THE VERTICAL BLOCK EXEMPTION REGULATION – TIME FOR BOLDNESS?

BY IAN FORRESTER & NATHALIE LEYNS[1]

1 Ian Forrester is a Judge of the General Court of the European Union and an Honorary Professor in European law. Nathalie Leyns is a Legal secretary of the General Court of the European Union. The speculative views and ideas expressed in this paper are entirely personal contributions to an important legislative process.

I. INTRODUCTION

For a young lawyer in Brussels in the 1970's or 1980's, the easiest and clearest advice on competition law would relate to vertical distribution. If one could imagine European competition law then as a tree, the branches representing joint ventures, technology licensing, abuse of dominance or even cartels were thin and scraggly, whereas the parallel trade branch was huge and well furnished with smaller branches.

More fines were imposed for breaches of the rules on parallel trade than for any other category of infringement. To a certain degree, cartels involving national champions enjoyed a milder climate. Although they were never tolerated, the enforcement priorities of DG IV tended to focus on easier targets. One can understand this phenomenon. An infant institution which could not count on the political support of Member States, and which was pursuing a new – and not particularly welcome – policy that threatened severe sanctions on successful businesses for pursuing classic capitalist policies (exclusive relationships, volume discounts, national as opposed to European market approaches) tended for understandable reasons to choose easy targets rather than over-ambitious ones.

The focus on cross border trade also corresponded to a higher political policy objective: achieving and encouraging the single market. The Treaty of Rome made elaborately detailed provisions on the elimination of governmental obstacles to trade (tariffs, certificates of origin, health and safety checks, and so on). Those were massive incursions on the regulatory freedom of the six Member States, and the proper reach of those incursions was hotly debated. DG IV understandably wished to avoid the creation of private contractual obstacles having an equivalent effect to the official ones whose removal had been a hardly won battle.

On the other hand, in the 1960's, a very high percentage of physical goods were handled by agents (commercial travelers with a car full of brushes, wine or cosmetics) or by exclusive trading relationships. These operators were a vital part of the daily commerce of a Europe of nation states. Parliamentarians, chambers of commerce, lawyers, and ministries spoke up for their interests. The status of agents was addressed in one of the so-called Christmas Messages in December 1962,[2] but exclusive distributors and supply agreements were covered by Regulation 67/67,[3] which became so celebrated that in the London Underground, adverts were posted asking (more or less) "Do you know the Do's and Don'ts of Regulation 67/67? If not, read the Economist."

The huge merit of that text was its great simplicity. Vertical distribution agreements on a territorially exclusive basis could be legal. However, that exclusivity had clear limitations. Resellers could be prohibited from

2 Commission Notice of December 24, 1962 on exclusive dealing contracts with commercial agents, OJ 139/62, pp. 2921-2922.

3 Regulation n° 67/67/EEC of the Commission of March 22, 1967 on the application of Article 85 (3) of the Treaty to certain categories of exclusive dealing agreements.

looking for customers for the goods to which an agreement related, or from establishing a branch or warehouse outside the assigned territory.[4] By contrast, fierce penalties awaited those who hindered the resellers' right to accept orders from other Member States.

In the early case of *WEA-Filipacchi Music S.A.*,[5] Dr. Hartmut Johannes (a kind, learned and jovial teacher as well as an official of DG IV) encouraged a retailer in Paris to offer to sell Rolling Stones records in another Member State. Dr Johannes had been buying records for his daughter who lived in Belgium. He was told by the shop manager that such sales were forbidden by contract. The manager wrote and signed a short letter of complaint as requested by the Commission official and in less than nine months a fine of 60,000 units of account was imposed by the Commission. A succession of cases involving clothes, alcohols, construction materials, tennis balls, cars, hi-fi equipment, record players, and pharmaceuticals followed. In some cases, the accused company argued that the offensive contractual language had never been implemented, or that parallel trade actually occurred routinely regardless of the contractual terms, or even that the offending contract had been forgotten in a drawer when all the other parallel contracts were being corrected (*Toshiba TEG*[6]). Such arguments were nearly always unsuccessful. Gradually, business people got the message. Regulation 67/67 was thus a safe haven for those who organized exclusive distribution networks. Ignoring it could risk huge fines (huge, that is, according to the standards of the time). Toshiba TEG had to pay 2 million ECU in punishment for not having "cleaned up" one out of a dozen contracts. One of the parties in the *Pioneer Hi-Fi* decision[7] was fined 4,350,000 units of account for a more intentional infringement.

The heirs of Regulation 67/67 were rather more sophisticated. Regulation 1983/83[8] and Regulation 1984/83[9] established more complex rules dealing respectively with exclusive distribution agreements and exclusive purchasing agreements. Gradually, the diet of enforcement evolved, and European priorities better matched those of other antitrust authorities around the world. Technology licensing became a hot topic (Dr Johannes moved on to patent licensing).

The next versions of the block exemption were Regulation 2790/99[10] and its successor Regulation 330/2010[11] together with the Guidelines on Vertical Restraints,[12] which brought a radical change in the way vertical agreements were approached. The Commission's goal was to introduce a single regulation that would cover all vertical restraints in the field of distribution of goods or services. Individuals and businesses were expected to self-assess vertical agreements and decide for themselves whether they could benefit from a block exemption or not. The regulations established a presumption of legality for vertical agreements that fitted specifically listed criteria.

The furor which accompanied the Commission's renunciation in 2004[13] of its monopoly over the granting of exemptions pursuant to Article 101(3) (formerly 85(3) of the EC Treaty) somewhat overshadowed the more technical tweaking of the heir and successor of Regulation 67/67.

Some regretted the disappearance of a process whereby a business could request formal advice from the authority, but most welcomed the relaxation of a system where hundreds of notifications were filed not really to get clarification but to create the appearance of good faith legality. To some degree, the reform of the most recent block exemption regulation offers a similar choice between rigid specificity and flexible analysis in light of basic principles.

This paper will address this significant revision of the block exemption regulation and assess the merits or demerits of being more flexible and less prescriptive.

4 Article 2 of Regulation 67/67.

5 Commission Decision of December 22, 1972, 72/480/CEE, *WEA-Filipacchi Music S.A.* [1972] OJ L303/52.

6 Commission Decision of June 5, 1991, Case IV/32.879, *Viho/Toshiba* [1991] OJ L287/39.

7 Commission Decision of December 14, 1979, Case IV/29.595, *Pioneer Hi-Fi Equipment* [1980] OJ L60/21.

8 Regulation (EEC) 1983/83 of June 22, 1983 on the application of Article 85 (3) of the Treaty to categories of exclusive distribution agreements.

9 Regulation (EEC) 1984/83 of June 22, 1983 on the application of Article 85 (3) of the Treaty to categories of exclusive purchasing agreements.

10 Regulation (EC) 2790/1999 of December 22, 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices.

11 Regulation (EU) 330/2010 of April 20, 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 [2010] OJ L102/1.

12 Commission Guidelines on Vertical Restraints, 2010/C 130/01.

13 Council Regulation (EC) 1/2003 of December 16, 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, OJ, L.1, 4.1.2003, pp. 1-25.

II. PROSPECTS OF A FLEXIBLE FUTURE?

Currently, selective distribution agreements are presumed to be legal, under narrow conditions. The market share held by each of the parties to the agreement on any of the relevant markets affected by the vertical agreement should not exceed 30 percent,[14] and the agreement should not contain any "hardcore restrictions" of competition in the sense of current Regulation 330/2010.[15]

Targeting vertical agreements for companies over a certain market threshold was intended to limit the possibility that companies having great market power could enter agreements substantially restricting competition. They could thus claim, in case of controversy, that they were entitled to believe in the availability of the block exemption and escape scrutiny of competition authorities' individual control.[16] This concern can be seen as a repetition of the concern at the time of the abandonment in 2004 of the old prescriptive regime: does certainty with a degree of rigidity deliver a more effective compliance than self-assessment with guidance?

The conventional wisdom in the 1970s was that businesses could not be trusted with too much freedom to maneuver. There was by no means consensus among manufacturers that permitting and even empowering "free riders" was fair or necessarily beneficial for consumers, since intermediaries took too much of the profit. Thus, the basic principle was easy to explain for the lawyers, but the client might be hesitant to accept it.

Nowadays, maybe it is time for a fresh approach. Greater market power does not automatically hinder inter-brand competition and have negative effects on competition, though of course it may. Additionally, a restriction on competition does not automatically amount to a restriction on the economic freedom of operators in the marketplace. Many vertical agreements do not have any anti-competitive effect. Is it worth reflecting once more on whether "free riders," who buy in a low price market and sell in a high price country where the local distributor has made costly marketing, necessarily confer advantage on consumers?

One may also reflect on whether the 30 percent market share threshold is an appropriate tool for distinguishing agreements that can automatically benefit from the block exemption and those that need an individual examination. A 30 percent market share threshold does not say much about the overall market situation. Perhaps a vertical agreement has anti-competitive effects when the parties have, or one of them has, a market share between 20 and 30 percent? There may be grounds for concern at 29 percent or no grounds for concern at 31 percent. Moreover, as recent practice makes clear, defining the "relevant market" of the goods or services can frequently be controversial and indeed technically very abstract. This type of analysis remains largely subjective. Whereas some categories of products or services appear to be clearly different from one another, in most situations an exact confident definition of the relevant market is liable to be hazardous.

Does the current block exemption system perfectly deliver legal certainty and equal treatment of competitors? The 30 percent market share threshold necessarily envisages a sharp distinction between competitors who may be similarly situated. Discouraging one company from using a distribution system available to its competitors on the same market for the sole reason that such competitors are below the market share threshold puts it in a position that might constitute a real disadvantage. Thus, a business that is nervous of infringing the law may elect not to enter a deal because its market share might be found too high. The bolder competitor might decide to go ahead and trust in its defenses if there were a challenge.

In the same spirit, why blacklist certain classic contractual provisions as hardcore restrictions such as resale price maintenance[17] which, in the absence of high market power, are not certain to have negative effects on competition and do not necessarily decrease consumer welfare? Maybe we should try to be more certain that such provisions produce negative effects on competition in the sense of article 101(1) TFEU. Of

14 Under Regulation 2790/99, the market share threshold only applied to the supplier. The change brought by Regulation 330/2010 aimed at taking into account the increasing market power held by large distributors.

15 According to Recital 10 of Regulation 330/2010 and paragraph 47 of the Guidelines on Vertical Restraints, an agreement that contains a "hardcore restriction" is presumed to fall within article 101(1) TFEU.

16 Communication from the Commission on the application of the Community competition rules to vertical restraints, Follow-up to the Green Paper on Vertical Restraints, OJ C 365/3, November 26, 1998.

17 The Commission's approach is very different from that of the U.S. Supreme Court in *Leegin* [*Leegin Creative Leather Products, Inc. v PSKS, Inc.*, 551 U.S. 877 (2007)], in which the Supreme Court overruled an earlier judgment which had held that resale price maintenance was *per se* illegal. The Supreme Court indicated that pro and anti-competitive effects of such practice deserve to be fully analyzed under a "rule of reason" standard, thus requiring the courts to analyze the actual effects of the restraint.

course, in many cases the imposition of resale price maintenance has a damaging impact on consumer welfare. In four recent decisions, the Commission imposed a total fine of more than 111 million euros on four consumer electronics manufacturers for imposing fixed or minimum resale price maintenance, as a result of which consumers faced higher prices for kitchen appliances, hair dryers, notebook computers, headphones, and other products.[18]

We wonder if there are really no cases where it might help a small supplier to make progress in the market place. Departing from the strict language of article 4 of Regulation 330/2010, the Commission itself presents a more relaxed attitude towards hardcore restrictions in the Guidelines on Vertical Restraints.[19] We are not commenting on the merits of those efforts to promote price competition, just noting that there might be situations where "safety," "luxury," or "public health" (examples at random) might indicate a different conclusion.

It is not our purpose to set a match to burn fifty years of jurisprudence. Achieving the common market is an important goal of EU competition policy and that will not change. However, there is no harm in considering afresh how traditional doctrines are best applied. Rigid certainty has confronted flexible common sense on many occasions in European law in many sectors. How to balance the conflicting arguments?

The same reasoning applies to internet sales restrictions. Online sales have constituted a major market development in the last twenty years and have led to a variety of selective distribution agreements. Whereas the first condemnations related to more simple and general prohibitions to sell via the Internet (*B&W Loudspeaker*,[20] *Yves Saint Laurent Parfums*,[21] *Yamaha*[22] and *Pierre Fabre*[23]), they were followed by the recognition that certain internet sales restrictions could be adequate, proportionate, and justified in light of the nature of the products at hand.[24] The geographic "neutrality" of online sales is not easy to reconcile with exclusive territories, which are a traditional feature of how many luxury products are sold.

Again, it is not our purpose to say that perfumes are apt for luxury law and face creams are not. We suggest that each situation is best decided on its merits. If a platform ban (such as the ban on using Amazon or eBay for online sales) is not a hardcore restriction and can be justified by the desire to preserve the luxury image of the supplier's products, provided it does not equate with a total online sale ban (*Coty*), what about other categories of products and other types of online restrictions? The Commission recently fined the clothing company Guess 40 million euros.[25] Guess had imposed a series of restrictions on its authorized retailers of footwear, clothes and accessories, and had prevented them from selling the contract products online without obtaining a prior specific authorization from the company. It also restricted the retailers' ability to decide their resale prices and banned them from using the Guess brand names and trademarks as keywords in Google AdWords. The Commission found that Guess' restrictive practices prevented the retailers from being sufficiently "findable" online, seriously reduced their viability, and amounted to an unjustifiable ban on using trademarks and brand names for online sales advertising.

Vertical restraints can have both competitive and anti-competitive effects, depending on the context in which they are used and the goal they are supposed to achieve. We gently suggest that there should be less focus on whether specific restrictions are deemed illegal *per se* while others are always acceptable, and more on the effect they have on the market. The argument that platform bans and the prohibition on

18 Commission Decisions of July 24, 2018, Case AT.40465, *Asus (vertical restraints)*, 2018/C 338/08; Case AT.40469, *Denon & Marantz (vertical restraints),* 2018/C 335/05; Case AT.40181, *Philips (vertical restraints)*, 2018/C 340/07 ; Case AT.40182, *Pioneer (vertical restraints),* 2018/C 338/11.

19 Guidelines on Vertical restraints, paragraphs 60 to 64, 106 to 109, and 255.

20 Commission's press release IP/00/1418, 6 December 2000.

21 Commission's press release IP/01/713, 17 May 2001.

22 Commission Decision of 16 July 2003, Case COMP/37.975, *PO/Yamaha*.

23 Decision of October 13, 2011, Pierre Fabre Dermo-Cosmétique, C-439/09, EU:C:2011:649.

24 Decision of December 6, 2017, *Coty Germany*, C-230/16, EU:C:2017:941; Guidelines on Vertical Restraints, paragraphs 52-64; See also F. Amato, "Internet Sales and the New EU Rules on Vertical Restraints," The CPI Antitrust Journal, June 2010 (2) for examples of national courts' decisions to declare selective distribution systems compatible with article 101(1) TFEU, such as different pricing of goods intended to be sold online or offline, the requirement to sell a portion of goods offline, the obligation to have at least one physical point of sale and exclusion of pure online retailers, and the prohibition of sales through an internet auction website.

25 Commission Decision, December 17, 2018, Case AT.40428 — *Guess*, 2019/C 47/04.

using comparison shopping sites should be considered as hardcore restrictions (*Adidas*,[26] *Asics*,[27] KVZ,[28] *Samsung*[29]) could be opposed to other decisions (less numerous) showing tolerance towards third-party platform bans for the sales of mechanical garden equipment (*Stihl*[30]), as well as cosmetics (*Caudalie*[31]) and sport products (*Nike*[32]) of a "luxury" nature. Now, these differences in approach could be explained by a thorough consideration of the business environment and its specificities in each country. According to the Commission, the results of its e-commerce sector inquiry indicate that there are important differences from one Member State to another in the incidence of online sales by retailers. In Germany, 62 percent of the respondent retailers indicate that they sell via online marketplaces, compared to 13 percent in Austria and Italy, and 4 percent in Belgium. In general, the proportion in other Member States is lower than one third of the retailers.[33]

It might be useful to reflect on why and how these big differences arise and consider whether competition enforcement should be adapted in consequence. Depending on the circumstances, and the importance of the role played by online marketplaces (where the goods are sold through an independent platform like Amazon or eBay) as sales channel, a third-party platform ban or a price-comparison site ban could still permit several other methods to sell online or, to the contrary, could amount to an illegal significant restriction upon online sales.

Regulation 330/2010 expires on May 31, 2022. The Commission has already launched a public consultation before deciding whether the current regime should be extended unchanged, revised or come to an end. Without arguing that it would be preferable to return to the system prior to the block exemption regulations, the strong economic diversity of the Common Market and constant innovation in a huge market may advocate for a less prescriptive regime in which the practical effects of a vertical restraint are pragmatically balanced.

One question continuously in dispute is whether companies could be trusted with the evaluation of the legality of their conduct. The old regime of a blanket prohibition coupled with an exemption regime was good for its day but needed to be discarded.

It should be borne in mind that it is impossible for any regulation to contain all possible cases, and that rules aiming at covering every possible scenario may become unnecessarily complicated. Why not consider that guidelines alone are capable of attaining the intended goal? Faced with complicated rules, businesses may be willing to live without knowing with certainty whether an agreement is consistent with article 101(1) TFEU.

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26 German FCO Decision of June 27, 2014, B3-137/12, Adidas, https://www.bundeskartellamt.de/SharedDocs/Entscheidung/DE/Fallberichte/Kartellverbot/2014/B3-137-12.html; On November 18, 2015, the French Competition Authority announced it closed its investigation after Adidas announced it had changed its online sales terms: http://www.autoritedelaconcurrence.fr/user/standard.php?id_rub=606&id_article=2668.

27 German FCO Decision of August 26, 2015, B2-98/11 – *ASICS*, https://www.bundeskartellamt.de/SharedDocs/Entscheidung/DE/Entscheidungen/Kartellverbot/2015/B2-98-11.html.

28 BGH, Decision of December 12, 2017, *KVZ* 41/17, http://juris.bundesgerichtshof.de/cgi-bin/rechtsprechung/document.py?Gericht=bgh&Art=en&Datum=Aktuell&Sort=12288&nr=80673&pos=25&anz=515.

29 Autorité de la Concurrence Française, Decision of July 23, 2014, n° 14-D-17 – *Samsung*, http://www.autoritedelaconcurrence.fr/user/avisdec.php?numero=14D07.

30 Autorité de la Concurrence Française, Decision of October 24, 2018, n° 18-D-23 – *STIHL*, http://www.autoritedelaconcurrence.fr/pdf/avis/18d23.pdf. Stihl was nevertheless fined for imposing obligations to either personally pick-up the product at the retailer's premises or to have the retailer hand-deliver them to the customers.

31 Cour de cassation française, Judgment of September 13, 2017, *Caudalie/eNova santé*, n° 16-15-067, https://www.legifrance.gouv.fr/affichJuriJudi.do?oldAction=rechJuriJudi&idTexte=JURITEXT000035573298&fastReqId=1430212509&fastPos=1; Court of Appeals, Paris, Pôle 1, ch. 8, July 13, 2018, n° 17/20787, *eNova santé/Caudalie*.

32 District Court of Amsterdam, Decision of October 4, 2017, https://uitspraken.rechtspraak.nl/inziendocument?id=ECLI:NL:RBAMS:2017:7282.

33 Report from the Commission to the Council and the European Parliament, Final report on the E-commerce Sector Inquiry, 10 May 2017, COM(2017)229 final, paragraphs 39-40; Preliminary report on the E-commerce Sector Inquiry, Brussels, 15 September 2016, SWD(2016) 312 final, p. 9.

III. A FINAL WORD

It will be clear from the foregoing that the European Commission has invested huge efforts in turning the competition rules to aid the integration of the common market. Its pursuit of this goal was a world first. It was called a civil religion. The U.S. authorities did not have as an enforcement priority economic integration or the removal of contractual barriers to trade between the states. The fines imposed were for their days enormous and the cases contributed to achieving a successful respect for the applicable rules.

Today, the market place has altered significantly. Online shopping is universal. Economic frontiers barely exist anymore (what rules might apply in the event of a Brexit are of course uncertain). Consumers know very well where products are the cheapest. They can choose to go to a local shop or to buy online. A common market in physical goods has largely been created. It is at least possible that the Commission's efforts over 52 years have achieved what competition rule making can hope to achieve.

In parallel, we may note that from 2004 the enforcement of competition rules has been shared with national courts and national competition authorities. This renunciation of the Commission's former monopoly of interpretation has permitted a richer case law to emerge. Yes, there will be divergences between the Commission and national authorities' or courts' appreciation of what constitutes an unlawful restriction of competition. There will also be changes of course and decisions which history will declare erroneous or imperfect. Gradually, however, the principles of sound competition law will emerge and will prevail, not through rule making but through self-assessment by intelligent business people who take account of the competition rules when arranging how to deliver goods or services in a Europe of 500 million people, always tempered by judicial oversight.

In an ideal world, the application of competition law principles by a competition authority to a complicated set of facts should be the same, whether there is a detailed block exemption regulation or not. The presence or the absence of a block exemption regulation ought to be a matter of convenience only and should not change the outcome of a case. The merit of a block exemption is that it shortens the process of examination of a competition problem. It should ideally go further than stating the obvious, while not being too cautious in offering reassurance. We await the new version – if any – with lively interest.

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