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90 YEARS
1919-2009
INTERNATIONAL CHAMBER OF COMMERCE

Comments

Prepared by ICC Commission on
Competition

Review of EC competition rules applicable to vertical agreements

Highlights

- Main proposed changes
- Missed opportunities

Document No. 225/662 – 28 September 2009

Review of EC competition rules applicable to vertical agreements

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Introduction

ICC is pleased to comment on the Commission's proposals for a revised block exemption regulation and guidelines on vertical restraints.

The draft documents contain some much needed clarification regarding sales over the Internet, foresee a two-year period during which new products can be introduced to market without fear of infringing the otherwise unchanged rules on territorial restrictions on sales, and recognise that resale price maintenance may sometimes be justified by efficiencies. Some proposals are less encouraging especially the application of the market share threshold to the buyer. ICC believes that the guidance on RPM and Internet sales could better reflect commercial realities. A number of other opportunities to modernise the existing law also risk being missed.

In the following pages, ICC first discusses the Commission's main proposed changes and then turns to other possible reforms that might be incorporated in the final versions of the regulation and guidelines.

Main changes

The dual market share threshold

The biggest change to the existing regulation would see the current 30% market share threshold become applicable to both the supplier and the buyer. ICC understands that while the current EU policy treatment towards vertical restraints is focused on supply-led trading relationships within the supply chain, the new policy framework as put forth by the Commission mirrors recent economic thinking that buyers (e.g. retailers), far from being passive, are increasingly able to exercise a certain amount of pressure on their suppliers and that the "power struggle" going on within the supply chain can imply much more than a simple wealth transfer, since it could directly or indirectly distort the working of competition.

However, ICC does not believe that the proposed change is required. Requiring that the buyer's market share also be below 30% would greatly restrict companies' ability to rely on the regulation's safe harbour and is an unwelcome development. If the need to take greater account of buyer-driven vertical restraints should certainly be approved, the 30% market share threshold would be quite an inadequate tool to deal with the anticompetitive effects of demand-led vertical restraints.

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[1] The members of the ICC Task Force on Vertical Restraints are:
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The ICC Task Force thanks Gabriele Accardo and Eleonora Wäktare (both at WilmerHale) for their assistance.

First, the more recent economic analysis has shown that anticompetitive effects cannot be excluded even in cases where the market share of the buyer is well below the levels at which supply-led vertical restraints start raising concerns under the current BER (for example, dealers with relatively low market shares may still gain considerable leverage from their ability to substitute other brands).

Moreover, while buyers' more powerful market positions can sometimes produce anti-competitive effects, EU law can tackle this in other ways. For example, the Commission (or a NCA) could withdraw the benefit of the block exemption (this possibility was noted in Recital 13 of Regulation 2790/99 but has been deleted in the draft) or disapply it in a particular sector. In addition, if the buyer power is due to buying alliances, the Commission and NCAs can analyse these as horizontal agreements under Article 81. These would be more proportionate responses to potential buyer power.

ICC would also note that, while it is not aware of the details of every case in every EU Member State, the buyer's market position has never caused significant problems in the context of applying the existing block exemption.

Requiring that the buyer's market share be below 30% also gives rise to practical problems. Suppliers may find it difficult to ascertain distributors' market shares with certainty. If, for example, the buyer is a retailer operating on numerous local markets, then it will be very difficult for the supplier to assess the retailer's market position in a comprehensive manner.[2] This could result in the supplier relying on the buyer's estimate of its market position yet the buyer later trying to escape liability under the distribution agreement by arguing that, because of its market share, the agreement did not benefit from the block exemption and is invalid. A further complication could arise if a supplier is also active downstream yet needs information on the distributor's market share; exchanging such information could be anti-competitive. Besides the reduced legal certainty, buyers may also be reluctant to share this type of information with their "suppliers" if that attracts the risk of potential antitrust liability. Finally, should the market share threshold apply to local markets, a very significant number of agreements would be excluded from the block exemption since even small retailers may hold a significant market share locally (which does not mean they enjoy any market power vis-à-vis the supplier).

ICC therefore calls on the Commission to re-examine the need for the buyer's market share to be under 30%. Indeed, ICC would suggest that arguments could be made in favour of removing the market share cap applicable to retailers entirely from the block exemption.

Sales to unauthorised distributors in the context of selective distribution

The Commission proposes to modify Article 4(b), third indent, of the regulation (which provides for an exemption to the prohibition of the restriction on passive sales) as follows: "*the restriction of sales by the members of a selective distribution system to unauthorised distributors **in markets where such a system is operated***".

This modified (additional) wording could be interpreted to mean that a supplier may no longer prevent an authorised retailer from selling to an unauthorised retailer in a territory where the selective distribution system is not or not yet, in place for a certain product. This risks jeopardising the essence of the selective networks as the supplier would be prevented from securing the network against unauthorised distributor in case the network does not cover the entire European Union.[3] The smaller

[2] *Moreover, the use of the term "markets affected by the agreement" in Article 3 of the draft Block Exemption, rather than simply "the markets on which either party sells the contract goods or services", adds a further degree of uncertainty in the self-assessment the parties have to carry out. If ICC understands the proposed change correctly, under the new BER and Guidelines, undertakings should carry out an assessment similar to that already indicated in recital 96 of the current Guidelines which refers to the "[…] relevant markets at each level of trade affected by restraints contained in the agreement […]". ICC would welcome any additional guidance in this respect.*

[3] *For example, if a supplier cannot set up a selective distribution system in, let say, 5 EU Member States, then it will not be able to prevent its authorised distributors in the other 22 Member States from selling to unauthorised distributors in the 5 Member States in question. Further, the supplier will not be able to prevent unauthorised distributors in the 5 Member States from selling to other unauthorised distributors in the 22 Member States where the selective distribution has been implemented.*

brand/suppliers which do not necessarily have the means of effectively operating a selective network in all EU Member States would be particularly affected. If it is considered that this risk to the integrity of selective distribution systems is material, ICC would recommend that the Commission keep the current wording of the regulation.

Resale price maintenance

Under the Commission's proposals, resale price maintenance (RPM) would remain a hardcore restriction in the draft regulation. The draft guidelines explain that including RPM in an agreement gives rise to a twin presumption that (a) the agreement infringes Article 81(1) and (b) the agreement is unlikely to fulfil the criteria for exemption under Article 81(3).

ICC, however, approves the guidelines' statement that RPM may sometimes lead to efficiencies that can be taken into account under Article 81(3). The guidelines instance three such situations:

- Stipulating a fixed or minimum retail price may align distributors and suppliers' interests and allow them to introduce new brands or enter new markets. In particular, RPM may enable increased promotional efforts and incentivise distributors to expand overall demand for the product, which would benefit consumers.
- Fixed prices may be necessary to organise short term low price campaigns, which benefit consumers.
- Fixed or minimum prices can limit the potential negative effects of a large distributor using a particular brand as a loss leader. The guidelines recognise that selling below cost may be advantageous for consumers in the short term but, if other distributors delist the product, the practice may also lead to a reduction of inter-brand competition, which in the long term would damage consumers.

Generally, this recognition of RPM's potential efficiencies is positive. However, it is questionable how sympathetic the Commission will be towards such efficiencies given that agreements containing RPM will still be hardcore restraints under the regulation. It is to be hoped that the Commission, national competition authorities and courts will not require an unattainable quantum of evidence before accepting that the presumption of RPM's illegality has been rebutted. In particular, national judges are unlikely to consider or accept complex economic justifications for any restriction that falls within the hardcore category. Overall it seems somewhat unsatisfactory to regard a restriction as hardcore, meaning that the entire agreement loses the benefit of the block exemption, yet list exceptional situations in the guidelines when the restriction may be pro-competitive. ICC would have preferred to see the exceptions reflected in the language of the regulation (like is the case for Article 4(b)).

The guidelines' examples also raise a number of questions. First, is the list exhaustive? If not, additional, more general, guidance, would be much welcome. This can easily be clarified in the final text. Second, the guidelines consider that short term low price campaigns would normally be two to six weeks in length. While six weeks may as a rule be sufficient, what if a particular company felt it had good reasons for initiating a campaign that was a bit longer, for example two months? ICC would hope that the Commission would in appropriate situations examine the reasonableness of the provision taking full account of all relevant circumstances rather than sticking to the suggested six weeks specified in the guidelines. Finally, the anti-competitive character of loss-leading activities is dependent on third parties changing their behaviour over time, which would appear to create uncertainty for the loss leading distributor.

While ICC therefore is broadly supportive of the Commission's proposals in this area, it would submit that much will depend on the way in which the Commission, national competition authorities and courts apply the efficiencies analysis. ICC hopes that this will be similar to the way that the US Supreme Court has recommended applying the "rule of reason" in the *Leegin* case. ICC also considers that the Commission should apply its *de minimis* notice to RPM obligations where each party to the agreement has a market share below 15 %.

However, ICC is aware that in spite of international developments promoting a more benevolent treatment of RPM, the theoretical and empirical analysis of the anticompetitive effects of these practices, as well as of their possible "efficiencies", are far from settled (e.g. a recent economic study prepared for the Office of Fair Trading - "*An Evaluation of The Impact Upon Productivity of Ending Resale Price Maintenance on Books*" at http://oft.gov.uk/shared_oft/economic_research/oft981.pdf - discusses the negative effects on innovation in the retail market caused by RPM and shows that a link can be possibly established between innovative book retailing in the UK and the abolition of RPM).

Moreover, ICC wonders whether the Commission's increased focus on demand-led vertical restraints could call for even more caution concerning these practices despite the Commission's proposed (more favourable) approach in this area (e.g. retailers could be motivated to impose resale price maintenance on their suppliers, thereby making it more difficult for more performing, efficient competitors to play a greater role in the retail market).

Clarification regarding Internet sales

ICC welcomes the draft guidelines' additional guidance on online distribution. ICC considers the draft generally balances the Commission's policy goal of supporting Internet sales and suppliers and distributors' legitimate expectations that the sale of certain goods/services may be limited to sales via a particular distribution channel. Further clarification may, however, be needed regarding the criteria for distinguishing active and passive sales.

During its discussion with participants in the Online Commerce Roundtable meetings held towards the end of 2008, the Commission expressed concern about barriers to online retailing in Europe. The Commission pointed out that its policy on vertical restraints was already very favourable to online retailing but that it intended to change rules that may be preventing the expansion of Internet sales. The Commission, however, also recognises that, in some instances, certain Internet sales restrictions may produce efficiencies, such as avoiding "free riding" between distributors.

Active vs passive sales

ICC believes that the distinction between active and passive sales is also useful in the Internet context, although here technology blurs the boundaries between the two types of sales. The guidelines could perhaps elaborate on the criteria used to distinguish between active and passive sales.

In addition to the existing provisions, under which a website is not considered active selling provided it is not specifically targeted to certain customers while a transaction concluded as a result of sending unsolicited e-mails is active selling, the draft guidelines add that online advertisement specifically addressed to certain customers constitutes active selling. The revised text does not, however, explain when advertisement is "specifically addressed" to certain customers.

ICC would suggest the Commission elaborate on whether a particular factor, on its own or combined with other factors, may be used to distinguish active and passive selling. For example, the following would seem relevant:

- Use of a particular language that is not spoken in the area in which a distributor is active or that is not widely used in the distribution of the goods in question may be an indication, either on its own or with other factors, that the distributor's aim is to seek customers in other territories and sell actively to them. The Commission's current position that language has no relevance for distinguishing active from passive sales sometimes overlooks commercial reality;
- Use of some technology/software (for example, ad serving tools) aims to "induce" web users to visit certain websites. ICC therefore suggests that the existing guidelines' view that the use of banners or links in pages that are only available to certain customers is a form of active selling, should be retained in the revised guidelines and possibly be a basis for further elaboration.

The draft guidelines consider that general advertisement or promotion on the Internet may sometimes be active selling. In particular, they suggest that investments in advertising that would not be financially attractive unless there was the prospect of attracting customers in other distributors' (exclusive) territories or customer groups may be indicative of active sales. While ICC understands this view, the Commission should better clarify the borderline between such "general advertisement" and advertisement that is "specifically addressed" to certain customers.

Restrictions of passive Internet sales

In general, ICC agrees with the Commission that certain restrictions of passive internet selling should be prohibited as hardcore restrictions.

Restrictions aimed at preventing customers from viewing the website of a distributor located in another exclusive territory, automatic re-routing, or terminating a transaction when credit card data reveals an address that is not within the distributor's (exclusive) territory should all be prohibited.

While ICC generally favours prohibiting limiting the proportion of a distributor's online sales, the draft guidelines lack any precision regarding the types of efficiencies that the Commission might eventually take account of in this area. The same comment applies to the prohibition on demanding a higher price for products to be resold online. In particular, such restrictions may be objectively justified in the context of selective distribution in order to preserve the authorised distributors' incentive to invest in the brick and mortar network and avoid free-riding by online distributors. Moreover, it is unclear whether such restrictions fit within the categories of hardcore restrictions listed at Article 4 of the regulation, and it is particularly questionable whether the Commission can identify new hardcore restrictions within guidelines, i.e. *soft law*. ICC therefore believes that such restrictions should not be called hardcore restrictions in the guidelines. Alternatively, the hardcore restrictions of paragraph 52 of the guidelines should be included in Article 4 of the regulation.

ICC agrees with the possibility, if substantial distributor investments have been incurred, of restricting active and passive sales, including Internet sales, during a two-year start up period. Allowing for such a restriction offsets the generally more favourable approach the Commission is advocating towards Internet sales. The possibility seems particularly relevant for branded luxury products, which are the most affected by Internet sales. As currently drafted, the provision seems to apply only to the launch of new brands or the opening of new markets. The possibility could, however, be extended to the launch of new products (of existing brands) even if this exemption was for a shorter period. In any event, ICC would encourage the Commission to provide guidance on this.

Quality standards

ICC supports the Commission's general position that imposing criteria for online sales that are not equivalent to those imposed for sales from a brick and mortar shop, thereby dissuading appointed distributors from using the Internet, will be regarded as a hardcore restriction. Similarly, the view that the criteria for online sales must not necessarily be identical to those for off-line sales but that the two criteria should pursue the same objectives and achieve comparable results is economically justifiable. As the guidelines note, the different nature of the two distribution models can sometimes justify different criteria.

However, the concept of equivalence may be too uncertain a criterion to define a hardcore restriction. This is likely to increase litigation, and force suppliers to bear the burden of proof. As already mentioned, it is also doubtful whether the Commission guidelines can extend the concept of hardcore restrictions to clauses that are not directly related to the hardcore restrictions listed in Article 4 of the regulation. ICC therefore proposes to remove the word hardcore from paragraph 57 of the draft guidelines, alternatively to include the hardcore restriction of paragraph 57 of the guidelines in Article 4 of the regulation.

At a minimum, in order to reduce the level of legal uncertainty, ICC would, however, recommend the inclusion of some practical examples in the guidelines. For example, ICC would advocate that, within a selective distribution system, a supplier may require its distributors to have a brick and mortar shop

or showroom before engaging in online distribution. This seems a justifiable quality standard for online distributors as already acknowledged by the Commission at paragraph 54 of the draft guidelines. In addition, ensuring an efficient operation of the brick and mortar shops and that the online activity of the distributors remains consistent with the supplier's distribution model would be similarly justifiable. Similarly, requiring a distributor to sell a certain absolute amount of products off-line, ostensibly perhaps to ensure an efficient operation of its brick and mortar shop, may be justifiable provided that it does not amount to an indirect prohibition of Internet sales.

Other changes

The draft guidelines have been aligned with legal developments since 1999. These include the revised *De minimis* Notice, the Guidelines on the application of Article 81(3), the revised Technology Transfer block exemption and guidelines. The guidelines now also incorporate reference to the case-law on the possibility of apparently unilateral conduct falling within Article 81.

ICC questions the need for examining a further category of risks (other activities in other markets) to determine whether an agent is a true agent or a distributor. In particular, the draft guidelines suggest assessing whether these other activities are "indispensable" to selling or purchasing goods on behalf of the supplier. Indispensability is too uncertain a criterion for whether the agreement falls within Article 81(1) and the requirement to examine additional markets is likely to be unnecessarily onerous. Moreover, ICC questions whether the Commission's approach would be entirely justified in the light of the *Daimler* case to which the draft guidelines refer. Although, the CFI did not exclude that other types of risks may be relevant, the CFI's judgment found that the Commission did not show that the risks associated to other activities were "exceptional", "meaningful" or "material" and ultimately could not rule whether, in such latter case, those risks would have affected the relationship between the supplier and the agent under competition law.

ICC welcomes the new discussion on upfront access payments and category management. It also notes the mention of sub-contracting even if it is merely proposed to refer to the existing notice in that area. As regards upfront access payments, the draft guidelines should however clarify the circumstances in which upfront access payments might be prohibited in case they are not block exempted. Moreover, ICC considers that upfront access payments should not be considered as a single branding obligation which is limited to situations where the purchaser shall not purchase the contract goods or similar products from other suppliers.

As regards category management, the Commission should provide more clarity on whether such agreements can lead to potential antitrust concerns. The draft guidelines explain that anticompetitive foreclosure might arise "*where the category captain is able, due to its influence over the marketing decisions of the distributor, to limit or disadvantage the distribution of products of competing suppliers*", but that such a concern can exist only if the category captain is able to cause the distributor *to act against its own interests* in maximising sales and profits. It is unclear from the draft guidelines when the Commission envisages such a circumstance might occur.

Apart from resale price maintenance, the guidelines contain few changes in the analysis of other specific vertical restraints. The discussion on tying now, however, refers to the *Microsoft* judgment. While the existing guidelines repeatedly note the Commission's "flexible" and "economic" approach, such references are absent from the draft. This is probably because such approaches have become increasingly accepted at the Commission and certain paragraphs in the draft, such as paragraph 93, now contain more detailed explanation of this economic approach.

Missed opportunities

While the Commission has suggested a number of changes to the existing rules, ICC believes that it should have proposed a more ambitious set of reforms. After all, the Commission only gets to re-examine its rules in this key area of antitrust law once every decade.

In particular, ICC would encourage discussion of the following:

1. The Commission could consider the fundamental question of whether the EU still needs a block exemption regulation in this area. Are detailed guidelines on their own not sufficient? Does the co-existence of a regulation and guidelines not introduce unnecessary complications? In particular, since 1 May 2004, it has no longer been possible to notify potentially restrictive agreements to the Commission so firms self-assess whether their agreements (i) fall within the scope of Article 81(1) and (ii) whether they qualify for exemption under Article 81(3). Such assessments can just as easily be made by referring to standalone guidelines than by attempting to mesh a regulation and guidelines together. While some might argue that this will result in ever more complex guidelines, this is probably inevitable as the context in which guidelines are applied is also more complex.

2. Assuming that it is felt necessary to have a regulation, it should be asked if it is also necessary to include black-listed clauses that exclude its application. On balance, ICC favours the continued existence of a short black list as it provides legal certainty. Such certainty risks being, however, at the expense of a more far-reaching case-by-case analysis of the particular restraint in its factual and legal context. Sometimes such an analysis is necessary and the Commission must guard against being overly formalistic even when black-listed clauses are concerned. In this respect, paragraph 47 of the draft guidelines is positive in that it indicates that including a black-listed clause in an agreement implies that, not benefitting from the block exemption, it is caught by Article 81 EC and thus merely gives rise to a rebuttable presumption of illegality. It is to be hoped that, in practice, rebutting this presumption does not prove an impossible hurdle (in particular before national competition authorities and courts). As noted above, the same is hoped when companies seek to argue that RPM produces efficiencies.

3. ICC would recommend that the Commission clarify the core concept of a “vertical agreement”. The current criterion of undertakings acting for the purposes of the agreement at different levels of the production or distribution chain is not always easy to implement in practice. For example, if in the IT sector a company develops an interface to a competitor’s software program, it is unclear if the companies are in a vertical or a horizontal relationship.

4. ICC believes that further examination of territorial restrictions on sales is warranted.

- It had been suggested that the Commission would amend the current rule that a prohibition on active sales is only possible when the territories to which the prohibition applies have been exclusively reserved to the supplier or allocated to another distributor. This would be welcome as in a dynamic distribution network a territory that was exclusively reserved or exclusively allocated may cease to be so. Under the current rules, maintaining the prohibition on active sales with respect to other territories may require amending other distribution contracts to keep them within the block exemption. This exercise is particularly burdensome for those suppliers, including many ICC members, operating mixed distribution systems that can include up to 30 EEA countries with large network of resellers. The current rule is unnecessarily prescriptive and economically inefficient and ICC would therefore recommend its removal; it is noteworthy that this requirement did not exist under Regulation 1983/83.

- It is regrettable that the Commission still black lists, under Article 4(c), such bans on active sales in selective distribution arrangements.

- It also disappointing that the Commission appears to continue to judge combinations of exclusive and selective distribution as unlikely to be exempt under Article 81(3). Dynamic multi-tiered distribution models should be promoted and it should, for example, be possible to have exclusive distribution at wholesale level and selective at retail.

5. ICC also regrets the continued characterisation of non-compete clauses as excluded restrictions under Article 5 of the draft regulation. In the absence of market power, non-compete obligations should be treated like other non-black listed clauses. Particularly if both the supplier's and the buyer's market shares must be below 30%, it is difficult to see how a non-compete clause can be more damaging to competition than other common obligations in distribution agreements. If both parties' market shares are below 30%, neither can be said to be an essential trading partner. Treating non-competes like other obligations would also remove the need to ensure these clauses' duration does not exceed five years. Non-competes should be valid throughout the agreement's duration unless, exceptionally, a complainant can demonstrate significant anti-competitive effects. Again, if both parties' market shares must remain below 30%, this is difficult to envision.

As a final remark, ICC notes that European competition policy on vertical restraints has shown an ever increasing tendency to focus primarily on short-term economic effects on prices and quantities. This trend has been confirmed within the proposed policy framework. However, as far as vertical restraints are concerned, ICC suggests the focus should be shifted to ensuring effective choice and innovation at all levels of the supply chain. Crucially, sufficient freedom of *all* parties with the supply chain should allow for more experimentation with new trading practices, ultimately benefiting consumers.

The International Chamber of Commerce (ICC)

ICC is the world business organization, a representative body that speaks with authority on behalf of enterprises from all sectors in every part of the world.

The fundamental mission of ICC is to promote trade and investment across frontiers and help business corporations meet the challenges and opportunities of globalization. Its conviction that trade is a powerful force for peace and prosperity dates from the organization's origins early in the last century. The small group of far-sighted business leaders who founded ICC called themselves "the merchants of peace".

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ICC

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