

**Linklaters LLP submission in response to
the European Commission's consultation process regarding
the competition rules applicable to vertical agreements**

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A. Introduction and Overview

1 Introduction

Linklaters LLP, an international law firm headquartered in London, welcomes the public consultation launched by the European Commission (the “**Commission**”) of its review of the competition rules applicable to vertical agreements. In this regard, we would like to thank the Commission for the opportunity to comment on the draft Commission Regulation (the “**Draft Regulation**”) and accompanying draft Guidelines (the “**Draft Guidelines**” and together with the Draft Regulation, the “**Draft VRBE**”) published on 28 July 2009.

With the expiry of Regulation 2790/1999 (the “**1999 Regulation**”) and its accompanying Guidelines (the “**1999 Guidelines**” and together with the 1999 Regulation, the “**1999 VRBE**”) on 31 May 2010, the Commission is turning the page on what has been, in our experience, a successful regime that has been a useful tool for the wider business community.

We welcome the Commission’s approach of maintaining the concept of a block exemption in light of Regulation 1/2003. We also agree with the Commission that the 1999 VRBE does not require a major overhaul but rather warrants reviewing and updating to allow for its successful application over the next ten years. In this regard, we believe the Commission has perhaps missed two opportunities: (i) to extend the safe harbour (rather than reducing it), and (ii) to push competition law policy for vertical restraints even further towards an economically sound effect-based approach. It therefore appears to us that what was successfully started in 1999 is not fully brought to fruition by the Draft VRBE.

As a final introductory remark, in parts of the Draft Guidelines the Commission has decided to use footnotes to explain the proposed amendments; in others, it has not. Generally, and perhaps as a suggestion for future Commission reviews, we would welcome the publication of a document that explains the reasoning behind the proposed amendments. For example, it would be useful to understand the reasoning behind the Commission’s concern about buyer power; perhaps the Commission has encountered a number of examples where the supplier had a market share below 30%, and the relevant buyer’s market share on its selling market exceeded 30%, with restrictions having anticompetitive effects? We consider that such insight would facilitate the review procedure and add value to the consultation process, stimulating open discussion amongst the stakeholders.

1.1 The concept of hardcore restrictions and RPM

We understand that the debate in the run up to the Commission’s consultation has in large part centred around the concept of hardcore restrictions and retail price maintenance (“**RPM**”). After what has been an interesting debate on these issues – sparked in no small part by the U.S. Supreme Court decision in *Leegin*¹ – the Commission has not been able to persuasively alleviate concerns that (i) hardcore restrictions are effectively viewed as *de facto per se* restrictions in Europe, and (ii) RPM is unduly seen as an anticompetitive restriction by object.

We welcome the Commission’s explanation that hardcore restrictions can be exempted under Article 81(3) EC in paragraph 47 of the Draft Guidelines. However, we are not persuaded that this will allow the business community to bring successful arguments before national courts (where the enforcement of vertical restraints is typically handled) even where there is a strong case for efficiencies. In our view, more guidance on an effect-based approach will be necessary before hardcore restrictions are moved outside the remit of *de facto per se* restrictions.

¹ *Leegin Creative Leather Prods. v. PSKS, Inc.*, 551 U.S. 877 (2007).

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With this in mind, we were surprised to see the Commission use the concept of hardcore restrictions in a number of new scenarios. In particular, with regard to online sales, the Commission appears to have introduced a concept of hardcore restrictions apparently outside the realm of Article 4. Given the sensitivity surrounding the use of hardcore restrictions, both legally (restrictions that do not flow from Article 4 should not be termed as restrictions by object) and practically (hardcore restrictions being seen as *de facto per se* restrictions of competition), the Draft VRBE seems to send mixed signals to the business community.

2 Overview of comments on the Commission's proposal

The Commission has in particular requested comments in relation to its treatment of buyer power and online sales in the Draft VRBE.

2.1 Buyer power

We comment in sections B and C on the Commission's treatment of buyer power. Overall, we do not consider the introduction of a new threshold on the downstream market of the buyer as (i) appropriate to deal with buyer power or (ii) practical for the self assessment of vertical contracts. We would urge the Commission to remove the introduction of the new threshold. Should the Commission consider it absolutely necessary to change the current threshold, we would consider a market share threshold on the buyer's upstream purchasing market as more appropriate. With regard to the new sections on category management and upfront access payments, we question whether such practices fall within Article 81(1) at all. We would also be grateful if the Commission would clarify the scope of its definition of category management.

2.2 Definition of agreements and agency agreements

We comment in section D on the definition of agreements and the new third category of risks introduced for the assessment of agency agreements. In relation to both issues, we find it very difficult to follow the Commission's approach and do not find this adequately supported by case law. Without a full impact assessment, we consider it problematic to go beyond the case law of the European Courts and would urge the Commission (i) with regard to the definition of agreements, to narrow its concept of tacit acquiescence, and (ii) with regard to the third category of risks for agency agreements, to limit itself to the current wording in the 1999 VRBE.

2.3 RPM

In section E we comment on the Commission's new section on RPM, which we welcome. We do, however, advocate that RPM should not be considered as a hardcore restriction and should instead be subject to a standard balancing analysis under Article 81(1) and Article 81(3) EC. In other words, we would suggest removing RPM from Article 4 in the Draft Regulation and introducing RPM in Article 5 as new (d).

2.4 Online distribution

In section F, we comment on the Commission's proposal for online distribution. We welcome the recognition, in the context of selective distribution, that the requirement to have a bricks and mortar shop before being able to sell online is important and needs to be protected. However we are concerned by the designation of additional restrictions as hardcore apparently over and above those within the scope of Article 4. In summary, we understand that the Commission is already "very supportive"² of online sales and would urge the Commission to treat online sales in the same

² As the Commission notes in its Online Commerce Roundtable Report on Opportunities and barriers to online retailing in paragraph 13, "the current policy towards vertical agreements is already very supportive of internet sales".

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way as any other distribution channel rather than creating a special regime governing online sales (which the Draft Guidelines appear to do in some places).

2.5 Other issues in exclusive and selective distribution

In section G, we comment on the concept of exclusive distribution and territorial protection in mixed distribution systems. Such systems are currently unduly prohibited. We would welcome a liberalisation of active sales in Article 4(b).

Once more, we would like to thank the Commission for the opportunity to comment on the Draft VRBE.

B. The new market share threshold (buyer power)

1 Overview

The market share thresholds are at the core of the Draft VRBE, acting as a gateway to the protection offered by the Draft Regulation. It is only where these safe harbour thresholds are met that the Draft Regulation allows parties to avoid the need for a detailed, costly and potentially inconclusive self-assessment analysis. Consequently, we consider that great care should be taken when amending these thresholds, since even small changes could have a drastic effect on the usefulness of the block exemption.

1.1 The new market share threshold

The 1999 Regulation applied a 30% market share threshold for suppliers in relation to any vertical restraint within the scope of the 1999 Regulation, except for exclusive supply agreements, for which a 30% threshold applied to the buyer's share of the purchasing market.

The Draft Regulation, however, applies a 30% market share threshold to both the supplier and the buyer, in each case in relation to their sales (i.e. it is the buyer's downstream market share, not its share of the purchasing market that counts). Since both thresholds must be satisfied for a restraint to fall within the Draft Regulation, this has the effect of excluding from the Draft Regulation some restraints that would have fallen within the 1999 Regulation. For exclusive supply agreements it is possible that some restrictions will fall within the Draft Regulation that would have been excluded from the 1999 Regulation (i.e. those in which the supplier has a market share of less than 30%, the buyer has a downstream market share of less than 30%, but the buyer has a purchasing market share of more than 30%).

2 Concerns with the new approach

We understand that the Commission is concerned that some agreements that would have fallen within the 1999 Regulation may have been anticompetitive because of the buyer's market power, even if the supplier's market share was lower than 30%, and that the Commission's proposed change addresses this concern. Indeed, it is unlikely that there will be many – if any – anticompetitive agreements that would still fall within the Draft Regulation in light of these changes.

However, we have two principal concerns with the Commission's proposed change:

- (a) The new threshold is too restrictive, excluding agreements from the Draft Regulation that are clearly pro-competitive, and therefore exposes parties to unnecessary costs as well as uncertainty as to enforceability; and
- (b) The new threshold will be very difficult for parties (particularly suppliers) to apply when conducting a self-assessment, thus undermining the objective of the Draft Regulation and potentially giving rise to opportunistic behaviour by buyers seeking to escape vertical restraints to which they have agreed by arguing that they exceed the market share threshold.

There are also a number of areas in which the application of the new threshold is unclear and it would be helpful if the Draft Guidelines would clarify these points.

2.1 The buyer's market share threshold is too restrictive

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A buyer's downstream market power may in some circumstances be relevant to the competitive effects of a vertical restraint – either directly or as a proxy for its buyer power. In particular, downstream market power may provide an incentive for a buyer to seek to foreclose its downstream competitors, and would be relevant to the issue of whether a vertical restraint could be used to facilitate downstream collusion.

However, in many cases the nature of the restraint in question (e.g. single branding and exclusive distribution) is such that the buyer's downstream market power (and in some cases even its buyer power) is all but irrelevant to the competitive impacts of the restraint if the supplier does not have market power. The Draft Regulation will no longer cover these restraints, thus exposing parties to unnecessary uncertainty as to enforceability.

Moreover, in a number of important scenarios, the nature of the buyer's markets or the contract goods/services is such that the buyer's market share is irrelevant. In particular, national retail chains may have high market shares in small local markets, but purchase the contract goods on national wholesale markets. It is hard to believe that such chains would alter their national purchasing strategies to affect competition in one or two small local markets. Similarly, buyers often procure inputs that have only weak connections to the downstream products that they sell. For example, if a hospital was to agree to purchase cleaning products from a single supplier, it is difficult to see what relevance its market power in the market for medical treatment could have to the competitive effects of such an agreement. In both cases, however, suppliers may need to conduct a full self-assessment because they may be unable to rely on the protection of the Draft Regulation.

We realise, however, that it may be undesirable to have different market share thresholds for different types of vertical restraints (although we note that this approach was taken in the 1999 Regulation) and markets. Accordingly, the relevant question is whether the harm caused by excluding pro-competitive agreements from the Draft Regulation outweighs the benefits of excluding potentially anticompetitive agreements. Given that the 1999 Regulation has now been in force for 10 years, if there was a serious concern that it had protected a significant number of anticompetitive agreements, one would expect to have seen a number of cases in which the Commission had disapplied the 1999 Regulation because of concerns about the downstream power of the buyer. If there have not been any such cases (and we are not aware of any such cases having arisen) the case for changing the market share threshold is questionable.

If, despite the lack of any cases over the past 10 years where the 1999 Regulation protected an anticompetitive agreement, the Commission nevertheless considers it important to protect against the possibility that such a case could arise in the future, an alternative approach to the buyer power issue would be to use a test of the buyer's share of the purchasing market instead of its downstream market share. This would be a much more direct way of addressing the Commission's concerns over buyer power and would reduce the number of pro-competitive agreements that are excluded from the Draft Regulation.

Indeed, it is striking how much more frequently the Draft Guidelines refer to the relevance of buyer power compared to the relevance of downstream market power in assessing the competitive effects of restraints that are outside the Draft Regulation. The Draft Guidelines only mention downstream market power as an important consideration independent from buyer power in respect of foreclosure concerns in the exclusive supply context (and with restraints having equivalent effect) as well as in respect of downstream cartels with upfront access payments.

We consider that it is implausible that foreclosure could take place with a competitive upstream market and buyers without buyer power. Moreover, the possibility that a case may arise in which

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the supplier has a market share below 30%, the buyer has a purchasing market share below 30% and yet concerns arise as to the possibility of the vertical restraint facilitating downstream collusion does not appear to us likely to be significant enough to justify excluding the wide class of pro-competitive agreements referred to above. Cases with serious downstream collusion can be dealt with through other mechanisms (e.g. a cartel investigation) if the collusion is explicit and by withdrawing the benefit of the Draft Regulation for specific cases where tacit collusion is a genuine and plausible concern.

2.2 The proposed threshold would be impractical to apply for self-assessment

The principal practical difficulty with the proposed buyer market share threshold is that downstream market shares are difficult for the supplier to observe because they concern a market or potentially many markets (product and/or geographic) on which the supplier does not operate. It is no answer to this concern that the buyer should have reliable information on its downstream market shares. The supplier needs to come to an independent view as to whether the agreement falls within the Draft Regulation. It cannot rely on the buyer as the supplier's interest in the enforceability of the restrictions or the agreement may not coincide with the buyer's interests. Thus, while the agreement is being negotiated, the buyer may seek to persuade the supplier that the Draft Regulation applies to the agreement, but if a dispute arises later (for instance if the buyer no longer finds compliance with the restrictions or even the agreement convenient) the buyer may argue that its market share always was or has become greater than 30%.

The effect of amending the thresholds as proposed in the Draft Regulation is therefore that the supplier will in many cases be unable to carry out a self-assessment. This is particularly likely to be the case where the buyer is active in many local geographic markets and where the downstream products are far removed from the supplier's area of expertise (as they may well be if the contract goods are intermediate products). This would seriously undermine the objective of the Draft Regulation and may lead to parties being unable to obtain the social benefits that vertical restrictions can provide.

2.3 Points of clarification

In addition to the substantive and practical concerns that we have with the proposed downstream market share threshold in the Draft Regulation, there are some aspects of the threshold that we consider could benefit from further clarification.

In particular, in circumstances where a buyer sells a range of products on the downstream market, only some of which are relevant to the contract goods, it is not clear from the Draft VRBE which downstream market share should be used. For example, where a supermarket procures electrical products for sale in its stores, it is not clear whether the threshold would apply to the supermarket's share of the downstream supermarket market or the supermarket's share of the electrical products market. Given that the supermarket could have very different market shares depending on which approach is taken, it would be helpful for the Draft VRBE to clarify this point.

A further issue is that although the Draft Guidelines make it clear that the buyer's market share threshold applies to the downstream market rather than the buyer's share of the purchasing market, this is not clear from the text of the Draft Regulation itself. Given that the Draft Guidelines are not binding on Member State courts whereas the Draft Regulation in its final form will be, it may be preferable to make clear in the Draft Regulation which market share is relevant.

3 Buyer's share of the purchasing market is better approach

In our view, the thresholds in the 1999 Regulation strike a better balance between over-inclusion and over-exclusion than those proposed in the Draft Regulation. We consider that for a block exemption to be of practical use, it is necessary to compromise and accept that there may be some – albeit very few and of doubtful significance – agreements that fall within the exemption but that may be anticompetitive. Indeed, this is precisely why the Commission reserves to itself the power to disapply the Draft Regulation in particular cases.

If the issue of buyer power must be addressed, however, we would propose that the buyer's market share threshold should be applied to the buyer's share of the purchasing market rather than the downstream market so as to address some of the practical difficulties with the proposed threshold while preserving the effect of excluding some potentially anticompetitive agreements from the Draft Regulation.

c. Category management and upfront access payments

1 Category management

The Draft Guidelines address category management agreements in paragraphs 205 - 209. These types of agreements are not addressed in the 1999 Guidelines. We have a number of observations on these paragraphs.

First, the intended scope of the Commission's guidance needs clarification. The Draft Guidelines define category management agreements as "agreements by which ... the distributor entrusts the supplier (the "category captain") with the marketing of a category of products including in general not only the supplier's products, but also the products of its competitors". However, the meaning of "marketing" in this context is unclear. In practice, suppliers and distributors may enter into a variety of arrangements which might be characterised as "category management", but which may have very different effects on competition. For example, there is in particular an important distinction between (i) arrangements (sometimes referred to as "category management") whereby suppliers may provide advice to distributors on, e.g., the range of products displayed, placement and size of product displays, stock management and so on, and (ii) agreements (sometimes referred to as "category captaincy") whereby suppliers are designated by distributors to have full responsibility for the way in which products (including those of competitor suppliers) are selected, presented and sold to customers. We would recommend that, at a minimum, this range of possibilities be reflected in the Draft Guidelines and greater clarity provided as to the types of agreements which are more or less likely, in the Commission's view, to give rise to concerns.

The Draft Guidelines state that, above the market share threshold of 30%, "the following guidance is provided for the assessment of category management agreements in individual cases", before citing a number of reasons why category management agreements may, on the one hand, distort competition between suppliers or facilitate collusion between distributors and/or suppliers or, on the other hand, lead to efficiencies. However, the draft paragraphs are not very clear as to the extent to which particular characteristics of, or mechanisms in, such an agreement would be considered to be of sufficient concern to bring the arrangements within the scope of Art 81(1) in the first place, which is the fundamental issue, before any balancing against efficiencies may be required. This is important in relation to a commonly encountered set of commercial practices which have not generally attracted adverse attention in the past.

We agree that agreements whereby a supplier has complete control over a sufficient amount of distribution for a period of time may, theoretically, have foreclosure effects. We also agree that collusion between suppliers or distributors is anticompetitive. However, the existence of a category management agreement does not necessarily of itself result in foreclosure or collusion and we feel that, if this issue is to be addressed at all in the Draft Guidelines, this must be made more explicit.

In this respect, we note that the UK Competition Commission ("CC") considered the effects of category management agreements in depth during a recent market investigation into the retail supply of groceries by retailers in the UK.³ Although it found some evidence of category management facilitating meetings and interactions between suppliers that would not have otherwise occurred, the CC did not find any anticompetitive effects resulting from the conduct that it observed. In addition, the CC also observed that, in practice, retailers validate and cross-check sales recommendations made by their suppliers because it is in their best interests to do so, and that retailers were generally well placed to identify quickly any sub-optimal recommendation for a category.

³ http://www.competition-commission.org.uk/rep_pub/reports/2008/538grocery.htm.

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The CC also found that category management practices may directly benefit consumers, and result in increased total sales for a category from a retailer's perspective and increased efficiency. Ultimately, the CC did not find any adverse effect resulting from category management practices, regardless of the market share of the suppliers or retailers in the UK that may engage in such practices.

Arguably, therefore, the inclusion of specific guidance regarding category management is unnecessary given the absence of evidence that such agreements of themselves cause anticompetitive effects and also given the fact that such agreements may result in efficiencies. To the extent that discussion of these arrangements remains in the Draft Guidelines, we would request that greater detail and comfort be provided in order to avoid innocent (and indeed potentially pro-competitive) arrangements from being unintentionally discouraged.

2 Upfront access payments

We welcome the Commission's discussion of upfront access payments in the Draft Guidelines at paragraphs 199 - 204. Our views on the provisions regarding upfront access payments are similar to those set out above in relation to category management. Again, the CC recently considered these types of payments during its market investigation into the supply of groceries by retailers in the UK.

As with category management agreements, the Commission notes that upfront access payments may have both anticompetitive and pro-competitive effects. However, the draft paragraphs are again unclear as to the circumstances in which the Commission considers that potential anticompetitive effects are likely to outweigh any pro-competitive effects.

In the UK market investigation, the CC found that practices such as the requirement of upfront access payments could result in an adverse effect on competition. Its main concern, however, was related to circumstances in which retailers transferred excessive risks or unexpected costs onto their suppliers, rather than a particular concern about upfront access payments in and of themselves. Where this is not the case, we consider that upfront access payments are in a number of cases a compensatory service charge, e.g. for promotional services, and as such should not fall within Article 81(1) at all.

On 4 August 2009 the CC made an order requiring 11 grocery retailers in the UK to comply with a Groceries Supply Code of Practice (GSCOP), which contains a number of restrictions and prohibitions on certain supply chain practices. With respect to upfront access payments, the GSCOP provides that such payments may be required by retailers in the context of new products (provided that the payment reflects a reasonable estimate of the risk run by the retailer in stocking the new products) and in the context of promotions. In other circumstances payments may not be "required" by retailers, but may be agreed as a result of negotiations between the supplier and retailer.

In our view, there may be many scenarios in which upfront access payments are the result of normal commercial negotiations between suppliers and distributors for efficiency reasons. In the UK, the CC has been mindful of the unintended consequences that might arise from excessive regulatory intrusion and we would encourage the Commission to take a similarly prudent approach. To the extent that discussion of these arrangements remains in the Draft Guidelines, we would request that greater detail be provided in order to avoid potentially pro-competitive arrangements from being unintentionally discouraged.

D. The definition of agreements: Agency and agreement in general

1 The concept of agreement

In paragraph 25, 1st indent, of the Draft Guidelines the Commission introduces the concept that acquiescence can result in an agreement in two ways: (i) acquiescence that is deduced from an agreement that provides explicitly that a unilateral policy can be binding on the other party, and (ii) tacit acquiescence that is deduced from the implementation of a parties' unilateral policy. While we agree with the Commission that an agreement exists where there is an explicit reference to the binding nature of a unilateral policy, we are concerned with the following amendments:

1.1 Tacit acquiescence through implementation

"Secondly, in the absence of such an explicit acquiescence, the Commission can show the existence of tacit acquiescence. For that it is necessary to show first that one party requires explicitly or implicitly the cooperation of the other party for the implementation of its unilateral policy and second that the other party complied with that requirement by implementing that unilateral policy in practice [FN 15]"

The Commission's proposal as it currently stands is problematic. For one, it seems to suggest that the Commission does not need to show that a policy of one party results from the unilateral policy of another party. The following example better illustrates the point:

Example 1.1: A supplier of chemical products sells its products through a number of distributors in Europe. The supplier provides recommended retail prices to its distributors.

In light of paragraph 25, it would appear that the Commission could come to the conclusion that the supplier and the distributor agreed on fixed prices, should the distributor decide to adopt the recommended prices. Paragraph 25 could therefore have the effect of banning the use of recommended prices as the mere factual result of corresponding policies could give rise to an agreement.

We do not disagree with the Commission's concept that tacit acquiescence gives rise to an agreement but would suggest that the Commission sets out more clearly that the effect of the implementation of a policy has to flow directly from the unilateral policy essentially establishing a concurrence of wills.⁴

1.2 Tacit acquiescence through coercion

We do not, however, agree with the introduction of the following:

"Similarly, for vertical agreements, tacit acquiescence may be deduced from the level of coercion exerted by a party to impose its unilateral policy on the other party or parties to the agreement in combination with the number of distributors who are actually implementing in practice the unilateral policy of the supplier."

It is not clear to us how the level of coercion could result in tacit acquiescence and, therefore, in an agreement. The Commission⁵ has rejected the concept that a monitoring system and penalties

⁴ We note that in T-208/01 Volkswagen v Commission [2003] ECR II-5141, para. 38, the Court held that it was not established that the calls at issue were implemented in practice and came to the conclusion that there was no agreement. It is true that implementation of a unilateral policy is a relevant factor. It should, however, not be a determinative one. The Court did not say in para. 38 that implementation leads necessarily to the existence of an agreement.

⁵ The Commission in its decision COMP/C-3/37.980 *Souris/Topps* of 26 May 2004 explicitly rejected the relevance of penalties or enforcement measures as critical element to determine whether an agreement exists (para. 79).

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alone could constitute an agreement. The European Court of Justice in *Bayer* similarly pointed out that, “[...] the existence of an agreement does not necessarily follow from the fact that there is a system of subsequent monitoring and penalties, [...]”⁶

In this regard, *Volkswagen*⁷ is applicable by analogy: just as a unilateral communication does not prove the existence of an agreement neither does a penal policy. We therefore suggest that the Commission remove this reference from the Draft Guidelines.

2 Agency agreements

We agree with the Draft Guidelines that the crucial factor is the magnitude of risk borne by the dealer. This is confirmed by case law.⁸ We regret, however, that the Commission maintains a very high level of discretion pursuant to paragraph 17, as it remains free to take account of factors that are not set out in paragraph 16.

We also respectfully invite the Commission to clarify the following points:

2.1 The intensity of the risk

First, the Draft Guidelines set out in paragraph 16 that the agent may not, among others, “contribute to the costs relating to the supply of the contracts goods”, “directly or indirectly be obliged to invest in sales promotion” or “create and/operate an after sales service, repair service or a warranty service unless it is fully reimbursed by the principal”. It would be useful to specify in the Draft Guidelines whether the Commission intends to show some flexibility in applying the concept of “risk” as laid down in paragraph 14 and to demonstrate how an obligation that is borne by an agent represents material risks for which the latter is responsible.⁹ The Draft Guidelines should also explain when residual risks borne by the dealer would also qualify as “risk” under paragraph 14 in light of the assertion by the Court in *DaimlerChrysler* that a key factor is that the dealer bears the main price risk.¹⁰

In other words, we would welcome that, besides providing guidance as to categories of risk, the Draft Guidelines would also specify how the Commission will interpret ‘insignificant’ in paragraph 15 and explain the extent to which the intensity of the risk is a relevant factor.¹¹

2.2 The third type of risk

Second, the third category of risk goes, in our view, beyond the findings of the European Courts and is likely to exclude relationships from the agency safe harbour that would not necessarily fall outside that protection pursuant to the Courts’ case law.¹² We invite therefore the Commission to explain why it refers to the *CEPSA* cases in footnote 10 to justify the addition of such new type of

⁶ Case C-2/01 P and C-3/01 P – *BAI and Commission v Bayer AG* of 6 January 2004 at paragraph 83

⁷ Case T-208/01 *Volkswagen v Commission* [2003] ECR II-5141.

⁸ E.g. Case T-325 *DaimlerChrysler AG v Commission* [2005] ECR II-3319, para. 87.

⁹ See for example the Court’s approach in T-325 *DaimlerChrysler AG v Commission*, where it admitted in para. 99 that the fact that a German agent was authorised, without, however, being obliged, to grant discounts which were deducted from his commission and exercised his commercial freedom in forgoing a part of his commission on individual sales in order to maximise his overall commission by selling more cars could not be classified as “price risk”. See also paras. 108-112.

¹⁰ The Court held in para. 118 that “an independent dealer is in a position to determine, or at the very least to influence, the terms on which the sales are made, as he is the seller, who bears the main price risk in the vehicle”.

¹¹ In Case C-217/05 *Confederación Española de Empresarios de Estaciones de Servicio* [2006] ECR I-11987, para. 61, the Court held that Article 81 is inapplicable where the dealer bears only a negligible share of the risks. See also C-279/06 *CEPSA Estaciones de Servicio SA v LV Tobar e Hijos SL* [2008] ECR I-6681, para. 41.

¹² Neither C-217/05 *Confederación Española de Empresarios de Estaciones de Servicio* nor C-279/06 *CEPSA Estaciones de Servicio SA v LV Tobar e Hijos SL* considered such type of risk.

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risk in the Draft Guidelines. Similarly, in *DaimlerChrysler*, paragraph 113 (which the Commission cites in footnote 11), the Court explicitly rejected the Commission's argument that a risk in relation to the provision of after sale services could disqualify an agent in relation to the separate activity of the sale of cars.

Therefore, we do not consider paragraph 16, 8th indent, as appropriate and question its introduction. We have set out some points in this regard below.

- It appears inappropriate to extend a concept specifically developed in relation to certain ancillary services (after sales, repair and warranty services) in a particular sector to a very broad notion ("operation in any other (product) market") in potentially all industries. Also from a policy point of view, it appears very unfortunate to put generally all agency relationships in doubt just because the agent may have business activities also on other markets (where he does not act as an agent).
- We consider the proposed concept of "indispensability" as very vague and difficult to apply in practice. For example, should the concept of indispensability concern (a) the ability of the agent to be competitive (at all or in an economically viable way?), (b) the customer when purchasing the contract goods, or (c) the agent's ability to be invited to enter into a distribution contract with the supplier?
- The proposed wording in the 8th indent does not (explicitly) provide that the agent's "operation in other (product) market" must be "required by the principal". It appears to us that such a contractual requirement¹³ would be necessary to provide legal certainty as well as consistency with the text in the 7th indent and paragraphs 14 and 17.

2.3 One or several risks?

Third, the Draft should be amended in order to align paragraph 17 ("one or more") with paragraph 21 ("some or all"). The Commission should clarify whether the existence of a single factor would necessarily lead to the conclusion that the dealer assumes risks such as to trigger the application of Article 81 EC.

2.4 More guidance on inter-brand competition

Fourth, we welcome that paragraph 19 and paragraph 20 put more emphasis on inter-brand competition. We would welcome, however, that more guidance be provided (a) on the efficiencies under Article 81(3), and (b) on the assessment of the facilitation of collusion.

¹³ See Case T-325 *DaimlerChrysler AG v Commission* [2005] ECR II-3319, para 112 where the Court referred to "activities which are contractually linked" to the sale of vehicles.

E. Retail Price Maintenance

1 Overview

The Draft VRBE proposes continuing the categorisation of RPM as a “hardcore restriction”, while providing more detailed guidance than the 1999 VRBE on the circumstances in which it may nevertheless be considered lawful under Article 81 EC. We welcome the more detailed analysis of the competitive effects of RPM in the Draft Guidelines, but are concerned that the Draft VRBE does not go far enough in softening the treatment of RPM in EC competition law. In particular, as outlined below, we consider that the hardcore categorisation of RPM is practically almost indistinguishable from *per se* illegality (we are not aware of a single case in the last 50 years in which the Commission has considered RPM to be lawful under Article 81 EC). Given that economic evidence suggests that there is a wide range of cases in which RPM is likely to have net pro-competitive effects and only limited circumstances in which it is likely to have net anticompetitive effects, we would propose that the hardcore categorisation of RPM be removed and that it be subject to a standard balancing analysis under Article 81(1) and (3) EC. In other words, we would suggest removing RPM from Article 4 in the Draft Regulation and introducing RPM in Article 5 as new (d).

2 Potential anticompetitive effects of minimum RPM

Paragraph 220 of the Draft Guidelines sets out a number of mechanisms through which RPM could lead to competitive harm. These include the facilitation of collusion among manufacturers or retailers, the softening of competition between manufacturers and/or retailers, the reduction of pressure on the profit margins of the manufacturers and the reduction of innovation at the distribution level. The Draft Guidelines also point out that “the immediate effect of RPM will be that all or certain distributors are prevented from lowering their sales price for that particular brand”.

This illustration of potential competitive harm will be helpful for parties to identify concerns that may arise in particular cases. However, in some respects the Commission’s position could benefit from further clarification. In particular, it would be helpful if examples were provided to illustrate the Commission’s concern that RPM may soften competition or reduce pressure on profit margins, as well as of how RPM could reduce dynamism and innovation at the distribution level.

It would be helpful if the Draft Guidelines would confirm that concerns about the facilitation of cartel behaviour will not arise unless the relevant market features a tight oligopoly with high barriers to entry. Moreover, the Draft Guidelines could also discuss the circumstances in which RPM would be expected to be chosen by the participants to facilitate the cartel. In particular, where other more effective or less detectable methods are available, prospective cartelists would presumably prefer to use these mechanisms. Where these mechanisms are available, we consider that the inference should be drawn that RPM has not been imposed to facilitate a cartel.

More generally, it would be helpful for the Commission to confirm that its analysis of vertical restraints more generally also applies to RPM. In particular, where inter-brand competition is fierce, RPM – like other vertical restraints – is unlikely to have anticompetitive effects and is therefore more likely to be motivated by efficiency objectives. The Draft Guidelines make this clear in respect of vertical restraints more generally,¹⁴ but it is not clear whether the same applies to the Commission’s analysis of what it considers to be “hardcore” restrictions such as RPM.

¹⁴ Draft Guidelines para. 98.

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Furthermore, it would be helpful if the Draft Guidelines made clear that RPM can serve as a tool to *enhance* inter-brand competition. As with other vertical restraints, by protecting retailers' profit margins, RPM can ameliorate the free-rider problem associated with retailers' investments in, for example, high-quality service. RPM can therefore operate to the benefit of the manufacturer, the retailer and the consumer by increasing the competitiveness of the non-price elements of the product offering. It would therefore be helpful for the Draft Guidelines to make clear that such effects are relevant for the analysis of whether RPM is caught by the prohibition in Article 81(1) and the circumstances in which the Commission expects that these positive effects on competition might be outweighed by negative effects.

More fundamentally, we are concerned that while the Draft Guidelines refer to the fact that the direct effect of RPM is to increase retail prices as an anticompetitive concern distinct from collusion and the other theories of harm discussed, the Draft Guidelines do not refer to the fact that (unlike in the case of horizontal price fixing) manufacturers receive no direct benefit from those higher prices through increased revenue. Thus, apart from facilitating collusion, incentivising investment and the other potential motivations for RPM discussed in the Draft Guidelines, manufacturers would generally have an incentive to minimise retailers' margins at any given wholesale price so as to maximise sales.

3 Efficiencies

Paragraph 221 of the Draft Guidelines outlines the potential for efficiencies from RPM and summarises the Commission's view that RPM "may also sometimes lead to efficiencies". It is not clear to us whether the Commission's use of the term "sometimes" is intended to suggest that the Commission expects efficiencies to arise less frequently than anticompetitive effects (since the Draft Guidelines do not similarly qualify the likelihood of anticompetitive effects). If so, it would be helpful for the Draft Guidelines to refer to support for this assumption. We note in this regard that even the dissenting opinion of the US Supreme Court in *Leegin*¹⁵ did not make the claim that anticompetitive effects arise more often than significant efficiencies.

The Draft Guidelines provide three examples of efficiencies that can result from RPM: (i) product or brand development at the time of entry; (ii) coordinated short-term price campaigns in franchise systems or similar distribution systems; and (iii) prevention of loss-leader strategies by large distributors. We welcome the inclusion of these examples. While this list is clearly only illustrative, we consider that it would be helpful to provide further examples. In particular, we would welcome a discussion of the interaction between the analysis of the effects on competition under Article 81(1) and efficiencies under Article 81(3) where the parties can show that RPM addresses free-riding concerns. In principle we can see that resolving free-riding issues both increases inter-brand competition (which should be relevant to Article 81(1)) and provides benefits to customers (which should be relevant to Article 81(3)). It would be helpful, however, if the Draft Guidelines could clarify this issue further.

4 Characterisation of RPM as hardcore

The Draft VRBE continues to consider RPM as a hardcore restriction.¹⁶ This means that if an agreement includes an RPM clause, the Commission will presume that the agreement restricts competition and therefore falls within Article 81(1). The inclusion of the RPM clause would also

¹⁵ *Leegin Creative Leather Prods. v. PSKS, Inc.*, 551 U.S. 877 (2007).

¹⁶ Draft Guidelines, para. 219.

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give rise to the presumption that the agreement is unlikely to fulfil the conditions of Article 81(3) EC.

Furthermore, an agreement that includes an RPM clause would not fall within the protection of the Draft Regulation, even where the parties each have low market shares. According to the Draft Regulation, this is because the Commission considers that RPM is a restriction which is “more likely than not to restrict competition and harm consumers or which [is] not indispensable to the attainment of the positive effects [of the agreement]”.¹⁷ Moreover, the Commission’s Article 81(3) Guidelines describe hardcore restrictions as those which feature “such a high potential of negative effects on competition that it is unnecessary for the purposes of applying Article 81(1) to demonstrate any actual effects on the market” and that “generally ... neither create objective economic benefits nor do they benefit consumers”. The Draft VRBE does not, however, provide any evidence to support these conclusions in relation to RPM.

The Draft Guidelines do state, however, that the presumptions as to the net negative effects of RPM and the exclusion of agreements including RPM clauses from the Draft Regulation do not preclude parties raising an efficiency defence. However, we are not aware of a single instance in the last 50 years in which the Commission has considered an RPM clause to be compatible with Article 81 EC. This would suggest that the Commission’s approach is in practice very close to *per se* illegality.

The economic evidence establishes that RPM – like other vertical restraints – can give rise to both positive and negative effects. There is no evidential basis to presume that RPM restrictions are more likely to be harmful than beneficial. Moreover, RPM clauses can be used by parties to address the same issues (e.g. free-riding) as other vertical restraints (e.g. territorial exclusivity). Although the types of competitive harm that price and non-price restraints can give rise to differ to some extent, it is not the case that price restraints give rise to more competitive concerns than non-price restraints. In a number of circumstances, price constraints may be the optimal solution to a free-rider problem from all parties’ perspectives (including consumers). In that context, applying different antitrust treatment to price and non-price restraints risks distorting parties’ choice of mechanism to the detriment of consumer and social welfare.

For these reasons, we consider that the best approach would be to apply a standard effects-based analysis to the assessment of RPM clauses under both Article 81(1) and 81(3) EC. Therefore, we would suggest removing RPM from Article 4 in the Draft Regulation and introducing RPM in Article 5 as new (d). An analogous amendment would be required in the Commission’s *De Minimis* Notice¹⁸ removing RPM from the list of hardcore restrictions. Such an approach would allow the Commission to gather experience as to the pro- and anti-competitive effects of RPM.

We would also welcome additional guidance – as suggested above – as to how a balancing assessment would be conducted in particular circumstances.

¹⁷ Draft Regulation, para. 10.

¹⁸ Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty establishing the European Community (*de minimis*) (2001/C 368/07)

F. Online distribution

1 Background

Since the introduction of the 1999 VRBE, the internet has undoubtedly brought a number of advantages to consumers including (i) reduced prices through reduced overheads and price comparison tools, (ii) bringing down barriers between countries and (iii) providing easier access to products. That having been said, the internet has the power to adversely affect the wider economy including consumers.

Since the internet is particularly powerful in lowering prices, it is especially important to understand the impact that the internet can have on products and industries that do not primarily compete on price. Although the internet has the potential to compete on non-price elements in some respects (e.g. convenience and easy access), the most successful online models, especially where the development of a brand is important, can free-ride on the investments that companies and distributors make in the offline channel. These arguments have been amply explored in the Commission's public consultation on the *Opportunities in online goods and services*.¹⁹

1.1 Consultation draft

The Commission in its consultation press release²⁰ asks, in particular, for comments on its treatment of restrictions on online sales in the Draft VRBE. We welcome the Commission's work to date that clearly aims to achieve a balance between the different effects of the internet. However, we consider that the current draft requires clarification in some parts and rebalancing in others.

Clarification in particular areas will help businesses apply an instrument that is designed as a self-assessment tool. We also consider that the Draft Guidelines require a rebalancing where the impact of new text appears to tilt the balance too far in one direction and beyond the purpose and intent of the block exemption. As the Commission notes in its *Online Commerce Roundtable Report on Opportunities and barriers to online retailing*,²¹ "the current policy towards vertical agreements is already very supportive of internet sales" (para. 13). Even more so, we would suggest maintaining an overall approach based on competition law without advocating a new policy-driven online regime.

1.2 A balancing exercise

We understand that it is difficult to balance the positive and negative effects of the internet. On the one hand, the internet appears to be the perfect tool to push market integration forward. On the other hand, giving the internet special protection could destroy established structures with unknown consequences. Given the above, we wish to highlight that the development of the internet necessitates an assessment not only of policy objectives today but also of policy objectives tomorrow.

For one, the internet has the power to change the shape of the "high street", potentially eliminating individual retailers for products conducive to sale over the internet. This can have consequences for the wider economy as employment patterns adjust. Secondly, mainstream online distribution is host to a number of powerful players operating in concentrated markets. As the internet develops and takes market share away from the bricks and mortar channel, successful online players may have significant market power in a number of industries.

¹⁹ http://ec.europa.eu/competition/consultations/2008_online_commerce/.

²⁰ IP/09/1197 - Antitrust: Commission launches public consultation on review of competition rules for distribution sector.

²¹ http://ec.europa.eu/competition/consultations/2009_online_commerce/roundtable_report_en.pdf.

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Naturally, these effects may happen with or without the introduction of the Draft VRBE (for instance as suppliers restructure their own distribution channels). However, the issue should not be prematurely forced by legislation that protects online sales from legitimate restrictions by suppliers. As such, we suggest that different policies need to be weighed up against each other and short-term objectives evaluated against long-term effects.

Therefore, we consider that the internet has positive and negative effects; however, it is not a panacea to market integration, but rather a distribution channel that should be treated according to the principles of economics and competition law and therefore should not receive special treatment within the different distribution modes.

2 Exclusive distribution

2.1 Distinction between active and passive sales

The definition of active and passive sales is important for exclusive distribution systems. Such systems can restrict “active” sales into exclusively allocated territory or to exclusively allocated customer groups, but cannot restrict passive sales.

The definition of active sales has remained largely unchanged in the Draft Guidelines when compared to the 1999 Guidelines, meaning that online sales are still generally considered as passive sales. As such, the internet has the power to undermine exclusive distribution systems as the following example shows.

Example 2.1.a: A supplier of aircraft spare parts uses a system of exclusive distribution in the EU allocating each country to one exclusive distributor. A distributor in Germany uses its website extensively and sells significantly into Austria through online sales. The Austrian distributor provides information to Austrian maintenance, repair and overhaul service providers (its main customers) by visiting various airports but cannot compete on price with the German distributor. Potential effect: Online sales into Austrian territory from the German distributor could rise steadily to the point that the Austrian distributor will struggle to stay solvent.

The issue in the above example explains the inherent problem in online sales coupled with exclusive systems that rely on territorial protection. As long as internet sales cannot be restricted, the concept of exclusive distribution in its current form is unlikely to provide a workable distribution system going forward.

In tackling this issue, the Commission has made some changes and notes that “[a]s a general rule, a website is not considered a form of active selling to certain customers unless it is specifically targeted at these customers. For instance, the Commission considers online advertisement specifically addressed to certain customers a form of active selling” (para. 53).

Without further guidance on the application of the above text, it is difficult to distinguish between adverts that are targeted at a particular customer group or particular territory. Generally speaking, the fact that a website has different language functionalities would appear to be an obvious example of targeting a particular territory but the Draft Guidelines explain that such functionality does not “normally” play a role in deciding whether sales are passive or active and that “[t]he fact that it [the internet] may have effects outside one’s own territory or customer group results from the technology, i.e. the easy access from everywhere” (para. 52).

There are two points to address in this respect. One, it would be useful for the text to clarify when the Commission would consider the language functionalities of a website to have an effect on the distinction between active and passive sales. The text only states that “normally” language options

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have no impact, suggesting that sometimes using a different language on a website can be considered as active sales. Two, it would be useful if the Commission would provide examples of when it considers advertising as targeting a particular customer group. Currently, it is not clear where to draw the line in making such a distinction. Two examples illustrate this point:

Example 2.1.b: Websites can make use of meta tags for search engine optimisation. In particular the use of *keywords* has proved popular in the past. Another function of meta tags is to define the *language* used and provide a *description* of the website. Generally, with such *keywords*, *language* and *description* tags, particular customers can be targeted. Does the Commission consider the use of such meta tags to amount to targeting a particular group?²²

Example 2.1.c: In an exclusive distribution system a distributor (who has been allocated the territory of the UK exclusively) purchases *adwords* on google.fr, thereby effectively targeting French customers and a territory that has been allocated to a different distributor. Would such practice be considered targeting of a particular customer group?

Trying to define active and passive sales in the context of online sales is difficult due to the changing nature of the technology which would make specific rules, for example based on meta tags, very difficult to enforce and probably obsolete in a very short time. In the absence of the ability to consider the use of different languages on websites as normally (rather than “not normally”) making a difference, we consider the use of a distinction between active and passive for online sales as, generally, inappropriate. As the Commission explains, the internet has effects outside one’s own territory or customer group due to the technology, “i.e. the easy access from everywhere”. Generally then, advertisements placed online are usually available to everyone, even if they may be targeted in some respect.

We would welcome more guidance on how the Commission considers – taking into account the growth of the internet – the new wording will be applied in practice. We do, however, submit that the Commission’s fine distinction is unlikely to provide the necessary protection to exclusive distribution systems and so successfully tackle free-riding concerns, such as the one set out above in Example 2.1.a.

2.2 Outright ban on online sales

The importance of the distinction that the Commission provides for active and passive sales is exacerbated by the fact that the Draft Guidelines consider only in the most limited of circumstances that an outright ban on online sales is acceptable. The new text states that:

“In an individual case, besides the possibility to plead an efficiency defence under Article 81(3) EC, an outright ban on internet or catalogue selling may be objectively necessary and fall outside Article 81(1) EC and will thus not be considered to be a hardcore restriction if it does not restrict competition that would take place in its absence given specific circumstances in which the agreement operates, such as when its purpose is to align on a public ban on selling dangerous substances over the internet or by mail order for reasons of safety or health.” (para. 54)

Though this applies not only to exclusive distribution systems but also generally across the spectrum of distribution agreements (including open- and selective distribution agreements), we consider the new wording too narrow. We believe that an outright ban on online sales can be justified in a number of circumstances.²³

²² In a previous draft of the text, the Commission considered that “the use of meta tags or any other technique with the sole purpose of targeting these customers” was active selling. This has not been included in the Draft Guidelines.

²³ For example, technically complex products of very high value.

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Therefore, we would suggest reverting to the original language set out in the 1999 Guidelines: “An outright ban on Internet or catalogue selling is only possible if there is an objective justification” (para. 51).

3 Selective Distribution

We welcome the clarification proposed by the Commission in the Draft VRBE in relation to selective distribution, in particular with regard to online sales. However, some concerns remain.

3.1 Article 4(b)

Article 4(b) states that territorial sales restrictions (or restrictions on sales to a particular customer group) are generally considered as hardcore restrictions, before providing a number of exceptions to this rule. The third exception relates to selective distribution systems. It states that “the restriction of sales by the members of a selective distribution system to unauthorised distributors in markets where such a system is operated” is exempted.

The Commission has added the words “in markets where such a system is operated” and it is not entirely clear to us what the new wording is targeting. On current reading, it can be misinterpreted to undermine selective distribution systems, especially for young brands as shown in the example below.

Example 3.1: Consider a new luxury leather bag start-up in France. The company uses a selective distribution system to create an “aura of luxury” around its brand. After two years of success in France it starts to expand and enters the UK using a selective distribution system. It has not launched its product in any other European country because it wishes to avoid being overstretched both financially and operationally. It is important for this company to keep its products out of countries where it has not yet launched its products in order to have the ability to enter and to promote the brand in line with its values.

Applying the new wording, it seems that the start-up company in the above example cannot restrict authorised distributors in France and the UK from selling to unauthorised distributors (i.e. any distributor including discount supermarkets) in any of the other 25 Member States.

Given that the ability of suppliers using selective distribution systems to restrict sales to unauthorised distributors is a fundamental concept, we assume that the Commission does not intend such a result. We would suggest removing the new wording from the Draft Regulation in order to avoid ambiguity.

3.2 Brick and Click

The Draft Guidelines introduce the concept of “brick and click”, essentially allowing a supplier to require its distributors to have a bricks and mortar shop or showroom before engaging in online distribution.

We welcome this new addition to the Draft Guidelines and consider that, in particular for users of selective distribution systems, the bricks and mortar channel is a necessity to build the brand, provide services and to communicate with the customer. Although pure online players can provide lower prices in the short term (through a lower cost base) pure online player sales can have the long-term effect of undermining the bricks and mortar sales channel and therefore the ability of the supplier to build its brand. The long-term effects would result in significant reductions in investments in the bricks and mortar channel, which can have the effect of reducing the value of the brand and therefore be to the detriment of consumers.

One point that remains open, however, is best illustrated using an example.

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Example 3.2: A distributor of mid-market watches located in Vienna has extensive online sales through ranking highly on the Google search engine in a number of countries including France, Germany, and the UK. It has constantly increased its proportion of online sales and these currently stand at 90% of its overall sales. Through online sales the Austrian distributor has been able to reduce its marginal cost continuously, thus allowing it to charge lower prices than its competition in other countries. Potential effect: As distributors in France, Germany and the UK do not have the same economies of scale they cannot compete with prices that will not cover the cost of their bricks and mortar channel.

The above is a clear example of free-riding as customers can go to the bricks and mortar shops before searching online for the cheapest provider. While free-riding between bricks and mortar shops in selective distribution systems has always occurred to a limited extent (e.g. holiday makers purchasing items when abroad), the internet has the power to exponentially exacerbate this problem.

As discussed in the introduction to this section, there is potential for online markets to become concentrated in a number of industries. Therefore, suppliers using selective distribution systems – where this can be objectively justified depending on the product at hand – should be allowed to protect the viability of their bricks and mortar distribution outlets.

We understand that the Commission has tried to deal with the above scenario in Footnote 29, where the Commission appears to allow the supplier to restrict, to some extent, online sales. However, as discussed below in section 3.3 of this submission, further clarification would be useful to understand how the Commission will see the somewhat contradictory hardcore restriction (para. 52) and accompanying exemption (Footnote 29) working in practice.

3.3 Hardcore restrictions in paragraph 52

The text introduces a number of new hardcore restrictions.

“[...] The Commission regards for instance the following as hardcore restrictions of passive selling:

- [...]*
- [...]*
- requiring a distributor to limit the proportion of overall sales made over the internet [FN 29];*
- requiring a distributor to pay a higher price for products intended to be resold by the distributor online than for products intended to be resold off-line. [FN 30]”*

We understand that the first two indents relate to the concept of passive selling and given that Article 4(b) prohibits the restriction of passive sales into territories or to allocated customers – if one considers customers generally buying over the internet as one customer group – this hardcore restriction understandably flows from Article 4.

However, the last two indents do not clearly flow from the Draft Regulation. In that regard, we question the introduction of new hardcore restrictions that do not flow directly from the Draft Regulation and discuss these in more detail below.

3.3.1 Limitation of online sales

As Example 3.2 above suggests, without the ability to limit the proportion of overall sales made over the internet, the “brick and click” concept that the Commission introduces

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cannot be protected and can be circumvented. As such, and in particular in the selective distribution context, a provision that protects the viability of a distribution system that is reasonable and proportionate should not be considered a hardcore restriction.

This is in line with the concept of ancillary restraints that the CFI made reference to in *Metropole v Commission*.²⁴ Such an approach would also be consistent with Member States' case law. For example, in *Lancaster*,²⁵ the German Federal Supreme Court (Bundesgerichtshof) held that a supplier of perfume operating a selective distribution system can require its individual bricks and mortar distributors to achieve no more than 50% of their individual turnover through online sales.

Therefore, we welcome Footnote 29, where the Commission appears to take this into account and which states in the first sentence: "...nor does it preclude the supplier from making sure that the online activity of the distributor remains consistent with the supplier's distribution model...".

In conclusion, a "hardcore" restriction is a restriction which "by its nature" has the object and effect of fixing prices or sharing markets.²⁶ Such a classification is inappropriate in this case, given that it does not concern price fixing or market sharing. However, we welcome the anti-avoidance provisions that the Commission introduces.

3.3.2 Dual pricing

The same considerations as discussed above apply to the fourth indent: "requiring a distributor to pay a higher price for products intended to be resold by the distributor online than for products intended to be resold off-line". Without repeating the arguments above, we question whether this restriction should be considered a hardcore restriction.

3.3.3 Hardcore restriction in paragraph 57 ("Equivalent")

We welcome the Commission's discussion regarding internet criteria in selective distribution systems. However, we are concerned with the Commission's proposed approach of classifying as a hardcore restriction any obligation which dissuades appointed dealers in a selective distribution system from using the internet by imposing criteria for online sales which are not "equivalent" to the criteria imposed for the sales from the bricks and mortar shop.²⁷

As explained in section 3.3.1. above, the application of the concept of a hardcore restriction should be limited to restrictions that are anticompetitive by object and, more importantly, can be easily identified as such. Only in clear-cut cases is it appropriate for the burden of proof to shift and a presumption of illegality to stand. The Commission maintains in the Draft Guidelines (para. 171) that purely qualitative selective distribution systems do not generally fall within Article 81(1) at all. It is therefore of concern to see the concept of hardcore restrictions being applied to potentially qualitative criteria (which online criteria will generally be).

²⁴ Case T-112/00 *Metropole v. Commission* [2001] ECR II-2459 at para. 109: "If, without the restriction, the main operation is difficult or even impossible to implement, the restrictions may be regarded as objectively necessary for its implementation."

²⁵ *Lancaster Group GmbH v. Beauty Net AG* KZR 2/02.

²⁶ See for example Cases T-374/94 etc *European Night Services v Commission* [1998] ECR II-3141, para. 136; Case T-67/01 *JCB Services v Commission* [2004] ECR II-29, para. 85, upheld by the ECJ; Case C-167/04 *JCB Services v Commission* [2006] ECR I-8935.

²⁷ Draft Guidelines para. 57.

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We consider the examples provided in Footnote 31 of the Draft Guidelines as useful. Although additional examples would be welcome, we understand the difficulty of being specific in what is essentially a case-by-case analysis.

The Commission uses explanatory text to make clear that the concept of equivalence can be set aside when the difference between the online/offline criteria appears irreconcilable due to the nature of the different distribution channels. However, rather than relying on an exemption to the equivalence test, we would suggest amending the wording and using the concept of “objective justification” instead.

Further, the Commission has already set out guidance for qualitative criteria which we suggest it should follow for online criteria. In analysing selective distribution systems, the Commission states that purely qualitative selective distribution systems do not fall within Article 81(1) at all if three conditions are met: (i) the nature of the product in question necessitates a selective distribution system; (ii) resellers are chosen on the basis of objective qualitative criteria without discrimination; and (iii) the criteria do not go beyond what is necessary.²⁸

In line with this guidance, the practical questions for suppliers and distributors for imposing and accepting online criteria will not be whether a criterion is equivalent to the one applied in the bricks and mortar outlet but rather whether it is necessary and, therefore, objectively justifiable. Given that both concepts require an assessment and comparison exercise, we suggest that online criteria applied on the basis of “objective justification” is in line with existing practice and is the more appropriate test. We also submit that the use of the concept of “hardcore restriction” is inappropriate.

4 Exemption to ban passive sales for a period of 2 years in certain circumstances

We welcome the Commission’s example of where passive sales can be restricted. The Commission notes in paragraph 56 of the Draft Guidelines:

“A distributor which will be the first to sell a new brand or the first to sell an existing brand on a new market, thereby ensuring a genuine entry in the relevant market, may have to commit substantial investments to start up and/or develop the new market where there was previously no demand for that type of product in general or for that type of product from that producer. Such expenses may often be sunk and in such circumstances it could well be the case that the distributor would not enter into the distribution agreement without protection for a certain period of time against (active and) passive sales into its territory or to its customer group by other distributors. Where substantial investments by the distributor to start up and/or develop the new market are necessary, restrictions of passive sales by other distributors into such a territory or to such a customer group therefore generally fall outside Article 81(1) during the first two years that this distributor is selling the contract goods or services in that territory or to that customer group.”

With regard to the concept of “new brands”, it is not clear how this should be applied in practice. For example, does the Commission consider a new product or a new range of products that are introduced under an existing family of brands as a “new brand”? Also, we query whether 2 years is a long enough period in particular cases where heavy upfront investments are necessary. We therefore suggest keeping the wording more open to allow for extraordinary circumstances (if only to refer to Article 81(3)).

²⁸ Draft Guidelines para. 171.

G. Other issues in exclusive and selective distribution

1 The restriction of active sales in mixed distribution systems

The current system of exclusive distribution set out in Article 4(b) imposes an unduly restrictive formal requirement when dealing with territorial restrictions. The Draft Guidelines in paragraph 51 explain that a supplier is required to ensure that the territory allocated exclusively to a buyer is protected from all other buyers of the supplier inside the Community (see extract below).

“The first exception [from the hardcore prohibition] allows a supplier to restrict active sales by a buyer party to the agreement to a territory or a customer group which has been **allocated exclusively to another buyer** or which the supplier has reserved to itself. A territory or customer group is exclusively allocated when the supplier agrees to sell his product only to one distributor for distribution in a particular territory or to a particular customer group and the exclusive distributor is protected against active selling into his territory or to his customer group by the supplier and **all the other buyers of the supplier inside the Community.**” [Emphasis Added]

This has the result that a supplier is forced to introduce exclusive distribution systems across the Community whereas the situation may not necessitate such an approach. An example better illustrates the point.

Example 1: A supplier uses an open distribution system but wishes to penetrate a particular market. The supplier considers the best strategy is to use an exclusive distribution arrangement in order to ensure significant investments will be made. The supplier understands that only a limited amount of sales are currently being made cross border into that particular territory. Therefore the protection required would be minimal in order to achieve exclusivity.

Taking Example 1 above, in order to achieve exclusivity, the supplier would need to change its entire European distribution strategy before being able to legally provide for territorial protection in one Member State. In this regard, it can be argued that applying such a strategy (i.e. creating an exclusive distribution system throughout the Community where this is not needed) has negative competitive effects.

Similarly, it is not possible to use mixed distribution systems involving exclusive distribution despite this being potentially the most appropriate method, e.g. on the basis of regional preferences. For example, using a selective distribution system in Scandinavia and an exclusive distribution system in Southern Europe is currently not possible.

It is our understanding that the Commission has previously considered liberalising the restrictions on active sales in general through amending Article 4(b) to apply to passive sales only. We consider this to be the most effective way of the dealing with the above raised concerns and would welcome such an amendment.