Prohibition of parallel Imports as a hard core Restriction of Article 4 of Block Exception Regulation for vertical Agreements: European Law and Economics

Nikolaos Zevgolis and Panagiotis Fotis

Hellenic Competition Commission, Directorate of Competition, Athens University of Economics and Business, University of Central Greece, Department of Regional and Economic Development

16 August 2011

Prohibition of parallel imports as a hard core restriction of article 4 of Block Exception Regulation for vertical agreements: European Law and Economics[*]

Nikolaos E. Zevgolis† and Panagiotis N. Fotis ‡

† Hellenic Competition Commission, Legal expert/Directorate of Legal Services. & Athens University of Economics and Business, 12 Themou Anninou, 11141, Athens, Greece, Tel.: + 30-210-2023338, Fax: +30-210-3303625, E-mail address: nikzevgolis@aueb.gr.

‡ *Hellenic Competition Commission, Director/Directorate of Economic Analysis & University of Central Greece, 5 P. Ioakim, 12132, Peristeri, Athens, Greece, Tel: + 30-210-5712588, Fax: + 30-210-5712588, E-mail address: pfotis@epant.gr*

Abstract

This paper attempts, on the one hand, to reveal the main principles of Competition Law (regulatory and case law framework) covering the prevention of parallel trade, mainly the prohibition of parallel imports or exports, and on the other hand to cast light on the main effects of parallel imports prohibition imposed by an upstream supplier on the competitive structure of the downstream market. Especially, the regulatory framework relates Block Exception Regulation 330/2010, (ex Block Exception Regulation 2790/99), with Block Exception Regulation 461/2010 (ex Block Exception Regulation 1400/2002) in order to determine whether prohibition of parallel trade constitutes a hardcore restriction or not, while the economic analysis evaluates it in a geographical vertical market which constitutes an upstream and a downstream market with few suppliers & buyers respectively which sell goods to the final (domestic) consumers. The results indicate that prohibition of parallel imports by the upstream sellers causes vertical restraints to the domestic customers of the buyers.

*JEL c*lassifications: D43; K21; L13; L43; L67

Key words: *Antitrust Law, Vertical Restraints, Block Exception Regulation, Market Imperfection, Consumer Nondurables, Repeated Games of Oligopoly Theory*

[*] The views expressed herein are purely those of the authors and do not necessarily reflect the Hellenic Competition Commission or any individual Commissioner. Usually disclaimer applies.

1. Introduction

Block Exception Regulation (*BER*) 330/2010[1] (ex *BER 2790/99*[2]) states that article *101(1) of the Treaty shall not apply to vertical agreements*, wheatears *such agreements contain vertical restraints* (ar.2) and *the market share held by the supplier does not exceed 30 % of the relevant market on which it sells the contract goods or services and the market share held by the buyer does not exceed 30 % of the relevant market on which it purchases the contract goods or services* (ar. 3).

Also, *BER 461/2010*[3] (ex *BER1400/2002*[4]) declares that *article 101(1) of the Treaty shall not apply to vertical agreements relating to the conditions under which the parties may purchase, sell or resell spare parts for motor vehicles or provide repair and maintenance services for motor vehicles, which fulfil the requirements for an exemption under Regulation (EU) No 330/2010 and do not contain any of the hardcore clauses listed in Article 5 of this Regulation,* (see below) whereas such *agreements contain vertical restraints* (article 4).

However, both BERs contain hardcore restrictions that remove the benefit of the block exemption. Especially, article 4 of *BER* 330/2010 (see below) outlines the basic categories of hardcore restrictions, for which the exception provided for in the abovementioned article 2 of BER shall not apply to vertical agreements.

The main question which this paper tries to answer is whether prohibition of parallel trade (i.e. of imports or exports or both of them)[5] constitutes a hardcore restriction of BER for vertical agreements, that is a *per se* approach. For that purpose, we analyse the existing regulatory framework in combination with case law into real economic environment so as to determine if prohibition of parallel

[1] O.J. L102/1, 23.4.2010.
[2] O.J. L336/21, 29.12.1999.
[3] O.J. L 123C/52, 28.05.2010.
[4] O.J. L 203/30, 1.8.2002.

imports by upstream suppliers may cause vertical restraints in the downstream market and especially the customers of the buyers[6].

The remainder of the paper is organized as follows: Section 2 provides and evaluates the main principles of BER 330/2010 & BER 461/2010. Section 3 combines both BERs, while section 4 highlights some administrative anticompetitive measures. Section 5 imports the theoretical argument into real economic environment. Lastly, sections 6 and 7 provide some conclusions and policy implications respectively.

2. The content of the BERs

2.1 Hard core restrictions of BER 330/2010

Logically, it would be expected that the prohibition of parallel imports would be explicitly referred as a *hardcore restriction* in the content of article 4 of BER 330/20 ('Restrictions that remove the benefit of the block exemption — hardcore restrictions'). According to that, "*The exemption provided for in Article 2 shall not apply to vertical agreements which, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object:*

(a) the restriction of the buyer's ability to determine its sale price, without prejudice to the possibility of the supplier to impose a maximum sale price or recommend a sale price, provided that they do not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties;

[5] In this paper parallel trade, imports, exports and parallel imports & exports are used interchangeably.

(b) the restriction of the territory into which, or of the customers to whom, a buyer party to the agreement, without prejudice to a restriction on its place of establishment, may sell the contract goods or services[7]*,*

(c) the restriction of active or passive sales to end users by members of a selective distribution system operating at the retail level of trade, without prejudice to the possibility of prohibiting a member of the system from operating out of an unauthorised place of establishment;

(d) the restriction of cross-supplies between distributors within a selective distribution system, including between distributors operating at different level of trade;

(e) the restriction, agreed between a supplier of components and a buyer who incorporates those components, of the supplier's ability to sell the components as spare parts to end-users or to repairers or other service providers not entrusted by the buyer with the repair or servicing of its goods"[8].

It is obvious that there is no specific provision of the prohibition of parallel imports as a hardcore restriction. Consequently, according to the basic principle governing BER 330/2010 (as well as the former BER 2790/99), which provides that *whatever is not prohibited by article 4 is permitted*[9], it would be expected that the prohibition of parallel imports is not a hardcore restriction.

---

[6] According to BER 330/2010, 1(i), *'customer of the buyer' means an undertaking not party to the agreement which purchases the contract goods or services from a buyer which is party to the agreement.'*

[7] Except from *(i) the restriction of active sales into the exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another buyer, where such a restriction does not limit sales by the customers of the buyer, (ii) the restriction of sales to end users by a buyer operating at the wholesale level of trade, (iii) the restriction of sales by the members of a selective distribution system to unauthorised distributors within the territory reserved by the supplier to operate that system, and (iv) the restriction of the buyer's ability to sell components, supplied for the purposes of incorporation, to customers who would use them to manufacture the same type of goods as those produced by the supplier*".

[8] See O.J. L102/1, 23.4.2010, p. 5.

[9] See Dethmers F. & Posthuma de Boer P. (2009) p. 425.

However, the significance of the parallel trade protection is mentioned in the new Guidelines about vertical restraints[10], mainly in paragraph 25, where it is referred as an instance that "*if after a supplier's announcement of a unilateral reduction of supplies in order to prevent parallel trade, distributors reduce immediately their orders and stop engaging in parallel trade, then those distributors tacitly acquiesce to the supplier's unilateral policy. This can however not be concluded if the distributors continue to engage in parallel trade or try to find new ways to engage in parallel trade*"[11].

In any case, in our view, before someone come to a conclusion whether the prohibition of parallel trade constitutes a hardcore restriction or not, it would be plausible to examine mainly the following issues: firstly, the necessity of focusing on the interpretation of article's 4 content of the Block Exemption 330/2010 and the consideration of the guidelines about vertical restraints in combination with the content of Regulation 461/2010 and its relevant guidelines. Secondly, the possibility that such a point of view would come in contradiction with the settled case law about parallel imports and thirdly, the characteristics of the markets in which parallel trade prohibition is imposed.

2.2 Prohibition of parallel imports as an effective measure for RPM

The hardcore restriction set out in article 4(a) of the BER 330/2010 focuses on Resale Price Maintenance (RPM), that is, agreements or concerted practices having as their direct or *indirect object* the establishment of a fixed or minimum resale price or a fixed or minimum price level to be observed by the buyer. In the case of contractual provisions or concerted practices that directly establish the resale price, the restriction is clear cut.

[10] O.J. C130/01, 19.05.2010.
[11] See para. 25 (a).

However, RPM can also be achieved through indirect means. Examples of that are an agreement fixing the distribution margin, fixing the maximum level of discount the distributor can grant from a prescribed price level, making the grant of rebates or reimbursement of promotional costs by the supplier subject to the observance of a given price level, linking the prescribed resale price to the resale prices of competitors, threats, intimidation, warnings, penalties, delay or suspension of deliveries or contract terminations in relation to observance of a given price level.

Direct or indirect means of achieving price fixing can be made more effective when combined with measures to identify price-cutting distributors, such as the implementation of a price monitoring system, or the obligation on retailers to report other members of the distribution network that deviate from the standard price level.

Similarly, direct or indirect price fixing can be made more effective when combined with measures which may reduce the buyer's incentive to lower the resale price, such as the supplier printing a recommended resale price on the product or the supplier obliging the buyer to apply a most-favoured-customer clause. The same indirect means and the same "supportive" measures can be used to make maximum or recommended prices work as RPM.

However, the use of a particular supportive measure or the provision of a list of recommended prices or maximum prices by the supplier to the buyer is not considered in itself as RPM[12]. Nevertheless, it should also be assessed that in few cases[13], maximum and recommended prices will work as a focal point for the resellers and might be followed by most or all of them; in such a case the possible

[12] See O.J. L102/1, 23.4.2010, para. 48.
[13] See O.J. L102/1, 23.4.2010, para 227.

competition risk is that maximum or recommended prices may soften competition or even facilitate collusion between suppliers.

The strategy of parallel imports' prohibition may be seen as a measure which reduces the buyer's incentive to reduce resale price by diminishing the sources of supply. Such a strategy may raises dangerously the level of selling prices of the products in question, since the elimination of sources of supply restricts the ability of the buyer to distribute the product in a profitable way. As a consequence of that, the consumer welfare is negatively influenced.

The consumer welfare may also be negatively influenced in cases where the abovementioned strategy takes place in markets where the buyers resell the products in question to domestic customers of the buyers. To our view, such a product market example may have more severe anticompetitive effects since the buyers of the downstream market are not export oriented firms.

Lastly, by imposing a price floor, an upstream firm increases the non-cooperative profits of downstream firms and makes collusion relatively less profitable. As a result, collusion may be destabilized and the price floor enables a manufacturer to *prevent* collusive behavior among downstream firms (Overvest B 2010).

2.3 The argument of exclusive supply of a specific trademark by itself

Hypothetically speaking, if someone is in favour of the opinion that the prohibition of parallel imports is not a hardcore restriction, he could argue that, since the prohibition of parallel imports seem to have the same results with an exclusive supply agreement, therefore *de facto* constitutes an exclusive supply.

Nevertheless, at this point an absolutely necessary distinction ought to be made: the exclusive supply of specific products of a trademark is not the same with the exclusive supply of a specific trademark by itself; in the first case, the exclusive

supply of specific products of a specific trademark is legal, since it does not prohibit the parallel imports of these products of the same trademark; If a retailer can find the same products of the same trademark by a cheaper source of supply (for instance, a wholesaler or an authorized dealer in an other member state), he can buy them in order to resale them without breaking the exclusive supply agreement.

On the contrary, the exclusive supply of a specific trademark by itself, which actually constitutes *exclusive source of supply*[14] and not exclusive supply, should be treated in a completely different way, because it *de facto* constitutes an indirect (but effective) prohibition of parallel imports; in this case, the real purpose of the exclusive supply agreement concerning not specific products but a trademark as a whole is not a non compete obligation[15], but to prevent the retailer from finding products of the same trademark in lower prices by other sources. So, the point of view that prohibition of parallel imports constitutes an exclusive supply agreement and therefore ought to be allowed as a practice is postponed; an exclusive supply agreement which indirectly prevent parallel imports is always illegal.

[14] Exclusive sourcing is something different, since in this case the existence of exclusive distributors is demanded; according to para 162 of the Guidelines on vertical restraints [O.J. C130/01, 19.05.2010], "*[e]xclusive sourcing, requiring the exclusive distributors to buy their supplies for the particular brand directly from the manufacturer, eliminates in addition possible arbitrage by the exclusive distributors, which are prevented from buying from other distributors in the system*".

[15] See D.G. Goyder (2004), p. 187. See also para 129 of the Guidelines on vertical agreements [O.J. L102/1, 23.4.2010] referring that: "*Under the heading of 'single branding' fall those agreements which have as their main element the fact that the buyer is obliged or induced to concentrate its orders for a particular type of product with one supplier. That component can be found amongst others in non- compete and quantity-forcing on the buyer. A non- compete arrangement is based on an obligation or incentive scheme which makes the buyer purchase more than 80% of its requirements on a particular market from only one supplier.* ***It does not mean that the buyer can only buy directly from the supplier****, but that the buyer will not buy and resell or incorporate competing goods or services*" [emphasis added].

2.4 BER 461/2010

2.4.1 The content of supplementary guidelines

The necessity for protection of parallel trade in the motor vehicles sector is formulated absolutely clearly in the Commission notice — Supplementary guidelines[16] on vertical restraints in agreements for the sale and repair of motor vehicles and for the distribution of spare parts for motor vehicles[17,18]. The Commission considers the protection of parallel trade in the motor vehicles sector as an important competition objective, since the internal market has enabled consumers to purchase motor vehicles in other Member States and take advantage of price differentials between them[19].

The main concept of the internal market is the consumer's ability to buy goods in other Member States. This ability is especially important as far as motor vehicles are concerned, given the high value of the goods and the direct benefits in the form of lower prices accruing to consumers buying motor vehicles elsewhere in the Union. It cannot be ignored that the specific nature[20] of the motor vehicle ought to be taken into account, since it is about one of the most complex products[21]. The Commission is therefore concerned that distribution agreements, generally but also specifically in this particular sector, should not restrict parallel trade, since this cannot be expected to satisfy the conditions laid down in Article

[16] O.J. C138, 28.05.2010, p. 0016 – 0027.
[17] See Clark J. and Simon S., (2010), pp. 1-13 and Simon S., (2010), pp. 83-91.
[18] The new guidelines about the motor vehicle sector are called "supplementary", since they should be read combined with the guidelines on vertical agreements. According to J. Clark and S. Simon, (2010), p. 3, "*[t]he guidelines carry the word supplementary in their title to signal that they have to be read in conjunction with the General Vertical Guidelines*".
[19] O.J. C138, 28.05.2010, para 48.
[20] See Karydis G. and Zevgolis N., (2009), p.95.
[21] As Goyder D.G., (2004), p.203 has mentioned: ''*The motor car is probably the most complex consumer product of all, as well as being the most expensive purchase that many consumers ever make*''. See also Vezzoso S., (2004), p.190-191 who wrote: ''*The whole concept was centred on the belief that the car was not an ordinary good*''.

101(3) of the Treaty[22]. In the same concept, it is remarkable that the European Court of Justice (ECJ) in its C-338/00P (Volkswagen/Commission) decision clearly ruled that "*[…] a measure which is liable to partition the market between Member States cannot come under those provisions of Regulation No 123/85 that deal with the obligations which a distributor may lawfully assume under a dealership contract. The Court of First Instance properly held in paragraph 49 of the judgment under appeal that, although that regulation provided manufacturers with substantial means by which to protect their distribution systems, it did not authorise them to adopt measures which contributed to a partitioning of the market (Bayerische Motorenwerke, cited above, paragraph 37)*"[23]. So, the application of a BER 461/2010 should never be used as an excuse for the partitioning of the market. Besides, compartmentalisation of the market is not included (and cannot be included) in the purposes of a Block Exemption Regulation.

2.4.2 Case law in motor vehicle sector

The relevant case law can safely be considered as settled, since the Commission has brought several cases against motor vehicle manufacturers for impeding parallel trade, and its decisions have been largely confirmed by the European Courts[24]. This experience shows that restrictions on parallel trade may take a number of forms (direct or indirect)[25,26]: a supplier may put pressure on distributors, threaten them with contract termination, fail to pay bonuses, refuse to

[22] The notion that cross-border trade restrictions may harm consumers has been confirmed by the Court in Case C-551/03 P, para 67 and 68; Case C-338/00 P, para 44 and 49 and Case T-450/05, para 46-49.
[23] O.J. C138, 28.05.2010, para 49.
[24] See Case IV/35.733 — VW, Case COMP/36.653 — Opel, Case COMP/36.264, Cases F-2/36.623/36.820/37.275.
[25] O.J. C138, 28.05.2010, para 49.
[26] See indicatively Bellamy C. and Child G., (2001), para. 7-053. See also Korah V. & O'Sullivan D., (2002), p. 58.

honour warranties on motor vehicles imported by a consumer or cross-supplied between distributors established in different Member States, or make a distributor wait significantly longer for delivery of an identical motor vehicle when the consumer in question is resident in another Member State. The relative remarks of Advocate General Antonio Tizzano in the General Motors case (C-551/03P) are very characteristic. According to his view, "*[…] such an objective [*compartmentalisation of the single market[27]*] can be achieved not only by direct restrictions on exports but also through indirect measures aimed at deterring a dealer from making foreign sales, particularly by influencing the economic and financial conditions of such operations. The Court of Justice has thus regarded as inherently restrictive of competition measures which, like the measure at issue here, 'make parallel imports more difficult'[28] by subjecting them to treatment less favourable than that reserved for official imports or 'restricting the buyer's freedom to use the goods supplied in accordance with his own economic interests'* [29,30]". His point of view had been accepted by the ECJ[31].

The case where a distributor is unable to obtain new motor vehicles with the appropriate specifications needed for cross-border sales constitutes a particular example of indirect restrictions on parallel trade[32]. In those specific circumstances, the benefit of the block exemption may depend on whether a supplier provides its distributors with motor vehicles with specifications identical

[27] Addition made by the authors.
[28] Judgment in Cases 96-102, 104, 105, 108 and 110/82**,** para 6.
[29] Judgment in Case 319/82, para 6.
[30] Such principles are also to be found in the Community rules governing the application of Article 81 EC to distribution agreements [already Article 101 of the Treaty].
[31] See Court's decision, para. 68.
[32] O.J. C138, 28.05.2010, para. 50.

to those sold in other Member States for sale to consumers from those countries (the so-called "availability clause")[33].

3. Distribution of new motor vehicles: point of combination of the two Block Exemptions (330/2010 & 461/2010)

It could be said that the two Block Exemptions, ie 330/2010 and 461/2010, are actually combined; According to recital 10 of the preamble of the BER 461/2010, as regards the distribution of new motor vehicles[34], there are not any more significant competition shortcomings which would distinguish this sector from other economic sectors (such as vertical relations) "*and which could require the application of rules different from and stricter than those set out in Regulation (EU) No 330/2010*".

The market-share threshold, the non-exemption of certain vertical agreements and the other conditions laid down in Regulation 330/2010 normally ensure that vertical agreements for the distribution of new motor vehicles comply with the requirements of Article 101(3) of the Treaty. Therefore, the vertical agreements for the distribution of new motor vehicles ought to benefit from the exemption granted by Regulation (EU) No 330/2010, subject to all the conditions laid down therein.

Furthermore, since the settled case law about the protection of parallel trade concerns basically the distribution of new motor vehicles, it is obvious that the protection of parallel imports or exports –either it concerns vertical agreements in the new motor vehicles sector or vertical agreements in an other sector – it is (and

[33] Joined Cases 25 and 26/84.

[34] See the conclusions of the in-depth monitoring of the motor vehicle sector set out in the Evaluation Report on the operation of Commission Regulation O.J. C138, 28.05.2010 and the Commission Communication on The Future Competition Law Framework applicable to the Motor Vehicle sector of 22 July 2009 [COM(2009) 388].

should be) the same: it is about a hardcore restriction, consequently *per se* approach.

4. Administrative anticompetitive measures - measures of having equivalent effect

Nevertheless, in some cases it is a member-state (and not the manufacturer of a motor vehicle or a producer generally) which creates an indirect restriction on parallel trade or influences negatively the parallel trade by specific administrative means; it is about the case of measures having equivalent effect. For instance, as far as it concerns the sector of motor vehicles, the ECJ in its recent decision 170/07[35] (Commission of the European Communities v Republic of Poland) declared that, by subjecting imported second-hand vehicles registered in other Member States to a roadworthiness test prior to their registration in Poland, whereas domestic vehicles with the same characteristics are not subject to such a requirement, the Republic of Poland had failed to fulfil its obligations under Article 28 EC (already Article 34).

It is estimated that the *ratio* of the above mentioned decision of the ECJ adds up to its decision C-154/85 **(**Commission of the European Communities v Italian Republic)[36], where the ECJ ruled that article 30 (then 28 and already 34) of the Treaty, prohibiting measures having equivalent effect to a quantitative restriction, is infringed by an increase by a member state (Italy) in the number of administrative requirements involving the production of documents necessary for parallel imports of vehicles, whether new or already registered, from other member states.

[35] OJ C 183, 4.8.2007. The case concerns second hand vehicles.
[36] [1987] ECR 02717.

Those requirements, which make registration of the vehicles more complicated, longer and most costly, cannot be justified on grounds of public policy connected with the detection or prevention of dealing in stolen vehicles[37], since they cannot be regarded as necessary for that purpose (principle of proportionality). That is the case when the information required duplicates that supplied by the authorities of the exporting member state and less restrictive measures would be sufficient to achieve the desired objective. In reality, it was about an unacceptable distinction between domestic and imported goods (motor vehicles).

5. The Greek example: the sector of detergents for domestic use

5.1. National Law and competitive environment

According to the national regulatory framework which rules the sector of detergents for domestic use in Greece, a Greek wholesaler who intends to make parallel imports concerning detergents, he is obliged to visit the importer asking for the specific content of each detergent in centigrams. In special circumstances[38], he has to deposit all the necessary documents to the State's General Chemical Laboratory (or for instance to the Supreme Chemical Council) in order to be licensed for the imported detergents. It is obvious that under these strict circumstances the 'legal' parallel imports of detergents for domestic use in Greece are practically almost impossible. National legal framework for the parallel imports in the specific sector is extremely strict, perhaps the most rigorous in the E.U.[39].

[37] See para. 14 of the Court's decision.
[38] i.e. the importer denies to 'satisfy' the Greek wholesaler's demand.
[39] Probably, this is the reason why the Greek market mainly in the sector of detergents for domestic use is one of the most expensive (or maybe the most expensive) in the E.U.

Therefore, the sector of detergents for domestic use in Greece constitutes an oligopolistic market where only a small number of firms are activated, because of the existence of measures having equivalent effect and the concentrations that have taken place[40]. These activated firms have the possibility to raise their profit margin in upper levels, due to the absence of competition in the specific market[41].

5.2 The nature of competitive restraints

The Greek example of parallel imports prohibition concerns vertical restrictions imposed in distribution agreements. There are an upstream and a downstream market in which firms in both markets (sellers[42] in upstream market and buyers[43] in downstream market) behave in an oligopolistic way. In the upstream market there are few but large producers/sellers of final goods whereas in the downstream market there are firms/buyers that sell the upstream firms' products to the final consumers (domestic costumers of the buyers).

Especially, the upstream market involves the production and distribution of daily consumer goods to retailers[44], such as detergents for domestic use. Upstream producers may also export the products in different geographical downstream product markets. Each producer specialises in individual products or product

[40] See Fotis, P., Polemis, M., Zevgolis, N., (2011), p. 76-77 for a review of major concentrations that have been cleared by Hellenic Competition Commission during the period from 1995 to 2010. Also, see Fotis, P., Polemis, M., Zevgolis, N., (2009), p. 219-222 and Fotis P., Polemis M., (2011) for a financial and statistical analysis of concentrations in Greece respectively during the same period. In Fotis P., Polemis M., (2011) there is a review of the use in economic tools in merger analysis.

[41] See Zevgolis N. and Fotis P., (2009), p. 1184-1190. According to the paper, the clause of prohibition of parallel imports constitutes a hardcore restriction of competition, since, *ceteris paribus*, it consists of a barrier to entry for potential competitors. By prohibiting the supply of products of a significant brand name by cheaper sources of supply, the clause has as its indirect (if not direct) object the maintenance of a minimum level of supply prices and resale prices of the specific products. As far as it concerns the Greek geographical market, the clause of prohibition of parallel imports aggravates the already restrictive national regulatory framework which rules the sector of detergents for domestic use, having as its result the restriction –if not the disappearance- of parallel imports of the specific products.

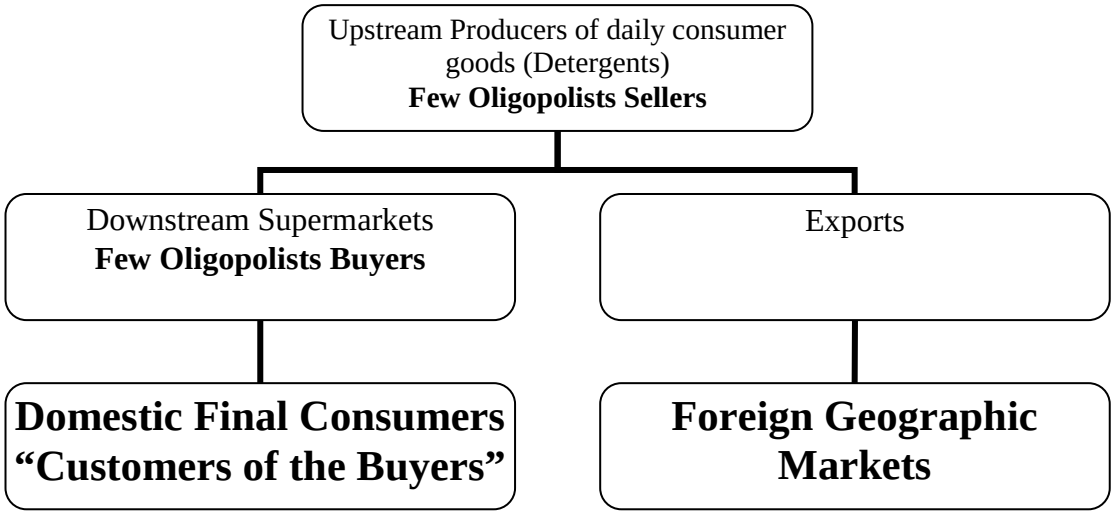
[42] Sellers, wholesalers and producers are used interchangeably.

[43] Supermarkets and buyers are used interchangeably.

groups, such as fresh products, or dry food or non-food products (i.e. detergents). Therefore, the latter are grouped into small segmentations each of one constitutes an individual product market, both from the demand and the supply side. In each product market a producer[45] may hold a dominant position of economic strength or it is assumed to be the leader of the market[46].

In the downstream market the firms are not export oriented. That is, they distribute the products to the domestic final consumers. Therefore, the clause of prohibition of parallel imports includes both imports (directly) and exports (indirectly). The downstream firms provide a basket of foodstuffs and non-food household consumables sold in a supermarket environment[47]. Figure 1 illustrates the abovementioned vertical markets.

Fig. 1 The Upstream & Downstream markets of daily consumer goods



[44] A small fraction of the upstream sales are sold to downstream wholesalers. Since that fraction of upstream sales consists of less than 10% of the total sales in the downstream market, in the remainder of the paper will assume that retailers are the only buyers of the upstream sales.
[45] The same producer or different producers in each product market.
[46] Stackelberg product market whereas the other firms of the product market are assumed to be the followers.
[47] See, *inter alia*, case no IV/M.1612 and footnote 1 therein.

The clause of parallel imports prohibition creates barriers to entry for potential competitors in the upstream market. The latter leads, *ceteris paribus*, to a restriction of competition in this market. Potential competitors with easy and effective entry in the upstream market may possibly prevent an already active firm in the upstream market from increasing the selling price of the final product to the supermarkets[48].

Also, the decrease (diminution) of competition intention by the mean of such a clause enforces the already powerful existence of upstream firms (sellers) with strong trademarks, driving to a segmentation of the specific market in comparison with the rest of the national markets in the E.U. The prohibition of parallel imports creates almost automatically more available space for the already existing firms in the upstream market, active in the specific market, to raise or at least stabilize their market shares and consequently to enforce their market power in the national market.

5.3 A practical example

5.3.1 The Nature of Competition in the upstream & downstream markets

In the downstream market a supermarket (buyer) may prefer to import the final good from different European geographic markets and takes advantage of price differentials between them[49]. The scope of this strategy is to increase the supermarket's market share via a decreased selling price of the final good[50].

However, if all the supermarkets exercise the same strategy, the effect on each supermarket's market share and consequently on its profits, depends on the

[48] Motta M., (2009), p. 104.
[49] For an example of that see O.J. C138, 28.05.2010, para. 48.
[50] The supermarket will not increase the price of the final good in the future since that will give the opportunity to the other supermarkets to enjoy increased profits (*free – rider problem*).

juncture where the strategy takes place. Generally speaking, whether each supermarket cannot foresee competitor's counteraction, it is possible to overestimate the potential gaining from the abovementioned strategy.

Additionally, the pursuit of the same strategy for a long period of time by all supermarkets, may lead in a '*war of attrition*'. This refers to a situation where the object of firms in a product market is to induce the competitors to give up and, consequently, to suffer economic losses in the short - run until their rivals exit the market. In such an environment, firms try to abstain closing plants and giving up market shares as thereby they would increase their costs[51]. This situation in game theory is referred to as a '*prisoner's dilemma*'[52].

In the upstream market, the producers of the final good get the point that downstream firms would not preferred to engage in a '*price war*' since that may ultimately eliminate their profits. At the same time, they realize that a potential explicit or tacit collusive behavior from the supermarkets may cut down their profits, especially in the case where the upstream market "behaves" competitively. Therefore, upstream firms will try to eliminate the possibility of the aforementioned behavior by imposing vertical restrictions in distribution agreements. Such a policy smuggles away the risk of anticompetitive practices by the downstream firms and ensures the upstream firm's profits in upper normal levels. The final goal of strategic interaction between upstream & downstream firms is to enhance the '*producer welfare*' without considering the probable reduction of '*consumer welfare*' via high prices of final goods.

[51] Sectors characterized by increasing returns to scale and/or large costs of exit in case of high fixed or sunk costs are among the fundamental examples in which a 'war of attrition' may take place.

[52] See J. Tirole (1998), p. 425-426.

The downstream firms recognize the increased strategic power of the upstream firms with respect to their ability to bargain better terms in distribution agreements. They also realize that eventually, the cooperation with the sellers will reach a settlement which increases their profits.

5.3.2 A repeated game among sellers of detergents for domestic use and supermarkets

Both producers and supermarkets prefer to cooperate rather than to engage in a «*war of attrition*». Also, both of them are patients, that is, they prefer to get the profits which accrue from the long – run time span, rather than to get the short – run returns and they communicate in frequently temporal periods. Therefore, if supermarkets choose not to cooperate with upstream producers, the short – run payoff is less than the long – run profits.

Additionally, an upstream seller will eventually realize whether a supermarket strives to cheat by choosing not to cooperate while, the profits from cheating are less than the cost of cheating.

Table 1 represents the normal form of the one – shoot game matrix among sellers and buyers.

Table 1 One – Shoot game among producers (sellers) and supermarkets (buyers)

		Buyer (supermarket)	
	Strategies	CHEAT	NO CHEAT
Seller (producer)	NO COOPERATION	25, 25	50, 0
	COOPERATION	0, 50	40, 40

Payoffs in mil. Euro
Cheat/No Cheat: *imports*/*no imports* of final good from different geographical areas
Cooperation/No cooperation: *distribution agreement*/*no distribution agreement* which prohibits imports of final good from a different geographical areas

The payoffs of both of them are their profits[53]. The consumer welfare increases as soon as all the other supermarkets in the downstream market do not follow the same strategy. The Nash – equilibrium of the static game reveals that the selling price of the final good remains low since each player simultaneously maximizes its profit by choosing the dominated Nash equilibrium.

The dominated strategy for supermarkets is cheat and the equivalent dominated strategy for producers is no cooperation (25>1 & 50>40)[54]. The static game results in a dominated Nash – equilibrium even though both players may increase their profits by *'communicating'* between each other (the payoffs for both players are 40). However, if all the supermarkets follow to cheat, that will trigger a war price among each other which eventually results in profit losses. Although this is the best scenario for the consumers, firms in both levels of vertical chain realize that the best for them is not to independently choose their strategies.

Suppose now that upstream & downstream firms communicate in frequently temporal periods. That is, the game is repeated in the near future. We assume that the static game of complete information is repeated infinitely, with the results of all previous periods observed before the current period begins. That is, for each t period the results for each $t-1$ preceding periods of the game are observed before the t^{th} period begins. In our example the periods cover different distribution agreements among producers and supermarkets. The results of the distribution agreements are known to both them before the new period begins.

[53] The lower the selling price of the final good, the higher the market penetration and hence the profits of an individual supermarket.

[54] The first column presents the producer's payoff and the second column presents the supermarkets' payoff.

We denote $\delta = \frac{(1-p)}{(1+r)}$ the discount factor[55] of producers and supermarkets where p is the probability that the game will end immediately after a period and $1-p$ is the probability that the game continues at least one more period. The payoffs for each chosen set of strategy by upstream & downstream firms are given by the 2X2 game matrix in Table 1.

The present value of the infinite sequence of payoffs $t = 1,2,3,.....,n$ is given by

$$payoff_1 + \delta\ payoff_2 + \delta^2\ payoff_3 + ... = \sum_{i=1}^{\infty} \delta^{t-1} payoff_t \quad (1)$$

Equation (1) reflects both the time value of money & the probability the game will end. The *payoff* to be received in the next period and two periods from now is worth $\frac{(1-p)payoff}{(1+r)}$ and $\frac{(1-p)^2\ payoff}{(1+r)}$ respectively.

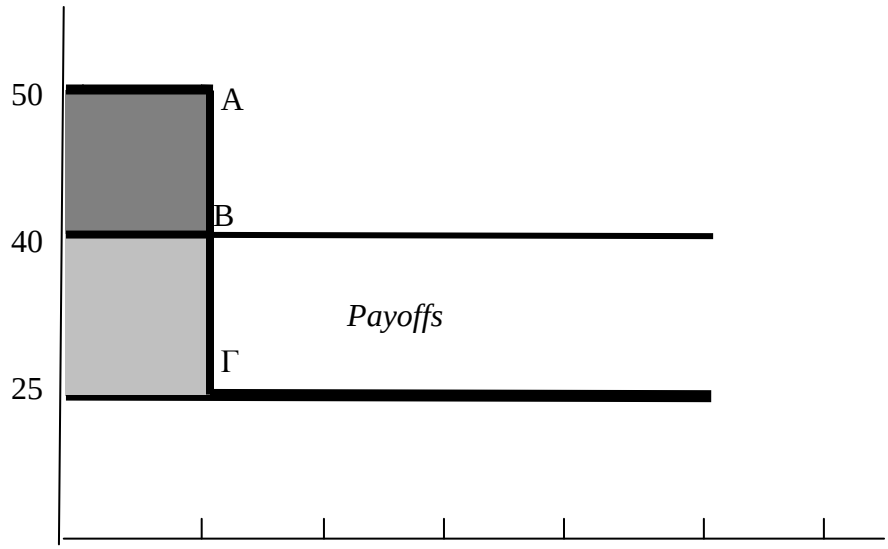
Following payoffs in Table 1 we argue that cooperation among producers and supermarkets may occur in every period of distribution agreements (or, cooperation may occur in every period of a subgame perfect outcome of the infinitely repeated game) if both sides from the vertical chain commit from the outset that they choose the high payoff equilibrium (cooperation). Otherwise, they will choose the low payoff equilibrium (cheat) in the subsequent periods[56].

Upstream firms will cooperate with downstream firms if the latter do not import the final good from different European geographical areas. Downstream firms prefer not to import the final good since the profits from cooperation are higher than the profits from cheating.

[55] The value today of a euro to be received one period later, where r is the interest rate per period.
[56] This strategy is called *trigger strategy*.

A supermarket cooperates if $\delta \geq 0{,}4$ [57]. According to figure 2, the straight distance AB depicts a lump sum payoff of a supermarket after cheating and the distance BΓ shows the reduction of supermarket's payoff if an upstream producer decides to follow the trigger strategy. A supermarket cheats whether $AB > B\Gamma$ and cooperates if the distance AΓ is higher than the distance BΓ (that is, $B\Gamma > AB$). Figure 2 depicts the payoffs of the infinitely repeated game among producers and supermarkets according to the aforementioned trigger strategy.

Fig. 2 Payoffs of the infinitely repeated game among producers (sellers) and supermarkets (buyers)



Following cooperation, the price of the final goods remains in upper normal levels. Supermarkets do not cheat (import the final good) and therefore the consumer welfare decreases.

[57] The infinite payoff when a supermarket cheats or cooperates is $50 + \frac{25\delta}{1-\delta}$ or $\frac{40}{1-\delta}$ correspondingly. A supermarket cooperates if $\frac{40}{1-\delta} \geq 50 + \frac{25\delta}{1-\delta}$ or $\delta \geq 0{,}4$.

6. Concluding remarks

The main question which this paper tries to answer is whether prohibition of parallel imports constitutes a hardcore restriction of Block Exception Regulation for vertical agreements, that is, a *per se* approach.

Firstly, it is mentioned that in downstream markets where firms are not export oriented, the clause of prohibition of parallel imports coincide with that of prohibition of parallel trade (both imports and exports).

Secondly, the answer to the abovementioned question is yes. The prohibition of parallel imports is a measure which reduces the buyer's incentive to decline resale price by diminishing the sources of supply and consequently, raises dangerously the selling prices and reduces the consumer welfare. It is also an exclusive supply of a specific trademark by itself (exclusive source of supply), which prevents the retailer/buyer from finding products of the same trademark in lower prices by other sources.

Above all, it constitutes an important anti-competitive objective for the internal market since it prevents consumers to purchase products in other Member States and take advantage of price differentials between them.

The abovementioned conclusions further enhanced at least in some cases by the structure of the market and the national law of the member state (measures of having equivalent effect constitute an indicative example) where the prohibition of parallel imports takes place. In vertical situations where both in upstream and downstream markets firms (sellers in upstream market and buyers in downstream market) behave in an oligopolistic way, free trade may be restricted more than in markets where the probability of cooperation among buyers and sellers may not be achieved in practice.

7. Policy implications

Competition authorities of member states may be more skeptical in situations where a clause of prohibition of parallel imports is imposed via distribution agreements. An in depth analysis of legal framework and case law in combination with the market structure and the nature of completion therein, may lead to the approach that eventually, parallel trade is prohibited, even though parallel exports are not directly prohibited.

An intervention by competition authorities in markets where the prohibition of parallel imports takes place, especially in sectors where entry by potential competitors is not easy, may prevent upstream firms to follow the same strategy in the future (*Threat – Based Competition*, Acutt & Elliott 2001).

Policy makers of European Law especially by means of regulation for vertical agreements and concerted practices, should consider more clearly (i.e. explicitly) the parallel trade prohibition into the hard core restrictions of Block Exception Regulations or at least to define a hard core list of circumstances under which it should be considered as a hard core restriction.

References

Acutt, M., Elliott, C., (2001). Threat-Based Competition Policy. *European Journal of Law and Competition*, 11(3), 309-317.

Bellamy, C., Child, G. (2001). *European Community Law of Competition*. Sweet & Maxwell, 5th ed..

Case T-450/05, Peugeot/Commission, [2009], available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62005TJ0450:EN:HTML.

Case C-551/03 P, General Motors, [2006] ECR I-3173, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62003J0551:EN:HTML.

Case C-338/00 P, Volkswagen/Commission, [2003] ECR I-9189, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62000J0338:EN:HTML.

Case No IV/M.1612, WAL-MART/ASDA, [1999], available at http://ec.europa.eu/-competition/mergers/cases/decisions/m1612_en.pdf.

Cases 25 and 26/84 Ford-Werke AG and Ford of Europe Inc. v Commission, [1985] ECR 2725, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:-61984J0025:EN:HTML.

Case 319/82 *Société de vente de ciments et bétons de l'Est* [1983] ECR 4173, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61982J0319:EN:HTML

Cases 96-102, 104, 105, 108 and 110/82**,** NV IAZ International Belgium and others v Commission of the European Communities, [1983] ECR 3369, [1984] 3 CMLR 276, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61982-J0096:EN:HTML.

Clark, J., Simon, S., (2010). The New Legal Framework for Motor Vehicle Distribution: A Toolkit to Deal with Real Competition Breakdowns. *Journal of European Competition Law & Practice*, 1-13.

COM(2009) 388, COMMUNICATION FROM THE COMMISSION, The Future Competition Law Framework applicable to the motor vehicle sector, {SEC(2009) 1052}, {SEC(2009) 1053}, Brussels, 22.7.2009 [available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2009:0388:FIN:EN:PDF].

Commission Decision 2006/431/EC of 5 October 2005 in Cases F-2/36.623/36.820/37.275 — SEP et autres/Peugeot SA [available at http://ec.europa.eu/competition/antitrust/cases/dec_docs/36820/36820_191_1.pdf].

Commission Decision 2002/758/EC of 10 October 2001 in Case COMP/36.264 — Mercedes-Benz [available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=-OJ:L:2002:257:0001:0047:EN:PDF].

Commission Decision 2001/146/EC of 20 September 2000 in Case COMP/36.653 — Opel [available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2001:-059:0001:0042:EN:PDF].

Commission Decision 98/273/EC of 28 January 1998 in Case IV/35.733 — VW [available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:l:1998:124:.0060:0108:en:PDF].

Dethmers, F., & Pier Posthuma de Boer, P., (2009). Ten years on: Vertical Agreements under article 81. *European Competition Law Review,* 30(9), 424-439.

Fotis P., Polemis M., (2011). The use of Economic Tools in Merger Analysis: Lessons from US & EU experience. *European Competition Journal*, (forthcoming).

Fotis, P., Polemis, M., Zevgolis, N., (2011). Robust Event Studies from Derogation from Suspension of Concentrations in Greece during the Period 1995 – 2008. *Journal of Industry Competition and Trade*, 11, 67-89.

Fotis, P., Polemis, M., Zevgolis, N., (2009). Stock price performance as an argument for derogation from suspension of concentrations: Reality or a myth?. *European Competition Law Review*, 30(5), 216-222.

Goyder, D.G. (2004). *EC Competition Law*. Oxford University Press, 4th ed..

Karydis, G., Zevgolis, N., (2009). Regulation 1400/2002 and access to technical information: Necessity of convergent interpretation with the principles established by the relevant case law. *European Competition Law Review*, 30(2), 95-101.

V. Korah, V., O'Sullivan, D. (2002). *Distribution Agreements under the EC Competition Rules*. Hart Publishing.

Motta, M. (2009). *Competition Policy Theory and Practice*. Cambridge University Press.

Overvest, M. B., (2010) A note on collusion and resale price maintenance. *European Journal of Law and Competition*, doi: 10.1007/s1065701091480.

O.J. L 123C/52, 28.05.2010, COMMISSION REGULATION (EU) No 461/2010, of 27 May 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices in the motor vehicle sector [available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=-OJ:L:2010:129:0052:0057:EN:PDF].

O.J. C130/01, 19.05.2010, EUROPEAN COMMISSION, Guidelines on Vertical Restraints [available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:-2010:130:0001:0046:EN:PDF].

O.J. L102/1, 23.4.2010, COMMISSION REGULATION (EU) No 330/2010, of 20 April 2010, on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices [available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:102:0001:0007:EN:-PDF].

O.J. L 203/30, 1.8.2002, COMMISSION REGULATION (EC) No 1400/2002, of 31 July 2002 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices in the motor vehicle sector [available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:l:2002:203:0030:0041:en:PDF].

O.J. L336/21, 29.12.1999, COMMISSION REGULATION (EC) No 2790/1999, of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices [available at http://eur-lex.europa.eu/LexUriServ/-LexUriServ.do?uri=OJ:l:1999:336:0021:0025:en:PDF] .

Simon, S., (2010). Die neue Kfz-GVO 461/2010, ÖZK (Österreichische Zeitschrift Fur Kartellrecht). *Austrian Competition Journal*, 3, 83-91.

Tirole, J. (1998). *The Theory of Industrial Organization*. The MIT Press, Cambridge.
Vezzoso, S., (2004). On the Antitrust Remedies to Promote Retail Innovation in the EU Car Sector. *European Competition Law Review*, 25(4), 190-204.

Zevgolis, N., Fotis, P., (2009). Prohibition of parallel imports and application of Regulation on vertical agreements in the sector of detergents for domestic use. *Business and Company Law*, 11, 1184-1190 (in Greek).