

Award in Competition Law

Lecture Title: Article 101 TFEU Vertical Agreements



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Recap: What does Article 101 TFEU cover?

EU Comp. law applies to anti-competitive agreements or business practices between:

- competitors (**horizontal agreements**) and/or
- Trading parties at different levels of the distribution chain(**vertical agreements**) (NB not consumers)

The TEXT READS “all [(**horizontal**) or **vertical**] agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market.”

1. An agreement (decision or concerted practice) between two or more
2. Undertakings (an economic activity)
3. Which has the “object” or “effect” of restricting or preventing competition
4. Having an effect on trade between MS (jurisdictional element for application of TFEU)



Competition Element: The Concept of Object/Effect

- The words "object" or "effect" are to be read disjunctively. It is, therefore, sufficient that an agreement has either an "object" or an "effect" that is anti-competitive
- By Object: "certain forms of collusion between undertakings can be regarded, by their very nature, as being injurious to the proper functioning of normal competition." : it is not necessary for the authority or the court to prove that the restriction had anti-competitive effects.
- For "by object" agreements regard must be had inter alia to the content of its provisions, the objectives it seeks to attain and the economic and legal context of which it forms part"
- The former EU DG for Competition Alexander Italianer has stated:

"Drunk driving is always illegal, because all our experience tells us that it is extremely likely to cause harm. The risk of harm is sufficiently great to warrant an outright prohibition, rather than judging infringements on a case by case analysis."

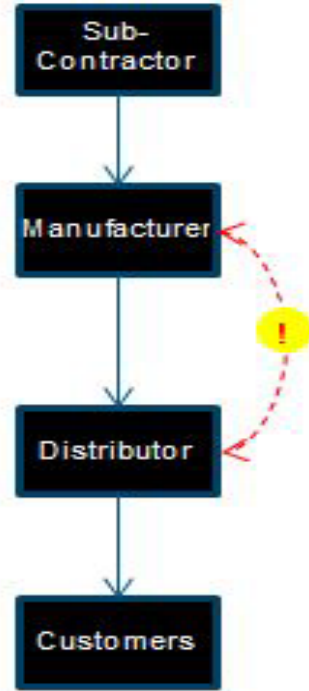
Competition Element: The Concept of Object/Effect

- On the other hand, where the analysis of the object of the agreement does not reveal an obvious anti-competitive objective, the next question is whether it restricts competition by effect.
- Classification: “non per-se” – not necessarily harmful to competition, their effect depends on particular circumstances as the nature of the agreement and market conditions
- This means that, for an agreement to have restrictive effects on competition within the meaning of Article 101(1) it must have, or at least be likely to have, an appreciable adverse impact on at least one of the parameters of competition on the market, such as price, output, product quality, product variety or innovation.
- Under certain conditions, vertical agreements are likely to help realise efficiencies and the entry of new markets in a way which may offset possible negative effects. In general, vertical restraints will be viewed more favourably if they are of limited duration and assist in the introduction of new and complex products or the protection of specific investments.

VERTICAL VS HORIZONTAL ISSUES

Vertical

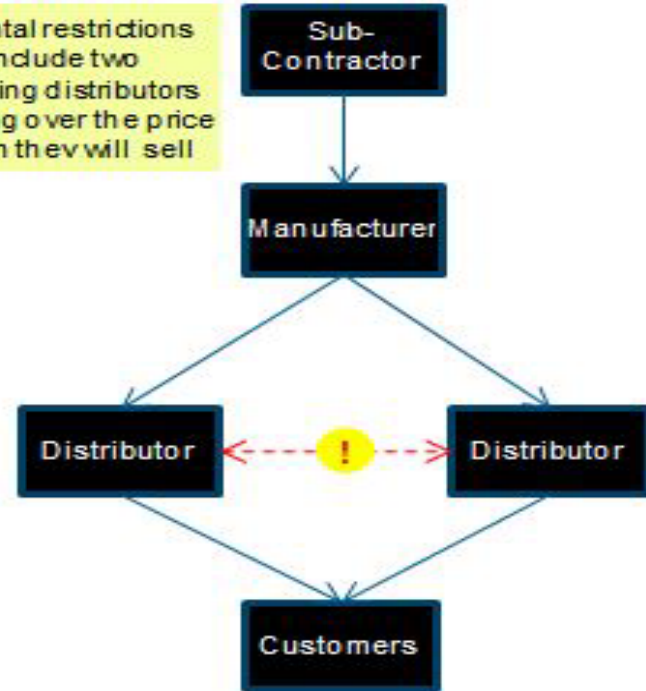
Vertical restrictions would include an a manufacturer requiring distributors to resell at a particular price



- Common Supply Chain Issues: Vertical**
- What price you can sell at
 - Who you can sell to (or buy from)
 - What markets you can sell to

Horizontal

Horizontal restrictions would include two competing distributors colluding over the price at which they will sell



- Common Supply Chain Issues: Horizontal**
- What price to buy or sell at
 - Who to sell to or buy from
 - What markets you can sell to
 - In formation sharing



Object or Effect: Horizontal Agreements

Article 101 TFEU - Horizontal

- **There are 4 key cartel agreements that incur the highest penalties and should never be entered into:**
 - ✓ Price Fixing – when firms agree to sell items at a price higher than they normally would if they were competing against each other.
 - ✓ Restricting Supply – When firms restrict the quantity of goods/services supplied with the intention of raising prices.
 - ✓ Market Sharing – When firms agree to operate only within agreed areas in the country.
 - ✓ Bid Rigging - When businesses agree, when bidding for a contract, which one will win that contract and at what price.

Object or Effect: Vertical Agreements

Article 101 TFEU - Vertical

- The categories of vertical agreements that are typically treated by the Commission as having the **object** of restricting competition are those that are deemed to be "hardcore" agreements for the purposes of the vertical agreements block exemption for example:
- Imposition of fixed or minimum resale prices.
 - Restrictions of passive sales (including sales over the internet) in exclusive distribution agreements.
 - Restrictions of cross-supplies between members of a selective distribution arrangement.
 - Restrictions of sales to end-users by buyers operating at the retail level of trade.



Horizontal Restraints v Vertical Restraints

Horizontal	Vertical
Cartels eg. Price fixing or output restrictions	Prohibition of on-line sales
Bid Rigging (collusive tendering)	Exclusive supply or distribution
Sharing markets by territory or customer	Certain restrictions on a selective distribution system
Limiting production, supply or technological development	Resale price Maintenance
	Territorial/Customer restrictions

Another Quick Example of a Vertical Restraint

Commission fines **Nike** €12.5 million for restricting cross-border sales of merchandising products



Article 101 - Moving onto Vertical Agreements

Vertical Agreements:

- Article 101 TFEU does not apply to purely unilateral conduct, as in such cases there is no agreement or concerted practice between the parties. However, the definition of "agreement" is wide, and catches anything that expresses the parties' joint intention to conduct themselves on the market in a specific way (See Bayer case General Court T-41/96 and compare Topps case)
- do not generally give rise to competition concerns. Although it is recognised that vertical agreements may hinder intra-brand competition (same brand), vertical agreements tend to stimulate inter-brand competition (different brands), so providing wider benefits to end-consumers;
- the agreement must relate to the conditions of purchase, sale or resale of services or goods. The block exemption applies to goods sold and purchased for renting to third parties, but not to rental and lease agreements
- can cause competition problems if one of the parties to the agreement possesses market power or the agreement is one of a number of similar agreements having a cumulative effect on the market

Article 101 - Moving onto Vertical Agreements

- "Vertical agreements" are defined as agreements or concerted practices entered into 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 which relate to the conditions under which the parties may purchase, sell or resell certain goods or services

- "Vertical restraints" are restrictions of competition contained in vertical agreements (Article 1(1)(b)).

- There are three elements to this definition:
 - i. The agreement must be between two or more undertakings.
 - ii. Each undertaking must operate, for the purposes of the agreement, at a different level of the production or distribution chain.
 - iii. The agreement must relate to the conditions of purchase, sale or resale of services or goods. This means that vertical agreements relating to goods and services, final and intermediate, are all covered.



Advantages	Disadvantages
promote non-price competition and improve quality of services	reduction of intra-brand competition (competition between the buyer and its competitors)
They may eliminate the “free rider” problem	facilitation of collusion amongst these competitors if it concerns distributors' competition on the basis of the brand or product of the same supplier
Facilitates entry or expansion in new market – client-specific investments have to be made by either the supplier or the buyer, such as in special equipment or training	limitations on the freedom of consumers to purchase goods or services in a Member State
Economies of scale in distribution (the manufacturer may want to concentrate the resale of his product on a limited number of distributors in order to exploit economies of scale)	anticompetitive foreclosure of other suppliers or other buyers by raising barriers to entry or expansion
Uniformity and quality standardization (creation of brand image)	



Vertical Restraint

Definition

Single Branding

Buyer is obliged/forced or induced/incentivised to purchase all or most of its requirements from only one supplier, that is, not to buy and resell (or not to incorporate) competing goods/services.

Exclusive Distribution

Where the supplier agrees to sell its products only to one distributor for resale in a particular territory (and where usually the distributor is restricted from active selling into other exclusively allocated territories)

Exclusive Customer Allocation

Where the supplier limits sales to only one buyer for a certain class of customer

Selective Distribution

Where the supplier agrees to sell the contract goods/services, either directly or indirectly, only to dealers selected on the basis of certain pre-defined qualitative or quantitative criteria and where those dealers agree not to sell to unauthorised dealers

Exclusive Supply

Where the supplier agrees, or is incentivised, to sell only or mainly to one buyer

Resale Restrictions

Buyer is obliged/induced not to resell the contract goods below certain price levels: minimum resale prices, fixed resale prices, recommended or maximum resale prices

Up-Front Access Payments

Fixed fees that suppliers pay to distributors at the beginning of a relevant period, in order to obtain access to their distribution network and remunerate services provided to the suppliers by the retailers.



Sample Distribution Agreement

DRAFT FOR DISCUSSION PURPOSES ONLY

DISTRIBUTION AGREEMENT

Between

[_____]

and

[_____]

Draft 1- for discussion purposes only



Exemption/Exclusions

- Genuine agency agreements/parent-subsidiary agreements excluded
- De minimis agreements are excluded from Article 101 See *Case C-226/11 Expedia Case*
 - Test 1 (where the customer is not a competitor): (i) Each party has $\leq 15\%$ market share and (ii) the agreement has no “hardcore” restrictions
 - Test 2 (where the customer is a competitor): (i) The parties’ aggregate market share is $\leq 10\%$ and (ii) the agreement has no “hardcore” restrictions
- Agreements entered into by **SMEs**
- **VBER**: Regulation 330/2010
- If none of these apply, full assessment under **Article 101(3)**



The VBER: Regulation 330/2010

The Presumption

- Where the market share held by each of the parties in a Distribution Agreement falls below **30%** and there are no severe restrictions on competition it is presumed that the agreement will lead to an improvement in the market, with consumers ultimately benefiting from the arrangement.
- If the market share exceeds the 30% threshold, there is **no presumption of illegality**, but companies are encouraged to make their own assessment of an agreement in order to determine whether it restricts competition

The Hard-Core Restrictions

- If a Distribution Agreement contains a **hard-core restriction** the entire agreement falls outside of the Block Exemption and the parties must embark on the difficult task of showing that the agreement is in compliance with competition law. Eg RPM



Hardcore Restrictions

- The block exemption contains a "blacklist" of vertical restraints which, if included in a vertical agreement, will mean that the block exemption cannot apply (despite the fact that the market share threshold is not exceeded) (Article 4).

- The inclusion of any such restraint prevents the entire agreement from obtaining the benefit of the block exemption, not merely the clause or sub-clause in which the restraint is contained: there is no severability for hardcore restrictions for the purposes of the block exemption. Exemption of hardcore restraints is unlikely, but undertakings can demonstrate pro-competitive effects under Article 101(3) in any individual case.

- The hardcore restrictions are as follows:
 - i. Resale price maintenance
 - ii. Resale (territories)
 - iii. Cross supplies in a selective distribution system
 - iv. Access to spare parts



Hard Core (1): RPM

- Suppliers must not take any action that **interferes with a retailer's ability to set their own price** of the supplier's goods online or through other channels.
- Any agreement or restrictive practice having as its direct or indirect object the establishment of a **fixed or minimum** resale price level to be observed by the buyer is blacklisted.
- However, a supplier may impose a **maximum** resale price (above which the buyer may not sell the goods or services), or **recommend** a resale price, as long as it does not have the effect of a fixed or minimum resale price as a result of pressure from or incentives offered by the parties imposing the restriction.

Resale price maintenance

As in most jurisdictions, EU law imposes strict limitations on the principal's ability to impose a retail price on the distributor. The restrictions apply to explicit contract clauses as well as indirect resale price maintenance, such as using threats and penalties or delaying or suspending deliveries to punish a distributor.

- Minimum or fixed resale prices not permitted
- Maximum resale prices may be imposed
- Recommended sales prices are permitted provided that they do not amount to a fixed or minimum price as a result of incentives offered by, or pressure from, the principal

Example: A clause that makes the grant of rebates or reimbursement of promotional costs by the supplier subject to the observance of a given price level is invalid.

What amounts to RPM?

- Fixing the distributor's margin;
- setting a maximum discount which a distributor must apply;
- making rebates or promotional costs (or other supply benefits) conditional upon adherence to a given price level;
- linking the resale price to that of competitors' products;
- Imposing a most favoured nation clause
- using threats, intimidation or warnings to coerce a buyer to comply compliance with the supplier's recommended resale prices;
- indirect pressure linked to mechanisms to identify instances of discounting;
- monitoring the prices of distributors; and
- obliging retailers to report other distributors deviating from the "recommended" price level.



What amounts to RPM?

The UK

- high street clothing retailers Debenhams, John Lewis and House of Fraser and the sports bra manufacturer DB Apparel were found guilty of fixing the resale price of DB Apparel's 'shock absorber' brand of sports bra.
- a supplier of domestic light fittings was found guilty restricting resellers' freedom to set their own prices online – a form of resale price maintenance (RPM)
- A supplier imposed a 'minimum advertised price' (MAP) policy that restricted the price at which retailers could advertise the supplier's product online. It enforced this MAP policy by threatening to charge dealers higher cost prices for products, or stopping supply altogether, if they advertised below the minimum price.
- A manufacturer threatened retailers with penalties for not pricing at or above a 'recommended' online price as set out in 'online trading guidelines'

Germany

- Tooltechnic Systems Deutschland (TTS) established a resale price maintenance system. TTS sells power tools through a network of specialist stores. TTS pressured these stores verbally to observe the recommended resale price set by TTS. They were threatened with contract suspension and other measures if they deviated from the RRP. These actions amounted to RPM.
- contact lens provider CIBA Vision Vertriebs GmbH was fined for fixing resale prices on the basis (amongst others) that it telephoned its retailers when they deviated too low from RPM to try and convince them otherwise.



ASUS, Philips, Pioneer by way if example



- The Commission found the four companies to have engaged in so-called “fixed or minimum resale price maintenance (RPM)” by restricting the ability of their online retailers to set their own retail prices for widely used consumer electronics products — such as kitchen appliances, notebooks, and hi-fi products.
- The manufacturers put pressure on ecommerce outlets who offered their products at low prices, writing, *“If those retailers did not follow the prices requested by manufacturers, they faced threats or sanctions such as blocking of supplies.”*
- Many, including the biggest online retailers, use **pricing algorithms** which automatically adapt retail prices to those of competitors. This is the first Commission decision that has considered the use of pricing algorithms.
- Asus in particular had monitored retailers' resale prices for certain computer hardware and electronics products. Specifically, Asus had intervened with retailers in two EU Member States (Germany and France) that were **selling their products below Asus's recommended resale prices**, and had asked them to increase their prices. The Commission concluded that this practice had had the effect of limiting effective price competition, thus leading to higher prices for consumers.

Hard Core (2): Resale into Territories

- Restricting the **territories** into which, or the **customers** to whom, the buyer may sell is blacklisted

Territorial restrictions

Arguably the most distinguishing feature relative to other jurisdictions is the way EU law addresses territorial restrictions. With the objective of creating a single market, the Commission takes a particularly strict view on barriers such as export bans. These rules are not only relevant in contractual disputes but have also led to fines where companies used territorial restrictions to limit parallel trade from low-price to high-price countries.

A ban on passive sales is a "hardcore" restriction that causes an agreement to fall outside the VABER safe harbor.

- No restriction permitted on passive sales (i.e., sales not solicited by the distributor)
- Restriction on active sales only permitted in relation to exclusively allocated territories or customer groups
- No restriction on customers of direct distributor

Example: Principal has 1 exclusive distributor for France and 3 non-exclusive distributors for Germany. A clause that restricts any of the distributors from accepting orders when approached by a customer from another EU country is invalid. Principal may restrict the German distributors from approaching customers in France, which has been exclusively allocated to a single distributor, but it may not restrict the French distributor from actively selling in Germany.

Types of Territorial Restrictions

Direct obligations

- Obligation not to sell or supply certain customers or territories
- Obligation to refer orders from those customers to other distributors
- Export bans

Indirect measures aimed at inducing compliance/monitoring

- Refusal or reduction of bonuses or discounts
- Termination of supply
- Price discrimination – higher price for exported products
- Failure to provide EU-wide guarantee service



BUT Permitted Restrictions (Resale into Territories)

- The restriction of **active sales** into the exclusive territory/customer group reserved to the supplier or allocated by the supplier to another buyer, provided that such restrictions are imposed by the supplier on its direct buyers (and so do not limit sales by the buyer's customers).
- Restrictions on **passive sales** are not permitted. For example, in the Volkswagen case, Volkswagen was fined for the ban it placed on its Italian distributors from selling to German and Austrian customers seeking to buy Volkswagen models more cheaply in Italy (Case T-62/98 Volkswagen AG v Commission)
- The supplier **cannot** require a buyer to impose an **active sales ban on the buyer's customers**. Consequently, where a supplier relies on a dealer to appoint sub-dealers in its territory, the supplier cannot ensure that the sub-dealers are made subject to an active sales ban to protect its exclusive dealerships in other territories; unless those sub-dealers also enter into a contractual distribution relationship with the supplier.



An Important Definition of Sales

Active' sales mean actively approaching individual customers

'Passive' sales mean responding to unsolicited requests from individual customers including delivery of goods or services to such customers.



An Important Definition of Sales

Active sales means

- Actively approaching individual customers.
- Sending direct mail.
- Sending unsolicited e-mails.
- Sales visits.
- Actively approaching a specific customer in a specific territory through advertisement in media, on the internet or other promotions specifically targeted at that customer in that territory.
- Online advertisement specifically addressed to certain customers.
- Territory-based banners on third party websites
- Paying a search engine or online advertisement provider to have advertisements displayed specifically to users in a particular territory.



An Important Definition of Sales

Passive sales means

- Responding to unsolicited requests from individual customers.
- General advertising or promotion that reaches customers in other distributors' (exclusive) territories or customer groups, but which is a reasonable way to reach customers outside those territories (including customers in one's own territory).
- Using a website to sell products (in general, that is, unless it is specifically targeted at particular customers).
- A customer visiting the website of a distributor and contacting the distributor, leading to a sale, including delivery.
- A customer visiting the website of a distributor and opting to be kept (automatically) informed by the distributor, leading to a sale. (Even if a distributor's website offers different language options, this does not change the passive character of such selling.)



Coming Back to Nike

In its decision the Commission found a series of “practices” restricting active and passive cross-border sales of the licensed products. Namely,

- a) **direct measures** (contract clauses) restricting out-of-territory sales by licensees, such as (i) prohibitions of out-of-territory passive (including online) and active sales; (ii) obligations to refer orders for out-of-territory sales or queries to Nike; (iii) clauses clawing back royalties and revenues deriving from out-of-territory sales; and (iv) clauses imposing double royalties for out-of-territory sales;
- b) **indirect measures** restricting out-of-territory sales by licensees such as threats to end the agreements selling outside their allocated territories;
- c) restrictive practices implemented vis-à-vis master licensees to compel them not to sell outside their territories and to **enforce restrictions vis-à-vis their sub-licensees** on behalf of Nike; and
- d) Prohibited **out-of-territory online sales** – from 2012, Nike began to restrict licensed merchandise from being marketed on websites that were accessible outside of the relevant licensee's allocated territory.



An example of a French supplier and a Dutch distributor

The assignment of territory protection in a distribution agreement is not deemed to be a 'hardcore' restriction provided that five conditions are met. In that case a benefit can be obtained from the VBER. The cumulative conditions are:

1. Both the supplier and the distributor may not have a **market share** that exceeds 30%;
2. A geographic territory or block of customers must be **assigned exclusively** to a single distributor;
3. **Active selling** may be prohibited, **passive selling** must be permitted;
4. The distributor must be protected against active selling by others (**parallel imposition**);
5. There is **no restriction** on active and passive selling by the **customers/end users of the distributor**.



Consider: (i) a French supplier that distributes its products directly in France but that wishes to distribute its products in the rest of the EU via distributors, and

(ii) a Dutch distributor that is assigned the Netherlands as an exclusive territory by the French supplier

- You have a vertical agreement between supplier and distributor;
- So the VBER may apply depending on market share;
- The VBER may apply provided there are no Hard Core Restrictions;
- In this case one would have to assess the restriction by territory



1. The 1st condition for the VBER to apply: market threshold of 30% for supplier and distributor

- Firstly, the application of the block exemption requires that both the supplier and the distributor do not have a market share that exceeds 30%. If those market shares are exceeded, it will not be possible to benefit from the block exemption.



The 2nd Condition: Exclusive Assignment - a territory or block of customers is deemed to be exclusively assigned if the supplier undertakes to only supply its products to a single distributor with a view to active selling in that territory.

- This means that the French supplier assigns the territory of the Netherlands exclusively to the (in this case Dutch) distributor
- This condition is not met if there is a situation of what is known as 'shared exclusivity' or if the supplier has already assigned a territory or block of customers to a distributor but retains the freedom of appointing other distributors at a later stage
- A supplier can also decide to retain that territory or block of customers for itself, even if it is not (yet) active in that territory or with regard to that block of customers.



The 3rd condition: active selling ✓ but passive selling ✗

- The French supplier may impose a prohibition on parties other than the Dutch distributor with regard to preventing them from actively selling to customers in the Netherlands
- A ban on active selling means that a German distributor may not actively target Dutch customers. The German distributor may not therefore, for example place advertisements in Dutch monthly magazines.
- When a German distributor sells products via a website it is also prohibited from, for e.g., paying search engines to display its website when searches are made from the Netherlands (these are targeted forms of advertising)
- The exclusive Dutch distributor will have to accept the passive selling by other distributors in its territory or to its block of customers, since the French supplier is only able to restrict the active selling.



The 4th Condition: Parallel Imposition - the exclusive distributor is protected against active selling in its territory or to its block of customers by other customers of the supplier

- In this example this means, on the one hand, that when for example the French supplier prohibits the active selling in the Netherlands by German distributors while that ban is not imposed on distributors from other MS, the competition between the German and all other distributors is restricted. German distributors are the only party specifically refused access to the Dutch market
- If the French supplier fails to restrict the active selling by all (exclusive) distributors, the condition of parallel imposition is not complied with. A German distributor can invoke the invalidity of the active selling prohibition and claim damages from the French supplier for the loss it has suffered as a result of the ban.



- Therefore, the condition of parallel imposition means that if the French supplier fails to prohibit active selling in the Netherlands by its other (European) distributors, the Dutch distributor is not protected against active selling in the Netherlands and the other distributors can simply acquire customers in the Netherlands. In effect and from a legal perspective, the Dutch distributor therefore has no exclusive territory, while this is what was agreed between the French supplier and the Dutch distributor
- By not providing the Dutch distributor with any protection against active selling by other distributors, the French supplier is acting in conflict with the distribution agreement. Protection against active selling by other distributors is necessary in order to protect the investments of the Dutch distributor
- The French supplier will therefore do well to ensure that all agreements with distributors contain a parallel imposition or a prohibition on active selling in the Netherlands. If not, it runs the risk of being faced with a claim for compensation from the Dutch distributor, because the French supplier has not fulfilled what it should have done on the basis of the block exemption and the agreement: protect the Dutch distributor.



The 5th Condition: active and passive selling restrictions on customers of the distributor

- Finally, the active selling may only be restricted with regard to the distributor that is a party to the distribution agreement. This means that when the distributor in turn uses sub-dealers or enters into agreements with independent resellers, the supplier may not demand of the distributor with whom it has concluded an agreement that that distributor also restricts the active and passive selling by the sub-dealers or resellers in respect of a specific territory or block of customers
- With regard to the sub-dealers, this problem can be easily resolved: the supplier can become a party to the agreements between the exclusive distributor and the sub-dealers, so that in these agreements the active selling can also be restricted
- With regard to independent resellers, the problem is more difficult to resolve: after all, they do not form part of the supplier's distribution system. An exclusive distributor would be able to bypass the active selling restriction imposed on it by utilising independent resellers, without the supplier being able to impose any restrictions on these resellers



Hard Core (3) Resale by members of a selective distribution system

- Restricting the members of a **selective distribution** system, operating at a retail level, from making active or passive sales to end users, whether professional end users or final consumers
- The dealers in a selective distribution system cannot therefore be restricted as to the users to whom they sell, including via internet sales.

Selective distribution

A selective distribution system allows the principal to limit sales only to distributors that meet certain qualitative or quantitative criteria. Selective distribution systems are often used by suppliers of branded goods to protect and control the reputation of their brand.

- Selective criteria must be objectively justified
- Distributors can be prohibited from selling to non-authorized dealers i.e., those not meeting the principal's criteria

Example: Principal restricts its distributors to sell only to dealers that have a minimum shop-size and have specially trained sales personnel.

Selective Distribution (SD)

- **Why?** An SD arrangement will typically be used by a supplier to achieve a consistent standard and quality of service in the outlets where the products are sold
- **What is an SD?** In such a system, the supplier agrees to supply only those distributors who meet certain minimum (qualitative or quantitative) criteria. The distributors, in return, agree to supply only other “selected” distributors who are within the approved SD system OR end users
- The selection criteria used will typically require that the products are sold only through outlets that convey a particular image or that the distributor undertakes specific obligations such as staff training or after-sales services.
- **What products are eligible?** These systems are often used for the distribution of complex/technical consumer products or luxury/branded goods where there is a brand image to protect or where there is a need to preserve quality or to explain its use.



Selective Distribution (SD)

Examples of permitted qualitative criteria:

- Suitably trained staff
- To sell the products in a specialised shop or display
- Providing an after-sales service which is compliant with the product warranty
- Ban on sale of down market goods in proximity

Examples of quantitative criteria which would be permitted:

- Buying a minimum quantity of goods
- Achieving a particular turnover
- Maintaining minimum stock



Hard Core (3) Cross Supplies by members of a selective distribution system

- Restricting the restriction of **cross supplies between distributors within a selective distribution system**, including between distributors operating at different levels of trade
- This provision is meant to promote trade between authorised distributors (i.e. intra-brand competition), so that if, for example, a distributor in one country faces higher prices than a distributor in another country, there will be scope for the distributor facing higher prices to purchase cross-border at lower prices.
- Moreover, appointed wholesalers cannot be restricted as to the authorised distributors they can supply, and similarly authorised distributors cannot be restricted in relation to the authorised wholesalers from whom they buy.. For example, an appointed wholesaler in one EU country cannot be prevented from actively selling to authorised distributors elsewhere in the EU.



BUT Permitted Restrictions: Selective Distribution

- The restriction of sales by members of a **selective distribution system** to **unauthorised distributors** within the territory reserved by the supplier to operate that system. So, Selected distributors must remain free to purchase the contract products from other appointed distributors within the network, operating either at the same or at a different level of trade
- In addition, selected dealers **may be restricted as to the location of their business premises**, prevented from running their business from different premises or from opening a new outlet in a different location
- In this context, the use by a distributor of its own website cannot be assimilated to the opening of a new outlet in a different location. Consequently, a supplier can give an authorised dealer a degree of territorial protection by assigning a territory to the dealer, and committing not to allow other authorised dealers to operate premises within that territory, provided those other authorised retailers remain free to make active and passive sales into the relevant territory.



GUESS by way of example



- Guess Europe sold the contract products only to distributors selected on the basis of specified selection criteria and, second, the selected distributors are prohibited from selling the contract products to other distributors not belonging to the selective distribution network = **Guess Europe's distribution network fulfilled the criteria to qualify as a selective distribution system**
- The Commission fined the US Guess EUR 39.8 million for anti-competitive practices in its European selective distribution system. Guess had imposed various restrictions, including **restrictions on cross-border sales and online advertising**, which enabled the company to maintain artificially high retail prices, particularly in Central and Eastern Europe
- Cross network sales must not be restricted either among **authorised wholesalers, or among authorised retailers and wholesalers**
- **[Guess decision.pdf](#)**

Hard Core Restrictions Recap

- i. The **first** hardcore restriction concerns RPM: i.e. placing restrictions on the buyer's ability to determine its own resale price, in particular where a minimum or fixed resale price is imposed.
- ii. The **second** hardcore restriction concerns restrictions concerning the territory into which or the customers to whom the buyer may sell. This hardcore restriction relates to market partitioning by territory or by customer
- iii. The **third and fourth** hardcore restrictions concern selective distribution. Firstly, selected distributors, while being prohibited to sell to unauthorised distributors, cannot be restricted in the end-users to whom they may sell. Secondly, the appointed distributors must remain free to sell or purchase the contract goods to or from other appointed distributors within the network

The **fifth** hardcore restriction concerns the supply of spare parts. An agreement between a manufacturer of spare parts and a buyer which incorporates these parts into its own products may not prevent or restrict sales by the manufacturer of these spare parts to end users, independent repairers or service providers



Restriction by **Object** - Vertical Agreement

Roma Medical Aids Limited - restrictions on resale prices in respect of online sales of mobility scooters over the internet

- Roma Medical Aids is a company based in Bridgend in Wales that makes mobility scooters. It got together with seven UK online retailers and agreed (i) a ban on their selling Roma-branded mobility scooters online and (ii) advertising their prices on the internet.
- Not surprisingly, this cosy little arrangement meant that vulnerable consumers – who obviously found it difficult physically to visit several stores – had a seriously restricted choice of scooters. It was also a lot harder for them to compare prices.
- The restrictions were not formally set out as contractual clauses, but were rather contained in circulars sent by Roma to its retailer network.
- Roma monitored retailer compliance and threatened retailers with cessation of supplies if they did not comply. The infringements were found to exist even though not all of the retailers complied all of the time. For competition law purposes, this constituted an infringing agreement or concerted practice.



Restriction by **Object** - Vertical Agreement

- Documentary evidence demonstrated that one reason why Roma introduced the Prohibitions was to incentivise bricks and mortar retailers to stock and sell their products, on the basis that retailers would not face intra-brand competition from the internet and could therefore achieve a higher margin than would otherwise be the case
- Nonetheless a Restriction by **Object**

- Documentary evidence demonstrated that one reason why Roma introduced the Prohibitions was to incentivise bricks and mortar retailers to stock and sell their products, on the basis that retailers would not face intra-brand competition from the internet and could therefore achieve a higher margin than would otherwise be the case
- Some correspondence found from Roma Commercial Director:

'[...] please police issues such as this in the way [Roma Area Sales Manager's name redacted] has approached it, ie [sic] send an update on who is underselling our products and the outcome of the calls you've had with those Dealers who have been offering lower than recommended prices.

It's as [sic] important to inform me of those who give you a hard time or are unwilling to change their pricing. I will deal with those who fall into this category.'



'We've received an order for an Alcora- ROM 765- today from your company.

Unfortunately, we are not in a position to supply you with the product until you've withdrawn the pricing for all Roma branded scooters from your official website [...]

Once this has been done and you inform us then we will be more than happy to process all orders for future Roma branded scooters. We will hold onto this order and hopefully you can make the change to your sites so we may supply with you with the product.'



The OFT found that:

- by prohibiting retailers from using the internet as a sales channel, retailers were in practice restricted from accessing a wider group of end-consumers that are situated outside of the relevant retailers' local geographic area and who would wish to make online purchases, which is liable to restrict competition
- the online prohibitions had as their object the restriction of the territory into which, or the customers to whom, the retailer may sell Roma-branded scooters, and therefore constitute 'hardcore' restrictions within the meaning of the VABER
- any provision which restricts a retailer's freedom to inform potential customers of discounts which are being offered removes a key incentive for, and constitutes an obstacle to, price competition between retailers. Where recommended resale prices are provided by the supplier, any such provision makes it more likely that the recommended price will not be deviated from by retailers, thereby indirectly limiting the latter's ability to compete on price. Such a provision has as its obvious consequence the restriction of a retailer's ability to determine its own resale prices.



Outside the VBER

- If the vertical agreement does not conform to the criteria set out in the VBER, it will not benefit from the block exemption, **but it does not necessarily follow that the agreement is automatically void or unenforceable**
- In this situation, the parties must first legally assess whether the agreement is likely **to breach Article 101(1)**. If an analysis determines, on balance, that the agreement does not breach the prohibition, then the parties do not need to consider the matter any further
- If the agreement does fall within the prohibition however, the parties must go on to evaluate whether the benefits of the agreement justify imposing such restrictions on competition and whether the agreement satisfies the criteria for individual exemption as **set in Article 101(3)**

Hypothetical Case: AirCo Ltd

- AirCo produces basic screws for use in aircraft, which it sells in the US and has a global share of approximately 18%
- AirCo wishes to begin distributing in the EU, beginning with France and Germany only (and with the rest of EU reserved to itself)
- Its distributors will accept significant financial risk
- AirCo has the following initial objectives:
 - appoint one exclusive distributor in each of France and Germany. AirCo wishes to (i) prohibit these distributors from making sales into another territory; and (ii) ensure that restriction applies to its distributors' customers
 - Its chosen distributors each have about 20% shares in their respective markets
 - Reserve “global” customers to itself (regardless of order origin)
 - Prohibit its distributors from using the Internet under any circumstances



Analysis of AirCo Strategy

- Article 101 applies: The agreement is between separate firms
- Possible exemptions/exclusions: Agency unavailable distributor accepts risk
- De minimis unavailable (market shares exceeded)
- VBER – possible, assessment of market shares and specific restrictions required
- Unavailable if “hardcore” restrictions or if market shares exceeded
- Only limited availability if “excluded” restrictions are present
- If VBER unavailable, a full assessment under Article 101(3) is necessary



Application of the VBER

Market Share

- Market shares within VBER limits ($\leq 30\%$) AirCo has a global share of 18%
- AirCo's distributors each have approximately 20% share

Assessment of specific restrictions required

- Territorial restrictions as each distributor is only permitted to sell in its allocated territory
- Customer restrictions - AirCo reserves "global" customers to itself
- Channel restrictions - Distributors are not permitted to use the Internet under any circumstances

Application: Territorial Restrictions

- **Territorial restrictions under EU competition law - AirCo's territorial restriction is potentially "hardcore" and would make the VBER unavailable and likely cause the agreement to infringe Art. 101**
- Why is AirCo's restriction potentially "hardcore"? A supplier may prohibit a distributor from "actively" seeking sales outside its territory
- BUT a supplier may not prohibit a distributor from filling unsolicited ("passive") orders requested by customers outside its territory
- Potential fix to enable AirCo to confer maximum exclusivity, while still applying the VBER (or reducing risk of infringing Article 101) AirCo can prohibit its distributors in France and Germany from making "active" sales outside of France and Germany, but not from filling unsolicited orders (including over the Internet)
- What constitutes a "passive" Internet sale is complex; subject to individual assessment



Application: Customer Restriction

- Customer restrictions - This restriction is potentially hardcore. A supplier is permitted to reserve a customer group to itself (or to another distributor) consistent with the VBER and, more broadly, EU competition law
- Why is AirCo's customer restriction potentially hardcore? Because it threatens a distributor's ability to fill passive orders, which creates risks to the single market
- BUT a supplier cannot prohibit a distributor from filling unsolicited (passive) orders sought by customers in that group
- Potential fix to enable AirCo to reserve global customers, while still applying the VBER (or reducing risk of infringing Article 101) - AirCo can reserve to itself global customers, but it cannot prohibit its distributors in the EU from filling unsolicited orders from these customers



Application: Channel Restriction

- Channel restrictions under EU competition law - This restriction is hardcore
- Why is AirCo's Internet restriction hardcore? - The Internet must be available to all distributors, consistent with the VBER and a total restriction on use of the Internet is unlikely to be compliant with EU competition law
- There is no fix for this restriction, but AirCo can create guidelines for Internet use. If AirCo wishes to benefit from the VBER (and avoid infringing Article 101) it must not prohibit its distributors from using the Internet
- AirCo can impose reasonable guidelines on how its distributors use the Internet



AirCo Conclusions

- To ensure that the VBER is available, AirCo should amend its restrictions as follows:
 - Territories: AirCo can appoint an exclusive distributor for France and one for Germany. In this context, “exclusive” means that each distributor can be prohibited from making active sales outside of its territory, but not from filling passive (unsolicited) orders
 - Customers: AirCo can reserve global customers to itself, but it cannot prohibit its distributors from filling passive (unsolicited) orders received from these customers
 - Channel: AirCo cannot prohibit its distributors from using the Internet to sell its products, but it can introduce reasonable quality standards





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Award in Competition Law

Lecture Title: Article 101 TFEU Vertical Agreements



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