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UNIVERSITY OF GOTHENBURG

SCHOOL OF BUSINESS, ECONOMICS AND LAW

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SELECTIVE DISTRIBUTION AND ONLINE SALES

\- the transformation of European Competition Law into the electronic society

Master of Law Thesis

30 Credits

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Autumn 2010

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Abstract

This thesis evaluates the new Vertical Block Exemption Regulation and accompanying Guidelines regarding their treatment of selective distribution. Further, it makes a prospective examination of the view on selective distribution in European Competition Law, especially regarding online sales.

During the ten years that passed since the last Vertical Block Exemption Regulation and accompanying Guidelines were introduced, the global market has developed in a rushing speed, much thanks to the Internet. The growing online markets have created enormous opportunities as well as problems, by shrinking the world and completely change the possibility to control markets. Therefore, the treatment of online distribution was at heart of the discussion when the old rules were to be reviewed. The main issues approached were the application of the concepts of "active" and "passive" sales on the internet and the ways in which suppliers may restrict the online behaviour of their distributors within exclusive and selective distribution systems.

The review of the old rules led to an intense debate between the promoters for selective distribution systems on one side and the so called pro-internet lobby on the other. The former argued for the importance of controlling the online behaviour of appointed distributors, while the latter held that all restrictions on online sales must be individually justified and not benefit from the Block Exemption.

The final result appears to be a compromise and the Commission has more than anything tried to find ways of translating the rules on offline distribution to online sales, giving wide opportunities for distributors to operate online once they have a physical point of sales. The Commission has done quite well in its ambition to clarify the rules on internet distribution even if some uncertainties remain. Whilst continuing towards a more economic approach, it has been clearly influenced with the aim for market integration, which can be seen in the tough treatment of restraints hindering parallel trade and the protection of differential price settings on markets within the European Union.

Part I - Introduction

1. Subject background

Since EU Competition Law aims to protect not only an undistorted competition, but also the creation of a single market, it has a tradition of treating vertical restraints very strictly. For many years the Commission refused to recognise the vertical restraints could be pro competitive and instead it adopted a very strict approach, where the aim for a single market clearly stood above economic efficiency. After being heavily criticised during the 1990's, the Commission issued a Vertical Block Exemption Regulation with accompanying guidelines in 2000. This was the start of a new, more economic based approach that ruled EU Competition Law at the start of the new millennium. The Block Exemption Regulation and Vertical Guidelines expired 31 May 2010 and the new Vertical Block Exemption Regulation (VBER) and Vertical Guidelines entered into force the day after. During the decade that has passed since the last Regulation and Guidelines were introduced, the global market has developed in a rushing speed, much thanks to the Internet. To describe the ways that internet has changed the conditions under which business is carried on can hardly be done. At the same time as creating enormous opportunities, the growing online markets have created troubles for both legislators as well as market actors, by shrinking the world and completely change the possibility to control markets. Therefore, online distribution was at heart of the discussion when the old rules were to be reviewed. The main issues were the application of the concepts of "active" and "passive" sales on the internet and the suppliers' ability to restrict online sales by distributors within exclusive and selective distribution systems.

As a part of its review, the Commission consulted third parties through an Issues Paper followed by a draft version of the new Block Exemption Regulation and accompanying Guidelines long before the old rules expired. Regarding selective distribution, these consultations led to an intense debate with the promoters for such systems on one side and the so called pro-internet lobby on the other, stating that selective distribution deserves cautious treatment and that all restrictions on online sales must be individually justified and not benefit from the block exemption.

1.2 Purpose

The purpose of this thesis is to evaluate the new Vertical Block Exemption Regulation and accompanying Guidelines regarding their treatment of selective distribution, as well as prospectively examine the view on selective distribution in European Competition Law, especially regarding online sales.

In doing so it is essential to examine the following:

- What interests are protected in the new VBER and Vertical Guidelines? Is market integration in focus or are they inspired by a more economical approach?
- Are the rules foremost protecting the freedom of the supplier to choose in which way to distribute its goods, or are they more concerned with consumer welfare?

- What changes are made regarding selective distribution?
- Has the Commission succeeded in its aim to clarify the rules on online sales?
- Has legal certainty got lost in the aim for flexibility and the effect based approach?

1.3 Method and material

The first part of this thesis encompasses a review of European Competition Law and case-law relevant to selective distribution. Guidance and data is also sought in reliable publications in this field, such as legal doctrine and articles. Regarding the review of the old Vertical Block Exemption Regulation with accompanying Guidelines and online distribution, guidance and data is instead primarily sought in reliable online material such as legal and economic publications, since traditional material does not address the issues subject to discussion within this sphere.

1.4 Delimitations

Even though the new Vertical Block Exemption Regulation and accompanying Guidelines concern all vertical restraints, the topic is narrowed down to one certain restraint, namely selective distribution. Other restraints in vertical distribution agreements such as territorial restraints or resale price maintenance will not be elaborated upon

The thesis does not touch upon the rules on motor vehicle distribution, which is subject to a different Block Exemption Regulation. The part regarding online sales does not elaborate on music distribution, since this is primarily not an issue of selective distribution.

In the examination of the review of the old rules the thesis mainly presents the view of two parties, one from the luxury industry and the other a part of the pro-internet lobby.

1.5 Outline

After this introductory part on the topic of selective distribution, follows part three with an overview of the European Competition Law, followed by part four which deals with the treatment of selective distribution in European Competition Law. In part five focus shifts to Internet distribution and the new rules on online sales are discussed. Finally, in part six the analysis is taken one step further so as to discuss the results of the questions asked above and so as to transmit to the reader the most central conclusions drawn throughout the course of the entire thesis.

Part II - Selective distribution

1. Selective distribution systems

A supplier can distribute its products in a number of ways. To start with, it can distribute the products through vertical integration, either within the company or through controlled

subsidiaries. It may also take use of an agent, who sells the products in the name of the supplier or use a franchise system where the dealers use the supplier's intellectual resources to distribute the product. Finally, a supplier may use independent distributors to reach out to the customers.

When distributing goods and services through independent distributors, many suppliers choose to conclude long term agreements, rather than one time contracts. To ensure that the products in question are sold under the right circumstances, it is common to use selective distribution, especially for final branded products.[1] In a selective distribution system a supplier agrees to supply only distributors fulfilling certain criteria, so called authorised distributors, which in return agree to sell only to other authorised distributors and end users.[2] Selective distribution is the only method apart from agency through which a supplier may control the channels of distribution all the way to the end users.[3]

There are two main kinds of selective distribution systems; pure qualitative systems where the supplier appoints only distributors that meet qualitative criteria primarily linked to the nature of the product, and systems with quantitative restrictions, where the supplier restricts the number of resellers in certain market territories. As will be seen below, purely qualitative selective distribution systems are normally not a threat to competition, but rather beneficial. Systems with quantitative restrictions on the other hand, are often considered harmful for competition.[4] This kind of selective distribution has obvious similarities with exclusive distribution agreements in that they restrict the number of authorised distributors within an area at the same time as they determine certain conditions under which resale of the products is to be made. The main difference between the two models is that selective distribution systems restrict selling on any sales to non-authorised distributors, as well as restricting sales to other territories, where exclusive distribution only regulates the latter. Hence, a selective distribution system leaves only appointed dealers and final customers as possible buyers and thus thwarts potential free-riders. Combinations of exclusive distribution and selective distribution are therefore considered hazardous for competition if it restricts the selected distributors' right to actively sell to each other and to end users.[5]

2. Potential harms and benefits of Selective Distribution

The use of selective distribution systems can have both pro-competitive and anti-competitive effects. Historically, courts and competition authorities, especially in Europe, have been unwilling to make use of economics in their decision making.[6] However, nowadays they increasingly use economic theories to determine whether a provision is to be considered as anti-competitive.[7] From an economic point of view, all agreements regarding vertical

[1] Vertical Guidelines para 174.
[2] Article 1(d) VBER.
[3] Goyder, J. *EU Distribution Law,* p 66.
[4] Jones, A. and Sufrin, B. *EC Competition Law, text cases and materials* p 646.
[5] See e.g. Vertical Guidelines para 176.
[6] See e.g. Jones, A. and Sufrin, B. *EC Competition Law, text cases and materials,* p 618 ff.
[7] Ibid p 624.

restraints are capable of being either pro- or anti-competitive, and the outcome depends on the circumstances.[8]

2.1 Potential Benefits

Generally it can be said that there are two main reasons to impose a selective distribution system, namely to maintain certain standards and qualities of branded products and to protect marketing and service investments by the distributors. As will be seen, there are several benefits to selective distribution, such as prevention of free-riding and manufacturer opportunism, which benefit consumers through making distributors want to invest in sales services. To impose vertical restraints such a selective distribution system is costly for the suppliers, why they would only do this where it provides some benefits to the upstream suppliers.[9]

2.1.1 Protection of Brand Image

For many goods, especially in the luxury industry, the right brand image is vital for enhancing the demand of the product. To ensure that the customers are receiving the right image, the supplier needs to require its retailers to invest in exclusive showrooms, sales assistance and a comfortable shopping experience. The retailer will not only have to be able to provide the right information to the right customer, but also make sure that the advertisement and the presentation of the products is of such kind that it suits the brand.[10] Hence, to protect brand image it is necessary for manufacturers and suppliers to be able to choose to sell their goods only to distributors with the right qualities. The supplier imposes restraints on distribution with the aim of promoting the provision of services which are appreciated by consumers, thereby enhancing their demand, which, when used in the right way under the right circumstances, benefits the supplier itself as well as its distributors and customers. To allow a manufacturer to protect the image of its branded products also means allowing consumers who appreciate the value of such goods to enjoy them. Without the possibility to protect the image of branded goods, such products might disappear from the market and leave the consumers with less to choose from.[11]

2.1.2 Protection from Free-riding and Opportunism

2.1.2.a Free-riding

Free-riding occurs when one market actor takes advantage of the investments and inputs from another market actor.[12] The issue can arise on both inter-brand and intra-brand level.[13] Free-riding on inter-brand level arises when an upstream firm invests in improving the quality of retail facilities, which benefits not only its own brands but also the brands of rivals, when they are sold in the same facilities. Issues with intra-brand free-riding arise on distributors' level. A distributor or retailer are often required to invest in enhancing the demand for a

[8] Goyder, J. *EU Distribution Law,* p 65.
[9] Buettner, T., Coscelli, A., Vergé, T. and Winter, R. A. *"An Economic Analysis of the Use of Selective Distribution by Luxury Goods Suppliers" (*2009) 5 European Competition Journal 201. (CRA Paper), sec 5(a).
[10] See e.g. Ibid sec 48 f.
[11] Motta, M. *Competition Policy – Theory and Practice*, p 334.
[12] Paldor, I. *The Vertical Restraints Paradox: Justifying the Different Legal Treatment of Price and Non-Price Vertical Restraints* p 8.
[13] See e.g. Slade M. *The Effects of Vertical Restraints: An Evidence Based Approach* p 16 f.

manufacturer's product, not only through such investments regarding brand image as mentioned above, but also through advertising, promotion and before- and after sales services for the products in question. For a distributor to make such investments it must know that it will regain the expenses, why it has to be protected from other distributors free-riding on its investments. If another retailer may sell the product without having to market the product itself, it can compete with a lower price, and thereby thwarting the first retailer from making a profit, leading to unwillingness to make future investments.

The free-riding problem is one of the main defenses for the use of selective distribution systems. Without protection from free-riding it will be hard to find the right balance between price and services to maximise consumer welfare. The problem can be solved either through price- or non-price vertical restraints.[14] Selective distribution systems solve the free-riding problem with making it if not impossible, so at least very difficult for unauthorised distributors to purchase and resell the products in question.[15] As long as the qualification requirements for entering the selective distribution system are applied in a non-discriminatory manner, all distributors will make the necessary efforts to sell the products and thereby prevent others from free-riding.

2.1.2.b Protection from Manufacturer opportunism

Manufacturer opportunism arises when the manufacturer wants the distributor to make investments *ex ante* in order for him to provide better service to consumers.[16] These investments can consist of for example human capital or special facilities. The distributor will not make such investments as long as it cannot be assured that its investments are fully protected, why it will not accept such demands from a manufacturer which has several unauthorised dealers marketing its products on the same market.[17] It is both common and understandable that a distributor demands exclusivity to make this kind of investments and it is normally not considered harmful for competition. The problem is usually solved through exclusive or selective distribution.[18]

2.2 Potential harms

Selective distribution can be a threat to efficient intra- brand competition as well as leading to foreclosure on the distribution market.[19] There is a risk that such systems lead to competition being softened and collusion between suppliers being facilitated, especially where there is a cumulative effect of several selective distribution systems. Reduced intra-brand competition is harmful only where there is limited inter-brand competition.[20] If a big part of the suppliers of a certain product use selective distribution for the selling of their products, competition may be softened at both suppliers and distributor's level. Hence, it would also effect inter-brand competition which in turn would increase the effects of the reduced intra-brand competition.

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[14] Telser (1960) argued that the problem should be solved through RPM, whereas Klein and Murphy (1988) held that it instead could be solved through non-price vertical restraints.

[15] Kinsella, Melin and Shropp question whether selective distribution can solve the free-riding issue in *Comment on the CRA paper entitled "An Economic Analysis of the Use of Selective Distribution by Luxury Goods Suppliers",* p 239.

[16] Slade, M. *The Effects of Vertical Restraints: An Evidence Based Approach in The Pros and Cons of Vertical Restraint,s* p 18.

[17] Ibid.

[18] See e.g. Vertical Guidelines para 107(a) together with para 185.

[19] See e.g Ibid para 175.

[20] Ibid para 177.

2.2.1 Foreclosure of the market

By establishing a big selective retail network that involves most retailers, a manufacturer can prevent his competitors from accessing the market.[21] If all the major retailers are tied to a selective network, the manufacturer's competitors must pay high prices for entering the market. If they choose to distribute their products through new retailers, those retailers must be built up and marketed before the products will reach a broad consumer base. If they instead choose to distribute the products themselves, they might have to build up a complete retail business from the start, which is not only risky and pricy, but also takes time in which the market for a certain product may already be subdued.

Since a well working selective distribution system makes it impossible for non-authorised dealers to obtain supplies, the method is an efficient way of avoiding pressure by price discounters on the margins of the manufacturer, as well as of the authorised distributors. The result of such foreclosure is reduced possibilities for consumers to enjoy the benefits that can be brought by selective distribution systems, such as lower prices and access to a wider range of products.

2.2.2 The motives affect the effects on competition

It has been shown that the effects of vertical restraints depend on how and why the restraints have been imposed. Empirical studies have shown that privately imposed vertical restraints are very likely to benefit consumers and only harm them in a few cases.[22] On the other hand, restraints that are mandated by the government do not seem to improve consumer welfare, in fact they are actually likely to reduce it, even when initiated by the consumers themselves.[23] It is a clear tendency for consumer well being to be congruent with manufacturer profits, at least with respect to the voluntary adoption of vertical restraints.[24] This also convergences with the above mentioned fact that privately imposed restraints often gain consumers. If they would not have been beneficial for the manufacturer, they would not have existed in the first place. This also constitutes a sign that the market has a system of regulating itself in a way that increases competition.

Part III - The context of EU Competition Law

1. The Foundation of EU Competition Law

The European Union consists of 27 member states and is more than just a free trade area; it is a union for the people of Europe, with greater integration as a political goal. Still, the Member States have their own national legislation, even if a great deal of their legislative power has been transferred to the bodies of the EU. Community law is derived from several different

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[21] Slade, M. *The Effects of Vertical Restraints: An Evidence Based Approach,* p 19.

[22] Slade, M. *The Effects of Vertical Restraints: An Evidence Based Approach in The Pros and Cons of Vertical Restraints* p 22.
[23] Ibid p 23.
[24] Ibid.

sources, such as Treaties, Regulations, Case law and the general principles of EU law. The European Union is based on the treaty of Rome, which later tuned into the EC Treaty and the EU Treaty which since December 2009 are joined together in the Treaty of the Functioning of the European Union, TFEU. The second section of the preamble of the TFEU states that the Treaty's main goal is *'to lay the foundations of an ever closer union among the peoples of Europe'.*

One of the main aims of the EU is market integration why the rules on free trade are extremely important. Article 35 TFEU (former Article 28 TEC) states that '*Quantitative restrictions on imports and all measures having equivalent effect shall be prohibited between Member States.',* whereas Article 36 TFEU (former Article 29 TEC) says the same about quantitative restrictions on exports. Both the Commission and the ECJ have approached a broad definition equivalent effect.[25]

The provisions on free movement are applicable both to products and services originating in Member States as well as product and services from third countries as soon as they have been put in free circulation in the Member States. The definition of being put into the EU market has been disputed in several cases, but generally it can be said that a product is in free circulation once it has overcome the border and the common external tariff, which is the same in all Member States.

The main aim for EU Competition Law is set out in Article 3(1)(b) TFEU:
Article 3
1. The Union shall have exclusive competence in the following areas:
(b) the establishing of the competition rules necessary for the functioning of the internal market

As can be seen, EU Competition Law has a combined goal of market integration and undistorted competition, which distinguish it from other competition law systems. The aim for a single market is largely political and is not necessarily consistent with economic welfare.[26]
The goal of market integration has historically led to a high protection of parallel trade by the Community Courts and the European Commission, since it is considered to have positive effects on competition and to thwart divergence between national or regional markets within the Union. Parallel trade is also a special issue in Europe due to the fact that the EU market constitutes almost ideal conditions for lucrative price arbitrage, even after the introduction of the Euro in 15 of the EU Member States in 2002. This is due to several factors, such as low transportation costs due to the small distances and good infrastructure, varying national price controls, strong demand, and a wealthy consumer market.[27] Selective distribution systems will normally not thwart the integration of the European market unless combined with direct or indirect export bans.

[25] Craig, P and de Burca, G. *EU Law, Texts, Cases and Materials*, p 615.
[26] Motta, M. Competition Policy – Theory and Practice, p 23.
[27] Bird, R. C. and Chaudhry, P. E. Pharmaceuticals and the European Union, managing grey markets in an uncertain legal environment, p 2.

To be caught by EU Competition Law, an act must be covered by Article 101(1) TFEU. Even though Article 101(2) provides that agreements caught by Article 101(1) are automatically void, they may still be allowed if the exemption in 101(3) is applicable. If it is clear that a conduct is of that sort mentioned in 101(3), there is no longer any need to see if all the conditions in Article 101(1) are fulfilled. If, on the other hand, the Commission can show that the agreement falls within the scope of Article 101(1) it is then for the undertakings to show that the exemption in Article 101(3) is applicable.[28]

2. Historical treatment of vertical restraints

2.1 The early years

EU Competition Law has a tradition of treating vertical restraints very strictly. From the early days of the Union until the 1980's, the Commission and the Community Courts managed to build a competition law regime without direct support from the Member States.[29] For many years the Commission refused to recognise that vertical restraints could be pro-competitive. Instead it adopted a very strict approach, where the aim for a single market clearly stood above economic efficiency. During this era, the Commission was inspired by the Freiburg school and concerned with agreements restraining the economic freedom of the parties.[30]

The strong aim for the single market made the Commission apply Article 101(1) very widely, which raised a lot of criticism.[31] Generally, the Commission was criticised for its inadequate economic analysis, its stubborn use of the economic freedom theory and its constant ignorance of court judgments with a more nuanced and approach.[32]

The Courts, which are supposed to legally try the Commission's decisions on appeal, had a more economic approach than the Commission and ruled that agreements shall be seen in both an economic and in a legal context.[33] For example, in *Delimitris*[34], ECJ held that an agreement concerning exclusive purchasing would only fall within the scope of Article 101(1) if it had the effect of foreclosing market access to competitors. When having a more flexible approach than the Commission, the Community Courts were still criticised for favouring intra-brand competition over inter-brand competition and for failing to reconcile consumer welfare with the goal of market integration.[35]

Until the 1990's, the EU Competition law protected legal certainty rather than economic efficiency.[36] Although making it easier for law practitioners, the way of which the law dealt

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[28] Council Regulation 1/2003, Article 2.
[29] Hawk, B. E. System failure - Vertical Restraints and EC Competition Law. Until the 1980's Germany was the only member State which regarded the policy of competition as a serious concern.
[30] Ibid p 977, Jones, A. and Sufrin, B. *EC Competition Law, text cases and materials* p 619.
[31] Jones, A. and Sufrin, B. *EC Competition Law, text cases and materials* p 620.
[32] Hawk, B. E. *System failure - Vertical Restraints and EC Competition Law*, p 922 ff.
[33] Korah, V. and Rothie, W. *Exclusive Distribution and the EEC Competition Rules*, p 51.
[34] C-234/89**,** *Delimitris v. Henninger Brau AG* (1991) ECR 935.
[35] Hawk, B. E. *System failure - Vertical Restraints and EC Competition Law* p 981.
[36] Korah, V. and Rothie, W. *Exclusive Distribution and the EEC Competition Rules* p 32.

with agreements by category[37] involved a risk of falling in between regulations as the principles changed but the rules were consistent.[38] This, in combination with the Commission's wide approach of Article 101(1), imposed a heavy burden on the companies which would have to seek exemption or rely on conduct letters when concluding distribution agreements.[39]

2.2 Green Paper on Vertical Restraints in Competition Policy, 1996

After being heavily criticised for its handling of competition law issues, the Commission adopted a Green Paper on Vertical Restraints in 1996. The Green Paper suggested four different options on how to reform the application of Article 101 (then Article 85 EC). The first option was to maintain the existing system, the second was to maintain the system but taking a more flexible approach on the then existing block exemptions. The third option was to limit the existing block exemptions to agreements between undertaking with a market share of less than 40%, at the same time as introduce a presumption that agreements between undertakings with a market share of less than 20% do not infringe Article 101(1). The forth and last option put forward in the green Paper was to make changes to the then existing Block Exemption Regulations. The Green Paper was followed with intense debate leading up to a fifth option, namely a completely new approach to Article 101.[40] In 1999, the new Vertical Block Exemption Regulation, followed by new Vertical Guidelines, showed a more economic approach on vertical restraints, focusing on the effect on competition rather than the kind of the agreement.

2.3 Modernisation Regulation and the assessment of vertical restraints

The Modernisation Regulation[41] entered into force in 2004, stating that agreements fulfilling the criteria for exemption no longer need to be tested against Article 101(1). The change has improved the efficiency in the dealing with Article 101 for both the Commission and businesses, although, it has also created some confusion and uncertainty as it turned the exemption into somewhat more of an exception. The Regulation also withdrew the notification procedure[42], making it for the companies themselves to decide whether they would benefit from the exemption or not, with high prices to pay if making the wrong judgment.

Even though the approach of both the Commission and the Community Courts has been made more flexible since the late 1990's, the EU Competition law is still quite extensive when it comes to regulating distribution agreements.

[37] For example was exemption Regulation 1983/83 only applicable on agreements regarding exclusive territory, whereas Regulation 1984/83 applied on agreements regarding excusive supply, with no exclusive territory.
[38] Korah, V. and Rothie, W. *Exclusive Distribution and the EEC Competition Rules*, p 33.
[39] Ibid p 42 ff.
[40] Jones, A. and Sufrin, B. EC Competition Law, text cases and materials p 624.
[41] Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, OJ [2003] L1/1.
[42] Council Regulation 1/2003, Article 1.

3. The current legislation

There are several regulations and guidelines on how to interpret and apply Article 101. The two major acts of this text are the newly renewed Vertical Block Exemption Regulation,[43] which exempts a big number of agreements under 101(3) without all requirements in the statue needing to be tested, and the accompanying Vertical Guidelines.[44]

When the VBER is a binding legal act directly applicable in all Member States, the Vertical Guidelines are non-binding papers where the Commission aims to help companies assess whether their distribution agreements are in accordance with the EU Competition rules. The Guidelines are in fact not law, but have many similar effects with legislative acts since they are followed by the Commission. Further, market actors normally follow the Guidelines, since they can count on the Commission to take actions according to them. It is to be acknowledged that national authorities or the European Courts are able to grant actions of companies, also when they are not in accordance with the Guidelines.[45]

3.1 Article 101(1) TFEU

Article 101(1) is the entrance for most competition law cases and essentially prohibits restrictions on competition originating from non-unilateral conduct. It thus prohibits a wide range of both vertical and horizontal anti-competitive agreements and practices between undertakings.
The Article reads as follows:

> *"The following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market, and in particular those which:*
> *(a) directly or indirectly fix purchase or selling prices or any other trading conditions;*
> *(b) limit or control production, markets, technical development, or investment;*
> *(c) share markets or sources of supply;*
> *(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;*
> *(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations*
> *which, by their nature or according to commercial usage, have no connection with the subject of such contracts."*

As can be seen, the article does not expressly address vertical agreements. However, already in 1966, the ECJ made clear that the rule applies on agreements between non competing

[43] 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, OJ [2010] L 102/1.

[44] Commission Notice, Guidelines on Vertical Restraints, OJ [2010] C 130/01.

[45] Vertical Guidelines para 4. 'These Guidelines are without prejudice to the case-law of the General Court and the Court of Justice of the European Union concerning the application of Article 101 to vertical agreements'.

undertakings on different level of trade, since such agreements may affect trade between Member States.[46]

When deciding if Article 101(1) is applicable in a certain case, there are three important things to examine:

1. Is there an agreement between undertakings?
2. Does the agreement have any actual or potential appreciable effect on trade between Member States?
3. Has the agreement as its object or effect to restrict competition?

3.1.1. Agreement between undertakings

The first requirement for a conduct to be caught by Article 101(1) is that it is an agreement between undertakings. For an agreement to be at hand, it is necessary that there is an expression of a joint intention to a certain market behavior.[47] What form the expression takes does not matter as long as it is clear and faithful. In the absence of an explicit agreement, it is for the Commission to prove that the anti competitive behavior of one party is adopted with the acquiescence of the other party.[48] The Commission must also show that there is an existing concurrence of wills and not a matter of unilateral conduct. In *AEG Telefunken v Commission*[49], AEG adopted a selective distribution system where it refused to approve retailers operation on low margins. The ECJ referred to the special nature of selective distribution and stated that refusals of approval of new distributors are part of the contractual relations with the authorised distributors and may therefore be caught by Article 101(1).[50]

When determining whether or not a body is an undertaking, the assessment shall be based on economic considerations rather than strict legal ones. In *Höfner and Elsner vs Macrotron GmbH*[51] the ECJ stated that the conception of undertaking includes *"every entity engaged in an economic activity regardless of the legal status of the entity and the way it's financed"*.[52]

Article 101 is not applicable on agreements between undertakings that form a single economic entity. Companies can therefore avoid competition issues related to distribution by having wholly or partly owned subsidiaries, which do not enjoy autonomy, to undertake their distribution. A subsidiary is part of a single entity in absence of "*real freedom to determine it course of action on the market*".[53] Absence of freedom is presumed for majority shareholdings, but this assumption may be overturned if the subsidiary has a strong influence on its own management and business plans.[54] Internal group practice may still be caught by Article 102 TFEU, regarding abuse of dominance, if the undertaking has a dominant position on the relevant market.

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[46] Cases 56 & 58-64 *Etablissements Consten S.A.R.L. and Grundig-Verkaufs-GmbH v. EC Commission* (1966) ECR 299.
[47] Vertical Guidelines, para 25.
[48] Ibid para 25(a) (referring to vertical agreements in the VBER).
[49] 107/82, *Allgemenie Elektricitäts-Gesellschaft AEG Telefunken AG v. Commission*, 25 October 1883,[1983] ECR 3151.
[50] Ibid paras 38 and 39.
[51] C-41/90 [1991] ECR I-1979.
[52] Ibid para 21.
[53] C-30/87, *Corinne Bodsin v. Pompes Funèbres des regions Libérées SA*, ECR 2579, para 19.
[54] Whish, R. *Competition Law,* p 93.

3.1.1.a Agency

Agency is a special form of distribution agreement, where the agent is acting as a conduit between the principals and the buyer, without negotiating the contract himself or taking any major financial risk. If an agreement is classified as a true agency, Article 101(1) is not applicable since it is a matter of unilateral conduct. Whether an agreement is a true agency agreement or not is determined on de facto basis rather than the parties labeling and an agent can be considered to be an own entity if he has got enough autonomy and take own risks.[55]

3.1.2 Actual or potential effect on trade between Member States

For an agreement to be caught by Article 101(1) is has to have at least a potential effect on trade between Member States. In a classic case from 1966 ECJ stated that:

'For this requirement to be fulfilled it must be possible to foresee with a sufficient degree of probability on the basis of a set of objective factors of law or of fact that the agreement in question may have an influence, direct or indirect, actual or potential, on the pattern of trade between Member States.'[56]

In its ruling in *Consten and Grundig*[57], which came shortly after the judgment cited above, the ECJ stressed that in making the assessment whether an agreement has effect on trade between Member States, it is important to determine the capacity of the agreement to threaten the freedom of interstate trade in a way which would undermine the single market objective. This capacity could be actual or potential, direct or indirect.[58]

The European Commission gives some guidance to when an agreement shall be considered to fall outside the scope of EU Competition Law because of lacking effect on trade. According to the Commission it is rare for agreements between small and medium sized enterprises (SMEs) to have appreciable effect on trade between Member States or being able to appreciably restrict competition.[59] An undertaking is considered an SME when it has maximum 250 employees, a turnover below 50 million EUR and a balance sheet of less than 43 million EUR.[60] However, if at least one of the parties of an agreement holds a dominant position in a substantial part of the EU the agreement can still be considered as having appreciable effect.[61]

According to the Commission's Notice, no appreciable effect on Member States arises if the aggregate market share of the parties is below 5% and the parties' turnover in the EU is below

[55] Vertical Guidelines para 13.
[56] C-56/65 *Société Technique Minière (L.T.M.) v. Maschinenbau Ulm GmbH* (1966) ECR 249.
[57] Joined Cases 56 & 58-64 *Etablissements Consten S.A.R.L. and Grundig-Verkaufs-GmbH v. EC Commission* (1966) ECR 299.
[58] Ibid para 28.
[59] 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, OJ [2001] C 368/13, para 3.
[60] Annex to Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, OJ [2003] L 124/56.
[61] Commission Notice, Guidelines on the effect on trade concept contained in Articles 81 and 82 of the Treaty (2004) OJ [2004] C 101/81, para 7.

40 million EUR.[62] Moreover, some agreements fall outside of Article 101 TFEU since they are covered by the *de minimis* Notice.[63]

3.1.2.a Appriciable effect - de minimis doctrine

Agreements between undertakings with small market shares fall outside the scope of Article 101. *De minimis* Notice says that if the parties in an agreement are actual or potential competitors and have less than 10 % of the market share, or are not competitors and have less than 15 % of the market share, the agreement falls outside the scope of Article 101 since it is not considered to have effect on trade between Member States.[64] In case of existing parallel networks, this threshold is set to 5% regardless of whether or not the parties are competitors.[65] There are however some limitations of the Notice and the ECJ has stated that it is not accurate to approach a strictly quantitative approach to *de minimis*.[66] For example, it is necessary to take into consideration the saturation of the market as well as the customers loyalty to existing brands.[67] The Notice excepts some hardcore provisions from *de minimis*. The hardcore restrictions include export bans, price-fixing, market sharing agreements, resale price maintenance and certain territorial restrictions[68] and may be caught by Article 101, as long as the agreement is to be ruled by EU Competition Law.

3.1.2.b Territorial reach of Art 101

The requirement that agreements must have an effect on trade between the EU Member States does not mean that the agreement in question has to be concluded of European undertakings. Even if two non-EU undertakings enter into an agreement outside the Union, it can still be caught by Article 101 if it is wholly or partly implemented within the EU.[69] In *Javico International & Another v. Yves Saint Laurent Perfums SA* [70], the ECJ held that an export ban, which was imposed on distributors in Russia and the Ukraine, had an effect on trade between Member States.

3.1.3 Object or effect to restrict competition

To be caught by Article 101(1), an agreement must have as its actual or potential object or effect the restriction of competition. An agreement which has an anti-competitive object are considered caught by Article 101(1) per se, regardless of the actual effects it has on competition. Since such an agreement normally does not bring such efficiencies with it that the anti-competitive purpose is outbalanced it will usually not benefit from the exemption in Article 101(3).[71] In order to establish whether an agreement has as it object to affect competition negatively there are several factors to take into consideration, such as the provisions in the agreement, the economic background of the agreement and the conduct of

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[62] Ibid para 52.
[63] 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), OJ [2001] C 368/13.
[64] *De Minimis* Notice para 7.
[65] Ibid para 8.
[66] See e.g. C-234/89, *Delimitis v. Henninger Bräu AG* (1991) ECR 935.
[67] C-234/89, *Delimitis v. Henninger Bräu AG* (1991) ECR 935, para 22.
[68] *De minimis* Notice para 11.
[69] C-114/85, *A Ahlstrom Oy v Commission* [1988] ECR 5913.
[70] C-306/96 [1998] ECR 1-1983.
[71] Commission Guidelines an Application of Article 81(3) of the Treaty OJ [2004] C101/97, para 21, Jones, A. and Sufrin, B. EC *Competition Law, text cases and materials* p 188.

the parties to the agreement.[72] Even if the restriction of competition is not the sole aim of an agreement, it may still be considered having an anti-competitive object.[73] Regarding export bans, the ECJ has held that an agreement is considered as having an anti-competitive objective even if the export restrictions are an indirect result of another provision, rather than that of a direct action.[74]

If an actual or potential object to upset competition cannot be established, the effects of the agreement will be examined.[75] If an agreement is found to either actually or potentially affect competition negatively, it is likely to fall within Article 101(1) and sufficient counterbalancing effects must be shown for the exemption in Article 101(3) to be applicable.

As can be seen, the scope of Art 101(1) is quite extensive. It is enough for an agreement, which has not as its objective to restrain competition, to have a potential indirect effect on trade between Member States for it to be caught under the EU Competition rules. As a result, many vertical agreements fall within the scope of the article. However, many of those benefit from the exemption in 101(3), either through an individual assessment or because they are within the 'safe harbour' of the VBER.

3.2 The exemption in Article 101(3) TFEU

Article 101(3)

> *The provisions of paragraph 1 may, however, be declared inapplicable in the case of:*
> *— any agreement or category of agreements between undertakings,*
> *— any decision or category of decisions by associations of undertakings,*
> *— any concerted practice or category of concerted practices,*
> *which contributes to improving the production or distribution of goods or to promoting technical or*
> *economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:*
> *(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;*
> *(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.*

Compared to many provisions in the TFEU, Article 101(3) is relatively clear in its definition of the criteria for its appliance, although it is hardly uncomplicated to apply.

First of all, the agreement in question shall provide efficiency gains and contribute to improvement of production and distribution. Further, the agreement shall be indispensible for efficiency, which does not mean that it has to be the only or even the main purpose of the agreement, but that there has to be a link between the efficiency and the agreement in question.[76] Thirdly, a fair share of the results and benefits should reach the consumers. Thus,

[72] Kolstad, *Object contra effect in Swedish and European competition law*, p 10.
[73] See ECJ's decision in *General Motors v Commission,* C-551/03 P [2006] ECR I-3173, para 64.
[74] Ibid para 68.
[75] *See* C-56-65 *Société Technique Minière (L.T.M.) v. Maschinenbau Ulm GmbH* (1966) ECR 249.
[76] Commission Guidelines an Application of Article 81(3) of the Treaty (2004) OJ [2004] C 101/97, para 51(b).

it is not sufficient to prove that the agreement gains society as a whole, but the consumers must end up in a better position than if the contract had not been concluded. The provision suggests that consumer welfare is one of the ultimate objectives in EU Competition Law, a view which is also shown in the Vertical Guidelines where the Commission holds that the objective of Article 101 is to ensure that undertakings do not conclude anti-competitive agreements to the detriment of consumers.[77]

Forth, the agreements shall not eliminate competition in respect of a substantial part of the products in question. It is for the undertaking claiming the benefit of Article 101(3) to proof that the criteria set out in this article are fulfilled.[78]

As has been mentioned, there is no longer necessary to examine whether an agreement falls foul of 101(1) if the conditions in 101(3) are met. This is especially significant for agreements that benefit from the VBER.

3.3 The Vertical Block Exemption Regulation

The Vertical Block Exemption Regulation, exempts all agreements, or parts thereof, covered by it from the application of Article 101(1), as they are said to automatically be benefitting from Article 101(3).[79] It is for the undertakings themselves to decide whether or not their agreement is covered by the Regulation.[80]

3.3.1 The Scope of the Vertical Agreements Block Exemption

The VBER covers vertical agreements between undertakings where the market share held by the supplier does not exceed 30 % of the relevant selling market and the market share of the buyer does not exceed 30 % of the relevant buying market, to the extent such agreements regard vertical restraints.[81] In the former VBER the focus was on the suppliers' market share, except for agreements regarding exclusive supply, but the increasing acknowledgement of buyer power has led to a change on this point.

According to Article 2(4) VBER, vertical agreements entered into between competing undertakings fall outside the scope of the regulation and are instead to be reviewed under the Horizontal Guidelines[82] before the vertical effects are to be reviewed. There are, however, some exceptions to this rule. The VBER still applies where competing undertakings enter into a non-reciprocal vertical agreement and at least one of the following requirements is fulfilled:

- the supplier is both a manufacturer and a distributor of goods, whereas the buyer is a distributor and do not compete with the supplier at the manufacturing level.

- the supplier provides services at several levels of trade, whereas the buyer is a provider of goods or services at retail level and does not compete at the level of trade where it purchases the services concerned.

[77] Vertical Guidelines para 7.
[78] Council Regulation 1/2003 Article 2.
[79] VBER Article 2.
[80] Council Regulation 1/2003, Article 2.
[81] VBER Articles 2 and 3.

[82] Commission Notice - Guidelines on the applicability of Article 81 of the EC Treaty to horizontal cooperation agreements (2001) OJ [2001] C 3/02.

3.3.2 Market Share Threshold

When calculating an undertaking's market share, it is necessary to determine the relevant market where that undertaking sells respectively purchases the contract products. How this is to be calculated is explained in the Commission Notice on Market Definition.[83] Market definition has both a product- and a geographical dimension. The relevant product market consists of all products and/or services which the consumer regards as interchangeable or substitutable due to their characteristics, their prices and their intended use.[84] The relevant geographic market comprises the area in which the firms concerned are involved in the supply of products or services and in which the conditions of competition are sufficiently homogeneous where it can be distinguished from neighbouring geographic areas due to appreciably different conditions of competition.

3.3.2.a Product market dimension

Demand substitutability is the essence of market definition.[85] One way of determine to which consent a consumer would be prepared to switch between products is through the SSNIP-test.[86] The test is based on price-elasticity. It takes the view of a hypothetical monopolist and examines whether a small increase in price, normally 5-10%[87], would be profitable or if marginal consumers instead would choose to move to other products. If this increase in price would make customers choose another product, that product is considered interchangeable with the product of the hypothetical monopolist.

The product dimension may also be based on supply side substitutability. Products between which a supplier is able to switch production in a short time and at insignificant additional costs are regarded as interchangeable, even if they are not exchangeable for the consumer.

3.3.2.b Geographical market dimension

The geographical dimension examines how far is a buyer prepared to travel to pursue the product. In the assessment the nature of the products due to transport costs and local and national preferences as well as market integration must be taken into consideration. The SSNIP test can be applied to geographical markets by examining the customers' willingness to switch to a supplier further away due to a small increase in price by their local retailer.

The geographic wholesale market is usually wider than the retail market, since distributors are professional buyers unlike the final consumers. The geographical wholesale markets are often considered to be a whole Member State or even wider.[88]

Regarding multi party agreements, an undertaking buying from one party and selling to another must respect its market share both as a supplier and a buyer when applying the VBER.[89]

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[83] Commission Notice on the definition of the relevant market for the purposes of Community Competition Law, OJ [1997] C372/5.

[84] Ibid para 7.

[85] See e.g. Whish, R. *Competition Law* p 29.

[86] Commission Notice on Market Definition para 14. SSNIP stands for Small but Significant Non-transitory Increase in Price. The test is sometimes referred to as the 'Hypotetical Monopolist test'.

[87] Numbers are taken from the Hypotethical Monopolist test in the Commission Notice on Market Definition para 17 and indicates 'significance' within the SSNIP-test, see Whish, R. *Competition Law* p 30.

[88] Vertical guidelines para 89.

[89] VBER Article 3(2).

3.3.3 Hardcore restrictions that remove the benefit of the Block Exemption, Article 4 VBER.

There are certain restrictions, that, once part of an agreement, completely excludes the whole agreement from benefitting from the Block Exemption. There is still a possibility that the agreement will be exempted after an individual examination of 101(3), although this is not likely to happen.[90] The hardcore restrictions are laid down in Article 4 of the VBER and include agreements which have as their object to either restrict resale prices or to restrict the territories and/or customers from/to the buyer can resell the goods or services. The hardcore restrictions regarding selective distribution are to be found in Article 4b(ii, iii and iv), (c), (d) and (e) and will be discussed below.

3.3.4 Individual cases of hardcore sales restrictions that may fall outside the scope of Article 101(1) or may fulfil the conditions of Article 101(3)

There are situations where hardcore restrictions may be objectively necessary and therefore fall outside the scope of Article 101(1). This appears only under exceptional circumstances, such as when a restriction is necessary to ensure the respect of a public ban on selling dangerous substances.

It is also possible for undertakings to plead an efficiency defense under Article 101(3) and thereby be exempted from Article 101(1), even when the restriction is considered hardcore. Such defense is most likely to succeed where the distributor is the first to sell a new brand or to enter a new market with an existing brand, since this often require substantial investments.[91] The distributor may be protected from both active and passive sales for a limited period of time up to two years.

3.3.5 Withdrawal of the VBER

The VBER creates a safe harbour for parties of the agreements covered by it. However, the presumption of legality conferred by the Block Exemption Regulation may be withdrawn where a vertical agreement is within the scope of Article 101(1) without fulfilling the criteria in 101(3).[92] The agreement does not have to have such effect in itself; it is enough that the effect is reached together with similar agreements enforced by competing suppliers or buyers.[93]

The VBER may only be withdrawn for undertakings which make an appreciable contribution to the anti-competitive cumulative effect. If the effect of a certain agreement is not appreciable it does not fall within the scope of Article 101(1) at all. It is for the Commission to proof that the agreement falls within Article 101(1) and that it does not meet the criteria in 101(3).[94] Thus, with regards to the burden of proof, there is some extra protection provided for agreements that fall within VBER, compared to those which are not covered by the safe harbour. In the latter case it is for the contracting parties to prove that the agreement fulfils the criteria in Article 101(3) and therefore shall benefit from the exemption.

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[90] Vertical Guidelines para 47.
[91] Ibid para 61.
[92] VBER Article 13, Vertical Guidelines para 74.
[93] Vertical Guidelines para 74.
[94] Council Regulation 1/2003 Article 2.

It is also possible for the competition authority of a Member State to withdraw the benefit of VBER where the anti-competitive effects of the agreement affect that state, or a distinct geographical market thereof.[95]

A decision about withdrawal only affects the status of the agreement from the date the decision becomes effective.[96]

3.4 Consequences of infringing Article 101

There are three legal consequences of infringing Article 101. First of all, the agreement or practice in question is void and is therefore not enforceable.[97] If the offending part can be separated from the rest of the agreement, the remaining part of the agreement will still stand.[98] If, on the other hand, a separation is not possible, the whole agreement will be void.[99]

Second, the Commission can impose penalty fines up to 10 % of the parties' annual turnover worldwide,[100] which means that an infringement can be very expensive. The largest fine so far imposed for a vertical agreement was in Nintendo Distribution[101] for the prevention of parallel trade. The Commission imposed a fine of a total EUR 167.8 million on the manufacturer and its distributors, out of which EUR 149 million was imposed on Nintendo alone, for being the driving force behind the behavior and also for continuing with the infringement after being notified of the investigation.[102] Nintendo and its distributors appealed the case to the General Court, which reduced the fines to a total EUR 119.2425 million.[103]

Finally, third parties affected by the anti competitive conduct may sue for damages, which is encouraged by the Commission.[104]

4. Article 102 TFEU – Abuse of dominant position

Where vertical restrictions are seen as unilateral conduct rather than an agreement between undertakings, they do not fall within Article 101, but may still be caught by Article 102 TFEU if the imposing part has a dominant position on the market in question. Article 102 prohibits a dominant undertaking, or a number of jointly dominant undertakings, to abuse their market strength. The test of dominance is whether the entity is in a position to behave "*to an appreciable extent independently of its competitors, customers and ultimately of its consumers*".[105] However, market share has traditionally been and consists to be the main measurement in the assessment[106] even if other factors such as position of competitors and

[95] Vertical Guidelines para 78.
[96] Ibid para 77.
[97] TFEU Article 101(2).
[98] Case 56-65 *Société Technique Minière (L.T.M.) v. Maschinenbau Ulm GmbH* (1966) ECR 249.
[99] Jones, A. and Sufrin, B. *EC Competition Law, text cases and materials,* p 103.
[100] Council Regulation 1/2003 Article 23.
[101] OJ [2003] L 255/33.
[102] Ibid paras 406 and 407.
[103] T-13/03 [2006] ECR II-975.
[104] See: *White Paper: Damages actions for breach of the EC antitrust rules*, COM(2008) 165, 2 April 2008, at: http:// ec.europa.eu/competition/antitrust/actionsdamages/files_white_paper/whitepaper_ en.pdf.
[105] C-27/76, *United Brands v Commission* [1978] ECR 207.
[106] Generally can be said that a market share exceeding 40 % will be considered evidence that a dominant position is at hand, but depending on other factors this can vary.

structure of the market are to be examined.[107] Since selective distribution is normally based on agreements between two or more parties it is usually covered by Article 101 rather than Article 102.[108]

Part IV - Selective distribution in EU Law

Selective distribution, especially when qualitative, is normally not considered hazardous for competition. The Vertical Guidelines state that even though selective distribution can be harmful for intra-brand competition, have foreclosing effects on distributor's level, and soften competition and facilitate collusion between suppliers and buyers, it is generally exempted by the VBER, due to its pro competitive effects.[109] This applies even when selective distribution is combined with other non-hard core vertical restraints. Although, when combined with exclusive distribution, selective distribution is considered a hardcore restraint and will only be exempted if active selling into other territories is allowed.[110] If a selective distribution agreement does not benefit from the VBER, it might still be exempted by Article 101(3), especially where there is strong inter-brand competition on the market in question.[111]

1. Selective distribution within the context of Article 101(1)

When making the assessment whether or not an agreement infringes Article 101(1) it is necessary to make a distinction between purely qualitative selective distribution and quantitative selective distribution.[112]

1.1 Purely Qualitative Selective Distribution Agreements

As long as a selective distribution system is purely qualitative, it will not infringe Article 101(1), due to lacking anti-competitive effects.[113] In *Metro v. Commission*[114]*(Metro),* the ECJ stated that selective distribution may be adapted for high quality and technically advanced products, where the distributors are chosen on the basis of objective criteria of qualitative nature relating to their technical qualifications and the suitability of their trading premises. Such conditions must not be applied in a discriminatory manner, but be laid down uniformly for all potential distributors.[115] The *Metro* test was used in *L'Oréal v. De Nieuwe*[116], where the Court also stated that a selective distribution system is in conformity with Article 101(1) (then

[107] Whish, R. *Competition Law* p 175 f.
[108] See e.g. C-107/82, *Allgemenie Elektricitäts-Gesellschaft AEG Telefunken AG v. Commission*, [1983] ECR 3151. Even unilaterally imposed requirements can be part of distribution agreements and therefore ruled under Article 101.
[109] Vertical Guidelines para 176.
[110] Ibid.
[111] Ibid para 177.
[112] Ibid para 175.
[113] Ibid.
[114] C-26/76 *Metro v. Commission* [1977] ECR 1875. Often referred to as *Saba I*.
[115] Ibid para 20.
[116] C-31/80, *L'Oréal NV aud L'Oréal SA v. De Nieuwe AMCK Puba* [1980] ECR 3775.

85(1)), where such a system is necessary to preserve the quality of the products as well as ensure their proper use.[117]

1.1.1 The *Metro* Doctrine

In *Metro*, a manufacturer of televisions, radios and tape-recorders, SABA, distributed its products through a selective distribution system. Metro was a self-service dealer which appealed to the ECJ after being denied access to SABA's distribution network. The Commission had accepted SABA's distribution system by holding parts of it outside Article 101(1) and fit in the rest under the exemption in 101(3), a decision that was challenged by Metro. In its judgment, the ECJ stated that three criteria must be satisfied for a selective distribution system to be treated as purely qualitative and thereby fall outside the scope of Article 101(1). First of all, the product in question must be of such nature that it necessitates selective distribution. The judgments of the Community Courts and the decisions of the Commission show three different categories of goods that may be included. First there are the technical complex products, such as cars[118], cameras[119], computers[120] and clocks and watches[121], that requires specialist sales staff and after sales services. However, all such products are not included. For example in *ETA Fabriques d'Ebauches SA v. DK Investment SA* regarding an export ban, the ECJ questioned whether mass-produced watches were of such nature that it would justify selective distribution.[122] The second category of goods which may fall within the Metro-doctrine is products which brand image is of major importance, like perfumes and luxury cosmetics[123], diner services[124] and gold and silver jewellery[125]. Here it is necessary to assess the need for the producer to preserve the image of its brand as well as the need to safeguard the image of exclusivity and prestige of the product.[126] The third and final category of products is newspapers and periodicals; since their distribution is extremely important due to the extremely limited time, those products can be sold by the retailer.[127]

Even if the product in question is included in one of the categories above, it might be problematic for a supplier to argue that a product is of such type that it necessitates selective distribution if selective distribution systems are used in some, but not all jurisdictions.[128]

The second criteria in the doctrine is that the supplier only have the right to limit its resellers based on purely qualitative criteria, laid down uniformly and applied in a non-discriminatory manner. In *AEG Telefunken v Commission*[129], AEG's selective distribution system where the

[117] C-31/80, *L'Oréal NV aud L'Oréal SA v. De Nieuwe AMCK Puba* [1980] ECR 3775.
[118] *BMW* OJ [1975] L 29/1.
[119] *Kodak* OJ [1970] L 147/24.
[120] *IBM Personal Computers* OJ [1984] L 118/24.
[121] *Omega Watches* OJ [1970] L242/22..
[122] C-31/85 *ETA Fabriques d'Ebaucher SA v. DK Investment SA* [1985] ECR 3933., para 16.
[123] See e.g. C- 99/79 *Lancome SA etc v. Etos BV* [1980], ECR 2511. Case T-88/92 *Groupement d'Achat Édouard Leclerc v. Commission* [1996], ECR II-1961, paras 105-117.
[124] *Villeroy & Boch* [1985] OJ L376/15. 461 para 21-24.
[125] *Murat* OJ [1983] L 348/20..
[126] Jones, A. and Sufrin, B. *EC Competition Law, text cases and materials*, p 644.
[127] C-243/85, *SA Binon & Cie v. SA Agence et Messageries de la Presse* [1985] ECR 2015, para 32.
[128] Jones, A. and Sufrin, B. *EC Competition Law, text cases and materials* p 645.
[129] 107/82, *Allgemenie Elektricitäts-Gesellschaft AEG Telefunken AG v. Commission*, ECR 3151.

company refused to approve retailers operation on low margins, was not considered as purely qualitative and was therefore caught by Article 101(1).

As mentioned above, qualitative requirements may concern suitably trained staff, suitable premises in an appropriate area, a shop with a proper name and the provision of sufficient after sales services. The supplier is also allowed to prevent its dealers from selling to non-authorized distributors and retailers. The key to determine whether or not a requirement is purely qualitative seems to be that qualitative criteria are those aiming to select dealers due to their objective suitability to distribute the particular type of goods, whereas quantitative more directly limit the potential number of dealers.[130] Borderline issues are for example the holding of minimum stocks, minimum turnover or the percentage of minimal turnover.[131] Such provisions have often been regarded as quantitative and therefore fallen within the scope of Article 101(1), although not consistently. Jones and Sufrin assert that the Courts' judgments and the Commission's decisions indicate that the classification of the obligation may depend on the nature of the product in question.[132] Even if a provision should be regarded as quantitative and therefore not avoid Article 101(1), it may still have good chances to benefit from the exemption in 101(3).[133]

Guidance can be sought in the following cases and decisions:

In *Vichy*[134], the producer's restriction of its sales to include only officially appointed pharmacies, was found to be a quantitative rather than qualitative restriction since the requirement of being a dispensing chemist was considered necessary for the cosmetic products in question.

In *Yves Saint Laurent*, the distribution agreements included provisions on minimal annual purchase figures, obligations of the carrying of stocks, stock rotation and cooperation in advertising and promotion. The Commission found the agreements to fall within the scope of Article 101(1).[135]

Finally, for an agreement to fulfill the criteria in the *Metro* Doctrine and thereby avoid being caught by Article 101(1), it must be proportional. Thus, it may not include any provisions that go further than objectively necessary to protect the quality of the product in question. In *Hasselblad*[136], the Commission found that the producer went too far when maintaining the right to exercise supervision of the advertising of its distributors and retailers.

[130] Jones, A. and Sufrin, B. *EC Competition Law, text cases and materials* p 645.
[131] T-19/92 *Groupement d'Achat Édouard Leclerc v. Commission* [1996], ECR II-1851 paras 148-155; T-88/92 *Groupement d'Achat Édouard Leclerc v. Commission* [1996], ECR II-1961, paras 141-148.
[132] Jones, A. and Sufrin, B. *EC Competition Law, text cases and materials*, p 646.
[133] See e.g. Vertical Guidelines para 176 stating that both quantitative and qualitative selective distribution agreements are covered by the VBER.
[134] OJ [1991] L 75/57, upheld on appeal Case T-19/91 [1992] ECR II-415.
[135] OJ [1992] L 12/24, [1993] 4 CMLR 120, mostly upheld on appeal Case T 19/92 *Groupement d'Achat Édouard Leclerc v. Commission* [1996], ECR II-1851. However, in 2001, the Commission confirmed that YSL's selective distribution system benefitted from the VBER : IP/01/713, 17 May 2001.
[136] OJ [1982] L 161/18.

In *Grohe*[137] and *Ideal Standard*[138], the Commission found that provisions requiring wholesalers to resell only to plumbing contractors were infringements of Article 101(1). The laws of the Member States require major plumbing work to be performed only by official plumbers and it was therefore not necessary for producers to control the quality of such work.

1.2 Selective Distribution Systems that are not purely Qualitative

Selective distribution systems including quantitative restrictions are likely be caught by Article 101(1). However, such systems are often exempted by Article 101(3), either through the VBER or through individual assessment. The VBER exempts both qualitative and quantitative selective distribution systems where the parties of the agreement are within the 30% threshold.[139]

Since the loss of intra-brand competition only harms competition when inter-brand competition is weak, the Commission will examine the market position of the supplier and its competitors when making the assessment whether a selective distribution system infringes Article 101(1).[140] Further, it will look at the number if selective distribution systems operating on the same market, since this may affect the market access for certain distributors.

As been said, there are situations where a quantitative selective distribution system can be approved. In *Omega*[141], the Commission approved of a distribution system where Omega did not only require that their distributors satisfied qualitative conditions, but also limited the number of retailers per town or suburb based on the local population and presumed wealth. The system was not regarded as anti-competitive since Omega watches are manufactured in limited numbers and the quantitative restrictions ensured that each retailer has a turnover big enough to invest in the promotion of the watches.

2. Selective distribution within the context of Article 101(3)

2.1 Selective distribution in the VBER

Selective distribution is normally not considered a hardcore restraint and can therefore benefit from the VBER even if combined with other non-hardcore restraints.[142] However, selective distribution agreements may not be combined with agreements on exclusive distribution unless both active and passive sales are allowed within the system.[143]

2.1.1 Territorial restrictions

Article 4(b) of the VBER says that a supplier may not restrict the territory into which or the customer group to whom the distributor sell the products in question, although it may still make restrictions as to the distributors' place of establishment. However, there are some further exceptions to this rule.

[137] OJ [1985] L 19/17.
[138] OJ [1985] L 20/38.
[139] Vertical Guidelines para 176.
[140] Ibid para 177.
[141] *Omega Watches* OJ [1970] L242/22.
[142] Vertical Guidelines para 176.
[143] Ibid.

First of all, it is possible to prevent a wholesaler from selling to end users, so that the wholesale and retail level of trade can be kept separate.[144] The wholesaler shall still have the right to sell to certain end users, such as "big" end users.[145]

It is also possible to restrict members of a selective distribution system from selling to unauthorised distributors, as long as the restrictions stay within the territory reserved by the supplier to operate the system.[146] It has here been a change from the former VBER, where it was generally permitted to restrict sales to all unauthorised distributors, regardless of on which market they operated. After some complaints on the wording in the drafted Guidelines,[147] which referred to territories where selective distribution systems are operated, rather than territories reserved by the supplier, it is now clear that authorised distributors do not have the right to sell the products to unauthorised dealers in territories where the supplier is yet to put the product on the market. The drafted wording would have put smaller suppliers in a tough position, since they might have the aim or means to sell their products in all Member States.[148]

The new limitation of the suppliers' rights has been criticised for creating practical problems where a supplier decides that selective distribution not is the appropriate distribution model for all markets within the Union.[149] If a supplier applies a selective distribution system in some, but not all, EU markets, it will be problematic to prevent distributors in markets without such system from reselling the products to unauthorised distributors in markets where a selective distribution system is adopted. Although affecting all kinds of suppliers, the new wording is especially regretful for small suppliers which may not be able to operate a selective distribution system in all Member States.[150] If such reselling cannot be prevented, the whole selective distribution system is at risk.[151] It has been suggested that the restriction of sales to non-authorised distributors always should be considered legitimate within a selective distribution system, regardless of where the non-authorised distributor is situated, as it is necessary for the functioning of a selective distribution system.[152] The current wording may lead to an extended use of selective distribution systems, even on markets where other alternatives might be at hand.[153]

[144] Vertical Guidelines para 55.
[145] Ibid.
[146] VBER Article 4(b)(iii).
[147] See e.g. LVMH *Submission Concerning the review of the Community competition rules applicable to vertical restraints*, paras 18-23.
[148] Ashurts LLP - *Response to DG competition's draft revised Block Exemption and Guidelines for the assessment of vertical agreements under EC Competition Law,* sec 2.3
[149] See e.g. LVMH *Submission Concerning the review of the Community competition rules applicable to vertical restraints*, paras 20 and 21.
[150] International Chamber of Commerce - *Review of EC competition rules applicable to vertical agreements* p 3 f.
[151] LVMH *Submission Concerning the review of the Community competition rules applicable to vertical restraints*, paras 20 and 21.
[152] See e.g Ashurts LLP - *Response to DG competition's draft revised Block Exemption and Guidelines for the assessment of vertical agreements under EC Competition Law*, sec 2.2.
[153] Ibid sec 2.3.

2.1.2 Restriction of sales to end users

Article 4(c) of the VBER provides that the restriction of both active and passive sales to end users by members of a selective distribution system operating at the retail level of trade is considered a hardcore restraint. However, it is still possible to for the seller to restrict the retailer from operating out of an unauthorised place of establishment. The provision means that members of a selective distribution system cannot be restricted in the customers to whom they sell. The Guidelines stress that the dealers within a selective distribution system shall be free to sell, both actively and passively, offline or on the Internet, to all end users.[154]

2.1.3 Restriction of cross-supplies

Furthermore, it is not allowed to restrict cross-supplies between the authorised distributors within a selective distribution system. The distributors must remain free to purchase the contracted products from other dealers within the system, whether they operate on the same or a different level of trade.[155] Since the appointed distributors cannot be required to purchase the products from a certain source, selective distribution cannot be combined with exclusive purchasing agreements.[156] It also means that no restrictions may be imposed on appointed wholesalers as regards their sales of the product to appointed retailers within the selective distribution network, a wholesaler in one EU Member State is allowed to distribute goods to appointed retailers all over the Union.

The provision encourages trade between distributors in different Member States and thereby benefits the single market imperative. If a supplier facilitates price discrimination and sell to different prices to different distributors, the distributors may engage in arbitrage and purchase from one another. The prohibition covers both direct and indirect restrictions,[157] meaning that a supplier may not restrict its supply to the specific amount a distributor is supposed to sell in its own market.

2.1.4 Restriction of sales to certain competitors

According to Article 5(1)(c) VBER, the supplier may not directly or indirectly oblige its distributors not to sell the products of certain competitors of the supplier. Such a restriction would not make the exemption inapplicable on the whole agreement, but just on the specific provision. A provision restricting sales to certain competitors is unlikely to be exempted through an individual assessment where the market share of the five largest suppliers (CR5) is 50% or more, as long as the supplier in the agreement is one of those five undertakings. When the restrictions concern all other suppliers it is instead a matter of single branding, which in combination with selective distribution is exempted as long as the authorised distributors may sell actively and freely to each other and to end users.[158]

2.1.5 Withdrawal of the benefit of the VBER for selective distribution agreements

Where a supplier imposes a selective distribution system for products that do not require it, or implies certain criteria not necessary due to the characteristics of the products, the benefit of

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[154] Vertical Guidelines paras 52 and 176 together.
[155] VBER Article 4(d).
[156] Vertical Guidelines para 58.
[157] Ibid.
[158] Ibid para 176.

the VBER is likely to be withdrawn since the reduction of intra-brand competition generally will not be counterbalanced by sufficient efficiency gains.[159] Such criteria could be the requirement for distributors to provide specific pre- or after sale services. It could also be to demand the distributor to have one or more brick and mortar shops for goods that need not to be seen in real life and therefore do not need to be sold offline.[160] As has been said above; where the benefit from the VBER is withdrawn it is for the Commission to prove that the agreement in question does not benefit from the exemption in Article 101(3) through an individual assessment.

2.2 Selective distribution above the 30 % threshold

When making an individual assessment whether an agreement that does not benefit from the VBER fulfill the criteria in Article 101(3), the market power of the supplier is highly relevant.[161] As long as inter-brand competition is strong, a reduction of intra-brand competition will not be harmful, but if the supplier has a strong market position the agreement must bring some real efficiency with it to balance out the loss of intra-brand competition for Article 101(3) to be applicable.

Not only the market power of the supplier matters, but also the number of selective distribution networks present in the same market.[162] If only one of the suppliers on the market uses a selective distribution system, there is little risk that a quantitative selective distribution system would hurt competition, provided that the nature of the contracted goods is of such art that the use of a selective distribution system is required and it only applies to a necessary extent to ensure efficient distribution.

However, normally there are several different selective distribution systems on one market, why most quantitative selective distribution systems are considered to be a threat to competition. In *Metro II*[163] the ECJ held that Article 101(1) may apply also to purely qualitative selective distribution agreements, where such big part of the market is covered by selective distribution systems that there is no room left for alternative distribution models.

The case concerned the same parties as in *Metro I* and regarded the renewal of SABA's grants for exemption of their selective distribution system Just like the time before, the Commission approved the exemptions, but Metro claimed that this was wrongful since the market structure had changed so dramatically since the last decision. The number of selective distribution systems operated by the major producers had increased significantly on the markets throughout the community, leading to a foreclosure of non authorised distributors.[164] The Court ruled against Metro saying that it had failed to show that the number of distribution system had increased in such a way that it left no room for alternative distribution arrangements. At the same time, the Court stated that when there is no longer any room for

[159] Vertical Guidelines para 176.
[160] Ibid.
[161] Ibid para 177.
[162] Ibid.
[163] C-75/84, *Metro-SB-Grossmärkte GmbH & Co KG v Commission* , [1986] ECR 3021.
[164] Ibid para 35.

alternative distribution methods, even pure qualitative distribution systems may be caught by Article 101(1).[165]

According to the Guidelines, situations where parallel distribution networks create cumulative anti-competitive effects may lead to a withdrawal of the benefit of the VBER, which means that undertakings always have to be observant of such factors when deciding how to structure their distribution, even when their market share is below 30%.[166] This may for example occur where some suppliers apply purely qualitative systems, whereas others also have quantity requirements in their selective distribution systems.[167] However, this is unlikely to take place when less than 50% of the market is covered by selective distribution networks. Even if the networks cover more than 50%, there should normally not create any problems as long as the aggregate market share of the CR5 is below 50%. If the market is of the kind that more than 50% of it is covered by selective distribution networks and also more than 50% is shared between the CR5, it might create problems. The result of such an assessment depends mostly on whether or not all CR5 make use of exclusive distribution systems. If not, it might still not be harmful for competition and the benefit of the VBER will not be withdrawn.

The position of the competitors also plays a significant role. If the competitors are strong, the inter-brand competition is normally good and the reduction in intra-brand competition will not be harmful.[168] On the other hand, if there are only a few big competitors on the market, and the majority of them use a selective distribution system, intra-brand competition will be reduced. It may also lead to foreclosure of some distributors, since non-authorised dealers are excluded, especially where the suppliers use the same dealers to a high extent. Further there is a risk of collusion between the big suppliers.

Finally it is important to consider the maturity of the market. If the market is lively, with changing market positions and technologies, the loss of intra- brand competition will not have such damaging effect. On the other hand, if the market is mature and very stabile, it may create serious problems, since there is less room for new players to enter.[169]

2.2.1 Efficiencies

For an agreement to benefit from Article 101(3), it must bring with it efficiencies that outweigh the possible anti-competitive effects. Selective distribution is especially likely to lead to efficiencies where the distributors must invest to protect or build up the brand image, as with new products, complex products and so-called experience products (products whose qualities are difficult to judge before consumption) or credence products, whose qualities are hard to evaluate even after consumption.

Where a selective distribution system includes both wholesalers and retailers, there might be a need for the appointed wholesalers in different territories to invest in promotional activities to support the appointed retailers within ‘their’ own territory. Such promotional activities may

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[165] C-75/84, *Metro-SB-Grossmärkte GmbH & Co KG v Commission* , [1986] ECR 3021.paras 40 and 41.
[166] Vertical Guidelines para 179.
[167] VBER Article 15, Vertical Guidelines para 75.
[168] Vertical Guidelines para 178.
[169] Ibid para 184.

be specified in a contract, but when this is not efficient, agreements where the wholesalers are restricted from active sales to appointed retailers in other wholesalers' territories, may solve the free-riding problem and therefore benefit from Article 101(3).[170]

3. Export bans in selective distribution agreements

Free trade and integration are primary goals for the European Union. Hence, any restraints hindering trade between member states are villous, why export bans in vertical agreements will be held to infringe Article 101(1) and are unlikely to be exempted by Article 101(3).[171] As will be seen, agreements constituting export bans are considered anti-competitive by object, which in principle leads to a per se prohibition of such provisions. This approach shows the political influence on European Competition Law and has been criticised for the lacking of economic rationale.[172]

3.1 Direct export bans

Selective distribution systems where the distributors are directly prohibited from exporting goods are considered to have as their object to restrict competition without any need to demonstrate anti-competitive effects.[173]

In *Nintendo Distribution*[174], Nintendo obliged its distributors to prevent parallel trade and the contracting parties collaborated to find the source of any such behavior. The purpose was to maintain the significant price differences in the EU, with the UK market up to 65% cheaper than Germany and the Netherlands. Traders which allowed parallel export were punished through smaller supplies or completely boycotted. The undertakings involved were punished through high fines for the breach against Article 101(1). The size of the fines imposed was set to reflect the real impact the offending conduct of each firm had on competition as well as the size of the firms. The fines were then reduced due to co-operation with the Commission in the later stages of the investigation.

In *Volkswagen v. Commission*[175], the parent company of the Volkswagen group (Volkswagen AG) owned 98,99% holding of Audi AG and 100% of Volkswagen's and Audis importer for Italy, Autogerma SpA. The three companies had, together with their Italian dealers, concluded agreements creating an export ban.

The contracts included penalties on Italian dealers selling outside the country. Bonuses were in principle only paid for the sales the distributors conducted within their territory and the cars even had to be registered within the territory for the sale to be put to the base of the bonus. Further, the agreements prohibited cross-deliveries to authorised dealers in other Member States. The Italian dealer also only received the number of cars necessary to supply customers in their own territory. The result was that customers from other Member States were kept from the possibility to buy the cars from Italy. The export bans were considered parts of the

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[170] Ibid para 63.
[171] Export bans are considered hardcore restrictions in Article 4(b) VBER.
[172] Motta, M. *Competition Policy – Theory and Practice*, p 23.
[173] See ECJ's decision in C-551/03 P *General Motors v Commission* [2006] ECR I-3173.
[174] OJ [2003]L 255/33.
[175] T-62/98 *Volkswagen AG v. Commission* [2000] ECR II-2707.

distribution agreements since the dealers followed the given instructions. The Commission held them to be hardcore restrictions, not to be exempted by the Regulation that exempted agreements from what then was Article 85(3).[176] The General Court agreed with these findings on appeal, even if disagreeing with a few other part of the decision.[177] Its ruling was then confirmed by the ECJ.

3.2 Indirect export bans

Just like direct export bans, indirect measures that will have the same effect as export bans are also black-listed in the VBER.[178] There are a number of ways in which a supplier may prevent its distributors from exporting contracted goods. It can set different prices on products to be exported or withdraw a buyer's discounts due to the exporting of goods. Further, it can buy up the supplies itself to cut the benefits of parallel traders or reducing the supplies to a certain territory so that no products will be left to export. Another example of an indirect export ban is where the distributors are obliged to pay a fee when exporting into another distributors' territory, unless the fee relate to the value of the after-sale services that the latter might have to provide.[179] A producer may wish to require information on where its products are sold, or impose serial numbers on its products, to make it possible to trace their movement between territories. The use of such practices to prevent parallel trade is considered an indirect export ban.[180]

In *GlaxoSmithKline v. Commission*[181], a pharmaceutical company had entered into an agreement with Spanish wholesalers operating a distinction between prices charged to wholesalers in the case of domestic resale of reimbursable drugs to pharmacies or hospitals and the prices charged in the case of exports of medicines to any other Member State. The parties thereby created an indirect export ban. The Commission held that the agreements infringed Article 101(1) as they had an anti-competitive object. The General Court referred to the special conditions on the pharmaceutical market and partly annulled the decision holding that export prohibitions are not necessarily anti-competitive by their object and that it is necessary to examine their possible impact on the market before deciding that they infringe Article 101(1).[182] The Court found that the agreements in question had anti-competitive effect,[183] but that the Commission had not conducted an adequate assessment of whether the sales conditions fulfilled the criteria for an exemption under Article 101(3). The ECJ dismissed GlaxoSmithKlines' appeal against the General Court's decision since it considered that the operative part of the General Court's judgment in which it confirms the Commission's finding that the pricing system breached Article 101(1) needed not be set aside. Though, the ECJ did not agree with General Court that the agreement should be treated as an effect-based restriction rather than an object-based restriction. Instead it held that *agreements*

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[176] Commission Decision 98/273/EC [1998] OJ L 124/06.
[177] T-62/98 *Volkswagen AG v. Commission* [2000] ECR II-2707.. The General Court ruling was confirmed in C-338/00P *Volkswagen AG v. Commission* [2003] ECR I-9189.
[178] VBER Article 4(b).
[179] Whish, R. *Competition Law* p 625.
[180] OJ [1982] L 161/18.
[181] C-501/06 P *GlaxoSmithKline and others v Commission* [2009] ECR I-9291.
[182] T-168/01 *GlaxoSmithKlineand others v Commission* [2006] ECR II – 2969, para 10.
[183] Ibid paras 148-192.

aimed at prohibiting or limiting parallel trade have as their object the prevention of competition[184] and that nothing in Article 101(1) *indicates that agreements have to deprive consumers of certain advantages to have an anti-competitive object.'*[185] Thereby the ECJ thwarted the less strict approach to the issue of the single market and parallel trade suggested by the General Court.

In 2003, the Commission found that the way *Yamaha* operated its selective distribution system led to the partitioning o the single market as well as the fixing of resale prices.[186] In its distribution agreements, Yamaha prohibited its distributors to sell to other than final customers which meant a restriction of cross-supplies, which is considered a hardcore restriction in Article 4(d) VBER. Further, the distributors were obliged to purchase the products from their national Yamaha subsidiary as well as supply solely to distributors appointed by the national subsidiary, both obligations restricting cross-border trade. The distributors where also obliged to contact Yamaha before exporting products over the Internet, even though no other restrictions on online sales were provided. Moreover, the agreements included territorial protection of warranties and restrictions of parallel trade in Iceland. Yamaha also had a market share over 30 %, which contributed in it failing to benefit from the VBER.[187]

3.2.1 Guarantees

Indirect export bans may also consist of agreements where the manufacturer provides that its guarantees only are available to the consumers in a Member State if they purchase the product from a distributor within the state. Since this would be a strong initiative not to buy the product elsewhere, the general proposition is that the same guarantees shall be available to customers regardless of where in the Union the product was bought.[188] In *ETA Fabriques d'Ebauches v. DK Investments SA*, the ECJ held that denial of the benefit of guarantees from goods imported from another Member State was an infringement of Article 101(1).[189] The court then continued with limiting the right to guarantees to service provided after local standards. Hence, if a product is sold in Germany to a customer in Sweden, the customer shall be satisfied with the standards of the Swedish service, would they be lower than the German ones. Further, the manufacturer has no obligation to guarantee products sold from unauthorised distributors, which is one way to protect selective distribution systems.

Part V - Internet distribution

To describe the ways that Internet has changed the conditions under which business is carried out can hardly be done. At the same time as creating enormous opportunities, the growing

[184] C-501/06 P para 59.
[185] Ibid para 63.
[186] Commission decision of 16 July 2003.
[187] Ibid para 168.
[188] Whish, R. *Competition Law* p 625.
[189] C-31/85 [1985] ECR 3933.

online markets have created troubles for legislators as well as market actors, by shrinking the world and completely change the possibility to control markets. Before discussing the matter of internet distribution more in detail, it is useful to shortly present how the EU has dealt with this new era in general.

1. E-Commerce in the EU

In October 2009, the commission released a communication on e-commerce in the EU.[190] The Communication puts forward two key consumer benefits with cross-border online shopping, namely lower prices and an increased range of products to choose from.[191] Cross-border online shopping increases the chance of finding cheaper offers since there is such a great variety of offers for the same products at the same time as it is easy for the customers to compare different offers.

In 2009 an EU-wide test of online shops showed a considerable potential for cross-border savings, even when the costs for encouraging of customers are taken into account.[192] In 13 of the 27 Member States testers were able to find at least one cross-border offer that was no less than 10% cheaper than the best domestic offer for more than half of the products.

Further, cross-border shopping makes it possible for customers to find products that are not distributed on the domestic online market.[193] This advantage is especially important for customers in smaller Member States.

When e-commerce within borders is clearly growing, the cross-border online shopping has not seen the same development. Between 2006 and 2008, the gap between domestic and cross border e-commerce got bigger rather than smaller, even if the European consumers clearly recognise the advantages of cross-border online shopping.[194] Hence, it is clear that the businesses do not fully agree on the potential of cross-border trade. Whereas 51% of EU retailers sell their products online, only 21% conduct sales across borders.[195] Most of those retailers trade just with one or two Member States and only 4% trade with 10 Member States or more.[196] Many online shops give different treatment to consumers from different territories and it is not unusual for customers to be hindered to register on the website or to pay for the products. Many websites also refuse to ship the products to the country of the consumer.[197]

Whereas the fragmented European market is strongly affected by the difference in rules on consumer protection, VAT, recycling fees and levies,[198] competition rules on vertical restraints have already made a large contribution with removing undue restrictions on e-commerce in distribution agreements. The vertical review starting in 2008 further explored

[190] *Communication from the Commission to the European Parliament, the Council, The European Economic and Social Committee and the Committee of the Regions on Cross-Border Business to Consumer e-Commerce in the EU*.

[191] Ibid para 1.

[192] Ibid paras 7 and 8.

[193] Ibid para 9.

[194] Ibid paras 4 and 5.

[195] Ibid para 6.

[196] Ibid.

[197] Ibid para 14.

[198] Ibid para 16.

whether or not within selective distribution networks manufacturers dissuade appointed dealers from use of the internet.

1.1 EU law on E-commerce

There are a number of different directives on how to regulate behaviour on the internet, such as the E-Commerce Directive[199], the Directive on the Protection of Consumers in respect of Distance Contracts[200], the EC Directive on Transborder Flows of Personal Data[201], the Directive on Privacy and Electronic Communications[202] (the Privacy Directive) and the Data Retention Directive[203]. The E-commerce Directive from 2000 seeks to ensure the free movement of '*information society services*' across the Union. Among other things, the Directive covers electronic contracts, the establishment of service providers, the liability of intermediaries, codes of conduct, court actions and out-of-court dispute settlements. It also states the terms for co-operation between Member States on these issues.

One very important function of the E-Commerce Directive is to solve the problem of uncertainty as to which national law shall apply. The Directive uses the principle of '*Country of Origin*', stating that the law shall be determined to be the one where the seller is based.[204] However, this rule does not apply to consumer transactions, where instead it is the law of the country from where the consumer purchases the product that is to be applied.[205] Hence, if a seller wants to reach out to consumers all over the EU, it must meet the requirements of the laws in each and every Member State. This basically means that the '*Country of Origin - principle*' applies to producers and wholesalers but not to retailers. It shall though be reminded that the laws of the Member States have been harmonized through numerous directives and this inconsistency shall therefore not create such a heavy burden.

General rules on private international law and the jurisdiction of courts still apply, such as the Brussels Convention, the Lugano Convention, the Brussels Regulation and the Rome Convention.

2. EU Competition Law on online distribution

Online trading creates special problems within distribution law since internet makes it possible for retailers to reach out to customers all around the world, far beyond the agreed territories, in ways that might be hard to control. It also increases the possibilities for counterfeiting and fraud.[206] The numerous ways in which manufacturers have tried to keep control of their distributors' online behaviour and the retailers' use of the Internet in ways not agreed upon has forced the legislators to start regulating the ways in which online distribution can be restricted. The issue was acknowledged in the Vertical Guidelines from 2000 and was

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[199] Directive 2000/31/EC, OJ [2000] L 178/1.
[200] Directive 97/7/EC, OJ [1997] L 144/19.
[201] Directive 1995/46/EC, OJ [1995] L 201/31.
[202] Directive 2002/58/EC, OJ [2002] L 201/37.
[203] Directive 2006/24/EC, OJ [2006] L 105/54.
[204] Directive 2000/31/EC on electronic commerce, recital 22.
[205] Ibid recital 55.
[206] See e.g. *Online Commerce Roundtable Report on Opportunities and barriers to online retailing,* paras 78-80.

in focus when the Guidelines and VBER were to be renewed. Generally, online sales are to be treated as offline sales and attempts by a supplier to discourage online selling by retailers are typically within the scope of Article 101(1).[207] Though, as will be seen, a few restrictions are allowed, especially regarding active sales and quality requirements.

2.1 The review of the old guidelines

When the Commission officially started its review the VBER and the Vertical Guidelines in the fall of 2008 the main issues were the application of the concepts of "active" and "passive" sales on the internet and the suppliers' ability to restrict online sales by distributors within exclusive and selective distribution systems. For selective distribution, the review explored whether the requirements used to select distributors can be justified on grounds of consumer welfare and whether or not such criteria will unduly limit online and cross-border transactions. The review also examined whether or not a manufacturer or supplier can prevent appointed dealers from using the internet.[208]

To ensure to find the most suitable solutions to the issues mentioned above, the Commission consulted the stakeholders. Their first big possibility to give the Commission their opinion on the matter was the *Consumer and industry Roundtable on Opportunities and barriers to online retailing and the European Single Market* in September 2008, where Commissioner Neelie Kroes invited several senior consumer and industry representatives to discuss the business opportunities created by the Internet and the existing barriers to increased online retailing in Europe. Before the meeting, the Commission sent out an Issues Paper, searching answers from undertakings regarding online distribution.[209] Overall, the outcome of the Roundtable discussions was hardly surprising: the representatives for luxury products, such as LVMH (Moët Hennessy Louis Vuitton) argued that selective criteria for online sales shall comply with the criteria for retailers with a physical pint of sales, since it is in the interest of both the businesses and the consumers to preserve brand image and prevent free riding.[210] EBay on the other hand, as a leading figure of the pro-internet lobby, wanted the Commission to consider all restrictions on online sales as hardcore restrictions within the VBER, leaving it for the supplier to prove that the criteria in Article 101(3) are fulfilled in each individual case.[211]

After considering the results of the Roundtable and Issues Paper, the Commission released a draft of the VBER[212] and the Guidelines[213] giving a final possibility for interested companies, authorities and organisations to influence the new rules. When reading the submissions it is

[207] See e.g. Dean M. J. *International distribution – Overview of relevant distribution laws: Europe*, p 15 referring to the Commission's decision in *B&W Loudspeakers.*
[208] *Communication from the Commission to the European Parliament, the Council, The European Economic and Social Committee and the Committee of the Regions on Cross-Border Business to Consumer e-Commerce in the EU*, para 43.
[209] *Opportunities in online goods and services: Issues Paper*, http://ec.europa.eu/competition/consultations/2008_online_commerce/online_issues_paper_annex.pdf
The Issues Paper was sent to both the member of the Roundtable discussion, as well as other third parties.
[210] *Online Commerce Roundtable Report on Opportunities and barriers to online retailing*, para 77.
[211] See eBay, Contribution to *Opportunities in Online Goods and Services: Public Consultation on the Issues Paper*, p 4.
[212] Draft Commission Regulation (EC) on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices, Brussels, C(2009) 5365/3.
[213] Draft Commission Notice, Guidelines on Vertical Restraints, Brussels, SEC(2009) 946/3.

clear that the promoters for selective distribution were more satisfied with the drafts than was the pro-internet lobby.

LVMH welcomed the maintenance of the suppliers' freedom to choose its own distribution model[214] and stated that selective distribution is at the heart of the business model for the luxury goods industry.[215] It put forward four consumer benefits from selective distribution: service, experience, choice and protection[216] and reminded that the system of selective distribution has proved to be efficient during the last VBER and therefore shall not be eliminated or put at risk.[217] While recognizing how e-commerce offers new opportunities for luxury brands by being a complement to brick and mortar shops, it clearly stated that online sales must be regulated not to weaken the viability of the physical network. Pure players, that is, retailers selling exclusively online, may be willing to comply with the criteria for online sales and therefore argue that they should have the right to sell the products online. LVMH pointed out that this will make it difficult for the other distributors to get a fair share of the online market. The pure players are experts on the internet market and have also got the possibility to invest the money on online marketing instead of investing in brick and mortar shops. Since the pure players can keep their prices far below those in the physical shops, it would lead to the customers choosing the products in the brick and mortar shops to then purchase them online.[218] This would not only be devastating for the authorised offline distributors, but also for the whole industry, since it would lead to the disappearance of the very sought for physical shops.

LVMH also stated that quality criteria and standards must be determined according to the means of the distribution channel. Priority should be given to those who manage high-quality internet sites for online sales of luxury brands, but the vast majority of consumers still require a connection to a network of physical shops.[219]

On the opposite side of LVMH, eBay continued to argue that all restrictions on online sales shall be considered as hardcore and therefore not be covered by the VBER at all.[220] Since the distributor often is in a weaker position vis-a-vis its supplier, it shall be for the supplier to prove that the restriction shall be exempted by Article 101(3).[221]

Although aiming to protect small businesses, eBay mainly argued from a consumer perspective, claiming that some of the Commissions choices are inconsistent with competition and consumer choice.[222] The company criticised the right for the supplier to stop pure players by requiring its distributors to have at least one or more brick and mortar shops, claiming that such a requirement has no qualitative benefits.[223] According to eBay, consumer satisfaction is

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[214] LVMH, *Submission Concerning the review of the Community competition rules applicable to vertical restraints*, para 16.
[215] Ibid para 5.
[216] LVMH, *Submission Concerning the review of the Community competition rules applicable to vertical restraints,* para 2.
[217] Ibid para 14.
[218] Ibid para 11.
[219] Ibid para 2.
[220] eBay, *Response to the Public Consultation on the European Commission's Review of the Vertical Restraints Regulation and Guidelines* p 15.
[221] Ibid p 15.
[222] Ibid p 1.
[223] Ibid.

higher for online sales than for sales in brick and mortar shops, which makes the latter unnecessary in the sales of most products.

Regarding selective distribution, eBay argued for a cautious treatment that only allows such systems where they are necessary, rather than the systematic approach that has ruled the last decade.[224] EBay's attempts to change the quite supplier friendly line of the Commission did not succeed and most of the drafted rules were kept.

2.2 Current VBER and Guidelines regarding online sales

The main view in the VBER and the Guidelines is that online sales should be restricted in a way equivalent to the treatment of offline sales.[225] Since all distributors shall be free to use the internet to reach a great variety of end users, any restrictions that are not equivalent to the criteria imposed for the sales from the brick and mortar shop are considered hardcore restrictions and will exclude the whole agreement from benefitting from the VBER. That the restrictions must be equivalent does not mean that they have to be identical, but rather that they should aim for the same purpose and achieve comparable results and that any differences in the requirements must be justified by the differences in the nature of the sales methods.[226] The Guidelines provide that it is possible to have stricter rules on how many items can be sold to the same end user online than offline where it is easier for unauthorised dealers to obtain the products in question over the internet.[227] Where it instead is easier to obtain the products from a brick and mortar shop, the supplier may have stricter restrictions on such sales. Further it is allowed for a distributor to demand faster delivery times for offline sales, where it often is possible to deliver directly unlike for online sales. The after sales costs may also differ, due to requirements on online after-sales services and for the appliance of secure payment systems.[228] The VBER exempts selective distribution agreements regardless of the nature of the product and of the selection criteria.[229] Though, where an agreement include provisions that are not required by the nature of the product in question, the VBER is likely to be withdrawn, since the system does not bring about sufficient pro-competitive effects to counterbalance the a substantial loss of intra-brand competition.[230]

2.2.1 The principle of 'Brick and Click'

The supplier has the right to require that a distributor has at least one brick and mortar shop.[231] As with other demands, such requirements will only be lawful when the product in question is of such nature that it requires a physical outlet.[232] As has been said above, the decision of mentioning this right in the paragraph and thereby create an assumption that it is a lawful demand, has been applauded by the luxury industry and criticised by the pro-internet lobby.

[224] eBay, *Response to the Public Consultation on the European Commission's Review of the Vertical Restraints Regulation and Guidelines* p 9 f.
[225] Vertical Guidelines para 56.
[226] Ibid.
[227] Vertical Guidelines para 56.
[228] Ibid.
[229] Ibid para 176.
[230] Ibid.
[231] Ibid para 54.
[232] Ibid para 176.

The American Bar Association have raised concerns regarding the right of a distributor which has one brick and mortar shop in one Member State to sell both actively and passively to authorised distributors and end users all over the Union via the Internet.[233] The Association suggested that it should be allowed for suppliers to restrict the territory in which the distributor may conduct online selling. Although a good reminder for suppliers, the suggestion fails to take into consideration the aim for market integration which is one of the fundaments of the European Competition Law, which shows the difference in the view of the role of Competition Law in the EU and the US.

There are not many cases to be found regarding this issue, but a French case concerned the right of a pure online distributor to gain access to the selective distribution network of a watch manufacturer (*Festina*).[234] The French competition authority accepted commitments from Festina to amend its distribution agreement to introduce the possibility for current and future distributors to sell over the internet. The authority agreed to let Festina refuse to extend its network to companies selling exclusively over the internet and thus allowing it to require that its distributors have at least one Brick and Mortar shop.

2.2.2 Restraints considered hardcore

Article 4(c) VBER provides that the restriction of both active and passive sales to end users by members of a selective distribution system operating at the retail level of trade is considered a hardcore restraint. It is considered necessary that the dealers within a selective distribution system shall be free to sell, both actively and passively, offline or on the Internet, to all end users.[235]

2.2.2.a Active and passive sales online

The Guidelines clearly state that every distributor must be free to use the internet for the sales and advertising of products.[236] Having a website that is accessible to all without targeting certain customers is not considered as active sales making and where a selling is the result of a customer visiting the distributor's website and then contacting the distributor himself, it is a matter of passive selling which cannot be restricted by the supplier, even in case of exclusive distribution. The distributor is allowed both to accept and to carry out the request.[237] The supplier may not oblige the distributor to guarantee that transactions are to be cancelled when credit card addresses reveal the purchaser to be located in another territory.[238] Further, the supplier may not require that the distributor prevent customers located in another territory to view its website. Neither may he demand that the distributor automatically reroute customers to other distributors or to the manufacturer's website. However, the supplier may require that the distributor, on its website, offer links to websites of other distributors and/or the supplier.

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[233] *Joint comments of the American Bar Association Section of Antitrust Law and Section of International Law on The proposal of the European Commission for a revised Block ExemptionRregulation and Guidelines on supply and distribution agreements* p 16 f.

[234] Conseil de la Concurrence, Decision 06-D-24 of 24 July 2006.

[235] Guidelines para 56.

[236] Vertical guidelines para 52.

[237] Ibid para 51 sec 3.

[238] Ibid para 52(b).

On the other hand, when a distributor's website is specifically targeted at another distributor's customers, for example through links put in pages exclusively available for those customers, this is normally seen as active selling.[239] The same applies when the distributor e-mails one or several customers directly. Restrictions on active selling into other territories are allowed in exclusive distribution agreements; however, a supplier may not stop the members from its selective distribution system to actively sell to end users, or to one another, whether or not on different levels of the distribution chain.[240]

2.2.2.b Limit the proportion of sales made online

The supplier may not force the distributor to limit the proportion of sales made online.[241] Though, it shall be possible for a supplier to require an absolute amount of sales to be made offline, so that the supplier can be sure that customers who wish may see the products nicely presented in real life. [242] The supplier may require different amounts of offline sales from different distributors, as long as the decision are based on objective criteria, e.g. geographic location or the size of the part the distributor play in the supplier's distribution network. The rule has been criticised for hindering the supplier to protect those distributors who make really high investments in their Brick and Mortar shops. [243] It has also been questioned whether it is justified to prohibit a supplier of an experience product with a small market share from demanding that the consumers shall have a possibility to have direct contact with the product before purchasing.[244] Further, it has been argued that the Guidelines contradict themselves in allowing a supplier to require its distributors to have at least one physical sales point, but then restricting the extent to which this possibility may efficiently be used. It would be in line with this rule to allow the suppliers to require a minimum percentage of sales to be made offline.[245]

The Guidelines do not give any guidance on how the certain amount shall be calculated. The lack of such guidance has been acknowledged by the American Bar Association, asking the Commission to clarify the amount or value of sales that may be restricted within the safe harbour of the VBER.[246]

It seems natural that a supplier, when deciding which amount to be required, would look at the numbers from the last year's sales of the distributor and then require that an amount equal to a certain percentage of those sales to be traded in a Brick and Mortar shop. It also makes sense that the Commission would look at last year's sales when assessing whether an agreed amount is too high. Though, it remains to be seen if this really will be the case, as well as what amounts will be accepted.

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[239] Vertical Guidelines para 51, Van Bael & Bellis, *Competition Law of the European Community,* p 199.
[240] Vertical Guidelines para 176.
[241] Ibid para 52(c).
[242] Ibid. The amount can be either in value or volume.
[243] Baker & McKenzie, *Vertical Restraints - Response to Consultation*, para 6.4.
[244] See the American Chamber of Commerce to the EU response to the public consultation, *Response to the European Commission's Consultation on the Review of the Vertical Restraints Block Exemption Regulation and Guidelines,* p 8.
[245] A S Watson Europe - *Response to the Commission's review of the Block Exemption Regulation and Guidelines on vertical Restraints,* p 8 f.
[246] *Joint comments of the American Bar Association Section of Antitrust Law and Section of International Law on The proposal of the European Commission for a revised Block ExemptionRregulation and Guidelines on supply and distribution agreements,* p 13.

In 2003 a case was brought to the Federal Supreme Court in Germany, regarding restriction on online sales.[247] A perfume manufacturer reserved the right to terminate its distribution agreements when the distributor sold a certain percentage of all sales online, or when the total online sales exceeded the sales in the Brick and Mortar shops. The Federal Supreme Court accepted the clause, stressing that it is for the manufacturer to protect its distribution channels that might have a negative effect on the branded products aura of exclusivity. The limit on 50% was considered reasonable (german: *angemessen*). The ruling is yet to be confirmed since it is the only case that has been brought to the Federal Supreme Court on this matter.

As can be seen, the case is not in compliance with the current Vertical Guidelines, which do not allow percentage restrictions on online sales, but only minimum requirements for offline sales. However it is interesting not only that the Court granted a limitation based on percentage of sales, but also that such a high requirement of offline sales was accepted.

2.2.2.c Demand higher prices for products intended to be resold online

A supplier may not require higher prices for products intended to be resold online. However, a fixed fee can be agreed to support the offline or online sales efforts.[248] The fee has to be based on differentials in costs between the different distribution models and may not vary depending on offline turnover, since this would constitute an indirect form of dual pricing. This solution has been criticised for making '*no commercial sense'* since it will be hard for the supplier to regain the investment if it cannot be connected to the actual sales.[249] It has also been criticised for failing to consider the fact that different distribution methods often have different sales costs per unit.[250] Further, The American Chamber of Commerce to the EU has stated that the rule constitutes a potential heavy administrative burden on suppliers, which normally do not have efficient information about the costs of their distributors.[251] The Chamber argues that a supplier with marginal market power should be free to demand different prices for products sold through different channels as long as this behaviour does not effectively prevent online sales.

2.2.3 The right to go online

Another question is whether a distributor wishing to start selling products online needs to ask for permission from the supplier if their agreement does not touch upon this issue. Considering that the Guidelines state that each distributor shall have the right to use internet for sales and advertisement, the answer should be negative. However, it is not entirely clear and the issue has been addressed on both EU- and national level.

The French case *Pierre Fabre Dermo-Cosmetique SA v Alain Breckler*[252]from 1999 concerned a ban on online sales of cosmetics. The selective distribution agreement between Pierre Fabre and Breckler made no reference to online sales and when Pierre Fabre found out

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[247] KZR 2/02. Decision of the Federal Supreme Court of 4 November 2003.
[248] Vertical Guidelines para 52(d).
[249] Baker McKenzie, *Vertical Restraints - Response to Consultation,* para 6.13.
[250] Clark, E. Hughes, M. and Waelbroeck, D. *Selective Distribution and Luxury Goods: The Challenge of the Internet?* p 6.
[251] American Chamber of Commerce to the EU, *Response to the European Commission's Consultation on the Review of the Vertical Restraints Block Exemption Regulation and Guidelines,* p 8.
[252] Tribunal de Commerce, Pontoise, 15 April 1999.

that Breckler was selling its products on the internet, it asked the court to order Breckler to cease with this conduct. The Tribunal did not consider itself in the power to do so. Instead it held that restrictions on sales in distribution agreements are to be interpreted strictly and that no ban could be implied in the absence of a mentioned restriction. The online selling was considered a new marketing method, and could therefore not be stopped by the Tribunal.

On the other hand, in EU Law it seems to be possible to agree that a distributor must ask for permission before starting to sell the products online. Back in 2002, when agreements still could be cleared by the Commission, *B&W Loudspeakers Ltd* got clearance for its distribution agreements on the condition that it removed the outright ban on online sales.[253] It should be possible for retailers to request permission from B&W to undertake distance selling, including on the internet. B&W could refuse such requests only in writing and based on criteria regarding the maintenance of the brand image and the reputation of the contracted products. The criteria had to be comparable to the criteria for offline sales and had to be applied indiscriminately. Even though this decision was based on the old rules, nothing in the new Guidelines implies that there has been a change.

3. Online Auction Platforms

The purpose of online auction platforms is to connect buyers and sellers and acting as an intermediary for third party buying and selling. By acting as an intermediary, the platform aims to provide a safe framework for online trade. Today there are a large number of different platforms, connection millions of people on a daily basis and there is no doubt that online auction platforms are important factors in the market for online sales and also for the overall businesses. The growing trade on online auction platforms has created problems for suppliers selling through selective distribution systems. Even if a supplier may keep its own system closed and effective so that no unauthorised resellers get their hand on the products, they may still end up on such a platform at a later stage since a supplier cannot control the behaviour of its distributors' customers. Question arises whether this could be harmful for the brand. In its contribution to the new VBER and Guidelines, eBay argued that the shops on eBay are just as good as other online stores.[254] LVMH on the other hand showed a survey where 65% of the customers considered it harmful for luxury brands to be sold on such platforms. [255]

EBay had commissioned a survey showing that platforms such as improve consumer welfare in many different ways, especially through price savings.[256] According to this, costumers in the UK, Germany and France can save about 17% by purchasing new products, such as computers, electronics and clothing on eBay rather than in an offline store.[257] The total

[253] Dean, M. J. *International distribution — overview of relevant distribution laws: Europe*, p 15.

[254] eBay, *Response to the Public Consultation on the European Commission's Review of the Vertical Restraints Regulation and Guidelines* p 17, see also Dean, M. J. *International distribution — overview of relevant distribution laws: Europe*, Annex 3.

[255] LVMH, *Submission Concerning the review of the Community competition rules applicable to vertical restraints*, p 4.

[256] eBay, *Response to the Public Consultation on the European Commission's Review of the Vertical Restraints Regulation and Guidelines* p 17. Referring to Frontier Economics, *Economic study of the consumer benefits of eBay, A Report Prepared For eBay,* September 2008, http://ec.europa.eu/competition/sectors/media/ebay_frontier_report.pdf, pp 12-19.

[257] Frontier Economics, *Economic study of the consumer benefits of eBay, A Report Prepared For eBay* p 19.

savings of European users on the eBay platform are an estimated EUR 1.1 billion per annum for new products.[258]

By providing the consumers with extensive listings from local, national and international sellers, eBay argued that it gives the consumers' search and transaction costs. The company also stated that online auction platforms impede trade between Member States by connecting trading partners from different locations within the European Union.

3.1 Counterfeit and fraud

A big problem with online trading platforms is that they constitute a heavenly market place for the trading of counterfeited goods. This was discussed at the *Online Roundtable Discussion*, where eBay made it clear that they are well aware of the problem and that they are working hard to prevent such conduct.[259]

3.2 EU Competition Law on Online Auction Platforms

According to the current Guidelines, a supplier has the right to prevent its distributors from selling the products on third party platforms, where such platforms do not comply with the standards in the distribution agreement.[260] The supplier may also impose certain conditions for the use of third party platforms. For example, a distributor which homepage is hosted by a third party platform may be required to guarantee that customers do not *'visit the distributor's website through a site carrying the name or logo of the third party platform.'*[261] Given this wording, it is possible for a supplier to prevent a retailer from selling the contracted products on an eBay store, or to require certain conditions on which the retailer can use such store for the distribution of the goods.

There are no cases in EU Law addressing the issue, although two German cases from 2009 can give some guidance on the matter. They are overall in compliance with the new rules, but suggest a higher protection of the suppliers' rights to restrict the online behaviour of its distributors.

In *Scout*[262], a manufacturer of popular satchels and backpacks had seized to supply a retailer who had distributed those products via eBay. Such sales did not meet the quality requirements set out in the selective distribution agreement between the manufacturer and the retailer, why the supplier seized to supply the retailer who then asked the court to order a continuance of the supply. The Higher Regional Court of Karlsruhe (OLG Karlsruhe), declined to impose a duty to supply, stating that a prohibition on online auction sales does not constitute a restriction of competition, when within a permissible selective distribution system. Such a prohibition was to be considered analogous to quality requirements regarding minimum standards on Brick and Mortar outlets and the Court therefore found it unnecessary to examine whether an exemption could be made pursuant to the VBER or Article 101(3) TFEU. The Court then went even further by saying that the same principle would apply to non luxury

[258] Frontier Economics, *Economic study of the consumer benefits of eBay, A Report Prepared For eBay* p 21.
[259] *Online Commerce Roundtable Report on Opportunities and barriers to online retailing* paras 78-80.
[260] Vertical Guidelines para 54.
[261] Ibid.
[262] Decision of the Higher Regional Court of Karlsruhe of 25 November 2009.

products, especially to branded goods that manufacturers consider as top-of-the range products. This consideration shall be based on the objective characteristics of the products and be of qualitative art, for example aim to present the products in an adequate way or to provide competent advice. In its ruling, the Court rejected the view from the Regional Court in Berlin, which in a similar case suggested that an overall prohibition of distribution through eBay was illegitimate.

The decision of the OLG Karlsruhe is in compliance with the decision of the Higher Regional Court of Munich (OLG Munich) of 2 July 2009[263], where the Court allowed *Amer*, a manufacturer of sports products to prohibit its distributors to resell its products through auction websites. The German Association against Unfair Competition had sued *Amer* claiming that *Amer*'s prohibition on direct or indirect resale through auction websites was against the law. Notable in this case is that *Amer's* distributors were not part of a selective distribution network. As *Amer* had a market share below 30%, the case would be exempted by the VBER and OLG Munich did not examine whether such a restriction would be an infringement of Article 101(1). The Court held that a prohibition on online auction sales does not constitute a customer restriction pursuant to Article 4(b) of the VBER, since online auction buyers do not constitute a separate group of customers within the group of internet buyers. Instead the Court stated that a resell prohibition through auction websites was simply a quality requirement related to Internet sales and not to be considered a hardcore restriction within the meaning of the VBER.

The Court further declared that it is lawful for *Amer* to prevent its distributors from indirect sales through auction websites, that is, prohibit its distributors from reselling to retailers who would sell the products on such websites. The allowance of indirect bans and the fact that *Amer*'s distributors were not part of a selective distribution system shows that the Court opens for a soft approach towards restrictions on certain forms of Internet sales. It remains to be seen which approach the Community Courts will take on the issue.

4. Free-riding online

It seems as though the Commission has the view that online distributors are more likely to free-ride on offline distributors than vice versa.[264] Even if this paper is not a study in either business- or customer behaviour, this is an assumption that has to be questioned when analysing the new rules on online distribution. Chevalier holds that the free-riding issue goes both ways[265] and eBay argued in its submission to the new Guidelines that the assumption that online retailers would free-ride on retailers with physical outlets is '*simply unsubstantiated'*.[266]

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[263] Decision of the Higher Regional Court of Munich of 2 July 2009.
[264] See e.g. Vertical Guidelines para 52(c).
[265] Chevalier, J. A. *Free Rider Issues and internet Retailing*, p 2.
[266] eBay, *Response to the Public Consultation on the European Commission's Review of the Vertical Restraints Regulation and Guidelines,* p 6.

It is not under dispute that the maintenance of a high standard Brick and Mortar shop with good location and service requires significant investments. However, it is also clear that it is hard to run an online shop where customers actually want to buy products, since the alternatives are only a couple of mouse clicks away. Online it is easy for the customers not only to gather retailers selling the product sought for and show the different pricings, but also to gain information about the services provided in the shops, thanks to previous customer ratings.

Although many customers try out products in a Brick and Mortar shop to later purchase them online for a lower price, certain customer groups are more likely to sit at home and compare products on online shops before they purchase the items in a brick and mortar shop.[267] On the Internet they can read not only about the characteristics of the products, but also what experts and other customers think about it. After making such a comparison many customers then choose one, two or more products to see in real life in a suitable physical sales point. The staff in the shop then is in a quite pleasant position where they just have to welcome the already informed customer and show the product(s) asked for before assisting in the purchase. Though, many customers are likely to then return and purchase the product online, whereas others still prefer buying a product and being able to bring it home instead of waiting for a package to be delivered.

This said, it seems more likely that online retailers would free-ride on offline retailers than vice versa. The possibility for the supplier to require its distributors to have at least one Brick and Mortar shop and to require certain amount to be sold offline is therefore rational. However, it may vary depending on the circumstances and it is good that the Guidelines do open up for the possibility that online sales may require more investments[268] and thereby acknowledge the work that online distributors will have to do, especially considering that all restraints shall be proportional and required by the nature of the products in question.

4.1 Alternatives to Selective Distribution

Selective distribution, together with other vertical restraints, has for long been regarded as a solver of the free-riding problem, making it one of the most important justifications for the adoption of such systems. The pro-internet lobby questions the importance of selective distribution and stresses that there are several other ways that the problem with free riding may be solved.[269] The issue has been acknowledged in the Vertical Guidelines, where the Commission states that it should be ensured that the least anti-competitive restraint shall be used to solve a certain problem.[270] Another restraint should be used if it would solve the problem *to a comparative cost*. As an example, instant service requirements are mentioned.

[267] See e.g. Fiats input in *Online Commerce Roundtable Report on Opportunities and barriers to online retailing,* para 70, where it states that it is observed that customers use the internet to gather information on the cars, but tend to purchase the cars offline. See also Chevalier, J. A. *Free Rider Issues and internet Retailing*, p 2 f.
[268] See e.g. regarding the possibilities to impose a fixed fee for sales effort on- or offline, Vertical Guidelines para 52(d).
[269] See Kinsella S, Melin H, and Schropp S, *Comment on the CRA paper entitled "An Economic Analysis of the Use of Selective Distribution by Luxury Goods Suppliers* p 244 f.
[270] Vertical Guidelines para 186.

The pro-internet lobby has put forward a few different alternatives. First of all, it argues that the problem could be solved through “incentive contracts” where online retailers face higher wholesale charges than Brick and Mortar retailers, to compensate the latter for their investments in facilities and services.[271] One way of doing this is to let the wholesale price vary depending on effective sales, so that the retailers will have incentives to invest in appropriate services and protection of the supplier’s brand image. It could further be solved through supporting payments from the supplier, to give incentives to marketing efforts.

Other alternatives put forward are specific payment schemes, franchising and direct supplier investments.[272] These alternatives can be used by the supplier to create effective incentives for the distributors to offer an optimal level of service to the customers without using vertical restrictions such as selective distribution.

Part VI - Conclusion

In the introductory part of this thesis I asked the following questions.

- What interests are protected in the new VBER and Vertical Guidelines? Is market integration in focus or are they inspired by a more economical approach?
- Are the rules foremost protecting the freedom of the supplier to choose in which way to distribute its goods, or are they more concerned with consumer welfare?
- What changes are made regarding selective distribution?
- Has the Commission succeeded in its aim to clarify the rules on online sales?
- Has legal certainty got lost in the aim for flexibility and the effect based approach?

To start with, the new VBER and Guidelines can hardly be called revolutionary. In lack of clear judgments from the Community Courts on the old rules, the Commission has more than anything else tried to find a way of translating the rules on offline distribution to online sales. The Commission continues towards a more economic approach, but is clearly influenced with the Single Market Imperative, which can be seen in the tough treatment of restraints hindering parallel trade and the protection of differential price settings on markets within the European Union. Regarding the interest of the suppliers, it was clear already in the consultation process that the promoters for suppliers’ right to impose selective distribution systems were far more positive than the pro-internet lobby. Even if the latter claimed to act in the interest of the consumers, it is important to distinguish between short-term and long-term consumer benefits; the investments from the manufacturers and distributors must be protected in order to keep a wide range of products for the consumers to choose from in the future. It is therefore not accurate to say that rules that are beneficial for the suppliers necessarily are harmful for consumers.

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[271] Kinsella S., Melin H., and Schropp S. *Comment on the CRA paper entitled "An Economic Analysis of the Use of Selective Distribution by Luxury Goods Suppliers,* p 245.
[272] Ibid.

1. Changes regarding selective distribution

Apart from the rules on online distribution, the only real difference regarding selective distribution is that the supplier now only may restrict members of a selective distribution system from selling to unauthorised distributors within the territory reserved by the supplier to operate the system. Luckily, the wording from the drafted Guidelines was changed to clarify that authorised distributors do not have the right to sell the products to unauthorised dealers in territories where the supplier is yet to put the product on the market.

The new provision makes it difficult for suppliers to impose different distribution systems in different parts of the European Union. It will be hard for a supplier which applies a selective distribution system in some, but not all, EU markets to prevent distributors in markets without such system from reselling the products to unauthorised distributors in markets where a selective distribution system is adopted. The new rule creates problems that may put whole selective distribution systems at risk. It might lead to an extended use of selective distribution systems, even on markets where other alternatives are at hand, which does not correspond to the statement in the Vertical Guidelines that the least anti-competitive restraint shall be used to solve a certain problem.

One short term solution should be for the supplier to require its authorised distributors to purchase the contracted products either from the supplier itself or from each other. Such non-compete clauses are exempted by the VBER as long as the contracting parties are within the 30 % market threshold and the requirements are limited to maximum five years[273] and may be combined with selective distribution.[274] However, this is not a solution to be relied upon in the long term; more lasting solutions need to be found.

2. Do the new rules clarify the issue with online distribution?

The Commission has only partly succeeded in clarifying the issue with online distribution. The definitions of “active” and “passive” sales are quite clear and useful. However, regarding the restrictions more directly connected to selective distribution, quite a few question marks still remain.

The supplier may not force the distributor to limit the proportion of sales made online. Though, it shall be possible for a supplier to require an absolute amount of sales to be made offline. The Guidelines do not give any directions on how the certain amount shall be calculated. It seems natural that a supplier, when deciding which amount to be required, would look at the numbers from the last year’s sales of the distributor and then require that an amount equal to a certain percentage of those sales to be traded in a brick and mortar shop. It also makes sense that the Commission would look at the percentage of last year’s sales when assessing whether an agreed amount is too high. Though, it remains to be seen if this really will be the case, as well as what requirements will be accepted.
It is regretful that the Commission has set out such a rule without any further guidance, although the possibility to set certain thresholds disappears together with the rule itself. It

[273] Vertical Guidelines para 131.
[274] Ibid para 176.

would not be efficient to mention certain amounts or values in the Guidelines. At the same time; to mention a threshold concerning percentage of sales would go straight against the rule. The rule is likely to create uncertainties and it will also be difficult to interpret future decision and judgments without connecting the set amount with percentage of sales or turnover.

Considering that the Guidelines state that each distributor shall have the right to use internet for sales and advertisement, a distributor should not have to ask for permission of the supplier in order to start distributing online. However, since the Commission itself has accepted agreements where the supplier had the right to deny distributors the right to go online, a clarification on the matter would have been eligible. The absence of such clarification might be based on an unwillingness to make a decision on the matter. It must though be assumed that suppliers generally cannot stop their distributors from online sales, considering that it is not accepted to limit the proportion of sales made online.

The fact that a supplier may not require higher prices for products intended to be resold online, but may impose a fixed fee to support the offline or online sales efforts is a clear attempt to strengthen online distribution. Since products sold in brick and mortar shops normally have a higher price per unit, many distributors will only make such efforts to the extent it will be profitable and often not exceeding what they are the required to according to the contract. At the same time the supplier will only pay such fees to the extent the investment will result in upstream profits. If it is not possible to base the fees on actual turnover it should be possible to connect them to the minimum amount having to be resold offline. However, the Guidelines have not made such a connection and it remains to be seen if it is going to be a convergence between the two in the future appliance of the rules.

3. Legal certainty

The effect based approach is positive in its flexibility and creates the possibility for the new rules to survive another decade of technical development. However it might be hard for the market actors to foresee the effects their agreements may have on competition. The VBER creates a safe harbour for the agreements covered by it and in many cases the rules are clear and easy to apply. Though, as stated above, a few uncertainties remain. Furthermore, the possibility to withdraw the benefit of VBER even if the agreement as such does not create the anti-competitive effect, creates additional uncertainty and puts high requirements for undertakings to have knowledge of the rest of the market. At the same time it might be essential for the Commission and the Community Courts to take the whole market situation into account to ensure an undistorted competition, why a definite exemption is not an alternative.

4. The future

It seems as though the Commission has tried hard to balance the different interests against each other when constructing the new Vertical Block Exemption Regulation and accompanying Guidelines. When searching to keep the economic approach presented in year 2000, it is still clear that the Commission has been strongly influenced aim for a single

market. The new rules offer good possibilities for distributors operating both on- and offline, whilst strengthening the suppliers' position against pure internet retailers. It remains to be seen if this is a way of baby stepping into the e-society or if the approach will survive another ten years of technical development. The future of EU Competition Law is now in the hands on the Community Courts, which have an important role in implementing and applying the new rules to clarify the remaining uncertainties.

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