



RESPONSE TO DG COMPETITION'S DRAFT REVISED BLOCK EXEMPTION AND GUIDELINES FOR THE ASSESSMENT OF VERTICAL AGREEMENTS UNDER EC COMPETITION LAW

Ashurst LLP welcomes the opportunity to submit its comments to DG Competition on its draft revised block exemption and guidelines for the assessment of vertical agreements under EC competition law (together the "**draft revised documents**"). Ashurst regularly advises clients on all aspects of EU and national competition law but this response is made on our own behalf, based on our experience of advising clients on these issues. We are not responding on behalf of any particular client or group of clients.

The contents of this response are not confidential.

1. INTRODUCTORY REMARKS

1.1 At the outset, we would comment that we welcome the Commission's 'evolution not revolution' approach to reviewing the existing block exemption and guidelines for vertical agreements¹. In our view, the current regime generally works well and is in the interests of consumers. A flexible, effects-based approach fosters competition by allowing innovation and different business models to flourish and, crucially, recognising that competition does not take place on price alone but on a number of different variables.

1.2 We believe it is right that the Commission should continue and further refine its economic effects-based approach to the assessment of vertical agreements. In that regard, we welcome a number of changes to the draft revised guidelines that further enshrine this approach including: the explicit recognition that vertical agreements may provide substantial scope for efficiencies (paragraph 6); the recognition that even 'hardcore' restrictions can fulfil the Article 81(3) criteria and that where efficiencies can be shown, negative effects on competition should be assessed and not assumed (paragraph 47); as well as the recognition that the Commission bears the burden of proof under Article 81(1) and (3) when withdrawing the benefit of the block exemption from an agreement (paragraph 73).

1.3 Notwithstanding our overall support for the approach taken by the Commission, there are some areas in the draft revised documents where we have more detailed comments and some concerns and these are explained below. These comments should be seen in the context of an overarching theme which is that, in the era of modernisation and self-assessment, legal certainty as to the scope of the block exemption (which is aided greatly by clarity in the guidelines) takes on even greater significance. This clarity and certainty can be lost where, for example, the guidelines are not sufficiently precise.

2. BROADENING OF THE BLACKLIST IN ARTICLE 4(b)

2.1 We note that the draft revised block exemption proposes an amendment to the current Article 4(b) which would only allow, in the context of a selective distribution system, restrictions of sales to unauthorised distributors in those markets where selective distribution is applied. Restrictions of sales to unauthorised distributors operating in markets not covered by the system would therefore become "hardcore" restrictions, presumed to infringe Article 81(1) – paragraph 47 of the draft revised guidelines.

¹ **Commission Regulation (EC) 2790/1999** on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices OJ (1999) L 336/21; and **Commission Notice** guidelines on vertical restraints OJ (2000) C 291/1

- 2.2 In our view, this proposed change will seriously constrain and undermine the ability of suppliers to implement and maintain a selective distribution system. Specifically, where a supplier considers that selective distribution is not appropriate in one or more EU markets (which may be for a variety of legitimate commercial reasons²), it will be almost powerless to prevent unauthorised distributors in such markets from then reselling to unauthorised distributors in other markets where it does adopt selective distribution, thereby undermining its system. To look at it another way, a restriction on sales to non-authorised distributors - wherever they may be situated - can be viewed as a type of "*ancillary restraint*" which is necessary and proportionate to the perfectly legitimate objective of establishing and maintaining a functioning selective distribution system.
- 2.3 The proposed amendment is likely to be to the particular detriment of smaller suppliers who will often not sell their products across the whole of Europe, as compared to larger suppliers active across the EEA, whose positions are therefore less likely to be affected by the proposed change. Nevertheless, even larger suppliers may roll out their selective distribution network in phases that may not necessarily cover all the countries of the EEA. The proposed change may therefore force suppliers to immediately deploy selective distribution in all EEA Member States. Such a result is difficult to reconcile with the thinking of the ECJ³ which has recognised that the legitimacy of selective distribution is not conditioned by any requirement that a supplier uses selective distribution everywhere.
- 2.4 A final point we would make is that, rather than seeking to broaden the scope of the Article 4(b) blacklist, the present review represents an opportunity to consider whether it might be narrowed, given the Commission's acceptance that vertical agreements are generally benign from a competition perspective and, moreover, can provide significant scope for pro-competitive efficiencies and innovation. Specifically, we would encourage the Commission to consider returning to its previous position which allowed the prohibition of active sales into exclusive distributors' territories, whereby such a prohibition was allowed even if the exclusivity was of a *de facto* (as opposed to formal, contractual) nature. From an economic perspective, we do not consider that there is much difference between the two situations and the rationale for allowing such distributors to be protected from active sales in their territory is in fact the same in both cases. Indeed, the situation overall is less restrictive in the *de facto* situation as the opportunity remains for new distributors to enter and increase intra-brand competition and it seems odd not to protect such distributors from active sales when distributors who are already protected from competition by formal exclusivity additionally benefit from this further protection from active sales.

3. THE APPROACH OF THE DRAFT REVISED GUIDELINES TO INTERNET SALES

- 3.1 Given the ever-increasing importance of online commerce, we appreciate and understand the Commission's desire to include guidance as to how Article 81 in general, and the vertical agreements block exemption in particular, apply to internet selling. We also appreciate the Commission's enthusiasm for the internet as a potentially powerful facilitator of single market integration. Nonetheless, it is important not to lose sight of the fact that suppliers must be allowed to ensure that consumers are well informed and protected in terms of being given proper service and technical advice; that adequate control against the sale of counterfeit, deteriorated or stolen products can be maintained; and that brand image and related investments are not compromised.

² These reasons may include that there are very low sales of the product in particular countries and selective distribution is not considered financially worthwhile. It could also be that the supplier considers that there is a lack of suitable retailers for his product in particular countries. A brand may also be perceived quite differently in different countries (for instance, in terms of cachet) which may also make selective distribution inappropriate in some countries.

³ Case C-376/92, **Metro v Cartier** [1994] ECR I-15

- 3.2 With this in mind, we believe that there are certain passages in the draft revised guidelines in respect of internet selling that warrant further clarification; these are discussed in the following paragraphs.
- 3.3 We note the statement, at paragraph 57 of the draft revised guidelines that *"the Commission regards as a hardcore restriction any obligation which dissuades appointed dealers from using the internet by imposing criteria for online sales which are not equivalent to the criteria imposed for the sales from the brick [sic] and mortar shop."* We note also that the guidelines (in the same paragraph) do make it clear that this does not mean that the criteria for online and offline sales have to be identical but should pursue the same objectives and differences in criteria should be justified by differences between the distribution channels. Whilst this further explanation and clarification is welcome, nevertheless, in our view determining whether or not criteria for online and offline sales are *"equivalent"* will be a difficult and unnecessary task. For example, is a requirement that an internet distributor's website is available 24 hours a day, 7 days a week *"equivalent"* to a requirement that a physical shop be open from 10:00h to 19:00h? Or would it be a hardcore restriction to require an internet distributor to sell the full range of the supplier's products and for bricks and mortar distributors to be allowed to sell a limited range, given the absence of physical constraints for online sales as opposed to normal retail outlets? Whilst it is understandable that the Commission should object to rules which make it impossible or excessively difficult for an authorised distributor to sell over the internet, the Commission seems to be introducing a requirement to justify obligations imposed on internet distribution. Such a requirement does not exist under the current guidelines in respect of obligations imposed on offline distribution i.e. the block exemption does not currently cease to apply on the basis of quality of service and similar obligations imposed on distributors. In our view this should be true also for virtual outlets. In both cases, the supplier should not be constrained in his discretion as to the requirements necessary to ensure acceptable customer service and general quality control.
- 3.4 We also note the statement, at paragraph 52 of the draft revised guidelines that the Commission will consider as a hardcore restriction of passive selling if a supplier requires an exclusive distributor *"to prevent customers located in another (exclusive) territory from viewing its website or requiring the distributor to put on its website automatic re-routing of customers to the manufacturer's or other (exclusive) distributors' websites"*. In this regard, whilst we accept the existing principle in the current block exemption that exclusive distributors should not be prevented from making passive sales to customers located outside their exclusive territory, we believe that the Commission should explicitly acknowledge that delivering a proper customer service may legitimately require the ability for customers to be advised and to receive service in their own language (for example, advice in relation to safety and proper use) and taking into account any particular requirements (legal or otherwise e.g. in relation to after-sales service) that are applicable in the country of location of the customer. The two aims are not incompatible, particularly where sales are made over the internet. Therefore, in our view the guidelines should clarify that the prohibition against automatic re-routing of customers should not be understood as preventing suppliers from requiring their distributors to ensure that customers are given all relevant information (including that specifically relevant to their particular location) in their own language and that it is legitimate to achieve this by directing customers to the supplier's website, or to other distributors' websites, where appropriate. The end-consumer should not be prevented from ultimately buying the product wherever he wants, but the supplier must be allowed to ensure he has been properly informed beforehand.
- 3.5 In our view, the effect of the current approach to internet selling in the draft revised guidelines is to introduce a form-based broadening of the hardcore restrictions in the block exemption which does not allow suppliers to objectively evaluate the appropriateness of the internet as a distribution channel (as it may not be an appropriate way to supply each and every type of good and service) in the same way that they have

hitherto been able to evaluate any other distribution channel. The Commission should be wary of de facto mandating any distribution channel, especially in the absence of market power, and have confidence that the normal interplay of market forces is the best guarantee that the internet is exploited to its full potential as an innovative distribution channel.

- 3.6 In summary, we therefore consider that it is essential that the revised guidelines contain clear unequivocal statements that suppliers in a selective distribution scenario are allowed to impose quality and other standards on the online operations of their distributors in the same way as they are allowed to do so in respect of offline operations.

4. **RESALE PRICE MAINTENANCE**

- 4.1 We welcome the Commission's recognition, at paragraph 219 of the draft revised guidelines, that it is possible for an agreement which includes resale price maintenance ("RPM") to fulfil the Article 81(3) criteria and that where the parties to an agreement can demonstrate that efficiencies and customer benefits pertinent to the Article 81(3) conditions arise from the RPM arrangements, the Commission will not presume (but will assess factually) negative effects on competition. In this regard, we also welcome the discussion, at paragraph 221 of the draft revised guidelines, acknowledging that RPM may in particular lead to efficiencies and increased competition in a number of specific scenarios including new product launches and targeted short-duration sales campaigns.

- 4.2 However, in our view, the discussion of the potential anti-competitive effects of recommended or maximum resale prices, in paragraphs 223 and 224 of the draft revised guidelines, requires clarification. In particular, the position that maximum or recommended prices may be problematic where they become a "*focal point*" does not seem helpful. It seems to us that maximum or recommended prices will always constitute some kind of focal point by their very nature. As a result, further explanation is required as to how and when these pricing practices may be problematic from a competition law perspective. Such a discussion might be likely to centre around the effects in the market of deviating from the maximum or recommended prices in different market situations. In this context, we do not believe that the existence or otherwise of monitoring and "retaliation mechanisms" are particularly relevant or helpful as appears to be suggested by the Commission. Monitoring of prices is a perfectly normal and legitimate behaviour which often plays a key role in the competitive dynamics in a market. (AC Nielsen etc. do this daily in all sectors) and it is difficult to see how its existence should be the starting point for a hypothesis that maximum or recommended prices are harming competition. Indeed, it is not possible for a supplier to have an effective system of maximum or recommended prices if he is not able to monitor the prices that his distributors are actually charging. Similarly, the mere "*possibility of retaliation*" seems a vague concept which is likely to confuse both authorities and judges, without a proper explanation as to its relevance to finding anti-competitive harm in relation to these pricing practices. Moreover, the Commission's position appears difficult to reconcile with jurisprudential developments by the ECJ in cases such as *Bayer/Adalat* and *Volkswagen*⁴ which consider that mere possibilities of retaliation or even threats of retaliation are not enough to justify the applicability of Article 81.

- 4.3 The discussion of maximum and recommended prices also fails to recognise that they can have a legitimate purpose in ensuring that products are priced appropriately and in accordance with the suppliers' overall commercial strategy. Moreover, these practices can have significant pro-competitive effects, for instance by helping to prevent the raising of downstream prices where there may be market power at that level.

⁴ Joined Cases C-2/01 P and C-3/01 P **Bundesverband der Arzneimittel-Importeure v Bayer and Commission**, judgment of 6 January 2004; Case T-208/01 **Volkswagen A.G. v. Commission**, judgment of 3 December 2003.

5. THE BUYER'S MARKET SHARE THRESHOLD

- 5.1 In our view, the introduction of an overarching buyer's market share threshold across the totality of the block exemption is unnecessary. The key competition concern in respect of the exercise of buyer power in a vertical agreement scenario is that the buyer demands exclusive supply i.e. that the supplier may not supply competitors of the buyer, thus restricting competition downstream where the buyer is active. The current block exemption already deals perfectly adequately with this issue by removing the safe harbour from such clauses where the buyer's market share is greater than 30 per cent as a buyer on the upstream market.
- 5.2 In any event, even if the Commission were to introduce the proposed 'across-the-board' buyer's market share threshold, we have serious concerns as to the Commission's explanation in the draft revised guidelines as to how the threshold is to be applied. In particular, we are concerned by the statement in paragraph 23 of the draft revised guidelines that the buyer's market share is to be assessed by reference to the markets "*where it sells its product produced with the help of the contract goods or services*". In our view, this statement has the potential to be interpreted extremely broadly with the result that the safe harbour of the block exemption will be removed from supply agreements whenever the purchaser has more than a 30 per cent market share in any market downstream, even in circumstances where, in respect of the supply agreement in question, the purchaser has no buyer power and the agreement does not have any effect on the competitive position downstream.
- 5.3 A buyer may have a high market share downstream for any number of reasons entirely unrelated to its position or activities as a purchaser on upstream markets. To give one example, many retail markets will have a narrow local geographic limit, and the market shares of the participants in that narrow local market may be high. However, their market shares on the upstream markets where they are purchasers may be negligible and it is not obvious why those upstream supply agreements should not benefit from the safe harbour of the block exemption. By way of illustration, an independent convenience store in a rural area may have a very high market share, but that convenience store's buyer market share vis a vis the wholesalers from whom it purchases may be negligible. As a result, there is no reason to suppose that those supply arrangements with wholesalers contribute to any anti-competitive effects at either downstream or upstream levels such that they should not benefit from the block exemption (subject, of course, to the absence of hardcore restrictions) on the sole basis of the convenience store's downstream market share. Another example could be of an airline that happens to have a monopoly on one particular route: it can be argued that the airline provides its service on that route "*with the help of*" complementary pencils that it gives to passengers. On the upstream market for pencils, the airline may have an immeasurably small market share as a buyer and it is difficult to understand why the pencil supply agreement should not benefit from the block exemption on the sole basis of the downstream monopoly on one particular route. In other words, there are no obvious anticompetitive effects stemming from the agreement that are predicated on the downstream monopoly.
- 5.4 To look at the issue another way, the Commission explains in paragraph 93 of the draft revised guidelines that the effect of vertical agreements on competition should be assessed by reference to the effects of the vertical agreement on the relevant market by reference to parameters of competition such as prices, output, innovation, variety and quality. In the same paragraph, the guidelines further explain that a vertical agreement may have anticompetitive effects where the agreement contributes to the creation, maintenance, strengthening or exploitation of market power. Given this sensible framework for analysis, it is difficult to understand why agreements in the scenarios described in the previous paragraph should not benefit from the block exemption: there is no obvious potential for anticompetitive effects that should be guarded against. Yet, the result of paragraph 23 of the draft revised guidelines would seem to be the removal of the

block exemption in these scenarios and we would therefore urge the Commission to revisit this.

- 5.5 In conclusion, we would urge the Commission to clarify unequivocally that the buyer's market share threshold is to be assessed by reference to the buyer's position on the market where he is a buyer in relation to the vertical agreement under consideration.

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