemption by a Member State

Article 7 states that the competent authority of a Member State may withdraw the benefit of the block exemption regulation in respect of vertical agreements whose anti-competitive effects are felt in the territory of the Member State concerned or a part thereof, which has all the characteristics of a distinct geographic market.

This new power given to the authorities of the Member States was made possible as a result of the amendment to Regulation 19/65 effected by Regulation 1215/99.²⁰⁹

If a Member State has not adopted legislation which enables the national competition authorities to apply EC competition law or at least to withdraw the benefit of the block exemption regulation, the Member State has a possibility to ask the Commission to initiate proceedings to this effect.

Where a vertical agreement restricts competition on a relevant geographic market which is wider than the territory of a single Member State the Commission has the exclusive power to withdraw the benefit of the block exemption regulation. In the case where the territory of a single Member State, or a part thereof, constitutes the relevant geographic market, the Member State concerned and the Commission have concurrent competence for withdrawal. In such cases it is most likely that the Member State authorities will initiate the proceedings, unless there is a particular Community interest, such as new points of law.²¹⁰

²⁰⁸ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter IV, para. 72 and 75.

²⁰⁹ Read more about this under chapter 8.

²¹⁰ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter IV, para. 77.

Where national authorities decide to adopt decisions of withdrawal they must be taken in accordance with the procedure laid down in national law. The decisions will only have effect within the territory of the Member State concerned. Such decisions taken by the national authorities must not prejudice the uniform application of EC competition rules and the full effect of the measures adopted in implementation of those rules.²¹¹ Compliance requires that national competition authorities must carry out their assessment under article 81 in the relevant criteria developed by the ECJ and CFI and in the light of notices and decisions adopted by the Commission. The *Notice on co-operation* should be used to avoid the risk of conflicting decisions and duplication of procedures.²¹²

9.8 Article 8: Disapplication of the block exemption by the Commission

Article 8 states that the Commission may declare that, where parallel networks of similar vertical restraints cover more than 50% of a relevant market, the block exemption regulation shall not apply to vertical agreements containing specific restraints relating to that market. A measure of this kind adopted by the Commission is not addressed to individual undertakings but concerns all undertakings whose agreements are defined in the regulation disapplying the block exemption regulation.

As already mentioned before this article should be distinguished from article 6. The withdrawal of the benefit of the block exemption regulation under article 6 implies the adoption of a decision by the Commission establishing an infringement of article 81 by an individual undertaking. Article 8 enables the Commission to adopt a regulation which removes, in respect of the restraints and the market concerned, the benefit of the block exemption and restores the full application of article 81(1) and 81(3).²¹³

If the block exemption regulation is made inapplicable according to article 8 in respect of certain vertical restraints on a particular market, the case law developed by the ECJ and CFI should be a guidance in the applicability of article 81 to individual agreements.

Where the 50% market-coverage ratio is exceeded article 8 does not impose an obligation on the Commission to act. It is generally considered that in the case

²¹¹ Case 14/68, *Walt Wilhelm and Others v. Bundeskartellamt* [1969] ECR 1, [1969] CMLR 100.

²¹² Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter IV, para. 78-79.

²¹³ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter IV, para. 81.

where the access to the relevant market or competition therein is appreciably restricted, there is a need for disapplication of the block exemption regulation.²¹⁴

Before the Commission adopts a regulation in accordance with article 8 it should consider whether a more appropriate remedy would be to adopt an individual withdrawal.

In the case where a regulation is adopted according to article 8 the Commission must set out its scope clearly. The relevant product and geographic market(s) must be defined and the type of vertical restraint in respect of which the block exemption regulation will no longer apply has to be identified.²¹⁵

A regulation adopted under article 8 shall not become applicable earlier than six months following its adoption and will not affect the exempted status of the agreements concerned for the period preceding its entry into force.²¹⁶

9.9 Article 9: Calculation of market share

Article 9 deals with the calculation of market share. According to article 9(1) the market share shall be calculated on the basis of market sales value of the contract goods or services and other goods or services sold by the supplier, which are regarded as interchangeable or substitutable by the buyer, by reason of the products' characteristics, their prices and their intended use. If such market sales value data are not available, the calculation of market share may be based on other reliable market information such as market sales volumes.

It is necessary to determine the relevant market in order to calculate the market share. The relevant product market and the relevant geographic market must be defined. The Commission uses the *Notice on definition of the relevant market for the purposes of Community competition law*²¹⁷ when to consider market definition issues. This *Notice* gives guidance on the rules, criteria and evidence.

The relevant product market is defined in article 9(1) but the relevant geographic market is not. The *Guidelines* stipulates that the relevant geographic market 'comprises the area in which the undertakings concerned are involved in the supply and demand of relevant goods or services, in which the conditions of competition are sufficiently homogeneous, and which can be distinguished from

²¹⁴ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter IV, para. 83.

²¹⁵ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter IV, para. 85.

²¹⁶ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter IV, para. 86-87.

²¹⁷ Commission Notice on the definition of the relevant market for the purposes of Community competition law, 9 December 1997, [1997] OJ C 372/5.

neighbouring geographic areas because, in particular, conditions of competition are appreciably different in those areas'.²¹⁸

Where the market share of the supplier shall be determined, it is his share on the relevant product and geographic market on which he sells to his buyers that are decisive.²¹⁹ The relevant product market depends first and foremost on substitutability from the buyers' perspective. In the case where there is an exclusive supply obligation, the buyer's market share is his share of all purchases on the relevant purchase market.

Where a vertical agreement includes three parties, each operating at a different level of trade, their market shares at both levels will have to be below the market share cap of 30% in order to benefit from the block exemption. For instance, if an agreement between a manufacturer, a wholesaler and a retailer contains a non-compete obligation, the market share of both the manufacturer and the wholesaler must not exceed 30% in order to be block exempted.²²⁰

Article 9(2)(a) states that the market share shall be calculated on the basis of data relating to the preceding calendar year.

Article 9(2)(c)-(e) provide that the block exemption shall continue to apply for up to two years where the market share rises above 30% but not beyond 35%.

9.10 Articles 10 and 11: Turnover and connected undertakings

Article 10 explains how the total annual turnover shall be calculated for the purpose of the rules in article 2(2) and 2(4).

Article 11 states that the terms 'undertaking', 'supplier' and 'buyer' shall include their respective connected undertakings. For instance, according to article 11(2)(a), a connected undertaking is an undertaking where a party to the agreement has the power to exercise more than half the voting rights.

²¹⁸ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter V, para. 90.

²¹⁹ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter V, para. 91.

²²⁰ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter V, para. 93.

9.11 Articles 12 and 13: Transitional provisions and entry into force

As already written before the block exemption regulation entered into force on 1 January 2000 and the block exemption applies with effect from 1 June 2000.

In article 12(2) a transitional relief can be found for existing agreements provided that they were in force on 31 May 2000 and which satisfy one of the three old regulations but not the new one. These agreements will be exempt until 31 December 2001. Suppliers with a market share not exceeding 30% who entered into agreements imposing the buyers a non-compete obligation with a duration exceeding five years are covered by the block exemption if on 1 January 2002 the non-compete agreements have no more than five years to run.²²¹

The new block exemption regulation shall expire on 31 May 2010.

9.12 Agency agreements

The Commission issued, in 1962, a *Notice on Agency Agreements*²²² that stated that agency agreements did not infringe article 81(1). The reason why the *Notice* was issued was the Commission's fear of more notifications under regulation 17/62 than it could handle. Vertical integration could therefore take the form of appointing agents instead of dealers, in order to avoid entering into vertical agreements that were subject to article 81(1). However, the ambit of this possibility was very narrow. In many cases the ECJ and the Commission declared that in order for an agreement to come within this exception, the agent had to be integrated into the undertaking of the principal.²²³

The *Notice* was not entirely reliable and there was a need for a revision. A long time elapsed and the revised *Notice* is now embodied in the *Commission's Guidelines on the new Regulation*. The *Guidelines* state that they replace the *1962 Notice*.²²⁴

An agency agreement can be defined as an agreement where one legal or physical person negotiates and/or concludes contracts on behalf of another person for the

²²¹ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter III, para. 70.

²²² Commission Notice on exclusive dealing contracts with commercial agents, 24 December 1962, [1962] OJ 139/62 p. 2921.

²²³ Case 40/73, *Suiker Unie v. Commission* [1975] ECR 1663, [1976] 1 CMLR 295 and Case 311/85, *Vereniging van Vlamse Reisbureaus v. Sociale Dienst van de Plaatselijke en Gewestelijke Overheidsdiensten* [1987] ECR 3801, [1989] 4 CMLR 213.

²²⁴ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter II, para. 12.

purchase or sale of goods or services.²²⁵ Where agency agreements can be considered to be ‘genuine’, obligations imposed on the agent do not normally fall within article 81(1), whereas ‘non-genuine’ agency agreement may be caught, in which case the block exemption regulation may apply. When to determine whether article 81(1) is applicable, attention should be paid to ‘the financial or commercial risk borne by the agent in relation to the activities for which he has been appointed as an agent by the principal’.²²⁶

According to paragraph 14 in the *Guidelines* there are two types of financial or commercial risk that are material in determining ‘genuine’ agency agreements. First, there are the risks which are directly related to the contracts concluded and/or negotiated by the agent on behalf of the principal, for instance financing of stocks. Secondly, there are the risks related to market-specific investments, meaning risks that the agent undertakes in order to be appointed. In the case where the agent bears no or only significant risks in relation to either of these two matters, the agency agreement is considered a genuine agency agreement and falls outside article 81(1).²²⁷ The agent’s activity forms part of the principal’s activity, even if the agent is a separate undertaking. The opposite situation means that the agent does bear such risks and the agreement is considered to be a non-genuine agency agreement which may fall under article 81(1).²²⁸ In that case the agent will be treated as independent.

The risk must be assessed on a case-by-case basis and attention should be paid to the economic reality of the situation instead of the legal form.²²⁹ The *Guidelines* state that article 81(1) do not normally apply where the goods do not vest in the agent or where the agent does not himself supply the services and where the agent is not involved in costs or risks in relation to various matters listed in paragraph 16. These matters may be transport, sales promotion, maintaining stocks, after-sales service and responsibility for third-party damage and customers’ non-performance.²³⁰ Paragraph 17 states that the list is not exhaustive and where the agent incurs one or more of the risks or costs, article 81(1) may apply as it would do to any other vertical agreement.

²²⁵ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter II, para. 12.

²²⁶ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter II, para. 13.

²²⁷ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter II, para. 15.

²²⁸ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter II, para. 15.

²²⁹ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter II, para. 16.

²³⁰ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter II, para. 16.

Where article 81(1) is not applicable to an agency agreement, all obligations imposed on the agent fall outside the provision, including territorial and customer limitations and prices and conditions at which the agent must sell or purchase the goods or services.²³¹

There are a few situations in which there could be an infringement of article 81(1) in the case of an agency agreement, irrespectively of whether it is a genuine or non-genuine agency agreement. Exclusive agency provision, whereby the principal is prevented to appoint other agents in respect of a given type of transaction, will in general not produce anti-competitive effects. Non-compete provisions, whereby the agent is prevented to act as an agent for undertakings which compete with the principal, and post-term non-compete provisions, may infringe article 81(1) if they lead to foreclosure on the relevant market.²³²

Article 81(1) may also be infringed where the agency agreement facilitates collusion. This could occur where a number of principals use the same agents while collectively excluding others from using these agents. This could also be the case where the principals use the agents to collude on marketing strategy or to exchange sensitive market information between each other.²³³

²³¹ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter II, para. 18.

²³² Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter II, para. 19.

²³³ Commission Notice, Guidelines on Vertical Restraints, 13 October 2000, [2000] OJ C 291/01, chapter II, para. 20.

10 Final comments

Vertical distribution agreements play an important role in the distribution sector which evolves dynamic and constantly. The distribution system has an important function within the European Community since almost all goods and services pass from producer to consumer by a process of distribution. At the beginning of the 1990's, distributive trades within the European Union employed more than 15% of the active population and almost 30% of the undertakings were involved.²³⁴

All industries need distribution and the distribution chain is an important element of competitiveness. If the distributor can provide a high level of service or if there is a high level of efficiency the possibility to reach customers may be increased. Therefore there is an incentive to keep the distribution channels open and competitive.

The long-term viability of any individual member of a supply chain is becoming increasingly dependent on the ability of the entire chain to compete with the chain of other economic operators.²³⁵ As a consequence, members of a chain may seek to influence its functioning. If complete control is desired a member of the chain may acquire the other members, i.e. vertical integration. However, in most distribution systems, there is no vertical integration and this result in relationships governed by vertical restrictions. Many producers lack the financial resources to sell directly to the final consumers and the distribution system is used because of its eminent efficiency in making goods available to customers.

Distribution channels have traditionally consisted of independent manufacturers, wholesalers and retailers but these are in decline. In this system the independent operators have been acting at arm's length seeking to maximise their own profit rather than to maximise the profit of the channel as a whole.

By the introduction of information technology the whole nature of distribution has changed.²³⁶ Undertakings have been forced to re-evaluate and adapt their commercial relationships with both customers and suppliers as a result of the information systems. Companies have also been enabled to adopt more tightly managed and efficient business practices. Due to the information technology revolution the Just-in-time (JIT) principle has been adopted and has had a great

²³⁴ Annex A to the Commission's Green Paper on Commerce, 20 November 1996, COM (96)530.

²³⁵ Commission's Green Paper on Vertical Restraints in EC Competition Policy, 22 January 1997, COM (96)721 Final, [1997] 4 CMLR 519, chapter I, para. 16.

²³⁶ Commission's Green Paper on Vertical Restraints in EC Competition Policy, 22 January 1997, COM (96)721 Final, [1997] 4 CMLR 519, chapter I, para. 41.

impact on the whole distribution chain.²³⁷ The JIT-principle means that no products should be made, no components ordered, until there is a downstream demand. This development seems to replace 'conventional supply-driven distribution channels by planned, professionally managed, demand-driven supply chains in which suppliers, manufacturers, wholesalers and retailers act as an integrated system and compete against other integrated systems to maximise efficiencies and consumer response'.²³⁸

The development in the distribution system that has taken place in the European Union has led to considerable restructuring. A number of different changes can be noticed. There are a reduced number of larger operators and closer vertical links between them. This leads to concentration. It can also be noticed that there is a development of networks of independent traders. There is a general reduction in the number of independent national distributors/traditional wholesalers and a series of transformations in the retail sector. Finally there is a tendency towards diversification of activities into other service areas.²³⁹

All these changes in structure of distribution and other developments led to that the Commission got a growing feeling of unease with the effectiveness of its own competition policy concerning vertical restraints. As a result, the Commission adopted the new block exemption regulation and it remains to see whether this new approach will be successful or not.

The new block exemption regulation has only been in force for one year and there has not been any decisions from the Commission or judgments from the Court which give guidance on the interpretation and applicability of the regulation. It will certainly take some time before there is a number of cases which clarify the regulation due to the fact that the regulation also contains transitional provisions. Therefore it is difficult to predict the impact of the regulation on vertical restraints and if it realises the Commission's new approach towards vertical restraints efficiently. Certainly the new regulation will have several advantages compared to the old regulations but there is still the question whether the regulation will achieve the Commission's objectives concerning competition policy in the most satisfactory way.

Mark Griffiths is quite critical to the new regulation in an article and states that the regulation presents little improvement.²⁴⁰ Griffiths considers that the regulation is still plagued by an ignorance of economics. The Courts demand a more economic

²³⁷ Commission's Green Paper on Vertical Restraints in EC Competition Policy, 22 January 1997, COM (96)721 Final, [1997] 4 CMLR 519, chapter I, para. 41.

²³⁸ Commission's Green Paper on Vertical Restraints in EC Competition Policy, 22 January 1997, COM (96)721 Final, [1997] 4 CMLR 519, chapter I, para. 50.

²³⁹ Commission's Green Paper on Vertical Restraints in EC Competition Policy, 22 January 1997, COM (96)721 Final, [1997] 4 CMLR 519, chapter I, para. 44.

²⁴⁰ Griffiths M. *A Glorification of de minimis – The Regulation on Vertical Agreements*, [2000] ECLR p. 241-247.

approach and this can be seen in the case law which prescribes the recognition of the broader economic context. The black list of clauses in the regulation is too long and selective distribution systems are treated more cautiously than necessary. Griffiths states that there is an over-emphasis on the importance of market share evaluation. The Commission believes that market share analysis is a good indicator of market power. However, according to Griffiths, market share analysis is a crude method of evaluating market power. Instead attention should be paid to many other indicators. There must also be awareness that market share is liable to change very rapidly in fast innovative areas. Last but not least, Griffiths concludes that the regulation can be seen as no more than an extension of the *de minimis Notice*, with the market share threshold being raised to 30%.²⁴¹

²⁴¹ Griffiths M. A Glorification of de minimis – The Regulation on Vertical Agreements, [2000] ECLR p. 241-247, p. 241.

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