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I. INTRODUCTION

On April 20, 2010, The European Commission adopted a new Block Exemption Regulation ("BER") on vertical restraints[2] and its supplementary Guidelines.[3] They replace the corresponding texts[4] that dated back from 1999 and provide a new framework for analyzing distribution agreements for the next twelve years.

The main novelty of the BER lies in its Article 3, which narrows the "safe harbour" by taking into account buyer power. In addition to the incumbent 30 percent market share threshold for manufacturers, it introduces a new threshold that applies to distributors, and which is measured on the upstream market. This will induce a more detailed analysis at national or local levels and provide more refined tools to national competition authorities ("NCAs").

But this should not eclipse two major updates of the Guidelines in which NCAs' experience and decisional practice were important contributors and which will significantly affect future enforcement, i.e. hardcore restrictions (I) and online sales (II).

II. HARDCORE RESTRICTIONS AND EFFICIENCY CLAIMS

The Commission launched the debate on the modernization of the approach to vertical agreements a few months after the Supreme Court of the United States reversed the 1911 *Dr. Miles* doctrine[5] and ruled that retail price maintenance ("RPM") should, as are all other clauses of distribution agreements, be analyzed through the rule of reason.[6] This shift away from a *per se* rule has had concrete consequences: The burden of proof of actual or likely harmful effects of retail price maintenance has been transferred onto claimants, including antitrust enforcement agencies.

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[2] Commission Regulation N. (EU) 330/2010 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 N L102/1 of 23 April 2010.

[3] Commission notice, Guidelines on Vertical Restraints, C(2010) 2365, OJ C 130 of 19 May 2010.

[4] Commission's Regulation (EC) N. 2790/99 of 22 December 1999 regarding the application of Article 81, paragraph 3, of the EC Treaty to categories of vertical agreements and concerted practices, OJ N L 336 of 29 December 1999, and Communication N. 2000/C 291/01 of 13 October 2000 relative to guidelines on vertical restraints, OJ N. C 291 of 13 October 2000.

[5] Supreme Court of the United States, Dr. Miles Medical v. John D. Park and Sons, 220 U.S. 373 (1911).

[6] Supreme Court of the United States, Leegin Creative Products, Inc v PSKS, Inc, 551 U.S. 877 (2007).

This upheaval has stirred much debate in the United States and in the OECD,[7] but it reached particular intensity in the European Union on the eve of the modernization of the BER. From part of the legal community's point of view, the conditions in the EU stood in sharp contrast with the relaxation of antitrust rules that had occurred overseas.

Indeed, as they stood, the Guidelines did not reflect the latest academic studies that had probed into theories of harm and efficiencies. Moreover, the last sentence of paragraph 46 of the former Guidelines, which provided that "Individual exemption of vertical agreements containing [such] hardcore restrictions is also unlikely," did not encourage NCAs and undertakings from discussing efficiency gains in enough detail. This situation may have given the impression that hardcore restrictions were handled in practice as if they had been prohibited *per se*, although the stipulations of Article 81 of the EC Treaty[8] give sufficient leeway for measuring efficiency gains and checking whether they outweigh the harmful effects of practices, even if those are qualified as hardcore restrictions.

In this context, the *Conseil de la concurrence* (which was transformed into the *Autorité de la concurrence* in 2009) had very few opportunities to adjudicate cases where parties put forward efficiency claims in order to rebut the qualification of a hardcore restriction. For instance, in two cases, on the distribution of toys[9] and skin-care cosmetics,[10] it carefully assessed hardcore restrictions under Article 81(3) of the EC Treaty but did not grant individual exemption as the claims were not substantiated enough and there were no indications that the alleged gains would be somehow passed on to consumers.

If EU enforcers agreed that there needed to be a drive towards a more effects-based approach, there were then two theoretical options:

1. The first was to draw inspiration from the U.S. approach. As Article 101 TFEU did not allow the EU to take on the "rule of reason," this would have led to discarding the notion of hardcore restriction—or, at least, to suppressing RPM from Article 4 of the BER—and to switch towards a more effects-based case-by-case analysis. But the new approach had not been tested yet and, indeed, is still trying to find its way in the United States where a debate is taking place, not only among judges and enforcers[11] but also in Congress.

2. The second option was more balanced. It was twofold: it consisted in taking full advantage of the flexibility offered by the EU Treaty, while renewing the narrative on the pro- and anti-competitive effects of hardcore restrictions in the new Guidelines, so as to balance them better.

For the *Autorité*, there were strong reasons for advocating an incremental approach in the modernization rather than choosing the first option, including motives drawn from its experience

[7] The acts of the OECD policy roundtable on retail price maintenance of October 2008 are available at http://www.oecd.org/dataoecd/39/63/43835526.pdf.

[8] Now Article 101of the TFEU, which content is identical.

[9] *Conseil de la concurrence*, decision N 07-D-50 of 20 December 2007 relative to practices in the sector of toys distribution.

[10] *Conseil de la concurrence*, decision N 08-D-25 of 29 October 2008 relative to practices in the sector of skin-care cosmetics (appeal pending).

[11] For instance, Christine Varney, Assistant Attorney General of U.S. Department of Justice, suggested building a "structured rule of reason," in *Antitrust Federalism: Enhancing Federal/State Cooperation*, Remarks as Prepared for the National Association of Attorneys General (October 7, 2009)

of supplier-driven RPM cases along with compelling policy reasons such as the need for legal certainty. The *Autorité* adjudicated two cases where those practices caused significant harm to consumers. In the calculators case in 2003[12] it found that the average retail price of standard calculators had increased by 16.3 percent between 1992 and 1995, while the prices of other products not subject to RPM practices decreased. Another example is the aforementioned 2007 toys case where manufacturers colluded with distributors during the Christmas season, during which 60 percent of their toys' turnover was realized. The *Autorité* consequently recommended maintaining Article 4 of the BER as it stood.[13] Nonetheless, the *Autorité* advocated, even before the landmark Court of Justice judgment in *GlaxoSmithKline*,[14] revising the Guidelines to send a clear encouragement to NCAs to actually discuss efficiency claims with defendants, where they could be substantiated.

The modernization has been consistent with the second option. It has not changed the BER and has concentrated on the Guidelines. They now take into account the *Glaxo* ruling in paragraph 47 and send clear and substantial signals to the marketplace that the Commission—and NCAs—are prepared to receive efficiency claims. This will hopefully encourage undertakings to plead an efficiency defense.

An illustration of the Commission's willingness to deal with vertical restraints in a much less formal way is the introduction in the Guidelines of a number of sub-sections, which describes in detail not only the theories of harm, but also the potential efficiencies of specific practices.[15] This is, in particular, the case for RPM in paragraphs 223 to 229. After having set out in paragraph 224 the anticompetitive scenarios of RPM, the Commission acknowledges in paragraph 225 the efficiencies RPM may lead to. For instance, it admits that RPM may be a way to avoid free-riding phenomena between retailers (whereby those retailers providing high levels of pre-sale services may not be rewarded for their efforts if customers turn to other price-cutting retailers, resulting in the first category of retailers ceasing to deliver costly pre-sale services or promoting products). To prevent such free-riding behavior, applying RPM to all distributors is thus efficient: it suppresses the disadvantage experienced by retailers who provide high levels of pre-sale services as described above. However, the Guidelines warn that the Commission will need concrete examples and will not content itself with theoretical arguments:

[12] *Conseil de la concurrence*, decision N 03-D-45 of 25 September 2003 relative to practices implemented in the sector of calculators used in schools.

[13] *Autorité de la concurrence*, Opinion of 28 September 2009 on the review of EC regulation N. 2790/99 and of the Guidelines on vertical restraints, available at: http://www.autoritedelaconcurrence.fr/user/standard.php?id_rub=316&id_article=1270.

[14] Court of Justice of the European Communities, GlaxoSmithKline Services Unlimited v Commission and Others, 6 October 2009, joined cases C-501/06, C-513/06, C-515/06 and C-519/06P. In this judgment, the Court recalled that a restriction by object was not a restriction *per se* and that the Commission—and all NCAs—should not just presume the illegality of agreements containing hardcore restrictions. They should genuinely undertake to assess the possible contribution of practices to improving the production or distribution of goods or to promoting technical or economic progress in the light of the factual arguments and evidence provided by the undertaking in connection with a request for individual exemption.

[15] See namely paragraphs 60 to 64 regarding hardcore restrictions in general, paragraphs 106 to 109 regarding vertical agreements in general (free-riding, opening of new markets, hold-up, vertical externalities, economies of scale, capital market imperfections, standardization), paragraphs 144 to 148 regarding non-compete obligations, and paragraphs 223 to 229 regarding retail price maintenance.

> The parties will have to convincingly demonstrate that the RPM agreement can be expected not only to provide the means but also the incentive to overcome possible free riding between retailers on these services.

Moreover, the new draft of the Guidelines offers further guidance to NCAs and undertakings on the different steps that must be followed in the analysis of competition law.

First, it is important to note that it is logical and practical to require defendants to provide information to justify their conduct. Indeed, they are in a much better position to explain the agreements they have put in place; they presumably have designed their distribution strategy according to a business plan that only they know, and which is supported by market data to which they have primary access.

Then, as described in paragraph 47 of the new Guidelines,[16] the authority shall have the responsibility, as a second-mover, to assess the likely negative impact of the clause before making the final assessment on whether the conditions to grant individual exemption are satisfied. The Guidelines indicate that "although, in legal terms, these are two distinct steps, they may in practice be an iterative process where the parties and Commission in several steps enhance and improve their respective arguments." In other words, the Guidelines fit into the formal allocation of the burden of proof an open and sequential discussion between enforcers and market players; the evidence may be discussed by the parties and the competition authority throughout the whole process.

Overall, the final decision resulting from this process is close to the one that would follow from a structured rule-of-reason approach, in the sense that substantiated and plausible efficiency claims will be considered, before any conclusion is made, in any anticompetitive scenario put forth by the competition authority. Moreover, balancing anti- and pro-competitive effects should, in principle, allow conducts that are associated with lower levels of actual or likely negative effects to be outweighed by proportionate levels of pro-competitive effects.

III. ONLINE SALES

Another major feature of the new Guidelines that has been stamped with the feedback of NCAs is the treatment of online sales, which has been substantially updated. It is therefore useful to recall the context in which the modernization has taken place and the lessons that have been drawn from the past and nurtured the new text.

When Regulation 2790/99 was enacted, online commerce was still in its infancy and did not yet shape business strategies and distribution models. All the same, the potential of online commerce was known: it could lead to increases in consumer surplus through overall higher sales, lower transaction costs, and diversification of services to consumers.

The concern of the Commission was then to exclude from the safe harbor those practices that reduced competition. As a result, in paragraph 53 of the Guidelines, it forbade suppliers from imposing on their distributors a general and absolute prohibition to sell online. Indeed, such a ban is deemed as a restriction by object inasmuch as it sets up barriers to trade between Member States. As such a ban deprives consumers from the supply of goods when no shop is

[16] "Where the undertakings substantiate that likely efficiencies result from including the hardcore restriction in the agreement and demonstrate that in general all the conditions of Article 101(3) are fulfilled, the Commission will be required to effectively assess the likely negative impact on competition before making an ultimate assessment of whether the conditions of Article 101(3) are fulfilled."

established in the vicinity of their residence, it also has the effect of limiting passive sales, and has therefore to be qualified as a hardcore restriction under Article 4(c) of the Regulation.

The French *Autorité de la concurrence* applied this framework in the skin-care cosmetics cases[17] in 2007 and 2008 and rejected the objective justification defense as well as the alleged efficiency gains that were put forward by the parties (see above). It recalled that objective justifications were to be understood narrowly, i.e. when suppliers have to abide by legal bans justified by public interest reasons of public health or safety. Paragraphs 52 and 54 of the new Guidelines corroborate this decisional practice. The *Autorité* also referred to the EU rules to conclude that an internet website was not to be considered as a new outlet that had been agreed to by the supplier; a conclusion which was later upheld by the Court of cassation[18] and is now expressly endorsed in paragraph 58 of the new Guidelines.

NCAs also had to deal with new questions that had not yet been addressed by the EU legal framework. They had no guidance on how to handle the intra-brand effects of online commerce and achieve a balanced combination of "brick and mortar" shops and Internet retailers, especially in selective distribution systems.

A substantial effort to provide market players with legal certainty in contractual relations was thus required from NCAs. The uptake of online sales and the way it dramatically changed distribution models could not indeed have been anticipated by EU rules. Moreover, there was no substantial decisional practice of the Commission, for it ceased to examine notifications of agreements on January 2004, and had understandably, since then, adapted its strategy to the decentralization of antitrust enforcement. It has focused on major cases of parallel trade and left most of the litigation on distribution agreements to NCAs and national judges.

The case-by-case approach adopted by NCAs has filled in the gaps. It has helped identify the needs for clarification of Regulation 2790/99, and prepare the drafting of Regulation 330/2010.

The first question pertained to the criteria that suppliers might impose on retailers for online sales and the way they had to be compared to the criteria that distributors have to meet as regards brick-and-mortar sales. The *Autorité* held in the hi-fi[19] and watches[20] cases in 2006 and in the afore-mentioned skin-care cosmetics case in 2008 that the two sets of criteria did not need to be identical owing to the different nature of these two channels; they should rather pursue the same objectives and be meant to reach comparable results. This decisional practice inspired paragraph 56 of the new Guidelines.

The second—and most acute—question regarded the degree of flexibility certain categories of suppliers were allowed to retain in order to implement business strategies based on brand image, quality, and proximity, and which encourage brick-and-mortar sales. Traditionally, competition law had been neutral towards such selective distribution systems as they respond to

[17] *Conseil de la concurrence*, decisions 07-D-07 of 8 March 2007 relative to practices in the sector of skin-care cosmetics (footnote 9).

[18] *Cour de cassation* [Supreme Court] (commercial law chamber), 14 March 2006, Flora Partners. In this ruling, the Court overturns the judgement of the Court of Appeal of Bordeaux of 26 February 2003 which considered that an Internet website opened by a franchisee constituted a new point of sale covering the whole national territory.

[19] *Conseil de la concurrence*, decision N. 06-D-28 of 5 October 2006 relative to practices implemented in the selective distribution sector for hi-fi and home cinema equipment.

[20] *Conseil de la concurrence,* decision N. 06-D-24 of 24 July 2006 relative to the distribution of watches by Festina France.

certain consumer preferences and subsequently contribute to consumer welfare. They qualified for the safe harbor as long as three main requirements were satisfied: selection criteria had to be justified by the nature of the product and be non-discriminatory;[21] manufacturers' market shares had to stay below 30 percent; and distribution agreements had to be free of any hardcore restriction. But the EU legal framework did not provide answers to market players who sought guidance on how to encourage brick-and-mortar sales without infringing competition law. In handling this issue, NCAs gave some food for thought to the European competition network on the eve of the modernization of Regulation 2790/99.

Following from an individual letter of comfort that the Commission directed at Yves-Saint-Laurent,[22] the *Autorité* accepted, in the afore-mentioned watches case, that online sales could be reserved to selected retailers that already run a brick-and-mortar shop. German judges adopted the same approach in 2008.[23] The rationale behind this decisional practice is that the membership of a selective distribution system involves not only rights, but also duties—in particular, investment in brand image and services—which cannot be adequately carried out exclusively over the Internet and are at the core of the firm's identity and reputation.

Paragraphs 52 and 54 of the new Guidelines confirm this reasoning and expand it in further detail so as to deliver a more comprehensive approach. They provide that suppliers may require their retailers to sell a minimum value or volume of products offline to ensure an efficient operation of their brick-and-mortar shops and they allow manufacturers to pay their distributors a fixed fee to support their off-line sales efforts. Suppliers are consequently provided with the necessary tools to ensure that all their distributors perform the minimum investment in the services that are most important to their reputation.

Nevertheless, the Guidelines define a balanced approach and set out major safeguards. Thus, retailers are not allowed to impose on retailers a ratio of off-line sales to total sales as this would be equivalent to restricting online sales and, therefore, to a limitation of passive sales, which is a hardcore restriction under Article 4(c) of the Regulation. In addition, the Commission has made it clear that it would pay particular attention to cumulative effects in concentrated markets that result in the foreclosure of online or off-line discounters and has called upon NCAs and national judges to take part in this assessment.

IV. CONCLUSION

In consideration of the effects of the decentralization of the enforcement of EU law, the Commission has closely involved the European competition network in the modernization process of Regulation 2790/99.

The many decisions and opinions in which the *Autorité* applied EU rules on vertical agreements had given it particular hindsight. With regard to the flexibility offered by the Treaty and to its experience in handling cases concerning hardcore restrictions, the *Autorité* felt that the BER was appropriate but that it was imperative to give a practical compass to NCAs and undertakings for reviewing cases and truly assessing efficiencies. It also suggested attaining fine-tuning in the combination of off-line and online sales.

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[21] Court of justice of the European communities, Metro, 25 October 1977, case 26/76, ECR 1875.

[22] Yves Saint Laurent Perfumes (OJ N. L 12 of 18 January 1992), confirmed by a ruling of the European Court of First Instance of 12 December 1996, Edouard Leclerc v. Commission, case T-19/92, ECR. II-1851.

[23] District Court of Mannheim, March 14, 2008, 7 O 263/07; District Court of Berlin, July 24, 2007, 16 O 412/07.

On both topics, during the two years of reflections within the European competition network, the *Autorité* insisted that the new Regulation and Guidelines should foster not only consistency across the European Union, but also consistency over time.

The new texts have responded to this demand. They have provided detailed guidance at an EU level on the contractual clauses upon which suppliers and distributors may agree and on the categories of efficiency gains they may claim. Most importantly, these texts set forth in a much clearer way the underlying policy principles that should guide the enforcement of EU law and will hopefully allow these principles to accommodate ever changing business practices.