

**E.C. COMPETITION LAW RELATING TO THE MAIN
METHODS OF COMMERCIAL DISTRIBUTION**

A Thesis Submitted in Partial Fulfillment of the Requirements for the
Award of the Degree of Doctor of Laws (LL.D)

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The scope of this thesis is to contribute towards the understanding of current EC Competition Law regarding the main methods of commercial distribution in the light of the Block Exemption Regulation 2790/99 and other Community instruments that have affected the system to date.

A characteristic of distribution agreements is the passing of title. However not all of the above mentioned agreements involve the passing of title from the producer to the distributor. Chapter 1 deals with agreements between suppliers and agents which in theory do not involve agreements between independent undertakings since the agent constitutes an integral part and is counted as one with the undertaking that uses its services. Chapter 2 discusses agreements between suppliers and independent distributors, the function of which is to grant the latter the role of promoting, marketing and distributing, the particular goods or services within a particular territory. This distributor may in turn enter into a myriad number of exclusive distribution agreements with various other retailers in the different regions of that same territory. Exclusivity, territorial protection, resale price maintenance and other means are features commonly inserted in such agreements. Each such practice is addressed in Chapter 3 the focus of which is an appraisal of the Block Exemption Regulation.

The quality and the ambience of the premises, the expertise or knowledge of the retailers, the equipment and services at the point of sale, amongst other things could have an astounding effect on sales. This is the primary justification behind those suppliers that insist not only on carefully selecting their distributors but also on permitting each of the latter to sell only to final buyers or other selected retailers. Selective distribution is taken up in Chapter 4. Chapter 5 deals with Franchising and the licensing of trademarks or trade names and the transferring of confidential marketing know-how. Central to this method is the idea of having a good measure of uniformity of goods, services and ambience at diverse points of sale. This in turn would normally attract tighter controls which ensure the consistency in marketing practices and generality in overall performance. The thesis aims at achieving an exposition of the Community's approach towards the select methods of commercial distribution.

To My Parents

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This is to certify that the work and research in this thesis is my own personal work.

Roderick V. Mifsud

All E.R.	All England Law Reports
Art.	Article
BER	Block Exemption Regulation 2790/99
CMLR	Common Market Law Reports
COM	European Commission
DG	Directorate General
ECJ	European Court of Justice
ECR	European Court Reports
EC Treaty	European Community Treaty
EEA	European Economic Area
EEC	European Economic Community
ELR	European Law Review
EU	European Union
ICC	International Chamber of Commerce
IPR	Intellectual Property Rights
NLJ	New Law Journal
OJ	Official Journal of the European Communities
RPM	Resale Price Maintenance
SEA	Single European Act
UK	United Kingdom
U.S.	United States of America

**JUDGEMENTS OF THE EUROPEAN COURT OF JUSTICE (ECJ) AND THE COURT
OF FIRST INSTANCE (CFI)**

CASE	DETAIL	DATE	ECR	COURT
56/65	<i>Societe' Technique Miniere v Maschinenbau Ulm GmbH</i>	[1966]	235	ECJ
58/64	<i>Consten and Grundig v Commission</i>	[1966]	299	ECJ
23/67	<i>Brasserie de Haecht v Wilkin</i>	[1967]	407	ECJ
5/69	<i>Volk v Vervaecke</i>	[1969]	295	ECJ
41/69	<i>ACF Chemiefarma NV v Commission</i>	[1970]	661	ECJ
78/70	<i>Deutsche Grammophon v Metro</i>	[1971]	487	ECJ
48/69	<i>ICI v Commission</i>	[1972]	619	ECJ
8/72	<i>Vereeniging van Cementhandelaren v Commission</i>	[1972]	977	ECJ
15/74	<i>Centraform BV and de Peijper v Sterling Drug Inc</i>	[1974]	1147	ECJ
16/74	<i>Centrafarm BV and de Peijper v Winthrop BV</i>	[1974]	1183	ECJ
20/74	<i>Kali und Salz AG v Commission</i>	[1975]	499	ECJ
71/74	<i>FRUBO v Commission</i>	[1975]	563	ECJ
73/74	<i>Groupement des Fabricants de Papiers Peints de Belgique v Commission</i>	[1975]	1491	ECJ
40-48	<i>Cooperatieve Vereniging Suiker Unie UA v Commission</i>	[1975]	1663	ECJ
26/76	<i>Metro SB-Grossmarkte GmbH & Co. KG v Commission</i>	[1977]	1875	ECJ
19/77	<i>Miller International Schallplatten v Commission</i>	[1978]	131	ECJ
27/76	<i>United Brands v Commission</i>	[1978]	207	ECJ

85/76	<i>Hoffmann-La Roche v Commission</i>	[1979]	461	ECJ
120/78	<i>Rewe-Zentrale AG v Bundesmonopolverwaltung für Branntwein</i>	[1979]	649	ECJ
22/78	<i>Hugin v Commission</i>	[1979]	1869	ECJ
30/78	<i>The Distillers Co Ltd v Commission</i>	[1980]	2229	ECJ
253/78	<i>Procureur de la République v Giry and Guerlain</i>	[1980]	2327	ECJ
55/80	<i>Musik-Vertrieb Membran GmbH v GEMA</i>	[1981]	147	ECJ
58/80	<i>Dansk Supermarked A/S v Imerco A/S</i>	[1981]	181	ECJ
258/78	<i>Nungesser v Commission</i>	[1981]	45	ECJ
107/82	<i>AEG-Telefunken v Commission</i>	[1983]	3151	ECJ
110/82	<i>IAZ International Belgium v Commission</i>	[1983]	3369	ECJ
322/81	<i>Michelin v Commission</i>	[1983]	3461	ECJ
319/82	<i>Société de Vente de Ciments et Bétons de l'Est SA v Kerpen & Kerpen GmbH und Co KG</i>	[1983]	4173	ECJ
229/83	<i>Association des Centres Distributeurs Edouard Leclere v Au Ble Vert Sarl</i>	[1985]	1	ECJ
234/83	<i>Binon & Cie SA v Agence et Messageries de la Presse SA</i>	[1985]	2015	ECJ
42/84	<i>Remia BV and Verenigde Bedrijven and Nutricia v Commission</i>	[1985]	2545	ECJ
25/84	<i>Ford and Ford Europe v Commission</i>	[1985]	2725	ECJ
C-311/85	<i>ABSL Vereniging van Vlaamse Reiskbureaus v ASBL Sociale Dienst van de Plaatselijke en Gewestelijke Overheidsdiensten</i>	[1985]	I-3801	ECJ
161/84	<i>Promotion de Paris v Schillgalis</i>	[1986]	353	ECJ
75/84	<i>Metro v Commission</i>	[1986]	3021	ECJ
27/87	<i>Erauw-Jacquery SPRL v La Hesbignonne SC</i>	[1988]	1919	ECJ

246/86	<i>SC Belasco V Commission</i>	[1989]	2117	ECJ
277/87	<i>Sandoz v Commission</i>	[1990]	I-45	ECJ
C-10/89	<i>CNL Socal v Hag</i>	[1990]	I-3711	ECJ
T-51/89	<i>Tetra Pak Rausing SA v Commission</i>	[1990]	II-309	CFI
C-234/89	<i>Delimitis v Henninger Brau</i>	[1991]	I-935	ECJ
C-62/86	<i>AKZO Chemie BV v Commission</i>	[1991]	I-359	ECJ
T-7/89	<i>SA Hercules Chemicals NV v Commission</i>	[1991]	II-1711	CFI
T-14/89	<i>Montedipe v Commission</i>	[1992]	II-1155	CFI
T-17/83	<i>Matra Hachette v Commission</i>	[1994]	II-595	CFI
C-360/92	<i>Publishers' Association v Commission</i>	[1995]	I-23	ECJ
C-70/93	<i>Bayerische Motorenwerke AG v ALD Auto-Leasing D GmbH</i>	[1995]	I-3439	ECJ
C-399/93	<i>HG Oude Luttikhuis and others v Verenigde Cooperatieve Melkindustrie Coberco</i>	[1995]	I-4515	ECJ
T-102/92	<i>Viho v Commission</i>	[1995]	II-17	CFI
T-29/92	<i>SPO and Others v Commission</i>	[1995]	II-289	CFI
T-7/93	<i>Langnese-Iglo GmbH v Commission</i>	[1995]	II-1533	CFI
C-266/93	<i>Bundeskartellamt v Volkswagen</i>	[1995]	I-3477	ECJ
C-73/95P	<i>Viho Europe v Commission</i>	[1996]	I-5457	ECJ
T-528	<i>Metropole Television SA v Commission</i>	[1996]	II-649	CFI
T-79	<i>SNCF and BRB v Commission</i>	[1996]	II-1491	CFI
T-19/92	<i>Association des centres Distributeurs Edoward Leclerc v Commission</i>	[1996]	II-1851	CFI
T-504/93	<i>Ladbroke v Commission</i>	[1997]	II-923	CFI
C-200/96	<i>Metronome Musik GmbH v Musik Point Hokamp GmbH</i>	[1998]	I-1953	ECJ
C-306/96	<i>Javico International v Yves Saint Laurent Parfums</i>	[1998]	I-1983	ECJ

T-374/94	<i>European Night Services v Commission</i>	[1998]	II-3141	CFI
C-215/96	<i>Bagnasco v Banca Popolare di Novara</i>	[1999]	I-135	ECJ
C-73/98	<i>Sebago Inc v GB-Unic SA</i>	[1999]	I-4103	ECJ
C-235/92	<i>Montecatini v Commission</i>	[1999]	I-4539	ECJ
C-22/98	<i>Jean Claude Becu</i>	[1999]	I-5665	ECJ
T-305-307	<i>NV Limburgse Vinyl Maatschapij v Commission</i>	[1999]	II-931	CFI
C-67/99	<i>Albany International BV v Stichting Bedrijfspensioenfonds Texielindustrie</i>	[1999]	I-5751	ECJ
C-344/98	<i>Masterfoods Ltd and HB Ice Cream v Commission</i>	[2000]	I-6659	ECJ
T-41/96	<i>Bayer AG v Commission</i>	[2000]	II-3383	CFI
T 25/99	<i>Roberts v Commission</i>	[2001]	II-1881	CFI
T-11/99	<i>Metropole Television & Co. v Commission</i>	[2001]	II-2459	CFI
C-214/99	<i>Neste Markkinointi Oy v Yotuli Ky and Others</i>	[2001]	I-1121	ECJ
C-309/99	<i>Wouters, Savelbergh, Price Waterhouse Belastin gadviseurs BV v Algemene Raad van de Nederlandse Orde van Advocaten</i>	[2002]	I-1577	ECJ
T-325	<i>Daimler-Chrysler AG v Commission</i>	[2005]	OJ C- 296/20	CFI

DECISIONS OF THE EUROPEAN COMMISSION

DETAILS	DATE	REFERENCE	DECIDED
<i>Grundig</i>	[1964]	OJ L2545/64	COMMISSION
<i>Pittsburgh Corning Europe</i>	[1972]	OJ L272/35	COMMISSION
<i>Re Intergroup Trading BV</i>	[1975]	OJ L212/23	COMMISSION
<i>Kabelmetal/Luchaire</i>	[1975]	OJ L 222/34	COMMISSION
<i>SABA (I)</i>	[1976]	OJ L 28/19	COMMISSION
<i>Reuter/Basf</i>	[1976]	OJ L 254/40	COMMISSION
<i>Junghans</i>	[1977]	OJ L 30/10	COMMISSION
<i>Vacuum Interrupters Ltd</i>	[1977]	OJ L 48/32	COMMISSION
<i>The Distillers Co. Ltd</i>	[1978]	OJ L 50/16	COMMISSION
<i>Brooke Bond Liebig</i>	[1978]	OJ L 53/20	COMMISSION
<i>Campari</i>	[1978]	OJ L 69/70	COMMISSION
<i>RAI v UNITEL</i>	[1978]	OJ L 157/39	COMMISSION
<i>GB-Inno-BM SA v Federation Belgo-Luxembourgeoise des Industries du Tabac</i>	[1978]	OJ L 224/29	COMMISSION
<i>Zanussi</i>	[1978]	OJ L 322/26	COMMISSION
<i>Vaessen BV v Moris and Alex Moris Pvba</i>	[1979]	OJ L 19/32	COMMISSION
<i>Atka A/S v BP Kemi S/S and A/S de Danske Spritfabrikker</i>	[1979]	OJ L 286/32	COMMISSION
<i>Re Floral</i>	[1980]	OJ L 39/51	COMMISSION
<i>Michelin</i>	[1981]	OJ L 53/33	COMMISSION
<i>Italian Flat Glass</i>	[1981]	OJ 326/32	COMMISSION

<i>Hasselblad</i>	[1982]	OJ L 161/18	COMMISSION
<i>Re SSI</i>	[1982]	OJ L 354/28	COMMISSION
<i>National Panasonic</i>	[1982]	OJ L 354/28	COMMISSION
<i>Murat</i>	[1983]	OJ L 348/10	COMMISSION
<i>Nutricia</i>	[1984]	OJ L 376/22	COMMISSION
<i>John Deere Ltd v Commission</i>	[1985]	OJ L 35/58	COMMISSION
<i>Velcro SA v Alpix SA</i>	[1985]	OJ L 233/22	COMMISSION
<i>BP Kellogg</i>	[1985]	OJ L 369/6	COMMISSION
<i>Villeroy and Boch</i>	[1985]	OJ L 376/15	COMMISSION
<i>Mitchell Cotts/Sofiltra</i>	[1987]	OJ L 41/31	COMMISSION
<i>Computerland</i>	[1987]	OJ L 222/12	COMMISSION
<i>Sandoz</i>	[1987]	OJ L 222/28	COMMISSION
<i>Yves Rocher</i>	[1987]	OJ L 35/31	COMMISSION
<i>Tetra Pak (I)</i>	[1988]	OJ L 272/27	COMMISSION
<i>Charles Jourdan</i>	[1989]	OJ L 35/31	COMMISSION
<i>Servicemaster</i>	[1989]	OJ L 332/38	COMMISSION
<i>Sippa</i>	[1991]	OJ L 60/19	COMMISSION
<i>Screensport/EBU</i>	[1991]	OJ L 63/32	COMMISSION
<i>Alcatel/Tellettra Case IV/M 42</i>	[1991]	OJ L 122/48	COMMISSION
<i>Rhone-Poulenc/SNIA I Case IV/M 206</i>	[1992]	OJ C 212	COMMISSION
<i>Tetra Pak (II) Case No IV/31.043</i>	[1993]	OJ L 72/1	COMMISSION
<i>Scholler Lebensmittel GmbH & Co KG</i>	[1993]	OJ L 183/1	COMMISSION
<i>Langnese-Iglo GmbH</i>	[1993]	OJ L 183/19	COMMISSION
<i>Adalat</i>	[1996]	OJ L 201/1	COMMISSION

<i>Van den Bergh Foods</i>	[1998]	OJ L 246/1	COMMISSION
<i>Portuguese Airports Case No IV/35.703</i>	[1999]	OJ L 69/31	COMMISSION
<i>Volkswagen Passat</i>	[2001]	OJ L 262/14	COMMISSION
<i>Glaxo Wellcome</i>	[2001]	OJ L 302/1	COMMISSION
<i>Mercedes Benz</i>	[2002]	OJ L 758/1	COMMISSION

REGULATIONS

NUMBER	DATE	DETAILS	REFERENCE
17/62	[1962]	Council Regulation Implementing Articles 85 and 86 of the Treaty	OJ Sp.Ed. 204/62 as amended [1959-62] OJ Sp.Ed. 87
19/65	[1965]	Council Regulation on the Application of Article 85 (3) of the Treaty to certain Categories of Agreements and Concerted Practices	OJ L 533, [1965-66] OJ Sp.Ed. 35
2821/71	[1971]	Council Regulation on the Application of Article 85 (3) of the Treaty to certain Categories of Agreements, Decisions and Concerted Practices	OJ L 285/46, [1971] OJ 1032
1983/83	[1983]	Commission Regulation on the Application of Article 85 (3) of the Treaty to Categories of Exclusive Distribution Agreements	OJ L 173/1
1984/3	[1983]	Commission Regulation on the Application of Article 85(3) of the Treaty to Categories of Exclusive Purchasing Agreements	OJ L 173/5
417/85	[1985]	Commission Regulation on the application of Articles 85(3) of the Treaty to Categories of Specialisation Agreements	OJ L 53/1 as amended by 151/93 [1992] OJ L 21/8 and [1995] OJ L 1/1
418/85	[1985]	Commission Regulation on the application of Article 85 (3) of the Treaty to Categories of Research and Development Agreements	OJ L 53/51 amended by 151/93 [1992] OJ L 21/8
4087/88	[1988]	Commission Regulation on the Application of Article 85(3) of the Treaty to Categories of Franchise Agreements	OJ L 359 /46
4064/89	[1989]	Council Regulation on the Control of Concentration between Undertakings	OJ L 395/1
1475/95	[1995]	Commission Regulation on the Application of Article 85(3) of the Treaty to certain categories of motor vehicle distribution agreements	OJ L 145/25

240/96	[1996]	Commission Regulation on the Application of Article 85(3) of the Treaty to Certain Categories of Technology Transfer Agreements	OJ L 31/2
1310/97	[1997]	Council Regulation amending Council Regulation 4064/89 on the Control of Concentration between Undertakings	OJ L 180/1
1215/99	[1999]	Council Regulation amending Council Regulation 19/65 on the Application of Article 81 (3) of the Treaty to certain Categories of Agreements and Concerted Practices	OJ L 148/1
1216/99	[1999]	Council Regulation amending Regulation 17: First Regulation Implementing Articles 81 and 82 of the Treaty	OJ L 148/5
2790/99	[1999]	Commission Regulation on the Application of Articles 81(3) of the Treaty to Categories of Vertical Agreements and Concerted Practices	OJ L 336/21
2659/2000	[2000]	Commission Regulation on the application of Article 81(3) of the Treaty to Categories of Research and Development Agreements	OJ L 304/7
1400/2002	[2002]	Commission Regulation on the Application of Article 81(3) of the Treaty to certain categories of motor vehicle distribution and servicing agreements	OJ L 203/30
1/2003	[2003]	Council Regulation on the Implementation of the Rules on Competition laid down in Articles 81 and 82 of the Treaty	OJ L 1/1

DIRECTIVES

89/104	[1989]	Council Directive to Approximate the Laws of the Member States relating to Trade Marks	OJ L 40/1
86/653	[1986]	Council Directive on the Co-Ordination of the Laws of the Member States Relating to Self-Employed Commercial Agents	OJ L 382/17

NOTICES AND OFFICIAL DOCUMENTS

[1984]	Commission Notice Concerning Commission Regulations	OJ C/101
[1993]	Commission Notice on Cooperation between National Courts and the Commission Applying Articles 85 and 86 of the EC Treaty	OJ C 39/6
[1997]	Commission Notice on Cooperation between the National Competition Authorities and the Commission in Handling Cases Falling Within the Scope of Articles 85 and 86 of the Treaty	OJ C 313/3
[1997]	Commission Notice on the definition of the Relevant Market	OJ C 372/5
[1998]	Communication from the Commission on the Application of the Community Competition Rules to Vertical Restraints	OJ C 365/3
[1999]	Commission White Paper on Modernisation of the Rules implementing Articles 81 and 82 of the EC Treaty	OJ C 132/1
[2000]	Commission Guidelines on vertical Restraints	OJ C 291/1
[2001]	Commission Guidelines on Horizontal Co-operation	OJ C 3/2
[2001]	Commission Notice on Agreement of Minor Importance which do not Appreciably Restrict Competition under Article 81 (1) of the Treaty	OJ C 386/07

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GENERAL INTRODUCTION

Vertical relationships refer to those dealings between undertakings at different stages in the production and marketing stages. Horizontal relationships are those between suppliers or those between distributors, the main characteristic being that the parties stand at the same level in the distribution chain. This thesis is concerned with vertical relationships and the effect that current EC Competition law and policy has on the diverse select methods of distribution.¹ The main question that any manufacturer or producer faces relates to the method of marketing which best suits his product.

There are different methods of distribution at the disposal of the producer and 'unless there is good reason, businessmen should be left to select the most cost effective method with as little distortion as possible induced by the competition rules and other kinds of legal measure.'² As rightly held by Ronald Coase, legal intervention should in principle be as minimal and as effective as possible. History has shown that rules of any type regulating competition are a must for a better functioning of the economy. There seems to be general agreement that the ultimate objective of any system of competition law is the economic prosperity or welfare of society in general. A competitive market, defined as a process of rivalry, and as a striving for superiority among businesses,³ generally leads to the maximization of consumer welfare by promoting economic efficiency. The latter includes productive,⁴ allocative⁵ and dynamic⁶ efficiency. Another seminal objective that EC Competition policy strives to achieve is the integration of national markets through the dismantling of all governmental and private barriers to

¹ This thesis deals with European competition law aspects of different types of distribution agreements and will only refer to Maltese and other domestic laws in passing.

² R. Coase, 'The Nature of the Firm' (1937) *Economia* 386 as quoted by V. Korah and O'Sullivan *Distribution Agreements under EC Competition Rules* (Hart Publishing Oxford 2002)

³ D. Neven *European Competition Law Annual 1997: Objectives of Competition Policy* (CD Ehlerman & L Laudati eds Hart Publishing Oxford 1998) 114

⁴ The manufacture and distribution of products at the lowest possible cost.

⁵ The availability in sufficient quantities of products in proportion to demand and at the price purchasers are willing to pay.

⁶ The improvement of technological progress and the development, through adequate investment, of innovative and progressively more cost-effective production techniques.

trade between Member States. The Single European Act⁷ may be rightly described as the instrument that evidenced the final death-knell of governmental barriers to trade. Private barriers as witnessed *inter alia* by the ever-more sophisticated anti-competitive agreements and abuse of dominance however remain, with increasing intensity, the main concern of EC competition policy. This, which may be seen as the incessant battle between the measures adopted by the European competition law policy-makers and the resulting and increasingly more complex solutions thought of by the average businessman and his advisor may be said to have acted as one of the catalysts for the writing of this thesis. In the view of the writer, it is only through research, study and analytical appraisal that competition policy may develop further and also that new and effective means are found for businesses to be guided to the method of distribution that best suit their interests.

‘A distribution network can consist of distribution *sensu stricto*, agents, occasional intermediaries and/or sales representatives.’⁸ This thesis will deal with the methods of distribution most widely used. Although different distribution methods can be divided into categories, the types of agreements that two or more parties may reach to regulate their vertical relationship cannot always fit into a specific one. The methods of distribution addressed in this thesis are agency agreements, distribution agreements, selective distribution agreements and franchise agreements. The latter are treated in this respective order and each will be analyzed in the context of current EC Competition Law. A characteristic of distribution agreements is the passing of title. The producer passes title of the products onto the distributor who then offers the same to the consumer. However not all of the above mentioned agreements involve the passing of title from the producer to the distributor. Vertical integration systems do not involve the passing of title since the producer is distributing himself. Agency agreements for instance do not involve the passing of title, since the producer retains ownership of the product and the agent makes it available to the consumer. Agreements ‘which affect trade between Member States and which have as their object or effect the prevention,

⁷ Single European Act (SEA), 1986, which introduced two major provisions into the EEC Treaty: Article 7a (now 14) and Article 100a (now 95).

⁸ R.Baldi, *Distributorship, Franchising, Agency: Community and National Laws and Practice in the EC* (Kluwer Deventer, 1987) as quoted by H.Van Houtte, *The Law of International Trade* (Sweet & Maxwell, London, 1993) 179

restriction, or distortion of competition within the common market⁹ will in principle fall squarely within the purview of Article 81.¹⁰

A supplier of goods or services whose ultimate aim is the delivery of the same to the end user could however do away with any agreements with other independent undertakings by instructing its own employees or subsidiaries to market and distribute the goods themselves. The setting up of branches or subsidiaries in different Member States offers a clean way of bringing the distribution of the particular goods or services out of the purview of Article 81. The ECJ has on various occasions held that the allocation of tasks within a group of companies¹¹ and the instructions from a parent to its wholly owned subsidiaries¹² do not constitute an agreement subject to Article 81(1). This is without prejudice to the application of Article 82 which prohibits the abuse of a dominant position within the common market, or a substantial part of it. This thesis will deal with this provision only in passing since the group exemptions relate exclusively to Article 81 not Article 82. It is to be acknowledged from the outset that an agreement which, for whatever reason, does not infringe Article 81 may still fall foul of Article 82.¹³ This first option available to the supplier is not always the most efficient of methods. The larger the business gets, the greater the chances of the management to lose track of what is actually going on throughout the whole organization. No doubt marketing and distribution requires thorough knowledge of the local conditions obtaining in that particular State which can only be fully mastered by independent local distributors. Operating through one's own subsidiaries often means doing away with potential local expertise. The option will not often be looked at favourably by small firms which may lack the resources to do their own distribution. For all of these reasons, stake holders have resorted to other mechanisms which will at this early juncture be briefly exposed and further dealt with in the respective Chapters that follow.

⁹ Treaty Establishing the European Community Rome 1957; Article 81

¹⁰ Cases 56 and 58/64 *Consten and Grundig v Commission* [1966] ECR 299; Case 13/61 *de Geus v Bosch & van Rijn* [1962] ECR 45/53

¹¹ Case 15/74 *Centrafarm v Sterling* [1974] ECR 1147/38-41

¹² Case C-73/95P *Viho v Commission* [1996] ECR I-5457

¹³ Case T-51/89 *Tetra Pak Rausing* [1990] ECR II-309

Agency, which at the level of EC Competition Law has a narrower and perhaps more specific meaning,¹⁴ remains one of the most widely used methods of distribution. As will become evident in Chapter 1, a 'genuine' exclusive agreement between a supplier and its agent is not tantamount to an agreement between independent undertakings because an agent constitutes an integral part and is counted as one with the undertaking that uses its services. The strict definition obtaining at EC Competition Law as developed by recent case-law eschews any nominalism and focuses attention on the actual content of the agency agreement and on the effect it seeks to produce.¹⁵ It certainly gives precedence to substance over form and function over legal position described in the agreement.

The appointment of distributors in *stricto sensu* may be said to constitute the central theme of this work. Distribution agreements are widely used at almost all the different levels of the distribution channel. Hypothetically one could come across an agreement between a supplier and a single distributor, the function of which is to grant the latter the role of promoting, marketing and distributing, the particular goods or services within a particular Member State. This single distributor then in turn may enter into a myriad number of exclusive distribution agreements with various other retailers in the different regions of that same territory. Exclusivity, territorial protection, resale price maintenance and other means are features commonly inserted in such agreements. Each such practice will be addressed in Chapter 3.

Different products necessarily require different methods of distribution. The quantity of sales of some products could be greatly affected by the means through which they are presented to the end user. The quality and the ambience of the premises, the expertise or knowledge of the retailers, the equipment and services at the point of sale, amongst other things could have an astounding effect on sales. This is the primary justification behind those suppliers that insist not only on carefully selecting their distributors but also on permitting each of the latter to sell only to final buyers or other selected

¹⁴ See generally Chapter 1

¹⁵ *Pittsburgh Corning Europe* [1972] OJ L272/35 and the *Sugar Cartel – Cooperatieve Vereniging Suiker Unie' UA and others v Commission*, Joined Cases 40-48, 50, 54-56, 111, 113-114/73 [1975] ECR 1663/537-554

retailers. The advent of Block Exemption Regulation 2790/99 has, as will be further analyzed in Chapter 4, ameliorated the chances of distributors to enter into agreements of the sort.

Franchising is yet another form of distribution at the disposal of a supplier who has managed to develop a good sales formula in a particular area and who intends to exhaust the same and extend it to other territories. This method involves licensing of a trademark or trade name and transferring confidential marketing know-how. Central to this method is the idea of having a good measure of uniformity of goods, services and ambience at diverse points of sale. This in turn would normally attract tight controls which ensure the consistency in marketing practices and generality in overall performance. Despite the lack of unanimity¹⁶ on the categorization of this method of distribution and on whether it could benefit from the former group exemption regulation 67/67,¹⁷ it is today safe to conclude that franchising agreements are in principle eligible for exemption under Regulation 2790/99.¹⁸ Further discussions on this matter will be delved into in Chapter 5.

The realization that vertical methods of distribution play an essential part in the culmination of the common market, together with the ever growing literature on the matter, had, back in the 1990s, led the Commission to greatly reconsider its unduly draconian approach towards most types of vertical agreements. The advent of Regulation 2790/99¹⁹ together with that of the accompanying Guidelines²⁰ has moved EC Competition Law and policy to a modern era, at par with the needs of the economy. The strong centralization which seemed never to give way and the Commission's monopoly over the application of 81(3) has now been radically defied with the coming into force of Regulation 1/2003.²¹ The previous regime as dictated by Regulation

¹⁶ Case 161/84 *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 353

¹⁷ Commission Regulation 67/67 – Group Exemption for exclusive dealing OJ Spec Ed 1967, 10, expired and replaced by Commission Regulation 1983/83, OJ 1983, L173/1, corrections OJ 1984, C101/2 [1983] 2 CLE 255.

¹⁸ Commission Regulation (EC) 2790/99 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices [1999] OJ L336/21

¹⁹ *ibid.*

²⁰ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1

²¹ Commission Regulation (EC) 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 [2003] OJ L1/1

17/62²² meant that any agreement restricting competition in terms of Article 81(1), and which failed to satisfy the conditions for the operation of any of the then available block exemptions, had to be notified to the Commission in order to be eligible for individual exemption. This situation led inevitably to DG COMP²³ to become extremely flooded with an ever growing number of applications for negative clearance and individual exemptions under Article 81(3). A commentator held that ‘the notification system set up in Regulation 17 has never worked and will never work... it has no redeeming enforcement virtues and should be scrapped.’²⁴ Certainly the limited resources of the Commission were being exhausted on such applications when there were more pressing infringements to be addressed.²⁵ The temporary solution of issuing comfort letters simply did not suffice. The latter were not binding on national Courts²⁶ and thus offered no certainty. Increased scrutiny came from most stake holders but the Commission did not initially take kindly to suggestions for the decentralization of its powers under Article 81(3). The beginning of this long process of transformation was marked by the adoption of notices on co-operation with national Courts²⁷ and national competition authorities.²⁸ The Commission was finally convinced that enhancing the role of national competition authorities will bolster the application of Community competition rules throughout the Community. For cases falling within the scope of Community law, checks should be carried out by a single authority (either a Member State’s competition authority or the Commission). Member States’ competition authorities often have a more detailed and precise knowledge than the Commission. Above all, they may be in a better position than the Commission to detect restrictive practices that have not been notified or abuses of a dominant position.

²² Council Regulation No 17 First Regulation implementing Article 85 and 86 of the Treaty [1962] OJ Spec Ed 204/62 as amended [1959-1962] OJ Spec Ed 87

²³ Commission Directorate responsible for competition policy

²⁴ B. Hawk ‘System Failure: Vertical Restraints and EC Competition Law’ (1995) 32 CMLR 973, 984

²⁵ Such as *inter alia* abuses of dominance, collective dominance and cartels.

²⁶ Cases 253/78 *Procureur de la Republique v Giry and Guerlin* [1980] ECR 2327

²⁷ [1993] OJ C 39/6

²⁸ Commission Notice on Cooperation between the National Competition Authorities and the Commission in Handling Cases Falling Within the Scope of Articles 85 and 86 of the Treaty [1997] OJ C 313/3

It was not until the adoption of the White Paper on the Modernization of the Rules Implementing Article 85 and 86 of the EC Treaty²⁹ of May 1999 that the Commission finally came to terms with what needed to be done. The way forward advocated by this White Paper was the total abolition of the system of notification and with the Commission's unduly long held monopoly. On the 1st of May 2004, Regulation 1/2003,³⁰ repealed Regulation 17/62 and rendered Article 81(3) directly effective in all Member States. This legal and cultural revolution has replaced the *ex ante* control of anti-competitive agreements and prior authorization by a system of *ex post* control through deterrence.³¹ The new Regulation excludes the application of Article 81(1) to agreements that satisfy the conditions of Article 81(3). The latter types of agreements are *ipso facto* legal and permissible without the need of any authority confirming its legality. This commendable novelty has shifted the focus on the duty of self-assessment by firms and their legal advisers whose task is facilitated by the advent of guidelines, notices and regulations. This new Regulation³² merits elaborate discussions but will not be further delved into in this work.

Coming back to Regulation 2790/99,³³ it is said³⁴ that this instrument is more firmly based on economic principles and market structure. It is far less formalistic and exempts a wider class of agreements with similar economic justifications than did its predecessors. It imposes a ceiling market share as well as a list of hard core provisions that prevent the Regulation from applying. If the supplier supplies more than 30 per cent of the relevant market, the Regulation will not apply. The responsibility of calculating this share is a central issue and it is one incumbent on the parties and their advisers. Even if the supplier's turnover exceeds the 30 per cent threshold, and its agreement fails to qualify for the exemption, there is no presumption that the agreement

²⁹ White Paper on the Modernization of the Rules Implementing Article 85 and 86 of the EC Treaty [1999] OJ C 132/1

³⁰ Commission Regulation (EC) 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 [2003] OJ L1/1

³¹ CD Ehlerman 'The Modernization of EC Antitrust Policy: A Legal and Cultural Revolution' (2000) 37 CMLR 537

³² n.30

³³ Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices [1999] OJ L336 / 21

³⁴ V. Korah and O'Sullivan *Distribution Agreements under EC Competition Rules* (Hart Publishing Oxford 2002) 123

infringes Article 81(1) and anyone alleging that it does will bear the burden of proof.³⁵ The above mentioned Block Exemption Regulation will be given its due consideration in Chapter 3.

³⁵ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1 62

CHAPTER 1

AGENCY

1.1 Introduction

The concept of distributorship is in essence different from the concept of a subsidiary or a branch and even different from that of an agent. The *raison d'être* being that whilst an agent, a subsidiary and a branch inherently form part of the same economic entity as that of the principal, the distributor has consistently been regarded as extraneous to his principal since he acts in his own name by purchasing goods or services from his principal and selling the same to third parties. The distributor does not act as a go-between the principal and the customer and as such the business relationship is always bi-lateral, involving a contract of sale between the principal and the distributor and another autonomous contract between the distributor and the customer.

Conversely an agent normally introduces the consumers to the principal and does not form part of the dealing between them. In this case there will only be one contract entered into between the principal and the customer, with the agent acting as an intermediary. The profit of the distributor is normally the difference between the buying and the selling price whereas the profit of the agent is usually the commission which he earns when concluding a transaction on behalf of his principal or when the principal concludes a transaction with a customer introduced by the agent. The relationship between agent and principal is now regulated by a specific Directive.³⁶ Agency is the relationship between principal and agent in which the agent identifies customers or suppliers and trades with them on behalf of its principal, in return for which the agent earns a pre-set commission. The principal generally exercises a higher degree of control over the agent, in particular over the terms on which it does business.

The Commission defines agency agreements as follows:

³⁶ Council Directive (EC) 86/653/EEC on the Co-Ordination of the Laws of the Member States Relating to Self-Employed Commercial Agents, [1986] OJ L382/17. This Directive will not be dealt with in detail in this thesis due to the word-limit restraints.

The situation in which a legal or physical person (the agent) is vested with the power to negotiate and/or conclude contracts on behalf of another person (the principal), either in the agent's own name or in the name of the principal, for the:

- purchase of goods or services by the principal, or
- sale of goods or services supplied by the principal.³⁷

Although in 'commercial language', he is sometimes loosely referred to as an agent, the distributor does not act on behalf of the principal and is not accountable to him for the profits derived from the resale of the goods he buys from the principal.³⁸

1.2 The *Viho* Doctrine

Article 81³⁹ focuses on agreements between independent undertakings and will not apply if one party is a person or an undertaking forming a 'single economic entity' with the other. A lack of autonomy between the two undertakings has very often resulted in the exclusion of the application of Article 81.⁴⁰ The *locus classicus* in this area of the law is the *Viho* Case⁴¹ where Viho, filed a complaint alleging that Parker Pen was restraining its subsidiaries from selling goods outside their territories. The question arose as to whether the subsidiaries in question were separate undertakings from the parent undertaking. It was held that in cases where the subsidiary does not act autonomously but follows the instructions of the parent undertaking, then they are considered to form one economic entity and any agreements between them cannot fall foul of Article 81. For this reason employer/employee⁴² and parent/subsidiary⁴³ relationships escape Article 81.

Likewise agency agreements can, under certain circumstances be assimilated to such arrangements. Agents are usually charged with introducing customers to their principal

³⁷ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1 12

³⁸ C.Schmitthoff, *Schmitthoff's Export Trade; The Law and Practice of International Trade* (10th edn Sweet & Maxwell, London 2000) 576, R Baldi *Distributorship, Franchising, Agency: Community and National Laws and Practice in the EEC* (2nd edn Kluwer Law International The Hague 1988) 33

³⁹ Treaty of Rome (EC) Treaty

⁴⁰ This is without prejudice to the application of Article 82 and the Merger Regulation.

⁴¹ Case C-73/95 *Viho Europe BV v Commission* [1996] ECR I-5457

⁴² Case C-67/99, *Albany International BV v Stichting Bedrijfspensioenfonds Textielindustrie* [1999] ECR I 5751

⁴³ Case C-73/95 *Viho Europe BV v Commission* [1996] ECR I-5457

or negotiating and/or contracting with customers on the principal's account.⁴⁴ Although engaged in vertical agreements, agents differ from distributors, which are independent entities purchasing and reselling goods of the supplier for their own account. As one author concludes:

The essential point about [an agent's] position is that it does not bear any risk itself...any property passes to it under the agreement; and it does not directly share in the profits or losses of the agent's business.⁴⁵

1.3 The Genuine Agent Doctrine

The prohibition contained in Article 81(1) is not applicable to certain types of provisions in agreements between a 'genuine agent' and its principal.⁴⁶ There can therefore be advantages to be gained from appointing agents as opposed to distributors. It is however not clear whether this is due to the fact that a genuine agent is considered not an independent economic entity, but rather as integral part of the principal's economic entity or business⁴⁷ or whether because of an absence of anti-competitive effect.⁴⁸ Whatever the theoretical justification for the favourable treatment of genuine agency agreements, its practical effect is as follows. If the agent is a genuine agent, then any restriction can be imposed on it in relation to the terms on which it conducts the principal's business. An exception to this freedom applies to dominant undertakings, whose business methods may constitute abuse whether they are distributing through independent dealers or genuine agents.

1.4 The Assessment of Risk

The key question is always how to determine whether an arrangement is a genuine agency. Even one Advocate General has previously⁴⁹ commented that this aspect of competition law would benefit from clearer guidance on how to address this question.

⁴⁴ Council Directive (EC) 86/653/EEC on the Co-Ordination of the Laws of the Member States Relating to Self-Employed Commercial Agents, [1986] OJ L382/17

⁴⁵ R. Whish, *Competition Law* (3rd edn Butterworths, London 2001) 538

⁴⁶ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1 13

⁴⁷ Cases 40-48 / 73 *Suiker Unie v Commission* [1975] ECR 1963, par 480

⁴⁸ Opinion of Advocate-General Tesouro, Case C-266/93 *Bundeskartellamt v Volkswagen* [1995] ECR I-3477

⁴⁹ The comment was made before the advent of the 2000 Commission Guideline on Vertical Restraints.

In the early years of EC Competition Law, this question used to be regulated by the 1962 Notice on Exclusive Agency Contracts⁵⁰ which was mainly based on the theory of risk. The test was quite a simple one, since the Commission used to assess whether the party is assuming any risks in the venture and upon that it would decide whether he is an agent or a distributor. If he assumed some risks, then he would be a distributor and as such fall within Article 81. If risk was lacking, then he would be an agent and therefore outside the scope of Article 81. This stance however suffered some deviation in the *Pittsburgh*⁵¹ case where the Commission stated that the test should not be based on risk but rather on whether the party would be acting in his own name or on behalf of his principal. This decision led to a degree of uncertainty which was only resolved in 2000 by the Commission Guidelines on the application of Article 81 to Vertical Restraints⁵² which reverted to the test based on risk. According to the latter guidelines, genuine agency agreements enjoy a special status in that the obligations imposed on the agent as to the contracts negotiated or concluded on behalf of its principal will not fall within the scope of Article 81. The Guidelines refer to the following types of obligations as being outside the scope of Article 81 in the case of a genuine agency:

- limitations on the territory in which the agent may sell these goods or services;
- limitations on the customers to whom the agent may sell these goods or services;
- the prices and conditions at which the agent must sell or purchase these goods or services.⁵³

According to the Guidelines, the key factor is that of financial risk assumed by the agent. The essential distinction drawn there and also used by the ECJ⁵⁴ is that between an agent and an independent dealer who assumes financial risks while transacting. It was stressed in the *Volkswagen* case⁵⁵ that the key distinction was between someone bearing any of the risks resulting from the contracts negotiated on behalf of the principal and someone not bearing any such risk.

⁵⁰ Commission Notice on Exclusive Dealing Contracts with Commercial Agents [1962] OJ L39/2921

⁵¹ *Pittsburgh Corning Europe* [1972] OJ L272/35

⁵² Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1 /12-20

⁵³ *ibid.* 18

⁵⁴ Case C-266/93 *Bundeskartellamt v Volkswagen* [1995] ECR I-3477

⁵⁵ *ibid.*

The Guidelines provide that the genuine nature of a true agency is to be established by examining the economic reality of the arrangement on a case-by-case basis. Two factors are critical to this analysis. The first is who bears the risks in relation to the contracts concluded with end customers on behalf of the principal and in relation to market-specific investments for that field of activity.⁵⁶ If the intermediary bears no risks, it is likely to be seen as part of the supplier's selling function, even if it is a separate legal entity. Otherwise, the intermediary will be seen as functionally independent and consequently the parties' arrangements will be caught by Article 81(1). Article 81(1) will not generally apply to the obligations of an intermediary which does not in the course of its duties actually acquire title to the goods prior to their being sold on to the end customer or does not provide the goods or services directly itself. The second consideration is which of the two parties is required to bear the risks associated with costs and investments which are inherent in providing the goods or services. The risk will be greater for those investments which are sunk, i.e. incapable of being recovered once the relationship is brought to an end. The Commission considers that in a genuine agency such risks should remain with the principal.⁵⁷

The Guidelines indicate that Article 81(1) may apply if the intermediary is required, *inter alia*, to make contributions to the costs of transporting the goods to the end customer without a right of recourse against his principal; invest in sales and promotion costs; maintain at its own cost or risk, stocks of goods or is unable to return unsold goods to the principal without a charge; provide at its own cost an after-sales, repair or warranty service to the end consumers; invest in certain equipment, premises or training; accept responsibility towards third parties in respect of general product liability; or take responsibility for an end customer's default under the contract of sale.⁵⁸ Other risks such as those 'related to the activity of providing agency services in general, such as the risk of the agent's income being dependant on his success as an agent or general investments' are not relevant to this issue.⁵⁹

⁵⁶ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1 16

⁵⁷ P.Henty, 'Agency Agreements – What are the risks?' [2006] ECLR 8,16

⁵⁸ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1

⁵⁹ J. Goyder, *EU Distribution Law* (4th edn Hart Publishing, Oxford 2005) 178

This 'list' approach is not totally satisfactory in so far as a weighting is not given to the individual items in the list. Accordingly one cannot conclude which of the mentioned risks is least compatible with an agency relationship. The key question is whether the obligations of the agent amount to a significant risk. The Guidelines require whichever risk to be significant. It could therefore be the case that the agreement does contain any of the elements contained in the list but nonetheless the Court could conclude that this element does not constitute a significant risk in terms of the Guidelines. To sum up, the language of the Guidelines suggested a categorical approach because an intermediary that does not stock and resell on its own account could still be subject to Article 81(1) if it was required to undertake one of the seven other costs of investments. The two considerations laid down in the Guidelines were cumulative and the Commission argued that Article 81(1) would still catch the activities of an intermediary that did not buy and resell products on its own account if it took on one or more of the listed obligations. *A contrario sensu*, however the CFI has showed in *Daimler Chrysler AG v Commission*⁶⁰ that an agent which does assume some minor obligations of this sort does not immediately become a distributor. It all depends of the significance of the risks.

From a careful reading of case law and of the Guidelines, it is manifest that there are points on which the two do not concur. The case-law of the ECJ is always however a higher authority than the Commission's Guidelines and therefore greater attention will be given to the former. This discrepancy clearly gives rise to a measure of inconsistency. In cases where the lack of certainty in the rules causes difficulty, officials in the Commission's Competition Directorate General should be willing to discuss specific situations and provide an indication of whether the Commission would be likely to consider a particular relationship to be one of agency or otherwise.⁶¹ What matters therefore is the real nature of the arrangement in economic terms.⁶²

⁶⁰ Case T-352 *Daimler-Chrysler AG v Commission* [2002] OJ C-68/15

⁶¹ J. Goyder, *EU Distribution Law* (4th edn Hart Publishing, Oxford 2005) 176

⁶² *Pittsburgh Corning Europe* [1972] OJ L272/35/7

1.5 *The Suiker Unie SA Case*⁶³

The ECJ stressed the economic integration of the agent into the principal's undertaking. Many independent dealers accept very detailed instructions, especially in relation to the preparation and maintenance of complex machinery but still integration is not a basis for the distinction that is easy to apply.⁶⁴ The ECJ examined one set of agreements concluded between supplier 'Pfeifer und Langen' and its trade representatives, which were prohibited from dealing in supplies of sugar from alternative sources without the supplier's consent. According to the Commission this obligation had as its object the restriction of imports of sugar from the supplier's competitors abroad, thus fell foul of Article 81. The ECJ accepted that the relationship between the supplier and the trade representatives in Germany had all the essential features of a genuine agency. The trade representative was required to sell sugar in the name and for the account of the principal, to carry out the principal's instructions, to promote its interests and to confine their activities within the allocated territories. However the ECJ ruled that these agreements could only escape Article 81(1) in so far as the trade representative was akin to an:

auxiliary organ forming an integral part of [the supplier's] undertaking bound to carry out the principal's instructions and thus, like a commercial employee, form[ing] an economic unit with [the supplier].⁶⁵

The trade representatives, in reality, were large business houses which dealt in the sugar markets on their own account. Aside from distributing the supplier's own supplies, they exported sugar from Germany to other Member States. Pfeifer und Langen had authorized its agents to trade as independent dealers in non-competing activities. Instead of being an auxiliary part of the principal's operation, each trade representative was able to operate autonomously. When it did, it assumed the same risks as an independent dealer. The Court decided that this was not a genuine agency agreement with all the well-known consequences attached to such a decision.

⁶³ Joined Cases 40-48, 50, 54-56, 111, 113 & 114-73 *Coöperatieve Vereniging 'Suiker Unie' UA v Commission* [1975] ECR I-1663

⁶⁴ V. Korah and D. O'Sullivan, *Distribution Agreements under the EC Competition Rules* (Hart Publishing, Oxford 2002) 101

⁶⁵ *ibid.* [539]

1.6 The Vlaamse case⁶⁶

This case, involved a structure of agreements between tour operators and travel agents in Belgium. These agreements, which were imposed by national legislation, obliged travel agents to observe prices fixed by tour operators and prevented price competition between travel agents. The Court disagreed with the pleading that the agent's activities were auxiliary to those of the tour operators. Travel agents acted independently in many respects, especially when it came to selling travel packages organized by a large number of operators.⁶⁷ The fact that the travel agents were acting for and on behalf of the tour operators was said not to be sufficient. The grounds for regarding the travel agents as independent traders rather than genuine agents were the following:

a travel agent of the kind referred to....must be regarded as an independent agent who provides services on an entirely independent basis. He sells travel organized by a large number of different tour operators and a tour operator sells travel through a very large number of agents. Contrary to the Belgian Government's submissions, a travel agent cannot be treated as an auxiliary organ forming an integral part of the tour operator's undertaking.⁶⁸

A true agent works only on behalf of one principal, and bears no commercial risk with respect to the goods being sold. In other words there must be an exclusive agency provision. The Commission's Guidelines are in direct contradiction to this because after referring to financial or commercial risk as the determining factor, they state that it is not material for the assessment of genuine agency whether the agent acts for one or several principals.

1.7 The Volkswagen case⁶⁹

This case involved the distribution network of Volkswagen, which generally prohibited dealers from supplying vehicles to any company active in car leasing other than the manufacturer's own car leasing company. Intermediary dealers were required by

⁶⁶ Case C-311/85, *ABSL Vereniging van Vlaamse Reisbureaus v ASBL Sociale Dienst van de Plaatselijke en Gewestelijke Overheidsdiensten* [1985] ECR I-3801

⁶⁷ *ibid.* [20]

⁶⁸ *ibid.*

⁶⁹ Case C-266/93 *Bundeskartellamt v Volkswagen AG and VAG Leasing GmbH* [1995] ECR I-3477

Volkswagen to purchase cars on their own account and sell these on to Volkswagen Leasing. Volkswagen Leasing would pay to the dealers a commission based on the profit that would have been made had the vehicle been sold on the open market. After a certain period, the dealers were required to re-purchase the vehicles from Volkswagen Leasing in their own names. Volkswagen argued that the intermediary dealers were integrated into its activities and were part of one economic unit, given that they had no independence on the market. According to the Advocate General⁷⁰ the following points were relevant to showing that an intermediary was an agent:

- whether the ‘principal’ bore at least for the most part, the risks associated with the ‘agency’ contract and in reality had all of the rights and obligations associated with contracts with end customers resulting from the agency arrangement;⁷¹
- whether the ‘agent’ was operating a business in its own name on the same market as its principal; and
- whether the ‘agent’ acted for a number of different ‘principals’ in competition with each other.⁷²

According to the Advocate General, the first limb of the test was crucial in determining whether the intermediary was an auxiliary part of another undertaking. Whilst the two other factors could be important in reaching the conclusion that the intermediary had been integrated into the business of its principal, these factors alone would not be enough for the arrangement to escape Article 81(1). Neither the Advocate General nor the Court saw Volkswagen’s distributors as genuine agents. Dealers were required to purchase and re-sell vehicles on their own account, and accordingly a significant part of the financial risk associated with the intermediary arrangement was borne by the dealer. The Court ruled:

Representatives can lose their character as independent traders only if they do not bear any of the risks resulting from the contracts negotiated on behalf of the principal and they operate as auxiliary organs forming an integral part of the principal’s undertaking.⁷³

⁷⁰ Opinion of Advocate General Tesouro of June 8, 1995, [1995] E.C.R. I-3477

⁷¹ Case C-266/93 *Bundeskartellamt v Volkswagen AG and VAG Leasing GmbH* [1995] ECR I-3477/17 and 18

⁷² *ibid.*[17]

⁷³ *ibid.* [19]

1.8 The Daimler Chrysler case⁷⁴

This case focused on the distribution system for Mercedes Benz vehicles in Spain, Germany and Belgium. In 2001, the Commission issued a decision against Daimler Chrysler finding that its selling arrangements of Mercedes Benz vehicles infringed Article 81.⁷⁵ The supplier had appointed a number of agents for the purpose of selling cars in the German territory. The agents' activities were confined to designated territories. The supplier prevented them from selling to customers passing through their territory, which the Commission considered to have the aim of restricting intra-brand competition for the re-sale of vehicles. The effect was to prevent parallel imports of Mercedes Benz vehicle between Member States.

The Commission argued that the supplier's arrangements were caught by Article 81(1) as its agents were subject to a number of risks which were atypical of genuine agency. These included *inter alia*, the following elements:

- the eventual sales price agreed between the agent and the supplier would affect the ultimate commission payable to the agent; any discount agreed between the agent and the customer would have a knock-on effect on the payment made to the agent.⁷⁶
- the risk and cost relating to transport; the agent was obliged under the contract to accommodate customers' requests to transport vehicles from the factory to their home.⁷⁷
- the agent was required to invest a large amount of its income in promotional material, notably being required to purchase demonstration vehicles and retain them for 3 to 6 months.⁷⁸
- the agent was required to provide an after sales service for vehicles, to carry out work on cars still under the manufacturer's guarantee and to ensure that end customers had the benefit of a breakdown service.⁷⁹
- to procure and maintain a workshop for the purpose of carrying out works on vehicles and acquire replacement car parts at its own cost.⁸⁰

⁷⁴ Case T-352 *Daimler-Chrysler AG v Commission* [2002] OJ C-68/15

⁷⁵ Commission Decision *Mercedes Benz* OJ 2002/758/EC [2001]

⁷⁶ At 13 and 22

⁷⁷ *ibid.* 14

⁷⁸ *ibid.* 15

⁷⁹ *ibid.* 16

⁸⁰ *ibid.*

Moreover, the Commission noted that the economic reality of the situation was that the commission received by the agent accounted for a relatively small proportion of its overall turnover. The remainder turnover originated for its own activities carried out on a self-employed basis.⁸¹ Daimler Chrysler disputed the calculation and argued that this was not relevant in any event.⁸² The calculation seemed designed to buttress the argument that the agent and its principal had an ambivalent relationship comparable to that at issue in the *Suiker Unie* case,⁸³ given that a major part of the agent's income came from its own independent activities.⁸⁴

In its reply to the Commission, the supplier had claimed that the agents were actually 'an integral part of Daimler Chrysler AG' for a number of reasons. The first was that under the agency agreement, the parties sold only Mercedes Benz vehicles and not those of its competitors, and were consequently agents of a single company. Secondly, the supplier made reference to the agent's own contractual arrangements to demonstrate that they were fully integrated into its network; notable that agents were required *inter alia*, to maintain brand exclusivity; take any action necessary to market Mercedes Benz vehicles; describe themselves to the outside world as the Mercedes Benz agents and to represent the Mercedes brand. They were also obliged to provide information on individual cases where the manufacturer's guarantee had been invoked and to refrain from establishing branches or premises outside the agent's main premises without prior written authorization from the supplier.

The Commission countered by stating that the degree of integration of the agent into the principal's network was not a separate criterion for distinguishing a commercial agent from a dealer, suggesting that integration is a cumulative condition, together with the absence of relevant risks. The Commission pointed to the earlier *Volkswagen* case⁸⁵ where the ECJ rejected Volkswagen's contention that its distribution network was exempt from Article 81(1) on the basis that it constituted a single economic unit as its

⁸¹ *ibid.* 159

⁸² *ibid.* 59-61

⁸³ Joined Cases 40-48, 50, 54-56, 111, 113 & 114-73 *Coöperatieve Vereniging "Suiker Unie" UA v Commission* [1975] ECR I-1663

⁸⁴ P.Henty, 'Agency Agreements – What are the risks?' [2006] ECLR 5.1

⁸⁵ Case C-266/93 *Bundeskartellamt v Volkswagen AG and VAG Leasing GmbH* [1995] ECR I-3477

dealers. The Court had found that in reality, the ‘purported agent’ assumed significant financial risks associated with the arrangement. The Court⁸⁶ began by underlining two essential principles enunciated in various preceding cases:

- that an agreement would not be a genuine agency if it conferred upon the intermediary rights or obligations approximate to those given to independent undertakings;
- that an agent’s economic independence is lost only if its principal bears all of the risks associated with the contract negotiated on the principal’s behalf and the agent acts as an auxiliary integrated into the principal’s business.⁸⁷

The Court observed first that agents had no actual authority to sell Mercedes Benz vehicles to customers directly. The Commission had not disputed that the manufacturer alone carried out that activity.⁸⁸ The agent’s real function is to solicit orders and to pass them on to the supplier for approval and execution. In this case the German agents were not required nor even allowed to maintain stocks of Daimler Chrysler’s cars on their own account. Not only did the agent lack the authority to sell cars on its own account, it was also unable to conclude the final terms of the contract or set the price of the sale. Equally it could not tie the manufacturer to discounts or rebates on sales without the consent of the supplier as orders passed on were always subject to the ultimate consent of Daimler Chrysler. The agent could agree to grant a discount on the sale price to the customer without the consent of the supplier where the reduction would be ‘imputed’ to the commission receivable for the sales. However, contrary to what the Commission said, this was not tantamount to the agent being forced to accept a risk associated with a reduced price. Where in its own free judgement, the agent decided to give a discount, this was done to increase its commission revenue as a whole.⁸⁹

Given that the supplier determined the final conditions of the sale, the agent’s economic independence was actually very limited. The Court concluded that it was the manufacturer and not the agent who assumed the principal risks and obligations associated with the sale of cars. Accordingly the Court concluded at this point of its

⁸⁶ Case T-352 *Daimler-Chrysler AG v Commission* [2002] OJ C-68/15

⁸⁷ *ibid.* 87

⁸⁸ *ibid.* 93

⁸⁹ *ibid.* 94 and 99

analysis that the agreement was outside the scope of Article 81(1).⁹⁰ The Court however did go on to examine whether that *prima facie* conclusion was affected by the risks related to certain of the agents costs, including but not limited to the transportation of vehicles.

In relation to the transportation of goods, it was noted that although the agent could be required to arrange for the transportation of cars to the customer's residence, the agent could require the customer to pick the car from its premises if the precise terms of delivery could not be agreed. Whilst the agent was required to perform the works on cars under guarantee and to stock spare parts, many of these costs were reimbursed under an indemnity from the manufacturer. Risks associated with the demonstration of vehicles were lessened by the preferential prices for such vehicles given to the agent. The manufacturer was obliged also to buy back the demonstration vehicles once these had reached a specified mileage. This was a material difference from *Volkswagen*,⁹¹ where dealers were obliged to purchase vehicles back from Volkswagen Leasing and sell these at their own risk. Finally, even though the agent had to install a workshop at its own cost, this was not a significant risk which altered the Court's evaluation.⁹²

The Court made the criticism that the Commission had not actually gone beyond listing the agent's obligations by adequately explaining why these amounted to risks. Furthermore, the obligations highlighted by the Commission related to markets separate to the one with which this case was concerned. It was not good enough that these markets were related to the one relevant to the case.⁹³ In fact the Court said, even if it should be accepted that the investment obligations entailed certain limited risks for the agent, this would not have changed the evaluation of the arrangement in relation to the actual market under examination in this case.⁹⁴ The Court did not agree with Daimler Chrysler's arguments that the Commission was required to show that the agents were not integrated into its business. It did indicate though that because the agent's independent activities, for example in carrying out after sales repairs and maintaining a

⁹⁰ *ibid.* 102

⁹¹ Case C-266/93 *Bundeskartellamt v Volkswagen AG and VAG Leasing GmbH* [1995] ECR I-3477

⁹² *ibid.* 111

⁹³ *ibid.* 66 The Commission had argued that there was a close nexus between the two.

⁹⁴ *ibid.* 113

car workshop, were on separate markets to that under examination, they did not have an 'ambivalent relationship' with their principal as had been the case in *Suiker Unie*.⁹⁵

The Court also rejected the Commission's argument that the presence of certain obligations in both the German agency and Spanish distribution agreements indicated that German agents had the same degree of independence as their Spanish counterparts. It was, said the Court, to be expected that obligations to protect Daimler Chrysler's name and trade mark and to use best endeavours to market the manufacturers' goods would be found in vertical agreements of any description.⁹⁶ It is submitted⁹⁷ that the Court's judgement suggests the following approach should be taken in deciding whether an arrangement is one of true agency:

- Does the 'agent' stock goods on its own account?
- Does the 'agent' have the power to determine the final price and/or terms of supply for contracts of goods or services to end customers?

If each of these questions is answered negatively, it is to be presumed that the intermediary is acting under the direction of its principal and not on its own account. The Court's reasoning also implies that the presumption can be rebutted if the intermediary is forced to accept significant risk resulting from requirements to:

- make 'sunk' investments which cannot be recovered during or at the end of the relationship;
- incur significant ongoing costs upfront in the course of the relationship which the agent cannot recover.

In the *Daimler Chrysler* case⁹⁸ the setting up of a workshop did not count as a significant sunk investment, possibly as this was basically an investment in property, which could ultimately be sold on at the end of the relationship, even if there could be an overall loss due to adverse movements in property prices. However the agent would stand to make losses over its initial outlay for fixtures and fittings, which it bought on its own account and which would depreciate over time. This was not considered

⁹⁵ *ibid.*

⁹⁶ At 114 /115

⁹⁷ P.Henty, 'Agency Agreements – What are the risks?' [2006] ECLR 8,19

⁹⁸ Case T-352 *Daimler-Chrysler AG v Commission* [2002] OJ C-68/15

significant by the Court, which suggests that an agent can be expected to risk some losses on initial investments without losing the essential elements which qualify him as an agent as opposed to a distributor. It would also appear that as the agent benefited from an indemnity offered by the manufacturer, its ongoing costs (for instance car transportation, repair works or cars) were not tantamount to significant risks. The Court indicated that it would have been possible for the Commission to overturn this presumption by showing that the indemnity was financially inadequate, but it had not done so. Given that an indemnified party is always exposed until it receives reimbursement in full and that in this case the indemnity would not always cover every outlay made, the reasoning of the Court again indicates that a degree of risk is acceptable.

The Court did not directly comment whether it is permissible for a single agent to work for a number of different principals. This is unfortunate, as the Guidelines, which state that this should not be a factor for consideration, apparently conflict with the earlier decisions of the ECJ in *Vlaamse Reisebureaus*⁹⁹ and *Suicker Unie*,¹⁰⁰ in which the ECJ appeared opposed to what it saw as an ‘ambivalent’ relationship. However, in evaluating whether there was ambivalence the Court looked at whether the agent dealt with a number of different undertakings competing with the principal in the same market. This was consistent with the approach of the Advocate General in *Volkswagen*.¹⁰¹

It is submitted that the effect of the *Daimler Chrysler* case¹⁰² is to make agency a more attractive vehicle for undertakings wishing to establish vertical arrangements that are outside Article 81(1). Moving beyond the ‘shopping list’ of relevant considerations in the Guidelines, this judgement emphasizes features of vertical agreements which are most characteristic of agency. It also moves away from a literal interpretation of the

⁹⁹ Case C-311/85, *ABSL Vereniging van Vlaamse Reisbureaus v ASBL Sociale Dienst van de Plaatselijke en Gewestelijke Overheidsdiensten* [1985] E.C.R. I-3801

¹⁰⁰ Joined Cases 40-48, 50, 54-56, 111, 113 & 114-73 *Coöperatieve Vereniging ‘Suiker Unie’ UA v Commission* [1975] ECR I-1663

¹⁰¹ Case C-266/93 *Bundeskartellamt v Volkswagen AG and VAG Leasing GmbH* [1995] ECR I-3477

¹⁰² Case T-352 *Daimler-Chrysler AG v Commission* [2002] OJ C-68/15

Volkswagen ruling¹⁰³ that an arrangement will be caught where the agent bears any of the risks resulting from the contracts negotiated on behalf of the principal. It cannot be disputed that the question of what constitutes a significant risk is left open, but will probably always remain so. The judgement does provide an insight into how to gauge the risk in relation to the agent's obligations. It now seems likely that an agent can be expected to assume a reasonable degree of costs and risks in connection with its activities without the parties having themselves to risk the application of Article 81(1) to their agreement.¹⁰⁴

According to the Commission's Guidelines, genuine agency agreements fall outside Article 81 only for the purposes of obligations relating to the contracts negotiated or concluded on behalf of the principal. Other restrictions, such as exclusivity provisions which prevent the principal from appointing other agents in respect of a given type of transaction, customer or territory (exclusive agency) or provisions preventing the agent from acting as an agent or distributor for its principal's competitors (non-compete clauses) do potentially infringe Article 81, even where the agent assumes no significant financial and commercial risk. This stance is at loggerheads with the case law of the ECJ which suggests that Article 81 does not apply to any of the relationships that the agent could have with his principal.

The Guidelines¹⁰⁵ state that exclusive agency does not in general have anti-competitive effects implying that it may sometimes do so. Again this is in direct conflict with the case law of the ECJ, principally *Volkswagen*¹⁰⁶ in which the fact that the agent works only for one principal is seen as an essential characteristic of genuine agency. The Guidelines say that non-compete provisions may infringe Article 81 if they lead to foreclosure on the market where the contract goods are sold or purchased. For instance in the Commission Decision *IMA Rules*,¹⁰⁷ the rules of trade association of Dutch importers, processors and agents dealing in plywood required the agents of the associations to work only on the basis of exclusive agency agreements and only to

¹⁰³ n.101

¹⁰⁴ P.Henty, 'Agency Agreements – What are the risks?' [2006] ECLR 6

¹⁰⁵ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1

¹⁰⁶ n.101

¹⁰⁷ *IMA Rules* [1981] OJ L318/1

deliver to the association's members. The Commission held that Article 81 was infringed because these restrictions prevented anyone who might prefer to work through a number of agents, or who was not a member of IMA, from engaging the services of agents working through the IMA. Exemption under Article 81(3) was refused because there was no evidence that the restrictions would bring about any improvement in distribution.¹⁰⁸

Again the Court's case law suggests that where the agent is integrated into the principal's setup, Article 81 does not apply at all to the agreement between them, with the logical assumption that even foreclosure effects are irrelevant. Apart from exclusive agency and foreclosure effects, the other factor which may bring any agency agreement within Article 81 is that it facilitates collusion between competitors. The Guidelines give examples of such practices. For instance a number of principals could either use the same agents while collectively they exclude other principals from using those agents or use them to collude on marketing strategy or to exchange sensitive market information between the principals.

If a particular distribution agreement does not fall within the Community definition of a 'genuine agency', then it is not presumed to be in breach of Article 81. The status of such an agreement depends on the terms of the agreement and the market situation both for the goods and services being sold through the agent, and for the services provided by such an agent. If Article 81 is infringed, then it becomes necessary to decide whether the agreement is nevertheless exempted. Exemption may be obtained through reliance on a Block Exemption Regulation. If no such exemption is applicable the agreement will only be exempted if it satisfies the four substantive requirements of Article 81(3).

The Block Exemption on vertical restraints¹⁰⁹ states explicitly that agency agreements may, upon satisfying its fixed criteria, benefit from the exemption. This will only be possible where the relevant market share does not exceed 30 percent. Where distribution

¹⁰⁸ J. Goyder, *EU Distribution Law* (4th edn Hart Publishing, Oxford 2005) 180

¹⁰⁹ Commission Regulation (EC) 2790/99 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices [1999] OJ L336/21

of motor vehicles or their repair and after sales services is concerned, a sector-specific block exemption¹¹⁰ may apply. The Block Exemption may provide exemption for provisions such as the allocation to the agent of an exclusive territory or customer group, non-compete obligations lasting less than five years, or the setting by the principal of maximum or recommended prices. These issues will be further dealt with in Chapter 3.

¹¹⁰ Commission Regulation 1475/95 on the application of Article 85(3) of the Treaty to certain categories of motor vehicle distribution and servicing agreements [1995] OJ L 145/25

CHAPTER 2

DISTRIBUTION

2.1 Introduction

A considerable proportion of European Competition policy expressed both in the administrative practice of the European Commission and in case-law of the Community Courts, concerns distribution arrangements. Indeed, distribution of one kind or another is central to much of business, economic and everyday life, whether this involves the supply of goods from the manufacturer, through the wholesaler and retailer to the end user; the supply of services; or the dissemination of commercial know-how through franchises and intellectual property licenses.

Much of the competition law and policy which is relevant to distribution arrangements in the EU has changed in the recent past. On the cusp of the millennium, the Commission adopted Regulation 2790/99 concerning vertical arrangements.¹¹¹ This introduced a wide-reaching exemption under Article 81(3) from which a large range of distribution arrangements can benefit, provided the parties' relevant market share does not exceed certain thresholds, and provided their agreement does not contain 'hard-core' restrictions. To complement the Regulation, the Commission also published new Guidelines for assessing distribution agreements.¹¹² In addition, Regulation 1/2003¹¹³ reformed the rules governing the application of Article 81(1). These considerable reforms necessitate a discussion as to the application of the Block Exemption Regulation by parties to vertical distribution agreements in line with the principle of legal certainty.¹¹⁴ These developments have altered the way in which undertakings and their legal advisors are now to approach the task of establishing distribution systems in

¹¹¹ Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices [1999] OJ L336/21

¹¹² Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1

¹¹³ Commission Regulation (EC) 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 [2003] OJ L1/1

¹¹⁴ D.Roitman, 'Legal Uncertainty for Vertical Distribution Agreements: The Block Exemption Regulation 2799/1999 (BER) and Related Aspects of the New Regulation 1/2003' [2006] ECLR 261

harmony with competition law rules. Although the changes have simplified, the law in this field, their very novelty has also introduced some element of uncertainty.

This Chapter will endeavour to explain the features of the new developments and identify their proper context in the existing structure of the law. It will analyze the nature of distribution agreements and delve in the reasons why these fall within the purview of the law or otherwise. Next it will examine those arrangements which, although caught by that provision, can benefit from Article 81(3) under a block exemption regulation. Finally it will deal with how individual distribution agreements not falling under the first two categories should be assessed under EC competition law.

2.2 History of Distribution and Competition Rules

Article 81 and 82 of the EC Treaty seek to prevent business entities from re-partitioning the common marketplace which was achieved by the removal of national trade and customs barriers between Member States. At the same time the rules are intended to foster the efficient allocation of economic resources and capital within the European Community, while ensuring that the consumer shares in the resulting benefits.¹¹⁵ The competition rules clearly forbid the type of market-partitioning behaviour associated with classical horizontal cartels, in which groups of manufacturers or groups of sellers agree among themselves to replace competition with co-operation. In *Consten*¹¹⁶ it was argued that Article 81(1) applied only to such horizontal agreements, and not to vertical agreements. The point was an important one, since distribution, for sound commercial and practical reasons, is frequently carried out through entities distinct from the manufacturers of goods, and is also frequently organized in a way which reflects traditional national boundaries.¹¹⁷

¹¹⁵ This is a matter of no small controversy. Economic efficiency had traditionally been treated as a subordinate policy goal that of integrating national markets. This leads commentators to object that competition rules tend to protect smaller firms from larger competitors, without necessarily taking the economic efficiencies into account. In this regard the EC regime is frequently contrasted with that of U.S. antitrust law, where efficiency is undisputedly a goal of highest priority.

¹¹⁶ Cases 56 and 58/64 *Consten and Grundig v Commission* [1966] ECR I-299

¹¹⁷ The fact that distributorships often cover areas corresponding to the Member States' respective territories can give rise to the unhappy, and not necessarily correct, assumption that the distribution system is intended to partition markets along national lines. Suspected attempts to re-partition the Common Market attract particular judicial opprobrium, as in *Consten*; '[An] agreement between producer and distributor which might tend to restore the national divisions in trade between Member States might

In *Consten*,¹¹⁸ the ECJ rejected this notion, and found that Article 81(1) could indeed apply to an agreement between manufacturer and distributor. In this case, the former sought to confer absolute territorial protection on the latter. Rather than address just the question of absolute territorial protection, the Court held generally that:

Article 81 refers in a general way to all agreements which distort competition within the Common Market, and does not lay down any distinction between those agreements based upon whether they are made between competitors operating at the same level in the economic process or between non-competing persons operating at different levels.¹¹⁹

Notwithstanding the *Consten*¹²⁰ judgement, certain types of distribution arrangements do not fall within the prohibition in Article 81(1).

2.3 Distribution Agreements falling outside the Article 81(1) prohibition

2.3.1 Refusal to supply at all:

It is settled law that a supplier who does not enjoy a dominant position may deal with whomsoever he chooses and may unilaterally refuse to deal with any party, without being required to offer any justification for his refusal.¹²¹ Case-law also indicates that a non-dominant supplier operating a selective distribution system is not obliged to supply all his approved dealers.¹²² In the appeal from the Commission's decision in *Adalat*,¹²³ the CFI made broad statements clarifying that it is possible unilaterally to adopt measures which, in themselves, restrict competition, without necessarily falling foul of the prohibitions in Articles 81 and 82:

be such as to frustrate the most fundamental objection [sic.] of the Community. The Treaty, whose preamble and content aim at abolishing the barriers between states, and which in several provisions gives evidence of a stern attitude with regard to their reappearance, could not allow undertakings to reconstruct such barriers.' (par.24)

¹¹⁸ n. 116

¹¹⁹ *ibid.*

¹²⁰ *ibid.*

¹²¹ A Jausas *International Encyclopedia of Agency and Distribution Agreements* (Wolters Kluwer Law & Business, Aspen Publishers, 2007) 105

¹²² Case 75/84 *Metro v Commission* [1986] ECR 3021 par.12

¹²³ Case T-41/96 *Bayer AG v Commission* [2000] ECR II-3383

...the right of a manufacturer faced as in this case, with an event harmful to his interests, to adopt the solution which seems to him to be the best is qualified by the Treaty provisions on competition only to the extent that he must comply with the prohibitions referred to in Article 85 and 86 [81 and 82]. Accordingly, provided he does so without abusing a dominant position, and there is no concurrence of wills between him and his wholesalers, a manufacturer may adopt the supply policy which he considers necessary, even if by the very nature of its aim, for example, to hinder parallel imports, the implementation of that policy may entail restrictions on competition and affect trade between Member States.¹²⁴

The ECJ has also accepted that where a decision on the part of a manufacturer constitutes unilateral conduct, that decision escapes the prohibition of Article 81.¹²⁵ However the question of what behaviour is 'unilateral' can in practice be problematic. For there to be an agreement within the meaning of Article 81 it is sufficient that the undertakings in question should have expressed their joint intention to conduct themselves on the market in a specific way.¹²⁶ Such a joint intention can be evidenced simply through the parties' acts, even where it is not the subject of an express or legally binding agreement.¹²⁷ In certain circumstances, measures adopted or imposed in an apparently unilateral manner by a manufacturer in the context of his continuing relations with his distributors have been regarded by the Commission and the ECJ as constituting an agreement in terms of Article 81.¹²⁸

The CFI referred expressly to the case law in the *Bayer / Adalat* appeal,¹²⁹ even though some of the earlier judgments are arguably examples of the Commission's and the Court's extension of the concept of concerted practice beyond its true meaning in order to sanction unmeritorious refusals to supply. Bayer had acted with meticulous circumspection, and was at pains to preserve the unilateral nature of its refusals. The Commission concluded that there was a concerted practice. Although the CFI held that

¹²⁴ *ibid.*

¹²⁵ Case 107/82 *AEG v Commission* [1983] ECR 3151, par.38; Joined Cases 25/84 and 26/84 *Ford and Ford Europe v Commission* [1985] ECR 2725, par.21; Case T43/92 *Dunlop Slazenger v Commission* [1994] ECR II-441, par.56

¹²⁶ Case 41/69 *ACF Chemiefarma v Commission* [1970] ECR 661, par.112

¹²⁷ *ibid.*

¹²⁸ Joined Cases 32/78, 36/78 to 82/78 *BMW Belgium and Others v Commission* [1979] ECR 2435, par.28 to 30; Joined Cases 25/84 and 26/84 *Ford and Ford Europe v Commission* [1985] ECR 2725, par.21

¹²⁹ n.123

the Commission's analysis was not properly grounded, the judgement emphasizes that the line between legal unilateral refusal and illegal concerted practice is a thin one indeed. The safe path for distributors who wish to unilaterally refuse supplies is narrow and should be tread with caution.¹³⁰

2.3.2 Single Economic Units and the *Viho* Doctrine

As explained in Chapter 1, a manufacturer of goods may integrate downstream into the distribution channel for its own products without giving rise to any agreement of concerted practice between undertakings which is amenable to Article 81. Therefore, provided it does not amount to the abuse of a dominant position under Article 82 and provided that it does not breach any of the provisions of the Merger Regulation,¹³¹ vertical integration, such as branching, triggers no intervention on the part of Community law.¹³²

2.3.3 Distribution Effected through Commercial Agents¹³³

The Commission recognized as early as 1962 that distribution carried on through an agent could be functionally equivalent to distribution through an integrated entity and that agency agreements may provide an alternative option for firms unwilling or unable to integrate downstream into the distribution chain.¹³⁴ As explained in Chapter 1, if the agent is sufficiently integrated into the undertaking of the principal there is not agreement or concerted practice between different undertakings within the meaning of Article 81(1).

¹³⁰ Korah, *Introductory Guide to EC Competition Law and Practice* (7th Edn. 2000 Oxford, Hart Publishing) 2.4.1 and n.11 8.03

¹³¹ Council Regulation 139/2004 on the Control of Concentrations between Undertakings [2004] OJL24/1

¹³² Case 15/74 *Centrafarm v Sterling Drug* [1974] ECR I 147

¹³³ Chapter 1 offers a more in-depth study of position of the commercial agent vis a vis Article 81. This short resume of the matter is being produced at this stage for the sake of completeness.

¹³⁴ Commission Notice of December 24, 1964, [1962] OJ 139/2921

2.3.4 Distribution Agreements of Minor Importance

In 2002, the Commission issued its latest 'Notice on Agreements of Minor Importance which do not fall under Article 81(1)' known as the *de minimis* Notice.¹³⁵ The Notice indicates the Commission's view that when the market share of each of the undertakings to an agreement do not exceed a particular percentage, the agreement falls outside the scope of Article 81(1). This reflects the prior case-law which required that in order for Article 81(1) to apply, the prohibited effect of intra-Community trade or competition must be 'appreciable'. In *Volk* the ECJ held that:

If an agreement is to be capable of affecting trade between Member States it must be possible to foresee with a sufficient degree of probability on the basis of a set of objective factors of law or of fact that the agreement in question may have an influence, direct or indirect, actual or potential, on the pattern of trade between Member States in such a way that it might hinder the attainment of the objectives of a single market between States... Consequently an agreement falls outside the prohibition in Article 81 when it has only an insignificant effect on the markets, taking into account the weak position which the persons concerned have on the market of the product in question.¹³⁶

The new Notice distinguishes between vertical and horizontal agreements. Since horizontal agreements are more harmful, the Notice allows a greater market-share in cases of vertical agreements. Whilst horizontal agreements are allowed a threshold of 10%, the vertical agreements are allowed a share of 15%.¹³⁷ The application of the Notice does not exclude the Court's test in *Volk*,¹³⁸ and agreements between parties whose market share exceeds the thresholds may nevertheless have no 'appreciable' effect. According to the Commission, where the vertical agreement in question has as

¹³⁵ Notice on agreements of minor importance which do not appreciably restrict competition under Article 81 (1) of the EC Treaty (*de minimis* Notice) [2002] OJ C368 13-15

¹³⁶ Case 5/69 *Franz Volk v S.P.R.L, Ets. J. Vervaecke* [1969] ECR 1969 / 295

¹³⁷ There is also a difference as to how these shares are calculated. Whilst the 10% relating to horizontal agreements is a combined share of the supplier and the distributor, the 15% relating to vertical agreements is not combined and therefore together the supplier and the distributor could have a share of 30% and still fall under the *de minimis* principle.

¹³⁸ n.136

its object the fixing of resale prices, or the conferring of territorial protection, the application of Article 81(1) cannot be ruled out, even though the market shares fall below the threshold. The previous *de minimis* Notice excluded from its benefit agreements operated on a market where ‘competition is restricted by the cumulative effects of parallel networks of similar agreements established by several manufacturers or dealers.’ This meant in practice that firms operating in sectors like the beer industry could usually not benefit from the *de-minimis* Notice. The new Notice introduces a special *de minimis* market share threshold of 5% for markets where there exist such parallel networks of similar agreements.

The Commission regards agreements between small and medium-sized undertakings as unlikely to significantly affect trade between Member States, and such agreements will not be subject to Commission proceedings unless they significantly impede competition in a substantial part of the relevant market, or where parallel networks of similar agreements restrict trade.¹³⁹

Also relevant in this context, is the Notice on the Guidelines on the Effect on Trade¹⁴⁰ which though not binding offers quite an extensive explanation of how the new system should work in practice. If the agreement is anti-competitive but it has no effect on trade, then Article 81 will not be applicable. It is only the national law which will be applicable. The National Authority has to monitor every agreement that comes before it to assess whether it effects trade between States. If it does, then it would be able to apply both national and community law, but if it does not, then Article 81 is not applicable. The Commission¹⁴¹ holds the view that in principle agreements are not capable of appreciably affecting trade between Member States when the following cumulative conditions are met:

- (a) The aggregate market share of the parties on any relevant market within the Community affected by the agreement does not exceed 5 %, and

¹³⁹ *ibid.* 19 & 20

¹⁴⁰ Commission Notice on the Guidelines on the Effect on Trade concept contained in Articles 81 and 82 of the Treaty, [2004] OJ C 101/81

¹⁴¹ *ibid.* par.52

(b) In the case of horizontal agreements, the aggregate annual Community turnover of the undertakings concerned in the products covered by the agreement does not exceed 40 million euro. In the case of agreements concerning the joint buying of products the relevant turnover shall be the parties' combined purchases of the products covered by the agreement.

In the case of vertical agreements, the aggregate annual Community turnover of the supplier in the products covered by the agreement does not exceed 40 million euro. In the case of licence agreements the relevant turnover shall be the aggregate turnover of the licensees in the products incorporating the licensed technology and the licensor's own turnover in such products. In cases involving agreements concluded between a buyer and several suppliers the relevant turnover shall be the buyer's combined purchases of the products covered by the agreements.¹⁴²

The interpretation of 'trade' is crucial since if it were to be given an extensive interpretation, it would result in an extension of the application of Article 81. The Commission used to interpret this phrase very extensively due to the fact that most of the Member States had not yet developed their own competition law systems. Had it not been for this extensive interpretation, most of the illegal agreements would have been unregulated. Today this is no longer the case, since the majority of Member States have set up the necessary authorities. In the light of the principle of subsidiarity, some argue that some work can easily be left for Member States.¹⁴³ In *Carlo Bagnasco*¹⁴⁴ and in the *Dutch Banks Case*¹⁴⁵ the Court gave the impression that it would change its approach. However in numerous successive rulings, the Court confirmed its extensive interpretation of the term 'trade'.

The Court in a number of cases held that an agreement which covers an entire territory, is intrinsically anti-competitive and therefore requires no individual examination of the terms which it includes. This is called the VCH principle. In these two cases the Court was faced with agreements covering whole territories and still did not find an effect on trade. However these were exceptional cases and the Court in no time reverted to the

¹⁴² *ibid.*

¹⁴³ J. Goyder, *EU Distribution Law* (4th edn Hart Publishing, Oxford 2005) 24

¹⁴⁴ *Bagnasco v. BPN Case C- 215/96 [1999] ECR I-135*

¹⁴⁵ *Dutch Banks OJ 1999 L 271/28 [2000]*

VCH principle in cases such as *Wouters*.¹⁴⁶ The latter involved an agreement that covered the Netherlands and the Court held that this in its own very nature has an effect on trade. The 2004 Notice,¹⁴⁷ justifies the exceptional rulings on the basis of their very peculiar facts. The term 'trade' is given a very wide meaning as it includes not only trade in goods but also any commercial activity.

It is the agreement as a whole that must have an effect on trade, and this to a certain degree irrespective of the restrictions inside it. It is not necessary, for the purposes of establishing Community law jurisdiction, to establish a link between the alleged restriction of competition and the capacity of the agreement to affect trade between Member States. Non-restrictive agreements may also affect trade between Member States. Selective distribution agreements based on purely qualitative selection criteria justified by the nature of the products, which are not restrictive of competition within the meaning of Article 81(1), may nevertheless affect trade between Member States. In *Consten-Grundig*, the effect on trade was a positive one as it increased trade, but since this is a jurisdictional test, the Court held that this was irrelevant. Any type of 'effect' or 'influence' will yield the necessary jurisdiction. The fact that the Court has jurisdiction does not render the agreement 'acceptable' or otherwise. It is in fact without prejudice to the merits of the agreement which will only come to be assessed at a later stage, that is, after it has been decided that the agreement falls within Article 81.

Moreover the influence could be actual or potential. Companies could have an agreement between them over a particular territory and there is no export involved. In such cases the Court held that even if the agreement does not have actual effect, it may still have potential effect because there is nothing impeding the companies from deciding to export one day. In the *Javico* Case,¹⁴⁸ the Court found an effect on trade even where the agreement related to exports to a non-EU Member State due to the possibility of parallel imports into the EU. The effect could be direct or indirect. In

¹⁴⁶ Case C 309/99 *Wouters* [2002] ECR I-1577

¹⁴⁷ Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices [1999] OJ L336/21

¹⁴⁸ Case 306/96 *Javico v Yves Saint Laurent* [1998] ECR I-1983

Zanussi,¹⁴⁹ the manufacturer did not prohibit his dealers from exporting but he obliged them not to honor a warranty issued by an overseas dealer of the same chain. The Court held that this condition had an indirect effect on trade because in principle it discouraged people from going abroad to buy appliances. However though the Court has been clear in its rulings that a distribution agreement will not infringe competition law if it has no appreciable effect on trade between Member States, it is also clear that if the agreement has an effect on trade and includes fixed or minimum resale prices or an absolute export ban (hard core restraints) it will almost certainly be unenforceable and may attract fines.

2.4 Distribution agreements that may fall outside the Article 81(1) prohibition.

2.4.1 Exclusive Distribution

In essence this arrangement involves the supplier giving assurance to his distributor that he will not supply his product to any other distributor within the territory assigned to him. Such arrangements are in practice found in complex networks involving different exclusive distributors for different territories. The allocation of exclusive territories is usually accompanied by provisions giving some degree of protection to the distributors' territories from exports from other territories. Choosing this method of distribution over other forms means also that the supplier would be missing out on the degree of control that such other methods proffer. In an agency context¹⁵⁰ for instance, the prices and terms and conditions of resale may be set, but the Community law definition of an agent often leaves the supplier with no option other than that of an exclusive distribution. The possible reduction of intra-brand competition and market-partitioning have always been fundamental concerns for the Commission but it was not clear, until *Consten and Grundig*,¹⁵¹ whether such vertical agreements could infringe Article 81(1). The latter case confirmed that in principle vertical distribution agreements fall within the purview of Article 81(1). In *Consten*,¹⁵² a manufacturer of electrical equipment appointed Consten as his exclusive distributor in France which in its turn assured Grundig that it

¹⁴⁹ Commission Decision of 23 October 1978 OJ L 322

¹⁵⁰ See Chapter 1 generally.

¹⁵¹ Cases 56 and 58/64 *Consten and Grundig v Commission* [1966] ECR I-299

¹⁵² *ibid.*

would not supply anyone outside the territory allocated to it. Grundig not only assured an exclusive supply and gave Consten the exclusive right to use its trademark 'GINT', but provided Consten with additional territorial protection by the imposition of similar restrictions on all its distributors in Germany. Within France its only competition could come from dealers selling the products of manufacturers and suppliers other than Grundig. It was subject to no competition at all in respect of Grundig products themselves, in which it enjoyed a monopoly.

It happened that an extraneous trader imported Grundig products into France and sold them at lower prices. Consten proceeded against this trader and sought to enforce its agreement with Grundig. The ECJ however upheld the Commission's decision to the effect that those provisions granting Consten exclusive territorial protection were illegal. Consten's argument that the provisions granting territorial exclusivity increased the flow of trade was to no avail. The Court held that if trade flow were disturbed from the course that they would otherwise have taken in the absence of the restriction, then this was sufficient to infringe Article 81(1) irrespective of the actual effect on the flow of trade. It is evident that the focus of the case was exclusive territorial protection and despite the fact that it laid down the principle, it left unprejudiced the matter of whether an agreement by a supplier to supply only one dealer in the contract territory¹⁵³ falls foul of Article 81(1). Further elucidation came in *Technique Miniere*,¹⁵⁴ where the ECJ held that pure exclusive distribution, as opposed to absolute territorial protection or export and import bans, does not necessarily infringe Article 81(1). The Court went so far as stating that exclusivity might be essential and thus beneficial and pro-competitive if it was justified to penetrate a new market. The factors to be taken into account are the following:

- a) the nature of the product;
- b) whether the agreement is for the supply of unlimited amounts or is limited to certain amounts;
- c) the share that each party has of the market in which he does business;
- d) whether the agreement is one of a number of similar agreements forming a distribution network for the goods;

¹⁵³ as opposed to a total ban on parallel imports and exports.

¹⁵⁴ Case 56/65 *Technique Miniere v. Maschinebau Ulm* [1966] ECR 235

- e) the strength of territorial protection provided to the distributor and the possibility of parallel imports.¹⁵⁵

Amongst other things, these points suggest that in cases where the parties to an exclusive distribution agreement hold small market shares and where their agreement is not one out of many that in all form a distribution network, such agreement would not infringe Article 81. Authors¹⁵⁶ hold that in practice the Commission considers exclusive distribution as an arrangement which falls squarely within the purview of Article 81 and that these points are only relevant in so far as exemption under 81(3) is concerned. The points also suggest that a simple form of territorial protection would not necessarily infringe Article 81(1). The Commission has in 1983 issued a block exemption¹⁵⁷ which assumed that any form of territorial protection required exemption. It is of little interest to the parties whether the agreement falls outside the scope of Article 81 outright or whether it falls within its scope but then is exempted under Article 81(3). The matter is however very different if the particular agreement does not qualify for exemption because under Regulation 1/2003¹⁵⁸ the party claiming exemption carries the onus of proof in respect of Article 81(3), whereas the same onus that Article 81(1) applies is carried by the party alleging infringement. More recent judgements¹⁵⁹ suggest that simple territorial exclusivity may in certain specific situations fall outside the scope of Article 81(1). The latter interpretation is however limited to the field of new technologies and thus in practice any form of exclusivity in other areas would attract the application of Article 81(1). Whilst the scope of the latter in this field is debateable, it is obviously safer to rely on Article 81(3) where this is possible. From the above-mentioned cases it is clear that any attempt to convince the Commission on the non-application of Article 81(1) will never be one which is easily welcomed.

¹⁵⁵ *ibid.*

¹⁵⁶ D.O'Sullivan, S. Spinks, and P.M. Louis, *Competition Law of the European Community* (2nd edn Lexis Nexis London 2004) 8.03, J. Goyder, *EU Distribution Law* (4th edn Hart Publishing, Oxford 2005)

¹⁵⁷ Commission Regulation No 1983/83 on the Application of Article 85(3) of the Treaty of Categories of Exclusive Distribution Agreements [1983] OJ L 173/1

¹⁵⁸ Commission Regulation (EC) 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 [2003] OJ L1/1

¹⁵⁹ Case 258/78 *Nungesser v Commission* [1981] ECR 45; Case 27/87 *Erauw-Jacquery v La Hesbignonne* [1988] ECR 1919

2.4.2 Qualitative Selective Distribution

Selective distribution is, as the name suggests, a system in which a manufacturer or supplier chooses the entities through which its products will be distributed, in order to control the circumstances under which the products will be presented and sold to the public, thereby protecting image and reputation. The system is closed as the supplier may prohibit authorized dealers from supplying the contract goods to non-authorized dealers. Such a 'closed' system provides authorized dealers with a measure of intra-brand protection, and may be pro-competitive in encouraging dealers to undertake investments and sunk costs which promote the distribution of the product. Selective distribution is defined as follows:

A distribution system where the supplier undertakes to sell the contract goods or services, either directly or indirectly, only to distributors selected on the basis of specified criteria and where these distributors undertake not to sell such goods or services to unauthorized distributors¹⁶⁰

In the *Metro* case¹⁶¹ the ECJ found that a system of selective distribution operated by a non-dominant supplier does not infringe Article 81(1) provided that resellers are chosen on the basis of objective criteria of a qualitative nature relating to the technical qualifications of the reseller and his staff and the suitability of his trading premises, and that such conditions are laid down uniformly for all potential resellers and are not applied in a discriminatory fashion.¹⁶² The Court held that the effectiveness of such a system depends on the suitable retailers receiving the supplies. The manufacturer may impose such obligations on its wholesalers as are proportionate to ensure that only approved retailers obtain supplies of contract goods.

Not all products, however, are regarded as capable of being the subject matter of a selective distribution system at all, or at a particular level of the production and chain supply. Complex, luxury, or technical goods lend themselves to selective distribution, whereas simple or commodity items do not. The restriction inherent in a selective

¹⁶⁰ Commission Regulation (EC) 2790/99 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices [1999] OJ L336/21 Article 1(d)

¹⁶¹ Case 26/76 *Metro SB-GroBarkte GmbH & Co. KG v Commission* [1977] ECR I-1977 par.20

¹⁶² *ibid.*

distribution system may be justified where they allow undertakings to compete in relation to properties of goods other than their price. Where the characteristics of the product in question are not such as to require a special distribution system in order to ensure its correct use, or to assure its quality or to guarantee a level of service to the potential buyer, the restrictions inherent in selectivity may not be justified.¹⁶³ This was set out in *Metro*¹⁶⁴ and re-affirmed, by the ECJ in *AEG Telefunken*¹⁶⁵ where, considering a selective distribution for consumer electronics, it pointed out:

It has always been recognized in the case-law of the Court that there are legitimate requirements, such as the maintenance of a specialist trade capable of providing specific services as regards high-quality and high-technology products, which may justify a reduction of price competition in favour of competition relating to factors other than price. Systems of selective distribution in so far as they aim at the attainment of a legitimate goal capable of improving competition in relation to factors other than price, therefore constitute an element of competition which is in conformity with Article 85(1) [81(1)]. The limitations inherent in a selective distribution system are however acceptable only on condition that their aim is in fact an improvement in competition in the sense above mentioned. Otherwise they would have no justification in as much as their sole effect would be to reduce price competition.¹⁶⁶

The Commission¹⁶⁷ has followed the *Metro* and *AEG* case-law, although it has added a further requirement that the distribution agreement for the appropriate goods and services, as well as applying purely qualitative selection criteria in a non-discriminatory fashion,¹⁶⁸ must also not contain a resale price maintenance scheme. It is highly likely that the Commission would also regard any selective distribution arrangement which implemented the other practices which are routinely characterized as hardcore restraints of competition such as territorial restraints and certain post-sale restraints, as falling within the purview of Article 81 and incapable of exemption.

¹⁶³ Case 31/80 *L'Oreal* [1980] ECR 3775

¹⁶⁴ n.161

¹⁶⁵ Case 107/82 *Allegemeine Elektrizitats-Gesellschaft AEG-Telefunken AG v Commission* [1983] ECR 3151

¹⁶⁶ *ibid.* 33 and 34

¹⁶⁷ Case T-88/92 *Leclerc v Commission* [1988] ECR II-1961

¹⁶⁸ *ibid.*

(a) Quantitative criteria

In *Metro*,¹⁶⁹ the ECJ referred explicitly to qualitative criteria with respect to which dealers may be selected. It also distinguished so-called 'additional obligations', including quantitative criteria, such as obligations to achieve a certain turn over, which the Court regarded as infringing Article 81 and therefore requiring exemption under Article 81(3). Since *Metro* both the Court and the Commission have taken the position that quantitative criteria for dealer selection have the effect of limiting the possible number of approved dealers, and thereby foreclose the market.¹⁷⁰

(b) Selective distribution under Regulation 2790/99 and 1400/2002

Following the *Metro* case-law, a system of selective distribution for appropriate goods, properly implemented with objectively justifiable qualitative criteria, where such criteria are applied without discrimination, and without provisions for RPM, does not come under Article 81(1) at all. Many undertakings still prefer to have distribution arrangements conform to a structure explicitly exempted under a block exemption regulation. BER 2790/99¹⁷¹ exempts selective distribution systems with both qualitative and quantitative restrictions where the supplier's market share does not exceed 30 percent, and where the distribution agreement does not contain certain hard-core restrictions of competition. Moreover the BER applies without regard to the type of product concerned or to the level of trade at which the parties operate. It is therefore possible for distributors to combine qualitative and quantitative selection criteria and to operate selectivity even in respect of products which, according to the *Metro* and *AEG* case-law, would not normally be regarded as justifying selective distribution. In the

¹⁶⁹ Case 75/84 *Metro v Commission* [1986] ECR 3021 par.12

¹⁷⁰ In Commission Decision *Omega* OJ 1970 L242/22, the Commission granted an exemption under 81(3) for a selective distribution system with quantitative criteria which limited the number of approved distributors in each region or each town to an optimum figure fixed on the basis of the local population and its presumed wealth.

¹⁷¹ Commission Regulation (EC) 2790/99 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices [1999] OJ L336/21

motor vehicle sector, Regulation 1400/2002¹⁷² exempts distribution systems which combine selectivity with exclusivity.¹⁷³

2.4.3 Franchising Agreements

Franchising is an agreement whereby the owner of a business method, commercial know-how, or trademark, licenses another party to use that information or mark in connection with the provision of goods or services, usually in return for royalties, and sometimes also in connection with an obligation on the licensee to obtain input goods or services from the licensor or his appointee. This system permits the licensor, with a minimum of own investment, to develop a network of franchisees through whom his product or service may be distributed. Conversely, franchisees with capital to invest can gain access to entrepreneurial know-how and opportunities which they may not have been in a position to develop independently. Often, the licence contains elements of selectivity and certain objective criteria intended to protect the franchisor's method, trademark or goodwill. This method will be further considered in Chapter 5.

2.5 Distribution Agreements and Article 81(1) since Consten

Since the *Consten* case,¹⁷⁴ the Community Courts have on numerous occasions found that the provisions of Article 81(1) are capable of catching distribution agreements of a vertical nature.¹⁷⁵ According to both the ECJ and the CFI, application of Article 81(1) necessitates an examination of all the relevant circumstances, including a market analysis to determine whether the agreement in question has the effect of distorting competition. In the *Delimitis* case, the Court emphasized that the market foreclosure brought about by the distribution arrangement is capable of attracting the prohibition in Article 81. In considering whether there is in fact foreclosure, a full market analysis is necessary, and even the effect of similar contracts between the same or other parties

¹⁷² Commission Regulation (EC) 1400/2002 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices in the motor vehicle sector [2002] OJ L203/30

¹⁷³ This Regulation merits longer discussions but due to the word-limit restraints, this work will not go into the relative greater detail.

¹⁷⁴ Cases 56 and 58/64 *Consten and Grundig v Commission* [1966] ECR I-299

¹⁷⁵ Case C-306/96, *Javico International and Javico AG v Yves Saint Laurent Parfums SA.* [1998] I ECR 1983, par. 11

must be taken into account. The agreement in the above mentioned case concerned the tenant of licensed premises, who contracted to purchase beer only from his landlord, a brewery. The ECJ held that two cumulative conditions must be met for the Article 81(1) prohibition to apply:

The first is that having regard to the economic and legal context of the agreement at issue, it is difficult for competitors who could enter the market or increase their market share to gain access to the national market... [the beer market in this case] the fact that in that market, the agreement in issue is one of a number of similar agreements having a cumulative effect on competition constitutes only one factor amongst others in assessing whether access to that market is indeed difficult. The second condition is that the agreement in question must make a significant contribution to the sealing off effect brought about by the totality of those agreements in their economic and legal context. The extent of the contribution made by the individual agreement depends on the position of the contracting parties in the relevant market and on the duration of the agreement.¹⁷⁶

So in theory, following the *Delimitis* judgement, distribution agreements of a vertical nature do not *ipso jure* fall foul of Article 81, unless they clearly have as their object the restriction of competition, or unless an exhaustive examination would reveal that they effectively hinder competition by significantly contributing to market foreclosure.

¹⁷⁶ Case C-234/89 *Delimitis v Henninger Brau* [1991] ECR I-935, par.27

CHAPTER 3

THE BLOCK EXEMPTION REGULATION

3.1 Introduction

BER 2790/99¹⁷⁷ entered into force at the beginning of 2000, and the exemption it confers became operative from the first of June of that year. It is a measure of general application, and replaces the previous regulations which dealt with exclusive distribution, exclusive purchasing, and franchising. The basic tenant of the new BER is simple; certain vertical agreements for the sale of goods or the supply of services are exempt from the prohibition in Article 81 where the relevant market share of the supplier does not exceed 30 percent, provided that the agreement does not contain certain hard-core restrictions of competition. The Commission refers to this exemption as a ‘safe harbour’.¹⁷⁸

This approach is revolutionary, compared to the previous regime of form-oriented block exemptions, and helps to ensure that businesses can structure their own arrangements without having to be overly concerned with the risk of nullity under Article 81(2). Agreements to which the BER applies benefit from what the Commission describes as a ‘presumption of legality’.¹⁷⁹ There is no corresponding ‘presumption of illegality’ for agreements falling outside the scope of the BER, except for agreements containing black-listed obligations. The economic rationale behind the Regulation is that if there is enough inter-brand competition, the competition authorities can be more flexible when dealing with restraints of intra-brand competition. The BER operates on the assumption that undertakings whose relevant market share is below thirty per cent are unlikely to have significant market power.¹⁸⁰

¹⁷⁷ Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices. [1999] OJ L336/21

¹⁷⁸ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/21

¹⁷⁹ *ibid.*

¹⁸⁰ This approach answers one of the principal criticisms of the previous block exemption regime. Under the old system, if an agreement conformed to the structure foreseen by the Regulation “white list”, it obtained an Article 81(3) exemption, regardless of the parties’ respective market shares. In those

3.2 Exemption of Certain Agreements

Article 2 of the BER states that:

Pursuant to Article 81(3) of the Treaty and subject to the provisions of this Regulation, it is hereby declared that Article 81(1) shall not apply to agreements or concerted practices entered between two or more undertakings each of which operates, for the purposes 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. This exemption shall apply to the extent that such agreements contain restrictions of competition falling within the scope of Article 81(1)¹⁸¹

3.2.1 Vertical Agreements and Vertical restraints

Article 2(1) provides that an exemption under Article 81(3) of the Treaty shall apply to certain agreements known as ‘vertical agreements’. To come within the scope of Article 2, such an agreement must now satisfy three requirements:

- two or more undertakings are party to the agreement; and
- those undertakings party to the agreement each operate at a different level of the production or distribution chain; and,
- the agreement relates to the conditions for the purchase, sale or resale of certain goods or services.

3.2.2 Two or more undertakings

The exception under the BER applies to agreements to which two or more undertakings are party whilst previous exemption regulations covered only bipartite agreements. Presumably, where the parties to an agreement are themselves affiliates of the same

circumstances, the only check on the parties was withdrawal of the exemption, or the possible application of Article 82. Some experts including Richard Whish, do not accept that market share is a substitute for market power, or that a market-share test is easier to apply than a market-power analysis. Others make the pragmatic point that the Commission “can hardly be criticised for using a principled, economics-based approach in order to escape from the discredited and formalistic regulations of the past”. See Richard Whish, ‘Regulation 2790/99: The Commission’s ‘New Style’ Block Exemption for Vertical Agreements’ (2000) 37 CMLR 887

¹⁸¹ n.177 Art. 2

corporate group, the *Viho* test¹⁸² will apply to determine whether two or more undertakings are involved. In its guidelines,¹⁸³ the Commission indicates that the BER is not intended to apply to agreements between a supplier of goods or services and ‘final consumers not operating as an undertaking’, and that such agreements would, in any event, not fall under Article 81(1). However, this interpretation does not flow naturally from the text of Article 2(1).

3.2.3 Different level of the distribution chain

This requirement ensures that the agreement in question exhibits the necessary degree of ‘verticality’.¹⁸⁴ According to the guidelines,¹⁸⁵ this definition covers agreements where for example, the seller produces a raw material which the buyer uses as input. It also covers a tripartite agreement between a manufacturer, a wholesaler and a retailer. It is also to be noted that the verticality is required only for the purposes of the agreement. The buyer and seller can actually be competitors in respect of goods and services other than those in the instant contract. Vertical agreements between competitors are further dealt with in Article 2(4).¹⁸⁶

3.2.4 The conditions of purchase, sale and resale

The BER applies only to agreements which relate to the ‘conditions under which the parties may purchase, sell or resell certain goods or services’. Arguably, a simple purchase agreement, with no clauses imposing conditions on the parties would not be an agreement within the meaning of the BER, while the intellectual property license could be. However, the guidelines¹⁸⁷ indicate that the purpose of the Regulation is ‘to cover purchase and distribution agreements’ generally. The guidelines¹⁸⁸ continue that, the BER also applies to goods sold and purchased for subsequent rental to third parties. Rental and leasing agreements as such are not covered since no good or service is being

¹⁸² Case C-73/95 P, *Viho v. Commission* [1996] I ECR 5457

¹⁸³ n.178 par.24

¹⁸⁴ In US antitrust law, an agreement is regarded as “vertical” if without the agreement one or other of the parties could not have entered the market in question.

¹⁸⁵ n.178

¹⁸⁶ R Christou International Agency, *Distribution and Licensing Agreements* (4th edn Sweet & Maxwell London 2003) 111

¹⁸⁷ n.178

¹⁸⁸ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/25

sold by the supplier. The Commission also says that where an agreement contains obligations not relating to purchase, sale and resale, such as research and development obligations, these are not covered by the BER.¹⁸⁹ This is contrary to the obvious meaning of Article 2(1).

3.2.5 Goods and Services

The BER applies not only to vertical agreements in respect of the sale of goods but also to agreements for the supply of services. It refers to both as ‘products’. Previously, the provision of services was covered by block exemptions only where it was ancillary to the distribution of goods.¹⁹⁰ Unlike the previous regulations, the BER makes no requirement that the products be for resale. According to the guidelines,¹⁹¹ the Regulation covers vertical agreements relating to all final and intermediate goods, with the exception of agreements in the automobile distribution and servicing sector, which are at present subject to a specific regime.¹⁹²

3.2.6 Vertical Restraints

The last sentence of Article 2(1) stipulates that the block exemption applies to vertical agreements to the extent that they contain restrictions of competition falling within the scope of Article 81(1), such restrictions being defined as ‘vertical restraints’. At first sight, this seems superfluous, since if there is no infringement of Article 81(1) no exemption is necessary. The purpose of this inclusion seems to be to indicate a division of Community and national law competences.

For the BER to apply, the agreement must contain a restriction of competition falling within the scope of Article 81(1). This means that the agreement must be capable of having an ‘appreciable’ effect on trade between Member States. Agreements whose effect is not appreciable, or which do not affect trade between Member States therefore fall outside the BER, and come under the competence of national competition law

¹⁸⁹ *ibid.*

¹⁹⁰ n.178

¹⁹¹ n.178

¹⁹² Commission Regulation (EC) 1400/2002 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices in the motor vehicle sector [2002] OJ L203/30

authorities. This creates a situation where agreements which could be prohibited under national rules would, if they had more effect on competition generally, be exempted by Regulation 2790/99.¹⁹³ It further creates an incentive for undertakings to ensure that their agreements contain at least one restriction clearly caught by the prohibition in Article 81(1), in order to benefit from the Block Exemption, rather than operating a system subject to the vagaries of twenty-seven different national competition law rules.

3.2.7 Associations of Retailers

Article 2(2)¹⁹⁴ was added to the Regulation to reassure associations of retailers. It is a common practice for smaller retailers to group their purchasing power, in order to benefit from favourable conditions when dealing with producers or wholesalers. Retailers' representatives were concerned that their members' purchasing arrangements, being affected through an association might not be capable of being exempted, while their larger competitors would, as unitary purchasers, enjoy the benefits of the BER.¹⁹⁵ Article 2(2) provides that vertical agreements between an association of retailers of goods and its members,¹⁹⁶ and between that association and its suppliers are exempted under Article 81(3), provided that no individual member of the association has an annual turnover exceeding EUR 50 million, and provided that the market share of the association's members, taken together does not exceed thirty percent.

The Commission¹⁹⁷ expresses the view that where a limited number of members of retailers' association exceed the turnover ceiling in Article 2(2), 'this will normally not change the assessment under Article 81(1)'. Authors remark that this statement is

¹⁹³ Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices. [1999] OJ L336/21

¹⁹⁴ Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices. [1999] OJ L336/21

¹⁹⁵ Retailers' representatives successfully lobbied the Economic and Social Committee which, in its Opinion on the Commission's vertical restraints green paper, noted: 'there is need to give greater recognition to the fact that horizontal forms of co-operation between SMEs in the distribution sector are not necessarily restrictions on competition under Article 85(1)...and should be accommodated either with a rebuttable presumption of negative clearance or, where they fall within the scope of Article 85(1), under a block exemption regulation.' [1997] OJ C296/19/3.1.3

¹⁹⁶ Although the Regulation does not define "retailer", the Commission, in Guideline 28, indicates that it takes this term to mean "distributors reselling goods to final customers".

¹⁹⁷ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/28

delphic.¹⁹⁸ If the Commission means that it is in some way flexible, beyond the marginal relief afforded by Article 10(2), that is clearly a view contrary to the plain wording of the Regulation, and the Commission has indicated no legal basis for its statement. On the face of the provision, the participation of just one retailer whose turnover exceeds the ceiling provision is sufficient to deny the agreement between the association and its members an exemption under the BER.¹⁹⁹ The guidelines²⁰⁰ may be intended to communicate that the Commission will regard the conditions of Article 81(3) as satisfied in circumstances where only a few members of an association exceed the turnover ceiling. Clearer drafting would not be a miss, but it is submitted²⁰¹ that at least the Commission itself will now be honour-bound to give associations ‘the benefit of the doubt’ in marginal cases.

3.2.8 Intellectual Property Rights

Article 2(3)²⁰² provides that vertical agreements containing provisions as to intellectual property rights (hereinafter IPRs) assigned to or used by the buyer, benefit from exemption. This applies where those provisions are not the ‘primary object’ of the agreement, and where they relate to the use, sale, or resale of goods or services by the buyer or its customers. The provisions are only exempted in so far as they do not have the same object or effect as other vertical restraints not exempted by the BER.

3.2.9 Agreements between Competing Undertakings

Article 2(4) of the BER sets out the general rule that exemption is not applicable to agreements between ‘competing undertakings’. The latter are defined as actual or potential suppliers in the same product market. The market includes goods or services which are regarded by the buyer as interchangeable with or substitutable for the contract goods or services, by reason of the products’ characteristics, their prices and their

¹⁹⁸ D.O’Sullivan, S. Spinks, and P.M. Louis, *Competition Law of the European Community* (2nd edn Lexis Nexis London 2004) 8.07/35

¹⁹⁹ *ibid.*

²⁰⁰ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/28

²⁰¹ n.197

²⁰² n.193

intended use.²⁰³ However the Regulation makes a limited exception in the case of three types of non-reciprocal agreements between competitors. This agreement even if coming under one of these exceptions in Article 2(4), must nevertheless comply with the other requirements of the Regulation in order to benefit from Article 81(3) exemption overall.

The first exception is where the buyer of the goods or services under the non-reciprocal agreement has a total annual turnover not exceeding EUR 100 million, calculated in accordance with Article 10 and 11.²⁰⁴ The second exception is where the supplier is a manufacturer and a distributor of goods, while the buyer is a distributor not manufacturing goods competing with the contract goods. The wording of this exception is not clear. It seems to imply that the buyer is necessarily a manufacturer of goods, but these goods do not compete with the contract goods. The Commission however in Guideline 27, describes the exception as dealing with ‘situations of dual distribution’. Presumably, the better interpretation seems to be that the manufacturer of the contract goods, although entering a distribution agreement with the buyer, nevertheless distributes those goods itself. This would cover the situation, for example, where a manufacturer of products which are normally sold through a distribution network also opens and operates a small number of ‘product showcase’ retail outlets. The outlets help to create an awareness of, and demand for, the manufacturer’s product line generally, and this demand is then met through the distribution network. The third exception is analogous to the second, but in respect of the provision of services, rather than goods. The supplier is a provider of services at several levels of trade, while the buyer does not provide competing services at the level of trade where it purchases the contract services. In other words the supplier of the services can also be a provider of services at the level of the buyer without preventing the BER from applying. The exception does not apply

²⁰³ Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices [1999] OJ L336/21 Art. (1)(a)

²⁰⁴ The relevant turnover is that of the buyer and all its connected undertakings as defined in Article 11(2) of the BER. Article 10(2) provides for marginal relief if the 100 million ceiling is not exceeded by more than 10% in two consecutive years.

however, where the buyer provides own services competing with the services it purchases from the seller.²⁰⁵

3.2.10 Interaction with other block exemption regulations

Article 2(5) declares that:

This Regulation shall not apply to vertical agreements the subject matter of which falls within the scope of any other block exemption regulation.

The wording of the article is peculiar since it is the ‘subject matter within the scope’ of another regulation which disapplies the BER, and not the exemption under another regulation. On the face of the article, this seems to mean that agreements of a type dealt with by another exemption are excluded, even if they are not actually so exempted. The Guidelines²⁰⁶ indicate that agreements the subject matter of which falls within the scope of any future block exemption will also be excluded. This raises the question of what is the legal position of an agreement which is today exempted by the BER, but the subject matter of which eventually comes under some future regulation, without that regulation actually granting an exemption in the specific case.

3.3 Regulation 2790/99 – Market Share Ceiling for Exemption

Article 3(1)²⁰⁷ provides the market share ceiling test which determines whether a particular agreement merits to be exempted under the BER. The Commission’s premise, as expressed in recitals 8 and 9 of the Regulation, is that vertical agreements tend not to have serious anti-competitive effects where the parties do not have market power, and where the agreement itself does not contain a serious restriction of competition. Since market power is a nebulous concept, the Regulation instead uses market share as an indicator. Where the relevant market share does not exceed the thirty percent ceiling, the agreement is eligible for exemption, but above that level, there is no presumption that an agreement’s benefits outweigh its anti-competitive effects. Article

²⁰⁵ This third exception to Article 2(4) would appear to exclude from the scope of the BER most supply agreements between telecommunications operators relating, for example, to wholesale capacity.

²⁰⁶ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1 45

²⁰⁷ n.203 Art. 3(1)

9 sets out the modalities for calculating market share, and Article 9(2) provides marginal relief where the ceiling is exceeded.

This market share test answers one of the main criticisms of the former system of block exemptions. Previously, even agreements between powerful market players enjoyed the exemption, provided they conformed to the white-list structure prescribed by the various exemption regulations. The market share test under the BER is intended to prevent this anomaly, and to acknowledge commercial realities, although the Commission's choice of thirty percent as a ceiling has not been universally welcomed.²⁰⁸

The market share analysis under the BER does not extend to markets downstream of the immediate buyer in any circumstances, since the Commission²⁰⁹ takes the view that this market is simpler to evaluate, and that below the thirty percent ceiling any effects further downstream are likely to be 'limited'.²¹⁰ The Commission also recalls that the exemption may be withdrawn in the event that downstream effects indeed assert themselves. However, where the agreement concerns three or more parties each operating at different levels of trade, the Commission takes the view,²¹¹ that each of the relevant market shares at each level of trade should be less than the thirty percent ceiling if the agreement is to benefit from exemption. The principal difficulty with Article 3 is in applying the market share ceiling test in practice, since many undertakings simply do not have detailed information as to their own share of the market. Some guidance is available from the Commission, in the form of a Notice on

²⁰⁸ During the preparation of the BER, the Commission proposed a number of different market share ceilings, ranging from twenty to forty per cent, which might also have been combined with some analysis of the counter-competitive effects of individual agreements. This latter system would probably have been unworkably complex. While experts have welcomed the market share ceiling test generally, as more economically realistic than the old regulation, there is still some speculation that with the relatively low thirty percent ceiling, more vertical restraints could not have been exempted. See F.Wijckmans, F.Tuytschaever, and A.Vanderelst, *Vertical Agreements in EC Competition Law* (Oxford University Press 2006) 140

²⁰⁹ n.206 par.22

²¹⁰ This is however, not the case in respect of agreements which fall outside the BER

²¹¹ n.206 par.89

the definition of the relevant market for the purposes of Community competition law,²¹² and in the Guidelines.²¹³

The Commission²¹⁴ determines the relevant product market using the formulation usually applied by the Community Courts. This refers to demand-side substitutability ‘by reason of the products characteristics, their prices and intended use’.²¹⁵ The Guidelines²¹⁶ use the different SSNIPs test.²¹⁷ The two tests may indeed be functionally equivalent but to use two separate definitions for the same concept introduces an unnecessary degree of complexity and ambiguity.

Authors²¹⁸ conclude that either test may be complex to apply in practice. Since substitutability is judged by reference to the demand side, what is for the supplier one and the same product may, depending on the target purchaser, belong to different product markets. The Commission²¹⁹ says that where suppliers sell a ‘portfolio’ of products and the buyer regards that portfolio (and not the individual products of which it is composed) as substitutable, then the entire portfolio may determine the relevant product market. Conversely, where a supplier uses one agreement to distribute several different products, potentially differing market share for the respective products may mean that one and the same agreement falls inside the scope of the BER in respect of some products, but outside in respect of others.²²⁰

²¹² Commission Notice on the definition of the relevant market for the purposes of Community competition law [1997] OJ C372

²¹³ n.206

²¹⁴ n.206 par.90

²¹⁵ Case T-65/69, *Kish Glass v Commission*, [2000] ECR 1145, par. 62

²¹⁶ n.206 par.26

²¹⁷ Small but significant non-transitory increase in prices, sometimes called the “hypothetical monopolist” test. Take the obvious product, A, and hypothesise a small increase in its price relative to other products of about 5 to 10% that is expected to last. Then consider whether so many buyers would switch to other products as to make the increase unprofitable and whether so many suppliers would start making or expanding production of A as to make the initial price increase unprofitable. In either case the possibilities of substitution constrain the market conduct of A suppliers.

²¹⁸ D.O’Sullivan, S. Spinks, and P.M. Louis, *Competition Law of the European Community* (2nd edn Lexis Nexis London 2004) 8.07/43

²¹⁹ n.206 par.91

²²⁰ *ibid.* 68 & 69

There is also the problem, for suppliers operating across several relevant geographic markets, that their market share may be ‘patchy’.²²¹ In some markets the supplier may have low market shares for a product, clearly coming under the ceiling of the BER, while in others the share for the same product could be higher and may in fact exceed the threshold. This can create a loop-hole in the distribution system, where the supplier may not wish or be able to apply its standard-form contractual restrictions, for fear that they may infringe Article 81(1), and that they might not be capable of exemption. This has the rather absurd consequence that the supplier may protect buyers within the area where the market share is high from those without and not vice versa. Moreover if a particular distribution contract extends to an area greater than that of the loop-hole, that entire agreement may lose the benefit of the exemption. However it can be argued based on the Guidelines²²² that this loss should extend to the agreement only in so far as it relates to distribution within the geographical market upon which the thirty percent ceiling is exceeded. This would be consistent with the Commission’s treatment where a product falls within several product markets, on some of which the supplier’s share exceeds the ceiling.

The Commission²²³ asserts that the relevant geographic market comprises the area in which the conditions of competition are sufficiently homogenous and which can, on the basis of appreciably different conditions of competition, be distinguished from neighbouring geographic areas. In Article 1(a), however, the EU is regarded as a single unit, when determining the presence of competitors and potential competitors. In practice, this double-standard creates a problem for certain undertakings which supply the whole EU. It is submitted that if it is correct to treat the entire EU as a single playing-field when assessing (potential) competition, it should be so regarded when assessing market power. This would in all mitigate the problem for suppliers who find they have loop-holes in their distribution network, because of one national or regional market in which their share exceeds the threshold. Conversely, if the market share is truly local, why should vertical agreements with potential competitors in another

²²¹ J. Goyder, *EU Distribution Law* (4th edn Hart Publishing, Oxford 2005) 145

²²² n.206

²²³ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1 90

locality be thought to pose a competition problem, unless the supplier also has market power in the region in question?²²⁴

Given the complexity of the market share and market definition issue, it is important to note that in Guideline 65, the Commission says that it will not fine undertakings which have failed to notify an agreement because they assumed, in good faith, that they had not exceeded the thirty per cent market share ceiling. The Commission is still adhering to this policy²²⁵ even now that the notification procedure has been abolished. In borderline cases, firms and their advisors should therefore be aware of the need to generate sufficient appropriate documentation to evidence a good-faith mis-assessment. This does not, however, cure the risk that the agreement in question may still have been rendered (at least partly) unenforceable by Article 81(2).

3.4 Black List

Article 4 of the BER sets out the ‘black-list’ of restrictive clauses or practices the inclusion or exercise of which will prevent an agreement benefiting from exemption under the Regulation. The Commission, in Guideline 66, takes the view that the presence of black-listed clauses deprives the entire agreement from exemption. Although there is no legal presumption that black-listed clauses actually infringe Article 81(1), such restrictions are in practice seldom exempted in the context of Article 81(3) and the Commission refers to the black listed clauses as ‘hardcore restrictions’ on competition. The introductory words of Article 4 are broad enough to cover not only contractual provisions as such, but also other ‘factors under the control of the parties’ which mean that the object or effect of the agreement is to restrict competition. Some experts²²⁶ argue that the Commission seems to be moving towards an approach under which agreements or concerted practices having the ‘object’ of restricting competition are almost regarded *per se* violations of Article 81, while exemptions under Article 81(3) should be reserved for agreements or concerted practices which may have the

²²⁴ F. Wijckmans, F. Tuytschaever, and A. Vanderelst, *Vertical Agreements in EC Competition Law* (Oxford University Press 2006) 125

²²⁵ n.218 8.07/54

²²⁶ n.224

‘effect’ of restricting competition, where these effects can be shown to be off-set by pro-competitive efficiencies.

3.4.1 Severability

It is stated²²⁷ that exemption under Regulation 2790/99 ‘shall not apply’ to vertical agreements which have as their object, black-listed restrictions of competition. The Commission says that ‘there is no severability for hardcore restrictions’.²²⁸ Any black-listed clause, however minor or ancillary, takes the agreement of which it forms part outside the scope of protection under the BER. This raises a serious question of the legal construction of contracts, the importance of which increased when the Commission’s plans for modernising the administration of competition law were put into effect and more so now that national Courts and authorities are allowed to apply Article 81 in its entirety. In order to know whether a particular agreement can benefit from exemption, it must be first determined whether, properly construed, it has as its object a black-listed restriction. If the parties are cautious and expressly provide that no clause in their agreement is to be construed as, or have the effect of, a black listed restriction, can ‘suspect’ clauses then be overlooked or severed from the agreement as a whole? Even if the clause cannot be regarded as ineffective, or severed, the validity, as a matter of Community Law, of saying that there is no severability for hardcore restrictions is not beyond reproach.

There are no common European Community Law rules as to the severability of contractual provisions. It is settled in the case-law of the ECJ that the extent of any nullity under Article 81(2) is a question for national, not Community law.²²⁹ In determining questions of nullity or severability, national Courts are bound only by their general duty to facilitate the operation of Community Law.²³⁰ This allows them the freedom to determine on the basis of national law whether offending clauses may be

²²⁷ Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices [1999] OJ L336/21 Art.4

²²⁸ n.223 par.66 states that ‘If there are one or more hardcore restrictions, the benefit of the Block Exemption Regulation is lost for the entire agreement’

²²⁹ Case 319/82, *Societe de vente de ciments et betons de l’Est v. Kerpen & Kerpen*, [1983] ECR 4173.

²³⁰ Article 10 of the EC Treaty

severed, or whether the agreement as a whole is invalid. In considering a severability issue, the Courts of most Member States will refer to the common will or intention of the parties.²³¹ It is conceivable that prudent parties to a vertical agreement which otherwise satisfies the conditions for exemption under the BER might provide that:

- i) they intend their agreement to benefit from exemption under Regulation 2790/99
- ii) no provision of the agreement is to be understood as having the object or effect of a black-listed clause; and,
- iii) if any provision must, as a matter of proper construction, be regarded as equivalent to a blacklisted clause, then it should be treated as never having been incorporated in the agreement, and/or as having been implicitly replaced with a non-blacklisted clause of a similar purpose.

In these circumstances, there seems to be no reason why a national Court could not in future decide to treat the offending clause as either void *ab initio* or amended, and declare that the remainder of the agreement benefits from exemption either under Regulation 2790/99, or under Article 81(3). In favour of this approach is the fact that the wording of the black-list in the BER is relatively opaque and certainly leaves room for interpretation. Therefore, why deprive an agreement of the benefit of exemption where only an ancillary or severable clause is caught by the black list? Arguably, if the offending clause is, on proper construction, denied any legal effects and is unenforceable in Court, the policy objectives of the black list in Regulation 2790/99 are met.²³² Interestingly, the Commission agrees that obligations ‘grey-listed’ under Article 5 of the BER may be regarded as severable from the agreements in which they feature, and that the presence of such an obligation does not deprive the whole agreement of the benefit of exemption under Regulation 2790/99.²³³

²³¹ Whish Regulation 2790/99: The Commission’s ‘New Style’ Block Exemption Regulation for Vertical Agreements (2000) 37 CMLR 887,904

²³² It is however to be noted that the ECJ has held in Case 19/77 *Miller International Schallpatten GmbH v Commission* [1978] ECR I 1131/12 that a restriction of competition need not even have been put into effect in order to attract the prohibition in Article 81(1)

²³³ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1 67

The complexity of the severability issue means that in practice, a ‘belt-and-braces’ approach is called for. Parties and their advisors should try correctly to interpret the black-list, the grey-list and the Guidelines, and thereby to avoid including clauses in their agreements which might be construed as hardcore restrictions or non-exempted obligations under Article 4 and 5 respectively. In addition, prudence dictates that they include an express proviso to the effect that no clause incompatible with exemption under regulation 2790/99 is intended to form part of the agreement.

3.4.2 Resale Price Maintenance (RPM)

Article 81(1)(a) of the Treaty specifically prohibits agreements which ‘directly or indirectly fix purchase or selling prices or any other trading conditions’. Therefore in Regulation 2790/99 minimum or fixed RPM is blacklisted. This covers all behaviour on the part of the seller which is intended to constrain the buyer to resell the contract products at or above a certain price. The Guidelines²³⁴ give a useful list of provisions which are tantamount to price maintenance, including: fixing a distributor’s or buyer’s margin, capping possible discounts by the buyer, and linking sales prices to those of competitors. The Commission also refers to indirect measures and so-called ‘supportive’ measures, such as price monitoring and reporting schemes, the operation of which tends to indicate price maintenance. In Guideline 48, it further points out that prohibiting an agent from reducing its own commission in order to offer customer discounts also amounts to price maintenance.

The Commission, while acknowledging that the seller may recommend prices, or set maximum sale prices, says that similar supportive and indirect measures, if applied in conjunction with recommended or maximum prices, may amount to price maintenance. These according to the Guidelines²³⁵, include affixing recommended retail prices on the products, or requiring the buyer to offer most-favoured-customer clauses. This is a difficult question in practice, especially as regards advertising or recommended pricing carried out by franchisors or by retailers’ associations. An individual franchisee or retailer may be very loath indeed to depart from the advertised pricing structure. Does

²³⁴ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1 47

²³⁵ *ibid.* par.47

this mean that the collective advertising is coercive as regards pricing, and that it amounts to ‘pressure’ or ‘incentives’ on the buyer within the meaning of Article 4(a)?

Similarly, a recommended price printed on the product’s packaging is a two-edged sword at the consumer level. Should the consumer think that goods offered below an affixed recommended price are a bargain or that they are shoddy? Maximum prices are also treacherous territory for the supplier. If the market will bear it, retailers are likely consistently to raise prices up to a permitted level, in order to maximise their margin. Does this mean that the maximum price in fact operates as a fixed price? The answer to these issues is unclear. What is clear, however, is that the Commission is ready to apply a broad interpretation of what behaviour amounts to price maintenance. In fact the prohibition on price maintenance is rather a dogma of Community law. In the Guidelines, the Commission concentrates on two negative effects which it identifies: a reduction of intra-brand price competition, and increased transparency of prices.²³⁶ For economists however, there is not particularly compelling reason why competition on price could not just as well be replaced with competition, for instance, on service.²³⁷ EC Competition law, probably because of the wording of Article 81(1)(a), neglects to take into account that price-fixing may in fact be an efficient and pro-competitive restraint, depending on the product and the market in question.²³⁸

In its decision on Glaxo Wellcome’s Spanish distribution system, the Commission rejected novel economic arguments adduced to justify a dual pricing system for pharmaceuticals.²³⁹ Because Spanish State regulation maintains drugs prices at an artificially low level, Glaxo had notified to the Commission a system under which Spanish wholesalers were obliged to buy supplies destined for parallel export at a higher price than those destined for domestic consumption. Although there are compelling arguments to be made in favour of the proposition that such State measures

²³⁶ *ibid.* par.112

²³⁷ Z Biro and A Fletcher *The EC Green Paper on Vertical Restraints: An Economic Comment* (1998) 19 ECLR 129

²³⁸ Professor Korah remarks that the Commission has been averse to RPM since the 1960s. Short-form notification, for example, has only been available in cases where the parties certify that their distribution measures contain no RPM. Only under pressure from the antitrust parties of the American Bar Association did the Commission agree to permit maximum and recommended retail prices. See V.Korah, *Introductory Guide to EC Competition Law and Practice* (7th Edn. 2000 Oxford, Hart Publishing) 2.6.1

²³⁹ Press Release IP/01/661 of 8th May 2001

distort the Common Market far more than any anti-competitive restraint implemented by a particular manufacturer, the Commission took the position that protecting the possibility of arbitrage by parallel traders is paramount and dismissed the economic arguments as unfounded. Since the system had been notified, the Commission could not impose a fine, but it ordered Glaxo to bring the dual-pricing system to an immediate end.²⁴⁰

The *Glaxo* case is a reminder that the Community Courts and the Commission continue to regard RPM as a hardcore anti-competitive behaviour, and it is thus best avoided entirely. Parties and their advisors must therefore consider their business activities carefully, to be sure that they are not maintaining prices either directly or indirectly and moreover, that they are not seen so to be doing. Furthermore, it is submitted that caution should be exercised even in operating the permitted recommended-price and maximum-price restrictions, in order to avoid arousing suspicion of clandestine or *de facto* price fixing.²⁴¹

3.4.3 Territorial and customer restrictions

Article 4 continues that:

The exemption provided for in Article 2 shall not apply to vertical agreements which directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object:

(a) the restriction of the territory into which, or of the customers to whom, the buyer may sell the contract goods or services, except:

Article 81(1)(d) prohibits agreements which ‘share markets or sources of supply’. The Commission and (to a lesser extent) the Community Courts have traditionally treated agreements seeking to confer territorial exclusivity as caught by this provision.²⁴² The

²⁴⁰ Although it is not directly mentioned in the Commission press release, Glaxo presumably could not rely on CFI’s new *Bayer/Adalat* doctrine that unilateral restrictions of competition imposed by a supplier escape the prohibition in Article 81(1), since the Spanish wholesalers had signed the new sales conditions.

²⁴¹ n.231

²⁴² Case 19/77 *Miller International Schallplatten GmbH v Commission* [1978] ECR I-1131

black list in the Regulation, therefore generally does not allow market-sharing or market partitioning agreements to benefit from exemption, except in four narrowly-defined cases, discussed below.

Attempts to prevent parallel traders from buying and selling freely within the EEA also amount to market-partitioning territorial restrictions.²⁴³ According to Guideline 49, certain obligations clearly amount to hardcore market partitioning, and their inclusion in an agreement will always preclude its exemption under the BER. The Commission mentions direct obligations, such as not selling to certain customers or territories, and the re-direction of orders to certain distributors, depending on the customer's location. Indirect measures which aim at market partitioning are also likely to be hardcore restrictions, such as refusal or restriction of supply based on distributor location, non-implementation of an EEA-wide guarantee,²⁴⁴ or threats addressed to distributors who do not abide by a partitioning scheme. The use by the supplier of monitoring schemes to verify the destination of goods is also likely to be seen as a measure supporting a restriction on the buyer's subsequent sales. Certain restrictions may, however, not be regarded as 'hardcore' if they are objectively justified, and apply impartially to supplier and buyer alike. The Commission gives the example of a general prohibition on reselling dangerous goods to certain inappropriate customer groups.

Article 4(b) first indent allows:

the restriction of active sales into the exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another buyer, where such a restriction does not limit sales by the customer to the buyer.

A limited degree of territorial or customer-group partitioning is possible, without losing the benefit of exemption under the BER. Relying on the first indent of Article 4(b), a supplier can presumably use a properly-structured distribution system to afford its buyers some, albeit weak, degree of territorial or customer exclusivity, at least as against active sales from the supplier itself or from other buyers. If the supplier reserves

²⁴³ Press Release IP/01/661 of 8th May 2001

²⁴⁴ Press Release IP/00/684 of 29th June 2000

a customer group or territory to itself, or to a buyer, it can contractually restrict all its other buyers from actively supplying the reserved group or territory. However the protection is weak because the supplier can restrict only sales made by its direct purchasers, not subsequent behaviour on the part of a purchaser's customers. In any event the supplier can restrict only active sales.²⁴⁵

It is less clear whether territorial protection can be afforded to a licensee. If the primary object of the agreement is the licensing of intellectual property, then under Article 2(3) it does not qualify for exemption under this Regulation. On the other hand if the agreement is not a bare IP license, and it relates to the 'conditions under which the parties may purchase, sell or resell' goods or services, then the words in Article 4(b) are probably broad enough to cover territorial or customer exclusivity conferred on a licensee-buyer.²⁴⁶ A distinction still needs to be made between pure licensing arrangements under the technology transfer block exemption²⁴⁷ and sales arrangements under Regulation 2790/99. Licensing agreements which come within the scope of the former may contain provisions restraining active and passive sales by the licensees into countries reserved by the licensor.²⁴⁸ However the protection of these licensees from the buyers under Regulation 2790/99 in other countries is arguably not provided for by Article 4(b), since the licensees are not 'buyers' to whom an exclusive territory or customer group is reserved. The protection is therefore asymmetric – buyers can be protected from sales by licensees, but not *vice versa*.

The exclusivities must be allocated, by reference either to geographical territory or to an intended customer group. The concept of reserved 'exclusive customer group' allows a supplier to differentiate between different types of purchasers. A supplier of pharmaceuticals, for instance, might wish to distinguish sales to hospitals from sales to retail pharmacies, and also to distinguish human-medical from veterinary supplies.

²⁴⁵ V.Korah, *Introductory Guide to EC Competition Law and Practice* (7th Edn. 2000 Oxford, Hart Publishing) 2.6.1

²⁴⁶ Professor Korah notes that certain products are not traded in the traditional sense, but are supplied under license as "bespoke" items to a particular user (ex. Speciality chemicals). In this case, it may be important to be able to prevent the buyer / licensee from reselling. (ibid)

²⁴⁷ Commission Regulation (EC) 772/2004 on the application of 81(3) of the Treaty to categories of technology transfer agreements [2004] OJ L 123/11

²⁴⁸ Korah, *Technology Transfer Agreements and the E.C. Competition Rules*, Oxford University Press, 1997 36

Similarly, a manufacturer of computers may wish to sell directly and in bulk to large companies, but prefer to supply the domestic user through wholesalers and/or retailers. A supplier may appoint both an exclusive-territory buyer and an exclusive-group buyer in respect of one and the same geographical area, or may combine both exclusivities in one buyer.²⁴⁹

The Commission²⁵⁰ says that a territory or customer group (hereinafter a ‘target market’) is exclusively allocated only when the exclusive distributor in question is protected against active selling by the supplier and all the supplier’s other buyers inside the Union. This does not follow from the wording of the Article, which on the face of it, does not preclude the supplier from allocating a particular buyer a target market which would be protected as against some, but not all other buyers. Indeed this may have to be the case where the supplier has a market share exceeding thirty percent in one or more target markets, and therefore cannot rely on Regulation 2790/99 in order to restrain buyers in those markets from active sales in other territories. Experience with the provision in practice has shown that suppliers usually allocate all target markets either exclusively, or reserve them to themselves, leaving none unaccounted for. This approach allows for staggered roll-out of products to target market in respect of which the supplier does not yet have a distributor, prevents a ‘patchy’ distribution network and, importantly, enables the supplier to reserve prime targets to itself, thus cutting out the middle-man and maximising profits on those sales.

i) Active and Passive Sales

Regulation 2790/99 is unequivocal, and the Commission is also adamant that the exclusivity afforded by a supplier to its buyers protects only against active sales from the supplier or from other buyers to whom an exclusive target market has been allocated. The Commission interprets active and passive sales as follows:

‘Active sales’ mean actively approaching individual customers inside another distributor’s exclusive territory or exclusive customer group by for instance direct mail or visits; or actively approaching a specific

²⁴⁹ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1 50

²⁵⁰ *ibid.*

customer group or customers in specific territory allocated exclusively to another distributor through advertisement in media or other promotions specifically targeted at that customer group or targeted at customers in that territory.

‘Passive sales’ mean responding to unsolicited requests from individual customers including delivery goods or services to such customers. General advertising or promotion in media or on the Internet that reaches customers in other distributor’s exclusive territories or customer groups but which is a reasonable way to reach customers outside those territories or customer groups, for instance to reach customers in non-exclusive territories or in one’s own territory, are passive sales.²⁵¹

ii) Internet Sales

The growth of the internet as a medium for commerce has effectively re-defined active and passive selling, and has serious consequences on the notion of distributor exclusivity. The Commission, influenced by its own ‘Information Society’ and ‘eEurope’ internal market programmes, seems to take the position that the distributed and increasingly ubiquitous nature of access to the internet creates not only marketing opportunities for sellers but also increases price transparency, comparability and choice for buyers and end customers.

The Guidelines²⁵² state that ‘every distributor must be free to use the internet to advertise or sell products’, and the Commission therefore generally treats internet advertising and selling as passive sales behaviour, not infringing the exclusivity of reserved or allocated targets, since the internet is a ‘reasonable way to reach every customer’.²⁵³ The supplier may however require the buyer to respect quality standards in its internet presentation, so as not to mislead the customer or to detract from the supplier’s brand name or image. Such a requirement arguably falls outside Article 81(1)

²⁵¹ *ibid.* par.50

²⁵² *ibid.* par.51

²⁵³ Authors hold that the Commission takes the view that the language used on the seller’s website or in its communications with the customer does not play a role in indicating whether internet selling is in fact targeted at reserved or allocated customer targets. D.O’Sullivan, S. Spinks, and P.M. Louis, *Competition Law of the European Community* (2nd edn Lexis Nexis London 2004) 8.07/56

entirely²⁵⁴ and including reference to ‘internet visual identification guidelines’ in distribution contracts is becoming standard practice.

In practice the Commission’s insistence on freedom of internet use means that even distributors to whom an exclusive target market has been allocated cannot be protected from internet selling carried on by other buyers or by the supplier itself. This considerably undermines the concept of ‘exclusivity’ and one might ask whether that term is still relevant at all.²⁵⁵ At least in the case of products which can be readily bought and sold at a distance and in relation to internet-connected customers, real exclusivity is no longer available. Alternative sources of supply are only a click away. The customer’s bargaining position, even vis a vis local distributors, is considerably strengthened by ready access to transparent comparison via internet.

It is to be acknowledged that the Commission assimilates selling by catalogue to the internet selling and ‘the same considerations apply’.²⁵⁶ Arguably, however the question of the language in which a catalogue is published must be more significant than in the case of a website when determining whether selling is active or passive. Clearly a catalogue needs to be physically brought to the potential customer for it to be of any effect. If a distributor in Ireland produces Greek-language mail-order catalogues, which find their way to Greece, it is fairly obviously attempting to encroach on the exclusivity afforded to its Greek counterpart by their common supplier. On the other hand, if a Greek customer browses the internet to the Irish distributor’s site, and orders there, the Irish distributor’s behaviour is considerably less active.²⁵⁷

Article 4(b) second indent allows:

²⁵⁴ By analogy to the qualitative restrictions found compatible with Article 81 in Case 26/76 *Metro SB-GroBarkte GmbH & Co. KG v Commission* [1977] ECR I-1977 (selective distribution) and Case 161/84 *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 353 (franchising).

²⁵⁵ Some commentators have suggested that internet sales might theoretically be regarded as a separate market, which could be assigned exclusively to a distributor, or reserved to a supplier. This proposition is clearly contrary to the Commission’s position as expressed in the Guidelines and is unlikely to be permitted in practice. n.98

²⁵⁶ n.249 par.51

²⁵⁷ D.O’Sullivan, S. Spinks, and P.M. Louis, *Competition Law of the European Community* (2nd edn Lexis Nexis London 2004) 8.07/55

restrictions of sales to end users by a buyer operating at the wholesale level of trade

This makes it possible for an agreement to restrain a wholesaler from making retail sales without thereby losing the BER benefit. This is probably a reflection of certain national competition law, particularly Germany which differentiate between the conditions for wholesale and retail sales. The principle has been acknowledged in some judgements of the ECJ.²⁵⁸

Although this provision has clearly been accepted, it is difficult to see what competition-law purpose it serves, other than allowing conformity with certain national legal tendencies.²⁵⁹ In most countries, the fact that a buyer ‘operates at the wholesale level’ does not necessarily preclude that undertaking from also operating as a retailer. Reinforcing the distinction, by specifically exempting such a restriction from the BER’s black-list probably runs against the current of commercial practice, in which the difference between large cut-price retailers and traditional wholesalers is becoming increasingly faint and unimportant. It is arguable that prolonging the general wholesale / retail distinction in fact deprives the final customer of access to certain goods at the near-wholesale prices which bulk retailers can achieve.

It is not clear from the Regulation or the Guidelines whether a supplier can prevent a wholesaler with an internet presence from selling to retail customers through the internet. Some experts²⁶⁰ take the view that a supplier could at least require its wholesalers to distinguish between wholesale and retail internet customers in some way. This might take the form of separate web-sites for wholesale and retail customers, or some system of wholesale-status verification, such as a minimum-order-size requirement or the submission of a VAT registration number with orders.

Article 4(b) third indent allows:

²⁵⁸ Case 26/76 *Metro v Commission* [1977] ECR 1875 / par.28-29

²⁵⁹ M Mendelsohn and S Rose *Guide to EC Block Exemption for Vertical Agreements* (International Competition Law Series Vol.4 Kluwer Law International The Hague 2002) 88

²⁶⁰ Vajda & Gahnstrom, *Competition Law and the Internet*, [2000] ECLR 94 and Burrichter, *Vertical Restraints and E-Commerce*, Fordham Law Institute. October 2000.

the restriction of sales to unauthorized distributors by the members of a selective distribution system

This makes it possible for suppliers operating a selective distribution system to prevent leakage of products to non-authorized distributors, without their agreements thereby losing the benefit of exemption under the BER. Such restriction is clearly compatible with the existing case-law on selective distribution and either does not infringe Article 81(1) at all, or merits exemption under Article 81(3), since preventing unauthorized or unsuitable distributors from getting access to the protected product is at the heart of a selective system. It is helpful however, that this restraint has been explicitly listed as an exception to the black-list.

The restraint of sales to unauthorized dealers raises an interesting and delicate question of whether the operator of a selective distribution system may legitimately take measures to identify and track products, and to sanction distributors who sell outside the network. If it is permissible to operate selective distribution, some means of controlling the integrity of the system is necessary. The Commission does not give any specific guidance on what type of tracking measures or sanctions might be acceptable. However one might reasonably construe that at least some of the ‘supportive measures’ referred to in the Guidelines²⁶¹ in the context of price-maintenance would be appropriate. In the *Metro* case, the ECJ accepted that:

To be effective, any marketing system based on the selection of outlets necessarily entails the obligation upon wholesalers forming part of the network to supply only appointed resellers and, accordingly, the right of the relevant producer to check that that obligation is fulfilled.²⁶²

The ‘checking’, however, must be ancillary to the selectivity inherent in the distribution system. In its decisions, the Commission has pointed out that a monitoring system which is simultaneously used to discourage or sanction parallel trading as between authorized dealers is not acceptable.²⁶³

Article 4(b) fourth indent allows:

²⁶¹ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1 47

²⁶² Case 26/76 *Metro v Commission* [1977] ECR 1875, par. 27

²⁶³ *Hasselblad* [1982] OJ L161/18

the restriction of the buyer's ability to sell components, supplied for the purposes of incorporation, to customers who would use them to manufacture the same type of goods as those produced by the supplier

The final customer retraction which is explicitly set out as an exception to the black-list and which may therefore be operated without disqualifying a distribution agreement from exemption, is that imposed by a supplier-manufacturer of goods. The supplier may prevent its buyers from re-selling the components to a third party who would use them to make competing product. This seems reasonable, since if a manufacturer is not itself obliged to supply input to its competitors, it should also be able to prevent such supply taking place through its distributors. This may take the form of appropriate and proportionate 'supportive' measures to identify and track component leakage, and to sanction buyers who sell-on to competitors.

The fourth indent of Article 4(b) is considerably narrower than the formulation which the Commission adopted in its draft for the vertical restraint regulation. That allowed 'restrictions on resales of goods or services which are supplied for the purposes of incorporation' generally. This would have made it possible for a buyer to prevent the manufacturer-supplier of components from supplying them to other prospective buyers. However, creating such a separation between the OEM channel and the reseller channel is not possible under the final version of Regulation 2790/99.²⁶⁴ It is not clear to what 'depth' the original supplier may apply the restriction. The wording of article 4(b) seems to indicate that it is the first buyer who is expected to incorporate the components. If this buyer chooses instead to re-sell the products, then he may be prohibited from selling to his supplier's competitors. Whether he may be contractually required to attach a similar restriction to his own sales downstream is not certain, although logic would indicate that components, merely by passing through the hands of several purchasers, are not thereby in some way 'cleansed' of the shadow of unfair competition, vis a vis the original manufacturer's other products. The Commission has not offered any guidance in this regard.

²⁶⁴ M Mendelsohn and S Rose *Guide to EC Block Exemption for Vertical Agreements* (International Competition Law Series Vol.4 Kluwer Law International The Hague 2002) 56

3.4.4 Restrictions on sales by members of a selective distribution system

Article 4(c) excludes from exemption agreements which include:

the restriction of active or passive sales to end users by members of a selective distribution system operating at the retail level of trade, without prejudice to the possibility of prohibiting a member of the system from operating out of an unauthorized place of establishment.

Article 4(c) provides that restrictions on active or passive retail sales to end users by members of a selective distribution system will deprive agreements of the exemption under Regulation 2790/99. This is consistent with the case-law on selective-distribution, which has held that the purpose of the system is to govern the circumstances under which certain types of products are sold, and by whom they are sold, rather than to afford the supplier a means of controlling which retail customers can obtain the products.²⁶⁵ Selective distribution under the BER cannot therefore be used as a back-door method of customer selection.

In the Guidelines,²⁶⁶ the Commission interprets Article 4(c) as meaning that the members of a selective distribution system may not be restricted in the customers to whom they sell, whether those customers be ‘professional end-users’ or ‘final consumers’ or indeed purchasing agents acting on behalf of such end-users. The same Guidelines add that dealers who are members of a selective distribution system network should be free to advertise and sell via internet.²⁶⁷ The Commission further says that ‘selective distribution may be combined with exclusive distribution provided that active and passive selling is not restricted anywhere’.²⁶⁸ In practice, Article 4(c) means that undertakings drafting a retail exclusive-distribution agreement including a customer limitation clause must ensure that it cannot be interpreted as being part of a selective distribution system within the meaning of Article 1(d) otherwise the whole agreement will lose the benefit of exemption under the BER.

²⁶⁵ On selective distribution generally see Chapter 5

²⁶⁶ n.261 par.53

²⁶⁷ *ibid.*

²⁶⁸ *ibid.*

i) **Location Clauses**

Article 4(c) takes effect ‘without prejudice to the possibility of prohibiting a member of the [selective distribution] system from operating out of an unauthorized place of establishment’. In other words, the operator of the selective distribution system may confine authorized dealers to operate out of approved outlets. This is usually achieved through a so-called ‘location clause’ in the agreement, which identifies the premises the dealer will use as shop or showroom, and prohibits him from carrying on sales elsewhere. This is explained in brief in the Guidelines.²⁶⁹

The use of a location clause to ensure that the dealer operates from premises suited to the products to be sold is a standard feature of selective distribution and franchising agreements, especially those concerning luxury goods. It may be justified as a purely qualitative restriction, aimed at preserving the image of and goodwill in the product or service being distributed. As such, it normally falls outside the prohibition in Article 81(1) entirely. A location clause may however, also be used by a supplier to operate quantitative restriction on the number of authorized dealers, or on the density of authorized outlets. A location clause used quantitatively is usually treated by the Commission and the ECJ as falling within the ambit of Article 81 but meriting exemption under 81(3) where it is applied objectively, proportionately and without discrimination.²⁷⁰ Under Regulation 2090/99, selective distribution systems based on qualitative and quantitative criteria are exempted, as long as the supplier’s market share does not exceed the thirty percent threshold.²⁷¹

However the wording of Article 4(c) has given rise to a practical problem with location clauses. It is not clear from the Regulation or the Guidelines whether such a clause can be used absolutely to prevent a dealer opening additional sales outlets. This is a particular difficulty in circumstances where the proposed new outlet meets the supplier’s objectively-justified qualitative standards, or where the new outlet would be located in a Member State other than that in which the dealer currently operates, since

²⁶⁹ n.261 par.54

²⁷⁰ Case 26/76 *Metro v Commission* [1977] ECR 1875

²⁷¹ n.261 par.186

to prohibit the new outlet would necessarily also have the effect of restricting active sales and/or cross border sales. Assuming that the supplier's market share does not exceed the thirty percent, is the supplier then obliged to agree to the opening of an additional outlet by an approved dealer in an area where the quantitative limit set by the supplier is reached?

Officials at the Commission's Directorate-General take the view that location clauses are a derogation from the basic prohibition on restricting active and passive sales in selective distribution systems, and those clauses would most likely be construed narrowly by the Commission.²⁷² A location clause cannot be used absolutely to limit a buyer to one premises where it proposes another premises which meets the objective qualitative criteria in the clause, even if the second premises is outside the buyer's allocated territory. The position therefore seems to be that a location clause can only be used to ensure compliance with objectively justified qualitative criteria, and not as a means to prohibit active sales.

Until the Commission issues official guidance on this point, the most compelling explanation is that when a selective supplier's market share does not exceed thirty percent, and in the absence of network effects, the supplier would not be obliged to permit an approved dealer to open an additional outlet if the supplier objects on quantitative criteria which are not entirely arbitrary and/or disproportional. The quantitative restriction would be subject to the Commission's understanding of permissible restriction generally being derogations from the principle of unrestricted sales. This would therefore not be justified where the restriction has a bare quantitative effect (for instance where its only function is to reduce supply and increase prices), rather than having some element of objective justification (such as making the number of outlets proportional to the available customer base, without flooding a particular local market, thereby undermining investments by existing retailers). The Guidelines²⁷³ indicates that quantitative restrictions must be set in proportion to the target market, and will be most likely to be accepted where the retailer is also free to sell competing brands.

²⁷² n.261 par.61

²⁷³ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1 197

3.4.5 Restriction on cross-supplies between selected distributors

Article 4(d) excludes from exemption agreements which include:

the restriction of cross-supplies between distributors within selective distribution system, including between distributors operating at different levels of trade

If the system of selective distribution is to benefit from the exemption under Regulation 2790/99, all the authorized members must remain free to buy and sell actively and passively between each other. This means that authorized retailers may source goods from authorized wholesalers or from other authorized retailers, and that authorized wholesalers in countries with low prices may supply their counterparts in higher-priced countries by way of parallel trading. The ability to cross-sell is derived from principles in the *Pronuptia* judgement,²⁷⁴ and makes it difficult for suppliers to discriminate significantly on prices as between authorized buyers. In the Guidelines,²⁷⁵ the Commission points out that selective distribution, if it is to benefit from the BER, cannot be combined with restraints which are aimed at fixing a source from which distributors may acquire products. This effectively rules out the combination of selective distribution and exclusive purchasing.

3.4.6 Restrictions on buyers of components

Article 4(e) excludes from exemption:

The restriction agreed between a supplier of components and a buyer who incorporates those components, which limits the supplier to selling the components as spare parts to end-users or to repairers or other service providers not entrusted by the buyer with the repair or servicing of its goods.

The meaning of the English language version of this Article is opaque, because the supplier is limited to selling components. Fortunately, the Guidelines²⁷⁶ are clearer. The

²⁷⁴ Case 161/84 *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 353

²⁷⁵ n.273 par.55

²⁷⁶ n.273 par.56

provision is in fact supposed to withhold exemption from agreements by which a buyer of components seeks to prevent those parts being made available to downstream users other than through the buyer's own network. Article 4(e) could instead read 'the restriction...which limits the supplier in selling the components...'

Even read as corrected, the provision is rather dense, It may be helpful to note that it most likely stems from a particular problem in the automotive industry, where powerful vehicle manufacturers have sought to prevent the companies from which they buy components (such as batteries, light-bulbs, spark plugs and so on) from independently selling these same goods into the after-market DIY and independent repairers. The manufacturer hoped thereby to maximise sales of the branded replacement components, and to bolster servicing and spare-parts revenues within their own authorised repair networks. Guideline 56 makes it clear that agreements which provide for such a restriction on sales by component manufacturers, either directly or indirectly cannot benefit from exemption under the BER. That Guideline also points out that restraining the component supplier from releasing necessary technical information or equipment into the aftermarket is an indirect measure also black-listed by Article 4(e). Measures aimed at requiring authorized repairers to buy replacement part only through channels approved by the original equipment manufacturer are not, however caught by the Article.

3.5 'Grey' Obligations – Article 5

Article 5 states that:

The exemption provided for in Article 2 shall not apply to any of the following obligations contained in vertical agreements

Article 5 contains a 'grey-list' of obligations which, if they appear in a vertical agreement, otherwise covered by Regulation 2790/99, will not benefit from exemption.²⁷⁷ Unlike the black-list in Article 4, it is not the entire agreement which

²⁷⁷ Many of the obligations dealt with in Article 5 concern so-called "single-branding". Under the *Delimitis* and *Pronuptia*, lines of case-law, some such obligations can, in certain circumstances escape the prohibition in Article 81(1) entirely, because they are either of limited effect, or because they are necessary for the operation of a pro-competitive distribution system.

loses exemption, but only specific obligations.²⁷⁸ This raises the issue of whether grey-listed obligations are severable from other provisions of an agreement. If not, and if the single-branding is not saved by the *Delimitis*²⁷⁹ or *Pronuptia*²⁸⁰ doctrines²⁸¹, then the whole agreement will be deprived of exemption under the BER. In practice, few single branding agreements would be expected to be caught by Article 81(1).

3.5.1 Non-Compete obligations

Article 5(a) grey-lists:

any direct or indirect non-compete obligation, the duration of which is indefinite or exceeds five years. A non-compete obligation which is tacitly renewable beyond a period of five years is to be deemed to have been concluded for an indefinite duration. However, the time limitation of five years shall not apply where the contract goods or services are sold by the buyer from premises and land owned by the supplier or leased by the supplier from third parties not connected with the buyer, provided that the duration of the non-compete obligation does not exceed the period of occupancy of the premises and land by the buyer

A ‘non-compete obligation’ is defined in Article 1(b), and means a provision which restricts the buyer from manufacturing, purchasing, selling or reselling products which compete with those of the supplier, or which requires the buyer to purchase more than eighty percent of its annual requirements of the contract products and their substitutes from the seller or from his nominee.²⁸²

Article 5(a) withholds exemption from a blanket obligation not to manufacture or sell competing goods or services, referred to in the Guidelines as ‘Single Branding’. This covers an obligation which directly requires the buyer to meet more than eighty percent of its needs for the supplier or from his nominee. It also covers any indirect restriction

²⁷⁸ n.273 par.57

²⁷⁹ Case C-234/89 *Delimitis (Stergios) v Henninger Brau* [1991] ECR I-935

²⁸⁰ Case 161/84 *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 353

²⁸¹ Under *Delimitis*, single branding will only infringe Article 81(1) if, having regard to its economic and legal context, it hinders access to the market or renders it difficult to increase existing market share. Under *Pronuptia*, certain restraints may fall outside the prohibition in Article 81(1) where they are ancillary to a pro-competitive transaction.

²⁸² The 80% test is applied to the buyer’s requirements in the year preceding conclusion of the contract. According to Guideline 58, if no relevant data is available for that period, the buyer’s best estimate of its annual total requirements may be used.

which prevents or discourages the buyer from purchasing products competing with those of the supplier entirely, or which limits such purchases to twenty percent or less of the buyer's needs. If the seller specifies a minimum purchase requirement by reference to value or numbers of units for instance, and this exceeds four-fifths of the buyers' relevant purchases, the obligation will still fall foul of this Article. The definition of non-compete obligation covers in large part what was formerly known as exclusive purchasing.

Non-compete obligations whose duration does not exceed five years, or which are not tacitly renewable beyond a five-year period are not caught by Article 5(a). In other words, such obligations should be expressed to run for five years or less, and should not be made automatically renewable, if they are to benefit from the exemption. According to Guideline 58, obstacles under the seller's control which effectively hinder the buyer from terminating the obligation after the five-year period, such as a tied loan or equipment, may take the non-compete clause outside the exemption under Article 81(3). There is a derogation from the five-year rule in the specific case where the supplier owns or leases out the premises used by the buyer. This is particularly important in the case of beer supply agreements between breweries and their tenant publicans, and petrol filling station 'solus' agreements, which normally include exclusive or semi-exclusive supply obligation of long duration.²⁸³

3.5.2 Post-term non-compete obligations

Article 5(b) grey-lists:

any direct or indirect obligation causing the buyer after termination of the agreement, not to manufacture, purchase, sell or resell goods or services, unless such obligation:

- relates to goods or services which compete with the contract goods or services, and
- is limited to the premises and land from which the buyer has operated during the contract period, and

²⁸³ V.Korah and D.O'Sullivan, *Distribution Agreements under EC Competition Rules* (Hart Publishing, Oxford 2002) p. 180-186

- is indispensable to protect know-how transferred by the supplier to the buyer, and provided that the duration of such non-compete obligation is without prejudice to the possibility of imposing a restriction which is unlimited in time on the use and disclosure of know-how which has not entered the public domain

Article 5(c) withholds exemption from post-term non-compete obligations on the buyer. However, there is a derogation under which indispensable obligations aimed at protecting the supplier's know how, may be exempted under the BER where their duration does not exceed one year, where they relate to the contract products or their substitutes, and where they are limited to the location in which the buyer operated under the contract. This does not however, prevent the supplier from taking measures to protect the confidentiality of know how for an indefinite period. In the *Pronuptia* judgement,²⁸⁴ the ECJ indicated that post-term non-compete obligations would be justified for a reasonable period after expiry of a franchise agreement.²⁸⁵

3.5.3 Supplier Boycotts

Article 5(c) grey lists:

any direct or indirect obligation causing the members of a selective distribution system not to sell the brands of particular competing suppliers.

This deals with measures aimed at establishing a targeted collective boycott operated through a selective distribution system. The BER exempts selective distribution which is combined with a general prohibition on dealers' selling competing brands, but Article 5(c) expressly denies exemption for practices by which a supplier singles out the products of specific competitors, and prevents its authorized dealers from selling those products. In Guideline 61, the Commission says that this is intended to prevent the situation where several suppliers connive at foreclosing access to their common selected outlets vis a vis a common competitor.

²⁸⁴ Case 161/84 *Pronuptia* [1986] ECR 353/16: what is reasonable period will depend on the individual case. There is no reason why, in appropriate circumstances, this reasonable period may not be longer than one year mentioned in Article 5(b) of the BER.

In the Guidelines²⁸⁶ the Commission takes the view that a boycott clause which falls outside the scope of the exemption under Regulation 2790/99 would also not benefit from individual exemption under Article 81(3) in circumstances where the aggregate market share of the five leading market players exceed fifty percent, unless the supplier in question is not one of the top five.

3.6 Individual withdrawal by the Commission

Particular agreements which, on the face of them, satisfy the conditions set out in Regulation 2790/99 may nonetheless be formally stripped of their exemption by the Commission where it determines that the requirement of Article 81(3) are not fulfilled. According to Guideline 71, the Commission will be particularly vigilant in respect of agreements which fail to ensure that final consumers share in the benefits brought by the restraints on competition.

As a matter of procedure, and because there is a presumption that agreements complying with the Regulation come under Article 81(3), the Commission bears the burden of proving that all four conditions for exemption are not being met.²⁸⁷ The Commission normally combines withdrawal of an exemption with a finding that the agreement in question is prohibited by Article 81(1). However, a withdrawal is effective only from the date it enters into force, and does not retroactively render void an agreement since its inception. The withdrawal option has long been a feature of block exemption regulations, but it is very seldom used, and then only in serious cases, where there is a clear infringement. To the knowledge of the current writer, there is only one²⁸⁸ reported instance where the Commission has actually withdrawn the benefit of the BER, since in most cases where a withdrawal is contemplated, the parties will, by negotiation, amend their agreement in order to allay the Commission's concerns.

²⁸⁶ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1 192

²⁸⁷ n.273 par.72

²⁸⁸ Case C-275/95P *Lagnese-Iglo GmbH & Co. KG v. Commission* [1998] ECR I-5609

3.7 Cumulative effect of parallel networks of vertical restraints

This phenomenon comes about where competing suppliers or buyers operate distribution systems containing similar restrictions of competition. In the Guidelines²⁸⁹ the Commission indicates the kind of restraints which would be expected to give rise to network effects.²⁹⁰ Following the ECJ's decision in *Demilitis*, the Commission can only attribute responsibility for network effects to those undertakings whose contribution to the overall foreclosure is 'appreciable'.²⁹¹ Therefore, if a market is covered and foreclosed by many agreements and a particular undertaking is a party to only a few of them, that undertaking and those few agreements may escape withdrawal.

The *Delimitis* judgement²⁹² has been further refined by the ECJ in the *Neste* case.²⁹³ There the buyer sought to avoid an action for damages for breach of contract on the ground that its exclusive purchasing agreement was contrary to Article 81(1), and therefore void. In its reference, the national Court called for clarification of *Delimitis*. The buyer's agreement was only one out of several exclusive supply agreements entered into by the supplier. Most of these agreements however, were of a long fixed duration, while that of the buyer was terminable upon one year's notice by the retailer.²⁹⁴ In these circumstances, the agreement in question accounted only for a small proportion of the overall market partitioning effect. The national Court asked whether the individual agreement could therefore be regarded as making only an insignificant contribution to the cumulative market foreclosure and thus not affected by the prohibition in Article 81(1).

The ECJ found that exclusive purchasing agreements for fuel are different from agreements relating to other goods, because service-stations stock only one brand of fuel,²⁹⁵ and because of the considerable investment necessary on the part of the supplier

²⁸⁹ n.273 par.73

²⁹⁰ The Commission's methodology for analysing such restraints is set out in more detail in Guidelines 104 to 114.

²⁹¹ n.272 par.74

²⁹² Case C-234/89 *Delimitis (Stergios) v Henninger Brau* [1991] ECR I-935

²⁹³ Case C-214/99 *Neste Markkinointi Oy v Yutuuli Ky and Others* [2001] 4 CMLR 27

²⁹⁴ In fact Neste's contract seems to have been for ten years certain, renewable annually thereafter. At the time the ten year period had already expired.

²⁹⁵ n.273 par.30

to adapt sales point to the image of the brand to be sold.²⁹⁶ The duration of such contracts is, therefore of more fundamental importance than the exclusivity which they offer, and this duration is the decisive factor in foreclosing the market.²⁹⁷ The Court held that a one-year notice period for termination of the supply agreement sufficiently protects the respective parties' interests and limits restrictive effects on the market for fuel distribution.²⁹⁸

The novel element of the Court's judgement lies in its acceptance of the proposition that the economic market assessment required under *Delimitis*, can exceptionally, be carried out selectively according to various categories of contract entered into by a particular supplier.²⁹⁹ Where the exclusive supply agreement in question is terminable by the retailer upon a year's notice and where exclusive supply agreements have an appreciable market foreclosing effect, but most other agreements of this kind are concluded for a fixed term of more than one year, the individual agreement in question will not be caught by the prohibition in Article 81(1).

This ruling suggests that certain contracts, even within a network of parallel agreements the overall effect of which is to foreclose a market, can be economically distinguished from the suppliers' other agreements by having regard to their insignificant impact on competition. Such agreements which are less harmful than the 'average' contract, can escape the prohibition in Article 81(1) entirely. In *Delimitis*,³⁰⁰ the ECJ ruled that the agreement would infringe Article 81(1) only if two conditions, including that of appreciable effect were met. The *Neste* agreement fell outside that prohibition altogether. In neither circumstance would Article 6 of Regulation 2790/99 apply to permit the Commission to withdraw the exemption for the agreement. However, from the Commission's point of view, Article 8 addresses this potential weakness in the withdrawal mechanism, by allowing markets to be designated, to which the block exemption will not apply.

²⁹⁶ *ibid.* at par.34

²⁹⁷ *ibid.* at par.32

²⁹⁸ *ibid.* at par.35

²⁹⁹ *ibid.* at par.36 and 38

³⁰⁰ n.292

3.8 Distribution Agreements Falling Outside Regulation 2790/99

Distribution agreements which fall under the prohibition in Article 81(1) but which do not meet the conditions for exemption under Regulation 2790/99 require to be considered in the light of the general competition-law rules, and with reference to the Commission's Guidelines on Vertical Restraints.³⁰¹ This category includes most agreements between competitors; agreements which contain clauses grey or black-listed by the available block exemption regulations, or which fall outside the scope of the exemptions entirely; agreements between parties whose relevant share exceeds the thirty percent thresholds; and, agreements in respect of which the European Commission or a competent national authority is contemplating withdrawing, or has withdrawn, the benefit of exemption.

Agreements which contain black-listed or so-called 'hardcore' restraints of competition are, according to the Commission, unlikely to be exemptible under Article 81(3).³⁰² Such restrictions bring the spectre of nullity under Article 81(2) upon the agreements in which they feature, and should as a matter of prudence, be avoided entirely. Where agreements which have an appreciable effect on trade between the Community Member States contain non-compete clauses analogous to those grey-listed in Article 5 of Regulation 2790/99, it is thought³⁰³ that limiting their duration to five years, should avoid problems in most circumstances.³⁰⁴ In the case of other arrangements which fall outside the available BER, the parties' practical options are often limited to amending their agreements.

³⁰¹ *ibid.*

³⁰² *ibid.* par.46

³⁰³ D.O'Sullivan, S. Spinks, and P.M. Louis, *Competition Law of the European Community* (2nd edn Lexis Nexis London 2004) 8.07/74

³⁰⁴ Cases T-374, 375, 384 & 388/94 *European Night Services and others v Commission* [1998] ECR-II 3141 - The Commission had granted an exemption for only seven years, since it could not foresee a more distant future. This was quashed by the CFI, which recognized that there had been a huge investment to protect, which had to be funded over a 25 year period.

CHAPTER 4

SELECTIVE DISTRIBUTION

4.1 Introduction

For a supplier, the purpose of a selective distribution system is to ensure that all resellers of its products meet the minimum common standards relating *inter alia* to the presentation and the level of service provided to the consumer. To achieve this, the supplier commits only to appoint as members of its distribution system resellers that meet these standards, known as selection criteria. In turn each of such selected resellers is prohibited from supplying unauthorized resellers that are not members of the system. By these means, a supplier can ensure that its products are only sold by authorized resellers who form part of the system, all of whom meet the criteria. The control which this system yields to the supplier over the resale environment in which its goods are sold may be a valuable tool to maintain the image of the brand.

Selective distribution systems may generate competition concerns. As resellers who fail to invest to meet the selection criteria will be prevented from obtaining supplies of the product covered by the selective distribution system, the scope of price discounting among resellers may be effectively restricted, thus potentially affecting intra-brand competition. Despite this, however, EC Competition Law had developed a liberal stance towards this method of distribution, on the ground that price competition is not the only form of competition that needs to be protected. From an early stage it was accepted that this protection is needed to ensure the existence of a specialized distribution channel that provides a high level of customer service and quality of retail environment.³⁰⁵ It was later accepted that selective distribution is also justifiable for luxury products, on the grounds that the nature of the products would be undermined unless they were presented in a high quality retail environment. In order to limit the potential negative effects on intra-brand competition, it was generally required that the selection criteria should be qualitative and that all the resellers that meet the criteria should be admitted to the network. The regime became substantially more permissible with the adoption of

³⁰⁵ Case 26/76 Metro *SB-GroBarkte GmbH & Co. KG v Commission* [1977] ECR I-1977 / 45

the BER, which now exempts selective distribution for all types of products³⁰⁶ and services and allows direct and indirect limitations to be placed by the supplier on the number of resellers appointed to the network.

The first step is to assess whether the agreement falls within the safe harbour provided by the De Minimis Notice.³⁰⁷ If it does not it should be established whether or not the agreement is exempted by the BER. Only if the agreement is not exempted by this instrument is it necessary to consider, on the standards of the fairly complex case law, whether the agreement falls outside the purview of Article 81(1) altogether. If the conclusion is that the agreement does infringe Article 81(1), the assessment then needs to be made as to whether it could qualify for exemption under Article 81(3). This is now assessed primarily on the basis of the guidelines.

4.2 De Minimis

A selective distribution agreement is presumed to fall outside the scope of Article 81(1) if it falls within the scope of the safe harbour provided by the De Minimis Notice³⁰⁸ as discussed in Chapter 2.

4.3 The Vertical Agreements Block Exemption

Selective distribution agreements are in principle exempted under the BER where the market share of the supplier is no higher than 30 percent in the relevant market. Thus, below this threshold, a supplier may agree only to supply authorized distributors which meet specified criteria, and prevent sales by authorized distributors to unauthorized distributors. The exemption applies regardless of the type of product or service supplied.³⁰⁹ There are no limitations imposed on the nature of the selection criteria as long as they are specified. Thus, as well as qualitative criteria related to the qualifications of the staff and the suitability of the retail environment, the exemption

³⁰⁶ This is without prejudice to the Motor Vehicle Industry which is governed by Commission Regulation (EC) 1400/2002 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices in the motor vehicle sector [2002] OJ L203/30

³⁰⁷ Notice on agreements of minor importance which do not appreciably restrict competition under Article 81 (1) of the EC Treaty (de minimis Notice) [2002] OJ C368/13

³⁰⁸ *ibid.*

³⁰⁹ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1 186

applies also to quantitative criteria which limit the number of distributors admitted to the system.

Only limited exclusivity can be granted to authorized distributors. The supplier may agree not to sell in the territory of an authorized distributor and may agree not to appoint other distributors in the territory. However, the only territorial restriction that may be imposed on an authorized distributor is an obligation not to operate out of an unauthorized place of establishment. An authorized distributor must be permitted to make both active and passive sales to all end-users in the territories of other authorized distributors, but may be restrained from opening premises in those territories.³¹⁰ Authorized distributors must also be permitted to buy from and sell to one another by way of cross-supplies. The BER does not permit the supplier to impose an exclusive purchasing obligation on an authorized distributor.³¹¹

4.4 Application of Article 81(1) – the case-law

An analysis of the applicability of Article 81(1) is required either where an agreement is not exempted by the BER, or even if it is so exempted, in order to evaluate the risk of withdrawal of the exemption by the Commission. According to the CFI in *Perfumes*, a selective distribution system will in principle not infringe Article 81(1) where each of the following conditions are met:

- 1) the system is justified by the nature of the product or the requirements of its distribution
- 2) the selection criteria are qualitative, uniform and applied in a non-discriminatory manner to all candidates seeking to join the system;
- 3) the selection criteria are proportionate, meaning that they are no more onerous than is necessary; and
- 4) the system seeks a result that enhances competition in order to offset the reduction in competition that is inherent in selective distribution.³¹²

If all the above conditions are satisfied, the selective distribution system is said to be qualitative, and the system as a whole, including the restrictions on sales to

³¹⁰ BER at Article 4(c): Selective distribution cannot be combined with exclusive customer allocation as, in particular, authorized distributors must be permitted to make active sales to all end-users.

³¹¹ M Parschalk *Vertical Restraints on Competition: Selective Distribution, Exclusive Distribution and Exclusive Purchasing Systems in Austria* (1998) 17 ECLR 422

³¹² Case T-19/92 *Leclerc v. Commission (Yves Saint Laurent)*, [1996] ECR II-1851 / 112

unauthorized resellers, generally falls outside Article 81(1). In contrast systems which do not meet the above conditions will generally infringe Article 81(1) and will normally be treated as quantitative. An exemption will however be possible for quantitative criteria, provided they generate efficiencies. In the light of the above, the following discussion examines each of the conditions which determine whether or not a selective distribution system infringes Article 81(1).

4.4.1 The nature of the product

In order to escape the application of Article 81(1), the use of selective distribution must be justified by the requirements of the product concerned. In particular, the use of selective distribution has been held to be legitimate if it is required to preserve the quality of the product and ensure its proper use. The determination in practice of which type of product justifies the use of selective distribution is not necessarily straight forward. To date the use of selective distribution has been found to be justified in respect of the following products: consumer electronic products,³¹³ automobiles,³¹⁴ personal computers,³¹⁵ jewellery,³¹⁶ luxury clocks and watches,³¹⁷ perfume,³¹⁸ dental products,³¹⁹ ceramic tableware,³²⁰ glass crystal,³²¹ photographic products,³²² and

³¹³ SABA, OJ [1976] L28/19; on appeal: Case 26/76 *Metro Grobmarkte GmbH & Co. KG v. Commission (Metro I)*, [1977] ECR 1875; *Demo-Studio Schmidt, Eleventh Report on Competition Policy* 118, on appeal *Demo-Studio Schmidt v Commission* [1983] ECR 3045; *SABA's EC distribution system (SABA II)*, OJ 1983 L376/41; on appeal: Case 26/76 *Metro SB-Grobmarkte GmbH & Co. KG v. Commission (Metro II)*, [1986] ECR 3021; *Grundig's EC distribution system (Grundig I)*, OJ 1985 L233/1; *Kenwood Electronics Deutschland*, OJ 1993 C67/9 (Article 19(3) Notice); *Grundig's EC distribution system (Grundig II)* OJ 1994 L20/15; *Sony Espana*, OJ 1993 C275/3 (Article 19(3) Notice); and *Sony Pan-European Dealer Agreement. Twenty-fifth Report on Competition Policy* 135

³¹⁴ Selective Distribution Agreements relative to the automobile sector is dealt with specifically in Commission Regulation (EC) 1400/2002 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices in the motor vehicle sector [2002] OJ L203/30

³¹⁵ *IBM Personal Computer*, OJ 1984 L118/24

³¹⁶ *Murat*, OJ 1983 L348/20

³¹⁷ Commission Decision *Omega* OJ 1970 L242/22; Commission Decision *Junghans*, OJ 1977 L30/10; *Metro GB-Grobmarkte v. Cartier*, [1994] ECR I-15; *Chanel, Twenty-fifth Report on Competition Policy* 136

³¹⁸ *Procureur de la Republique v. Giry and Geurlin*, [1980] ECR 2327, *Anne Marty v. Estee Lauder*, [1980] ECR 2481; *Lancome SA and others v. Etos BV and others*, [1980] ECR 2511; *Yves Saint Laurent Parfum*, OJ 1992 L12/24; on appeal *Leclerc v. Commission* [1996] ECR II-1851; *Parfum Givency system of selective distribution*, OJ 1992 L236/11; on appeal; *Leclerc v. Commission* [1996] ECR II-1961

³¹⁹ Commission Decision *Ivoclar*, OJ 1985 L369/1

³²⁰ Commission Decision *Villeroy & Boch* OJ 1985 L376/15

³²¹ *Compagnie des Cristalliers Baccarat, Twenty-fifth Report on Competition Policy* / 98

³²² *Kodak*, OJ 1970 L 147/24; *Hasselblad*, OJ 1982 L161/18; on appeal: *Hasselblad (GB) Ltd. v. Commission*, [1984] ECR 883

newspapers.³²³ In contrast, the necessity of the use of selective distribution has been questioned in cases dealing with plumbing fixtures,³²⁴ tobacco³²⁵ and less prestigious watches.³²⁶

Selective distribution for technically complex products has been considered necessary to ensure the existence of a specialized distribution channel providing a high level of pre and after-sales service for the consumer.³²⁷ In the case of high-quality luxury products, selective distribution has been justified on the grounds that inappropriate presentation of the products would undermine their luxury nature which, the CFI has judged, would be contrary to the interests of consumers who place great importance in the luxury image of the products.³²⁸ However the CFI has suggested that promotional investment by a brand owner will not in itself justify selective distribution.³²⁹ It is not yet decided at Community level whether the quality of the products would alone be sufficient to justify selective distribution, although there is support for this at national level.³³⁰ A product will not merit the use of selective distribution if the benefits which normally justify such a system are achieved by legal rules governing conditions for sale or admission to the resale trade.³³¹

Although the nature of the product must justify the use of selective distribution this justification, once established, is not necessarily called into question simply because the supplier chooses to use other forms of distribution outside the Community or even in other parts of the Community. In *Cartier*,³³² the ECJ held that the German principle of ‘imperviousness’ does not apply under EC law and that it is not a requirement of the validity of a selective distribution in the Community that resellers outside the

³²³ *Binon & Cie v. Agence et Massegiers de la Presse*, [1985] ECR 2015

³²⁴ *Ideal Standard's distribution system*, OJ 1985 L20/38; on appeal: *Ideal Standard v. Commission*, removed by order of 30th September 1987, OJ 1987 C307/10

³²⁵ *Van Landewyck v. Commission (FEDETAB)*, [1980] ECR 3125, at par.138-140

³²⁶ *ETA Fabriques d'Ebauches v. SA DK Investments*, [1985] ECR 3933, at par. 16

³²⁷ *Case 26/76 Metro SB-GroBarkte GmbH & Co. KG v Commission* [1977] ECR I-1977

³²⁸ *Leclerc v. Commission (Yves Saint Laurent)*, [1996] ECR II-1851, at par. 112-121

³²⁹ *ibid.* par.117

³³⁰ Judgement of the Cour d'Appel de Paris, 7 November 2001, *Auchan v. Levi Strauss*, in which the Court of Appeal confirmed, applying principles of EC law, that selective distribution can be legitimately used for the sale of Levi's jeans.

³³¹ *NVL'Oreal v. PVBA 'De Nieuwe AMCK'* [1980] ECR 3775, at par.16

³³² *Case C-376/92 Metro v Cartier* [1994] No 2 ECR I-15

Community should be prevented by the supplier from selling there to unauthorized resellers. The judgment also suggests that there is no requirement on a supplier to use selective distribution in all parts of the Community in which it supplies its products.³³³ The Commission has in the past approved systems established by multinational companies limited to single Member State.³³⁴

4.4.2 Qualitative and Proportionate criteria

A selective distribution system will infringe Article 81(1) unless the selection criteria are qualitative and proportionate. There is no generally applicable definition of what constitutes a qualitative criterion. In very general terms, such a criterion should be objective, it should relate to an aspect of quality in the reseller network and it should not limit the number of resellers within the system. In practice however, this requires very fine distinctions to be made, as all criteria, even those related to quality limit the number of resellers that can qualify for appointment. The level of quality must therefore be proportionate to the nature of the product. Not surprisingly, inconsistencies have emerged when this has been applied in practice, and apparently similar criteria have been qualified as qualitative in some cases and quantitative in others. The main criteria that are typically considered to be qualitative relate to the suitability of selling premises, the training and qualifications of the staff, the presentation of products, the level of service provided to the end consumer and the range of products available. Criteria are not qualitative if they exclude a priori the appointment of resellers belonging to certain distribution channels.³³⁵ In *Vichy*,³³⁶ the Commission considered that an obligation to have a holder of a diploma in pharmacy present at the point of sale of cosmetic products was a qualitative restriction. However a requirement that these products be sold through dispensing chemists was held to be disproportionate and therefore quantitative. In order to be qualitative, retail criteria should be capable of being met not only by specialized retailers, but also by supermarkets, hypermarkets and other multi-product stores,

³³³ *ibid.* par.24-29

³³⁴ *Kenwood Electronics Deutschland*, OJ 1993 C67/9 (Article 19(3) Notice); *Sony Espana*, OJ 1993 C275/3 (Article 19(3) Notice)

³³⁵ *AEG v. Commission*, [1983] ECR 3151, at paras 73-76; *Leclerc v. Commission (Yves Saint Laurent)*, [1996] ECR II-1851

³³⁶ *Vichy v. Commission*, [1992] ECR II-415 / 65-72

provided they make the necessary investment to sell products in equivalent conditions.³³⁷ Consequently, a requirement to have a separate space, area or department for the products concerned has been accepted, but not a requirement that a certain proportion of the turnover of the entire store should be derived from the products concerned. In practice, an important issue will be the degree of physical separation that can be legitimately imposed between the area in which the products subject to selective distribution are presented and the remainder of the shop.³³⁸

4.4.3 Quantitative Criteria

Quantitative criteria infringe Article 81(1) and require exemption under Article 81(3). By comparison with qualitative criteria, they limit the number of resellers in a selective distribution system. The most obvious quantitative criteria are those that place a numerical cap on the total number of resellers whether in absolute terms or, for example, by reference to population density or purchasing power in a given territory.³³⁹ A requirement on a member of the system to effect minimum purchases or sales may also be treated as a quantitative criterion.³⁴⁰

4.4.4 Non-discrimination – admission procedure

In order to fall outside of Article 81(1), selective distribution systems should not be applied in a discriminatory manner and all resellers meeting the selection criteria should on application be admitted to the network. Although the refusal to approve a reseller may appear to be a unilateral act by the manufacturer, the Commission and the ECJ have readily inferred the existence of an agreement so as to justify the application of Article 81(1). In *AEG Telefunken*,³⁴¹ the Commission decided that AEG was misusing

³³⁷ In Case T-19/92 *Leclerc v. Commission (Yves Saint Laurent)*, [1996] ECR II-1851 the CFI placed great emphasis on the fact that the selective distribution system did not a priori exclude any category of retailers, including hypermarkets, and that multi-product retailers were authorized in several Member States. Likewise, at the wholesale level, criteria should not in principle exclude self-service and cash-and-carry wholesalers.

³³⁸ In Case T-19/92 *Leclerc v. Commission (Yves Saint Laurent)*, [1996] ECR II-1851, the CFI simply noted that the protection of the luxury image of the perfumes could require that they not be sold near products such as food stuffs or cleaning products, or that they would be sufficiently separated from the sale of other lower-quality products.

³³⁹ Commission Decision *Omega* OJ 1970 L242/22 / 5

³⁴⁰ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1 51

³⁴¹ Case 107/82 *AEG Telefunken v Commission* [1983] ECR-3151

its selective distribution system by refusing to supply dealers who did not comply with its pricing policy. It held that:

The view must therefore be taken that even refusals of approval are acts performed in the context of the contractual relations with authorized distributors in as much as their purpose is to guarantee observance of the agreements in restraint of competition which form the basis of contracts between manufacturers and approved distributors. Refusals to approve distributors who satisfy the qualitative criteria mentioned above therefore supply proof of an unlawful application of the system if their number is sufficient to preclude the possibility that they are isolated cases not forming part of a systematic conduct.

The Commission has insisted on safeguards to prevent abuse in the selection process. On some occasions, the Commission has required authorized members of the network to have the right to appoint new members of the network provided they meet the supplier's selection criteria. In *SABA*,³⁴² the Commission required all SABA wholesalers to have the right to admit dealers that satisfied the selection criteria, subject to SABA's right to expel dealers who had been wrongly admitted. This however does not appear to be the current practice and the Commission generally seems willing to allow suppliers the exclusive right to appoint members of the network. In *Villeroy & Boch*³⁴³ the Commission stated that the principle that the producer should himself verify the qualifications of specialized retailers admitted to the network is necessary to ensure that the selective distribution system is uniform and remains closed.

The Commission has intervened to ensure that suppliers decide on application to join the network in accordance with transparent procedures and within fixed time limits. In *Yves Saint Laurent*,³⁴⁴ the Commission objected to arrangements whereby applications were placed on a waiting list and the decision to appoint was only made where the opening of a new account was considered to be justified on the basis of economic potential of the area. In its place, *Yves Saint Laurent*³⁴⁵ agreed to carry out inspections of all new applicants within an average of three months, and by a maximum of five months and afterwards to appoint applicants which were able to meet the criteria within

³⁴² SABA's EC distribution system (SABA II), OJ 1983 L376/41, at II.A(6)

³⁴³ Commission Decision *Villeroy & Boch* OJ 1985 L376/15 / II.A(6)

³⁴⁴ Case T-19/92 *Leclerc v. Commission (Yves Saint Laurent)*, [1996] ECR II-1851

³⁴⁵ *ibid.*

certain additional time limits. In contrast to the *Perfumes* cases, the Commission insisted in *SABA II* that a decision on admission should be reached within a maximum period of four weeks and that in the absence of a decision the candidate must be deemed automatically admitted. It is however not possible to derive from case-law a generally applicable time-limit within which a decision on appointment must be made following an application. The Commission has on occasion required an independent arbitration procedure to be established to which a refused applicant can appeal.³⁴⁶ As all resellers which meet the selection criteria have a right to become members of the system, once appointed, an authorized reseller can normally only be excluded from the system for breach of contract or if the distribution network is disbanded. Thus in the event that fixed term agreements are used, an authorized reseller will, on expiry of an agreement have a right to conclude a new agreement without undergoing the normal admission procedure.³⁴⁷

4.4.5 The Selective Distribution system must enhance competition

In order to escape the application of Article 81(1), a selective distribution system must have a valid objective capable of improving competition in order to compensate for the restriction in intra-brand price competition which results from the application of common standards to all resellers of the product. Arguably, this is not a separate requirement but is satisfied if a selective distribution system meets the remaining conditions for validity under Article 81(1).³⁴⁸

4.4.6 The structure of the market: cumulative effect

The European Courts have left open the possibility that even a qualitative selective distribution system can infringe Article 81(1) in certain circumstances, although no such finding on the facts has been reported. This requires an assessment of the cumulative effect on competition of all selective distribution systems operated in the relevant

³⁴⁶ Sony Pan-European Dealer Agreement, Twenty-Fifth Report on Competition Policy / 135

³⁴⁷ *Yves Saint Laurent Parfums*, OJ 1992 L12/24 at I C(5); and *Yves Saint Laurent Parfums*, OJ 1998 C120/2 [Corr. C141/24] (Article 19(3) Notice)

³⁴⁸ Although referred to by the CFI *inter alia* in Case T-19/92 *Leclerc v. Commission*, [1996] ECR II-1851, par.112, this requirement is not mentioned in the Vertical Guidelines.

market. According to the CFI in *Perfumes*, a qualitative selective distribution agreement can infringe Article 81(1) if, taking into account the cumulative effects of all the systems in the market, either (i) barriers are created which prevent access to the market ‘by new competitors capable of selling the products’, or (ii) there is ‘no workable competition’ in the product concerned in particular as regards price. The higher the share of the market covered by selective distribution, the greater is the risk of foreclosure of new competitors. However, even if all manufacturers in a market use selective distribution, access to the market by new types of distributors will not necessarily be considered to be prevented provided that the selection criteria do not exclude a priori certain categories of distributors.

4.5 The Application of Article 81(3)

Qualitative selective distribution systems are automatically exempted by the BER. They may also meet the conditions for exemption under Article 81(3) even if they fall outside the scope of the exemption provided by the Regulation. The main source of guidance on the individual application of Article 81(3) is provided by the Guidelines.³⁴⁹ It appears to be a precondition of eligibility for individual exemption that: (i) the product concerned should justify the use of selective distribution, and (ii) the criteria should be necessary for the efficient distribution of the product. Efficiencies which may result from the use of selective distribution include in particular: (i) savings in logistical costs for the supplier owing to economies of scale, although these will usually be marginal in selective distribution systems, (ii) the avoidance of free-riding amongst distributors, (iii) the creation of a common brand image, and (iv) the protection of substantial relationship-specific investments by the supplier or authorized distributors.³⁵⁰ As all restrictions must be indispensable in order to meet the requirements of Article 81(3), the use of quantitative criteria will not, however be justified if the same efficiency achieved as comparable cost by imposing (qualitative) service requirements alone.³⁵¹ In addition to the above requirements, the main determining factor will be whether the extent of

³⁴⁹ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1 187

³⁵⁰ *ibid.* 189 and 195

³⁵¹ *ibid.* 196

inter-brand competition that exists in the market is sufficient to outweigh the restriction in intra-brand competition resulting from the use of quantitative selective distribution.

CHAPTER 5

FRANCHISING

5.1. Introduction

The word ‘franchise’ is sometimes used in a wide sense more or less synonymous with distributorship. It is a distribution method adopted by a manufacturer or supplier who has developed a well-known name and appearance for its products. It may manufacture the goods itself, or it may simply select goods produced by a third party. In the latter case the franchise may be described as a ‘business format’ franchise, since it is essentially a business format that is being exploited. In either case, it will probably also have established an ‘image’ for its existing sales outlets, connected with the physical appearance of the outlets and business methods applied. These names, trademarks, and image will be known by the public and attract customers who recognize these familiar signs. In order to capitalize on this public awareness and on the package of intellectual property and business know-how it has created, it may license another independent person to use the package. In return for the license, it will demand royalties or a lump sum. The distributor will in return have the benefit of opening its outlet on the basis of a name and appearance readily recognizable to consumers, and the franchisor’s business know-how. Thus, a franchise is often attractive to an individual with little or no experience or reputation in the business, but with a small amount of capital available with which to buy the franchise.

The way in which the network is organized and in particular the terms of the agreements made between franchisor and franchisee, differ widely from one network to another. The ECJ has made it clear that in principle the validity of any specific franchising contract will be decided on the basis of the individual terms included in that contract.³⁵² In a number of respects the ECJ and the Commission have tended to be more generous in their appraisal of a clause in the context of a franchise network than of the same clause in a different method of distribution. It is therefore necessary to know

³⁵² Case 161/84 *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 353

what they consider as the essential characteristics of franchising, since this may indicate whether or not a particular contractual restriction is likely to be treated leniently.

The favourable treatment referred to above is due mainly to the conception that the ECJ and the Commission have of franchising as a system essentially advantageous to small businesses. It has been viewed as a means of allowing people who would not otherwise be able to set up a business independently, to do so. Considerable importance is attached to this concept in the application of competition law rules to franchising. The provision by the franchisor to the franchisee of substantial know-how is therefore a crucial element in the definition of franchising.³⁵³ In the *Charles Jourdan* decision³⁵⁴ the Commission listed the areas of know how and assistance provided as covering purchasing, decorating, stock management, sales, and advertisement. It is therefore likely that, provided that a distribution agreement includes a sufficient degree of provision of know how and continuing help to the dealer, it will be treated with relative leniency. The Commission expressly confirms this in its Guidelines.³⁵⁵

In addition to the license of [intellectual property rights], the franchisor usually provides the franchisee during the life of the agreement with commercial and technical assistance, such as procurement services, training, advice on real estate, financial planning etc. The license and the assistance are integral components of the business method being franchised.³⁵⁶

The more the vertical restraint is linked to the transfer of know how, the more reason there may be to expect efficiencies to arise and the more a vertical restraint may be necessary to protect the know-how transferred or the investment costs incurred.³⁵⁷

On the other hand, an agreement designated as a franchise by the parties is not likely to be treated as such if it does not embody this kind of relationship. The favourable attitude is always subject to the economic context in which the network operates.

³⁵³ *ibid.* par.15

³⁵⁴ Commission Decision *Charles Jourdan* [1989] OJ L35/31

³⁵⁵ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1

³⁵⁶ *ibid.* 42

³⁵⁷ *ibid.* 119

5.2 Franchise Agreements and Article 81(1)

As far as the requirement in Article 81(1) that the agreement affects trade between Member States is concerned, the ECJ stated expressly in *Pronuptia*³⁵⁸ that even if the franchise agreement is concluded between two parties in the same Member State it will affect trade between Member States if the franchisor is prevented from establishing itself in another Member State. Beyond this, the answer to this question depends on the precise terms of the contract in question. As in any other context, a term granting absolute territorial exclusivity to the franchisee or imposing on it fixed or minimum resale prices will certainly fall foul of article 81(1). Many franchising contracts contain clauses which provide for some degree of territorial exclusivity, since in the absence of such exclusivity a potential franchisee would not be prepared to make the necessary investments in setting up and equipping its outlet. Usually, the franchisee will be allotted a territory in which it is assured that no one else will be granted the right to exploit the franchise. For its part, the franchisee is required only to operate the franchise from the location specified in its contract so that it cannot either change location or open a second outlet. The Court in *Pronuptia*³⁵⁹ said that a territorial exclusivity clause, when combined with a clause prohibiting the opening of a second outlet, might infringe Article 81(1). Because the Court referred to this combination of clauses, it might be argued that bare exclusive territoriality, without a ‘second outlet’ clause, may not infringe Article 81(1). But given the radical departure from previous rulings that this would imply, it is not an interpretation which could be safely relied on.

The five Commission decisions³⁶⁰ in the 1980s followed this approach, namely that the infringement of Article 81(1) arose out of a combination of territorial exclusivity with the prohibition on opening a second outlet from which to exploit the franchise. In *Computerland*³⁶¹ this was the case even though each territory was less than one kilometre in radius, and franchisees were free to sell to customers outside their territory.

³⁵⁸ Case 161/84 *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 353

³⁵⁹ *ibid.*

³⁶⁰ Commission Decisions *Charles Jourdan* [1989] OJ L35/31, *Computerland* [1987] OJ L222/12, *Pronuptia* [1989] OJ L 13/39, *Servicemaster* [1989] OJ L332/38, *Yves Rocher* [1988] OJ L8/49

³⁶¹ Commission Decision *Computerland* [1987] OJ L222/12

However in all such five cases, exemption was granted under Article 81(3). In *Pronuptia*, the Court also qualified its statement that exclusive territoriality would infringe Article 81(1) with the words: if it concerns a business symbol which is already well known.³⁶² This requirement has not received much attention in individual Commission exemption decisions. This may not now make that much difference in practice: most franchise agreements containing such a clause will be automatically exempted by the block exemption on vertical restraints³⁶³ provided the relevant market share does not exceed 30 percent, and where it exceeds 30 percent the franchise would presumably be well-known. Also, given that the Court³⁶⁴ and the Commission³⁶⁵ have accepted that sometimes territorial exclusivity is essential to the establishment of the network, it might be thought that such a clause could fall outside the scope of Article 81(1) on this basis. In fact neither the ECJ nor the Commission has not yet gone that far. The Commission has consistently held that territorial exclusivity clauses require exemption under Article 81(3), even in the context of very competitive markets.³⁶⁶

In the Commission's decisions on franchising, all taken over 15 years ago, it paid little more than lip service to the notion that the surrounding economic circumstances and structures of the market should be taken into account in deciding whether a clause in a franchising agreement has restrictive effects. In every such decision there has been a competitive market and yet clauses giving a degree of territorial exclusivity have apparently brought the agreement virtually automatically within the scope of Article 81(1). For instance in *Computerland*, a franchise network for the sale of microcomputers was granted exemption, rather than negative clearance, chiefly because of the clauses granting territorial exclusivity. This was despite the fact that the Commission found that there were around 10,000 authorized microcomputer dealers in Western Europe, of which less than 1 percent were Computerland outlets. Furthermore these outlets accounted for about 3 percent of the total Community sales and in no

³⁶² Case 161/84 *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 353 par. 24

³⁶³ Commission Regulation (EC) 2790/99 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices [1999] OJ L336/21

³⁶⁴ n.360

³⁶⁵ *Computerland* OJ 1987 L222/12, [1989] 4 CMLR 259, par. 33

³⁶⁶ R Whish *Competition Law* (4th edn Butterworth's London 2001)153

Member State was the Computerland market share much above 4 percent. Similarly in *Yves Rocher*, the Commission found the cosmetics market in question to be extremely competitive. Rocher held 7.5 percent of the French market, 6 percent of the Belgian market and less than 5 percent of the market in other Member States. Furthermore the franchisor, though not permitted to open an outlet within the franchisee's protected territory, could sell into the area by other means including mail order. Even so, negative clearance was refused and an exemption granted instead. The block exemption³⁶⁷ and the accompanying Guidelines,³⁶⁸ which entered into force in 2000, are rooted in an approach giving much more attention to the economic analysis.

5.3 Case Law

The only case in which the ECJ has discussed franchising is the *Pronuptia*,³⁶⁹ which came before the ECJ in the form of a request for a preliminary ruling. The plaintiff before the German Court was a German subsidiary of the French franchisor Pronuptia de Paris, a distributor of wedding dresses and other clothes. This subsidiary, had granted a franchise to the German franchisee, Mrs. Schillgallis, for three separate territories in the Federal Republic, and a dispute had subsequently arisen over unpaid royalties claimed by the franchisor. The franchisee was relying on the argument that the contract was void and unenforceable for the infringement of Article 81(1).

The Court first stressed³⁷⁰ that franchising contracts must be judged individually, according to the particular restrictive clauses present in them. It commented favourably on franchising as a legitimate way for the franchisor to exploit an asset which it had developed. It then held that most of the clauses in this, fairly typical contract, were inherent in the nature of franchising itself, and which it could not function without them. Therefore in accordance with the principle of 'ancillary restraints' these clauses did not infringe Article 81(1):

³⁶⁷ Commission Regulation (EC) 2790/99 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices [1999] OJ L336/21

³⁶⁸ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1

³⁶⁹ Case 161/84 *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 353

³⁷⁰ *ibid.* par.15

In a system of distribution franchises of that kind an undertaking which has established itself as a distributor on a given market and thus developed certain business methods grants independent traders for a fee, the right to establish themselves in other markets using its business name and its business methods which have made it successful. Rather than a method of distribution, it is a way of an undertaking to derive financial benefit from its expertise without investing its own capital. Moreover the system gives traders who do not have the necessary experience access to the methods which they could not have learned without considerable effort and allows them to benefit from the reputation of the franchisor's business name...such a system, which allows the franchisor to profit from his success, does not itself interfere with competition. In order for the system to work, two conditions must be met.³⁷¹

The two conditions were then set out as follows: the franchisor's know how is to be protected and the identity of the network to be maintained. Each one provides the justification for a set of clauses that ensure that these conditions are met. Because they are considered essential to the success of a franchising system, they are characterized as not infringing Article 81(1). The two groups of clauses associated with these two conditions were subsequently developed through the 1988 block exemption regulation of franchise agreements,³⁷² which has since expired. Below will be considered three groups of clauses generally considered to fall outside the prohibition contained in Article 81(1), either because they are necessary to fulfill one of the two conditions stated to be essential to the working of a franchise network, or because they are irrelevant to competition.³⁷³

5.4 Clauses necessary for the protection of the Franchisor's Know-how

First the franchisor must be able to communicate his know-how to the franchisees and provide them with the necessary assistance in order to enable them to apply its methods, without running the risk that that know-how and assistance might benefit competitors, even indirectly.³⁷⁴

³⁷¹ *ibid.*

³⁷² Commission Regulation (EC) 4087/88 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices [1988] OJ L31

³⁷³ R Christou International Agency, Distribution and Licensing Agreements (4th edn Sweet & Maxwell London 2003) 155

³⁷⁴ n.368 par. 16

The obligations undertaken by the franchisee and deemed necessary to fulfill this condition are the following:

(a) Obligations of confidentiality: A franchisor may oblige its franchisees to observe confidentiality towards confidential information and know how that it transmits to them. This may include the duty not to make disclosure to employees unless necessary, and to pass on to employees to whom it disclosed the same obligation of confidentiality.³⁷⁵

(b) Prohibition during the term of the contract on opening the same or a similar kind of shop in an area where it might compete with another franchisee, or generally on carrying on any kind of competing activities. In *Yves Rocher*³⁷⁶ it was noted that such a clause did not prohibit the franchisee from carrying on a non-competing business, provided the franchisee's personal commitment to Yves Rocher franchise was ensured. In *Computerland*,³⁷⁷ the Commission required an absolute non-competition clause to be amended so as to allow franchisees to acquire financial interests in the capital of competing undertakings, although not to the extent that such participation would enable them to control those undertakings.³⁷⁸ A clause stipulating that a franchisee's acquisition of a financial interest in a competing undertaking was permissible provided it did not involve the franchisee personally in taking part in competing activities was held not to infringe Article 81(1) in *Yves Rocher*.³⁷⁹ Even a clause limiting acquisition of a financial interest in the capital of a public company to a maximum of 5 percent was held to be essential to the protection of the franchisor's know how and therefore outside the terms of Article 81(1) in *Servicemaster*.³⁸⁰

(c) Prohibition of a reasonable time after the termination of the contract on opening the same or similar kind of shop in an area where it might compete with another franchisee. Non-competition clauses lasting more than one year after the franchise contract comes to an end are unlikely to be considered necessary, or to be exempted under Article

³⁷⁵ Commission Decision *Computerland* [1987] OJ L222/12 par. 5 and 22(i)

³⁷⁶ Commission Decision *Yves Rocher* [1987] OJ L35/31

³⁷⁷ n. 375

³⁷⁸ *ibid.* par.22(ii)

³⁷⁹ n.376

³⁸⁰ Commission Decision *Servicemaster* [1989] OJ L332/38

81(3). In *Computerland*,³⁸¹ a term of three years, with the restrictions becoming gradually less strict over the three years, was considered excessive by the Commission and was not exempted. It was replaced with a one year ban on competing within a radius of 10 kilometers of the original outlet. However it was implied that even this reduced term was allowed partly on the basis that the very limited territorial restrictions imposed on the franchisees by the contract meant that they had the opportunity during the term of the agreement to build up goodwill and clientele beyond the area immediately surrounding their franchise outlet. A one-year post-term ban on the franchisee's opening a retail cosmetics store within its previous exclusive territory was held to fall outside the purview of Article 81(1) in *Yves Rocher*.³⁸² It was pointed out that an ex-franchisee thus had the possibility of immediately setting up a shop anywhere else, including within the exclusive territory of another franchisee. However, in *Charles Jourdan*³⁸³ it was stated that a post-term competition ban would not have been justified 'as the know-how provided includes a large element of general commercial techniques, and second, as this type of franchise is primarily granted to retailers who were already experienced in selling shoes'. This suggests that the Commission did not consider the know-how element of this franchise to be substantial enough to warrant generous treatment. But it was also stated in *Computerland*³⁸⁴ and *Yves Rocher*³⁸⁵ that although such a post-term ban may not infringe Community law, this does not prevent franchisees from benefiting from any rights to which they may be entitled under the applicable national law. National law may in fact be stricter in the kind of post-term competition bans it accepts. In such a case, the stricter national law will apply, provided that it is seen as pursuing an objective other than the maintenance of competition, such as franchisee protection. This latter stance was however revisited by Regulation 1/2003 which provides that in cases where the National sanction is one which is stricter than Article 81, it is Article 81 which will apply.³⁸⁶

³⁸¹ Commission Decision *Computerland* [1987] OJ L222/12

³⁸² n.376

³⁸³ Commission Decision *Charles Jourdan* [1989] OJ L35/31

³⁸⁴ n.381

³⁸⁵ n.376

³⁸⁶ Commission Regulation (EC) 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 [2003] OJ L1/1

(d) Prohibitions on selling to a third party the sales outlet used to exploit the franchise, without the prior consent of the franchisor. In *Charles Jourdan*³⁸⁷ a clause requiring the franchisor to be given a month to make up its mind was cleared.

(e) Prohibition on assigning in whole or in part the benefit of the franchise contract without the consent of the franchisor.³⁸⁸

5.5 Clauses Necessary to Maintain the Identity and Reputation of the Network

Secondly the franchisor must be able to take the measures necessary for maintaining the identity and reputation of the network bearing his business name or symbol.³⁸⁹

The types of clauses considered necessary to fulfill this condition are the following:

(a) Freedom to select franchisees and their managers: Franchisees may be chosen freely by the franchisor. Nor is it necessary that such choice be made on the basis of objective and qualitative criteria, as has been required in the context of selective distribution systems. In *Charles Jourdan*³⁹⁰ a clause requiring advance approval of the franchisor of any manager employed to run a shop was accepted. In the *Yves Rocher* system, franchisees were chosen on the basis of personality, aptitude for the cosmetics business and performance in a training programme. The absence of any stated selection criteria was justified on the basis that it was the franchisor itself which trained the franchisees:

Yves Rocher itself trains franchisees during the introduction course with a view to setting up new franchise shops. It is logically entitled to choose its partners freely and turn down application who do not, in its view, have the personal qualities and business qualifications which it requires for the application of the formula it has developed.³⁹¹

³⁸⁷ Commission Decision *Charles Jourdan* [1989] OJ L35/27

³⁸⁸ Commission Decision *Yves Rocher* [1987] OJ L35/31 par 47

³⁸⁹ Case 161/84 *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 353/17

³⁹⁰ n.387

³⁹¹ n.388 par. 41

(b) An obligation on the franchisee to apply the business and trading methods developed by the franchisor and to use the know-how and industrial property rights provided by the franchisor.

(c) An obligation on the franchisee to use the franchisor's know-how, trademarks, trade names or other industrial property rights in a manner in keeping with their subject matter.

(d) An obligation on the franchisee not to use the franchisor's trademarks, trade names or other identifying marks anywhere other than at the agreed franchise location and to stop using them after termination of the contract.³⁹² In *Computerland*,³⁹³ the Commission insisted that to this obligation be added the qualification that ex-franchisees be expressly entitled:

to continue using innovations or improvements they have developed which are demonstrably separable from the Computerland system.³⁹⁴

(e) An obligation on the franchisee to devote its best efforts to the operation of the franchise outlet and not to carry on activities incompatible with being a franchisee³⁹⁵.

(f) A term prohibiting the franchisee from carrying on any activity at the outlet apart from exploiting the franchise.³⁹⁶ In the case of a 'franchise corner' situated in a part of a larger shop, such a restriction must presumably be limited in application to the 'corner' only.

(g) An obligation on the franchisee to use for the sales outlet the layout and décor, both interior and exterior, required by the franchisor.³⁹⁷

³⁹² Commission Decision *Computerland* [1987] OJ L222/12 par 23(ii)

³⁹³ n.381

³⁹⁴ n.381 par.23

³⁹⁵ n.368 par.49

³⁹⁶ Commission Decision *Computerland* [1987] OJ L222/12 par 23(iv)

³⁹⁷ Case 161/84 *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 353 par 19, Commission Decision *Computerland* [1987] OJ L222/12 par 23(v), Commission Decision *Yves Rocher* [1987] OJ L35/31 par 43

(h) An obligation on the franchisee to exploit the franchise from a particular location and not to change that location without the franchisor's consent. A clause simply confining the franchisee to exploiting the franchise from a specified location was stated by the Court to be compatible with Article 81(1).³⁹⁸

In *Yves Rocher* the Court stated:

The franchisor must be able to participate in determining the location of the Beauty Centre with the franchisee, in their mutual interest; a bad choice might cause the franchise to fail in business and indirectly damage the network's reputation. In practice, Rocher carries out a preliminary market and location survey, and proposes to the franchisee the most promising area. The exact location of the shop is determined by the franchisee with the franchisor's consent. In any event, the shop's location is agreed upon in the general interest of all members of the chain.³⁹⁹

In *Computerland*,⁴⁰⁰ the Commission pointed out that in fact the location of sites was decided on the basis of objective criteria, and said that the main objective in setting up these criteria for site approval is to ensure that the success of the outlet is not hampered because of a possibly unfavorable location.⁴⁰¹

(i) An obligation on the franchisee not to sell competing goods. A franchisor may on certain conditions, prohibit a franchisee from selling any goods apart from those supplied or selected by the franchisor.⁴⁰² The Commission stresses in its Guidelines⁴⁰³ that a non-compete obligation which is necessary to maintain the common identity and reputation of the network does not infringe Article 81(1) and so does not require exemption. This is the case irrespective of the duration of the clause, provided it does not extend beyond the duration of the contract itself. Also, a non-compete restriction for the whole duration of the contract may fall outside Article 81(1) on the basis that the supplier has made a substantial and irreversible transfer of know-how and that the

³⁹⁸ n.388

³⁹⁹ *ibid.* par.42

⁴⁰⁰ n.395

⁴⁰¹ *ibid.* par.23(v)

⁴⁰² *ibid.* par.21

⁴⁰³ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1

duration of the restriction corresponds to the time necessary to justify such an investment

In *Yves Rocher*⁴⁰⁴ it seems to have been accepted without question that the franchisee could be restricted to selling only goods bearing the Yves Rocher trademark. It was said that the sale of other goods would allow other producers to benefit unfairly from Rocher's reputation and know-how and would detract from the identity of the network. Accessories, shop furnishings and products for beauty treatments could be obtained from other sources, though sale of these was subject to the prior approval of the franchisor. There is of course a distinction between the kind of system like that in *Yves Rocher*, in which the franchise is based on the sale of products through particular trademarks and symbols which are placed on the goods themselves, and a system as in *Computerland*⁴⁰⁵ in which the goods themselves bear no particular signs or marks connecting them with the franchise network. Stricter controls could be expected to be acceptable in the former type of franchise. It must be possible, though, for the franchisee to obtain goods not connected with the 'essential object' of the franchise from whomsoever it pleases. The franchisor may still control the quality of these ancillary goods and interfere if they would damage the reputation of the network.⁴⁰⁶

(j) An obligation on the franchisee to obtain the franchisor's approval for the nature of any advertising to be done by the franchisee. This is only acceptable provided it is not used to influence prices advertised or charged by franchisees. In *Yves Rocher*⁴⁰⁷ it was explained by the Commission that such a clause enables Rocher to ensure that the theme of natural beauty from plants, on which the network's image was based was adhered to in all advertising material. It is also acceptable for an advertising and promotional levy to be collected from franchisees.⁴⁰⁸

(k) An obligation on the franchisee to sell only to end-users or to other franchisees. In certain types of franchise this type of restriction will not infringe Article 81(1). This is

⁴⁰⁴ Case 161/84 *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 353

⁴⁰⁵ n.396

⁴⁰⁶ *ibid.* par.25

⁴⁰⁷ Commission Decision *Yves Rocher* [1987] OJ L35/31

⁴⁰⁸ *ibid.* par.26

the case when the goods, when passed on to other resellers, bear some mark or name connecting them with the franchise. Thus in *Computerland* the Court stated that:

In certain franchise systems, for example where franchisees sell products bearing the franchisor's name and/or trademark, the prohibition on resale by franchisees to resellers who do not belong to that franchise network is based on the legitimate concern that the name, trade mark or business format could be damaged if the contract products were sold by resellers who do not have access to the franchisor's know-how and are not bound by the obligations aimed at preserving the reputation and unity of the network and its identifying marks.⁴⁰⁹

An example of such system appeared in *Yves Rocher*.⁴¹⁰ In other circumstances, such as those in *Computerland*, such a restriction violated Article 81(1) and required exemption if it was to be valid. It is to be acknowledged that Article 81(1) will be infringed if franchisees are not allowed to obtain supplies from other franchisees. In *Charles Jourdan*,⁴¹¹ the Commission requested that an express clause permitting such cross-supply be inserted in the agreement used before exemption was granted.

(l) An obligation of the franchisee to submit to inspections of the outlet, including checking on stock levels, accounts and balance sheets. In *Yves Rocher*,⁴¹² the express warning was made that:

The Commission reserves the right to intervene in case these controls would be used by the franchisor to affect the freedom of the franchisees to fix their selling prices.

(m) An obligation on the franchisee to supply regular reports and accounts.

(n) Recognition by the franchisee of the validity and ownership of the franchisor's trade marks and trade names. In *Computerland*,⁴¹³ such a term was not objected to. It was however pointed out that there was no restriction on the franchisee's right to contest the

⁴⁰⁹ *ibid.*

⁴¹⁰ n.407

⁴¹¹ Commission Decision *Charles Jourdan* [1989] OJ L35/31

⁴¹² Commission Decision *Yves Rocher* [1987] OJ L35/31

⁴¹³ Commission Decision *Computerland* [1987] OJ L222/12

franchisor's industrial property rights. Such a non-contest clause would probably infringe Article 81(1).

(o) To hold stocks and make orders in advance according to a fixed time table.⁴¹⁴

(p) Recommended prices. The practice of recommending prices in the context of franchising agreements does not infringe Article 81(1). As in other contexts, any attempt to enforce adherence to minimum prices, which goes beyond simply informing dealers of those prices, will be a serious breach of Article 81(1). In *Pronuptia*,⁴¹⁵ the Commission required Pronuptia to remove a clause requiring the franchisee not to harm the brand image by its pricing level. Such a clause was presumably considered to set some kind of implied minimum price rule.

5.6 Exemption under Article 81(3)

If a franchising agreement includes clauses which infringe Article 81(1) then it will be void and unenforceable under Article 81(2), and incur the risk of fines and claims for damages, unless it is exempted. Exemption, where applicable, applies automatically. It may occur either through the operation of the BER or by satisfying the substantive criteria in Article 81(3).

The BER⁴¹⁶ provides a very broad definition of 'vertical restraints' to which it applies. Many franchising agreements, including those based on agency and those incorporating selective distribution, fall within its scope and thereby benefit from the exemption. In particular the Regulation expressly includes arrangements involving the assignment or use of intellectual property rights, provided they are ancillary to the main agreement. The idea is to cover agreements where the distribution of goods and services can be performed more effectively because such rights are assigned or transferred for use by the buyer.⁴¹⁷ There is, therefore, no obstacle to its application where the franchisor, for example, licenses the use of his know-how or of its trade mark to assist a buyer in

⁴¹⁴ *ibid.* par.27

⁴¹⁵ Case 161/84 *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 353

⁴¹⁶ Commission Regulation (EC) 2790/99 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices [1999] OJ L336/21

⁴¹⁷ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1 31

distributing goods or services. An agreement, on the other hand, which is essentially a trademark license or a technology transfer agreement, will not be covered.⁴¹⁸ Whether specific franchising agreements benefit from the Regulation will also depend on whether all the criteria laid down in the Regulation are satisfied: these are essentially that the franchisor's market share does not exceed thirty percent and that no black-listed clauses are present.

5.7 Non-compete Clauses

As has been seen above, non-compete obligations in a franchise agreement will generally not infringe Article 81(1), provided they are necessary to maintain the common identity and reputation of the franchised network. If they do infringe then, provided they fit within the definition of:

any direct or indirect obligation causing the [franchisee] not to manufacture, purchase, sell or resell goods or services which compete with the contract goods or services; or any direct or indirect obligation of the [franchisee] to purchase from the [franchisor] or from another undertaking designated by the [franchisor] more than 80 per cent of the [franchisee's] total purchases of the contract goods or services and their substitutes,⁴¹⁹

they can be imposed for up to five years, unless the franchisee operates from the franchisor's premises, in which case they may last as long as the occupancy of those premises. The Commission states that the following obligations are 'generally considered to be necessary to protect the franchisor's intellectual property rights' and so are exempted by the Regulation insofar as they infringe Article 81(1):

- (a) an obligation on the franchisee not to engage, directly or indirectly, in any similar business;
- (b) an obligation on the franchisee not to acquire financial interests in the capital of the competing undertaking, which would give the franchisee the power to influence the economic conduct of such undertaking.

⁴¹⁸ But it will be covered by Commission Regulation 772/2004 on the application of Article 81(3) of the Treaty to categories of technology transfer agreements [2004] OJ L123/11

⁴¹⁹ Commission Regulation (EC) 2790/99 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices [1999] OJ L336/21 Art (1)(b)

5.8 Post-term Non-Compete Clauses

Such clauses are treated less strictly in the context of arrangements in which substantial know-how is transferred, as opposed to other types of distribution arrangements, where the Regulation does not exempt them at all. Franchise agreements are therefore in substance the sole type of agreements in respect of which the Regulation exempts post-term non-compete clauses. According to the Guidelines⁴²⁰ they are exempted by the Regulation provided that they:

- relate to goods or services which compete with the contract goods or services; and
- are limited to the premises and land from which the buyer has operated during the contract period; and
- are indispensable to protect know-how transferred by the supplier to the buyer; and
- last no more than one year after termination of the agreement.

5.9 Use of Know-how

Know-how is defined in Article 1(f)⁴²¹ as a package of non-patented information, resulting from experience and testing by the supplier, which is secret,⁴²² substantial⁴²³ and identified.⁴²⁴ The information must be unpatented. If the know-how being passed on is of sufficiently technical or scientific nature to be patented then the arrangement does not fall within the Regulation definition of a franchise agreement. It may, however, benefit from the Block Exemption applicable to technology transfer.⁴²⁵ The amount of testing and experience that there must be behind the know-how is not specified, but presumably it means that the franchisor must itself have for some time worked in the business in which the franchisees will be engaged in. This experience and testing must be that of the franchisor and that it is not sufficient that it has been done by someone

⁴²⁰ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1 par.44

⁴²¹ Commission Regulation (EC) 2790/99 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices [1999] OJ L336/21

⁴²² ‘secret’ means that the know-how, as a body or in the precise configuration and assembly of its components, is not generally known or easily accessible.

⁴²³ ‘substantial’ means that the know-how includes information which is indispensable to the buyer for the use, sale and resale of the contract goods or services.

⁴²⁴ ‘identified’ means that the know-how must be described in a sufficiently comprehensive manner so as to make it possible to verify that it fulfills the criteria of secrecy and substantiality.

⁴²⁵ C Bellamy and G Child - European Community Law of Competition (PM Roth ed 5th edn Sweet and Maxwell London 2001) 101

independent of the franchisor. However, presumably, independent agents, management consultants and market researchers working for the franchisor would also be able to fulfill this requirement on behalf of the franchisor.

The requirement that the know-how be indispensable to the franchisee is a personal one. In fact, potential franchisees generally tend to be new to the business in question, and to be looking at a safe way to start up business on their own. In such cases it should not be difficult to this requirement. However, were the franchisee is already experienced, it might be harder to establish that the know-how was in fact indispensable to it. The know-how could be in the form of a written document, a video-tape or a course in the form of a programmed instruction that the franchisee could use on its computer. The following obligations relating to know-how are generally considered to be necessary to protect the franchisor's intellectual property rights and so are exempted by the Regulation insofar as they infringe Article 81(1):

- An obligation on the franchisee not to disclose to third parties the know-how provided by the franchisor as long as this know-how has not fallen in public domain;⁴²⁶
- An obligation on the franchisee to communicate to the franchisor any experience gained in exploiting the franchise and to grant it, and other franchisees, a non-exclusive license for the know-how resulting from that experience;⁴²⁷
- An obligation on the franchisee not to use know-how licensed by the franchisor for purposes other than the exploitation of the franchise.⁴²⁸

However, it is not easy to construe what would be the consequence of the know-how's ceasing to qualify as know-how during the term of an agreement exempted under the Regulation at the time of its conclusion.

⁴²⁶ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1 par.44

⁴²⁷ *ibid.*

⁴²⁸ *ibid.*

CONCLUDING REMARKS

Regulation 2790/99⁴²⁹ and the accompanying Guidelines⁴³⁰ signify a decisive break from the previously applicable 'category-specific' regime. With an aim of achieving a reasonable degree of legal certainty and of doing away with the formalism of the previous regime,⁴³¹ the above captioned Regulation endeavours to prohibit only the economically damaging distribution agreements. Businesses, whose market share does not exceed 30 per cent and are void of any of the black-listed practices, benefit from a greater degree of commercial flexibility whilst those businesses whose market share is greater than the mentioned limit must come to terms with the dictates of the law and adopt a more cautious approach. Agreements falling outside the scope of application of the Regulation are in no way presumed to be illegal but may require individual assessment in order to determine their actual effects on the market.⁴³² This principle is the closest that the current regime comes to an empirical system with a human face.

Many are those agreements which even though employed in market shares that exceed the set 30 percent, are benign and sometimes pro-competitive. Moreover, non-hardcore vertical agreements falling outside the purview of the block exemption are deemed not to exert significant anti-competitive effects where the market share of each party does not exceed 15 percent.⁴³³ On the other hand, hardcore restraints such as the imposition of export bans are generally outlawed by Article 81(1) and irreconcilable with the dictates of 81(3). A more reasoned approach in this regard would not be amiss. The use of restraints, some of which are black-listed by the Regulation are indeed part and parcel with the dynamic needs of the business world. A system which weighs the pro

⁴²⁹ Commission Regulation (EC) 2790/99 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices [1999] OJ L336/21

⁴³⁰ Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1

⁴³¹ Commission Regulation No 1983/83 on the Application of Article 85(3) of the Treaty to Categories of Exclusive Distribution Agreements [1983] OJ L 173/1; Commission Regulation No 1984/83 on the Application of Article 85(3) of the Treaty to Categories of Exclusive Purchasing Agreements [1983] OJ L 173/5; Commission Regulation No 4087/88 on the Application of Article 85(3) of the Treaty to Categories of Franchise Agreements [1988] OJ L 359/46.

⁴³² Commission Guidelines on the application of Article 81 to Vertical Restraints [2000] OJ C291/1

⁴³³ Notice on agreements of minor importance which do not appreciably restrict competition under Article 81 (1) of the EC Treaty (De Minimis Notice) [2001] OJ C368/13

and anti-competitive effects of such agreements would be even more profitable to the average businessman. Needless to say such a system would bring us back to the need of greater resources but since the system is now decentralized, the work load of such a case-by-case basis will now be shared between the authorities of the 27 Member States. This luxury however does not come without a threat to certainty which may be described as the golden thread which should run through any effective system of law.

The scope of application of the Regulation is much wider than that of the former block exemptions⁴³⁴ that it sought to replace and has largely enhanced a principle which is complementary to the dynamism of the business world of our era.⁴³⁵ This assertion however is not meant to iron out the difficulties affecting current EU distribution law which will require attention in the immediate future. Whilst the advent of the Internet is here to stay and it is indeed a commendable development in the history of mankind, it has brought with it a myriad number of issues which clearly lack a decisive answer. The changing patterns in the distribution of goods and the blurring of the traditional distinction between the manufacturing, wholesale and retail functions bring on added challenges. From a positive or consumer-oriented perspective one could see how this technological development is being used to foster efficiency and welfare. Who ever thought in the early seventies that he could order all the required commodities at the touch of a button? From a business-oriented perspective however one could see that these changes are more far-reaching. Music, movies, software programs, books to mention a few, can be ordered on the Internet and delivered to the given customer in no time at all with the traditional intermediary playing no role whatsoever. Many profess the elimination in due time of physical sale outlets by manufacturers which previously depended on a network of wholesalers and retail outlets. We have seen the development of Internet sites which do not belong to and are not developed by a particular

⁴³⁴ Commission Regulation No 1983/83 on the Application of Article 85(3) of the Treaty to Categories of Exclusive Distribution Agreements [1983] OJ L 173/1; Commission Regulation No 1984/83 on the Application of Article 85(3) of the Treaty to Categories of Exclusive Purchasing Agreements [1983] OJ L 173/5; Commission Regulation No 4087/88 on the Application of Article 85(3) of the Treaty to Categories of Franchise Agreements [1988] OJ L 359/46.

⁴³⁵ A. Buhagiar, *Vertical Restraints under EC Competition Law in the Light of the New Block Exemption and Guidelines on Vertical Restraints*, LL.D Thesis (2003) 185

manufacturer to sell his own goods or services but are intended to offer a platform for those businesses that prefer advertising on such sites instead of setting up their own.

These horizontal forms of co-operation raise a number of competition law concerns namely the exchange of confidential market information. All these phenomena bring important implications for price transparency and the possibility for price competition. An emerging practice which will need some address in the near future is that relating to a new form of free-riding where any given customer or business man can have physical access to the products at the local traditional outlet, make his investigations, take his decision and then place an on-line order for the same goods or services at a comparably lower price. Whether the substance of the law will in fact change to cater for these vicissitudes is a process which will inevitably take time and which has yet to be seen.

Conversely, in the procedural side of EU Competition Law we have witnessed greater changes in the last four years. The 'modernization' as triggered by Regulation 1/2003,⁴³⁶ requires businesses and its advisors to assume greater responsibilities and to vet their agreements. It also increases the Commission's enforcement powers and places new responsibilities on national competition authorities and Courts. Whilst being commendable, the effort to decentralize and to equalize the load between the authorities of the 27 Member States, has brought new potential problems to the fore. One of the adverse effects that the decentralization could have concerns the possibility of a lack of harmonization and unity of interpretation of current EU competition law rules posed by the possibility of divergent decisions that may be taken by the competition authorities and Courts of the various Member States. The relationship between the Commission on the one hand and the national competition authorities and Courts is central to the smooth operation of the system. Another worry could be the increase in forum shopping where businesses and their advisors would choose the forum which is most likely to pronounce the judgment which best suits them. Such a trend would be less likely to develop if there were to be safeguards which would limit the leeway of the national competition authorities and Courts in their interpretation of EU competition law. There

⁴³⁶ Commission Regulation (EC) 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 [2003] OJ L1/1

is always the risk of multiple court proceedings since decisions of national authorities will not be effective outside their jurisdiction. Another important point which perturbs some commentators⁴³⁷ concerns the readiness of some national courts to deal with complex competition law cases which require apart from a thorough understanding of competition law, a good grasp, to say the least, of economics. For many judges competition law in itself is still a new subject which is not always given the right approach and afforded the merited attention.

⁴³⁷ J. Goyder, *EU Distribution Law* (4th edn Hart Publishing, Oxford 2005) 194

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