Award in Competition Law

Lecture Title: Article 101 TFEU Vertical Agreements

Diploma in Law (Malta)

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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 of Article 101(1) 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)

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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.”

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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” – <u>not necessarily harmful to competition, their effect depends on particular circumstances as the nature of the agreement and market conditions</u>

- 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.

- Because: under certain conditions, 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.

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Restriction by Effect – Vertical Agreement

- Maxima Latvija the largest chains of supermarkets in Latvia, were party to several commercial lease agreements with shopping centres that granted Maxima Latvija, the anchor tenant in these shopping centres, the legal right to agree to the allocation of commercial premises to other tenants.
- This provision effectively enabled Maxima Latvija to block potential retail food competition in the shopping centres concerned.
- It was held that Maxima Latvija's market power rendered the purpose of the agreements the prevention of competition, and therefore that the test for restriction "by object".
- The ECJ (C-345/14) did not, however, consider the non-compete restrictions in the Maxima Latvija agreements to be among the categories of agreement considered harmful by their nature to competition.
- The ECJ responded that it was necessary for the national court to consider the full legal and economic context of the agreement to assess whether a lease restriction may close-off the relevant market and competition, such that it has the effect of preventing, restricting or distorting competition within the meaning of Article 101(1).

Restriction by Effect – Vertical Agreement

- As part of this assessment the ECJ indicated relevant factors may include:

- the relevant retail market and size of the catchment area covered by the agreements;
- the level of real, concrete possibilities for a new competitor to establish itself elsewhere in the relevant catchment area, for example in other shopping centres, or outside the shopping centre area;
- the number and size of the operators on the relevant market in the catchment area and levels of concentration;
- the nature of customer habits and loyalty to existing brands;
- the degree of any other economic, administrative and regulatory barriers to entry;
- the nature and duration of the restriction; and
- the existence of any other agreements which may create a cumulative effect on competition.

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Object Restrictions: 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.

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Object Restrictions: Information Exchange

Article 101 TFEU - Horizontal

- **A word on Exchange of Information among Competitors:**

✓ Exchange of Information – Exchanges of information are interactions among competitors that, from a competition law perspective, fall between hard-core "naked" cartels and cooperation, which leads to increased transparency in the market which can both bolster allocative and productive efficiencies.

For example, competing firms often exchange information in order to make more informed market decisions which can help to overcome market inefficiencies. However, case law has shown that information exchange may also enable firms to engage in collusion more readily and sustain it longer.

- The main competition law concern arises when the nature of the information exchanged between current or potential competitors makes it easier for them to predict each others' behaviour and adjust their own accordingly. This in its most severe form may ultimately enable participants to fix prices or allocate customers or markets, in other words to participate in a cartel.

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Object Restrictions: Information Exchange

Article 101 TFEU - Horizontal

- **Irrespective of whether a meeting is held in a formal or informal setting, or under the guise/guidance of a trade association, legal advice should be obtained before businesses share any current information relating to the following areas:**

- prices and pricing strategy including discounts, rebates, etc.;
- methods by which prices are calculated;
- terms and conditions of business, promotions and special offers;
- general market strategy; or
- other information which a competitor would not normally be able to discover.

The golden rule is that any exchange or disclosure of information should not enable you to reduce uncertainty, that is, in a way that enables you to forecast more precisely the competitive conduct of your competitors or reduce the degree of uncertainty about the operation of the market which would have existed in the absence of such an exchange of information.

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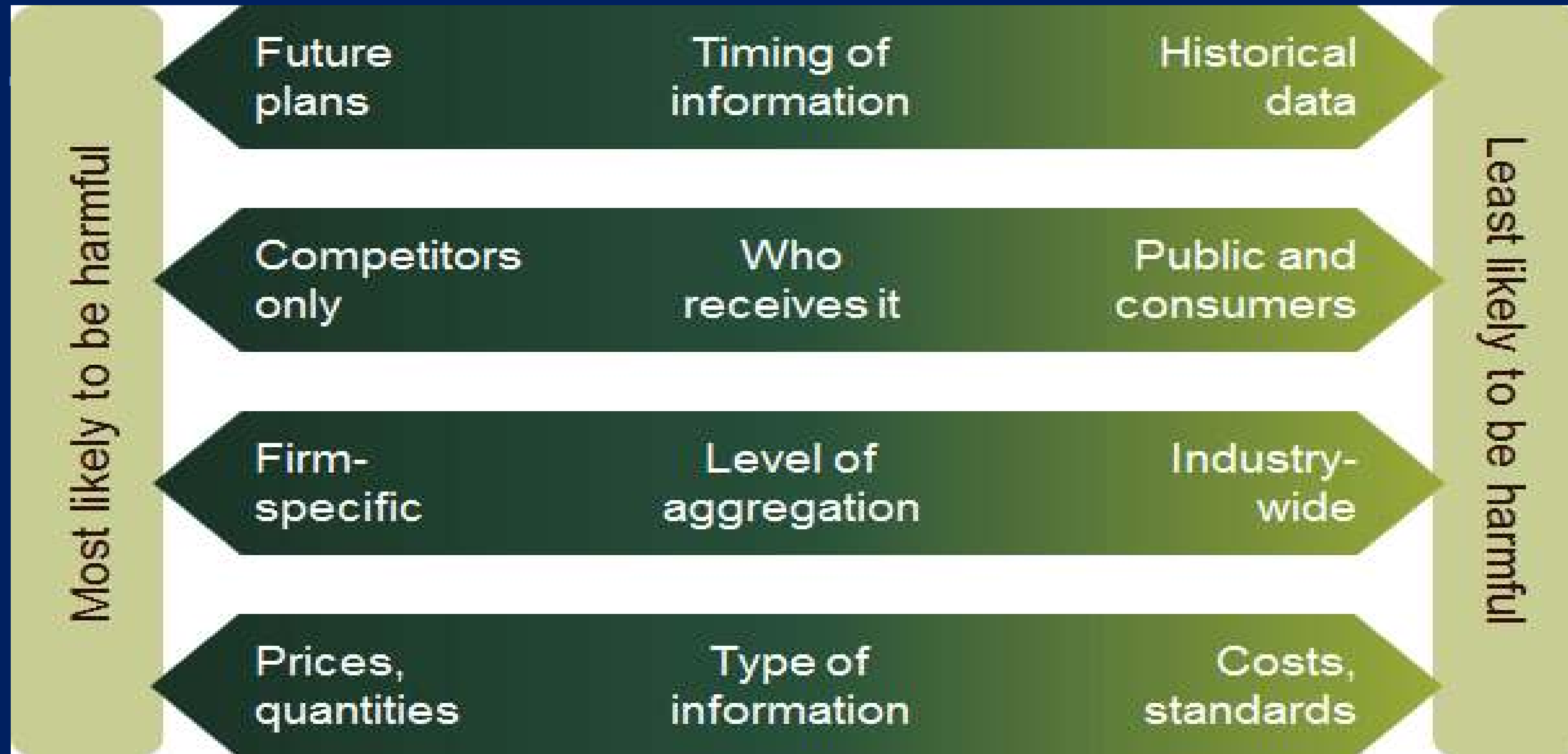
Object Restrictions: Information Exchange



Source: Oxera, based on European Commission (2011), 'Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements',

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Object Restrictions: Information Exchange

Article 101 TFEU - Horizontal

- **Example (Object) – Bananas (2015) In Case COMP/39188** –(upheld in Case C-286/13 P Dole Food and Dole Fresh Fruit Europe v Commission)
- The Commission fined Dole, Weichert and Chiquita for engaging in bilateral pre-pricing communications about price-setting factors for bananas. First, the parties discussed (ahead of the quotation price setting and announcement to customers) factors relevant to quotation prices, discussed or disclosed price trends or gave indications of quotation prices for the forthcoming week.
- The Commission found that this reduced the uncertainty between the parties as regards their price quotations.
- Second, after the prices were set, the parties exchanged their quotation prices bilaterally. The Commission found that this enabled the companies to monitor individual pricing decisions in light of pre-pricing communications.

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Object or Effect: Horizontal Agreements

Article 101 TFEU - Horizontal

- **Example (Effect) – Asnef-Equifax Case C-238/05 of 23 November 2006**
- The CJEU was asked to review the compatibility with the European competition rules of an online register set up by the Spanish association of financial institutions.
- The register contained sensitive information on existing and potential borrowers, such as past credit history, failures to pay, outstanding credit balances etc.
- The purpose of the register was to better inform lenders as to risks connected with granting loans, leading to greater and more efficient availability of credit.
- The CJEU concluded that the information exchanged on the creditworthiness of potential borrowers served to reduce the risk of lending by reducing the disparity between the information available to credit institutions and that held by potential borrowers.
- Therefore, the information exchange was capable of reducing the number of borrowers who default on repayments, and hence improved the functioning of the credit supply system as a whole, leading to a more efficient market outcome.
- As the credit register was designed to limit risks of credit institutions in granting loans, the Court concluded that the exchange of information did not have the object of restricting competition.

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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.

Object or Effect: Vertical Agreements

Article 101 TFEU - Vertical

- **Example – Supplier and Distributor Arrangement**

White Clauses

(i) technical information relating to the products or services,

(ii) logistical information, including information on production processes, inventory or stocks,

(iii) customer information, for ex in terms of preferences or feedback on the products,

(iv) but also information on resale prices, provided however that such information is not used by the supplier to engage in resale price maintenance.

Grey clauses

(i) Information relating to the actual future prices at which the supplier or buyer would sell the contract goods or services downstream

(ii) Customer-specific sales data, including non-aggregated information on the value and volume of sales per customer, or information that identifies particular customers (unless necessary to enable the adaption of contract goods/services to the consumers' requirements or to provide guarantee or after-sales services, or to allocate customers under an exclusive distribution agreement).

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- Where a restriction does not reveal obvious harm to competition, 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.

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- the number and size of the operators on the relevant market in the catchment area and levels of concentration;
- the nature of customer habits and loyalty to existing brands;
- the degree of any other economic, administrative and regulatory barriers to entry;
- the nature and duration of the restriction; and
- the existence of any other agreements which may create a cumulative effect on competition.

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Article 101 - Moving on to Vertical Agreements

Article 101 - Vertical Agreements

- "Vertical agreements" are defined as agreements 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.

Vertical Restraint	Definition
Single Branding	Buyer is obliged/forced/induced/incentivised to purchase all or most of its requirements from only one supplier, that is, not to buy and resell 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, 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

Sample Distribution Agreement

DRAFT FOR DISCUSSION PURPOSES ONLY

DISTRIBUTION AGREEMENT

The undersigned:

1. [____________________], a private company with limited liability incorporated under [__________] law, established and having its corporate seat at [________________] and with office at [________________________], Country, hereinafter to be referred to as the "**Company**", for the purposes hereof legally represented by its managing director [______________________];

and

2. [____________________]B.V., a private company with limited liability incorporated under established under Dutch law, established and having its corporate seat at [________________________], at [________________________], The Netherlands, hereinafter to be referred to as the "**Distributor**", for the purposes hereof legally represented by its (indirect) managing director Mr.[________________];

the undersigned sub 1 and sub 2 will hereinafter also individually referred to as the "**Party**" and together as the "**Parties**";

Whereas:

(i) the Company is active inter alia in the sales, marketing, and distribution in [________________]for the [_______]industry;

(ii) the Distributor is active inter alia in sales, marketing, trade and distribution of certain products and components;

(iii) The Distributor is willing to receive from the Company, which is willing to grant the Distributor, exclusive distribution rights to distribute the Products in the Territory, during the term of this Agreement, all subject to the definitions, terms and conditions specified in this Agreement;

Have agreed as follows:

1 Definitions

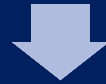
Draft 1- for discussion purposes only

Article 101 – Introducing the VBER

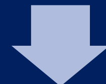
- The Vertical Block Exemption Regulation (VBER) creates an exception to the principles of the cartel prohibition for certain vertical agreements.
- The European Commission has adopted the new Vertical Block Exemption Regulation ('VBER') accompanied by the new Vertical Guidelines, following a thorough evaluation and review of the 2010 rules.
- The current revision is mainly due to the growing digitalisation of the economy, the unstoppable growth of online sales along with the expansion of large e-commerce companies and platforms.
- The European Commission had also already noticed that certain matters wrongly fell outside or within the block exemption, so that in certain cases the rules appeared to be either too strict or not strict enough.
- The revised rules provide businesses with simpler, clearer and up-to-date rules and guidance. The new rules will help them to assess the compatibility of their supply and distribution agreements with EU competition rules in a business environment reshaped by the growth of e-commerce and online sales.
- The revised VBER and Vertical Guidelines came into force on 1 June 2022.

Methodology for Assessment for Verticals

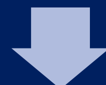
First, the companies involved need to **define the relevant market** (RM) in order to establish the market shares of the supplier and the buyer



If the RM shares of the supplier and the buyer are **each below** the 30% threshold, the vertical agreement is covered by the VBER subject to the **hardcore restrictions** and the conditions set out in the BER



If the relevant market shares of the supplier and the buyer are **above the 30%** threshold, it is necessary to assess whether the vertical agreement falls within Article 101(1).



If the vertical agreement falls within Article 101(1), it is necessary to examine whether it fulfils the conditions for legal exception under Article 101(3)

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Article 101 – Introducing the VBER

- 2023\Session02\VBER 2022.pdf

The VBER: Regulation 2022/720

The Presumption under the VBER

- 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 e.g., RPM
- it is presumed that the agreement will lead to an improvement in the market, with consumers ultimately benefiting from the arrangement.

Above 30%

- 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

Hardcore Restrictions

- The VBER 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 <u>entire agreement</u> from obtaining the benefit of the VBER, 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.

- OVERVIEW of the hardcore restrictions or blacklisted restrictions under VBER :

i. Resale Price Maintenance
ii. Territorial or Customer Restrictions
iii. Sales by a Selective Distribution System
iv. Online Restrictions

Hard Core (1) – Resale Price Maintenance

Resale Price Maintenance	
RPM constitutes the first of the hardcore restrictions described in Article 4(a) VBER. RPM, as a hardcore restriction, is presumed (i) to fall within the scope of Article 101(1) TFEU (definition of anticompetitive agreement) and (ii) not to satisfy the conditions of Article 101(3) TFEU (efficiency defence).	• Minimum or fixed prices are not permitted • Recommended provided they do not amount to a fixed or minimum amount as a result of incentives or threats by the supplier • Maximum prices are permitted
The European Commission recognizes that in some circumstances, RPM may be necessary to achieve certain efficiencies, in which case the agreement will be exempted under Article 101(3) TFEU.	• the launch of a new product • short-term promotion and • additional pre-sales services provided by retailers.
Example: A clause that makes the grant of rebates conditional to adherence to the general price level is invalid	

What amounts to RPM?

- Fixing the distributor's margin;
- setting a maximum discount which a distributor must apply;
- Minimum advertised prices

[*policies which prohibit retailers from advertising prices below a certain level set by the supplier. For example, such policies may infringe competition law if the supplier sanctions distributors for ultimately selling below the set level or prevents them from communicating that the final price could differ*]

- 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;
- 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.

ASUS & Co and RPM

The Commission found Asus, Denon & Marantz, Philips and Pioneer to have engaged in so-called **fixed or minimum resale** 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."*
- The Commission specifically pointed to the fact that the companies had used sophisticated algorithms to monitor the prices set by distributors, thereby allowing them to intervene quickly when there were price decreases.
- Asus in particular had monitored retailers' resale prices for certain computer hardware and electronics products and 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.

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Hard Core (2) Territorial or Customer Restrictions

First Things First: An Important Definition of Sales

Active sales involve some form of active targeting of a particular customer group or territory.

Passive sales consist of transactions in response to unsolicited requests from individual customers without having initiated the sales by means of active targeting of such customers.

Ex., So, if a distributor sends mail to a particular customer, there is an active sale when, that customer places an order. On the contrary, if the customer has picked up some general advertising in a magazine and visits the shop of the distributor, the subsequent sale is a passive sale.

There are numerous variations on the same theme, but the dividing line in legal terms is clear. It depends on the party that took a targeted initiative to arrive at the transaction. In the case of active selling, it is the distributor who does so. With passive sales, the initiative rests with the customer.

Active sales

- 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

Passive Sales

- 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)

Hard Core (2) – Territorial or Customer Restrictions

Territory or Customer Restrictions – Exclusive Distribution	
In order to protect efforts and investments made by exclusive, but non-selective distributors, the VBER accepts under strict conditions that other distributors may be obliged to refrain from active selling into the territory or to a customer group that is allocated to an exclusive distributor(s). The VBER enables suppliers to: (i) appoint up to 5 distributors per exclusive territory or customer group (ii) restrict active or passive sales to unauthorised distributors located in a territory where there is a selective distribution system	• Restriction on active sales only permitted in relation to exclusively allocated territories or customers • No Restriction permitted on passive sales • Parallel Imposition: the supplier must impose the active sales restriction on all its other buyers. • Roll over: the supplier can oblige its exclusive distributors to pass their active sales ban on to their direct customers
Example: Non-exclusive distributors A and B in territory X might be prevented from actively selling into territory Y that has been exclusively allocated to distributor C. But, un-intuitively, C cannot be prevented from actively selling in X (despite its exclusive status in Y) because X is a non-exclusive territory.	

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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

Quick Ex of Restrictions on Out of Territory Sales

"Football fans often cherish branded products from their favourite teams, such as jerseys or scarves. Nike prevented many of its licensees from selling these branded products in a different country, leading to less choice and higher prices for consumers. This is illegal under EU antitrust rules"

Margrethe Vestager, EU Commissioner

Quick Ex of Restrictions on Out of Territory Sales

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; and (iii) clauses clawing back royalties and revenues deriving from 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 4 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 distributor(s);
3. **Active selling** may be prohibited, **passive selling** must be permitted;
4. The distributor must be protected against active selling by others (**parallel imposition**)

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

I. The 1st condition for the VBER to apply: <u>market threshold of 30% for supplier and distributor</u>

- 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.

I. The 2nd Condition: <u>Exclusive Assignment</u>

- This means that the French supplier assigns the territory of the Netherlands exclusively to the (in this case Dutch) distributor (but up to five distributors)

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

- The French supplier must impose a prohibition on its other buyers other than the Dutch distributor with regard to preventing them from actively selling to customers in the Netherlands.

- E.g., If 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)

- But 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

IV. The 4th Condition: Parallel Imposition –

- This 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

- In this example therefore, on the one hand, when for instance 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

- 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.

Hard Core (3) Selective Distribution System

First things First – what is a SDS?

- **Why?** An SDS 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 SDS?** 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" or authorised distributors who are within the approved SDS OR end users
- **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.

The Selection Criteria for an SDS

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

Examples of quantitative criteria which would be permitted:

– Buying a minimum quantity of goods

– Achieving a particular turnover

– Maintaining minimum stock

Hard Core (3) Resale by members of a SDS

Resale in a Selective Distribution System (SDS)	
In a SDS the supplier undertakes to sell the contract products, either directly or indirectly, only to distributors who satisfy certain objective criteria. Selective distributors are free however to sell to all end-users without limitation. **The Supplier cannot:** **i. restrict cross-supplies between the members of the SDS operating at the same or different levels of trade** **The dealers in a selective distribution system cannot therefore be restricted as to the users to whom they sell, including via internet sales**	Restriction on active and passive sales to unauthorised distributors Restriction of active sales by members of the SDS, into a territory or to a customer group allocated by the supplier exclusively to a maximum of five exclusive distributors

Guess and its SDS

- Guess, a US-based company active in the clothing, shoes and accessories sector, employed a selective distribution system at the wholesale and retail level of trade. It also sold its products online directly through its own online shop and as a seller on online marketplaces.
- 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**

A bit more on this case and Article 101 TFEU

- **Online search advertising restrictions**: Guess banned retailers from using or bidding on Guess brand names and trademarks as keywords in Google AdWords. This restriction was not included in the distribution agreements but was systematically applied whenever an authorized retailer asked for permission – as was required – to use any of the Guess brand names or trademarks as keywords in Google AdWords.

In so doing, Guess sought to maximize traffic to its own website and minimize its own advertisement costs. This restricted the 'findability' and ultimately the viability of the online retailers in Guess' selective distribution system;

- **Online sales restrictions**: Guess favoured its own online shop by limiting the number of independent operators selling Guess products online. Authorized retailers were contractually obliged to first obtain explicit authorization from Guess to conduct online sales. In addition, Guess did not specify quality criteria for online sales and had full discretion in deciding whether retailers were allowed to sell online.

The primary objective was to protect Guess' own online sales activities and to limit intra-brand competition by authorized retailers;

- **Restrictions on cross-selling**: Guess prevented wholesalers and retailers from cross-selling to each other by imposing outright sales restrictions and applying disincentives to cross-sales. This was done through different types of clauses in the respective wholesale and retail agreements, for example:

- a restriction on wholesalers to promote or advertise outside their allocated territory, in some cases subject to termination of the agreement;
- an obligation for wholesalers to ensure at their own expense that the products sold to their retail customers "remain" within the "territory";
- restrictions on retailers on purchases across the selective distribution network, only allowing sales to end users

- **Restrictions on cross-border sales to end users**: Guess imposed restrictions on active and passive sales by retailers to end users located outside their allocated territory. These restrictions were typically included in the retail store sublicense agreements.

A bit more on this case and Article 101 TFEU cont.

- **Online search advertising restrictions: Guess claimed that the restriction served** the legitimate objective of protecting Guess' brand image. The Commission refuted this claim and concluded that the restriction had as its object to reduce the ability of authorized retailers to advertise and ultimately to sell the contract products to customers, in particular outside the contractual territory or area of activity, and to limit intra-brand competition.
- **Online sales restrictions**: The Commission found that Guess sought to protect its online sales activities from intra-brand competition and to limit the retailers' ability to sell outside their territory and concluded that this conduct constitutes a restriction of competition by object within the meaning of Article 101(1) TFEU.
- **Restrictions on cross-selling**: The Commission reiterated settled case law that a restriction of sales between authorized distributors constitutes a restriction of competition by object within the meaning of Article 101(1) TFEU, and concluded that the restrictions on cross-selling imposed by Guess restricted competition by object.
- **Restrictions on cross-border sales to end users**: The Commission found that these restrictions were capable of creating, maintaining or restoring national divisions in trade between Member States and therefore it concluded, in accordance with settled case law, that they restricted competition by object within the meaning of Article 101(1) TFEU.

Hard Core (4) Online Sales

Online Sales	
The prevention of the effective use of the internet by the buyer or its customers to sell the contract goods or services, as it restricts the territory into which or the customers to whom the contract goods or services may be sold is prohibited **The Supplier can impose:** **i. other restrictions of online sales; or** **i. restrictions of online advertising that do not have the object of preventing the use of an entire online advertising channel**	• ban sales on online marketplaces, provided that they do not constitute a hardcore restriction and prevent the effective use of the internet by the distributors and their customers • Clarification of restrictions such as prohibiting online advertisement including the use of price comparison tools and online search engines:

Case C-230/16 EU:C:2017:941

You have been requested to advise a client – Coty Germany GmbH ("Coty"), a supplier of cosmetic luxury products which operates a SD system;

It has a dispute with one of its authorized retailers in Germany Akzente

Akzente may:

- Sell via its own internet platform
- Sub-contract internet platform design to 3rd party
- But It cannot sell via Amazon.de

Can client impose a 3rd PARTY PLATFORM BAN? Does client have any objective justifications?

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Application of the OLD VBER

The case comes as a result of a request by the Higher Regional Court of Frankfurt, to the ECJ, for a preliminary ruling regarding the interpretation of Article 101(1) TFEU and Article 4(b) and (c) of Commission Regulation (EU) No 330/2010 (OLD VBER)

➢ **The key questions to be answered were:**

1. Whether selective distribution systems which have as their aim preserving a “luxury image” for goods are compatible with Article 101(1);
2. Whether selective distribution systems which prohibit distributors from engaging third-party undertakings, discernible to the public, to handle internet sales is compatible with Article 101(1); and
3. Whether a prohibition on engaging third-party undertakings, discernible to the public, to handle internet sales, imposed on members of a selective distribution system, was a hardcore restriction under either Article 4(b) or Article 4(c) of the VABE.

Application of the OLD VBER

- Coty's and Akzente's market shares were below 30% (Art. 3)

- **QUESTION: Was the ban on 3rd party platforms black-listed? (Article. 4)**

- **4(b): the restriction of the territory into which, or of the customers to whom, a buyer party to the agreement may sell the contract goods or services**

There is no such thing under VBER as a category of 3rd party platform purchasers

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

Akzente may advertise on its website on other websites or on search engines

Some Points to Consider before Q 3 and 4

- The reason why manufacturers of luxury products rely upon a SDS is not a secret. When products are sold through independent retailers, their reputation may suffer. There is also a risk that end-users' experience is not the same in all stores.
- The point of SDS is to ensure that only retailers that satisfy certain criteria are entitled to sell a given product; by imposing a set of a criteria to be satisfied by retailers, a manufacturer of luxury products can preserve the reputation of its products and a uniform end-user experience without resorting to vertical integration (which can be costly and thus limit its ability to expand or even enter the market).
- Therefore, by definition, this method of distribution only works if the retailers that are members of the system are prevented from selling to third parties that are not.
- Accordingly, a clause prohibiting resales to non-members is a textbook example of a restraint that falls outside the scope of Article 101(1) TFEU altogether
- Against this background, one key issue in Coty is whether prohibiting retailers from selling via online marketplaces = to a clause prohibiting sales to third-party retailers. It is not unreasonable to argue, in this sense, that the objective purpose of the two clauses is the same.

The CJEU on Q 3 and 4

- A marketplace ban neither (i) restricts the customers to whom authorized distributors can sell (ii) nor restricts passive sales to end users.
- A marketplace ban differs from an outright prohibition of the use of internet sales
- third-party platform customers are not a definable customer group in terms of Article 4(b), so that the ban did not exclude sales to a certain category of customers as a whole, which would have been illegal.
- Nor does it exclude (passive) online sales entirely, in terms of Article 4(c) given that distributors could still sell through their own web shops or non-discernible third-party platforms (e.g. price comparison websites) customers were usually able to find the online offer of authorized distributors.
- Conclusion: marketplace bans are not hard core under VBER

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)**

RECAP Quiz

Q1. May a supplier control the prices at which its distributor resells its products?

Q2. May a supplier influence resale prices in other ways, such as suggesting a minimum advertised price policy?

Q3. May a supplier restrict the geographic areas or categories of customers to which its distribution partner resells?

Q4. Is there a distinction between active sales efforts and passive sales that are not actively solicited, and how are those terms defined?

Q5. May a supplier restrict or prohibit e-commerce sales by its distribution partners?

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 prohibit these distributors from making sales into another territory;
    - 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 (≤ 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)

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

Diploma in Law (Malta)

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