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Vertical distribution agreements under E.C. competition law -background and the new Block Exemption Regulation

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Contents

Summary

Vertical distribution agreements are favourable for the market. They facilitate distribution and make it more efficient. Moreover, by the appointment of independent distributors, it gets easier for the manufacturer to distribute his goods over a wide geographical area and overcome barriers inherent in international trade.

However, the co-operation between manufacturer and distributor gives rise to difficulties that must be solved in the distribution agreement. In order to safeguard both the manufacturer’s and the distributor’s interests, the agreement often results in clauses that restrict competition and divide the market. The last aspect is of special relevance in a European perspective, where the openness of the Single Market plays an important role in competition policy.

In Europe, most vertical distribution agreements are assessed under Article 81 of the Treaty. Traditionally, the prohibition in Article 81(1) has been given a broad and formalistic interpretation, which as a result has captured a wide range of vertical distribution agreements. Consequently, it has been necessary for many agreements to receive the exemption under the third part of the Article either in form of compliance with a Block Exemption or by notification and individual exemption.

The European method of assessing vertical distribution agreements has attracted much criticism over the years. Firstly, a form-based approach has been applied without any opportunity for economic analysis neither in applying the prohibition nor the exemption system. Secondly, the administration surrounding Article 81 has been excessively complicated, resulting in that undertakings have drafted all their agreements to comply with a Block Exemption.

Both the Commission and the Community Courts have tried to mitigate the imperfections with the system. The Commission mainly by facilitating the administration system and the Community Courts by reducing the scope of Article 81(1). However, the steps taken have not been enough to make Article 81 function as intended, namely to sort out harmful vertical distribution agreements and allow the beneficial ones.

On the 1 June 2000 a comprehensive Reform of the competition policy on vertical distribution agreements took place. Vertical agreements will even after the Reform be assessed under Article 81 and fall foul of the prohibition in Article 81(1) to the same extent as before. However, a new wide Block Exemption has been adopted and the compulsory notification abolished in relation to vertical distribution agreements. The intention is to introduce a new system, which is more efficient and directed by economics.

In principle it is appropriate to maintain the assessment of vertical distribution agreements under the heading of Article 81. Nevertheless, it would have been desirable with some clarifications from the Commission to make undertakings more certain how to apply the Block Exemption and assess the likelihood for individual exemption. Furthermore, the Single Market objective still takes a too predominant place in the system, which threatens to impair the economic analyses.

The new system has a potential to effectively protect competition in relation to vertical restraints. However, there is a risk that the new system will soon degenerate and adopt the same shortcomings which the old one suffered from. To avoid this, the Commission must by all means uphold efficiency, firstly, by better educating undertakings how to assess their agreements, and secondly, by safeguarding fast decisions when agreements are challenged in national courts.

Abbreviations

CBI	Confederation of British Industry
CFI	Court of First Instance
CMLR	Common Market Law Report
CMLRev	Common Market Law Review
ECLR	European Competition Law Review
ECR	European Court Report
ECJ	European Court of Justice
NW J Int L and B	North Western Journal of Law and Business
OJ	Official Journal
UNICE	Union of Industrial and Employers' Confederation of Europe
YBEL	Yearbook of European Law

1 Introduction

1.1 The subject

This paper is concerned with vertical distribution agreements. These are agreements made between parties at different levels of the production process to facilitate the distribution of goods to the ultimate consumers. A typical example is an agreement between a manufacturer who produces the goods and different independent retailers who distribute them.

From these introductory remarks, it might be difficult to see the connection between these agreements and competition law. However, vertical distribution agreements constitute one of the most interesting and disputed areas in competition law. The effects of these agreements can have both a positive and negative effect on competition and the market as a whole.

On the one hand, vertical distribution is beneficial for the market as it makes distribution more efficient and helps the manufacturer to penetrate new markets and spread his goods over a wide geographical area. On the other hand, the agreements between manufacturers and distributors often give rise to competition concerns, mainly because exclusive rights are granted and the market divided between different distributors.

It is a challenge for all competition policy, first, to decide which provisions in vertical distribution agreements can be said to give rise to a restriction of competition, secondly, to distinguish harmless or beneficial restrictions from those which should be prohibited. The task is further complicated because it is difficult to decide in abstract what is meant by a restriction on competition. Instead individual analyses on the actual market must take place.

A final cause for concern with vertical agreements is peculiar to the EC. European competition law has an additional goal, namely to safeguard the Single Market. Even in this aspect vertical distribution agreements have a twofold characteristic–they can not only facilitate market integration but also contribute to a division of the Single Market. Agreements which divide the market along regional lines will be treated particularly severely by European competition authorities.

European competition law has as yet not provided an appropriate framework for the assessment of vertical restraints. Principally, the assessment has been criticised because it has concentrated on the clauses in the agreements without giving enough consideration to the broader economic consequences of the agreements. Furthermore, the lack of efficiency in administration has lead to many problems, for example legal certainty concerns. To improve the system and remove the imperfections recognised, a Reform was adopted this summer.

The Reform[1] signals a change in approach. Firstly, vertical restraints will no longer be assessed according to a form-based criteria, but on an economic criteria. Secondly, the administration is simplified with a view to decentralisation and intensified ex-post control. The reformed approach necessitates changes in the exemption procedure.

To start with, a modification in Regulation 17 makes prior notification in order to obtain individual exemption for a vertical restrains unnecessary. Consequently, the undertakings must themselves assess the likelihood for exemption. To help undertakings, the Commission has published Guidelines. Furthermore, the old Block Exemptions are replaced by one single wide exemption that is based on economic criteria. The exemption creates a safe harbour for vertical agreements, which is concluded by undertakings with less than 30 % market share, as long as they do not contain any of the listed black clauses. [2]

1.2 Purpose and Method

There are a number of reasons to focus on vertical restraints. The inspiration for this paper is the Reform on vertical restraints that took place this summer. The main purpose of the paper is to present the Reform and discuss the changes that it embraces.

However, vertical restraints raise complex theoretical and analytical problems. In particular, for somebody like myself, who is trained in law but without a deeper knowledge of economics, the discussion surrounding vertical restraints is problematic. To understand and be able to evaluate the Reform, I consider it necessary to have a deep general background on vertical restraints and the reasons why the European method of assessing

[1] Commission Regulation 1216/99 amending Regulation 17 [1999] OJ L148/5; Commission Regulation 2790/1999, on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices [1999] OJ L336/21; Commission Guidelines on Vertical Restraints, 24 May 2000, www.europa.eu.int/comm/competition/antitrust/others/. (The final version is, at the day of writing, only available on the web, and may still undergo minor linguistic changes.).
[2] Old Block Exemptions: Commission Regulation 1983/83, on the Application of Article [81(3)] of the Treaty to categories of Exclusive Distribution Agreements [1983] OJ L173/1; Commission Regulation 1984/83, on the Application of Article [81(3)] of the Treaty to categories of Exclusive Purchasing Agreements [1983] OJ L173/7; Commission Regulation 4087/88, on the Application of Article [81(3)] of the Treaty to categories of Franchise Agreements [1988] OJ L359/46.

these agreements failed. Consequently, this paper also examines vertical distribution agreements and the background to the Reform.

In the first part of this paper I consider why vertical distribution agreements are concluded and the advantages as well as the competition concerns inherent in this structure of distribution. After this part I hope the reader to be familiar with the vertical distribution agreement and understand its twofold structure when it comes to regulate it in competition law.

The second and third parts are devoted to assessing the old approach to vertical restraints under European competition law. The analysis of the old approach is important to understand the nature of its failure to avoid the same mistakes being repeated under the new system. Additionally, considerable space is left to examine the development of the prohibition in Article 81(1) by the Community Courts in relation to vertical restraints. I consider that this development can be compared with and regarded along with the structure of the new Block Exemption.

In the fifth and the sixth chapter of the paper I present and discuss the Reform. My intention is to explain how the new system functions and how it affects undertakings, Member States and the Commission’s working methods. I hope that the reader by the end of the paper will be able to evaluate the Reform, be critical of how the Commission has solved the problems, and with the help of the general parts of the paper be able to envisage alternative solutions.

It has been difficult to keep this paper short because there are many interesting aspects to discuss. I have tried to draw the limitations along the same lines as the Commission puts the limitations on the revision on the policy on vertical distribution agreements. These sectors that are not covered by the Green Paper on vertical Restraints, for example agency agreements and certain motor vehicle distribution agreements, are not considered in this presentation. [3]

The debate on how to change the assessment of vertical distribution agreements under European competition law has been animated in European Law Journals for years. It is also from these Journals that I have procured most of the material for this paper. I have also studied case law to analyse the old method of assessing vertical agreements. To complete the two last parts on the Reform I have mainly trusted the new Block Exemption

[3] Coverage of the Green Paper, Commission Green Paper on Vertical Restraints pp. 1-2; Excluded areas, Commission Regulation 240/96, on the application of Article [81(3)] of the Treaty to certain categories of technology transfer agreements [1996] OJ L31/2, Commission Regulation 1475/95, on the application of Article [81(3)] to certain motor vehicle distribution and services agreements [1995] OJ L145/25, Commission Notice, on exclusive dealing contracts with commercial agents [1962] OJ p. 2921.

Regulation and the Commission's Guidelines. Some inspiration for the last analysis is found in papers presented by Industrial Organisations. [4]

[4]Commission Green Paper on Vertical Restraints COM [1996] 721 final; Commission White Paper on Vertical Restraints COM [1998] 546 final; Communication from the Commission on the Application of the Community Competition Rules to Vertical Restraints, Follow-up on the Green Paper to Vertical Restraints COM [1998] 522 final; There are three big industrial organisations that have published much material on the topic: UNICE, CBI and BDI. Unfortunately, I have not considered the material from BDI since this only is available in German.

2 Vertical distribution agreements

2.1 Introduction

Each manufacturer must ensure that his product reaches the ultimate consumer. Of course, he can take care of the distribution himself, but it is more common to engage independent distributors who already are established within the market.[5] To govern the relationship between the manufacturer and his distributors, vertical distribution agreements are concluded. Thus from this starting point, a vertical distribution agreement is primarily an agreement between parties operating at different stages of the supply chain to bring goods and services to the market.

Manufacturers entrust independent distributors for their special distribution knowledge, and the efficiency that can be secured by their co-operation. However, the distributors are independent undertakings who strive to maximise their own profit, and who might not be fully committed to the manufacturer's business and his products. Moreover, the multi-party structure inherent in vertical co-operation might give rise to transaction costs.

The problems that stem from the vertical co-operation must be solved in the distribution agreement. Unfortunately, the clauses used often have an anti-competitive impact on the market and may jeopardise the creation of the Single Market.

2.2 Advantages of vertical co-operation[6]

Vertical co-operation facilitates a clear division of functions in the market. This enables both manufacturers and distributors to concentrate and specialise in one part of the supply chain, thus resulting in efficiency gains such as economies of scale and scope. Besides, the manufacturer gets access

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[5] The terms manufacturer and supplier are used synonymously to describe undertakings which constitute the first part in the supply chain, and distributor or retailer to describe the final part, before the product reaches end consumers. There might be an intermediate part between the supplier and distributor in the supply chain; the wholesaler. This stage of distribution will not be considered in detail in this work. For more details see, Commission Green Paper on Vertical Restraints pp. 5-7.

[6] Preambles to Commission Regulation 1983/83, Commission Regulation 1984/83, Commission Regulation 4087/88, Commission Green Paper on Vertical Restraints pp. 4-16.

to the distributor's outlets as well as his knowledge of and experience in the actual market. The outcome is minimum waste of resources, as already established outlets and experience are made the full use of through the co-operation.

Furthermore, co-operation with independent distributors is likely to be the most cost-saving way for a manufacturer to reach end consumers. The alternative solution; to own all operators from production to distribution (vertical integration), involves huge investments which are risky. Particularly for small manufacturers, and manufacturers who specialise in a narrow product market, vertical co-operation can be the only feasible way of reaching end-consumers. Consequently, a market which provides good possibilities for vertical co-operation also facilitates the business of small manufacturers.

Vertical co-operation also contributes to a flexible market. If the manufacturer has invested in his own outlets, he is unlikely to move to new markets before profiting from earlier investments. On the other hand, on a market where vertical co-operation exists the manufacturer can easily contact new distributors when he wants to change or expand sales areas. Moreover, to distribute the goods through vertical distribution demands small investments which makes it possible for the manufacturer to spread his goods through a wide geographical area. The flexibility, as well as the wide spread of goods, stimulates competition and provides the consumers with a large choice of products.

Finally, vertical co-operation helps the manufacturer to overcome distribution difficulties in international trade that result from linguistic, legal, or other barriers. Through a vertical distribution agreement, the manufacturer can access valuable distribution knowledge, which facilitates his establishment in previously unexplored markets, possible situated in foreign jurisdictions.

2.3 Difficulties with engaging independent

distributors[7]

There are efficiency gains to be made from vertical co-operation both for the parties involved and society as a whole. However, this organisation of distribution is not without difficulties.

To start with, when a manufacturer gets involved in vertical co-operation he has to maintain quite a number of business relations with different distributors. On the one hand, the multiplicity of distributors is desirable as it enables the manufacturer to distribute his goods through many outlets. On the other hand, it gives rise to transaction costs and it becomes difficult for the manufacturer to keep control over distribution and plan production, stocks and marketing. With the aim of obtaining an efficient distribution process and strengthening the manufacturer-distributor relationship, the manufacturer needs to limit the number of distributors.

The manufacturer might also wish to restrain the number of distributors with the view to ensure a certain standard in the distribution of his goods. Firstly, this facility is needed in relation to expensive, luxury goods where the reputation of the brand is very important. A distributor who does not pay attention to a brand's special image can fast destroy a policy which might have taken years for the manufacturer to build up. Secondly, the facility is needed in relation to complicated technical products where the distributor must be able to provide highly technical skilled staff in the shop to assist customers. By requiring that the distributors comply with certain criteria, the manufacturer can sort out distributors that are not suitable to deal with his products.

Another problem for the manufacturer that occurs in vertical co-operation is how to organise brand-promotional activity. Brand-promotional activity refers to different activities that promote a special brand in the manufacturer's interest. For example can advertisement, specially trained shop staff, and provision of repair facilities be mentioned. These services help consumers and enhance competition between different brands and are therefore desirable on the market and should accordingly be promoted.[8]

The first difficulty with brand-promotional activity in relation to vertical co-operation is that the activity is primarily in the manufacturer's interest as it

[7]L. Peepercorn, DG IV 'The Economics of Verticals' Competition Policy newsletter 1998-number 2-June; J. Faull and A. Nikpay *The EC Law of Competition* [1999] Oxford pp. 568-572; Commission Green Paper on Vertical Restraints pp. 17-40; Preambles to Commission Regulation 1983/83, Commission Regulation 1984/83, Commission Regulation 4087/88.
[8] There is division in opinion among different economists about the effects on inter-brand competition. Mainly if, and what sort of society welfare effects can stem from the activity. Some activity is considered as mere superfluous that only gives rise to a higher consumer price. P. Massay 'Reform of EC Competition Law: Substance, Procedure and Institutions' [1996] Fordham Corporate Law Institute, Ch. 7 pp. 91-123 at p. 108.

adds value to the goods on a long-term basis, rather than increases profits immediately. It is yet very impractical for the manufacturer to take care of the activities himself. Admittedly, it is more efficient if the distributor carries out the brand-promotional activity since he is closer to consumer and is better informed of what sort of activity the special market requires. Nevertheless, the distributor will not take part in brand-promotional activity for free. An incentive, for example in form of an exclusive right, must be given in the distribution agreement to render it attractive for the distributor to engage in promotional activity on behalf of the manufacturer.

The second difficulty with brand-promotional activity is that it brings about 'free-riding'.[9] 'Free-riding' means that the manufacturer's or his distributor's investments to promote a brand are exploited by traders that do not take an active part in brand-promotional activity. The incentive for 'free-riding' stems from the price differences in the market. These allows consumers to benefit from the activities provided in one shop but finally buy the goods in another shop which, by lack of expensive pre- and post-sales activities, is able to set a more competitive price. All traders, but in particular distributors who do not have an own interest in brand-promotional activity, need protection against 'free-riding'. Without such protection traders will stop taking part in pre- and post-sales activities to the detriment of the market as well as consumers.

The third problem with vertical co-operation is to get both manufacturer and distributor to work towards a price policy that is competitive for the distribution chain as a whole. When two independent parties co-operate, each tends to charge its own mark-up without thinking of the price that maximises their mutual profit on a long-term basis. [10] An independent decision by one party in the distribution chain to increase own profit margins can have fatal consequences for the competitiveness of the final product in the consumer market. With the view to stimulate the parties to look towards a common profit, it might be necessary to control the parties' price setting.

[9] There is no consensus among economists or traders as to what extent, and under which circumstances the 'free-riding' problem is a genuine problem. Some general reflections can yet be assumed: The goods must be relatively new or technically complex for a real consumer-need for pre- and post-sales activity. In addition, the goods must be of a reasonably high value to make it worth going to another shop to buy it. L. Peepercorn, note 7 p. 6; Communication from the Commission on Vertical Restraints p. 9; Commission Green Paper on Vertical Restraints p. 73.

[10] This theory of 'double marginalization' is very contested and in some literature described as merely hypothetical. For the effect to occur, the parties must have market power and operate independently. Today the vertical co-operation becomes more and more integrated where the same manufacturers and distributors co-operate over a long period of time. It can be questioned how independent the parties are in reality in such co-operation. Commission Green Paper on Vertical Distribution Agreements pp. 4-16; J. Faull and A. Nikpay *The EC Law of Competition* p. 572.

2.4 How to overcome the difficulties

The manufacturer faces, as has been described above, difficulties when he appoints independent distributors. One purpose of the distribution agreement is to solve these problems by restricting the parties.

With the help of an exclusive or limited distribution system, the manufacturer can limit the number of distributors that will deal with his goods. The arrangement enables the manufacturer to streamline the distribution process by concentrating on a few parties to the effect of enhanced efficiency. It might also be the distributor who asks for exclusivity as a condition to take an active part in brand-promotional activity on behalf of the manufacturer. Without the exclusivity right, the distributor's investments risk to be 'free-ridden' by other distributors.

The manufacturer can also limit his distributors by a selective process. Only distributors who comply with certain criteria will be appointed to distribute the manufacturer's goods. As a consequence, the manufacturer obtains better control over the distribution process.

Furthermore, the manufacturer might impose a single branding clause whereby a distributor is forbidden to deal with competing goods. A single branding clause is of special relevance when the manufacturer has invested in the distributors' shops and now needs protection against 'free-riding' activity from other manufacturers whose goods are sold in the same outlet.[11]

Besides, the manufacturer might wish to impose resale price maintenance (RPM). This means that the manufacturer sets the prices at which the distributor must sell the goods. The manufacturer can by RPM prevent distributors from overcharging. It is also an efficient weapon against 'free riding' at the distribution level, as it leaves no space for intra-brand price competition.

Finally, different minimum purchase obligations and other forms of tie-ins may be used to induce the distributor into buying a certain amount of a product or a whole range of goods and services from the same manufacturer. With such a clause, the distributor is more likely to keep the prices down, to be more faithful to one supplier, and find less incentive to deal in competing goods.

The clauses mentioned above are often combined with each other to reach the effects desired. In addition, the manufacturer can divide the market between his distributors to facilitate the planning of the distribution, but also to protect the distributors' investments. The territorial division of the market is upheld by restricting the parties from trading in territories that are

[11] This clause is also called Exclusive purchasing or Exclusive dealing.

allocated to other distributors, either by restrictions on active- or passive sales.[12]

2.5 Effects on competition

2.5.1 General remarks

Vertical distribution agreements are concluded to bring goods and services to consumers and they contribute to considerable efficiency gains. Most of them have an important role to play in the market, even if it cannot be excluded that some of them besides might have an underlying anti-competitive goal. Along with these general remarks, it is important to point out the difference in competition terms between a horizontal and a vertical agreement.[13] These differences explain why vertical restraints generally are considered as less harmful to competition than horizontal restraints.

A horizontal agreement is concluded between firms in competition which produce identical or substitute goods or services. In a horizontal relationship the parties have an interest in colluding to control the market in order to obtain market power. With market power the parties can raise prices above a competitive level and divide the profit reached between them. Competition between them is in the consumer's interest as it pushes prices down, but is of no interest to the firms themselves.

In a vertical relationship, on the other hand, the exercise of market power by either the upstream or the downstream undertaking normally hurts the other party. For example: It is primarily beneficial for the manufacturer if there is high intra-brand competition at the distribution level. This pushes down the distributor's profits to the effect that the manufacturer can take out higher margins without a rise in final consumer price. It can therefore be assumed that the manufacturer limits competition at the distribution level with a goal separate from that of restricting competition, for example to facilitate for brand-promotional activity.[14]

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[12] Active sale is when the distributor actively seeks customers in a territory allocated to another distributor. Passive sale is the mere answer to customer request from other territories. For more details, see Commission Guidelines on Vertical Restraints para. 50.
[13] The distinction between horizontal and vertical agreements may in some circumstances be unclear, especially with the introduction of new distribution and company structures on the market. Still, the most important is to examine whether the parties to the agreement are to be considered as actual or potential competitors. If this is the case, there is also a horizontal agreement. See, H.H.P Lugard 'Vertical Restraints under EC Competition Law: A Horizontal Approach?' [1996] ECLR pp. 166-177 at p. 169.
[14] V. Korah *An introductory guide to EC competition law and practice* [1997] Oxford pp. 172-173.

2.5.2 Anti-competitive effects

The majority of vertical distribution agreements affect intra-brand competition, i.e. the competition within one single brand. For example, an exclusive distribution agreement whereby the market is divided between different distributors decreases the competition between the distributors of the same brand. Another example is a resale price maintenance clause, which forces all distributors of a brand to resell the goods at the same price. As a consequence, there is no space for intra-brand price competition.

There is a considerable division in opinion on whether the restriction on intra-brand competition really can be said to pose a danger to competition in a wider perspective. Many economists today argue that this is not the case as long as the market is competitive, and the lack of intra-brand competition therefore will be compensated by competition from traders who promote similar goods. I will return to this discussion in more detail when I consider the Commission’s old approach to vertical restraints.

Vertical distribution agreement might also hamper inter-brand competition. A clear example is a single-branding clause or an incentive scheme that makes the distributor promote only one brand in his store. There is no longer any in-store inter-brand competition. However, an overall negative effect on competition is unlikely to occur as long as the distributor operates in a competitive market. The pressure of competition from other traders will mitigate the bad effects reached by the lack of in-store inter-brand competition.

Clauses in vertical agreements that bind the parties, particularly for a long period of time, can also in another way be a threat to inter-brand competition. If a particular producer has made exclusive contracts with certain outlets to sell only his brand, then it becomes difficult for other producers to secure outlets for their sales. The agreements constitute in this aspect a barrier to entry for new parties. If there are many similar agreements in the market that tie up almost all parties, the agreements can give rise to an almost complete foreclosure effect.

Finally, a vertical distribution system might facilitate collusion and the building up of horizontal agreements and concerted practices both at the manufacturing and the distribution level. The existence of vertical agreements makes the market more transparent where, for example, price information is more available. This can inspire the setting up of horizontal agreements, especially where the previous market was concentrated to a few parties. For example, an exclusive distribution system might raise the idea among distributors of horizontal co-operation in price setting. The already established structure with exclusive allocated territories facilitates this step.[15]

2.6 Single Market objective

Finally, consideration will be given to the special concern within the European Union regarding vertical restraints. European competition policy has a goal that does not exist in any other competition policy; to facilitate and conciliate the creation of the European Single Market.[16] To prevent division of the market and keep it open is recognised as a common goal in all competition policies, but has an extra dimension in Europe. Free trade between Member States is essential to end the price differences still apparent within the Union.[17]

As has been discussed, vertical distribution agreements are often concluded to give the distributors some sort of territorial protection. This protection can be formed in line with national boundaries, and upheld by absolute territorial protection or restrictions on parallel imports. In this aspect, the vertical distribution system hampers the movement of goods in the Union.[18]

On the other hand, vertical co-operation can also be seen as promoting and facilitating cross-border trade. To start with, vertical co-operation gives rise to a flexible market where the manufacturers are able to spread the goods through a large geographical area, which clearly promotes cross-border trade. Secondly, the territorial protection in a vertical distribution agreement can be a prerequisite for manufacturers to at all engage in cross-border trade.[19]

[15] This view is strongly contested. First, in empirical terms – does it really happen? Secondly, in terms of the appropriate policy approach– if the problem is the horizontal relationship, this agreement should be attacked, and not the vertical one. R. Bork *The Antitrust Paradox, A Policy at War with Itself* [1978] New York ch. 14; Commission Green Paper on Vertical Restraints p. 16.

[16] Art. 2, 3(c) of the Treaty See, also Commission 9th Report on Competition Policy, 1979, where the Commission stated: 'first fundamental objective of competition policy is to keep the common market open and unified'. More general, see, e.g., T. Frazer 'Competition Policy after 1992: The next Step' [1990] the Modern Law Review pp. 609-623.

[17] Commission Green Paper on Vertical Restraints pp. 21-24.

[18] Absolute territorial protection occurs when a dealer faces no intra-brand competition within his territory. Such competition could occur from sales by other network dealers selling into his territory, or from dealers outside the network parallel importing the goods from another jurisdiction. A restriction on parallel imports refers only to the barriers to free trade between different jurisdictions, for example by the imposition of an export ban. Nevertheless, the Commission and the Community Courts use the concepts without distinction.

[19] See, in particular, V. Korah's many discussions on the topic in relation to the *Consten and Grundig case*, V. Korah '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. 320, 354-5; V. Korah 'EEC Competition Policy –Legal Form or Economic Efficiency' [1986] Current Legal problems pp. 85-109.

Although the Single Market in theory is established, it is far from homogeneous. National markets within the Union are still regulated differently and the consumer preferences are not the same.[20] In order to engage in trade in a foreign jurisdiction, the manufacturer needs help to overcome administrative barriers and adapt his goods to the new market. An independent distributor who is established in the actual market can provide this help. Since dealing with a new product is risky and demands huge investments in promotional activity, the distributor asks for protection. The protection arrangements are likely to restrict competition and divide the market, but on the other hand, they might be necessary to induce manufacturers to participate in cross-border trade.

2.7 Conclusion

Most importantly, the operators in the market should to a wide extent be free to design their own distribution agreements. Public officials are unlikely to be better able to assess the efficiency gains from different methods of distribution than the parties themselves. In general, vertical collaboration is economically beneficial to the parties and consumers, since it, for example, streamlines distribution, distributes work, and makes further use of existing resources.

Nevertheless, there are difficulties facing the parties involved in vertical co-operation, such as price policy and the carrying out of promotional activity. The distribution agreement can be drafted to overcome these difficulties. Less convenient is that the agreement often results in anti-competitive effects on the market in the form of market foreclosure, reduced inter- and intra-brand competition, and increased horizontal collusion.

The task for all competition policies in this field must be to provide a system which makes vertical co-operation possible, but prohibits agreements that impose excessive restrictions on competition. This is not an easy mission, and it becomes even more problematic in the European context where the creation and consolidation of the Single Market must also be considered.

[20] Commission Green Paper on Vertical Restraints pp. 7-8.

3 Assessment of vertical distribution agreements under European competition law

3.1 Introduction

In this chapter I intend to consider how vertical agreements have been dealt with so far under European competition law. Both Article 81 and Article 82 can in principle be applied. However, in reality Article 81 is most frequently used. It is also in this respect interesting policy changes have taken place. Therefor the presentation will concentrate on this Article.

At first sight, Article 81 constitutes a straightforward framework for assessing vertical agreements as it provides a clear weighing mechanism between an agreement's pro- and anti-competitive effects. However, the Article has not worked as intended, mainly because of a cumbersome administrative system to implement the exemption system.

Here, the relevant Articles in the assessment of vertical restraints will be considered and the administration system discussed, but the main focus will be on how the prohibition in Article 81(1) has developed in relation to vertical distribution agreements. Some parts described in this part will be out of date with the coming into force of the new Block Exemption and the changes in Regulation 17. Nevertheless, the analysis of Article 81(1) is still of importance, even after the Reform. [21]

3.2 Treaty provisions and Block Exemptions

3.2.1 Article 81 and Article 82

Most vertical agreements are assessed under Article 81 which prohibits agreements between undertakings that prevent, restrict or distort competition. For the Article to apply, there must be some sort of bilateral conduct between two different undertakings. From a general point of view, most vertical distribution agreements fit this description.

[21] All references in this chapter to Regulation 17 are references to the old version before the amendments took place.

However, some vertical distribution systems are caught by Article 82 which prohibits the abuse of a dominant position. Only one undertaking is needed but it must be dominant.[22] The Article has, for example been applied to selective distribution systems so that a refuse to supply amounts to an abuse, and to exclusive purchasing agreements where unduly hard restrictions on the distributor have been considered to constitute an abuse.[23]

Naturally, there is a gap between the two Articles: if there is neither an agreement nor a dominant undertaking, neither of the Articles can in principle be applied. In relation to vertical distribution agreements, it has been considered necessary, not at least from a Single Market perspective, to fill the gap between the two Articles. [24] By an extensive interpretation of both Articles, agreements that by a literal interpretation would fall outside the Articles have been caught by the provisions.[25]

3.2.2 Article 81

Article 81 is clearly divided into two different parts. The first part 81(1-2) is a prohibition, which captures *'agreements which may affect trade between Member States and have as its object or effect the prevention, restriction or distortion of competition within the common market.'* Agreements that are caught by the prohibition are void, but can be exempted under the Article's second part, 81(3).[26]

By far the most interesting point in relation to vertical distribution agreements is how to interpret the last element *'object or effect to restrict …competition'* given that the restrictions on competition contained in these agreements often, in the long term, lead to enhanced competition or efficiency gains in the distribution system. With this twofold character in mind, it is doubtful whether vertical distribution agreements should at all be considered as restricting competition.

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[22] For definition of dominance Case 85/76 *Hoffman La Roche and Co. v Commission* [1979] ECR 461.
[23] Case 310/1993 P *BPB Industries plc v Commission* [1995] ECR 865.
[24] For criticism of this approach, see N. Green 'Article [81] in perspective: Stretching jurisdiction, narrowing the concept of a restriction and plugging a few gaps' [1888] ECLR pp. 190-206 at pp. 75-77.
[25] The discussion of how the Articles have been interpreted fall outside the scope of this presentation. However, mainly two doctrines have been imposed. 'The Single Economic Unit Doctrine' Case 22/71 *Béguelin Import v GL Import-Export* [1971] ECR 949 and Case 73/95P *Viho Europe BV v Commission* [1996] ECR I 5457; 'The Unilateral Doctrine' Case 107/82 *AEG-Telefunken v Commission* [1983] ECR 3151 and Case 25/84 *Ford v Commission* [1985] ECR 2725. See also, R. Whish *Competition Law* [1995] London p. 200.
[26] Article 81(2) does not necessarily render the whole agreement void. Where the offending clauses can be separated from the agreement without stripping it of its essence, the rest of the agreement can go ahead. Whether this is possible should be decided in the light of all relevant circumstances and in accordance with relevant national rules of severability.

However, it is clear from case law that a wide range of vertical distribution agreements are captured by the prohibition. Article 81(1) has been given a formalistic interpretation under which the smallest restriction makes the agreement fall under the Article. Such a broad application makes Article 81(1) easy to apply, whereas consideration of an agreement in its legal and economic context has been left for the exemption system under 81(3).[27]

Article 81(3) provides the major mechanism by which the reach of the prohibition set out in 81(1) is curbed. Four criteria must be met for an exemption to be granted. A distribution agreement must:

-contribute to improving the distribution of goods
-while allowing consumers a fair share[28]

at the same time it must not:

-impose restrictions which are not indispensable to the attainment of the objective, or
-afford such undertakings the possibility to eliminate competition in relation to a substantial part of the market

This part of the Article calls for a balance to be struck between the restrictions and the positive impacts of an agreement. If the agreement as a whole has a beneficial effect on competition and distribution in general it will be exempted. It is clear that most vertical distribution agreements qualify for an exemption. Nevertheless, this has not helped business much given the uncertainty and excessive administration inherent in the exemption system.

3.2.3 Individual Exemptions and Block Exemptions

Article 81(3) sets out criteria which must be complied with for an exemption to be granted, but the Commission still enjoys a wide discretion under the provision where it might take into account broader social policies as well as matters strictly related to competition.[29]

[27] The question was considered the first time in Case 13/61 *de Geus v Bosch & van Rijn* [1962] ECR 45. The view that vertical distribution agreements are captured by the prohibition in Article 81(1) has then been further developed in Case 32/65 *Italy v Council & Commission* [1966] ECR 299 and Joined Cases 56/64 and 58/64 *Etablissements Consten SARL and Grundig-Verkaufs-GmbH v Commission* [1966] ECR 299.
[28] It is not very clear how this consumer criterion must be showed. It might be sufficient to prove that the agreement contributes to a more efficient distribution system and this will automatically be assumed to be good for consumers.
[29] See, e.g., Commission 9th Report on Competition Policy, 1979 p. 10. More general, see, e.g., Whish *Competition Law* p. 227, Frazer, note 16, V. Korah ‘EEC Competition Policy – Legal Form or Economic Efficiency’.

A flexible system where all cases are assessed individually is desirable, e.g. for vertical restraints where the effect on competition is largely dependant on market conditions. Unfortunately, the flexibility makes the decisions from the Commission very hard to predict. The Block Exemptions provide a simplification of the procedure.

A Block Exemption can be described as a codification of the requirements in Article 81(3) in relation to a generic category of agreements. An individual agreement, which complies with all the clauses set out in a Block Exemption is automatically exempted from Article 81(1). No notification or any application for individual exemption is necessary. Naturally, once an agreement qualifies for a Block Exemption it provides legal certainty for business and saves valuable time.

The areas selected for Block Exemptions are those which although restricting competition within the meaning of Article 81(1) are on the whole economically beneficial, and pose no real threat to competition. Three Block Exemption Regulations were adopted for vertical distribution agreements under the old system.[30]

3.3 Administration –the notification system

Under the old administration system, all vertical agreements for which the parties sought exemption from Article 81(1) and which did not qualify for a Block Exemption had to be notified to the Commission.[31] Notification was of central importance. It was a prerequisite for any individual exemption to be granted and an agreement was only exempted from the day of notification. Thus even if a notification was submitted nothing could rebut the prohibition laid down in Article 81(1), which applied from the day of conclusion to the day of notification. This applied independent of whether the agreement complied with 81(3) from the very beginning or not.[32]

The division of enforcement powers between national courts and the Commission also contributed to the uncertain situation. Once an agreement was notified to the Commission, national courts had no jurisdiction and the

[30] Commission Regulation 1983/83, on the Application of Article [81(3)] of the Treaty to categories of Exclusive Distribution Agreements; Commission Regulation 1984/83, on the Application of Article [81(3)] of the Treaty to categories of Exclusive Purchasing Agreements; Commission Regulation 4087/88, on the Application of Article [81(3)] of the Treaty to categories of Franchise Agreements (Commission Regulation 1475/95 on the Application of Article [81(3)] to categories of motor vehicle agreements will not at all be considered.).

[31] Apart from a small number of agreements which only affected one member state and which were of minor importance. However the undertakings were allowed to notify even these agreements, which they often also did. Regulation 17 art. 4.

[32] Regulation 17 art. 4(1), 6(1); Case 30/78 *Distillers Co. Ltd v Commission* [1980] ECR 2229.

agreement could no longer be challenged in national courts. It was important to obtain this effect because if an agreement was declared void in a national court, the court could grant no exemption even if the agreement qualified for an exemption under Article 81(3).[33]

There was an element of precariousness as to what extent vertical agreements infringed Article 81(1) given their twofold characteristic, and the European Court of Justice's (ECJ) wide and sometimes inconsistent interpretation of the provision. Undertakings could have to pay a high price if they miscalculated, i.e. if they thought that their agreement did not infringe Article 81 and did not notify. The outcome was that undertakings notified all their agreements. The situation soon became unbearable. Business spent money on unnecessary notifications[34] and the Commission's workload grew every day.[35]

One way of solving the problem was to clarify the scope of Article 81(1) by Commission notices,[36] another to adopt block exemptions to reduce the number of notifications coming in. The Commission has also tried to speed up and simplify its procedure, for example by introducing the Comfort Letter.[37]

3.4 Reducing the scope of Article 81(1)

3.4.1 The debate around Article 81(1)

As mentioned previously, Article 81(1) has captured a wide range of vertical agreements where all true analyses have been left to Article 81(3). For years

[33] National courts have the power to declare an agreement void if it infringes Article 81(1) since the article is directly effective. On the other hand, the Commission is the only body with the power to grant an exemption under Article 81(3). Regulation 17 art. 9(1,3).
[34] When notifying an agreement the parties must not only provide the Commission with a great deal of information about the agreement but also about the structure of the actual market. Such information is to a high degree confidential and might be hard to access as it includes information about similar agreements held by competitive firms. The investigation the undertakings must undertake for a proper notification is both costly and time-consuming.
[35] The entry into force of Regulation 17 resulted in a 'mass notification' in excess 30,000 in early 1960, the majority concerning vertical agreements. Under the procedure laid down in Regulation 17 the Commission was only able to take about 20 formal decisions, and close 150 files by Comfort Letter a year. Commission Green Paper on Vertical Restraints Exec. Summary.
[36] Commission Notice on Agreements of Minor Importance [1997] OJ C372/1.
[37] A comfort letter is a decision from the Commission to the effect that, in its opinion, at that moment, the actual agreement neither infringes Article 81(1) nor qualifies for an exemption under Article 81(3). By the issue of the comfort letter the file is closed, but can be re-opened. The comfort letter provides no legal certainty because it is not binding on national courts or the ECJ and it can not be challenged in ECJ. Case 253/78 *Procureur de la Republique v Bruno Giry and Guerlain SA* [1981] CMLR 99.

there has been a debate within the Union whether the scope of Article 81(1) should be reduced. The malfunction of the administrative system might have been the most urgent reason for the discussion, but also a more academic debate inspired by the American Anti-trust can be identified.

The first option concerning how to reduce the number of cases falling under Article 81(1) advocates a new interpretation of ‘restrict competition’ so as to mean only restrictions that are capable of imposing a real threat to competition.[38] The second option, here called the ‘European Rule of Reason’, which has constantly been refused by the Commission, argues for a weighing of an agreement’s pro- and anti-competitive aspects already under Article 81(1).[39] None of the options would affect the exemption system under Article 81(3). Real complicated economic analyses must still take place under Article 81(3).

Many argue that a reduction in the application of Article 81(1) would result in efficiency gains, especially in relation to relatively harmless practices such as vertical distribution agreements. Since agreements which do not fall foul for the prohibition in 81(1) never infringe Article 81, fewer agreements would need to be notified. The Commission’s workload would diminish and in the same time business would avoid much costly and time-consuming administration. Accordingly, reducing the scope of Article 81(1) would result in large administrative advantages.

Even if there seems to be great consensus over the faults in the administration system, not everybody thinks that the solution lies in reducing the scope of Article 81(1). Some argue that this would deprive Article 81 of its two-part structure and entrust national courts with too much responsibility which they are not yet ready to handle.[40] The efficiency effects from such a reform have also been disputed. More analyses would have to be made under Article 81(1), which would have as its sole effect to remove the delay these analyses cause from the exemption system up to the

[38] V. Korah suggests application of a ‘filter mechanism’ inspired from the simplified application of the Rule of Reason under American Anti-trust law. See, V. Korah ‘The Future of Vertical Agreements under EC Competition Law’[1998] ECLR pp. 506-513 at p. 507.
[39] The American Rule of Reason removes cases from Sherman Act, s.1 by weighing pro- and anti-competitive aspects against each other, to allow agreements that are overall beneficial for society. For the Commission’s restrictive view see, e.g., Commission White paper on the Modernisation of the Rules Implementing Articles [81 and 82] of the EC Treaty COM [1999] 101 final para 57; For an application in Europe, see, Korah note 38, HHP Ludgard note 13, I. Forrester and C. Norall ‘The Lacization of Community Law’[1984] 21 CMLRev 11.
[40] National courts have the power to apply Article 81(1) but not Article 81(3). Reducing the scope of Article 81(1) would mean that more analysis must be carried out already under Article 81(1). As Article 81(1) can be applied by national courts this would mean that national courts would be entrusted with more responsibility than before.

prohibition system. A delay in applying the prohibition in Article 81(1) would be as harmful as the delay under 81(3) in the present system.[41]

Some parts of the discussion described above can be found in case law and the work of the Commission.[42] Generally speaking, the Commission has been less enthusiastic towards reducing the scope of Article 81(1) and the Commission has most reluctantly recognised the steps taken by the Community Courts.[43] Here I will examine three steps taken by the Courts to remove vertical distribution cases from the application of Article 81(1).

3.4.2 Object and effect

An agreement infringes Article 81(1) if its object or effect is to restrict competition.[44] The distinction between an agreement's object and effect has become quite important in the assessment of vertical agreements and was first considered in the case *Société Technique Minière.*[45] The term object is not used in its normal meaning as pointing to the intention of the parties, but should be interpreted as meaning the *'objective meaning and purpose of the agreement considered in the economic context where it is to be applied'.*[46]

In *Société Technique Minière* (STM) the ECJ considered a distribution system where STM had the exclusive right to sell in France certain grading equipment produced by a German undertaking. No absolute territorial protection was obtained by the agreement since STM was allowed to sell the goods outside France and parallel imports could be obtained from other countries. This case shows how the ECJ has reasoned upon object and effect.

The ECJ starts off by examining whether the agreement has as its object to restrict competition. If this is the case, no deeper analysis needs to be carried

[41] See, Furse *Competition Law of the UK an EC* [1999] London pp. 144-145; R. Whish and B. Surfin 'Article [81] and the Rule of Reason' [1987] 7 YBEL pp. 36-37.
[42] For different interpretations of the case law, R. Whish *Competition Law* pp. 203-205; V. Korah *EC Competition Law* pp. 62-67; P. Craig and G. de Burca *EU Law-text, cases and materials* [1998] Oxford pp. 903-914; J. Steiner and L. Woods *Textbook on EC Law* [1999] London pp. 204-216.
[43] See, Case T-7/93 *Langese v Commission* [1995] ECR II-1533 where the CFI criticises the Commission for not having carried out any economic analysis under Article 81(1). The Commission assumed that the agreement was an infringement of Article 81(1), and went directly to the economic analysis under Article 81(3). More generally see, R. Whish *Competition Law* p. 560; V. Korah *EC Competition Law* pp. 316-323.
[44] The term object has the same meaning as restriction by nature used in some cases; Case C-306/96 *Javico International and Javico AG v Yves Saint Laurent Parfums SA* [1998] ECR I-1983.
[45] Case 56/65 *Société Technique Minière v Maschinenbau Ulm GmbH* [1966] ECR 235
[46] Joined Cases 96 to 102, 105, 106, 108 and 110/82 *NV IAZ International Belgium and others v Commission* [1983] ECR 3369 This has special relevance for vertical distribution agreement as the primary purpose is not to restrict competition, but distribute goods and services more efficiently.

out. The arrangement is then per se[47] an infringement of Article 81(1). If, on the other hand, the agreement by its effect restricts competition, deeper economic analysis has to take place to determine if the agreement is in breach of Article 81(1) or not.[48]

To conclude whether an agreement's object is to restrict competition, the agreement should be looked at in its legal and economic context. In short, this means that a small investigation must take place where the agreement is considered in the market where it will be carried out.[49] These analyses are not as cumbersome as they sound. In reality, there are clauses that almost always will be ruled to have as their object the restriction of competition in the common market. These clauses can be divided into two groups: those that create a real threat to competition such as fixed resale prices,[50] and those that work against the creation of the Single Market, i.e. clauses that restrict parallel import or grant absolute territorial protection.[51]

When an analysis of the agreement does not reveal an object to restrict competition, wider examination of the agreement on the actual market must be carried out. The purpose is to carry out a very individual analysis to determine what effect the actual agreement is likely to have on the market where it is intended to be implemented. For example, the structure of the existing market for the relevant products becomes highly important. A single agreement might not be able to affect competition in isolation, but set in a market where similar agreements already exist the actual agreement can contribute significantly to a situation harmful to competition.[52]

In short, two notional markets must be compared: one where the agreement is implemented and one without such an agreement , where the difference between the markets constitutes the effect of the agreement. If implementation of the agreement in fact does not have a real effect on competition, it does not infringe Article 81(1).

The comparison between the notional markets is cumbersome and the ECJ has not clearly declared which criteria should be used. When the analyses

[47] The ECJ did not use this term in the judgement which originates in the American application of the Rule of Reason. The similarity between the two notions, Per se Rules and Object, is striking. Under neither of them is any inquiry made into the actual competition effects of the challenged agreement which is declared unlawful directly.
[48] See also, Case 48/72 *Brasserie de Haecht SA v Wilkin* [1973] ECR 77; Case T-7/93 *Langese v Commission* In these cases the agreements were held to be in breach of Article 81(1).
[49] For more details about the analysis at this stage, Case 56/65 *Société Technique Minière v Maschinenbau Ulm GmbH* at p. 247.
[50] Case 234/83 *Sa Binon & Cie v SA Agence et messageries de la presse* [1985] ECR 2015 para. 44.
[51] See, Joined Cases 56, 58/64 *Etablissements Consten SARL and Grundig-Verkaufs-GmbH v Commission,* where the Court ruled that an agreement infringed Article 81(1) without going into any deeper economic analysis of the market. This was not necessary since the agreement confined absolute territorial protection, i.e. a restriction by object.
[52] See, e.g., Case T-7/93 *Langese v Commission.*

take place before the agreement is implemented in the market, they must be quite hypothetical. In many such cases, the ECJ or the Commission would have to balance the potential anti-competitive risks of the agreement against its pro-competitive benefits to determine its likely overall effects on price and output. The analyses then get very close to the much criticised Rule of Reason approach.

3.4.3 The Ancillary Doctrine

A development of the effect analysis into an 'Ancillary Doctrine' can be seen in a small but growing number of decisions from the Community Courts.[53] Under the Doctrine restrictive clauses fall outside the prohibition of Article 81(1) if they are objectively necessary and in proportion to secure the implementation of a lawful agreement.[54]

The definition of ancillary restraints under European competition law is vague. Ancillary restraints are those that are 'directly related' to the agreement and 'remain subordinate in importance to the main object'. It is difficult, if not impossible to identify in the abstract whether a particular restraint will be treated as ancillary to a particular type of agreement.[55] However, there is some case law that gives a hint of what sort of agreements the ECJ wants in the market, and which restraints are necessary in order to promote these agreements.

First, the ECJ admitted that selective distribution arrangements were needed and desirable, for luxury goods, which require a high degree of trademark protection, and for technical advanced products, to guarantee suitable in-store services to advice the customers. [56] The restrictive element, i.e. the selection of certain distributors, has to be on a qualitative basis, and not carried out in a discriminatory way.[57]

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[53] It seems from case law that this doctrine only applies to agreements which have as their effect to restrict competition, and leaves the agreements with an object to restrict competition outside the doctrine, Case 161/84 *Pronuptia de Paris GmbH v Pronuptia de Paris* [1986] ECR 353 para. 24.

[54] It can be questioned if the test of necessity should be the same under Article 81(1) as for an exemption to be granted under Article 81(3). The test under Article 81(1) seems to concern the necessity for the existence and implementation of an agreement. Under Article 81(3) more focus is placed on the necessity of achieving the benefits recognised.

[55] Faull and Nikpay *The EC Law of Competition* p. 92.

[56] E.g., such as ceramic tableware Decision 85/616 *Villery & Boch* [1985] OJ L376/15; jewellery Decision 83/610 *Murat* [1983] OJ L348/20; luxury cosmetics Decision 92/33 *Yves Saint Laurent Perfumes* [1992] OJ L12/24, Decision 92/428 *Perfumes Givnchy SA* [1992] OJ L236/11; Such as electronic and audiovisual equipment, computers Decision 84/233 *IBM Computers* [1984] OJ L118/24.

[57] Cases 26/76 and 75/84 *Metro-SB-Grossmarkte GmbH and Co KG v Commission* A quantitative selection system can not be imposed and still escape Article 81(1). A quantitative system is a system where the supplier engages in a selection process not only to find the most suitable distributors, but also to restrict the number of dealers.

Moreover, the ECJ has ruled in favour of franchise agreements. In *Pronuptia*[58], the ECJ recognised a franchise agreement as an important way for an undertaking to derive financial benefit from its experience without investing in own capital. A franchise system did not itself interfere with competition, and some necessary restraints were allowed. Contrary to selective distribution systems, it was even legitimate to impose quantitative restrictions.

In *Delimitis*[59] the ECJ took the opportunity to detail which restrictions were in order to make an exclusive purchasing agreement in the beer sector to function. The agreement was deemed to help new entrants into the market and in order to reach this objective the ECJ accepted some restrictions in the agreement.

Regarding exclusive distribution systems, the ECJ ruled in the initial case, *La Société Technique Minière*[60] that a granting of exclusive territory to a dealer does not infringe Article 81(1) if the exclusivity is necessary to penetrate a new market.

Even this Doctrine, seen as a development of the effect analysis is close to an application of the Rule of Reason. In the case *European Night Services*[61] the CFI had a real chance to make a statement on the issue. The Court did not expressly recognise that a Rule of Reason approach could be applied already under Article 81(1), but neither did it reject it. Some writers have chosen to interpret this as recognition of the application of the Rule of Reason under Article 81(1).[62]

3.4.4 The De Minimis Doctrine

According to the De Minimis Doctrine an agreement will not be caught by Article 81(1) unless it has appreciable impact on competition. This principle was introduced in the *Völk case*,[63] and has since been explained and codified by the Commission in notices, the last from 1997.[64]

In determining whether an agreement has an appreciable impact on competition, the size of the parties and, even more importantly, their share in the relevant product market are essential factors. The De Minimis

[58]Case 161/84 *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgalis.*
[59] Case C-234/89 *Delimitis v Henninger Brau* [1991] ECR I-935.
[60] Case 56/65 *Société Technique Minière v Maschinenbau Ulm GmbH.*
[61] Case T 374/94 *European Night Services & Others v Commission* [1998] ECR II 3141.
[62] Faull and Nikpay *The EC Law of Competition* p. 445.
[63] Case 5/69 *Völk v Etablissements Verbaecke Sprl* [1969] ECR 295.
[64] De Minimis Notice is only binding on the Commission, Commission Notice on Agreements of Minor Importance para 7. Yet, the Notice is likely to have persuasive influence before Community as well as national courts.

Doctrine excludes agreements that are negligible from the scope of Article 81(1).[65]

In the *Völk case*, an exclusive distribution agreement that provided absolute territorial protection in the Belgian and Luxembourg market was concluded between a German producer (Völk) of washing machines, and a Dutch based distributor (Vervaecke). At first sight, the agreement is clearly in breach of Article 81(1) since it confers absolute territorial protection on the parties. Nevertheless, the agreement was excluded from Article 81(1) by applying De Minimis Doctrine because the agreement did not appreciably effect competition. Neither did it appreciably affect trade between Member States.[66]

The latest Notice from the Commission provides as a general rule that a vertical agreement falls under the De Minimis Doctrine if the total market share for the products in the relevant market of all business involved is not more than 10%.[67] Furthermore, agreements between small and medium-sized enterprises (SME)[68] will benefit from this doctrine even if they exceed the market threshold.[69]

However, the Commission firstly states that the benefit from the Notice will be removed when vertical agreements have as their object to fix prices or confer territorial protection.[70] Secondly, the Commission points out that agreements between SMEs that significantly impede competition in a substantial part of the market or contribute to a parallel network of similar agreements will be removed from the scope of the Notice.[71]

These last requirements are added to the 1997 Notice, and contribute to a significant uncertainty in the application of De Minimis, which before was quite straightforward for business to apply. From the statement it seems that de Minimis is no longer applicable to restraints which have as their object the restriction of competition. [72]

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[65] Compare with 'the first check' approach discussed in 3.4.1.
[66] Völk's market share of the German market for washing machines was 0.2 %. The market share of the exclusive distributor in the market for washing machines in Belgium and Luxembourg was 0.2 %. Moreover, the Völk's production of washing machines in the Community market represented only 0.08 %.
[67] Commission Notice on Agreements of Minor Importance para. 9(b).
[68] Meaning enterprises defined in Commission Recommendation on the Definition of Small and Medium-sized Undertakings [1996] OJ L107/4.
[69] Commission Notice on Agreements of Minor Importance para. 19.
[70] Territorial protection is not defined in the Notice, but it must be assumed that the Commission does not mean all territorial protection. It is likely that the Commission is referring to territorial protection where the object is to restrict competition, i.e. absolute territorial protection and the impediments of parallel trade.
[71] Commission Notice on Agreements of Minor Importance para. 11(b), 20.
[72] This view is also taken in the Commission Green Paper on Vertical Restraints para. 276. On the other hand, by reading the general statement in the Commission Notice on Agreements of Minor Importance I(2) it seems that the Notice applies even to restrictions by object.

The De Minimis Doctrine was before applied even to agreements with an object to restrict competition, at least when the accumulated market share of the business was insignificant. There is no definition of insignificant but the interpretation of the *Völk case* in combination with the *Miller case* gives a quite clear picture of the situation.

In the *Völk case* the agreement was not caught by Article 81(1) despite absolute territorial protection. Yet, the accumulated market share of the parties was less than 1%. In the *Miller case* absolute territorial protection was also reached by a vertical distribution agreement, but in this case the agreement was held to infringe Article 81(1). The difference from the *Völk case* was that the accumulative market share held by the parties was 5 %.

3.5 Conclusion

Most vertical distribution agreements are assessed under Article 81 of the Treaty. In principle, this Article could constitute an appropriate framework for the assessment of vertical distribution agreements since it provides a balancing test between harmful and beneficial features and accepts agreements that, as a whole, enhance competition and improve distribution.

Yet, in practical terms the balancing test has not worked as intended in relation to vertical distribution agreements so as to stop harmful agreements and allow the beneficial ones. A combination of a rigid application of Article 81(1) and a cumbersome exemption system has resulted in that too many beneficial agreements being struck down.

Both the Commission and the ECJ have tried to curb the imbalance. The Commission by providing a simplified procedure through the Block Exemptions or the Comfort Letter, and the ECJ by reducing the scope of the prohibition in Article 81(1). Some parts of these arrangements have been successful, others more criticised.

Unfortunately, the Commission has not always recognised the steps taken by the ECJ to remove cases from the prohibition in Article 81(1). This, in combination with unclear case law, has resulted in uncertainty as to what extent vertical distribution agreements infringe Article 81(1). The latest initiative from the Commission, the new De Minimis Notice, makes the situation even more confused.

4 Criticisms and justifications of the Commission’s approach towards vertical distribution agreements

4.1 Introduction

The Commission’s approach to vertical restraints has been one of the most severely criticised aspects of the Commission competition policy over the years.[73] Much of the new thinking in the area and inspiration for the critical debate, has derived from the predominant school of policy in the USA in the 1990s, the Chicago School.[74] It advocates an economic approach to vertical restraints and accordingly recognises most of them as purely beneficial for society.[75] I have chosen to highlight the theories from the Chicago School in my comparative analyses. (Hereafter the theories from the Chicago School will be referred to as ‘the Chicago School’.)

Some aspects of the Union’s policy towards vertical restraints can be explained by the Union’s special constitutional nature, others can be justified as being a part of and promoting broader policy goals. Yet, this is not always the case, and even in highlighting these justifications, it is arguable to what extent they should be given such a predominant place in competition law. It can instead be argued that the main concerns for competition policy should be of an economic character. Furthermore, it is not certain in practical terms that the promotion of general goals has the effect intended when they are implemented on a market directed by economic factors.

4.2 Administration system

As has been discussed, Regulation 17 provided a very centralised enforcement system for the Commission. All agreements in relation to

[73] V. Korah note 19; H.H. Lugard note 13; N. Green note 24; Hawk, ‘The American (Anti-trust) Revolution: Lesson for the EEC?’ [1988] ECLR pp. 53-86.
[74] See, e.g., R. Bork *The Antitrust Paradox*; R. Posner *Antitrust Law* [1976] Chicago.
[75] See, R. Bork *The Antitrust Paradox* pp. 297-298.

which the parties sought individual exemption needed to be notified to the Commission, the only body able to grant an exemption.[76]

The concentration of power in the Commission had its justifications during the building up of European competition law, particularly in relation to complicated cases such as vertical restraints. Through the notification system, the Commission obtained essential information about different practices in the market to be used in the adoption of a suitable competition policy and in surveying the need for Block Exemptions. In addition, the Commission's exclusive competence to grant exemptions was necessary to ensure a coherent application of the competition rules through the Community. At the time national authorities could not be entrusted with much power since many Member States had no tradition in competition law before they entered the Union.[77]

Today the justifications for the system are no longer as strong. The Commission has all the necessary information about the market; European competition law and policy have been established; and all Member States have their own competition law. Conversely, in recent years, the concentration of power has been much criticised, mainly because it overburdens the Commission, which does not have sufficient resources.[78]

Under the old system, the Commission was unable, due to its heavy workload, to grant individual exemptions in a reasonable time. Consequently, many agreements were out of date by the time a formal exemption decision could be granted. In this situation the undertakings had to choose between starting the co-operation without a formal decision or accepting a comfort letter that does not protect against ex-post investigation. Independently of which solution the undertakings chose, they faced considerable legal uncertainty, either while waiting for a formal decision or where the notification was dealt with by a comfort letter.[79]

Undertakings spent time and money on notification that, in practical terms, could not give them any protection since the agreements in most cases had to go ahead without a formal decision. Especially in relation to practices which do not constitute a real threat to competition such as vertical distribution agreements, there was a waste of resources. The uncertain situation also restricted undertakings from becoming involved in risky

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[76] Regulation 17 art. 9(1).
[77] V. Korah *EC Competition Law*; H. Ullrich 'Harmonisation within the European Union [1996] 3 ECLR pp. 178-184.
[78] The Commission has also started to oversee the rules. A trend towards decentralisation in competition policy can be seen in the documents published so far. See, Commission White Paper on the Modernisation of the Rules Implementing Articles [81and 82] of the EC Treaty.
[79] Decision 92/33 *Yves Saint Laurent Perfumes*; Decision 92/428 *Perfumes Givnchy* where it took two years from the date of notification to obtain a formal decision, F. Murray and J. Mac Lennan 'The future of selective distribution systems' [1997] ECLR pp. 230-233 at p. 230.

investments for which the costs are sunk,[80] since they were not sure if the agreement protecting the benefit of the investment would be exempted.

4.3 Block Exemptions

As has been described above, the application of Article 81 is detrimental to undertakings. The scope of the prohibition is uncertain and the exemption system is costly and time-consuming. On the other hand, if an agreement is drafted to fall under a Block Exemption, there is no need for economic analyses to determine whether the agreement infringes Article 81(1) or not. Neither is there any need for notification; the agreement is valid without specific authorisation. The benefits of bringing an agreement within the terms of one of the old Block Exemptions were such that they became, in effect, standard-term models for all distribution contracts.

In order to benefit from a Block Exemption, an agreement had to fit one of the categories of agreements for which the Commission had adopted a Block Exemption. Furthermore, there was a need to ensure that the agreement was within the spirit, as well as the wording, of a particular Regulation. It also appears from case law that undertakings could not ‘pick and mix’ from within the Block Exemptions, but had to demonstrate that the entire agreement benefited from the provisions of only one of the Regulations.[81]

The division of agreements into different groups was based on the backlog of notifications that the Commission had received over the years and did not necessarily show much of economic or commercial reality. In addition, before the Reform, only three Block Exemptions were adapted for vertical distribution systems, which were all in regard to bilateral agreements of final goods. It is hard to find economic arguments as to why selective distribution should not also benefit from a Block Exemption, or why there was not any exemption that covered multilateral arrangements dealing with services or intermediate goods. The system did not only force agreements into artificial groups, but it was also discriminatory in favour of certain distribution arrangements.[82]

Moreover, the Regulations were drafted in a very formalistic manner. To start with, each Regulation had a list of white clauses which were exempted from Article 81(1). Contrasting with white clauses, there was a list with black clauses. The inclusion of a black clause removed the benefit of the Block Exemption from the whole agreement. Some Regulations did even contain a list of grey provisions which did not usually fall within Article

[80] Sunk costs are investment costs which are entirely lost if leaving the market. For example, advertisement expenses to penetrate new markets.
[81] Case C-234/89 *Delimitis v Henninger Brau.*
[82] F. Murray and J. Mac Lennan note 79 at p. 230.

81(1).[83] In order to benefit from a Block Exemption, an agreement had to satisfy all the requirements of the relevant Regulation.[84]

The Regulations did in practice work as 'straight-jackets' for agreement drafting. The result was not beneficial to the market, since the agreements became unnecessarily restrictive and did not provide the most efficient solution in order to comply with a Regulation.[85] Furthermore, the system hampered innovative steps in distribution because the Regulations were adopted for an old model of distribution.[86] Particularly in relation to the Economic Freedom Doctrine, which has been given such weight at another level of the analysis of vertical restraints, can the construction of the Block Exemptions be questioned. The Block Exemptions did not in practical terms leave much choice for the parties in regard to the drafting of their agreements.

4.4 The work of the Commission

The Commission has been criticised for having failed in the analysis of whether vertical restraints harm competition and if so which ones. A lack of adequate economic analysis and involvement of broader policies in the assessment has driven the Commission towards a legal and formalistic approach. Here three main critical arguments will be presented which are relevant both in relation to the prohibition and the exemption system in Article 81.

4.4.1 The Economic Freedom Doctrine

The first explanation for the inadequate analyses lies in the tendency of the Commission to define a restriction on competition as a restriction on the economic freedom of the parties.[87] The concentration on the Economic

[83] This structure derives from the basic implementation Regulation which states that all Block Exemptions must be constructed in this manner, Council Regulation 19/65 on the application of Article [81(3)] of the Treaty to certain categories of agreements and concerted practices [1965] OJ L36/533.
[84] Case C-234/89 *Delimitis v Henninger Brau.*
[85] V. Korah *EC Competition Law* p. 71.
[86] Distribution is easier and can be more efficiently organised with today's technology. One example is what is called 'Just in time'. This means that the distributor gives instructions to the manufacturer what and when to produce when there is a need in the market, J. Riley 'Vertical Restraints: A Revolution?' [1998] ECLR pp. 486-487; Communication from the Commission on the Application of the Community Competition Rules to Vertical Restraints p. 7.
[87] Cases 56 & 58/64 *Etablissements Consten SA and Grundig-Verkaufs-GmbH v Commission* para. 8046. Also, Decision 80/13337 *Hennessey-Henkell* [1980] OJ L383/11, where foreclosure of competing suppliers and dealers resulting from an exclusive dealing contract has been described as a restriction on the freedom of choice; Commission 23rd Report on Competition Policy 1993.

Freedom Doctrine can be discerned from a general trend in the Union to involve itself in socio-political considerations. Competition policy becomes an instrument to promote economic and political freedom for individuals and traders, where the care of vulnerable, small and medium sized traders is of special relevance.

Many vertical distribution agreements do restrict the freedom of the parties. For example, an agreement with territorial protection restrains the parties from trading in territories which are allocated to other distributors. A selective distribution system selects the parties to the effect that non-selected distributors will not get the opportunity to deal with the goods at issue. Due to the fact that traders can not choose who they want to deal with or where to sell their goods vertical distribution agreements sit uneasily with the Economic Freedom Doctrine.

Yet, to involve the Economic Freedom Doctrine in competition policy is questionable for many reasons. Firstly, restriction on economic freedom should not be placed on an equal footing with restriction on competition. It is clear that vertical distribution agreements deprive the parties of some economic freedom, but on the other hand, virtually all contracts can be described as restricting the freedom of the parties since they bind the parties' behaviour for an agreed period of time. Nevertheless, no one, not even the Commission, would describe all commercial contracts as posing a danger to competition. The concentration of the Economic Freedom Doctrine in the assessment of vertical restraints has resulted in that agreements which restrict the freedom of the parties, but which nevertheless are harmless for competition have been caught by the competition rules.

Furthermore, it is questionable if the welfare of the traders should precede the goal of economic efficiency and if it is allowed to do so whether the involvement of the Economic Freedom Doctrine really helps traders in the long run.[88] Manufacturers do not have to involve themselves in vertical distribution. Instead, the reason for co-operating with independent distributors is that this is the most efficient way of distributing their products. A policy unfavourable to vertical co-operation merely leads to manufacturers promoting their goods by themselves. This risks to bring about that small, local distributors disappear altogether. In addition, a policy unfavourable to vertical restraints renders it harder for small manufacturers to survive since they are very dependent on independent distributors to resell their goods.

It is hard to reconcile this development with the Economic Freedom Doctrine since it makes it harder for small traders, promotes concentration of economic power, and deprives consumers of the freedom of choice. At the same time, the manufacturer is hindered from organising his brand in the

[88] J. Riley note 86 pp. 483-492; V. Korah note 29 ; L. Gyselen 'Vertical restraints in the distribution process' pp. 662-664, Hawk note 73.

most cost-saving manner, which leads to efficiency losses. The wasted money could instead have been transferred to consumers.

4.4.2 Old economic theories

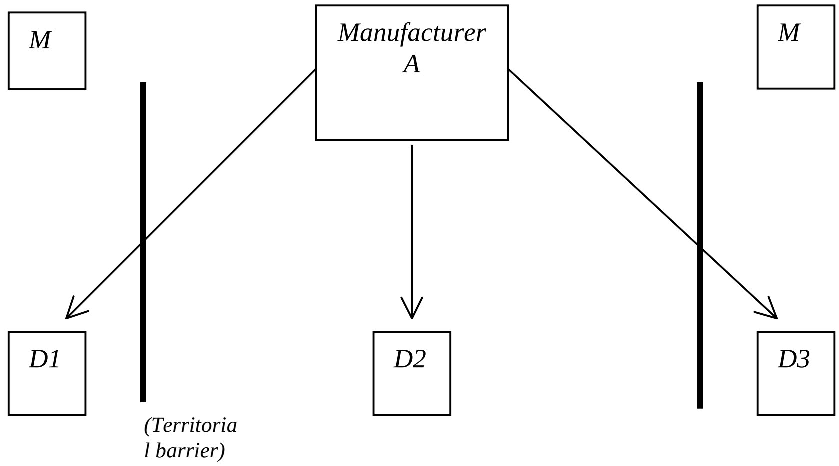
The second explanation for the Commission's inaccurate analyses is that the Commission has been rooted in old theories in the assessment of vertical restraints, theories which are not suitable for fast developing modern economies. This has resulted in the Commission failing to consider vertical distribution agreements in an adequate economic context. [89]

Firstly, the Commission has concentrated the analyses on intra-brand competition without considering which effects inter-brand competition has on the market. The outcome has been that the Commission has looked suspiciously on all vertical restraints irrespective of market power. The Chicago School, on the other hand, argues that vertical distribution agreements only pose a threat to competition when the parties have market power, i.e. when there is no or very weak inter-brand competition on the actual market. Secondly, the Commission has considered that the market is still full of barriers to entry. Conversely, the Chicago School asserts that the modern market is flexible, and without barriers to entry. The Chicago School thinks that a market with weak competition quickly self-regulates into a competitive structure.[90]

I will give an example where I explain these abstract terms. In order to make the reasoning comprehensive and the figures easy to understand, a very simplistic view is taken. The main purpose with the figures is to explain how the Commission's approach differed from the approach which is taken by the Chicago School.[91]

Figure 1

[89]See, e.g., Deacon 'Vertical restraints under E.U. Competition Law' [1995] Annual Proceedings of the Fordham Corporate Law Institute p. 307 at p. 318, New York; Z. Biro and A. Fletcher 'The EC Green Paper on Vertical Restraints: An Economic Comment' [1998] ECLR pp. 129-138; L. Peeperkorn note 7 pp. 1-6.
[90] Of course, it should be remembered that at the time of the original Block Exemption for Exclusive Distribution from 1967 and Joined Cases 56, 58/64 *Etablissements Consten SARL and Grundig-Verkaufs-GmbH v Commission*, mainstream economic thinking would have been quite hostile even to most non-price vertical restraints, *United States v. Arnold, Schwinn & Co*., 388 US 365 [1967] where the Supreme Court ruled against a vertical distribution agreement. Since then the American case law has developed, but not the European, *Continental T.V. Inc. V. GTE Sylvania Inc*., 433 US 36, 52 [1977].
[91] In my figures a market with three parties is considered as a competitive market. In reality this is a very concentrated market on which vertical restraints often give rise to competition concerns. Compare with the new Block Exemption where a market share over 30 % of one of the parties makes that the presumption of legality does not apply.

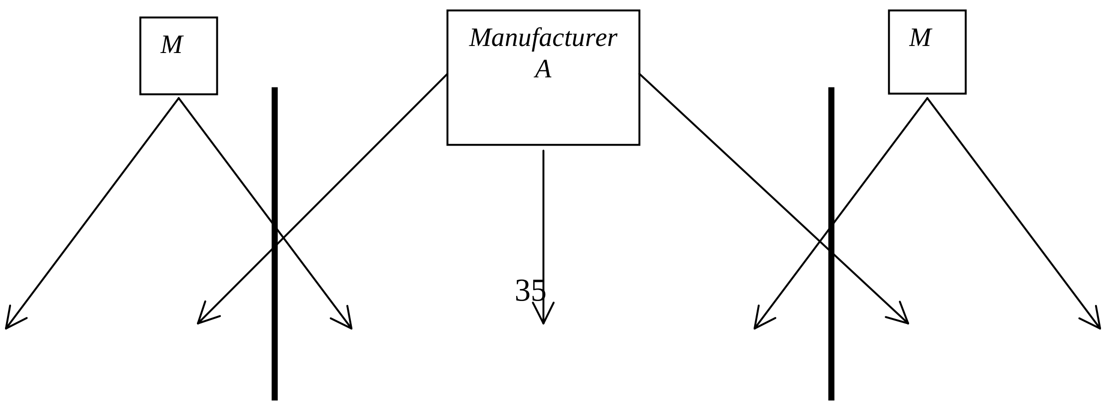


This is a market where three different manufacturers are present who promote similar goods. Manufacturer A has chosen to distribute his goods through a vertical distribution system with the assistance of the distributors D1, D2 and D3.

Manufacturer A has organised his distribution through an exclusive distribution agreement with territorial protection. Accordingly, he has divided the actual market between his distributors. Each distributor is only allowed to trade in his specially allocated territory.

The construction gives rise to a division of the market in three distinct parts. Since there is no competition between D1, D2 and D3, there is no intra-brand competition in the market.

Figure 2



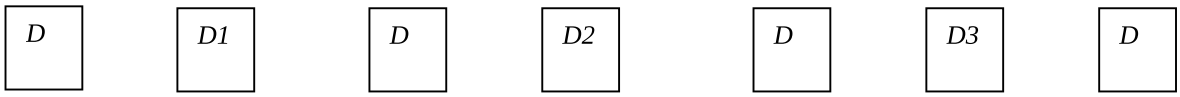


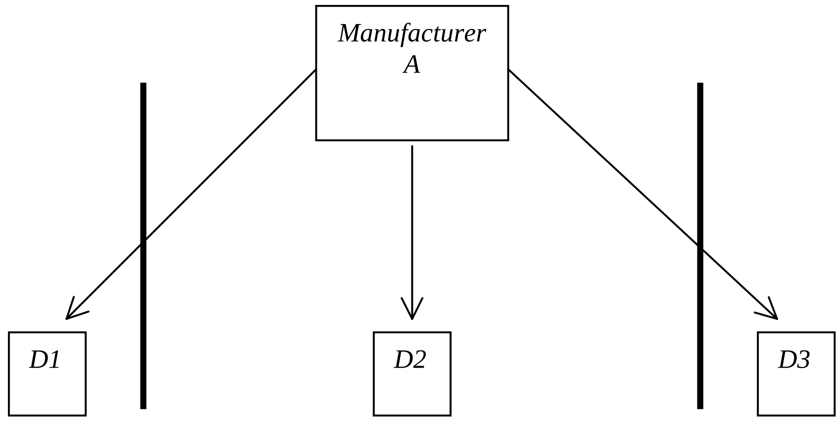
Figure 2 shows the same market as Figure 1. The difference from Figure 1 is that all three manufacturers take part in vertical distribution. There is still no intra-band competition as the division of the market remains. In contrast there is strong inter-brand competition because D1, D2 and D3 resell Manufacturer A’s goods in competition with other distributors (D, D, D, D) that promote similar goods from manufacturer M and M.

Traditionally, the Commission would consider that Manufacturer A’s exclusive distribution agreement gives rise to competition concerns in the market described in Figure 1 as well as the one described in Figure 2. In none of the markets is there any intra-band competition. The Commission would assume that the manufacturer and his distributors would exploit the lack of intra-brand competition by raising prices over a competitive level.

On the other hand, the Chicago School would say that none of the situations presented poses a threat to competition. By concentrating on potential and existing inter-brand competition instead of intra-brand competition the Chicago school comes to a conclusion contrary to the ones of the Commission. The Chicago School assumes that the pressure from other traders in the market that promote similar goods will deter Manufacturer A and his distributors from raising prices over a competitive level. They simply cannot afford a raise in consumer prices because then the consumers will switch over to another brand that promote similar goods.

In Figure 1 the inter-brand competition on the distribution level is not yet present because it is only Manufacturer A who resells his goods in the actual market. However, the Chicago School does not consider this a problem. Already the potential competition from other traders in the market will deter Manufacturer A and his distributors from raising prices. The assumption is that as soon as Manufacturer A charges excessive prices, the other manufacturers will start selling their products in the market. As the Chicago school assumes that there are no, or very low barriers to enter the market, the market will fast develop into a competitive structure.

Figure 3



Nevertheless, even the Chicago School is concerned when a manufacturer with market power or monopoly standing gets involved in a vertical exclusive distribution agreement. When there are no other manufacturers in the market that are able to compete with Manufacturer A, the only possible competition is competition between the Manufacturer A's different distributors.

The sketches above clearly show the importance of considering vertical distribution agreements in their economic context, at least if inter-brand competition is deemed to be relevant in the assessment. What influence a particular agreement in real terms will have on the actual market fluctuates owing to the structure of the same market. As has been discussed, the same agreement can on the one hand be dangerous for competition if implemented on a concentrated market, and on the other hand be harmless if implemented on a competitive market.

Consequently, it is impossible to see how a particular agreement will affect competition by assessing it in isolation. Instead, each agreement must be individually investigated in relation to the market where it intends to be implemented.

The ECJ early recognised the importance of considering vertical distribution agreements in their context by concentrating the analyses on the effect an agreement is likely to have on the actual market. This approach can be seen from the development of the analyses under Article 81(1) in the Community Courts. To define the scope of the prohibition in Article 81(1) effect analyses have been carried out.

On the contrary, the Commission has focused its analyses on the clauses contained in an agreement without considering the agreement in its market context. This approach is for example exemplified by the construction of the old Block Exemptions. Under the old Block Exemptions, agreements were exempted which complied with certain pre-defined clauses. There was no space for considering the effects of the same agreement under different market conditions.

4.4.3 Single Market objective

The third explanation that will be presented for the Commission's frequently sparse economic analysis derives from the market integration goal, which constantly impedes the Commission and the ECJ from developing the economic analyses. To prevent market division, as the one discussed above, is recognised as a common goal in all competition policies. A 'normal' competition policy would also consider the effects of wealth maximisation stemming from the vertical co-operation. In a European context this has not been the case. Any division of the Single Market has been prohibited under the competition rules, even if no or very sparse, economic arguments could be found to legitimise it.[92]

4.5 Conclusion

It is clear that the Commission has adopted a centralised, formalistic approach towards vertical distribution agreements. Naturally, a certain degree of formalism is needed in competition law, which would become too insecure and inefficient if it was only based on individual analyses. Especially in the controversial area of vertical distribution agreements, clear per-se rules could help undertakings.

Yet, a formalistic approach can never be justified per se. When the goals behind it are no longer strong, or the effects of the rules do not comply with the underlying goals, something must be done. Moreover, if the system neither provides legal certainty nor efficiency gains, the need for a change becomes urgent.

The Commission has been stuck in an obsolete system due to a lack of resources. Yet, this is not the only explanation. It also seems that the Commission has been too scared to apply economic analyses and has refused to consider modern economic thinking that might fit better within our modern society.

Finally, nothing can be said against the Union's wish to promote broader policies through competition policy, but if broader policies are to be considered it is even more important to be sensitive to the effects that this might bring about.

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[92] L. Gyselen, note 88.

5 The Reform

5.1 Introduction

Vertical distribution agreements, even after the Reform, will mainly be assessed under Article 81 and the broad interpretation of the prohibition in Article 81(1) will remain. Accordingly, vertical distribution agreements will infringe Article 81(1) to the same extent as before and will require some form of exemption under Article 81(3). The Commission also maintains the monopoly to grant such an exemption. Nevertheless, the Reform embraces three major changes, which alters the way Article 81 functions in relation to vertical distribution agreements.

Firstly, the administration system is changed by a simplification of the procedure in order to obtain individual exemption. Secondly, one wide Block Exemption replaces the old Block Exemptions with the effect that more agreements are automatically exempted from Article 81(1). Finally, the amendments to the administration system have the result that undertakings must assess the compatibility of their agreements with the competition rules themselves. To help undertakings, the Commission has published guidelines.[93]

5.2 Administration -the changes in Regulation 17

Agreements that infringe Article 81(1) and do not qualify for the Block Exemption are still void until they are exempted by the Commission. Yet, with the Reform Article 4(2) in Regulation 17 has been expanded to include all vertical distribution agreements. This means that it is no longer compulsory to notify an agreement in order to obtain individual exemption from the Commission.

Since notification is no longer necessary, the Commission will get very scarce information about agreements before they are implemented in the market. The outcome is that the focus has moved from ex-ante to ex-post investigation, which means that the Commission must initiate its own investigations to determine which agreements infringe the competition rules. It is yet more difficult to find agreements that constitute competition concerns once they are implemented in the market. To find agreements that

[93] Commission Regulation 2790/1999; Commission Guidelines on Vertical Restraints.

infringe the competition rules, it is therefore likely that the Commission to a large extent has to rely on private litigation where agreements get challenged in national court.

The abolishment of the compulsory notification also leads to the notification date no longer having such an influence on the exemption procedure as it had before. An exemption decision will be backdated to the date when the agreement was concluded, and not as before only to the notification date. As has been pointed out, agreements that infringe Article 81(1) and do not qualify under the Block Exemption will be invalid until they are exempted. Yet, the period of invalidity will be of little practical importance for agreements that can be individually exempted. As soon as these agreements are challenged, the parties will ask the Commission for an exemption, which will, if granted, validate the agreements retroactively from the day of conclusion.

Undertakings can still notify their vertical distribution agreements but the purpose of the changes in Regulation 17, from the Commission's point of view, is clearly to bring down the number of notifications and stop all precautionary notification. Exemptions after implementation will have the same effect as ex-ante exemptions and the Commission will not in any case punish the undertakings for not having submitted a notification when individual exemption is needed. Moreover, the Commission emphasises that superfluous notification of vertical agreements will not be given priority in the Commission's enforcement policy. [94]

Notification will still be of importance when it comes to impose fines. As before, undertakings are immune from fines from the day of notification.[95] The submission of a notification is therefore to recommend in ambiguous cases, as it will at least protect the undertakings from fines in case an individual exemption is not granted. However, the Commission points out that if undertakings do not notify an agreement because they assume in good faith that the market share threshold of the Block Exemption is not exceeded, no fines will be imposed.[96]

5.3 The Block Exemption

[94] Commission Guidelines on Vertical Restraints para. 63, 65.
[95] Regulation 17, art. 15(5).
[96] Commission Guidelines on Vertical Restraints para. 65.

5.3.1 Scope

The new Block Exemption applies 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'*

The new single exemption is considerably wider in scope than the old system of several Block Exemptions. A small comparison shows the differences and the advantages of the new exemption:

Before	Now
Several separate Block Exemptions which could not be combined	One big Block Exemption which also includes selective distribution
Only agreements between two parties	Multi-party agreements are possible
Only resale of final goods	Resale of intermediate/final goods or services

By definition, undertakings in competition could benefit from the exemption when they, in a particular agreement, operate at different stages of the distribution chain. Moreover, agreements concluded by associations of undertakings fall under the definition. There are still some restrictions regarding these two types of agreements since they have many features in common with horizontal agreements that the exemption has no intention of covering.

Firstly, agreements between associations of undertakings and their members or suppliers only benefit from the exemption when the association is made up of small retailers.[97] The co-operation between small retailers can counterbalance a strong supplier who otherwise would be able to abuse his strong position in the agreement for his own interests.

Secondly, as a main rule, the Block Exemption does not cover agreements between undertakings in actual or potential competition. The Commission defines a potential competitor as '*an undertaking that does not actually produce competitive products but could and would be likely to do so […] in response to a small and permanent increase in relative prices'* [98]

[97] All individual members of the association must have a turnover below EUR 50 million in order to benefit from the exemption; Commission Regulation 2790/1999 art. 2(2).
[98] Commission Guidelines on Vertical Restraints para. 26.

In two situations which both deal with non-reciprocal agreements, competitive undertakings may also benefit from the Block Exemption: Firstly, where the buyer has a turnover below 100 million EUR, and secondly where the agreement concerns dual distribution. (Dual distribution means that the manufacturer of a product/service distributes the same product/service in competition with independent distributors.)[99] In both cases, the agreements only impose obligations on one party which distinguish them from horizontal agreements. Additionally, a small firm, as in the first case, is unlikely to disturb competition. In the second case, the contracting undertakings are only involved in competition at the distribution level.

5.3.2 Conditions

The Block Exemption only applies if certain conditions regarding non-compete clauses are complied with. Non-compete clauses, especially if concluded for a long time can have severe foreclosure effects. However, they can be essential in some cases, for example during a starting-up period.

The first restriction refers to non-compete clauses of excessive duration, regardless of whether these are intended to apply under the agreement or since the main agreement of distribution has expired. The second restriction forbids a supplier from prohibiting selected distributors from selling products from another specific supplier.[100] The last provision is to avoid one supplier becoming the target of a collective boycott by the other suppliers, which would result in a total foreclosure from the market for this supplier.[101]

The Rule of Severability applies to these limitations. This means that if the non-compete obligations are taken away, the rest of the agreement can go ahead. Under the old Block Exemptions there was no space for severability as an agreement had to comply with all conditions laid down in order to benefit from the exemption. The Commission also points out that individual exemption is possible even if a non-compete clause is included in the agreement. [102]

5.3.3 Black Clauses

There are still some restrictions on how to draft the agreement so it falls under the Block Exemption. The list of white clauses is taken away but there are still five black clauses. The inclusion of a black clause directly removes

[99] Commission Regulation 2790/1999 art. 2(4).
[100] Commission Regulation 2790/1999 art. 5.
[101] Commission Guidelines on Vertical Restraints para. 61.
[102] Commission Guidelines on Vertical Restraints para. 57, 62, 67.

the agreement from the scope of the exemption.[103] Furthermore, the Rule of Severability does not apply and individual exemption is most unlikely.[104]

The first black clause prohibits direct or indirect resale price maintenance (RPM) in the agreement. To fix the price at which a buyer is to sell the goods with the effect of destroying all intra-brand price competition, is a clear-cut way of effectively annihilating competition. The prohibition applies both to RPM obtained by direct and indirect means.[105]

The second hard-core restraint concerns agreements which have as their object or effect the partitioning of the market. Passive resale must always remain possible whereas restrictions on active resale can be justified under some circumstances.[106] The Commission has chosen to keep the distinction between passive and active sales even in times of IT and E-commerce.[107] To use the Internet to advertise products will be regarded as passive sales, whereas involving in more direct contact with customers, for example by sending e-mails, will be seen as active sales.[108]

Furthermore, a supplier cannot restrict the retailers in a selective distribution system to resell only to certain end-users. Selective distribution is acceptable at the retail level to guarantee the quality of services provided by the retailers to suit a special brand. To combine it with restrictions on the retailer would create a double protection for the manufacturer's goods, and enable the suppliers to divide the market between different dealers.

The fourth hard-core restriction also deals with selective distribution systems. Members of a selective distribution system must not be deprived of the right to cross supply between them. Once the distributors are selected they have the right to obtain the goods from any approved source. Thus a selective distribution system can not be combined with, for example an exclusive purchase clause.

Finally, the last provision concerns agreements that prevent or restrict independent repairers and service providers from getting access to spare parts directly from the supplier. Agreements between suppliers of components and buyers who incorporate these components, which give the buyer an exclusive right to deal with the spare parts are prohibited. These sorts of agreements could give the incorporating buyer not only the monopoly over the spare part market, but also over all repair work.

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[103] Commission Regulation 2790/1999 art. 4.
[104] Commission Guidelines on Vertical Restraints para. 46, 66.
[105] For more explanation, see Commission Guidelines on Vertical Restraints para. 47.
[106] A supplier can restrict active sales by buyers in a limited or selective distribution system. It is also possible to prevent a wholesaler from retailing, and, finally, it is possible to prevent spare parts from being used to produce entire products.
[107] C. Vajda and A. Grahnström 'EC Competition Law and the Internet' [2000] ECLR pp. 94-106.
[108] Commission Guidelines on Vertical Restraints para. 51.

5.3.4 Market Thresholds

If the agreement in question does not contain any of the hard-core restraints the undertakings’ market shares for the actual product must be calculated. Where the market share stated in the exemption (30%) has not been reached, the agreement enters a safe-harbour i.e. the Block Exemption applies.

The relation between the hard-core restraints and the market-shares can be seen below:

100 %
Market Share

Agreements are not automatically illegal but they need clearance.

HARD-CORE RESTRAINTS

Agreements always need clearance and they are likely to infringe Article 81 (1)

30 %

10 %

Resale price maintenance

Passive sales restrictions

Restrictions on sale to end-users in a selective distribution system

Cross-supplies restrictions within a selective distribution agreement

Exclusive supply of spare parts

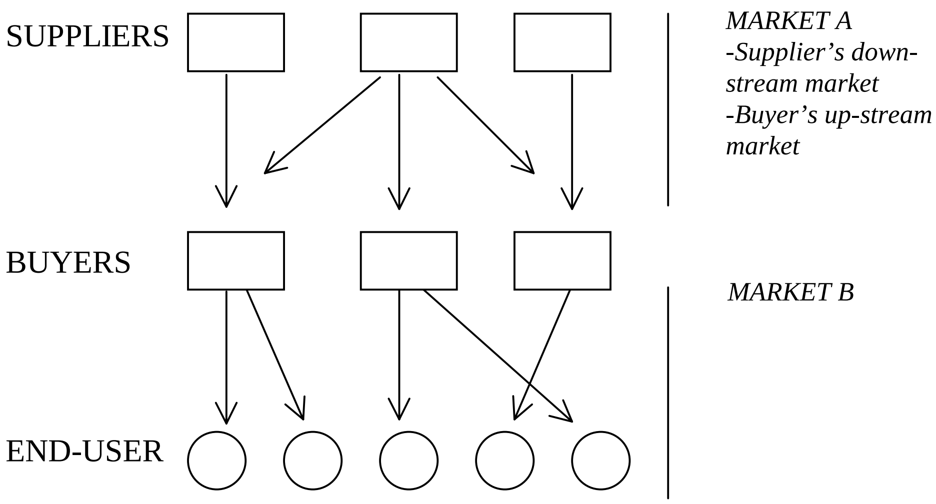
The relevant geographical and product market must be defined before the market shares are calculated. In this regard, the Commission mainly refers to the Notice that deals with the subject.[109] From an economic point of view, a vertical distribution agreement might affect two different markets. First the market between supplier and distributor, and then the market between distributor and end-user.

A slightly simplistic view is taken in the Block Exemption. No regard has to be had for the distributor's down-stream market in order to comply with the exemption. Instead, all calculation takes place on the same market, down-

[109] Commission Notice on the Definition of Relevant Market for the Purpose of Community Competition Law [1997] OJ C372/5.

stream from the supplier’s point of view and up-stream from the buyer’s. (Market A in the figure below)

Relevant market for the calculation of market thresholds in the Block Exemption.



In most cases, it is enough to calculate the supplier’s market share in his down-stream market to comply with the Block Exemption.[110] Most vertical distribution agreements reduce intra-brand competition at the distribution level by imposing exclusive or selective distribution clauses and territorial protection. It is thus important for competition that there is still a high level of inter-brand competition at the supplier’s level to mitigate the bad effects on intra-brand competition at the distribution level.

The buyer’s market share is of importance when dealing with an exclusive supply agreement, which is an agreement where the buyer imposes an obligation on the supplier to sell certain goods or services only to him.[111] Without any inter-brand competition at the buyer's level, the agreement would give the buyer an absolute monopoly given that all intra-brand competition is eliminated by the exclusive supply obligation.

5.3.5 Withdrawal

When calculating the market shares, no regard is to be had for similar agreements in the market or other specific circumstances that could affect competition independently of low market shares. Yet, the applicability of the Block Exemption should only be seen as a presumption that Article 81(1) is

[110] Commission Regulation 2790/1999 art. 3(1).
[111] Commission Regulation 2790/1999 art. 3(2).

not infringed. The presumption can be rebutted for cases that despite, falling inside the exemption, do not satisfy the conditions set out in Article 81(3).[112]

By the first procedure, the Commission or the Member States can withdraw the effect of the Block Exemption for an individual agreement or a network of similar agreements that produce effects contrary to Article 81(3).[113] Here Member States ought to apply Community competition law and have the same considerations as the Community Courts.[114]

The Member States have jurisdiction when an agreement affects a well-defined territory, either the whole Member State or a part of it. When a wider part of the Community market is affected the Commission and the Community Courts have exclusive jurisdiction. There are no special rules for resolving conflicts arising from either concurrent jurisdiction or a non-community application of the rules by Member States. Instead the mechanism established by the co-operation Notice should be applied.[115]

The next procedure, the disapplication of the Block Exemption, can only be carried out by the Commission and it takes the form of a Regulation. It applies to cases of networks of agreements where they cover at least 50% of the actual market. The Regulation removes the application of the Block Exemption in respect of certain restraints in a defined market and restores the full application of Article 81(1) to these agreements.[116] Undertakings must themselves assess whether their individual agreements infringe Article 81(1) after the disapplication Regulation. The Commission can nevertheless make a decision in an individual case to guide the undertakings in this assessment.[117]

In neither case has the Commission any obligation to act, but it emphasises that it acts purely on its own initiative. It also has the freedom to choose which procedure it considers to be the most suitable for a particular case.[118]

5.4 The Guidelines –individual exemption

Since notification is no longer compulsory, the task of investigating whether vertical agreements comply with the competition rules has switched from the Commission to the undertakings. To help the undertakings carry out this

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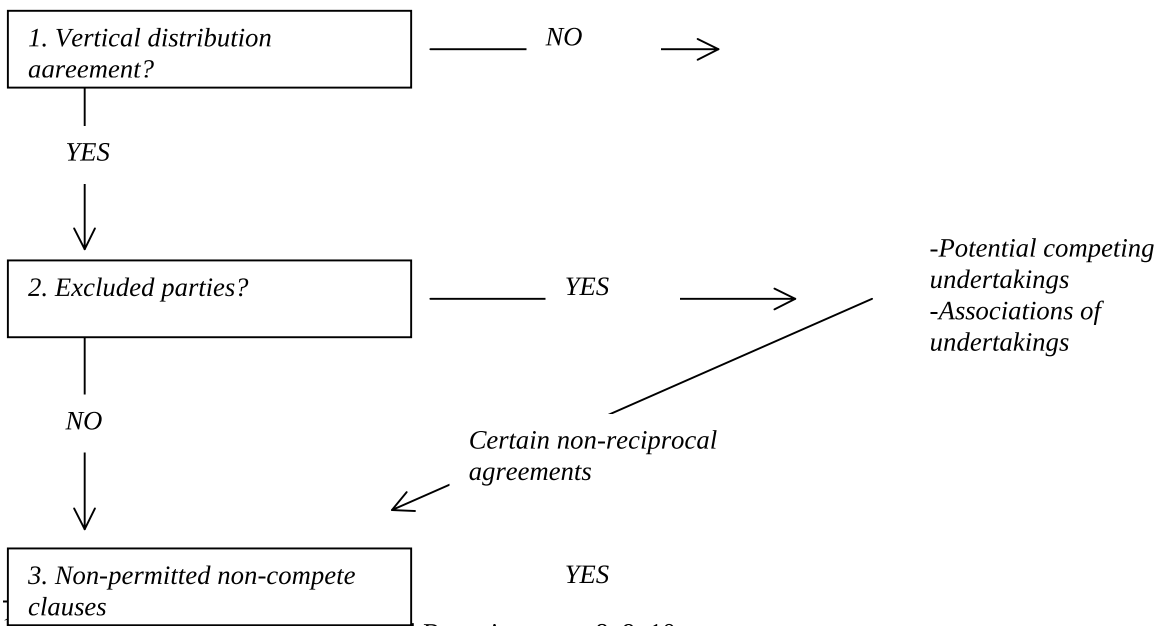
[112] Commission Regulation 2791/1999 art. 6-7.
[113] In relation to a network of agreements the old case law applies which means that an individual agreement must appreciably contribute to the harmful effect to be a target for the procedure. Case C-234/89 *Delimitis v Henninger Bräu.*
[114] Commission Guidelines on Vertical Restraints para. 76, 78.
[115] Commission Notice on co-operation between national competition authorities and the Commission [1997] OJ C 313.
[116] Commission Regulation 2790/1999 art. 8.
[117] Commission Guidelines on Vertical Restraints para. 81.
[118] Commission Guidelines on Vertical Restraints para. 81.

task, the Commission has published guidelines. The Commission Guidelines deal with agreements falling outside Article 81(1) and the application of the Block Exemption, but the main focus is on how to assess vertical agreements which fall under Article 81(1) but outside the Block Exemption.

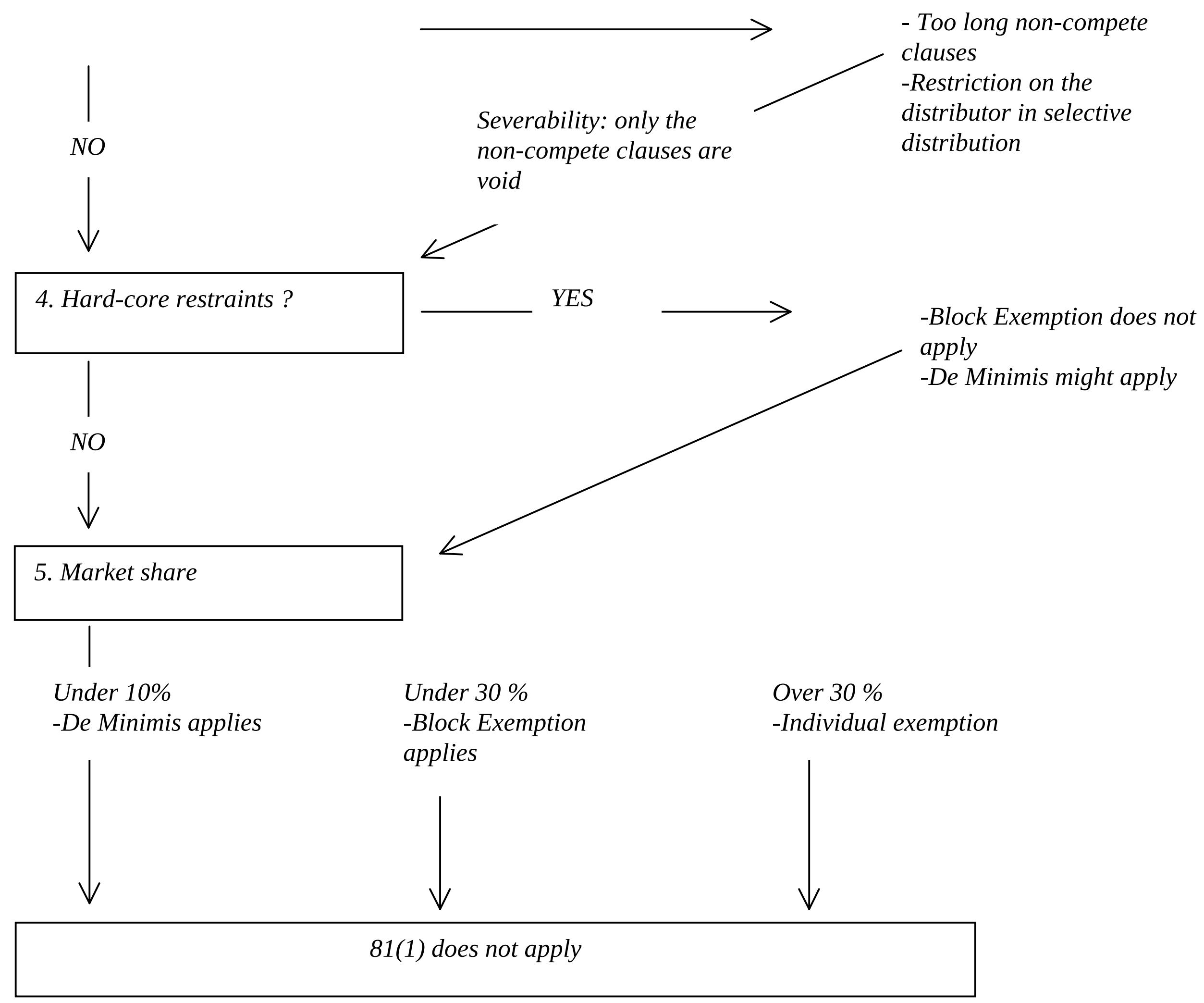
The Guidelines point out that the old case law and the Commission's Notices are still relevant to determine whether an agreement affects competition to an appreciable effect, and therefore infringes Article 81(1). Agreements falling under the De Minimis Notice will generally be considered not to infringe Article 81(1), but can be caught if they contain any of the hard-core restrictions given in the Block Exemption. Reference is made to old case law, which seems to suggest that insignificant agreements will not in general be caught even if they contain a hard-core restraint. Restrictions required in a starting-up period to introduce a product or to enter a new market are also likely to justify hard-core restraints in a De Minimis context.[119]

When a vertical agreement does not qualify for the Block Exemption, there is no presumption that it infringes Article 81(1) but the parties must obtain individual exemption. They can either notify for an ex-ante exemption, or wait until the agreement gets challenged in national court. Each agreement must be assessed individually and to help undertakings with this the Commission has published forty-six pages on the topic. It begins with general provisions about vertical agreements ending with concrete examples of different agreements and how they can threaten competition.

5.5 Conclusion –assessment of vertical agreements after the Reform



[119] Commission Guidelines on Vertical Restraints para. 8, 9, 10.


- Too long non-compete clauses
-Restriction on the distributor in selective distribution
NO
Severability: only the non-compete clauses are void
4. Hard-core restraints ?
YES
-Block Exemption does not apply
-De Minimis might apply
NO
5. Market share
Under 10%
-De Minimis applies
Under 30 %
-Block Exemption applies
Over 30 %
-Individual exemption
81(1) does not apply

6 The Reform –Final comments

6.1 Introduction

The Reform is now a fact; changes have taken place to transform the previously criticised concept of assessing vertical distribution agreements into a workable system. However, it is still of interest to analyse and evaluate the Reform, especially from the Commission's point of view, to see how the Commission has tackled the shortcomings recognised with the old system.

The Commission framed at an early stage five objectives for the Reform. These goals are further emphasised in the first paragraphs of the Guidelines where the Commission also reveals a willingness to change the methods of analysis in the implementation of the rules. In the future, the Commission will adopt an economic approach which will be based on effects on the market.[120]

The Commission's main aim with the Reform is to improve the protection of competition. Market integration remains an important part of competition policy, but should in the future be subordinate to competition protection. Furthermore, the new system must guarantee legal certainty at the same time as bringing down enforcement costs. Increased decentralisation is also considered important.

6.2 Old system remains

6.2.1 Few alternatives

On first reflection it could be said that the Reform does not implement very innovative changes. Vertical distribution agreements will also in the future be assessed under Article 81, where the majority of agreements will infringe Article 81(1) and thus require some form of exemption from the Commission.

One possible alternative, given the far-reaching development of Article 81(1) in the Community Courts, would be to abolish Article 81(3) and apply an all encompassing Rule of Reason under the first part of the Article.

[120] Commission Following-up Paper on vertical Restraints pp. 4, 6; Commission Guidelines on Vertical Restraints para. 5-7.

Nevertheless, this option would involve complicated treaty changes. It is hard to see how the Commission would manage to act within reasonable time limits. Additionally, this alternative would only really concern a distinct part of the competition law. An overall revision of the whole European competition policy is required if treaty changes are to be made.[121]

A less drastic option, still under Article 81, would be to take further steps in the decentralisation process by allowing Member States to grant exemptions under Article 81(3) for vertical distribution agreements. The modification does not imply treaty changes, and could easily be applied in relation to a well-defined group of agreements.[122] Yet, before this step is taken, a coherent application of the exemption system must be achieved. Otherwise the same facts would lead to different decisions in different jurisdictions, which would naturally lead to legal uncertainty. A non-coherent application of the exemption system would also create an incentive for undertakings to forum shopping in the Community, effectively creating increased enforcement costs.

It is questionable whether Member States are ready to take the full responsibility of applying Article 81(3).[123] This question is of special relevance for vertical distribution agreements that constitute a complicated field in the competition law. Moreover, as the Reform changes the old system of assessing vertical distribution agreements, it is hard for Member State Authorities to find clear guidelines from the Commission's old practices in how to apply the exemption system in relation to vertical distribution. The building-up of a new exemption policy towards vertical restraints requires the Commission to keep the exclusive jurisdiction to grant exemptions.

A third way to implement a change to the system would be to assess all vertical distribution agreements under Article 82, either with exclusive jurisdiction granted to the Commission or split with the Member States. As has been discussed, vertical distribution agreements are unlikely to harm competition where there is no market power. Article 82 could function as a Rule of Reason in relation to vertical distribution agreements. Agreements between parties who enjoy market power and which pose a danger to competition would constitute an abuse under the Article.

Yet, the previously noted complications still remain. The Article cannot be imposed in situations where the parties do not enjoy market power. Thus competition abuses, or more importantly behaviours which pose a danger to the Single Market by small undertakings with small market shares cannot be

[121] This also takes place at the moment. See, Commission White paper on the Modernisation of the Rules Implementing Articles [81 and 82] of the EC Treaty.
[122] Only art. 9 in Regulation 17 needs to be changed.
[123] The option was never considered in the Green Paper on Vertical Restraints. Instead, the Commission seems to be satisfied with the steps taken by allowing Member States withdrawal the Block Exemption.

punished. As long as market integration remains an individual goal in European competition law, the Article alone does not provide sufficient protection.

6.2.2 Old system could function

In view of the goals formulated by the Commission, the only feasible alternative is to maintain the assessment of vertical distribution agreements under the heading of Article 81. This may be a wise option. There is nothing inherent in the Article to render it not suitable for the assessment of vertical distribution agreements. On the other hand, the Article provides what is needed to assess vertical distribution agreement – a clear balancing test between an agreement's pro- and anti-competitive features.

In place of far-reaching changes, the Commission has concentrated on a revision of the rules implementing Article 81. A new wide Block Exemption is adapted, and notification has become less important. Both steps make the distinction between an agreement that infringes Article 81 or one which does not, less important. Firstly, agreements which previously needed to be individually exempted if they fell under Article 81(1) will now automatically be exempted by the Block Exemption. Secondly, notification is no longer compulsory, with the result that agreements can be exempted individually ex-post if undertakings miscalculate the scope of Article 81(1). The new rules will mitigate most of the disadvantages present in the old system and open up the way for Article 81 to function as initially intended.

Furthermore, the option for change does not render the old case law useless. Preferably, principles that have taken years for the Community Courts to established are still relevant and will serve as assistance for business. In formulating the new policy and constructing the new Block Exemption, the Commission has clearly considered the steps taken by the Community Courts under Article 81(1). The new approach can in different ways be seen as a codification of the developments by the Community Courts in relation to Article 81(1), but extended to involve Article 81(3).

For example, the black clauses in the Block Exemption can be seen as signifying restrictions by object. Agreements which contain these clauses are prohibited without further investigation. In principle, for the rest of the agreements individual effect analysis must take place. This is an impossible task for all competition policies. A presumption is therefore granted – agreement between parties who do not enjoy market power are presumed compatible with Article 81(3).

6.3 Evaluation of the Reform

6.3.1 Protection of competition

The new system has a far better potential than the old one of protecting competition, mainly because the form based approach is replaced by one directed by economics. No agreements, which are in real terms harmful for competition, but which include special clauses stated in the Block Exemption will benefit from any exemption. The new Block Exemption exempts agreements where the parties have no market power which is totally in line with recent economic theories. Additionally, the withdrawal procedure will function as a last safety valve to avoid dangerous foreclosure effects in the market.

The market thresholds over which there is no presumption of compatibility with the competition rules are set relatively low, especially compared with what is needed to establish dominance under Article 82.[124] Yet, all agreements considered under the Block Exemption contain some vertical restraint which is one factor that contributes to the establishment of dominance at relatively low market thresholds.[125] Thus low thresholds in the Block Exemption have economical explanations and are needed to ensure that no harmful agreements escape under the presumption.

What instead is a danger for competition is the long list of black clauses. The inclusion of these clauses in an agreement renders even individual exemption almost impossible. The approach makes it unfeasible to conclude agreements with strong protection that might be needed, for example to penetrate new markets that in the long run leads to enhanced competition.

6.3.2 Market integration

Market integration remains an important goal in European competition law and will thus even in the future influence the treatment of vertical restraints. However, it is made clear in the Commission Guidelines that the market integration objective should be subordinate to the one of competition protection.[126]

In the list of black clauses, most space is left for market integration considerations. It is still almost impossible to conclude an agreement with absolute territorial protection which complies with the competition rules. As long as linguistic and legal barriers remain in the European Single Market, strong protection is essential to make it feasible for undertakings to participate in cross border trade through the Union. To penetrate new markets is, as discussed above, favourable to competition, but will also strengthen market integration.

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[124] Case 85/76 *Hoffman La Roche v Commission.*
[125] Case 27/76 *United Brands v Commission* [1978] ECR 207.
[126] Commission Guidelines on Vertical Restraints para. 7.

The long list of black clauses is counterproductive both for competition and market integration. At any rate, it is clear that competition has not been given clear priority in the objective of market integration. If the list is not shortened, at the very least it should be made easier to obtain individual exemption when special market conditions so require.

6.3.3 Legal certainty

It is difficult to provide legal certainty in a system which is directed by economics because the focus must be on how every individual agreement is likely to affect the market. To obtain legal certainty, a simplification of the hard individual assessment must be found which stands close to economic reality but which is both easy to apply and efficient. By simplification undertakings feel at ease in complying with the competition rules by adhering to predictable per-se rules. Without efficiency the system becomes paralysed and unable to provide legal certainty, as the old European one.

The new Block Exemption is favourable for legal certainty in many aspects. Firstly, it contains fewer clauses to comply with to obtain the exemption. Thus it should be easier to apply for business. Secondly, it is considerablly wider in scope than the old Block Exemptions which allows a greater number of agreements to benefit from the legal certainty that the Block Exemption provides. The wide Block Exemption in combination with the abolishment of compulsory notification also brings down notification to the effect of enhanced efficiency and legal certainty.

Another aspect which is important for efficiency is that the Commission grants individual exemptions without delay when an agreement is challenged in national court. Otherwise, the incentive to use the competition procedure for reasons other than competition concerns, for example to delay agreements, will remain. Moreover, undertakings will not regard ex-post exemption as an alternative, but will continue to overnotify their agreements in order to avoid challenge in national courts. To avoid these bad effects that threaten legal certainty, there should be a clear time limit within which the Commission must act when an agreement is challenged in national court. Presently, there is no such time limit.

For the new system to provide legal certainty, it is essential that businesses feel secure in the assessment of their agreements both in terms of complying with the Block Exemption and in individual assessment. Without this certainty, undertakings might refrain from concluding agreements from fear of non-compliance with the competition rules, or continue to notify all agreements to the Commission which causes the new system to suffers from the same efficiency problems as the old one did. Unfortunately, the Block Exemption as well as the Guidelines have been criticised for being too complex and difficult to apply.

To start with, the scope of the Block Exemption is considered unclear because it depends on the calculation of market thresholds. Critics are right, to calculate market thresholds is not easy because the definition of the relevant market is an uncertain science and market thresholds fluctuate rapidly.[127] Yet, it is hard to find another way of defining the scope of the Block Exemption, which remains true to economic reality and is reasonably simple to apply.

Some authors have suggested a foreclosure test. Agreements which do not significantly contribute to a foreclosure effect in the market would be presumed to comply with the competition rules under the Block Exemption. This test renders the withdrawal procedure superfluous, which is advantageous since withdrawal in itself is a source of legal uncertainty.[128] Nevertheless, it is hard to se how the foreclosure test would be easy to apply for business. For it to be correctly applied, a lot of information about similar agreements in the market must be collected. This information is likely to be held by competitive firms and therefore hard to obtain.[129]

In my opinion, there is no good alternative to the market thresholds. However, the scope of the Block Exemption could be clarified in other ways. Ambiguous terms should be removed or clarified in the Guidelines. The most obvious shortage might be the definition of 'competitive undertakings' as including even 'potential competitive undertakings'. With the fast fluctuations in today's flexible markets most undertakings could be defined as potential competitors.[130]

6.3.4 Enforcement costs

The enforcement costs for the Commission will decrease with the diminution in notifications, even if an intensified ex-post control of the agreements in the market must take place. Ex-post investigations are costly, but they can be concentrated on dangerous areas and well-targeted which make them most efficient.

Also for business, the compliance costs will decrease in the long run as superfluous notification becomes unnecessary. However, during a transfer period, savings are likely to be absorbed by the setting-up of a new organisation to self-assess the agreements.

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[127] D. Shcroeder 'The Green Paper on Vertical Restraints: Beware of Market Share Thresholds' [1997] ECLR pp. 431-434; Commission Follow-up Paper on 'Vertical restraints', UNICE Comments, 8 mars 1999 pp. 1-2.
[128] EU Commission draft Block Exemption Regulation on the application of Article 81(3) of the EU treaty to categories of vertical agreements and concerted practices, CBI position Paper, 24 November 1999 p. 11.
[129] J. Pheasant and D. Weston 'Vertical Restraints, Foreclosure and Article 85: Developing an Analytical Framework [1997] 5 ECLR pp. 323-328; Z. Biro and A. Fletcher 'The EC Green Paper on Vertical Restraints: An Economic Comment' [1998] ECLR pp. 129-138.
[130] V. Korah, note 38 p. 508; UNICE Comments note 127 pp. 2-3; CBI position Paper note 128 p. 1.

6.3.5 Increased decentralization

Decentralisation is found to be something desirable for European competition law since it decreases the Commission's workload and brings decisions closer to the undertakings. In the new Block Exemption a small step towards decentralisation is taken by giving Member States the power of withdrawing the benefit from the exemption.[131]

There will certainly be situations with concurrent jurisdiction for the Member States and the Commission, which is also recognised in the Guidelines.[132] Concurrent jurisdiction in applying Article 81(3) is a new phenomenon in European competition law. Nevertheless, neither the Block Exemption nor the Guidelines state how these situations will be resolved. Clear guidance is needed in this aspect otherwise the parted enforcement risks leading to efficiency losses and uncertainty.

Furthermore, a withdrawal decision by a Member State is valid only within the actual jurisdiction. It is clear that a single Member State cannot take a decision valid for the whole Union, but national withdrawal decisions with territorial limitation might create a new partitioning in the Single Market.[133]

6.4 Conclusion

1 June might not have seen a revolution in European competition law. The Treaty has not been amended and despite heavy criticisms vertical distribution agreements will continue in the future to be assessed under Article 81.

Nevertheless, on the 1st June the Union officially recognised a policy change towards vertical distribution agreements. The Commission clearly declared that the formalistic approach is abolished in favour of economic analyses, and declared that competition protection is the predominate goal before market integration.

Tangible changes have taken place to enable the great words to be realised. A wide, flexible Block Exemption is adapted, and compulsory notification abolished. On the whole, the new system has got potential to reach the objectives set up, even if some modifications are desirable.

However, success is dependent on whether the Commission manages to apply the rules efficiently, and educate businesses to feel confident in self-

[131] Commission Regulation 2790/1999 art. 7.
[132] Commission Guidelines on Vertical Restraints para. 77.
[133] Commission Regulation 2790/1999 art. 7.

assessing their agreements. Without this, the new system will soon degenerate into something very similar to what ruled before.

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